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PREFACE AND ACKNOWLEDGEMENTS

This thesis is the product of an academic research project that was, for its better part, carried out in the policymaking environment of a central bank. My job at the European Central Bank from 2016 onwards – first as a lawyer, then as an economist – has, so I hope, enabled me to identify the legal questions most relevant to policymaking institutions dealing with sovereign default. Ultimately, drawing upon this experience, I attempt to bridge the divide between the academic and the policymaking world, and resolve some of the common misunderstandings in the realm of sovereign debt management and restructuring. Research stays at the University of New South Wales in Australia during 2015 and 2016, the participation in a summer school at the London School of Economics in 2017, and a specialised training at the European University Institute in 2018, allowed me to complement my practical insights with excellent coursework.

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TABLE OF CONTENTS

PREFACE AND ACKNOWLEDGEMENTS **2**

ACRONYMS, ABBREVIATIONS AND DEFINED TERMS **13**

INTRODUCTION **16**

I. CONTEXT OF THE STUDY **16**

II. PROBLEM STATEMENT **16**

III. SCOPE OF THE STUDY **18**

IV. METHODOLOGY **20**

1. THE LEGAL FRAMEWORK OF SOVEREIGN DEBT **22**

1.1. INTRODUCTION **22**

1.2. THE LEGAL FRAMEWORK OF SOVEREIGN DEBT **25**

1.2.1. Introduction 25

1.2.2. Sovereign Debt – A Definition 27

1.2.3. The Sovereign Debt Enforcement Conundrum 28

1.2.4. Sovereign Debt and Contractual Standards 32

1.2.4.1. Overview 32

1.2.4.2. The *Pari Passu* Clause 34

1.2.4.3. The Negative Pledge Clause 35

1.2.4.4. The Cross Default Clause 37

1.2.4.5. The Relevance of Contract Boilerplate Language 39

1.2.5. Governing Law 43

1.2.5.1. Choice-of-Law and Choice-of-Forum Clauses 43

1.2.5.2. Sources of Law 46

1.2.5.2.1. Municipal Law 46

1.2.5.2.2. International Law 47

1.2.5.2.3. Stock Exchange Trading Rules 50

1.3. THE EVOLUTION OF SOVEREIGN DEBT INSTRUMENTS **51**

1.3.1. Introduction 51

1.3.2. From Loan to Bond Financing 53

1.3.2.1. Legal Differences Between Sovereign (Syndicated) Loans and Bonds 53
1.3.2.2. Historical Background 54
1.3.2.3 Creditor Coordination Problems 57
1.4. SOVEREIGN IMMUNITY AND SOVEREIGN DEBT 60
1.4.1. Introduction 60
1.4.2. A Historical View on the Decline of Absolute Sovereign Immunity 63
1.4.3. Sovereign Immunity in Practice 67
1.4.3.1. Immunity Waivers 67
1.4.3.2. Immunity from Suit 68
1.4.3.3. Immunity From Execution (Enforcement) 71
1.5. CHAPTER CONCLUSIONS 74
2. LAW AND POLICY ASPECTS OF SOVEREIGN DEBT RESTRUCTURINGS 76
2.1. INTRODUCTION 76
2.2. DEFINITIONS 78
2.3. THE (ECONOMIC) RATIONALE FOR RESTRUCTURING SOVEREIGN DEBT 79
2.4. LEGAL AND TRANSACTIONAL ASPECTS 82
2.4.1. Debt Restructuring Techniques: Sticks and Carrots 83
2.4.2. The Role of Creditor Ranking 84
2.5. THE EVOLUTION OF SOVEREIGN DEBT RESTRUCTURING PRACTICE 86
2.5.1. The Paris Club 88
2.5.2. The London Club 90
2.6. THE IMF'S ROLE IN SOVEREIGN DEBT RESTRUCTURINGS 92
2.7. CHAPTER CONCLUSIONS 95
3. THE HOLDOUT CREDITOR PROBLEM 98
3.1. INTRODUCTION 98
3.2. A COLLECTIVE ACTION PROBLEM 100
3.3. TYPES OF HOLDOUT CREDITORS 102
3.3.1. Vulture Holdouts 104
3.3.2. Retail Holdouts 110
3.3.3. Official Sector Holdouts 113

3.3.3.1. The Ukraine Case and Russia's Holdout Strategy..114
3.3.3.2. The ECB's Holdout Conundrum in Euro Area Sovereign Debt Crises........116
3.4. DIFFERENT PERSPECTIVES ON HOLDOUT BEHAVIOUR........................120
3.4.1. Holdouts as Disruptors and Arbitrageurs?..121
3.4.2. Valuable Participants in International Debt Markets?..123
3.5. A BRIEF HISTORY OF HOLDOUT LITIGATION 127
3.5.1. Libra Bank v. Banco Nacional de Costa Rica..127
3.5.2. Allied Bank International v. Banco Credito Agricola de Cartago.......................129
3.5.3. Republic of Argentina v. Weltover..131
3.5.4. CIBC v. Banco Central do Brazil 133
3.5.5. Pravin Banker v. Banco del Popular del Peru..135
3.5.6. Elliott v. Peru 136
3.5.1. Litigation in US Courts..136
3.5.2. Litigation Before Belgian Courts...138
3.6. CHAPTER CONCLUSIONS...139
4. HOLDOUT CREDITOR PROBLEMS IN THE ARGENTINE DEBT RESTRUCTURING 141
4.1. ARGENTINA'S 2001 STATE DEFAULT 141
4.1.1. Introduction..141
4.1.2. The Argentine Debt Crisis Between 1998 and 2002 142
4.2. THE ARGENTINE DEBT RESTRUCTURING..145
4.2.1. The Challenges...145
4.2.2. The 2005 Debt Restructuring...145
4.2.3. The 2010 Debt Restructuring...148
4.3. HOLDOUT LITIGATION BEFORE US COURTS 151
4.3.1. Lightwater Corporation Ltd. v. Republic of Argentina 151
4.3.1.1. The Decision 151
4.3.1.2. Analysis...153
4.3.2. EM Ltd. v. Banco Central de la Republica Argentina 154
4.3.3.1. The Decision(s)..154
4.3.3.2. Analysis...157
4.3.3. NML Capital Ltd. v. Republic Of Argentina..159
4.3.3.1. Litigation Before the SDNY 160

4.3.3.2. The Second Circuit Court of Appeal 162
4.3.3.2.1. The Second Circuit's Ruling of 2012 162
4.3.3.2.2. The Second Circuit's Ruling of 2013 164
4.3.3.3. The US Supreme Court 166
4.3.3.4. Analysis 168
4.3.3.4.1. The Pari Passu Injunction 168
4.3.3.4.2. NML v. Argentina and Potential Implications for International Bond Markets 172
4.3.3.4.3. Post NML v. Argentina Developments: Pari Passu Undone? 173
4.4. HOLDOUT LITIGATION BEFORE GERMAN COURTS 176
4.4.1. BVerfG Judgement of 8 May 2007 176
4.4.1.1. The Majority Decision 176
4.4.1.2. The Dissenting Opinion by Judge Lübbe-Wolff 179
4.4.1.3. Analysis 180
4.4.2. BGH Judgement of 24 February 2015 183
4.4.2.1. The Decision 183
4.4.2.2. Analysis 185
4.5. HOLDOUT LITIGATION BEFORE ITALIAN COURTS 187
4.5.1. Luca Borri v. Republic of Argentina 188
4.5.1.1. The Decision 188
4.5.1.2. Analysis 190
4.6. HOLDOUT LITIGATION BEFORE ENGLISH COURTS 194
4.6.1. NML Capital v. Republic of Argentina (UK) 194
4.6.1.1. The Decision 195
4.6.1.2. Analysis 198
4.7. HOLDOUT LITIGATION IN FRENCH COURTS 199
4.7.1. NML Capital v. France I 199
4.7.2. NML Capital v. France II 201
4.7.3. Analysis 202
4.8. HOLDOUT LITIGATION IN OTHER JURISDICTIONS 204
4.8.1. Nml Capital v. Bis Before The Swiss Federal Supreme Court 204
4.8.1.1. The Decision 204
4.8.1.2. Analysis 207

4.8.2. The 'ARA Libertad' Case Before the ITLOS 210
4.8.2.1. The Decision 210
4.8.2.2. Analysis...212
4.9. HOLDOUT ARBITRATION BEFORE THE ICSID 214
4.9.1. Abaclat and Others v. Argentine Republic 214
4.9.1.1. Decision on Jurisdiction and Admissibility 214
4.9.1.1.1. Sovereign bonds as 'Investment' 215
4.9.1.1.2. Mass Claims Arbitration 217
4.9.1.2. The Dissenting Opinion by Abi-Saab 218
4.9.1.3. The Settlement 219
4.9.2. Ambiente Ufficio SpA and Others v Argentine Republic 220
4.9.3. CMS v. Argentine Republic..222
4.9.4. Analysis...224
4.9.4.1. The Definition of 'Investment' 225
4.9.4.2. Contribution to the Development of the Host State....................................225
4.9.4.3. Duration 227
4.9.4.4. Risk-Sharing 228
4.9.4.5. Territorial Link..229
4.9.4.6. The Admissibility of Mass Claims 230
4.10. CHAPTER CONCLUSIONS..232
5. HOLDOUT CREDITOR PROBLEMS IN THE GREEK DEBT RESTRUCTURING 235
5.1. INTRODUCTION...235
5.2. THE GREEK SOVEREIGN DEBT CRISIS OF 2009-2015 236
5.3. THE GREEK DEBT RESTRUCTURING OF 2012 241
5.3.1. Debt Restructuring Negotiations: the Role of the Troika and the IIF.................241
5.3.2. The 'Invitation Memorandum' 243
5.3.3. Restructuring Greek Law Bonds...246
5.3.4. Restructuring Foreign Law Bonds 247
5.4. HOLDOUT CREDITOR LITIGATION BEFORE MUNICIPAL COURTS 248
5.4.1. Holdout Creditor Litigation in Germany 249
5.4.1.1. BGH Judgement of 8 March 2016 249
5.4.1.2. OLG Oldenburg Judgement of 15 April 2016 251

5.4.1.3. OLG Köln Judgement of 12 May 2016 252
5.4.1.4. BGH Judgement of 19 December 2017 253
5.4.2. Holdout Creditor Litigation in Austrian Courts 255
5.4.2.1. OGH Judgments of 20 May 2014 and 16 January 2016 255
5.4.2.2. OGH Judgment of 25 April 2017 257
5.4.3. Analysis 259
5.5. HOLDOUT LITIGATION BEFORE EUROPEAN COURTS 260
5.5.1. Accorinti and Others v. ECB 260
5.5.2. Fahnenbrock v. Hellenische Republik 262
5.5.3. Mamatas and Others v. Greece 263
5.5.4. Analysis 266
5.5.4.1. Sovereign Immunity in Europe 266
5.5.4.2. The Constitutional Barriers to Unilateral Bond Modifications 267
5.6. HOLDOUT ARBITRATION BEFORE THE ICSID 268
5.6.1. Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic 269
5.6.2. Analysis 271
5.7. CHAPTER CONCLUSIONS 273
6. WALKING BACK FROM ARGENTINA AND GREECE: HOW TO RESOLVE THE HOLDOUT PROBLEM? 276
6.1. JUXTAPOSING ARGENTINA AND GREECE 278
6.1.1. Contract v. Statute 278
6.1.2. The Role of Governing Law(s) 281
6.1.3. Sovereign Immunity – Quo Vadis? 283
6.1.4. Jurisdictional Uncertainties 287
6.1.5. Property Right Protection and Other Substantive Law Aspects 288
6.1.6. Conclusions 292
6.2. RESOLVING HOLDOUT PROBLEMS AT THE INTERNATIONAL LEVEL 294
6.2.1. Collective Action Clauses 296
6.2.1.1. Definitions 296
6.2.1.2. Types of CACs Used in International Sovereign Bonds 299
6.2.1.3. Further Enhancing CACs – Some Proposals for Reform 303

6.2.2. Untangling the Pari Passu Puzzle 307
6.2.2.1. Background 307
6.2.2.2. *Pari Passu* Clauses under English and New York Law 309
6.2.2.3. *Pari Passu* Clauses in Domestic Law Bonds...311
6.2.2.4. The Future Role of *Pari Passu* Clauses in Sovereign Bonds 312
6.2.3. The Case for Bondholder Representation Clauses...313
6.2.3.1. Background 313
6.2.3.2. Trustee Structures As a Way To Mitigate Holdout Problems 315
6.3. RESOLVING HOLDOUT PROBLEMS AT THE EUROPEAN LEVEL: A EUROPEAN SOVEREIGN DEBT RESTRUCTURING FRAMEWORK 317
6.3.1. Introduction..317
6.3.2. Existing Proposals...318
6.3.3. The Legal Basis...321
6.3.3.1. EU Law 322
6.3.3.2. ESM Treaty...324
6.3.3.3. The Proposal to Establish a European Monetary Fund................................325
6.3.4. Institutional Aspects...326
6.3.4.1. Financial Function 327
6.3.4.2. Legal Function 332
6.3.4.2.1. Dispute Resolution Before the CJEU 333
6.3.4.2.2. A Sovereign Debt Arbitration Mechanism For the Euro Area 337
6.3.5. Enhancing the Contractual Framework 339
6.3.5.1. Enhancing the Euro CAC...339
6.3.5.2. Introducing Aggregation Features and a Single-Limb Voting Procedure 339
6.3.5.3. Majority Voting on Bond Acceleration 341
6.3.5.4. Majority Voting for Stays on Enforcement 342
6.3.5.5. Immunising ESM Funds from Holdout Attachment....................................344
6.4. CHAPTER CONCLUSIONS..345
GENERAL CONCLUSIONS 347
Bibliography 351
Books 351
Journal Articles and Commentaries 354

Newspaper Articles **362**
Online Sources **365**
International Treaties and Conventions **377**
Domestic and EU Statutes **378**

List of Authorities **379**
International and European Courts **379**
European Court of Justice 379
European Court of Human Rights 379
European General Court 379
International Tribunal for the Law of the Sea 379
International Centre for the Settlement of Investment Disputes 379
International Court of Justice 380
Permanent Court of Arbitration 380
Permanent Court of International Justice 381
Domestic Courts **382**
Argentina 382
Austria 382
Belgium 382
France 382
Germany 382
Italy 383
Switzerland 383
United Kingdom 383
United States of America 383

Annex **386**
ABSTRACT (in English) **386**
Abstract (in German) **388**
Curriculum Vitae .... Error! Bookmark not defined.

ACRONYMS, ABBREVIATIONS AND DEFINED TERMS

AMF	Arab Monetary Fund
AoA	Articles of Agreement of the International Monetary Fund
AOSIS	Alliance of Small Island States
ASEAN	Association of Southeast Asian Nations
BGH	*Bundesgerichtshof* (German Federal Court of Justice)
BIS	Bank for International Settlements
BIT	Bilateral Investment Treaty
BVferG	*Bundesverfassungsgericht* (German Federal Constitutional Court)
CAC	Collective Action Clause
CARICOM	Caribbean Community
CDS	Credit Default Swap
CEO	Chief Executive Officer
CJEU	Court of Justice of the European Union
CFR	Charter of Fundamental Rights
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
ECtHR	European Court of Human Rights
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
ESCB	European System of Central Banks
ESCI	European Convention on State Immunity
ESDRF	European Sovereign Debt Restructuring Framework
ESM	European Stability Mechanism
EU	European Union
EUR	Euro
FCL	Flexible Credit Line
FRBNY	Federal Reserve Bank of New York

FSB	Financial Stability Board
FSIA	Foreign Sovereign Immunities Act
FTA	Free Trade Agreement
G10	Group of Ten
G20	Group of Twenty
GATT	General Agreement on Tariffs and Trade
GBA	Greek Bondholder Act 4050/2012
GBP	Pound Sterling
GFC	Global Financial Crisis of 2008-09
EGC	(EU) General Court
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
IIA	International Investment Agreement
ICJ	International Court of Justice
ICMA	International Capital Market Association
ICSID	International Centre for Settlement of Investment Disputes
IEO	Independent Evaluation Office
IFI	International Financial Institution
IIF	Institute of International Finance
ILC	International Law Commission
IMF	International Monetary Fund
ISDA	International Swaps and Derivatives Association
ISDS	Investor-State Dispute Settlement
ISIN	International Securities Identification Number
LIA	Lending into Arrears
LOLR	Lender of Last Resort
MAI	Multilateral Agreement on Investment
MoU	Memorandum of Understanding
OECD	Organisation for Economic Co-operation and Development

OGH	*Oberster Gerichtshof* (Austrian Supreme Court)
PCIJ	Permanent Court of International Justice
PCL	Precautionary Credit Line
RFAs	Regional Financing Arrangements
SFSC	Swiss Federal Supreme Court
SDNY	United States District Court for the Southern District of New York
SDRM	Sovereign Debt Restructuring Mechanism
PSI	Private Sector Involvement
TFA	Task Force Argentina
TFEU	Treaty on the Functioning of the European Union
TIA	Trust Indenture Act
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
USD	US Dollar
VCLT	Vienna Convention of the Law of Treaties
WTO	World Trade Organisation

INTRODUCTION

I. CONTEXT OF THE STUDY

Described by some as the 'biggest gap in the international financial architecture'[1], countries cannot avail themselves of any form of bankruptcy proceedings if they default on their public debt. Rather, governments must invite their creditors to renegotiate the existing debt arrangements – a procedure referred to as 'sovereign debt restructuring'. Holdout creditors refuse to participate in such restructuring proceedings. Instead, they 'hold out', hoping that the government will pay them in full once its solvency has been restored. To increase the pressure and leverage their bargaining power, holdouts typically engage in litigation or arbitration against the insolvent state.

Sovereign debt litigation and holdout creditor problems typically go hand in hand. Holdout creditors resort to municipal courts or international tribunals with the aim of pressuring the sovereign debtor into (full) repayment. By obtaining and enforcing money judgements, injunctions, or arbitral awards against the sovereign, holdouts expect to receive a better treatment than those creditors who (voluntarily) accept a debt restructuring offer. Such (quasi-)judicial decisions can impose a *de facto* embargo on a sovereign debtor, thereby cutting it off from international credit markets. Moreover, successful holdout strategies discourage the participation in voluntary government debt restructurings, thereby thwarting the resolution of an economic and/or financial crisis more generally.

II. PROBLEM STATEMENT

The holdout creditor problem has not only undermined the possibility of a 'fresh start' for over-indebted countries but also eroded intercreditor equity during public debt crises, making it possible for a minority of creditors to exploit the goodwill others have exhibited. At the same time, holdout creditors hold valid and enforceable debt contracts in their hands. The sovereign's endeavour to reduce its public debt levels thus collides with the investors' legal right to repayment. This tension results in a multifaceted legal oxymoron.

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[1] See, eg, Brad Setser, 'The Political Economy of the SDRM' (2008) IPD Task Force on Sovereign Debt <www.cfr.org/content/publications/attachments/Setser_IPD_Debt_SDRM.pdf> accessed 14 September 2016.

While holdout inefficiencies have plagued sovereign debt workouts for decades, the frequency of holdout lawsuits has accelerated rapidly in the past two decades. From the infamous *NML v. Argentina* saga in US courts[2] and sovereign debt enforcement attempts by Argentine bondholders in Italian[3] and German[4] courts to litigation by Greek bondholders in German[5] and Austrian[6] courts, holdout litigation has become a critical feature of recent government debt restructurings. Moreover, legal action by holdouts[7] has not been confined to national courts: the ICSID has emerged as an important forum for settling disputes between sovereign lenders and borrowers.[8]

Schumacher et al provide compelling empirical evidence for the rise of holdout litigation and arbitration during government debt crises.[9] However, the pertinent legal literature has so far failed to provide a comprehensive overview of the holdout trials in the wake of the two biggest government debt restructurings in history: Argentina and Greece. Notably, there are few comparative legal studies that distil the commonalities as well as the differences in the judicial review of the two debt operations. This doctoral thesis seeks to close this gap in the scholarly literature.

In the aftermath of the Argentine and the Greek debt restructuring, fault lines emerged between different legal systems and traditions. While judiciaries in some countries bolstered creditor rights, others sought to reconcile the protection of investor rights with the sovereign

[2] *Argentina v NML Capital Limited,* Appeal judgment, Docket No 12-842, 573 US ___ (2014), ILDC 2201 (US 2014), 134 S Ct 2250 (2014), 189 L Ed 2d 234 (2014), 16th June 2014, United States; Supreme Court [US].

[3] *Borri v Argentina,* Request for a ruling on jurisdiction, Case No 11225, Order No 6532/2005, ILDC 296 (IT 2005), (2005) 88 Riv Dir Int 856, 27th May 2005, Italy; Supreme Court of Cassation.

[4] Court of Appeals Frankfurt am Main Judgement of 15 December 2004 – 23U 281/03; Court of Appeals Koblenz Judgement of 22 April 2004 – 5 U 1384/03; LG Münster Judgement of 1 July 2003 – 14 O 17/03.

[5] Compare more recently District Court Osnabrück Judgement of 15 May 2015 – 7 O 2995/13. For an overview see Christoph Thole, 'Klagen geschädigter Privatanleger gegen Griechenland vor deutschen Gerichten?' (2012) WM 2012 Heft 38 1794 and Otto Sandrock, 'Nationaler und internationaler Schutz vor privaten Inhabern von Staatsanleihen gegenüber Schuldenschnitten' (2013) WM 2013/9, 394. Also see, more recently, Matthias Müller, 'Kein deutscher Gerichtsstand für Klagen von Anleihegläubigern gegen Griechenland - Staatenimmunität - Anmerkung zum Urteil des LG Osnabrück vom 15.05.2015' RIW 2016, 76.

[6] OGH, Urteil vom 20.05.2014 - 4 Ob 227/13f, 4 Ob 227/13f, 20th May 2014, Austria; Supreme Court of Justice [OGH].

[7] While many authors make use of the term 'holdout litigation', no universally accepted definition exists. This thesis will subsume under holdout litigation 'any legal action filed by an investor, who either does not intend to participate in a debt restructuring or has already rejected to do so, against a sovereign debtor in a (foreign) municipal court with the aim of recovering the (full or partial) nominal value of the debt instrument .'

[8] *Maffezini v Spain*, Award, ICSID Case No ARB/97/7, (2001) 16 ICSID Rev-FILJ 248, IIC 86 (2000), (2002) 5 ICSID Rep 419, (2003) 124 ILR 35, 13th November 2000, World Bank; International Centre for Settlement of Investment Disputes [ICSID]; *CMS Gas Transmission Company v Argentina*, Application for annulment and request for stay of enforcement of arbitral award, ICSID Case No ARB/01/8, IIC 66 (2005), 8th September 2005, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[9] Julian Schumacher, Christoph Trebesch and Henrik Enderlein, 'What Explains Sovereign Debt Litigation' (2015) 58(3) The Journal of Law and Economics 585.

issuer's public interest in attaining debt relief. A comparative and comprehensive legal analysis of this jurisprudence is thus vital to devise solutions for the holdout creditor problem, thereby fostering the resilience of the international financial architecture.

III. SCOPE OF THE STUDY

The first three chapters[10] of this thesis explore the legal framework of sovereign debt, the law and policy aspects of sovereign debt restructuring, and the holdout creditor problem. In doing so, we rely on a comprehensive body of secondary literature, numerous decisions rendered by national and international courts and dispute settlement authorities, as well as newspaper articles, and a plethora of other electronic sources.[11] Chapters 4 and 5 examine cases of holdout litigation and arbitration in the wake of the Argentine and the Greek debt restructuring operations, respectively. These chapters provide a comparative review of seminal court decisions related to the two debt restructurings across a dozen different jurisdictions.[12]

Specifically, we cover holdout trials before courts and tribunals in the following jurisdictions:

- With respect to Argentina's debt crisis:[13]
    - United States of America,
    - United Kingdom,
    - Germany,
    - Italy,
    - France,
    - Switzerland,
    - the International Center for the Settlement of Investment Disputes (ICSID), and
    - the International Tribunal of the Seas (ITLOS).
- With respect to Greece's debt crisis:[14]
    - Germany,

[10] The thesis comprises 6 *chapters*. Each chapter has several *sections*.
[11] See below in the Annex for a full bibliography.
[12] In the economic literature, the seminal work on holdout creditors was written by Julian Schumacher, *Enforcement in Sovereign Debt Markets* (unpublished PhD thesis, Humboldt University Berlin 2015).
[13] See below chapter 4.
[14] See below chapter 5.

- Austria,
- Greece,
- the ICSID,
- the Court of Justice of the EU (CJEU),
- the EU General Court (EGC), and
- the European Court of Human Rights (ECtHR).

We concentrate on the Greek and the Argentine debt restructurings for three reasons. First, they were the two largest sovereign debt restructurings in history; while Argentina restructured public debts with a face value of approximately USD100 billion, Greece imposed a haircut on bonds with a face value of more than USD200 billion. Second, both debt restructurings resulted in thousands of lawsuits that spanned across several jurisdictions. Third, while the respective debt structures and the legal features of the debt instruments differed, a comparison between the Argentine and the Greek debt workout reveals important general principles of law that apply in a wide range of jurisdiction. At the same time, the vast majority of sovereign debt instruments are governed by domestic rather than international laws, which means that jurisdictional specificities must not be ignored when devising solutions to the holdout creditor problem.

Indeed, as the final chapter of this thesis argues, policymakers ought to consider two different approaches to mitigate holdout problems.

With regard to international sovereign bonds, ie debt instruments predominantly governed by New York and English law, we propose to enhance the existing contractual framework by introducing certain technical amendments that make it harder for holdouts to block a restructuring. The creation of a fully-fledged bankruptcy framework under international law remains politically improbable and technically difficult.

As regards domestic law bonds issued by euro area Member States, where sovereign default risks continue to be elevated, policymakers should consider a more ambitious approach, which includes a transparent procedure when debt becomes unstainable as well as the establishment of a genuine European dispute settlement function to balance creditor rights with the public policy objective of reducing debt.

IV. METHODOLOGY

This research relies on traditional methods of comparative legal research. Following Siems' approach to comparative legal analysis, this thesis concentrates on legal functionalism as the most important feature of traditional comparative law. It compares approaches and solutions produced by different states as well as international organisations for the same factual problem.[15] The factual problem at stake is that certain creditors try to interfere with a sovereign debt restructuring to maximise the individual return on their investment.

Rather than formally comparing different laws governing sovereign debt instruments[16], this research concentrates on court rulings and arbitral awards. Given that national and international rules to address sovereign debt crises are largely absent, the study of case law provides the greatest insights into the legal challenges facing countries that need to restructure their public debts.

While, at a practical level, comparative law has the tendency to determine that the law is relatively universal[17], this study reveals that the methodology of contract interpretation, the principle of sovereign immunity and the understanding of property rights protection, diverge across jurisdictions in the context of sovereign debt. The difficulty in scrutinising holdout problems stems from the intricate interplay between domestic, international and financial law.[18] Therefore, we follow the traditional approach and connect principles and doctrines across different areas of law rather than approaching the problem from specific angle, such as international law.[19] While this can – at times – hamper the readability of the study, a serious attempt to explain the holdout problem warrants a cross-jurisdictional and multidimensional legal analysis that takes account of the different legal regimes within which sovereign debt disputes are adjudicated.

By applying academic rigour to the analysis of a real problem for international policymakers, the thesis seeks to fill gaps in the existing sovereign debt literature. Given that most lawsuits

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[15] See Mathias Siems, *Comparative Law* (Cambridge: Cambridge University Press, 2014).

[16] According to Black's Law Dictionary, debt instrument is 'a written promise to repay a debt, such as a promissory note, bill, bond or commercial paper.' See Bryan A. Garner, *Black's Law Dictionary* (London: Thomson Reuters, 10th ed, 2014) 490.

[17] See, eg, Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (Oxford: Clarendon, 1998, 3rd ed) 40.

[18] See for the methodological challenges, eg, Matthias J. Müller, *Staatsbankrott und private Gläubiger* (Baden-Baden: Nomos, 2015).

[19] See, eg, Kenneth Rogoff and Jeromin Zettelmeyer, 'Bankruptcy Procedures for States: A History of Ideas, 1976-2001' (2002) 49(3) IMF Staff Papers 470.

related to the Argentine and the Greek debt workouts have now been settled, this thesis provides the first comprehensive account[20] of the seminal judgements delivered by courts in numerous jurisdictions as well as international (investment) tribunals.[21]

[20] Less comprehensive and more focused studies exist on the relationship between states facing economic crisis and their private creditors, albeit few of them take on the task of providing a comprehensive picture of holdout litigation and arbitration after Argentina and Greece. See, eg, Müller (n 18), Astrid Iversen, 'Holdout Creditor Litigation' (2015) University of Oslo Faculty of Law Legal Studies Research Paper Series No 2015-13, 35 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2613280> accessed 21 May 2017, and Charlotte Rault, *The Legal Framework of Sovereign Debt Management* (Berlin: Nomos, 2017). Also compare for an overview of sovereign debt restructurings and holdout problems, Udabir Das, Michael Papaioannou and Christoph Trebesch, 'Sovereign Debt Restructurings 1950-2010: Literature Survey, Data and Stylized Facts' (2012) IMF Working Paper WP/12/203, 16 <https://www.imf.org/external/pubs/cat/longres.aspx?sk=26190.0> accessed 2 June 2017.

[21] See, notably, Mark Weidemaier and Mitu Gulati, 'The Relevance of Law to Sovereign Debt' (2015) 11 Annual Review of Law and Social Science 395.

1. THE LEGAL FRAMEWORK OF SOVEREIGN DEBT

'*The prudence of a nation should dictate the same conduct as the prudence of the individual; to submit to as much privation immediately, as can easily be borne, and only when any further burthen would distress or cripple them too much, to provide for the remainder by mortgaging their future income'*

–Stuart Mill (1848)[22]

1.1. INTRODUCTION

Since time immemorial, government borrowing has been a crucial feature of the international economy as well as a cornerstone of the global growth and development process.[23] Countries have used debt instruments to wage war, to finance public infrastructure and, more recently, to preserve costly social welfare systems. Sovereign debt is also a pivotal factor in world affairs.[24] It has assumed a central role in the international finance system and is inextricably bound to fundamental progress economic and social development.[25]

Borrowing money from either domestic citizens or foreigners is economically sensible too. Macroeconomic theory suggests that a country with above average growth prospects should attract capital for both investment and consumption smoothing.[26] As a matter of (international) law, states have an unlimited capacity to borrow.[27] Indeed, virtually all modern nation states have made use of their 'right to borrow' and accumulated formidable piles of debt on their public balance sheets.

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[22] Cited in Kenneth H. F. Dyson, *States, Debt, and Power: 'saints' and 'sinners' in European History Integration* (Oxford: Oxford University Press, 2014) 68.

[23] Compare for an overview of sovereign debt and crises Carmen Reinhart and Kenneth Rogoff, *This Time Is Different: Eight Centuries Of Financial Folly* (Princeton: Princeton University Press, 2009).

[24] Kevin Gallagher, 'Financial Crisis and International Investment Agreements: The Case of Sovereign Debt Restructuring' (2012) 3(3) Global Policy 362; Robert Kolb, *Sovereign Debt – From Safety to Default* (Hoboken: Wiley, 2011) 3.

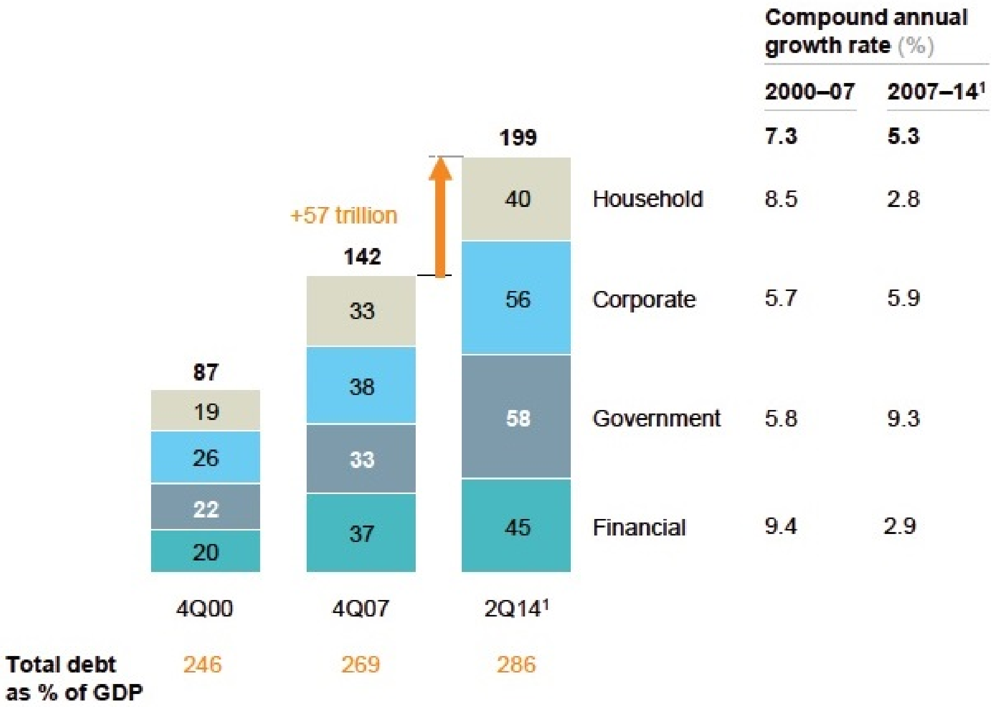
[25] See Hal Scott, 'An Overview on International Finance: Law and Regulation' (2005) unpublished manuscript <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=800627> accessed 17 May 2018.

[26] See, eg, Mark Aguiar and Manuel Amador, 'Sovereign Debt' in Gita Gopinath, Elhanan Helpman and Kenneth Rogoff, *Handbook of International Economics* (Amsterdam: Elsevier, 2014). However, as Reinhart et al show, in advanced economies a negative correlation exists between debt-to-GDP ratios and growth, see Carmen Reinhart, Vincent Reinhart and Kenneth Rogoff, 'Public Debt Overhangs: Advanced Economy Episodes Since 1800' (2012) 26(3) Journal of Economic Perspectives 69.

[27] See The Case of the S.S. 'Lotus' (*France v Turkey*), PCIJ, Series A, No 10, 18-19.

Sovereign debt issuances have firmly accelerated within the last three decades. In 2010, as indicated by Figure 1, it surpassed the amount of USD40 trillion[28], exceeding the combined GDP of the US, Germany, Japan and China.[29] Moreover, in both low-income countries and advanced economies, recent changes in general government debt point at a marked increase of debt-to-GDP ratios.[30]

Figure 1: Global stock of outstanding debt by type (in USD billion) [31]



While sovereign debt has allowed governments around the globe to spur growth and cultivate their social, economic and political development, borrowing excesses harbour risks. Financial crises stemming from over-borrowing have, too, become recurring and frequent features of the modern global economy. As Reinhart and Rogoff's seminal book *This Time is Different*

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[28] ibid [4]; Committee on International Economic Policy and Reform, 'Revisiting Sovereign Bankruptcy' (October 2013) Brookings Institution, 6 <https://www.brookings.edu/wp-content/uploads/2016/06/CIEPR_2013_RevisitingSovereignBankruptcyReport.pdf> accessed 1 July 2018.

[29] IMF, 'World Economic Outlook Database' (April 2016) <http://www.imf.org/external/pubs/ft/weo/2016/01/weodata/index.aspx> accessed 10 June 2016.

[30] IMF, 'Debt Use it Wisely, Chapter 1 – Fiscal Monitor' (October 2016) <https://www.imf.org/external/pubs/ft/fm/2016/02/pdf/fmc1.pdf> accessed 5 November 2016. In this report, the IMF warns, in particular, of the unprecedentedly high levels of private sector debt.

[31] Richard Dobbs, Susan Lund, Jonathan Woetzel, and Mina Mutafchieva, 'Debt and (not much) deleveraging' (2015) McKinsey Global Institute <https://www.mckinsey.com/featured-insights/employment-and-growth/debt-and-not-much-deleveraging> accessed 25 August 2017.

makes clear, most countries that are able to raise funds internationally have undergone one or more default episodes throughout history.[32]

Perhaps surprisingly, sovereign defaults occur in 'good' and 'bad' times.[33] However, they often coincide with major (global) financial crisis – such crisis can result in the collapse of the sovereign debtor's financial sector or a rapid and severe deterioration of the government's fiscal situation.[34] Overall, the effects sovereign defaults are negative, for they typically result in the exclusion from (international) credit markets, prolonged periods of economic stagnation, and considerable output losses.[35] At the same time, maintaining excessive sovereign debt levels for a longer period may amplify debt overhang effects, which can in turn severely undermine economic growth prospects.[36]

This thesis refrains from delving deeper into the controversies in the economic literature on optimal sovereign debt management strategies. Rather, it focuses on the legal problems associated with a given state's inability to repay its debts in full and on time. The greatest legal challenge for a sovereign seeking to reduce its debt levels stems from uncooperative creditors poised to block such efforts by leveraging their debt contracts against the sovereign in a (foreign) court. These creditors are also known as 'holdout creditors' or 'holdouts'.

However, in order to understand what happens at the end of a sovereign debt contract, we need to first look at its beginning.

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[32] Reinhart and Rogoff (n 23).

[33] See, eg, Aguiar and Amador (n 26) 650-651.

[34] ibid.

[35] See, eg, Stefano Neri and Tiziano Ropele, 'The macroeconomic effect of the sovereign debt crisis in the euro area' (2013) Paper presented at the Workshop 'The Sovereign Debt Crisis and the Euro Area' organized by the Bank of Italy and held in Rome on 15 February 2013 <https://www.bancaditalia.it/pubblicazioni/altri-atti-convegni/2013-2-sovereign-debt-crisis/neri_ropele.pdf> accessed 10 April 2017. Also see Davide Furceri and Aleksandra Zdziencka, 'How Costly Are Debt Crisis' (2011) IMF Working Paper WP/11/280 <https://www.imf.org/external/pubs/ft/wp/2011/wp11280.pdf> accessed 10 April 2017 (analysing the short- and medium-term impact of debt crises in 154 countries between 1970 and 2008 on GDP and finding that 'debt crises produce significant and long-lasting output losses, reducing output by about 10% after eight years').

[36] See, eg, Stephanie Lo and Kenneth Rogoff, 'Secular stagnation, debt overhang and other rationales for sluggish growth, six years on' (2015) BIS Working Papers No 482 <https://www.bis.org/publ/work482.pdf> accessed 2 December 2017.

1.2. THE LEGAL FRAMEWORK OF SOVEREIGN DEBT

1.2.1. INTRODUCTION

From a legal point of view, the concept of 'sovereign debt' appears to be an oxymoron. [37] On the one hand, the term 'debt' defines a legal relationship where the borrower has promised to repay the amount stated in the contract plus interest to the lender. On the one hand, the principle of *pacta sunt servanda* applies to financial promises rendered by sovereigns just as much as in a legal relationship under private law.[38] The sovereignty of states[39], on the other hand, confers a unique status of immunity[40] upon nations. Black's Law Dictionary[41] defines sovereignty as a 'supreme, absolute and uncontrollable power by which any independent state is governed.' This legal fiction is rooted in the well-established principle of equality of nations under international law: *par in parem non habet imperium*.[42]

Any study on the legal aspects of sovereign debt ought to take proper account of the abovementioned oxymoron, which is complicated by the multitudinous legal systems and doctrines that govern and influence this asset class. As Tietje and Szodruch rightly note, 'sovereign debt crises in the 21st century serve as a powerful example of how modern transnational economic transactions blur the traditional boundaries between international and

[37] Lee Buchheit and Mitu Gulati, 'Responsible Sovereign Lending and Borrowing' (2013) 73 Law and Contemporary Problems 63, 65. In German, the term 'debt' (*Schuld*) equates the English word 'sin', thus implicating a (negative) moral aspect to owing money. The Greek finance minister Yanis Varoufakis has referred to this grammatical particularity in the context of the Greek debt crisis, remarking that 'here was a tendency in Germany among strong creditors to demand penitence from weak debtors for their debt-guilt and to punish them if they did not seek redemption'. See The Economist, 'As we forgive our debtors' *The Economist* (London, 16 June 2015).

[38] Of course, originally, the *pacta sunt servanda* doctrine only referred to international treaty, as the word *pacta* suggests. However, in scholarship, the *pacta sunt servanda* principle is almost used synonymously with the principle of maintenance of contracts.

[39] Kelsen refers to sovereignty as the 'legal authority of the States under the authority of international law'. He adds 'a State's legal authority may said to be 'supreme' insofar as it is not subjected to the legal authority of any other sates'. Consequently, 'the State's sovereignty under international law is its legal independence from other States.' Hans Kelsen, 'The Principle of Sovereign Equality of States as a Basis for International Organisation' (1944) 53(2) The Yale Law Journal 207, 208.

[40] For an analysis of public debt and sovereign immunity see Georges R. Delaume, 'Three Perspectives on Sovereign Immunity – Public Debt and Sovereign Immunity: The Foreign Sovereign Immunities Act of 1976' (1977) 71(3) The American Journal of International Law 399.

[41] Garner (n 16).

[42] For a recent analysis of the non-intervention principle in contemporary international law compare Maziar Jamnejad and Michael Wood, 'The Principle of Non-Intervention' (2009) 22(2) Leiden Journal of International Law 345 and John P. Grant and J. Craig Barker (eds), *Encyclopaedic Dictionary of International Law* (Oxford: Oxford University Press, 2009, 3rd ed). A more critical view is taken by Yang, who argues that the *par in parem non habet imperium* maxim has nothing to do with sovereign immunity or even international law. Rather, the maxim is one of the grounds on which Dante argues that the rule of a single person is necessary for the well-being of humankind. See Xiaodong Yang, *State Immunity in International Law* (Cambridge: Cambridge University Press, 2012) 52.

domestic as well as public and private law.'[43] The objective must, however, not be to disentangle the different legal concepts shaping sovereign debt and sovereign default. Instead, we must focus review their relationship and distil common standards.

In the realm of cross-border public debt finance[44], the most important legal doctrine is the concept of sovereign immunity, for it puts significant strains on foreign creditors' power to enforce debt contracts.[45] Before the 1970s, the doctrine of absolute state immunity barred litigation against sovereign borrower in a foreign court. Nowadays, with the demise of the principle of absolute sovereign immunity *from suit*, foreign creditors may entertain legal actions against a debtor state in the courts of a third state. One result of this fundamental doctrinal shift in international law is that more than 50% of all sovereign debt workouts do now feature (holdout) creditor litigation of some sort.[46]

At the same time, sovereign debt enforcement mechanisms are still considered inefficient.[47] Moreover, the absence of a framework to resolve sovereign bankruptcy under international law has resulted in an ambiguous and intricate role of legal doctrines in the remit of sovereign debt – both in the literature and in practice.[48]

In fact, the number of legal disputes pertaining to sovereign debt has skyrocketed in recent years. Indeed, as empirical evidence suggests, holdout litigation and arbitration are no longer negligible nuisances during debt workouts.[49] Holdouts' increasing power has been particularly obvious after the Argentine debt restructuring, where, after a decade of fierce litigation, the government eventually accepted the holdouts' claims for full repayment.[50] Similarly, the Greek government expected aggressive speculative holdout litigation by hedge

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[43] Christian Tietje and Alexander Szodruch, 'Staatsnotstand bei Staateninsolvenz –Individualrechte und Gemeinwohlbelange im transnationalen Wirtschaftsrecht' (2007) 6 Zeitschrift für Bankrecht und Bankwirtschaft 498, 500.

[44] This term encompasses all types of debt financing countries may engage in and will be interchangeably used with the term sovereign debt.

[45] The legal doctrine of sovereign immunity constitutes on of the foundational principles of inter-State relations and – reminiscent of the principle of non-intervention into domestic affairs – limits foreign judicial, executive and legislative bodies to bind citizens in another State. Section 1.5. discusses sovereign immunity and explains in broad brushstrokes its relevance for cross-border financing.

[46] See Schumacher et al (n 9). Having said this, sovereign immunity *from enforcement* continues to limit significantly the creditors' ability to seize and liquidate the debtor country's assets.

[47] See for the pertinent economic theories regarding sovereign debt enforcement mechanisms in Aguiar and Amador (n 26) 650-655.

[48] See, eg, Weidemaier and Gulati (n 21).

[49] See, eg, Ran Bi, Marcos Chamon and Jeromin Zettelmeyer, 'The Problem that Wasn't: Coordination Failures in Sovereign Debt Restructurings' (2011) IMF Working Paper No 11/265 <https://www.imf.org/external/pubs/ft/wp/2011/wp11265.pdf> accessed 2 August 2017.

[50] See below 4.2.

funds and therefore decided to pay a number of vultures the full fact value of the outstanding bonds, despite their significantly lower acquisition price on the secondary market.[51]

Despite the increasing frequency and severity of recent sovereign debt crises[52], the law of sovereign debt has not been subject to revolutionary reform. Far from it.[53] The system continues to rely on international soft law and best practices as well as complex contractual arrangements borrowed from the world of corporate finance. Consequently, the manifold economic, political, and legal consequences of sovereign insolvency are not adequately reflected in the contemporary legal framework underpinning this central element of the international financial architecture.[54]

1.2.2. SOVEREIGN DEBT – A DEFINITION

Sovereign debt is a broad term that is not defined by international law. Scholars have put forward different definitions of the term 'sovereign debt', also referring to it as 'public debt', 'government debt,' or 'national debt'. According to Black's Law Dictionary, 'national debt' is '[t]he total amount owed by the government of a country; especially the total financial obligations of the federal government, including such instruments as Treasury bills, notes, and bonds, as well as foreign debt.[55]

Waibel defines sovereign debt as 'all financial obligations of a country towards both, sovereign and private creditors regardless of the debt's legal origin'.[56] Das et al refer to sovereign debt as 'debt issued or guaranteed of a sovereign state'.[57] Putting more emphasis on the type of countries that raise funds internationally, Sedlak holds that sovereign debt is 'the debt incurred by governments, typically those of developing countries, to foreign investors seeking a competitive return.' [58]

The terms 'sovereign debt', 'government debt', and 'national debt' are typically used interchangeably, albeit differences exist on the margins. As Olivares-Caminal notes, sovereign bond prospectuses use several other terms to define the financial obligation the

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[51] See for an overview below chapter 4.
[52] Aguiar and Amador (n 26) 650-651.
[53] For a critique, see, eg, Committee on International Economic Policy and Reform (n 28).
[54] For a discussion on the regulation of sovereign bankruptcy, see below chapter 6.
[55] Garner (n 16) 1184.
[56] Compare Michael Waibel, *Sovereign Defaults before International Courts and Tribunals* (PhD thesis, University of Vienna 2008) 7.
[57] Das et al (n 20).
[58] Jonathan Sedlak, 'Sovereign Debt Restructuring: Statutory Reform or Contractual Solution?' (2004) 152 University of Pennsylvania Law Review 1483, 1485.

state incurs vis-à-vis the owner of the respective instruments, such as: ‘Public Debt’, ‘External Debt’, ‘External Public Debt’, ‘Public External Debt’, ‘Public External Indebtedness’, ‘Publicly Issued External Indebtedness’, ‘Capital Market Indebtedness’, ‘Indebtedness’, ‘Obligations’, ‘General Obligations’, ‘borrowed money’, and ‘public foreign debt’.[59]

While scholars hold different views on the exact definition of sovereign debt, this thesis will adopt a broad definition that includes ‘all monetary obligations issued by sovereign nations in local or foreign currencies as well as such governed by domestic or foreign laws.’[60] This notion broadly aligns with the one advanced by Megliani[61], who contends that sovereign debt ‘generally includes debts owed, guaranteed, or secured by a sovereign state or an agency or instrumentality thereof; these debts may originate from various obligations and may be owed to domestic or foreign creditors’.[62]

1.2.3. The Sovereign Debt Enforcement Conundrum

Like in many other areas of modern macroeconomics, John Maynard Keynes influenced the intellectual debate on sovereign debt management and crises. In the context of post-World War II German reparations, Keynes drew the following conclusions when analysing the so-called ‘transfer problem’ that describes to the lack of credible commitment devices in the remit of bilateral sovereign lending:

> ‘[i]t is probable that loans to foreign Governments have turned out badly on balance…. *The investor has no remedy — none whatever — against default*. There is, on the part of most foreign countries, a strong tendency to default on the occasion of wars and revolutions and whenever the expectation of further loans no longer exceeds in amount the interest payable on old ones. [emphasis added]’[63]

[59] Rodrigo Olivares-Caminal, ‘The definition of indebtedness and the consequent imperilling of the pari passu, negative pledge and cross default clauses in sovereign debt instruments’ (2017) 12(2) Capital Markets Law Journal 164.

[60] See for the differences between external and domestic debt below 1.2.4.1. Also compare Michael Bradley, Elisabeth de Fontenay, Irving Arturo de Lira Salvatierra and Mitu Gulati, ‘Pricing Sovereign Debt: Foreign versus Local Parameters’ (2017) 24 European Financial Management 261.

[61] Mauro Megliani, *Sovereign Debt: Genesis, Restructuring, Litigation* (Berlin: Springer, 2015) 4.

[62] The rationale of holding sovereign assets may differ considerably amongst the various groups of investors in such instruments. This has effects on sovereign debt crisis resolution, with some investors more willing to take risks and hold out while others favour a consensual approach in dealing with the sovereign debtor. See below 3.3.

[63] See John Maynard Keynes, ‘Foreign Investment and National Advantage’ (1924) The Nation and Atheneum, cited in James A. Haley, ‘Sovereign Debt Restructuring: Bargaining for Resolution’ (April 2017) CIGI Papers No 124, 2 <https://www.cigionline.org/sites/default/files/documents/Paper%20no124web.pdf> accessed 2 June 2018.

As Haley observes, '[Keynes] emphasises that foreign creditors have little recourse in the event of opportunistic behaviour.'[64] The most famous economist of the 20th century thus recognised that sovereign debt was a unique asset class, providing the borrower with the option of reneging on its financial obligations without having to fear serious legal sanctions.[65]

Of course, the facts have changed since then, the mind perhaps less so. As discussed below, the demise of the doctrine of absolute sovereign immunity in the 1970s had a profound impact on the potential enforceability of sovereign debt. Private creditors could suddenly sue states over their financial promises in courts abroad.[66]

This takes us back to the sovereign debt oxymoron. From a theoretical legal viewpoint, when government officers sign debt contracts, they incur binding and enforceable obligations.[67] The general principle of law that contracts have to be obeyed (*pacta sunt servanda*) epitomises this notion, which is well established in both pertinent scholarly literature[68] and case law[69]. The validity and enforceability of a promise are crucial elements of the principal-agent relationship between the parties to a debt contract: the lender puts her fund at risk, knowing that the borrower can be disciplined into complying with the contractual obligation

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[64] ibid.

[65] This being said, as section 1.2.3. discusses, sovereigns may have economic incentives to maintain a favourable credit reputation, thus lowering the costs of rolling over maturing debt obligations. This means that even without any threats of enforcement, sovereigns may be very keen on paying all their debts when they fall due. The IMF also found that states exhibit a certain reluctance to offer a debt restructuring to their private creditors since they fear adverse market reactions. In a report from 2013, the IMF stated the following:

> '[w]hile the costs of delaying a restructuring are well recognized, pressures to delay can still arise due to the authorities' concerns about financial stability and contagion. Delays were also sometimes facilitated by parallel incentives on the part of official creditors, who accordingly may have an interest in accepting, and pressuring the Fund to accept, sanguine assessments of debt sustainability and market reaccess.' See IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework' (26 April 2013) <https://www.imf.org/external/np/pp/eng/2013/042613.pdf> accessed 12 May 2018.

[66] Of course, sovereign debt enforcement remains constrained. However, as argued in chapters 4 and 5, the Argentine and the Greek debt crises have somewhat changed the prevailing narrative that sovereign debt enforcement is too costly an option for creditors to pursue. In the wake of both debt workouts, thousands of litigious creditors took the insolvent nations to court, demanding a full repayment of their claims. For an overview, also compare Aguiar and Amador (n 26) 647-687.

[67] See, eg, Jesse, Kaplan, 'Collective Action and the Competence of Courts: The Lessons from NML v. Argentina' (2014) 1 Stanford Journal of Business and Finance Law 30 (holding that sovereign debt contracts are ultimately contracts).

[68] Anthony Aust, 'Pacta Sunt Servanda' in Rüdiger Wolfrum (ed), *Max Planck Encyclopaedia of Public International Law* (Heidelberg: Oxford University Press, 2007, online version) (noting that '[t]he pacta sunt servanda rule embodies an elementary and universally agreed principle fundamental to all legal systems').

[69] *Gabčikovo-Nagymaros Project, Hungary v Slovakia*, Merits, ICJ GL No 92, [1997] ICJ Rep 7, ICGJ 66 (ICJ 1997), (1998) 37 ILM 162, 25th September 1997, International Court of Justice [ICJ] [141] (citing Article 26 of the Vienna Convention on the Law of Treaties, which stipulates that '[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith').

by virtue of court sanctions.[70] Yet the sovereign debtor is often considered 'litigation proof'.[71]

In the course of the past three decades, national courts have gradually reinforced the principle of *pacta sunt servanda* in the context of government debt financing, or rather the modern interpretation of *pacta*, which does not only refer to international treaties but also private contracts entered into by sovereign states.[72] In the *Allied Bank* case, for instance, the US Court of Appeals held that '[…] under contracts subject to the jurisdiction of United States courts may assume that, except under the most extraordinary circumstances, *their rights will be determined in accordance with recognized principles of contract law*. [emphasis added]'[73] Like many other precedents[74], the *Allied Bank* case revealed that sovereigns neither borrow in an extra-legal sphere[75] nor sign gentlemen's agreements short of legal relevance.[76] Many argue that managing sovereign debt by making use of contractual – and enforceable[77] – agreements has proven indispensable to make sovereign debt markets work in the first place.[78] Starting with Kelsen, who found it 'logically impossible' to assume that sovereigns borrow without relying on valid legal contracts, most scholars have since emphasised the

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[70] See, eg, Mitu Gulati and George Triantis, 'Contracts Without Law: Sovereign Versus Corporate Debt' (2007) 75 University of Cincinnati Law Review 977.

[71] ibid (noting that '[m]ost contracts anticipate both formal and informal enforcement (such as reputational sanctions), in varying degrees of importance. Thus, even 'legal' contracts such as corporate debt instruments may well do more than simply anticipate the possibility of litigation).

[72] For a discussion, see Robert Howse, 'The Concept of Odious Debt in Public International Law' (2007) UNCTAD Discussion Papers No 185, 4.

[73] *Allied Bank International v Banco Credito Agricola de Cartago,* 733 F 2d 23 (2d Cir 1984), 1984, United States; Court of Appeals (2nd Circuit) [2d Cir]. Also see Karen Halverson-Cross, 'The Extraterritorial Reach of Sovereign Debt Enforcement' (2015) 12 Berkeley Business Law Journal 111, 141.

[74] See, eg, *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY]; *Argentina and Banco Central de la Republica Argentina v Weltover Incorporated and ors*, Final appeal, Docket No 91-763, 504 US 607 (1992), ILDC 1924 (US 1992), 112 S Ct 2160 (1992), 119 L Ed 2d 394 (1992), (1995) 100 ILR 510, 12th June 1992, United States; Supreme Court [US]; German BVerfG Case No 2 BvM 1/03 (8 May 2007); *Fedax NV v Venezuela,* Award, ICSID Case No ARB/96/3, IIC 102 (1998), (2002) 5 ICSID Rep 200, (1998) 37 ILM 1391, (1999) XXIVa YB Com Arb 39, 9th March 1998, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[75] However, Buchheit and Gulati argue that because of the principle of sovereign immunity countries are rarely held responsible for defaulting and therefore largely borrow extra-legal. See Buchheit and Gulati (n 37) 86. Some also contend that the lack of regulation in sovereign finance makes it seem like a 'law-free zone'; see Anna Gelpern, 'Sovereign Debt: Now What' (2016) 41(2) Yale Journal of International Law Online 45.

[76] US courts have emphasised that in New York 'a bond is a contract'. They seemingly fear creating precedents by not finding breaches in a sovereign context, where they would undoubtedly find one in a corporate context. See Kaplan (n 67) 6.

[77] However, countries increasingly emphasise in their bond disclosure documents that it may be difficult to obtain and enforce a judgement against them. See, eg, The Republic of Argentina, 'Prospectus Supplement to Prospectus Dated December 27, 2004' <http://www.sec.gov/Archives/edgar/data/914021/000095012305000302/y04567e424b5.htm> accessed 16 October 2016.

[78] Buchheit and Gulati (n 37) 82.

importance of promoting the enforceability of sovereign debt agreements.[79] Indeed, as Buchheit and Gulati argue, the legal validity of government debt contracts is the 'only viable assumption for the efficient functioning of global financial markets.'[80] If sovereigns had no legal obligation to repay their debt, this could reduce the flow of capital to sovereign debtors significantly.[81]

In this context, credible enforcement mechanisms are also considered vital to 'encourage lenders to take [sovereign] risk.' [82] Similarly, Pistor remarks that 'legally enforceable financial commitments that link market participants from different countries and legal systems to one another determine the scope of the financial system'.[83] However, given the legal constraint to enforcing sovereign debt, major parts of the economic literature on sovereign debt have focused on reputation, output losses, and trade sanctions to explain the functioning of sovereign debt markets – rather than legal enforcement.[84] Several studies also suggest that economic sanctions by third parties may play an important role in enticing sovereign debtors to comply with their financial obligations.[85]

The tension between the absence of efficacious enforcement procedures for creditors and the lack of a reorganisation or restructuring procedure for the sovereign debtor has generated what scholars refer to as the 'sovereign debt equilibrium'.[86] Neither the sovereign borrower nor its creditors are in a particularly strong position. In theory, this equilibrium encourages all stakeholders to converge on a consensual solution.

[79] Hans Kelsen, *Principles of International Law* (New York: Rinehart & Company, 1952) 305.
[80] Buchheit and Gulati (n 37) 65.
[81] ibid.
[82] ibid.
[83] Katharina Pistor, 'A legal theory of finance' (2013) 41 Journal of Comparative Economics 315.
[84] Eg Jonathan Easton and Mark Gersovitz, 'Debt with Potential Repudiation' (1981) 48(2) The Review of Economic Studies 289. Essentially, by choosing to default rather than repay government debt, States trigger a lender embargo. The cost of default to the sovereign is thus the cost of being shut out of the credit markets on the upward cycle and associated consumption constrains on the next downward cycle. Compare in particular William W. Bratton, 'Pari Passu and A Distressed Sovereign's Rational Choices' (2004) 53 Emory Law Journal 823 and Harold L. Cole, James Dow and William B. English, 'Default, Settlement and Signalling: Lending Resumption in a Reputational Model of Sovereign Debt' (1995) 36 International Economic Review 365.
[85] Eg Kris Mitchener and Marc Weidenmier, 'Supersanctions and Sovereign Debt Repayment' (2010) 29(1) Journal of International Money and Finance 19 (concluding that 'third-party enforcement mechanisms, with the authority to enact financial and fiscal reforms, may be beneficial for resuscitating the capital market reputation of sovereign defaulters'); Michael Tomz and Mark Wright, 'Empirical Research on Sovereign Debt and Default' (2013) 5 Annual Review of Economics 247 (reviewing economic literature on sovereign debt and default).
[86] International Law Association (ILA), 'Sovereign Bankruptcy Group – Johannesburg Report' (2016) Biennial Conference <www.ila-hq.org/download.cfm/docid/F128BD77-F45E-4DEC-B64DCA9F5A0B9470> accessed 9 November 2017 (noting that '[e]verybody's cards are poor so that at least there is an equality of misery'). Also compare Regis Bismuth, 'The Emerging International Law of Sovereign Debt Restructuring – Recent Developments' in ILA, 'Committee on International Monetary Law – Annual Report' (2018) Sydney Conference <http://www.ila-hq.org/images/ILA/DraftReports/DraftReport_MonetaryLaw.pdf> accessed on 2 August 2018.

However, the restructurings in Greece and Argentina have seemingly perturbed this equilibrium.[87] The victory of specialised holdout creditors against Argentina in New York City courts rattled debt markets, and so did Greek government's decision to pay some speculative hedge funds in full.[88] Indeed, both crises, as this thesis shows, have brought to the fore the flaws inherent to the legal framework applicable to sovereign bankruptcy.

1.2.4. Sovereign Debt and Contractual Standards

1.2.4.1. Overview

Regardless of potential obstacles to their enforcement under international or domestic law, contracts constitute the single most important source of law in the context of sovereign lending and borrowing. Sovereign debt contracts set out the core rights and obligations between the parties and, given the absence of bankruptcy procedures for states, need to provide mechanisms to steer the contractual relationship during both good and bad times.[89]

This stands very much in contrast to other legal frameworks for cross-border transactions, such as international trade law, where the WTO provides a genuine dispute settlement procedure that cultivated a process of 'judicialisation' in the realm of international trade.[90] Indeed, the IMF's role and influence in the world of international finance is inferior to that of the WTO in international trade.[91] Or at least the WTO's role before the Trump administration has come into power in 2017. For example, while IMF continues to provide vital financial assistance to sovereign borrowers in distress, its legal authority to mediate between government borrowers and their (private) lenders during sovereign debt crises is limited.[92]

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[87] For an in-depth analysis of the two respective crises, see chapters 4 and 5.

[88] Compare for many others, Brief of Joseph Stiglitz as amicus curiae in Support of Petitioner, *Republic of Argentina v NML Capital Ltd*, No 13-990 (US, 24 March 2014) <https://www.slideshare.net/jerogi/amicus-argentina> accessed 10 March 2017.

[89] Chris Brummer and Joost Pauwelyn, 'Introduction to Volume 13' (2010) 13(1) Journal of International Economic Law 1 (characterising (international) finance as a 'black hole' in international law).

[90] See, eg, Gregory Shaffer and Michael Waibel, 'The Rise and Fall of Trade and Monetary Legal Orders: From the Interwar Period to Today's Global Imbalances' (2016) University of Cambridge Faculty of Law Research Paper No 28/2016 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2781259##> accessed 17 April 2017 (arguing that the legalisation of the trade and monetary legal order diverges significantly, especially following World Trade Organisation's establishment in 1995 and the IMF's limits in exercising jurisdiction over international capital flows).

[91] See, eg, for an overview of the IMF's role in managing its members' capital accounts, Menno Broos and Sebastian Grund, 'The IMF's Jurisdiction Over The Capital Account—Reviewing the Role of Surveillance in Managing Cross-Border Capital Flows' (21)(3) Journal of International Economic Law 489.

[92] For a description of the Fund's legal and policy framework for sovereign debt restructuring, see 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework' (26 April 2013) 8 <https://www.imf.org/external/np/pp/eng/2013/042613.pdf> accessed 8 July 2018 (discussing the IMF's role in debt restructurings and noting that 'the Fund is precluded from providing financing

Against this backdrop, much of the literature has zoomed in on the contractual standards, given their relevance for both the management and the restructuring of sovereign debt.[93] Akin to most corporate debt contracts, sovereign bonds are characterised by uniform contract language, often referred to as 'boilerplate'.[94] The most important boilerplate provisions regularly used in international sovereign bond[95] offerings are *pari passu*, negative pledge and cross default clauses.[96] Their shared objective is to enhance the lender's rights in the event of default in order to counterbalance the fact that the lack of collateral weakens the rights of a sovereign bondholder.[97] Similarly, choice-of-law and choice-of-forum clauses are key clauses in the offering terms of a standard international bond.

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unless steps are taken to address the member's debt problems in a manner that restores sustainability, including via the restructuring of claims of the private and/or official sectors, and that will lead to renewed market access'). See below 2.6. for a discussion of the IMF's role in government debt restructurings.

[93] As the cases of holdout litigation assessed in chapter 4 and 5 illustrate, contractual standards often shape the legal design of sovereign debt restructuring operations. After all, they directly influence the likelihood of uncooperative creditors unwinding a debt workout in court.

[94] See, eg, See Mitu Gulati and Robert E. Scott, *The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design* (Chicago: Chicago University Press, 2012). Also see Anna Gelpern and Mitu Gulati, 'Innovation after the revolution: foreign sovereign bond contracts since 2003', 4(1) Capital Markets Law Journal (2010) 91 (discussing how boilerplate language in New York and London bonds has only slowly reacted to the official sector's call for more collective action provisions in sovereign bonds).

[95] International sovereign bonds are defined by the IMF as 'bonds issued or guaranteed by a government or central bank under a law other than the law of the issuer (or where a foreign court has jurisdiction over claims arising under the bond), in freely traded form with fixed maturities, normally in excess of one year'. See IMF, 'Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts' (2015) IMF Staff Report <http://www.imf.org/external/np/pp/eng/2015/091715.pdf> accessed 1 December 2017. In a previous report, the IMF deemed a bond 'international' if '(a) it is governed by a law other than the law of the issuer and (b) gives a foreign court jurisdiction over nay claims that may arise under the bond.' See IMF, 'The Design and Effectiveness of Collective Action Clauses' (6 June 2002) 14 <https://www.imf.org/external/np/psi/2002/eng/060602.pdf> accessed 9 August 2018.

[96] See, eg, Olivares Caminal (n 80) 3. It should, however, be borne in mind that some countries, most notably advanced economies in Europe, use very simple offering terms for their government debt instruments, especially when compared to the highly sophisticated prospectuses many emerging market countries attach to their bonds. For instance, the German standard offering terms for sovereign bonds have 13 pages; see German Ministry of Finance, 'Announcement of the Offering Terms for Government Bonds' (21 December 2012) <https://www.bundesbank.de/Redaktion/DE/Downloads/Service/Bundeswertpapiere/emissionsbedingungen_tenderpapiere_bundesanleihen_bundesobligationen_bundesschatzanweisungen_unverzinsliche_schatzanweisungen.pdf?__blob=publicationFile> accessed 2 December 2017. In contrast, Argentina's offering memorandum for four bonds placed at the stock exchange in Luxembourg has *264* pages; see The Argentina, 'Offering Memorandum: U.S.USD2,750,000,000 6.250% Bonds Due 2019, U.S.USD4,500,000,000 6.875%, Bonds Due 2021 U.S.USD6,500,000,000, 7.500% Bonds Due 2026, U.S.USD2,750,000,000 7.625%, Bonds Due 2046' (4 May 2016) <https://www.bourse.lu/security/USP04808AE45/236989> accessed 2 December 2017.

[97] Unsecured lending is usually restricted to very creditworthy borrowers: in the sovereign debt context, however, the vast majority of debt instruments are issued without collateral having to be posted in return. Naturally, there are also exceptions from this rule, especially in the aftermath of sovereign debt crises, where investors may demand additional security. See, eg, Thomas Duvall, 'Legal Aspects of Sovereign Lending' in Thomas Martin Klein (ed), *External Debt Management: An Introduction* (Washington D.C.: World Bank Report WTP 245, 1994) <http://documents.worldbank.org/curated/en/510421468739200034/External-debt-management-an-introduction> accessed 25 April 2017.

1.2.4.2. The *Pari Passu* Clause

Most bond international sovereign bond contracts entail *pari passu* clauses, albeit their precise drafting can vary. The rationale of using *pari passu* provisions, which literally translated from Latin means 'in equal steps', is to protect the lender from being subordinated either because of other concealed debt obligations or because of the creation of a legally senior class of creditors.[98] The clause arguably replicates statutory *pari passu* provisions in domestic bankruptcy laws. Indeed, the *pari passu* distribution of assets among creditors in the same class is a fundamental principle of most bankruptcy statutes.

The most famous *pari passu* clause, namely the one found in sovereign bonds issued by Argentina in the 1990s[99], reads as follows:

> '[t]he Securities will constitute … direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all time rank *pari passu* without any preference among themselves. The payment obligations of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness …'[100]

The meaning of *pari passu* is widely disputed in the context of sovereign lending and borrowing. The intellectual fault lines emerge between those who contend that it intends to merely avoid a 'legal' subordination by the issuer ('ranking' interpretation)[101] and those who

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[98] Rodrigo Olivares-Caminal, 'The pari passu clause in sovereign debt instruments: developments in recent litigation' (2013) BIS Papers No 72 – Sovereign risk: a world without risk-free assets? (Proceedings of a seminar on sovereign risk including contributions by central bank governors and other policy-makers, market practitioners and academics, Basel, 8–9 January 2013) 9 (further noting that 'the *pari passu* clause has elements of a representation has elements of a representation (the debt obligation ranks equally with the borrowers' other unsubordinated indebtedness) and a covenant (a promise that this status will be retained in the future)'.

[99] As discussed below, vulture holdouts invoked this provision against Argentina in US courts, ultimately obtaining an injunction that led to Argentina's default in 2014; see below 4.3.3.

[100] See, eg, *EM Limited and NML Capital Limited v Argentina*, No 11-4065-cv (L), 695 F 3d 201 (2d Cir 2012), 20th August 2012, United States; Court of Appeals (2nd Circuit) [2d Cir] (also discussed below in 4.3.3. An updated clause has been crafted by ICMA and recommended to international sovereign bond issuers. It stipulates the following:

'The Notes are the direct, unconditional and unsecured obligations of the Issuer and rank and will rank *pari passu*, without preference among themselves, with all other unsecured External Indebtedness of the Issuer, from time to time outstanding, p*rovided, however*, that the Issuer shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due on the Notes and vice versa.'

See ICMA, 'Standard Pari Passu Provision – August 2014' <http://www.icmagroup.org/resources/Sovereign-Debt-Information/> accessed 25 April 2017.

[101] This seems to be the predominant view under English law, see, most notably, Lachlan Burn, 'Pari passu clauses: English law after NML v Argentina' (2014) 9(1) Capital Markets Law Journal 2, 9 (holding that 'rank is not the same as pay' and contending that 'an English court would conclude that the *pari passu* provision could not have been intended by the issuer or the subscribers of the bonds to be interpreted on the 'payments' basis.').

believe that the clause conveys a protection from selective payments by a sovereign debtor ('payment' interpretation).[102]

Which interpretation a judge presiding over a sovereign debt disputes ultimately adopts can be decisive for the outcome of a debt workout. Under the payment interpretation, a sovereign borrower is, in principle, enjoined from making any payments to restructured bondholders if holdouts are not paid *pro rata*.[103] In other words, every time the sovereign makes payments to restructured bondholders, it would have to pay holdouts too. And, given that they have not accepted a haircut, holdouts can in fact demand repayment of the bonds' full face value.

As a result, cooperative creditors could become less inclined to accept a haircut if their less diplomatic peers can still demand full repayment by invoking the *pari passu* clause. While the described situation has so far only occurred twice in the history of modern sovereign debt, the implications were far-reaching, as discussed in more detail below.[104] Moreover, in chapter 6, we make some proposals on how policymakers may neutralise risks stemming from awry interpretations of this clause.[105]

1.2.4.3. The Negative Pledge Clause

A negative pledge clause restricts the sovereign debtor from issuing security interests to future creditors without securing the current debt on an equal basis.[106] It is typically the only negative covenant, ie a contractual obligation for the issuer to refrain from a certain action,

[102] Eg Robert A. Cohen, 'Sometimes A Cigar Is Just A Cigar': The Simple Story of Pari Passu' (2011) 40 Hofstra Law Review 11. According to the IMF, *pari passu* was mostly understood as a prohibition to subordinate claims of a government bondholder in favour of another creditor ('ranking' interpretation). However, under New York law (following *NML v Argentina*) *pari passu* bears a second – much broader – meaning that also prohibits the debtor from making payments to a creditor unless it makes ratable payments to other creditors whose debts are due and payable ('payment' interpretation). As we will see later, this view complicates restructuring proceedings and renders it easier for holdout investors to challenge a restructuring agreement *ex post*. See IMF, 'Strengthening The Contractual Framework To Address Collective Action Problems In Sovereign Debt Restructuring' (2014) IMF Policy Papers <https://www.imf.org/external/np/pp/eng/2014/090214.pdf> accessed 26 July 2017.

[103] See, eg, *Argentina v NML Capital Limited*, Appeal judgment, Docket No 12-842, 573 US ___ (2014), ILDC 2201 (US 2014), 134 S Ct 2250 (2014), 189 L Ed 2d 234 (2014), 16th June 2014, United States; Supreme Court [US]).

[104] See below 3.5.6. (discussing Court of Appeal of Brussels *Elliott Associates LP v Peru*, General Docket No 2000/QR/92, 26th September 2000, Belgium; Brussels; Court of Appeal; 8th Chamber) and section 4.3.3. (discussing *Argentina v NML Capital Limited*, Appeal judgment, Docket No 12-842, 573 US ___ (2014), ILDC 2201 (US 2014), 134 S Ct 2250 (2014), 189 L Ed 2d 234 (2014), 16th June 2014, United States; Supreme Court [US]).

[105] See, in particular, below 6.2.2.

[106] Stephen J. Choi, Mitu Gulati and Robert E. Scott, 'Variation in Boilerplate, Rational Design or Random Mutation' (2017) 20(1) American Law and Economics Review 1.

used in international sovereign bond issues.[107] A standard negative pledge clause in an international debt security says the following:

> '[c]ountry XY has agreed that as long as any of the debt securities remain outstanding, it will not create or permit to exist any security interest on its revenues or assets to secure its public external indebtedness, unless the debt securities are given an equivalent security interest.'

Scott defines the clause as 'a covenant in a bond indenture stating that the debtor will not pledge any of its assets to subsequent creditors if doing so impairs either the priority rank or rights to payment of existing creditors.'[108] Hence, such clauses seek to avoid time inconsistency problems, prohibiting the borrower from encumbering assets to secure an individual creditor's claim and thereby subordinating others. As Choi et al note, 'after a nation has borrowed money from unsecured creditors, it will be tempted to offer security to the next round of creditors in order to minimise the interest rate for the second group.'[109] Consequently, the first group of creditors may either demand higher interest payments to avoid a reduction in the value of the available pool of assets or the debtor credibly promises not to pledge security to future creditors.[110]

With respect to sovereign debt instruments, which are typically unsecured, negative pledge clauses are vital to avert competition among creditors for the debtor's assets in the event of default. Negative pledge clauses are not just enshrined in the vast majority government bonds but have a rather long-standing tradition in international loan agreements of all kind.[111]

This being said, the functioning and efficacy of these covenants in sovereign debt contracts remains contentious and ambiguous:

- First, the amount of assets held outside the sovereign's borders is often merely a fraction of the possible claims creditors have, thus rendering the negative pledge clause a toothless instrument to safeguard the creditor's interest.

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[107] Eli Withney Debevoise II, Neil M. Goodman, Carlos A. Pelaez, 'The Current State of the Sovereign Bond Market' (Capital Markets Law360, 2 May 2017) <https://www.apks.com/en/perspectives/publications/2017/05/the-current-state-of-the-sovereign-bond-market> accessed 19 August 2017.

[108] Robert Scott, 'A Relational Theory of Secured Financing' (1986) 86 Columbia Law Review 901.

[109] Choi et al (n 106).

[110] ibid.

[111] See, eg, Derek Asiedu-Akrofi, 'Negative Pledge Clauses in International Loan Agreements' (1995) 26(2) Law and Policy in International Business 407.

- Second, absent an efficient enforcement mechanism, sovereigns may well violate negative pledge clauses without further sanctioning by the contractual counterparty.[112]
- Third, while these clauses restrict the creation of security, they do not prevent the disposal of an asset.[113]

Against this backdrop, some lawyers suggest that negative pledge clauses are obsolete in public debt issues.[114] According to Wood, 'negative pledges in bonds are traditionally without teeth.'[115] At the same time, given the low level of creditor protection in the remit of sovereign debt, borrowers cannot avoid the inclusion of negative pledge clauses in practice. Creditors will continue to demand and use them to their advantage in the process of sovereign debt restructuring and subsequent litigation.[116]

1.2.4.4. The Cross Default Clause

Cross default clauses are a common method investors use to protect themselves against arbitrary behaviour by a debtor government.[117] Such clauses provide that 'if the sovereign defaults on some of its debt, then that action constitutes a default on other debt even though the sovereign is otherwise current on that debt.'[118] According to the IMF, a cross default takes place 'if a default event on one debt contract can trigger a default on another agreement.'[119] Cross default clauses are ubiquitous in bonds issued by countries with lower credit ratings – elite sovereign issuers, such as advanced European countries, typically do not include a cross default clause in their bond prospectuses.[120]

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[112] Lee Buchheit, 'Negative pledge clauses: the games people play' (1990) 9 International Financial Review 10.

[113] Olivares-Caminal (n 59) 14.

[114] Morey W. McDaniel, 'Are Negative Pledge Clauses in Public Debt Issues Obsolete?' (1983) 38(3) The Business Lawyer 867.

[115] Philipp Wood, *The Law and Practice of International Finance* (London: Sweet & Maxwell, 2008) 163 (further noting that 'they only prohibit the grant of security for comparable securities').

[116] For a recent case in which a holdout creditor invoked the negative pledge clause, see *Export-Import Bank of the Republic of China v Grenada*, No 13 Civ 1450 (HB), 19th August 2013, United States; New York; District Court for the Southern District of New York [SDNY]). For an analysis of the case, see Chen-Yun Tsang, 'Ex-IM Bank v Grenada: adding clarity or confusion?' (2015) 10(2) Capital Markets Law Journal 142.

[117] Choi et al (n 106) 12.

[118] ibid.

[119] IMF, 'A Survey of Experiences with Emerging Market Sovereign Debt Restructurings' (5 June 2012) <https://www.imf.org/external/np/pp/eng/2012/060512.pdf> accessed 31 May 2017.

[120] See, eg, The Republic of Austria, 'EUR 30,000,000,000 Medium Term Note Programme for the issue of Notes from 7 days to 70 years from the date of issue' (19 December 2012) <https://dl.bourse.lu/dl?v=ADyMFy5zxNFitbuuk6wDBq9dYUCtQyOZ44QQGOpgvv2m//kOyJ+obOA2hW4DPbUcv3KZka2pKh6SrQaoP/Vxlk2PpcveZ/brd15E1Vx+Bn86dLSfMuZqEa/oiov13pjuEVxTKjNt6sJszCQQsw5qkA==> accessed 13 July 2018.

A standard cross default clause that could be used in the sovereign or in the corporate context alike, reads as follows:

> '[t]he Borrower or any Subsidiary (i) fails to pay any of its Indebtedness as and when that Indebtedness becomes payable or (ii) fails to perform or observe any covenant or agreement to be performed or observed by it contained in any other agreement or in any other instrument evidencing any of its Indebtedness and, as a result of such failure, any other party to that agreement or instrument is entitled to exercise, and has not irrevocably waived, the right to accelerate the maturity of any amount owing thereunder.'[121]

The provision allows investors to impose significant penalties on a sovereign that defaults selectively. If a debt contract includes a cross default clause, a creditor, subject to the specific drafting of the covenant, may also declare default on her obligation and demand immediate repayment of the principal.[122] In a sense, cross default clauses are early warning systems that signal sovereign financial distress and offer creditors an exit strategy before the sovereign defaults on the protected creditor's debt instrument.[123]

Cross default clauses may also refer to other debt instruments, such as bilateral loans. Indeed, contractual freedom allows for countless different structures.[124] In most international sovereign bonds, the cross default clause covers any other 'external indebtedness', ie all obligations of any person from time to time for the payment or repayment of money.[125] What

[121] See Lee Buchheit, 'How to negotiate cross default clauses' (1993) 12 International Financial Law Review 27.

[122] Recently, cross default clauses were discussed in the context of the Venezuelan debt crisis, which has been lingering for the past two years and culminated in the country's default in 2017. Since bonds issued by the state-owned oil company PDVSA and government bonds are not linked to one another by virtue of a cross default clause, observers wondered whether Venezuela may exclusively restructure either PDVSA or government bonds without risking a full-blown default. See, eg, Lee Buchheit and Mitu Gulati, 'How to Restructure Venezuelan Debt' (21 July 2017) unpublished manuscript <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3006680> accessed 2 December 2017.

[123] See, eg, Stephen J. Choi, Mitu Gulati and Eric A. Posner, 'Pricing Terms in Sovereign Debt Contracts: A Greek Case Study with Implications for the European Crisis Resolution Mechanism' (2011) 6(2) Capital Markets Law Journal 163 (concluding that 'restructuring authorities would be well advised to abandon the past practice of largely ignoring variations in the boilerplate of sovereign debt contracts and giving equal treatment to different types of debt.').

[124] Some cross default clauses also introduce threshold amounts, below which a cross default is not triggered. For instance, the cross default clause used in Chile's base prospectus stipulates that investors may not trigger the cross default clause of the failure to make payments on bonds where the principal amount is below USD20 million. See, eg, Republic of Chile, 'USD2,000,000,000 3.240% Notes due 2028' (25 January 2018) <https://dl.bourse.lu/dl?v=ADyMFy5zxNFitbuuk6wDBs5q6Lcpawwr9lgHJ9GDJF3zHZB1j6GOEhLjCMzf0J+QRmIoEJ77adDFJ6zXe90bGmKl3scTmZZBKHoILYrB0igNXeVnqWclkDqa51CkmnENY1doSdoIla55k7JdkNTJ5A==> accessed 13 July 2018.

[125] Vinod Agarwal, 'Negotiation and Drafting Clauses in Loan Agreements: Events of Default' (2000) United Nations Institute for Training and Research (UNITAR) Sub-Regional Workshop on Negotiation Techniques for Senior Officials from Eastern and Southern Africa (Windhoek, Namibia 20 to 22 November 2000) <https://www.unitar.org/pft/sites/unitar.org.pft/files/DocSeries15.pdf> accessed 1 August 2017.

counts, and this applies to *pari passu* and negative pledge provisions too, is the definition of 'indebtedness' in the respective bond contract.[126]

Finally, it is important to note that, as a rule, cross default clauses are not linked to a sovereign issuer's default on official sector loans.[127] This reflects the implicit hierarchy between creditors, with the private sector being subordinated to the official sector.[128] This means that if a sovereign was to default on IMF loans, or bonds held by a (foreign) central bank, private bondholders may not declare their instrument as 'defaulted'.

1.2.4.5. The Relevance of Contract Boilerplate Language

Lee Buchheit, eminent counsel to nations in financial distress, describes the role of boilerplate language in international loan contracts:

> '[t]he permanent bedrock upon which rests the activity of the entire legal profession is plagiarism […] the mythical fellow who prepared the first loan agreement for a sovereign borrower marked up a loan agreement for a corporate borrower …[t]hen the process was repeated countless thousands of times until some lawyer somewhere was told to go off and draft the first sovereign debt restructuring agreement, and he or she just naturally fulfilled this commission by marking up the last sovereign loan agreement. And that, as they say, was that.'[129]

The pioneers of modern sovereign debt restructuring came to realise that the 'copy-and-paste' approach employed by many governments and their lawyers, which was aimed at attracting foreign investors, was fundamentally flawed.[130] Indeed, given the absence of clear rules for debtor insolvency, it should not surprise that a negative pledge clause[131] may be less effective an instrument to monitor and constrain the financial dealings of a sovereign rather than a corporate debtor.[132]

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[126] See Olivares-Caminal (n 59).

[127] See, eg, Moody's Investors Service, 'FAQ: Credit Impact of Sovereign Defaulting on Official Sector Debt' (May 2015) Sovereign and Supranationals <https://www.dropbox.com/s/34rohzrdmgwbth7/R2_Elena%20Duggar_Official%20debt%20default_28May2015.pdf?dl=0> accessed 24 June 2018.

[128] See below 2.2.4.

[129] See Lee, Buchheit, 'Negative pledge clauses: the games people play' (1990) 9 International Financial Review 10.

[130] See below 4.3. for evidence from the Argentine debt restructuring and ensuing litigation.

[131] See above 1.2.4.3.

[132] For instance, one may think of a situation in which a sovereign has pledged the same asset for several times. Even if a foreign court recognises this unlawful conduct, it may prove extremely difficult in practice to compel a state to reverse such transactions or to provide equivalent collateral. This is mainly because a sovereign debtor cannot be put into administration or transactions may not be retroactively avoided, as is the case in most domestic bankruptcy regimes.

Moreover, boilerplate language is considered very ‘sticky’, which implies that sovereigns are more likely to rely on standard-terms when they issue new bonds than adjust their contracts to each individual issuance.[133]

Literature suggests that this behaviour is largely market-driven.[134] First, governments will issue new bonds when interest rates are favourably low.[135] Capitalising on advantageous market conditions seems more attractive than engaging in tedious contractual engineering.[136] The (economic) benefit of relying on language used in previous bond offerings typically outweighs the advantage of trying something new (learning effect).[137] Second, legal representatives and advisors prefer to use cost-effective boilerplate rather than custom-tailored contracts (network effects).[138] Finally, adverse signalling effects are not to be underestimated. Governments could risk higher borrowing costs by introducing new standards to their bond issuances rather than relying on clauses well known to market participants.[139]

Since amending such standard clauses for a single bond issue could come at tremendous cost, governments might adopt boilerplate language that turns out to be suboptimal for the sovereign debtor in a subsequent debt crisis.[140] Indeed, as Choi et al note, sovereign bonds are more like commodities than custom-made items: a mass product sold by Wall Street or London City law firms that serves a huge number of clients.[141] Notwithstanding that

[133] Choi et al (n 106) 2.

[134] Anna Gelpern and Mitu Gulati, ‘Public Symbol in Private Contracts: A Case Study’ (2006) 84(7) Washington University Law Review 1627.

[135] See IMF (n 95) (noting that ‘frequent issues of sovereign bonds often rely on re-openings or take-downs because of faster and cheaper execution, where contractual amendments are few and far between’).

[136] Steven Choi and Mitu Gulati, ‘Contract as Statute’ (2006) 104 Michigan Law Review 1129, 1158 (arguing that boilerplate contracts among sophisticated parties need to be seen rather as statues than merely as contracts as court interpretation is prone to error in interpreting the later).

[137] Gelpern and Gulati (n 134) 1629 (noting that ‘[t]he prevalent theoretical explanation of boilerplate attributes its existence to learning and network effects and associated “switching costs.”’).

[138] Andrea Boyack, ‘Sovereign Debt and The Three and A Half Minute Transaction: What Sticky Boilerplate Reveals About Contract Law and Practice’ (2013) 35 Whittier Law Review 1, 2; Gelpern and Gulati (n 134) 1629-1631.

[139] See, eg, Anna Gelpern and Mitu Gulati, ‘The Wonder Clause’ (2013) 41(2) Journal of Comparative Economics 367 (noting that ‘debt managers often lack the understanding of specific contractual terms and their potential pricing implications’). For an analysis of the first-mover problem against Mexico’s introduction of a CACs in its New York law bonds in 2003, see Alejandro Diaz de Leon, ‘Mexico’s adoption of new standards in international sovereign debt contracts: CACs, pari passu and a trust indenture’ (2016) 11(1) Capital Markets Law Journal 12.

[140] Gelpern and Gulati (n 139) 372.

[141] Choi et al (n 106).

sovereign debt provisions may change, the prevailing view is that we do not yet fully understand why and when they do.[142]

As Choi et al note in this regard,

> '[e]ven sophisticated contracting parties do not tailor standardized contracts to articulate precisely their particular needs, expectations and understandings' but they instead 'copy the standard forms, making minor modifications at the margins to meet their clients' objectives as they understand them.'[143]

Moreover, while sovereign contract design is often market-driven, scholarship contends that governments are, too, involved in contractual innovation, particularly with respect to clauses that allow for some degree of private creditor 'bail-in'.[144] Indeed, targeted interventions by the official sector into contract drafting practices may be one explanation why boilerplate does nonetheless change from time to time: the Mexican CAC story and the recent push to insert amended CACs and *pari passu* provisions are cases in point.[145]

The problem of 'sticky' boilerplate[146] is that it makes it more difficult for market participants to swiftly adjust to new developments, such as changing market conditions or aberrations in municipal court practice.[147] Recently, US courts have been particularly enthusiastic in reinterpreting and reengineering boilerplate terms, attracting much criticism among

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[142] See Gelpern and Gulati (n 134) 1639 (noting that severe disruptions of the sovereign debt market have in the past resulted in amendments of sovereign debt boilerplate). One such event that shook the system's foundation was a Brussels court ruling against Peru in 2000 – see below 3.5.6. Following this decision, sovereigns implemented new standard terms in New York law bonds that allowed for collective creditor action (more specifically, such Collective Action Clauses allowed for a supermajority vote to 'cram down' holdout investors). Since 2003, most New York law governed bonds contain CACs. See Kaplan (n 67) 23; Choi et al (n 123) 141; W. Mark C. Weidemaier and Mitu Gulati, 'A People's History of Collective Action Clauses' (2013) 54 Virginia Journal of International Law 51.

[143] Choi et al (n 106) 141 (noting that 'contract clauses that no one understands can become part of the standard template, and variations among these clauses that are largely meaningless can arise and even grow in usage').

[144] See, eg, Mark Weidemaier, Mitu Gulati and Anna Gelpern, 'When governments write contracts: Policy and expertise in sovereign debt markets' in Grégoire Mallard and Jérôme Sgard (eds), *Contractual Knowledge - One Hundred Years of Legal Experimentation in Global Markets* (Cambridge: Cambridge University Press, 2016) 92-117 (focusing, in particular, on year-long efforts by the official sector efforts to implement majority action clauses in sovereign debt contracts).

[145] De Leon (n 139); IMF, 'Second Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts' (January 2017) <https://www.imf.org/external/np/pp/eng/2017/122716.pdf> accessed 28 April 2017.

[146] While, in principle, using a similar language in all sovereign bonds issued around the globe provides for greater certainty and generates a more transparent international government bond markets, the adverse effects of poor drafting or misguided interpretation may be much wider than the benefits achieved by the former.

[147] Moreover, different courts may reach diverging results when interpreting certain contractual provisions. The *pari passu* provision and its remarkably different understanding in English and New York law serve as a case in point. *Pari passu* clauses are part of virtually every sovereign bond and their meaning was – until the Judge Griesa in the Southern District Court of New York stepped into the game – relatively well-established. See IMF (n 145) 10.

scholars.[148] If jurisprudence deviates from the settled understanding of boilerplate provisions, they not only change the law in the adjudicated case, but also create new rules that in turn apply to practically any number of sovereign bonds featuring the identical – or at similar – language.[149] 'Bad law' thus, which was created by a single precedent, may affect thousands of bond indentures[150], putting the success of a debt workout at risk.

Taking a more positive view, however, amendments to boilerplate language may facilitate the simultaneous adjustment of a large number of instruments. The most prominent transformation of contractual standards in the remit of sovereign debt took place in 2003.[151] Following the Argentine default of 2001 and successful holdout litigation against Peru in 2000, market participants agreed to reshape New York law bonds by replacing unanimous action clauses (UACs) with CACs in an attempt to mitigate holdout behaviour.[152] Moreover, further reform is well underway, as chapter 6 of this thesis highlights. For instance, members of the euro area have agreed in 2013 to use one uniform aggregated CAC in all their bond issues[153], though the drafting still differs from the enhanced CAC proposed by ICMA in 2014.[154]

The variations in drafting standards are a main issue of concern to policymakers, for they jeopardise attempts to make the system less vulnerable to holdout inefficiencies.[155] Indeed, Audit points out that '[c]oherence in the interpretation of the bond contract provisions is essential to maintain, especially in the context of a debtor state facing insolvency', further arguing that 'there should not be any national relativism when applying contract provisions

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148 See Lee Buchheit and Mitu Gulati, 'Restructuring Sovereign Debt After Argentina' (2017) 12 (2) Capital Markets Law Journal 224.

149 ibid 225-226.

150 For a compelling analysis of the systemic risk boilerplate contract clauses pose in the ambit of public finance, see Gregory H. Shill, 'Boilerplate Shock: Sovereign Debt Contracts as Incubators of Systemic Risk' (2015) 89 Tulane Law Review 751 (arguing that '[…] the agreements governing transactions in debt capital markets are becoming at once more complex and more standardized, and they increasingly concentrate risk in any sector that relies on the same contracts').

151 For an overview, see, eg, de Leon (n 139).

152 See below 6.2.1.

153 See EFC Sub-Committee, 'Euro area Model CAC 2012' (14 November 2013) <http://europa.eu/efc/sub_committee/cac/cac_2012/index_en.htm> accessed 13 July 2018. For a discussion on the specificities of the euro area model CAC, see, eg, Christian Hoffmann, 'Sovereign-Debt Restructuring In Europe Under the New Model Collective Action Clause' (2014) 49 Texas Law Journal 384. Also compare for a more general overview, eg,

154 ICMA, 'ICMA Standard CACs' (August 2014) <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/collective-action/> accessed 1 September 2017.

155 See, eg, Gelpern (n 75) 91.

regarding the debt finance fundamental issue, discharge, or what constitutes performance of the obligation and what constitutes defences to payment.'[156]

1.2.5. Governing Law

1.2.5.1. Choice-of-Law and Choice-of-Forum Clauses

Since, in the context of international sovereign bonds, a debt contract establishes a legal relationship, the question of the law governing the security is essential. Already in 1957, Delaume[157] claimed that 'it is highly recommended for lenders to sovereigns to expressly stipulate the law and the jurisdiction applicable to international debt contracts.' *Ex ante* determining the law, which should govern the contract, helps to avoid inefficient and costly disputes for both sovereign borrowers and lenders in the event of a dispute, benefitting either party by reducing legal uncertainty. Somewhat surprisingly, the economic literature has paid little attention to the question of governing law.[158]

According to the IMF, '[a] bond's governing law plays a major role for debt restructurings as it predefines the contractual provisions for restructuring as well as the jurisdiction for potential litigations.'[159] A standard choice-of-law clause found in the archetypical international sovereign bond would stipulate the following:

> '[t]he fiscal agency agreement and the securities are governed by and interpreted in accordance with the *law of the State of New York*, except that all matters governing Mexico's authorization and execution of the fiscal agency agreement or the securities will be governed by the law of Mexico. [emphasis added]'[160]

A very standard formulation of a nonexclusive domestic jurisdiction clause, here of a bond governed by New York law, stipulates the following:

> '[c]ountry X will irrevocably submit to the non-exclusive jurisdiction of any New York State or Federal court in New York City in any related proceeding ie, any suit, action or proceeding

[156] See Matthias Audit, 'Sovereign bonds and national relativism: can New York law contracts safely cross the Atlantic?' (2014) 9(2) Capital Markets Law Journal 177, 178.

[157] Georges R. Delaume, 'Jurisdiction of Courts and International Loans. A Study of Lender's Practice' (1957) 6 The American Journal of Comparative Law 189, 190.

[158] However, this seems to be changing slowly. For a recent paper, see Marcus Chamon, Julian Schumacher, and Christoph Trebesch, 'Foreign law bonds: can they reduce sovereign borrowing costs?' (2018) ECB Working Paper Series No 2162 <https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2162.en.pdf> accessed 29 June 2018.

[159] IMF (n 145) 24 (further noting that '[a] large majority of outstanding emerging market bonds issued in international markets are under New York law, with English law the second most common.')

[160] Mexico, 'USD40,000,000,000, 7.500% Global Notes due 2033' (2013) Series A Prospectus (1 December 2003) <https://www.sec.gov/Archives/edgar/data/101368/000095012304005978/y96495bbe424b5.htm> accessed 31 May 2017.

arising out of or relating to the debt securities and Country X will irrevocably agree that all claims in respect of any related proceeding may be heard and determined in such New York State or Federal court.'[161]

Choice-of-law and choice-of-forum provisions serve an important purpose in the context of sovereign lending and borrowing.[162] Indeed, an international sovereign bond would exhibit the following characteristics: (i) the bond is governed by foreign law[163], (ii) New York or English courts have jurisdiction over disputes in relation to the debt security, and (iii) the bond is listed on a foreign stock exchange, such as Luxembourg.[164]

The reasons for selecting a court or tribunal outside the debtor country's jurisdiction are of legal *and* economic nature. From a legal viewpoint, it provides insurance to the creditor that the issuer may not simply change the law governing a contract. From an economic viewpoint, it means that countries may be able to obtain cheaper financing conditions.

Regarding the legal aspects, it is recalled that contracts do not only establish their own legal framework. Rather, with their creation, they become subject to other, mostly cogent, and normatively higher laws or rules. These either define or limit the scope[165] of a respective debt contract or specify enforcement procedures and mechanisms.[166] The law governing the contract is typically referred to as 'applicable law'.[167]

The assumption that international debt contracts alone can establish the legal basis for the relationship between the parties to a sovereign debt instrument (the so-called *lex contractus*)

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[161] See Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration' (2007) 101 American Journal of International Law 711, 734.

[162] See Weidemaier and Gulati (n 21). It is noted that the governing law and the selected dispute settlement forum must not necessarily belong to same jurisdiction

[163] New York and English law govern roughly 90% of all outstanding international sovereign bonds. See IMF (n 92) and below 1.2.5.2.1.

[164] See, eg, for an Austrian government bond that is governed by English law, subject to English court's jurisdiction over disputes, and listed on Luxembourg's stock exchange. The Republic of Austria (n 77).

[165] For instance, the law for the cross-border sale of goods is mainly regulated by the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (CISG). For a limitation, see Section 879 of the Austrian Civil Code (*Allgemeines Bürgerliches Gesetzbuch*), defining certain contracts that are deemed unlawful due to moral and ethical reasons and therefore unenforceable.

[166] Domestic sovereign immunity laws set out when foreign states can be sued in courts. According to § 1605 of the FSIA for instance, countries are not immune from the jurisdiction of courts of the United States, when 'the action is based on commercial activity carried on in the United States by a foreign State…'. Hence, foreign governments will not be immune from US jurisdiction if they issue debt instruments under New York law (note that the majority of external sovereign indebtedness is governed by New York law). See *Argentina and Banco Central de la Republica Argentina v Weltover Incorporated and ors,* Final appeal, Docket No 91-763, 504 US 607 (1992), ILDC 1924 (US 1992), 112 S Ct 2160 (1992), 119 L Ed 2d 394 (1992), (1995) 100 ILR 510, 12th June 1992, United States; Supreme Court [US]. Also see, eg, Jonathan I. Blackman and Rahul Mukhi 'The evolution of modern sovereign debt litigation: vultures, alter egos, and other legal fauna' (2010) 73(4) Law and Contemporary Problems 47, 52.

[167] Mohammed Maniruzzaman, 'Choice-of-law in International Contracts' (1999) 16 Journal of International Arbitration 141, 143.

is controversial.[168] The minority view suggests that contracts express the autonomous will of the parties and that, therefore, there may be scope for the concept of *lex contractus*. According to this doctrine, a contract may exist outside any legal system in the form of a 'lawless contract' (*rechtsordungsloser Vertrag*).[169]

The majority view however argues that the parties' will – and with it the notion that such will is binding (*pacta sunt servanda*) – does not sufficiently answer the question as to what is *pactum* and what *servandum* means.[170] Weisz et al, for instance, contend that 'unless the parties can agree on that law [which governs the debt instrument] in advance of any dispute, the very meaning of the agreement and the parties' rights and obligations thereunder will be uncertain'.[171] Thus, without a legal regime that ensures the enforceability of contracts, their legal value and authority would be significantly eroded.[172]

The core idea of choosing a third-country court as the dispute resolution forum is to protect investor rights[173]: indeed, the issuer's own courts may not protect foreign investors' interests in the same manner as a foreign court.[174] As Sandrock notes, 'courts of a sovereign that finds itself in a financial plight are unlikely to lend support to creditors.'[175] Anecdotal evidence supports this view. Argentina's Supreme Court for instance held that its sovereign debt restructuring was part of the *ordre public* of the forum and creditors could therefore not challenge them before Argentine courts.[176]

[168] ibid 146 (holding that doctrine of *lex contractus* is fraught with both theoretical and practical difficulties).

[169] See Holger Schier, *Towards A Reorganisation System For Sovereign Debt* (Leiden/Boston: Martinus Nijhoff Publishers, 2007) 12. Rights and obligations of either contractual party are established by virtue of the contract rather than requiring any additional rules to determine the value of the contractual promise.

[170] Maniruzzaman (n 167) 148. Also compare Louis Sohn and R. Baxter, 'Responsibility of States for Injuries to the Economic Interests of Aliens' (1961) 55 American Journal of International Law 545.

[171] Also see Derek William Bowett, 'State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach' (1989) British Yearbook of International Law 50.

[172] See below chapters 4 and 5.

[173] See for an overview Maniruzzaman (n 167).

[174] It seems unlikely that the sovereign's own courts would rule in favour of speculative foreign investors that try to make a profit by capitalising on the country's misery.

[175] Otto Sandrock, 'The Case For More Arbitration When Sovereign Debt Is To Be Restructured: Greece As An Example' (2012) 23 The American Review of International Arbitration 507, 522.

[176] See the *Galli* case before Argentina's Supreme Court, where it was held that debt restructuring is a political process and thus has a non-justiciable character in *Galli v Poder Ejecutivo Nacional*, G 2181 XXXIX, 5th April 2005, Argentina; Supreme Court [CSJN].

1.2.5.2. Sources of Law

Literature identifies three different forms of legal governance, which sovereign debt instruments may be subject to: municipal law[177], international law[178] and private regulatory regimes, notably stock exchange rules.[179]

1.2.5.2.1. Municipal Law

Municipal law still has the greatest relevance for sovereign lending and borrowing. Contrary to the cross-border sale of goods[180], where transnational trade partners have embraced international conventions, sovereign lenders and borrowers typically agree that domestic law is to govern their financial promises. Economic considerations too motivate sovereigns to rely on foreign municipal laws. Choosing foreign law reflects not only the debtor's (lack of) creditworthiness[181] on international markets but also the contract parties' respective bargaining power. For instance, the commercial courts of New York and the US Court of Appeals for the Second Circuit are generally perceived as 'creditor-friendly'[182], whereas Italian and French courts have gained the status of being more 'borrower-friendly'.[183]

Economically potent, industrialised nations hardly issue debt under foreign law, as this would mean (unnecessarily) surrendering the capacity to retroactively influence or alter financial obligations.[184] This stands in contrast to most emerging market economies, especially the poorer ones, which heavily rely on foreign capital inflows.[185] Nonetheless, dependencies on

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[177] Defined in Black's Law Dictionary as 'the internal law of a country, as opposed to international law'; see Garner (n 16) 1176.

[178] Defined in Black's Law Dictionary as 'the legal system governing the relationships between countries' or 'the law of international relations, embracing not only countries but also such participants as international organisations and individuals'; see Garner (n 16) 941.

[179] Weidemaier and Gulati (n 21).

[180] Compare United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (CISG).

[181] For an in-depth analysis of creditworthiness considerations in sovereign debt markets see Dyson (n 22) 376.

[182] See James Thuo Gathi, 'The Sanctity of Sovereign Loan Contracts and Its Origins In Enforcement Litigation' (2006) 38 The George Washington International Law Review 251, 255. Therefore, investors typically offer cheaper financing conditions when sovereigns submit to the jurisdiction of courts located in international financial centres such as New York or London.

[183] See below 4.4. for the seminal Italian court case on claims of Italian bondholders against Argentina.

[184] See below 5.3.3. describing such an amendment of bond terms through domestic law in the Greek debt restructuring.

[185] For a recent overview on emerging market sovereign debt by the IMF compare Serkan Arslanalp and Tkahiro Tsuda, 'Tracking Global Demand for Emerging Market Sovereign Debt' (2014) IMF Working Paper WP/14/39 <https://www.imf.org/external/pubs/ft/wp/2014/wp1439.pdf> accessed 15 October 2017). In recent years, however, more and more emerging market economies have actively fostered the development of local currency government debt markets.

hard foreign currencies, such as USD or GBP, come at a high price from a legal viewpoint.[186]

As of June 2015, New York law governs approximately 50% of the total outstanding stock of international external sovereign, while English law governs 46%.[187] The remainder is either issued under Japanese law or German law.[188] Box 1 provides a visual overview of the distribution of sovereign debt across different jurisdictions.

Box 1: Outstanding international sovereign bonds by governing law[189]					
	New York	**English**	**German**	**Japan**	**Total**
In USD billion	272	117	14	8	**411**
By number of issuances	435	140	28	28	**631**

1.2.5.2.2. International Law

As Megliani[190] notes, 'sovereign debt belongs to the domain of international financial law, ie the branch of international economic law regulating international financial relationships.' Sovereign debt is an inherently international subject matter, for most governments issue debt on international credit markets, where it is sold to foreign private creditors. Equally, sovereign default may affect legal relationships between states, with regard to not only bilateral official loans but also when states directly or indirectly participate in bond markets or when they represent the interests of private citizens and corporations that are subject to a debt restructuring.

[186] From an economic point of view, this facilitates considerably cheaper refinancing costs than bond issues under local law. Foreign investors are often reluctant to incur unknown risks by accepting the debtor's own legislative bodies and courts to exert influence over the debt agreement. However, sovereign immunity regularly puts halt to creditors' enforcement desires and renders the mentioned legal certainty rather ostensible than actually feasible. See below 1.2.2. and Das et al (n 20) 41.

[187] IMF (n 148) 3. As those jurisdictions are considered comparatively stable and predictable, investors are willing to pay a 'premium' on the debt. See, eg, Kaplan (n 67) 18 and John Weathley, 'New York law: not what it used to be' *Financial Times* (London, 23 November 2012) <http://blogs.ft.com/beyond-brics/2012/11/23/new-york-law-not-what-it-used-to-be/> accessed 2 October 2017 (holding that the *NML* litigation – by endorsing unconventional bond interpretations – might have significant impacts on the New York law premium).

[188] Tomz and Wright (n 85) 255. Also see Philipp Wood, 'Conflict of Laws and International Finance' (2007) 6 The Law and Practice of International Finance 1.

[189] Das et al (n 20); author.

[190] Megliani (n 61) 5.

However, the holdout creditor problem, notwithstanding some notable exceptions[191], arises between a sovereign and a (minority of) bondholders; a legal relationship which is, if anything, *indirectly* governed by international law. Following Müller[192], this thesis will therefore address and examine principles and doctrines of international law only insofar as they affect the private legal relationship between the sovereign debtor and its private creditors.

Overall, the significance of international law, as much of the pertinent literature suggests[193], is gradually decreasing in the realm of sovereign debt and default. In this regard, the erosion of the principle of absolute sovereign immunity for states under customary international law was critical.[194] Since immunity has been transformed into a more restrictive concept, municipal law has attained a far greater role than international law for the purpose delineating the boundaries within which creditors can file suit against an insolvent state.[195]

Besides several political economy reasons, there are several legal reasons for this shift. For one, cross-border financial transactions executed between sovereigns and their creditors are not subject to comprehensive international treaties or conventions. Consequently, the legal systems devised on a national level to remedy the adverse effects of default, such as common rules of bankruptcy as creditor priorities, debtor-in-possession financing or majority action procedures, are missing in the international context.[196] For another, the manifest increase of market-based finance as a means for countries to raise funds has shifted the focus on the contractual relationship between sovereign borrowers and lenders.[197]

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[191] See for a description and analysis of the official holdout creditor problem above 3.3.3.

[192] Müller (n 18) 81.

[193] Ugo Panizza, Federico Sturzenegger and Jeromin Zettelmeyer, 'The Economics and Law of Sovereign Debt and Default' (2009) 47(3) Journal of Economic Literature 651, 653 (describing the decline of sovereign immunity); Gelpern (n 75) (remarking that in contrast to international trade and finance sovereign finance is virtually unregulated); Frederico Sturzenegger and Jeromin Zettelmeyer, *Debt Defaults And Lessons From A Decade Of Crises* (Cambridge: MIT Press, 2007) 31-47 (discussing literature on sovereign debt enforcement within such an unregulated system). Conversely, Müller argues that big parts of the literature wrongly dismiss the relevance of international law, pointing at the IMF AoA as well as domestic court judgements that emphasise the role of international law in resolving debt crises; see Müller (n 18) 81-206.

[194] For a discussion of the sovereign immunity doctrine and its relevance for sovereign debt and default, see below 1.4

[195] The same holds true not just for sovereign debt but for international monetary law more generally. Scholars have even gone as far as coining the phrase of a 'black hole' in international law when it comes to money and finance, mainly referring to the lack of hard enforceable rules. See, eg, Rosa Lastra, 'The Coming of Age of International Monetary and Financial Law after the Global Financial Crisis' (2016) 19 Journal of International Economic Law 371.

[196] All of which national bankruptcy laws will typically address. See above 1.2.5.

[197] See for a discussion of sovereign debt contracts above 1.2.2.

Customary international law too plays a limited and rather indirect role for the resolution of financial and economic crises.[198] While international legal customs shape the interpretation sovereign immunity, municipal courts across different jurisdictions[199] have, in the majority of cases, denied the existence of a 'right to restructure debts', let alone endorsed a bankruptcy framework for states.[200]

While some scholars lament that the pertinence of customary international law is underestimated in the literature[201], evidence from holdout litigation and arbitration presented in chapters 4 and 5 reveals that courts[202] and other scholars[203] reluctant to entertain progressive interpretations of customary international law.[204] Given the high bar for the creation of customary international law[205], coupled with the difficulties in proving its existence, this might not surprise. Importantly thus, while judiciaries around the world acknowledge the economic and public policy rationale of expediting debt, they largely reject the existence of customary rules that would allow for a post-default stay on litigation – a crucial feature of any national bankruptcy mechanism.[206]

In an endeavour to reinvigorate the significance of international legal frameworks in the realm of government debt, the UNCTAD has developed the (soft) Principles of Sovereign Responsible Lending and Borrowing (PSRLB).[207] The PSRLB are a mix of well-established

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[198] See Juan Pablo Bohoslavsky, Yuefen Li and Marie Sudreau, 'Emerging customary international law in sovereign debt governance?' (2014) 9(1) Capital Markets Law Journal 55.

[199] See below chapters 4 and 5 for an overview of litigation and arbitration after Argentina and Greece, respectively.

[200] See below 4.3.2. (elaborating on a decision by the highest German Court from 2015, which stressed the absence of a rule of customary international law that would protect debt restructuring negotiations from aggressive and disruptive holdout litigation).

[201] See, eg, Müller (n 18).

[202] See Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG]. For an analysis of the case, see below 4.4.1.

[203] See, eg, August Reinisch, 'Sachverständigengutachten zur Frage des Bestehens und der Wirkung des völkerrechtlichen Rechtfertigungsgrundes „Staatsnotstand"' (2008) Zeitschrift für offentliches Recht 68.

[204] At the core of the problem lies of course the absence of a treaty-based insolvency framework for states, see, eg, Setser (n 1).

[205] See, eg, Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG]. This case is reviewed below in 4.4.1.

[206] See Matthias Goldmann, 'Necessity and Feasibility of a Standstill Rule for Sovereign Debt Workouts' (January 2014) Paper for the First Session of the Debt Workout Mechanism Working Group) <http://unctad.org/en/PublicationsLibrary/gdsddf2014misc4_en.pdf> accessed 2 September 2018.

[207] UNCTAD, 'Principles on Responsible Sovereign Lending and Borrowing (PRSLB)' (2012) <http://www.unctad.info/upload/Debt%20Portal/Principles%20drafts/SLB_Principles_English_Doha_22-04-2012.pdf> accessed 15 October 2017.

principles of national and international law to harness and elaborate existing best practices.[208] However, due to their non-binding nature, they are not applied in national sovereign debt litigation. Incorporation into the respective municipal legal systems, which would have that effect, seems unlikely at this stage, especially in arguably ‘creditor-friendly’ jurisdictions.[209]

Finally, general principles of law[210] may also inform sovereign financing practices. However, they are far more pertinent in the intellectual debate than in case law or (quasi-)legislative initiatives.[211] Applying an inductive mode of reasoning, Goldmann[212], for instance, argues that practically all domestic jurisdictions have certain rules that govern bankruptcy, such as a stay on litigation. With respect to state insolvency, few jurisdictions have rules that would constrain creditor enforcement action in the event of default.[213]

1.2.5.2.3. Stock Exchange Trading Rules

For some time, stock exchange trading rule played an important role for sovereign debt management.[214] An early example of where stock exchange rules proved highly relevant for sovereign finance was the in the 19th century when the London Stock Exchange acted as the primary gatekeeper to the world’s largest capital market.[215] The rules *inter alia* prohibited listing privileges to a sovereign that had defaulted on its debt, unless the government had worked out a ‘satisfactory arrangement’ with its creditors.[216]

The cheap financing options the London Stock Exchange provided for countries around the globe made many of them abide with those rules and undertake restructuring procedures they would have never considered otherwise. Nowadays, even though sovereigns typically list their bonds, stock exchange trading rules play a rather insignificant role.[217] In fact, after

[208] Gelpern (n 75).
[209] Goldmann (n 206) 11.
[210] According to Article 38(1)(c) of the Statute of the ICJ ‘the general principles of law recognised by civilised nations’ are a source of international law.
[211] See below in chapter 6 for an overview and a review of recent reform efforts.
[212] Goldmann (n 206) 17.
[213] ibid 18 (Goldmann for instance cites the 2010 UK Debt Relief Act which reduces the claims of private creditors against countries participating in the HIPC proportionate to the relief granted to them under the initiative).
[214] See Weidemaier and Gulati (n 21).
[215] Mark Weidemaier, ‘Remarks made before the United Nations General Assembly Ad hoc Committee on Sovereign Debt Restructuring’ (2015) UNC Legal Studies Research Paper No 2563124, 5 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2563124> accessed 3 July 2016.
[216] ibid.
[217] Weidemaier and Gulati (n 21).

London and New York, Luxembourg has become the prime jurisdiction for sovereign bond listings.[218] Other stock exchanges, such as Frankfurt or Zurich, have lost their appeal too.[219]

The rules of stock exchanges have also lost importance because the regulatory requirements sovereigns need to fulfil when issuing securities in Luxembourg are relatively lax.[220] This undermines the bonding hypothesis, according to which an issuer chooses a certain stock exchange to show its commitment to honour listing standards, thereby sending a credible signal to the markets to boost investor confidence.[221] Moreover, de Fontenay et al find that there was not a single instance in which a bond was delisted due to payment default or violation of a listing standard since 1945. Their research bolsters the hypothesis that stock exchange rules do not matter all too much in modern sovereign debt management and restructuring.[222]

1.3. THE EVOLUTION OF SOVEREIGN DEBT INSTRUMENTS

1.3.1. INTRODUCTION

Between the late 1980s and the beginning of the 2000s, sovereign debt instruments underwent a notable transformation.[223] Sovereigns gradually turned away from syndicated lending, the most innovative financial instruments for this purpose in the 1970s[224], to the more public form of issuing tradable debt securities on international capital markets. Within a few years, bonds eclipsed loans as the funding instrument of choice for state. Interestingly enough, sovereigns already issued bonds in the 18th and 19th century, albeit on a far smaller scale.[225]

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218 See for an in-depth analysis of sovereign issuers' listing practices in Elisabeth de Fontenay, Josefin Meyer and Mitu Gulati, 'The Sovereign Debt Listing Puzzle' (19 April 2018) unpublished manuscript <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2853917> accessed 24 June 2018.

219 ibid.

220 ibid 3.

221 See John C. Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications' (1999) 93 Northwestern Law Review 641.

222 De Fontenay et al (n 218) 18.

223 Misa Tanaka, 'Bank loans versus bond finance: implications for sovereign debtors' (2005) Bank of England Working Paper No 267, 7 <http://www.bankofengland.co.uk/research/Documents/workingpapers/2005/wp267.pdf> accessed 1 July 2018.

224 Mark Wright, 'Sovereign Debt Restructuring: Problems and Prospects' (2012) 2(1) Harvard Business Law Review 166.

225 See, eg, Ross Buckley, 'The Facilitation of the Brady Plan: Emerging Markets Debt Trading From 1989 to 1993' (1997) 21 Fordham International Law Journal 1802, 1820-22.

Intentional or not, the shift from loan to bond financing encouraged holdout creditors, which have become more successful in capitalising on the legal specificities inherent to multi-party debt instruments than those of two-party instruments, such as loans.[226] In very simple terms, the advantage for a holdout creditor holding a bond is that *ex post* contractual amendments often require the consent of a large majority of creditors.[227]

According to Black's Law Dictionary, a bond is defined as 'an obligation to pay a fixed sum of money, at a definite time, with a stated interest'.[228] The key difference between bond financing and the more traditional form of loan financing is that the former are tradable debt securities offered to a greater public audience. Bonds are typically held by an anonymous mass of investors, they are more or less monitored through credit rating agencies, and they can be transferred to virtually any other participant in the debt markets.[229]

Global capital markets – and particularly stock exchanges – facilitate such transactions and provide governments with the opportunity to match their financial needs with the appetite of international investors, essentially in real time.[230] The modern from of bond financing therefore reduces the state's fiscal dependence from other governments or bank syndicates and – most crucially – allows for faster and cheaper long-term financing of the public budget.[231]

Moreover, the finance literature supports the hypothesis that bonds augment liquidity in sovereign debt markets when compared to (syndicated) loans.[232] One reason for higher liquidity of bond markets is that the transfer, ie assignment, of the respective instrument does not require consent by the issuer or any other formal legal act that involves third parties: it

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[226] At the same time, bonds have a higher default risk than loans in the context of government debt. Miles instance notes, '[b]ondholders are too dispersed to negotiate with during a liquidity shortfall' and finds that 'empirical pricing of loans and bonds as assets reveals that bonds incorporate the greater risk of default into their spreads'; see William Miles, 'The Pricing of Risk in Emerging Credit Markets: Bonds versus Loans' (2000) 6(2) International Advances in Economic Research 221.

[227] See below 1.3.3. for a specific description of the coordination problems arising in the context of sovereign bond restructuring. Contractual reform in the sovereign debt market has *inter alia* focused on enhancing creditor coordination clauses, most notably CACs. See for in in-depth discussion of their advantages and shortcomings below in 6.2.

[228] Garner (n 16) 211.

[229] Tanaka (n 223) 11.

[230] ILA (n 86).

[231] ibid.

[232] See, eg, Robert Mc Cauley and Eli Remolona, 'Size and liquidity of government bond markets' (2000) BIS Quarterly Review <https://www.bis.org/publ/r_qt0011f.pdf> accessed 2 December 2017 (noting that [t]he finance ministries in emerging market countries view growing debt as providing an opportunity to develop domestic bond markets – private as well as government – to reduce not only the cost of borrowing but also reliance on overseas financing in foreign currency.').

suffices that the old bondholder (seller) advises her securities custodian to deliver the instrument to the new bondholders' (buyer) account.[233] Additionally, most (government) bonds are listed on a public stock exchange, which provides for pricing transparency and accommodates a large potential base for buyers and sellers alike.[234]

1.3.2. FROM LOAN TO BOND FINANCING

1.3.2.1. Legal Differences Between Sovereign (Syndicated) Loans and Bonds

Some key differences between loans and bonds exists that should be mentioned in the context of the holdout creditor problem.

First, syndicated loans are provided by sophisticated parties, such as a syndicate of big banks. This is true in both the corporate and the sovereign finance context. While sophisticated banks also play an essential role in preparing and facilitating a bond issue, bondholders are, in all instances, more diverse. Moreover, even though most bondholders are still institutional investors, such as pension funds, mutual funds, or governments, they often hold these instruments for the benefit of someone else, eg members of the public.[235]

Second, the legal documentation underpinning syndicated loans and bonds differs. Crucially, syndicated credit agreements contain the entire terms of the loan while, in the case of bonds, the loan documents are split into a subscription agreement, a trust deed (if there is a trustee) and a fiscal agency agreement.[236] The exact structure of a bond is important in the event of default and subsequent bondholder litigation. Jurisdictional differences, especially between English and New York law, matter too.[237]

Third, investment banks play an important role in facilitating a bond issue. In the context of syndicated loans, they are hardly involved.[238] Typically, the principal global investment bank

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[233] Wood (n 115).

[234] While syndicated lending was and still is predominantly a business for large credit institutions, bonds may be acquired and traded by wholesale investment funds, retail investors as well as governments. Due to their standardised legal and financial terms, bonds are also more suitable to secure refinancing operations by commercial banks at their central banks.

[235] For an overview, see Wood (n 115).

[236] ibid 161.

[237] For a discussion on the difference between New York and English law in the context of government bond financing, see, eg, New York City Bar Association, 'Governing Law in Sovereign Debt – Lessons from the Greek Crisis and Argentina Dispute of 2012' (February 2012) Committee on Foreign & Comparative Law <http://www2.nycbar.org/pdf/report/uploads/20072390-GoverningLawinSovereignDebt.pdf> accessed 7 December 2017.

[238] Syndicated loans are typically provided by commercial banks or the commercial banking arm of a universal bank.

acts as lead underwriter on transactions throughout the world.[239] The investment bank commits to procuring subscribers for the security against the payment of a fee.[240] This is achieved with the help of an offering circular, which aims at informing prospective buyers about the issuer's financial fundamentals and the details of the specific bond issue.[241]

The contractual terms and conditions underlying the debt security, which specify important (legal) features of the bond, such as maturity, bondholder representation, and payment terms, are referred to as 'bond indentures'. These indentures also contain the bond covenants, which set out certain rights or obligations on for the issuer that can result in a downgrade of the debt security when violated.[242]

1.3.2.2. Historical Background

The sudden advent of sovereign bonds was not merely driven by financial or legal motives.[243] Bond financing is widely considered a major consequence of a series of Latin American debt crises in the 1980s. Following an unprecedented economic boom in the 1970s and early 1980s, a protracted bust followed.[244] Latin American nations experienced a major foreign debt crisis that culminated in the infamous 'lost decade', which was *inter alia* characterised by huge output losses and unemployment.[245] A trifecta of banking, currency, and sovereign debt crises reinforced the adverse dynamics.[246]

Many of the foreign creditors to Latin American countries were US banks that recycled petrodollars by providing relatively cheap syndicated loan financing.[247] However, when debt-to-GDP ratios rose while economic output declined, the world's biggest financial institutions

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[239] See for a brief explanation of how modern sovereign bond markets function globally in Debevoise et al (n 153).

[240] Wood (n 115) 159.

[241] ibid.

[242] For a definition, see 'Bond Covenant', Investopedia <http://www.investopedia.com/terms/b/bond-covenant.asp> accessed 18 August 2017.

[243] This said, finance ministries are on the constant search for strategies to reduce their government's funding costs. Due to several reasons, which are not further elaborated here, bond financing is, in principle, cheaper than loan financing. For an overview of the issue, see, eg, Robert McCauley and Eli Remolona, 'Size and liquidity of government bond markets' (2000) BIS Quarterly Review <https://www.bis.org/publ/r_qt0011f.pdf> accessed 9 May 2018.

[244] Carmen M. Reinhart and Christoph Trebesch, 'The International Monetary Fund: 70 Years of Reinvention' (2016) 30(1) Journal of Economic Perspectives 3, 9.

[245] See, eg, Santiago Capraro and Ignacio Perrotini, 'Revisiting Latin America's debt crisis: some lessons for the periphery of the Eurozone' (2013) 37(3) Cambridge Journal of Economics 627 (comparing the Latin American debt crises of the 1980s and 1990s with the sovereign debt crisis in Europe, which erupted in early 2010).

[246] See, eg, Pierre-Olivier Gourinchas and Maurice Obstfeld, 'Stories of the Twentieth Century for the Twenty-First' (2012) 4(1) American Economic Journal: Macroeconomics 226.

[247] A syndicated loan is provided by multiple creditors, which make available a credit facility under a single loan contract. An agent bank represents the syndicate vis-à-vis the borrower and receives payments on their behalf for distribution among the members.

were suddenly confronted with billions of dollars in nonperforming sovereign debt on their balance sheets.[248] Markets slowly but surely started to question the sustainability of the enormous levels of debt many Latin American economies had accumulated.[249]

Unsurprisingly, big banks became reluctant to pour ever more money into low-income economies by the mid-1980s, culminating in a dangerous sudden stop of capital inflows to such countries.[250] Given the large credit exposure of its several systemic US financial intuitions, however, the US Treasury Department had a vital interest in averting the collapse of its banking system.[251]

Indeed, after several countries had defaulted on their debt, and US banks stood at the brink of bankruptcy, the US government – backed by the IMF and the World Bank – introduced a major policy shift and promoted the restructuring the outstanding loans.[252] Under the auspices of US Treasury Secretary Nicholas Brady, most loans were exchanged for fungible securitised debt instruments with a lower net present value but US Treasury Bonds as collateral.[253] 17 'Brady deals' were implemented that led to a relaxation of the protracted relationships between emerging market economies and Western creditors.[254] The IMF also played a central role in setting aside some of its own loans to support Latin American

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[248] For an analysis of the early years of the Latin American debt crisis in the 1980s, see, eg, Eduardo Wiesner, 'Latin American debt: lessons and pending issues' (1985) 75(2) American Economic Review 191. For possible lessons to be learnt for the resolution of the euro area sovereign debt crisis see Capraro and Perrotini (n 245). Additionally, the interest rates on these loans were typically linked to market rates, such as the London Interbank Offered Rate (LIBOR), which increased considerably in the 1980s.

[249] Andreas Lowenfeld, 'International Monetary Law' in Wolfrum (n 81).

[250] The reason why they lent to emerging market sovereigns in the first place was a dynamic referred to in literature as the 'recycling of petrodollars'. Due to a surge in the oil price, accompanied with worldwide inflation, commodity prices reached unprecedented levels and allowed oil-producing countries to deposit their surging dollar-denominated export revenues in international banks. In turn, these financial institutions aggressively expanded their lending to (non-oil-producing) emerging market economies, most notably in Latin America. See Reinhart and Trebesch (n 244) 9.

[251] Panizza et al (n 193) 656; Philip Power, 'Sovereign Debt: The Rise of the Secondary Market and Its Implication for Future Restructurings' (1996) 64(4) Fordham Law Review 2701, 2709. The ratio of the Latin American exposure of the nine biggest US banks to their capital decreased from 176.5% to 83.6% over the period between 1982 to 1988; see Ross Buckley, 'Rescheduling as the Groundwork for Secondary Markets in Sovereign Debt' (1997) 26 Denver Journal of International Law and Policy 299, 303.

[252] Das et al (n 20) 18; Kim Oosterlinck, 'Sovereign debt defaults: insights from history' 29(4) Oxford Review of Economic Policy 697.

[253] Oosterlinck (n 252) 699. See for an in-depth analysis Lex Rieffel, *Restructuring Sovereign Debt. The Case for Ad Hoc Machinery* (Washington DC: Brookings Institution Press, 2003)

[254] Das et al (n 20) 18. The exchange of non-performing syndicated bank loans to collateralised bonds strengthened investor confidence in emerging market economies and allowed them to re-access financial markets. As Lowenfeld notes, a bank had the following options under the Brady Plan:

a) exchange its existing debt for 30-year Debt Reduction Bonds having the face value of 65% of the debt being exchanged, with interest on the reduced value continuing at the existing rate (about 10%);

b) exchange its existing debt for 30-year Debt Service Reduction Bonds in the same face value as the existing debt but with a fixed interest rate of 6.25%;

c) retain its debt under the original terms without concession into bonds, on condition that it provided new credits equal to 25% of its original exposure repayable at market rates over 15 years.

sovereign borrowers in an attempt to dampen the devastating effects of the economic crisis.[255]

Consequently, the debt relief granted was positively received by both investors and sovereign debtors.[256] Of course, the stakes were high for all players involved. As Buckley for instance notes, 'the entire thrust of the debt restructurings of the 1980s as an attempt to prevent a massive shakeout in the international financial system.[257] Ultimately, after all Brady deals were concluded, developing countries in South America reduced their debt to foreign banks by a third or more.[258]

The packaging of syndicated loans into tradable securities offered the following practical advantages: (i) replacement of many debtors with one, (ii) the consolidation of sovereign indebtedness and the (iii) standardisation of transfer provisions.[259] At the time when policymakers devised and endorsed the Brady Plan, the specific features of bond financing and their impact on an (essentially unregulated) global sovereign bond market were not fully understood. In the following years, however, an increasing number of scholars[260] pointed out that the new composition of sovereign debt fostered other risks for the success of future sovereign debt restructuring operations; notably by creating opportunities for specialised investors to abuse the a multi-party structure of bonds. The IMF explicitly acknowledged these threats by proposing a new SDRM in 2002.[261] At the centre of the new debate was the holdout creditor problem.[262]

It was feared that the dispersion of creditors typical of bond securities would pose significant obstacles to achieving collective creditor action, in the course of future debt restructuring negotiations, which had proven vital to ensure an adequate degree of burden sharing both between sovereign lenders and borrowers as well as between borrowers.[263] Crucially, creditor committees would no longer have the same bargaining power. Indeed, during the loan crises

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[255] Reinhart and Trebesch (n 244) 10.

[256] See, eg, Serkan Arslanalp and Peter Blair Henry, 'Is Debt Relief Efficient?' (2005) 60(2) Journal of Finance 1017. Also see Lowenfeld (n 249).

[257] Buckley (n 36) 303.

[258] Lowenfeld (n 249).

[259] Buckley (n 36) 305.

[260] Patrick Bolton and Olivier Jeanne, 'Structuring and Restructuring Sovereign Debt: The Role of a Bankruptcy Regime' (2007) 115(6) Journal of Political Economy 905.

[261] See Anne Krueger, *A New Approach to Sovereign Debt Restructuring* (Washington, D.C.: IMF, 2002).

[262] See, eg, Samuel E. Goldman, 'Mavericks in the Market: The Emerging Problem of Hold-Outs in Sovereign Debt Restructuring' (2000) 5 UCLA Journal of International Law & Foreign Affairs 159 and Das et al (n 20) 28.

[263] Buchheit and Gulati (n 20) 1324-1330.

in the 1980s, highly coordinated bank committees acted as a strong collective to put forward forcefully their demands during the debt restructuring proceedings.[264] The Bank Advisory Committee (BAC)[265] operated as a forum to drive collective action and discouraged go-alone litigation by individual creditors.[266] To this end, the BAC provided an unofficial mechanism for renegotiating the principal repayment schedules and proved relatively successful in the first seven years of the debt crises.[267]

Having a forum for debt renegotiation in place did not only render inter-creditor coordination easier, it also enabled the banks, supported by the IMF, to demand serious macroeconomic adjustment[268] from the defaulted sovereigns as a condition for granting debt relief.[269] By contrast, bondholders are characterised by their heterogeneity, notable in respect of their level of sophistication, nationality, and investment motive.[270]

1.3.2.3 Creditor Coordination Problems

Judging by the delays, disruptions and number of lawsuits in the wake of recent sovereign debt workouts, fears voiced by several experts in the early days of modern sovereign bond

[264] For instance the case of Mexico's default in 1982 syndicated loans were first and foremost restructured through bank advisory committees, where the largest banks with the greatest exposure to the distressed debtor coordinated the rest. For a short overview on the history of sovereign debt crises and restructuring also compare above 1.2.3.

[265] See below 2.5.2. for an overview of the London Club.

[266] Nowadays, institutional investors are typically represented by the IIF. See, eg, ECB, 'Transitional Governance in Global Finance – The Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets' (2009) ECB Occasional Paper Series No 103 <https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp103.pdf?2010103292754243a36750d2757f03c9> accessed 2 December 2017.

[267] Robert Dineen, 'Brady Plan: The Siren Song of Debt Forgiveness' (1989) 11 International Financial Law Review 1, 22.

[268] See Laura Alfaro, Noel Maurer and Faisal Ahmed, 'Gunboats and Vultures: Market Reaction to the 'Enforcement' of Sovereign Debt' (2010) 73 Law and Contemporary Problems 39. Under this foreign economic policy named after Secretary Nicholas F. Brady, the US government orchestrated an unprecedented exchange of old loans in arrears to newly issued dollar denominated bonds with a value of over USD200 billion and 18 participating countries.

[269] Blackman and Mukhi (n 166) 50; Goldman (n 262). Moreover, to a certain degree, the political and economic interests of large financial institutions to swiftly implement debt restructuring measures and thereby render illiquid debt instruments liquid again, aligned with the sovereign debtors' desire for debt relief. Implicitly, the experience of the Latin American debt crisis also highlighted the dangers of the so-called 'sovereign-bank nexus', which describes a situation where banks have a high exposure to sovereign debt instruments or vice versa (sovereigns must bail-out large banks). However, during the European sovereign debt crisis the lessons of the 1980s seemed to have been forgotten and policymakers failed to anticipate the possible adverse contagion effects stemming from the sovereign-bank nexus. See, eg, for a recent proposal by the European Commission to mitigate these effects in Marcel Fratzscher and Mate Rieth, 'Monetary Policy, Bank Bailouts and the Sovereign-bank Risk Nexus in the Euro Area' (September 2015) European Commission Discussion Paper 009 <http://ec.europa.eu/economy_finance/publications/eedp/pdf/dp009_en.pdf> accessed 2 January 2018.

[270] Panizza et al (n 193) 656.

financing have seemingly materialised.[271] As discussed above[272], the market for sovereign debt instruments and its players were subject to a profound transformation.[273]

More and more different types of investors have since entered the sovereign debt space, ranging from sovereign wealth funds to new and powerful official sector lenders, such as China or Saudi Arabia.[274] In addition, active trading meant that the mix of creditors became subject to constant change and sovereign borrowers could no longer know who actually held their debt at a given point in time.[275]

Gelpern compellingly explains the implications of this transformation as follows:

> '[b]y 2010, a single bond exchange potentially had to sweep in Latin American pension funds, UK banks, euro area insurers, Asian governments, Italian pensioners, and Cayman Island hedge funds managed from Connecticut, holding bonds in a dozen currencies and governed by the laws of as many jurisdictions.' [276]

Others contend that'[t]he discretion of a creditor to accelerate its bond following a default, or to commence a lawsuit and attach the (sovereign) borrower's assets, could dramatically reduce the other bondholders' options for dealing with this event.' [277] Figure 2 below depicts the altered sovereign creditor landscape.

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[271] Schumacher et al (n 9) 1.

[272] See above 1.3.2.1.

[273] See for an in-depth analysis of the secondary market for emerging-market debt in Buckley (n 36). There are however voices challenging the view that the increasing reliance of global capital markets has in any way complicated the resolution of financial crises on the international plane. See, eg, Arturo Porzecanski, 'From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default' (2005) 6 Chicago Journal of International Law 311. Compare for a powerful critique of this theory in See Ran Bi, Marcos Chamon and Jeromin Zettelmeyer, 'The Problem that Wasn't: Coordination Failures in Sovereign Debt Restructurings' (2011) IMF Working Paper No 11/265, 6 <https://www.imf.org/external/pubs/ft/wp/2011/wp11265.pdf> accessed 2 August 2017.

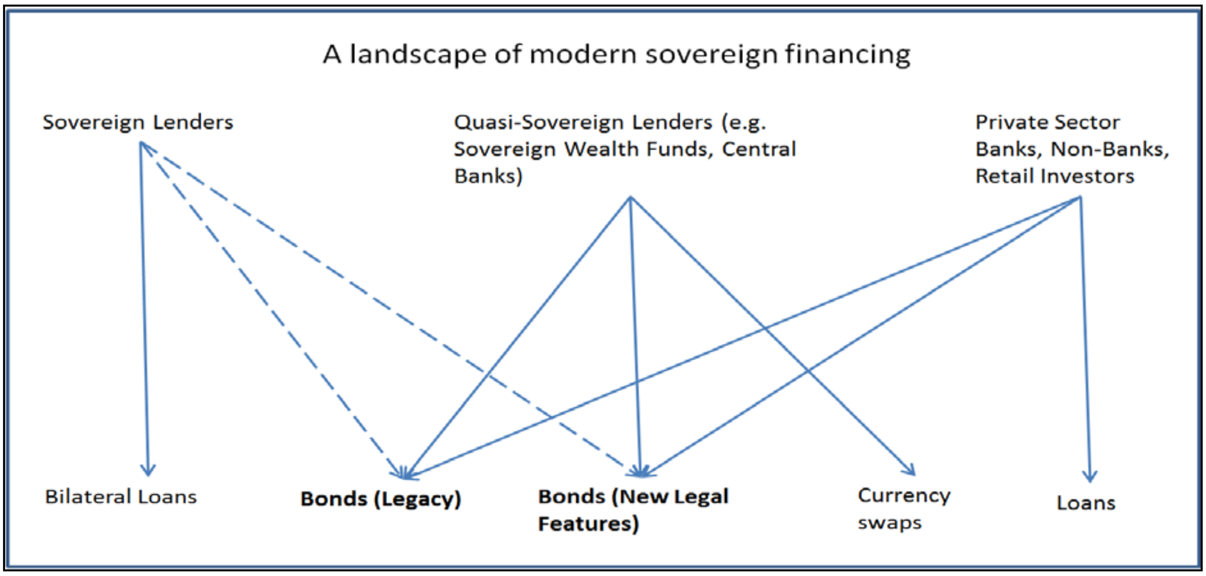
[274] See Gelpern (n 75) for a comprehensive overview.

[275] ibid 117.

[276] ibid 118.

[277] Marco Committeri and Francesco Spadafora, 'You Never Give Me Your Money? Sovereign Debt Crises, Collective Action Problems, and IMF Lending' (2013) IMF Working Paper WP/13/20 <https://www.imf.org/external/pubs/ft/wp/2013/wp1320.pdf> accessed 27 January 2017.

Figure 2: A landscape of modern sovereign financing[278]



The perhaps most important new actor in international sovereign debt markets are hedge funds.[279] They became increasingly active when the international secondary market for sovereign debt instruments grew.[280] Given that these funds are typically subject to slim regulatory constraints, hedge funds may acquire sovereign debt when other institutional investors have long abandoned the secondary market for sovereign paper.[281]

Another group of creditors that has gained importance recently are retail investors. They are the least sophisticated actors in sovereign debt markets and, thus, tend to react too late to a looming debt default.[282] Given their lack of tactical and legal expertise and the absence of a strong relational bond with the sovereign issuer, retail investors may be side lined by a sovereign debtor and become reluctant holdouts.[283]

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[278] Author's own descriptions.

[279] A hedge fund can be defined as 'an investing group usually in the form of a limited partnership that employs speculative techniques in the hope of obtaining large capital gains…' See 'Hedge Fund Definition' (3 November 2015) Merriam Webster Dictionary <http://www.merriam-webster.com/dictionary/hedge%20fund> accessed 3 November 2017.

[280] Power (n 251) 2702.

[281] Panizza et al (n 193) 656. For Argentina, see The Economist, 'A victory by default' *The Economist* (London, 3 March 2005).

[282] When retail investors are, however, residents of the very country defaulting on its debts, they might be treated even more favourably than foreign (retail and institutional investors) due to their political 'weight'. See, eg, Fernando Broner, Aitor Erce, Alberto Martin and Jaume Ventura, 'Sovereign Debt Markets in Turbulent Times: Creditor Discrimination and Crowding-Out' (2013) IMF Working Paper Series WP/13/270 <https://www.imf.org/external/pubs/ft/wp/2013/wp13270.pdf> accessed 15 April 2017 (concluding that '[c]reditor discrimination arises because, in turbulent times, sovereign debt offers a higher expected return to domestic creditors than to foreign ones.')

[283] However, it should not be forgotten that mass claims arbitration against Argentina before the ICSID has ultimately proven a powerful collective mechanism to secure the rights of retail investors. See below 3.3.3. for an

Indeed, with the deepening debt crisis in Latin America, banks resorted to selling their loans to third party investors for steep discounts. The discount typically reflected the probability that the debt will ever be repaid.[284] In some cases, debt papers shifted hands for a few cents in the dollar.[285] At this stage, second market buyers, such as transnational corporations, were particularly interested in cheap equity stakes in debtor countries.[286] Sovereigns, on the other side, proved willing to exchange their dollar-denominated debt obligations for local currency.[287]

As further argued below, a decisive difference between banks and specialist hedge funds was that the former rarely entertained holdout strategies to obtain favourable restructuring conditions.[288] They usually acted in concert.[289] Conversely, vulture holdouts have no allies.[290] They target particularly vulnerable countries and exploit weak bond contract to maximise their return on investment.

1.4. SOVEREIGN IMMUNITY AND SOVEREIGN DEBT

1.4.1. INTRODUCTION

Foreign sovereign immunity is a well-anchored principle of customary international law according to both the PCIJ (predecessor to the ICJ)[291] as well as domestic courts.[292] Sovereign immunity, also referred to as 'state immunity', is the 'immunity that a state enjoys

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analysis of so-called 'retail holdouts' and below 4.8. for an analysis of holdout arbitration in the wake of the Argentine crisis.

[284] ibid 2716.

[285] Even nowadays, the discounts on distressed sovereign debt instruments are tremendous. NML, the lead plaintiff in the Argentine litigation, bought their bonds for no more than 15% of the full face value. See David Bosco, 'The Debt Frenzy' *Foreign Policy* (Washington D.C., 13 October 2009).

[286] See Power (n 251) for an overview. Also compare Buckley (n 67).

[287] See Jon Sylvester, 'Impracticability, Mutual Mistake and Related Contractual Bases for Equitably Adjusting the External Debt of Sub-Saharan Africa' (1992) 13 Northwestern Journal of International Law & Business 263; Power (n 251) 2702.

[288] See, eg, *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY] and *Allied Bank International v Banco Credito Agricola de Cartago and ors*, Case No 225, Docket 83-7714, 757 F 2d 516 (2d Cir 1985), 77 ALR Fed 281, (1985) 24 ILM 762, 18th March 1985, United States; Court of Appeals (2nd Circuit) [2d Cir]. See below chapter 3 for a description of the (modern) holdout creditor problem.

[289] See for further reference below 3.2. (explaining the holdout creditor problems as an archetypical collective action problem).

[290] Especially when they seek to block bonds with CACs, several holdout creditors might decide to leverage their financial stake and act as a collective.

[291] See, eg, *SS 'Lotus', France v Turkey*, Judgment, Judgment No 9, PCIJ Series A No 10, ICGJ 248 (PCIJ 1927), (1935) 2 Hudson, World Ct Rep 20, 7th September 1927, League of Nations (historical) [LoN]; Permanent Court of International Justice (historical) [PCIJ].

[292] See for an overview Hazel Fox and Philippa Webb, *The Law of State Immunity* (Oxford: Oxford University Press, 2013) 408-411.

in respect of itself (jurisdictional immunity) and its property (enforcement immunity) from the jurisdiction of the courts of another state.'[293] State immunity is therefore an immunity *ratione personae*[294], which is related to the status of a state as an international legal personality.[295] With the emergence of the state as an entity distinct from the rule, the immunity of states evolved next to the immunity of the head of state and diplomatic immunity.[296]

Epitomised in the maxim *par in parem non habet imperium*[297], the principle of sovereign immunity reflects the equality of all states under international law.[298] British courts[299] held as early as 1851 that '[citing] a foreign potentate in a municipal court, for any complaint against him in his public capacity, is contrary to the law of nations, and an insult which he is entitled to resent.' On the one hand, sovereign immunity may considerably limit the rights of investors to have their claims recognised by foreign courts (immunity from suit). On the other, often foreign assets remain *de-jure* immune because they are typically held by state-owned entities, central banks or diplomatic representations, all of which enjoy some protection under international and domestic law, albeit to varying degrees (immunity from execution).[300]

In the past decades, numerous courts and tribunals across different jurisdictions, most notably in the wake of the Latin American debt crises in the 1980s and the Argentine default of 2001, have sought to establish principles as regards the immunity of states for their fiscal activities abroad.[301] The US Supreme Court has repeatedly held that bond issuances by a state constitute commercial activities, for which the issuer does not enjoy the privilege of

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[293] See Article 5 United Nations General Assembly Resolution 53/98: Convention on jurisdictional immunities of States and their property (United Nations General Assembly [UNGA]) UN Doc A/RES/53/98.

[294] Immunity *ratione personae* (status-based immunity) needs to be distinguished from immunity *ratione materiae* (functional immunity). See, eg, Sean D. Murphy, 'Immunity Ratione Personae of Foreign Government Officials and Other Topics: The Sixty-Fifth Session of the International Law Commission' (2014) 108(1) American Journal of International Law 41.

[295] Peter-Tobias Stoll, 'State Immunity' in Wolfrum (n 81).

[296] ibid 5.

[297] As Yang however claims, the origin of the *par in parem non habet imperium* principle is contentious. See Yang (n 42) 52.

[298] See, eg, Megliani (n 61) 390.

[299] *De Haber v Queen of Portugal*, [1851] 17 QB 196, (1851) 117 ER 1255, 1851, United Kingdom; England and Wales; High Court [HC]; Queen's Bench Division [QBD] [Lord Campbell].

[300] See, eg, below 4.3.2. for a case where holdout funds (unsuccessfully) attempted to attach assets held by the Argentine central bank in New York to collect on a money judgement issued in their favour. See *EM Limited and NML Capital Limited v Banco Central De La República Argentina and Argentina*, Appeal judgment, ILDC 2495 (US 2015), 800 F 3d 78 (2nd Cir 2015), 31st August 2015, United States; Court of Appeals (2nd Circuit) [2d Cir].

[301] See, eg, Fox and Webb (n 292) 408-411.

immunity under the FSIA.[302] British judges have too declined the immunity defence as regards state financing activities, regardless of whether the borrower seeks to restructure its debts and fend off disruptive holdout litigation.[303] In other jurisdictions, however, we observe more reluctance on the judiciary's part to interfere with sovereign debt restructuring measures.

As discussed below, the Italian *Corte di Cassazione* for instance held that 'the question whether state immunity applies depends on the balance struck by the bankrupt country between the basic human rights of its citizens and the human rights by the foreign creditors.'[304] The commercial nature of financial transactions with foreign private persons is also reflected in the UNCSI, which stipulates that loans and commercial transactions entered into by states must be classified as commercial activities for which states are not entitled to invoke immunity.[305] However, while 28 states have so far ratified the UNCSI, it has not yet entered into force, for this requires the ratification in at least 30 signatories.[306]

Essentially, holdouts must successfully challenge the sovereign's immunity from suit and execution in order to pressure the sovereign into a more favourable settlement.[307] In other words, as long as sovereign states can invoke the immunity defence in foreign municipal courts[308], the holdout creditors' business model remains unattractive, containing potentially disruptive effects of creditor litigation during debt restructuring negotiations.[309]

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[302] *Argentina and Banco Central de la Republica Argentina v Weltover Incorporated and ors*, Final appeal, Docket No 91-763, 504 US 607 (1992), ILDC 1924 (US 1992), 112 S Ct 2160 (1992), 119 L Ed 2d 394 (1992), (1995) 100 ILR 510, 12th June 1992, United States; Supreme Court [US].

[303] See, eg, NML Capital v. Republic of Argentina [2009] EWCH 110 (Comm).

[304] *Borri v Argentina, Request for a ruling on jurisdiction,* Case No 11225, Order No 6532/2005, ILDC 296 (IT 2005), (2005) 88 Riv Dir Int 856, 27th May 2005, Italy; Supreme Court of Cassation. See below 4.5.

[305] United Nations General Assembly Resolution 53/98: Convention on jurisdictional immunities of States and their property (United Nations General Assembly [UNGA]) UN Doc A/RES/53/98; see, eg, Megliani (n 61).

[306] UN Treaty Collection, '13. United Nations Convention on Jurisdictional Immunities of States and Their Property' Status as at 1 August 2018 <https://treaties.un.org/Pages/ViewDetails.aspx?src=IND&mtdsg_no=III-13&chapter=3&lang=en> accessed on 1 August 2018 (noting that the UNCSI has not yet entered into force, given that only 22 out of the 30 required instruments of ratification have been deposited).

[307] This conclusion can be drawn from the analysis of creditor litigation before New York courts. More specifically, holdout litigation following the Argentine default has considerably complicated the debt workout. The success of litigious creditors was largely due to a very restrictive interpretation of sovereign immunity. For a history of holdout litigation and an analysis of the evolution of sovereign immunity considerations in sovereign debt trials, see below 3.5. For the Argentine debt restructuring and ensuing litigation, which had considerable implications for sovereign immunity from enforcement, see chapter 4.

[308] Iversen (n 20) 3 (noting that '[t]he disparity affects debtor-creditor positions because creditors argue that their legal position as against debtors is much worse than is the case with the bankruptcy of individuals or corporations'). However, one should not forget that – in contrast to corporations – sovereigns can be sued by individual creditors even after their debts have become sustainable and they have become *de facto* insolvent.

[309] Panizza et al (n 193) 653 (noting that the sovereign debtors have traditionally been protected by the principle of sovereign immunity, which States that sovereigns cannot be sued in foreign courts without their consent); ILA (n 86) 22 (holding that States have a substantial degree from both suit and seizure of assets).

Prior to the demise of the absolute principle of sovereign immunity just a few decades ago, lenders were left with two choices following a sovereign default: (i) the restructuring of debt through (voluntary) participation in a debt workout[310] or (ii) the forceful resumption of payment through diplomatic or military pressure.[311] While the latter practice was, by way of example, pursued by the US government in the early 20th century, contemporary international law shuns the use of (military) force to enforce debtor discipline.[312] Even trade sanctions have seized to be lawful measures for collecting debt from other governments.[313]

For private creditors, sovereign immunity has long constituted a major obstacle for successful debt enforcement by means of litigation.[314] Even though the contractual design of sovereign debt instruments often favoured creditors[315], it was practically impossible to find (i) foreign courts honouring the investors' claim against a state[316] and (ii) foreign courts willing and able to enforce their respective judgement. Sovereigns could simply evade a foreign court's discretion by invoking the defence of sovereign immunity, arguing that raising funds – as well as not repaying them – was a purely sovereign activity or decision beyond the reach of a foreign court.[317]

1.4.2. A HISTORICAL VIEW ON THE DECLINE OF ABSOLUTE SOVEREIGN IMMUNITY

After 1945, the principle of absolute immunity of states was gradually abolished. In explaining this development, the revamped US foreign policy post-WWII played a critical role. The US began to encourage a more rigid regime for sovereigns who undertake business abroad, aiming to undermine the immunity of Soviet Union-owned companies located in the

[310] See above 1.4.

[311] Mark Weidemaier, 'Sovereign Immunity and Sovereign Debt' (2014) 1 University of Illinois Law Review 68; Alfaro et al (n 268) 7 (citing President Roosevelt who declared in 1904 that the United States would exercise an 'international police power' across the Western Hemisphere to insure that countries kept order and paid their obligations – this doctrine was referred to as Monroe doctrine); Mark Weidemaier, Robert Scott and Mitu Gulati, 'Origin Myths, Contracts and the Hunt for Pari Passu' (2013) 38(1) Law & Social Inquiry 72, 92 (arguing that gunboat diplomacy played a significant role in enforcing sovereign debt obligations).

[312] Art 2(4) United Nations Charter. See Charter of the United Nations (done at San Francisco, United States, on 26 June 1945) (United Nations [UN]) 1 UNTS XVI, 59 Stat 1031, TS 993, 3 Bevans 1153, 145 BSP 805, 892 UNTS 119.

[313] Marcus Miller and Dania Thomas, 'Eurozone sovereign debt restructuring: keeping the vultures at bay' (2013) 29(4) Oxford Review of Economic Policy 745.

[314] Weidemaier and Gulati (n 21) (noting that sovereign immunity is one of the cornerstones of sovereign debt literature).

[315] See above 1.2.4.

[316] ibid.

[317] This said, even before the erosion of the immunity doctrine, outright debt repudiation affected the pricing of such instruments as well as future possibilities to tap (international) markets, incentivising sovereign borrowers to fulfil their repayment promise on economic rather than legal grounds. See above 1.2.3.

US.[318] In 1952, Jack B. Tate, legal advisor of the US State Department at the time, explained the rationale behind this change in a letter to the US Attorney General:

> '[t]he Department of state has for some time had under consideration the question whether the practice of the Government in granting immunity from suit to foreign governments made parties defendant in the courts of the United States without their consent should not be changed. The Department has now reached the conclusion that such immunity should no longer be granted in certain types of cases…the Department feels that the widespread and increasing practice on the part of governments of engaging in commercial activities makes necessary a practice which will enable persons doing business with them to have their rights determined in the courts.'[319]

This more restrictive view on sovereign immunity denied immunity for commercial activities inside the US or with direct effect inside the US.[320] However, as Yang points out, the decline of absolute immunity was a worldwide phenomenon that has taken many years to accomplish, making it hard to delineate an exact timeline for each and every state.[321] Yang in fact refers to the decision in *Rau v. Duruty*[322], decided in 1879 by the Belgian Court of Appeal of Ghent, as the first mentioning of a more restrictive concept of sovereign immunity.[323]

Courts in other European jurisdictions gradually abolished the principle of absolute immunity in the course of the late 19th and the early 20th century: Italy did so in 1882[324], Switzerland in 1918[325] and Austria in 1920.[326] However, judgments pertaining to the immunity of a state in a foreign court were rare at the time. Globalisation was still in its infancy and two devastating world wars stymied endeavours to boost cross-border trade and financial transactions. Thus, most of the leading decisions in the realm of sovereign immunity date back to the mid-1970s. In England, for instance, the final shift towards a restrictive interpretation of sovereign immunity occurred in 1976 with the Privy Council's decision in *The Philippine Admiral* case,

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[318] Panizza et al (n 193) 653.

[319] See *Alfred Dunhill of London Incorporated v Cuba and Solano Pinera (intervening),* Docket No 73-1288, 425 US 682 (1976), ILDC 1680 (US 1976), 96 S Ct 1854 (1976), 48 L Ed 2d 301 (1976), 66 ILR 212, 24th May 1976, United States; Supreme Court [US]

[320] ibid.

[321] Yang (n 42) 13.

[322] ibid.

[323] ibid.

[324] *Morrellet v. Governo Danese,* Italy, 1882, 26 AJIL Supplement (1932) 480.

[325] *Dreyfus*, Switzerland, (1918) BGE 44 I 49.

[326] Immunities (Foreign State in Private Contracts), R II 282/19, (1919-22) 1 ADIL 118 (Case No 79), 5th January 1920, Austria; Supreme Court of Justice [OGH]. For an overview and further reference, see, eg, Yang (n 42) 13-16.

where – in reference to the Tate Letter – it held that '[the] restrictive theory is more consonant with justice they do not think that they should be deterred from applying it.' [327]

English courts subsequently confirmed the paradigm shift also in the realm of sovereign debt, notably in the seminal *Trendtex* decision, where Lord Denning from the Court of Appeal refused to grant the central bank of Nigeria immunity for a letter of credit issued in favour of a Swiss company.[328] Lord Denning's remarks provide a compelling explanation why courts saw a need to depart from the principle of absolute immunity towards a more flexible approach:

> '[a] century ago no sovereign state engaged in commercial activities. It kept to the traditional functions of a sovereign – to maintain law and order – to conduct foreign affairs – and to see to the defence of the country… Nearly every country now engages in commercial activities. It has its departments of state – or creates its own legal entities – which go into the market places of the world. They charter ships. They buy commodities. They issue letters of credit. This transformation has changed the rules of international law relating to sovereign immunity. Many countries have now departed from the rule of absolute immunity. So many have departed from it that it can no longer be considered a rule of international law.'

Following these and other indicative judgements by courts in the US and England, the US Congress was the first legislative body to codify the doctrine of restrictive sovereign immunity in domestic law. In 1976, it passed the FSIA, which has since set the standard for national legislation with respect to the protection of foreign sovereigns in court.[329] During the 1970s, European states sought to codify the shift from an absolute to a relative concept of sovereign immunity by preparing the ECSI. [330] The ECSI's explanatory memorandum provides the reader with a good understanding of the problems that arose in the context of sovereign immunity at the time, noting the following:

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[327] *Philippine Admiral, Owners of the Philippine Admiral v Wallem Shipping* (Hong Kong) Limited, [1977] AC 373, [1976] 2 WLR 214, [1976] 1 All ER 78, (1975) 64 ILR 90, 5th November 1975, United Kingdom; Privy Council [PC] [232-233].

[328] *Trendtex Trading Corporation v Central Bank of Nigeria*, Appeal decision, ILDC 1735 (UK 1977), [1977] 1 QB 529, [1977] 1 All ER 881, [1977] 2 WLR 356, (1979) 64 ILR 111, 13th January 1977, United Kingdom; England and Wales; Court of Appeal [CA]; Civil Division [EWCA Civ].

[329] The FSIA is a federal law, codified at Title 28, §§ 1330, 1332, 1392 (f), 1441(d), and 1602-1611 of the United States Code. See for an overview in Ralph Steinhardt, 'United States Foreign Sovereign Immunities Act (1976)' in Wolfrum (n 81) (Great Britain introduced the very similar State Immunity Act of 1978, which excludes sovereign immunity with respects to proceeding relating to a commercial transaction or a contractual obligation that falls to be performed within the United Kingdom. See State Immunity Act (United Kingdom [gb]) 1978 c.33.

[330] European Convention on State Immunity (Council of Europe) ETS No 74, 1495 UNTS 181, UN Reg No I-25699.

‘[t]here are, at present, two theories, that of absolute State immunity which is the logical consequence of the principle stated above and that of relative State immunity which is tending to predominate on account of the requirement of modern conditions. According to this latter theory, the State enjoys immunity for acts *iure imperii* but not for acts *iure gestionis*, that is to say when it acts in the same way as a private person in relations governed by private law.’

Several states followed the US, with Great Britain, for instance, introducing the SIA in 1978 and other European countries, such as Austria, Germany and Belgium, ratifying the ESCI in 1990.[331] Those laws strongly resemble the FSIA, stipulating that sovereigns, which have waived their immunity or have engaged in commercial transactions, no longer enjoy immunity from suit.[332]

This statutory cross-fertilisation of the restrictive doctrine of immunity was also observable in the judicial practice across the world, marked by constant references to cases decided by foreign national courts.[333] The abolition of the doctrine of ‘absolute’ sovereign immunity bore profound implications for the law of sovereign debt. As described by Buchheit and Gulati[334], the paradigm shift in international law was driven by ‘the assumption that the menacing prospect of legal enforcement of debt contracts, coupled with a fear of market exclusion and the prospect of a censorious raised eyebrow from the multilateral financial institutions, would act as an effective brake on casual sovereign defaults.’

Empirical research on sovereign debt litigation suggests that investors have welcomed and embraced this new legal avenue with vigour as the number of sovereign defaults with litigation rose from 5% in the 1980s to almost 50% in recent years.[335]

Box 2: The decline of absolute sovereign immunity 1888-2017[336]				
	1888-1929	**1929-1952**	**1952-1976**	**Post-1976**
France	• Absolute immunity • Waivers of	• Restrictive immunity • Contractual	• Restrictive immunity • Contractual	• Restrictive immunity • Contractual

[331] ibid.
[332] See Yang (n 42) 366-367.
[333] ibid 27.
[334] Mitu Gulati and Lee Buchheit, ‘The Coroner’s Inquest: Ecuador’s Default and Sovereign Bond Documentation’ (2009) 28 International Financial Law Review 22, 23.
[335] Schumacher et al (n 9) 1.
[336] Mark Weidemaier and Mitu Gulati, ‘Differing Perceptions? Market Practice and the Evolution of Foreign Sovereign Immunity’ (2018) 43(2) Journal of Law & Social Inquiry 496.

	jurisdictional and execution immunity irrevocable	waivers irrevocable (still valuable)	waivers irrevocable (still valuable)	waivers enforceable, still valuable
United Kingdom	• Absolute immunity • Immunity waiver revocable	• Absolute immunity • Immunity waiver revocable	• Absolute immunity • Immunity waiver revocable	• Restrictive immunity • Contractual waivers irrevocable but primarily relevant to execution
United States	• Absolute immunity • Unclear if waiver revocable	• Absolute immunity • Unclear if waiver revocable	• Restrictive immunity for jurisdiction only • State Department decides most cases • Increasingly likely that waiver is not revocable	• Restrictive immunity • Courts decide immunity • Contractual waivers irrevocable, still offer value

1.4.3. SOVEREIGN IMMUNITY IN PRACTICE

1.4.3.1. Immunity Waivers

Following the erosion of absolute immunity under the laws of many Western jurisdictions, sovereign borrowers have commenced to include waivers from immunity in their bonds.[337] The idea that states may waive their immunity is an old one. It was spelled out for the first time as part of the 'Harvard Project', a proposal to codify the rules of sovereign immunity, according to which states 'should lose their immunity if they had previously consented to the institution of such proceedings.'[338]

Referring to the seismic shift in the law of immunity, Weidemaier and Gulati note that 'almost overnight, bonds issued in multiple jurisdictions uniformly adopted detailed clauses bestowing legal enforcement rights on creditors.'[339] This shift was particularly obvious in the

[337] ibid.
[338] Harvard Research in International Law, 'Competence of Courts in Regard to Foreign States' (1932) 26 American Journal of International Law Supplement 451.
[339] Weidemaier and Gulati (n 21).

debt contracts of developing and low-income countries, where defaults risk are normally higher. However, differences remain with regard to domestic and external sovereign debt, respectively.

For instance, as chapters 4 and 5 illustrate, while Argentine waived its immunity under foreign law bonds, Greece did not include any provision to this extent in its sovereign bond contracts. When they waive their immunity, states tend to surrender both immunity from suit and execution. Indeed, courts often require both an express waiver of immunity from suit *and* a separate waiver of immunity from execution.[340] Moreover, execution immunity – even if an explicit waiver has been included in the bond prospectus – is more constrained in the majority of jurisdictions.[341]

Ultimately, in deciding whether to waive immunity in court, the borrower's creditworthiness plays a key role: investors will typically additional insurance in the form of an immunity waiver if the government has no or a mediocre credit history. In this context, Weidemaier[342] posits that 'issuers with no reputational 'bond' to post, such as new market entrants, might waive immunity from suit, while issuers who returned to the bond markets frequently and enjoyed sterling reputations for repayment might not.' Once a sovereign borrower has waived its immunity, the government must accept foreign jurisdiction and courts may pass negative judgements onto them.[343] Only in the event that an enforceable waiver of sovereign immunity is not contained in a sovereign debt agreement will a court be required to analyse whether the sovereign has lost its immunity under the other provisions of the FSIA.[344]

1.4.3.2. Immunity from Suit

Immunity from suit refers to a situation in which a municipal court may not exercise jurisdiction *ratione personae* over a foreign sovereign.[345] The UNCSI, as adopted by the UN

[340] Yang (n 42) 34 (immunity from suit does not automatically imply immunity from enforcement). For pertinent case law in the context of the holdout creditor problem, see, eg, 3.5.6. (on French courts' interpretation of immunity waivers in Argentine bonds).

[341] See, eg, August Reinisch, 'European Court Practice Concerning State Immunity from Enforcement Measures' (2006) 17(4) European Journal of International Law 803.

[342] Weidemaier (n 311).

[343] See, eg, § 1605(a)(1) FSIA (stipulating that 'notwithstanding any withdrawal of the waiver which the foreign State may purport to effect except in accordance with the terms of the waiver'. UK SIA Section 2 sets out that '[a] State is not immune as respects proceedings in respect of which it has submitted to the jurisdiction of the courts of the United Kingdom.'

[344] George Weisz, Nancy Schwarzkopf and Mimi Panitch, 'Selected Issues in Sovereign Debt Litigation' (1991) 12(1) University of Pennsylvania Journal of International Law 1.

[345] See below 1.4.3.3.

General Assembly in 2004, codifies the immunity of states from litigation under customary international law.[346] In essence, the UNCSI sets out to what extent states and their property enjoys immunity from national courts of other sovereign states.[347] It embodies the more ‘restrictive’ approach to immunity from suit, which, as described above, is now widely applicable in most national legal framework across the globe. The UNCSI works by way of exceptions: it stipulates that states are generally immune to lawsuits brought against them in foreign courts, unless they have expressly consented to a foreign state’s jurisdiction (Article 7) or have engaged in a ‘commercial transaction’ with a foreign natural or juridical person (Article 10). In most cases, the existence of an express waiver is easy to prove, which is why the relevant case law has typically focused on ascertaining whether an act was of commercial nature (*acta iure gestionis*).[348]

As Megliani[349] points out, the shift from absolute to relative sovereign immunity has culminated in major discrepancies in the criteria used by municipal courts to categorise an act as *iure imperii* (public nature) or *iure gestionis* (commercial nature).[350] Three different criteria have been used to decide whether a sovereign activity was to be characterised as commercial or not: (i) the nature of the act, (ii) the purpose of the act, and (iii) the nature of the subject.[351] This reading reflects the principles of sovereign immunity enshrined in the two most important laws for international sovereign finance: the US FSIA and the UK SIA.

[346] Reinisch (n 341) 806. Other jurisdictions, most notably Switzerland, tend to equalise enforcement and jurisdiction; see, eg, *Libya v Libyan American Oil Company*, BGE 106 Ia 142, (1981) 20 ILM 151, (1982) 62 ILR 228, 19th June 1980, Switzerland; Federal Supreme Court [BGer].

[347] See, eg, Iversen (n 20) 20.

[348] The dichotomy between private and public acts plays a major role in delineating the rights of holdout investors vis-à-vis sovereign debtors. However, given the fact that most international bond contracts encompass waivers from immunity from suit, the onus of the court’s assessment lies on whether the states’ assets are protected from measures of constraint, ie enforcement. For a discussion, see below 6.2.1.

[349] Megliani (n 61) 392. The difficulties in drawing clear boundaries between sovereign and commercial legal acts have become highly visible in the wake of recent holdout trials across numerous jurisdictions, yielding divergent interpretations of the sovereign immunity defence.

[350] As the various lawsuits following the Greek and the Argentine insolvencies, which are analysed in chapters 4 and 5, reveal, the boundaries between *acta iure gestionis* and *acta iure imperii* remain blurred, notwithstanding the substantial body of judicial and arbitral decisions in recent years. While, generally speaking, US courts follow a stricter, more narrow interpretation of sovereign immunity, (some) European courts avail greater protection to sovereign borrowers. See, eg, *NML Capital, Ltd. v. Republic of Argentina*, No 08 Civ. 6978 (TPG), 2011 WL 9522565 (S.D.N.Y. Dec. 7, 2011) for a pertinent US judgement (declining Argentina immunity) and BGH, Urteil vom 08.03.2016 - VI ZR 516/14, VI ZR 516/14, NJW 2016, 1659, 8th March 2016, Germany; Federal Court of Justice [BGH] for a European decision (granting sovereign immunity to Greece in German courts regarding bondholders’ challenges against the Greek debt restructuring of 2012).

[351] Megliani (n 61) 393.

Under the FSIA, states are generally immune from the jurisdiction of US courts if none of the exceptions set out in sections 1605 to 1607 FSIA apply.[352] In the context of sovereign finance, the first two exceptions, namely the waiver (Section 1605(a)(1) FSIA) and the commercial activity exception (Section 1605(a)(2) FSIA) are of crucial.[353] As outlined by Megliani, US courts furthermore specify three situations to ascertain when the commercial activity exception was to apply.[354] First, if the commercial activity is performed within the territory of the US[355] Second, if the commercial activity is carried on within the US as well as elsewhere, meaning that a single act with a connection to the US suffices to establish jurisdiction.[356] Third, even in situations where the act is performed abroad but the effects reverberate directly into US territory, the commercial activity exception applies.[357] Importantly, when distinguishing between commercial and non-commercial state activities, US courts focus on the *nature* of the act rather than its purpose.[358]

In Europe, the immunity from suit (as well as execution) is essentially governed by the ECSI. The ECSI and its Additional Protocol were drawn up by the Council of Europe and has so far been ratified by eight countries: Austria, Belgium, Germany, Luxembourg, the Netherlands, Switzerland and the United Kingdom.[359] The ECSI's objective is to foster a more consistent approach to sovereign immunity in Europe, where legal doctrines with respect to the immunity of states have traditionally differed.[360] Leaving aside the case of explicit waivers,

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[352] The FSIA waives sovereign immunity in nine situations: (1) waiver; (2) commercial activity, (3) expropriation; (4) property in the United states; (5) tort injury occurring in the United states; (6) arbitration; (7) torture, extrajudicial killing, sabotage, or kidnapping and (9) foreclosure of a maritime mortgage. See for an overview Alfaro et al (n 268) 19.

[353] See, eg, *Allied Bank International v Banco Credito Agricola de Cartago and ors*, Case No 225, Docket 83-7714, 757 F 2d 516 (2d Cir 1985), 77 ALR Fed 281, (1985) 24 ILM 762, 18th March 1985, United States; Court of Appeals (2nd Circuit) [2d Cir].

[354] Megliani (n 61) 402.

[355] ibid.

[356] See, eg, *Saudi Arabia and ors v Nelson and Nelson, Appeal judgment*, Docket No 91-522, 507 US 349 (1993), 113 S Ct 1471 (1993), 123 L Ed 2d 47 (1993), (1995) 100 ILR 544, [1993] IL Pr 555, 23rd March 1993, United States; Supreme Court [US].

[357] Megliani (n 61) 402. Also see, eg, *Marvin Morris v. The People's Republic of China*, 478 F.Supp. 2d 561 (S.D.N.Y. 2007), United States; New York; District Court for the Southern District of New York [SDNY] (holding that '[…]a financial loss to a plaintiff (individual or corporate) by virtue of its residence or place of incorporation is itself sufficient to establish a direct effect 'in the United States' when all other facts point abroad.').

[358] *Turkmani v Bolivia*, 193 F Supp 2d 165 (DDC 2002), 28th March 2002, United States; District of Columbia; District Court for the District of Columbia [DDC] and *Argentina and Banco Central de la Republica Argentina v Weltover Incorporated and ors*, Final appeal, Docket No 91-763, 504 US 607 (1992), ILDC 1924 (US 1992), 112 S Ct 2160 (1992), 119 L Ed 2d 394 (1992), (1995) 100 ILR 510, 12th June 1992, United States; Supreme Court [US]. For an overview also see, eg, Fox and Webb (n 292) 408-411.

[359] See above 1.4.2.

[360] See for a detailed discussion of the ECSI in Philipp Allott, 'European Convention on State Immunity' (1974) 33(1) The Cambridge Law Journal 8.

the ECSI sets out that states may not claim immunity from the jurisdiction of the courts of another signatory state to the ECSI if they have carried out *acta iure gestionis.'*[361]

With respect to foreign debts, Article 4 ESCI stipulates that a state cannot claim immunity 'if the proceedings relate to an obligation of the State, which, by virtue of a contract, falls to be discharged in the territory of the State of the forum.' It therefore confines the applicability of the ECSI to situations where the place of the payment coincides with the state of the forum, which is, however, often the case in the remit of external debts.[362] Overall, the ECSI has not attained the level of relevance envisaged by the Council of Europe in the 1972.[363] At the same time, in the jurisdictions where it was indeed ratified, the ECSI has shaped the jurisprudence on the immunity of foreign states from suit.[364]

1.4.3.3. Immunity From Execution (Enforcement)

Immunity from execution exclusively concerns the enforcement of a (money) judgement against a sovereign issued by a foreign court, albeit newer forms of enforcement, such as injunctive remedies, have emerged more recently.[365] Execution proceedings must be clearly distinguished from judgements on merits.[366] Therefore, many scholars tend to separate sovereign immunity from enforcement on the one side, also referred to as 'measures of constraint', and immunity from suit on the other.[367] Given that executions against foreign governments are more intrusive on the immunity of the debtor country, the problems from a creditor's perspective is 'not one of securing a judgement against a sovereign borrower but rather one of collecting on it.'[368]

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[361] Article 7 ECSI stipulates that '[a] Contracting State cannot claim immunity from the jurisdiction of a court of another Contracting State if it has on the territory of the State of the forum an office, agency or other establishment through which it engages, in the same manner as a private person, in an industrial, commercial or financial activity, and the proceedings relate to that activity of the office, agency or establishment.'

[362] See Megliani (n 61) 412.

[363] See, eg, Council of Europe, 'Explanatory Report on the Convention on State Immunity' (1972) European Treaty Series – No 74 <https://rm.coe.int/16800c96c3> accessed 23 October 2017.

[364] See, eg, *Consul-General of the Dominican Republic v Della Casa,* (1988-92) 8 Ital YB Intl L 49, 19th April 1990, Italy; Supreme Court of Cassation (in which the Italian Supreme Court noted that the ECSI can be regarded as customary law). For further discussions of this topic, see, eg, Megliani (n 61) 412.

[365] See below 4.3.3. for an analysis of injunctive remedies as a means of sovereign debt enforcement under New York law.

[366] Reinisch (n 341) 804.

[367] For an overview, see, eg, Yang (n 42) 347 (arguing that 'it seems more convenient and less misleading to speak of two immunities, rather than two aspects of the same immunity').

[368] Kaplan (n 67) 5 (noting that most national governments do not maintain substantial attachable commercial assets in foreign jurisdiction, where they could become subject to sovereign debt enforcement).

Sovereign immunity from execution is defined under customary international law and, to some degree, codified in the UNCSI.[369] In addition, many domestic legislators have set out rules on foreign states' immunity from execution in statues; domestic courts have generated a considerable body of case law. Section 12(1)(a) of the Canadian State Immunity Act, for example, stipulates that property of a foreign state that is located in Canada is immune from attachment and execution except where the state has, either *explicitly* or *by implication*, waived its immunity from attachment, execution, arrest, detention, seizure or forfeiture.'[370] Similarly, according to Article 19(a) of the UNCSI[371] and Article 23 ECSI[372], 'no measures of execution or preventive measures against the property of a Contracting State may be taken in the territory of another Contracting State except where and to the extent that the State has *expressly* consented thereto in writing in any particular case [emphasis added].'

Typically, creditors can only seek the attachment of assets of the foreign sovereign that are used for commercial purposes. As Yang notes, 'the 'purpose' test, much discredited where a court decides over the adjudicatory power over a foreign state, has become the decisive criterion for the enforcement of the court's decisions, orders, rulings and judgements.'[373] Along the same lines, Orakhelashvilli remarks that '[t]he universally accepted test for execution against foreign state property is that property used for sovereign or public *purposes* is immune from enforcement and execution, so enforcement measures can only be taken against property used for commercial activities. [emphasis added]'[374]

This view is also supported by case law. For example, the US Court of Appeals for the Fifth Circuit said in *FG Hemisphere* that '[a]lthough jurisdiction over the parties does not change after the action commences or after the party submits to the court's jurisdiction, 'immunity

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[369] Eva Wiesinger, 'State Immunity from Enforcement Measures' (2006) unpublished manuscript <https://deicl.univie.ac.at/fileadmin/user_upload/i_deicl/VR/VR_Personal/Reinisch/Internetpublikationen/wiesinger.pdf> accessed 2 April 2017.

[370] Act to Provide for State Immunity in Canadian Courts (Canada [ca]). Other exceptions are certain commercial activities and judgements pertaining to property that is used for terrorist activity.

[371] Convention on Jurisdictional Immunities of States and their Property (United Nations [UN]) UN Doc A/RES/59/38, Annex, UN Doc A/59/508.

[372] European Convention on State Immunity (Council of Europe) ETS No 74, 1495 UNTS 181, UN Reg No I-25699.

[373] Yang (n 42) 362. Note that § 1610(a)(2) FSIA stipulates, for instance, that property in the US of a foreign state shall not be immune from attachment if 'the property is or was used for the commercial activity upon which the claim is based'. Also see, eg, *First National City Bank v Banco Para el Comercio Exterior de Cuba*, No 81-984, 462 US 611 (1983), 103 S Ct 2591 (1983), (1983) 22 ILM 840, 17th June 1983, United States; Supreme Court [US].

[374] Alexander Orakhelashvili, Research Handbook on Jurisdiction and Immunities in International Law (Cheltenham: Edward Elgar, 2015) 421.

from execution' is nevertheless narrower than jurisdictional immunity.'[375] The same court held in *Af-Cap* that '[w]hat matters under the statute is what the property is 'used for,' not how it was generated or produced…'[376]

The UK SIA, in its section 13(4), too requires that property is 'in use or intended for use for commercial purposes'. In a decision from 2012, the UK Supreme Court clarified that the origin of the property against which execution is sought is irrelevant to determine whether such property was connected to a commercial activity.[377] Rather, it held that '[t]he central question in this appeal is whether the nature of the origin of the debts is relevant to the question whether the property in question was in use for commercial purposes.'[378]

In some jurisdictions, even if sovereigns have waived their immunity from enforcement contractually, such waiver must specify all the commercial assets that creditors may attach, especially if it is unclear whether the assets investors seek to attach are connected to the debtor state's sovereign functions.[379] In this regard, Articles 19 to 21 UNCSI assume a vital role, for they define the limits of holdout creditors' enforcement measures – referred to as 'measures of constraint'. Notwithstanding the fact that the UNCSI has not entered into force, several domestic courts have referred to the Convention as the applicable customary international law.[380]

The demise of an absolute protection from debt enforcement has *de facto* enabled creditors to impose an embargo on the sovereign, preventing it from undertaking a wide range of (commercial) transactions in the jurisdiction where a judgement was passed.[381] According to Weidemaier and Gelpern, with the prospect of having assets seized in the jurisdiction whose

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[375] *FG Hemisphere Associates LLC v Democratic Republic of Congo*, 637 F 3d 373 (DC Cir 2011), 15th March 2011, United States; Court of Appeals (DC Circuit) [DC Cir].

[376] *AF-CAP Incorporated v Congo, The Democratic Republic of the and ors*, Appeal judgment, No 03-50506, No 03-50560, ILDC 119 (US 2004), 383 F.3d 361 (5th Cir. 2004), 17th September 2004, United States; Court of Appeals (5th Circuit) [5th Cir]. For another seminal judgement in this context, see *De Letelier v Chile*, App No 83-9048, Case No 1251, 748 F 2d 790 (2d Cir 1984), (1985) 79 AJIL 447, 20th November 1984, United States; Court of Appeals (2nd Circuit) [2d Cir].

[377] *SerVaas Incorporated v Rafidain Bank*, Appeal, [2012] UKSC 40, [2013] 1 AC 595, [2012] 3 WLR 545, 17th August 2012, United Kingdom; Supreme Court [SC].

[378] ibid [15].

[379] See, eg, for a recent decision by the French Supreme Court, requiring an asset-specific waiver in *NML Capital Limited v Argentina*, Appeal judgment, Case No 09-72 057, 867, (2012) 139 JDI 668, 28th September 2011, France; Court of Cassation [Cass]; Civil Division. Also compare Theresa Monteleone, 'A vulture's gamble: high-stakes interpretation of sovereign debt contracts in NML Capital Ltd v Republic of Argentina' (2014) 8(2) Capital Markets Law Journal 159 (2014). Also see George K. Foster, 'Collecting From Sovereigns: The Current Legal Framework for Enforcing Arbitral Awards and Court Judgements Against States and Their Instrumentalities, And Some Proposals for Its Reform' (2008) 25(3) Arizona Journal of International & Comparative Law 666.

[380] See below, eg, 4.5. (for Italian case law) and 4.7. (for French case law).

[381] Weidemaier (n 311) 90.

courts passed a money judgement against the sovereign, trade and other relations to third parties located therein may be severely obstructed.[382]

1.5. CHAPTER CONCLUSIONS

This chapter explained the legal framework of sovereign debt instruments, its historical evolution, and the unique role of sovereign immunity in the context of sovereign lending and borrowing.

We showed that sovereign debt is a legally complex asset class, notably due to the lack of credible enforcement mechanisms and the absence of a procedure regulating debtor default. While the enforceability of sovereign debt contracts varies across jurisdictions, creditors to a sovereign must accept a high degree of uncertainty should the debtor become insolvent. State borrowers remain unique animals – both *de jure* and *de facto*. They have more and more powerful ways of evading a court judgement or an execution order than corporate or private debtors. Indeed, the absence of statutes regulating sovereign lending means that the rights and obligations of sovereign borrowers and lenders are defined through contracts.

Sovereign debt contracts can either be governed by the law of the issuer or by any other foreign law. The vast majority of foreign law debt instruments are governed by either New York or English law – they are also the two prime jurisdictions for international corporate securities. In the remit of international sovereign bonds, ie those governed by foreign laws, standard contract terms have been developed to foster legal certainty for the debt holder. Commercial contract boilerplate developed in the world's financial centres has become a common feature. Conversely, the terms and conditions of domestic law bonds continue to be shaped by the particularities of the jurisdiction where the instrument was issued – moreover, they tend to be much simpler and less detailed.

Over the past four decades, bonds have replaced commercial syndicated loans as financing instruments of choice for sovereigns that wished to tap international credit markets. This development bore profound implications for the rise of holdout creditor problems. Ensuring collective creditor action in a sovereign debt restructuring was relatively straightforward if only a few creditors needed to be brought to the green table. Conversely, with the increase of

[382] Mark Weidemaier and Anna Gelpern, 'Injunctions in Sovereign Debt Litigation' (2014) 31(1) Yale Journal on Regulation 189, 207.

multiparty instruments, a sovereign might need to approach hundreds of thousands of individual bondholders to bring about a (voluntary) debt restructuring.

Finally, this chapter reviewed the role of sovereign immunity – a fundamental principle of international law that ensures the equality of nations before the law. The original concept of immunity was absolute. This meant that private creditors could not sue states in foreign civil courts. However, with the rise of global trade and international capital flows, the protection of sovereigns from suit and enforcement became relative. As a result, private creditors may now initiate legal action against a sovereign borrower in a competent court, if the state has waived its immunity or engaged in a commercial activity (*acta iure gestionis*). Given that the issuance of debt securities is widely deemed a commercial activity, immunity no longer poses a procedural obstacle. Thus, the decline of absolute sovereign immunity and the rise of the modern holdout creditor problem are inextricably linked.

2. LAW AND POLICY ASPECTS OF SOVEREIGN DEBT RESTRUCTURINGS

'*When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both the least dishonourable to the debtor, and least hurtful to the creditor.'*

–Adam Smith, philosopher and economist (1776)[1]

'[T]he grand feature of [the Bankrupt Act] is to secure equality of distribution among creditors in all cases of insolvency.'

–US Supreme Court (1873)[2]

2.1. INTRODUCTION

Over the past decade, 14 countries have undertaken 18 debt restructurings.[3] From Greece to Grenada and Argentina to Cameroon, several governments in countries with different levels of economic development asked their creditors for public debt rescheduling or restructuring.[4] History shows that states have often chosen to default and subsequently restructure their debts, even if the associated costs are high.[5] As shown in Figure 3, between 1820 and 2012, 251 sovereigns defaulted on their public debts.

[1] Adam Smith, *The Wealth of Nations* (London: Methuen and Co, 2000 – first published in 1776) 478.

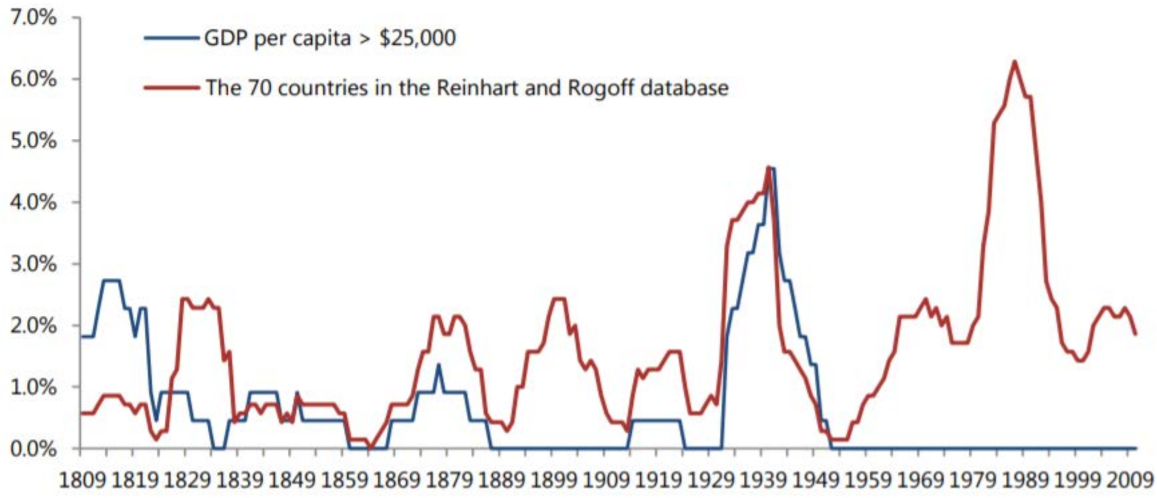
[2] *Wilson v. City Bank*, 84 United States Supreme Court [US] 473 (1873) [494].

[3] Tim Strickland, 'Sovereign Debt Restructuring: Recent Issues and Reforms' (2014) Reserve Bank of Australia Bulletin, December – Quarter 73 <https://www.rba.gov.au/publications/bulletin/2014/dec/pdf/bu-1214-9.pdf> accessed 5 August 2018.

[4] Those countries took different approaches in negotiating with their creditors. Some resolved their sovereign debt crisis with surprising ease such as in the case of Cameroon, whilst others – as evidenced by this thesis on the Argentine restructuring – fight court battles for over a decade against their lenders. See Paris Club, 'Annual Report 2008' 14 <http://www.clubdeparis.org/sections/communication/rapport-annuel-d/annual-report-2008/downloadFile/file/AnnualReport2008.pdf> accessed 2 June 2018.

[5] Economic literature suggests that default or restructuring can cause reputational damage and trigger sanctions, see, eg, Harold Cole and Patrick Kehoe, 'Models of Sovereign Debt: Partial versus General Reputations' (1998) 39 International Economic Review 55. For a more recent version, see Mark Aguiar, Styajit Chatterjee, Harold Cole and Zachary Stangebye. 'Self-Fulfilling Debt Crises, Revisited: The Art of the Desperate Deal' (2017) Federal Reserve Bank of Philadelphia Working Papers 17-7 <http://www.nber.org/papers/w23312> accessed 2 June 2018.

Figure 3: Frequency of sovereign defaults[6]



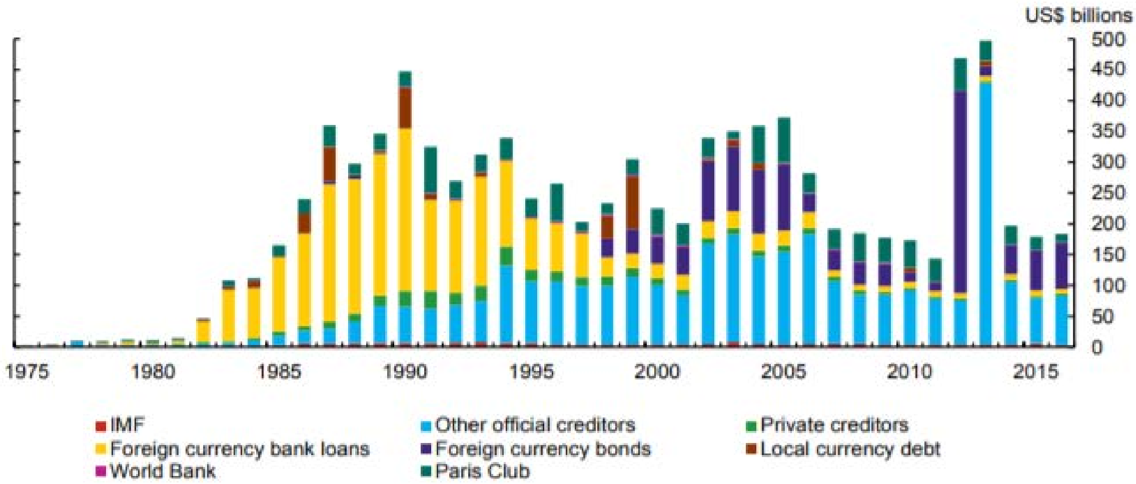
Some regions have been particularly prone to fiscal and financial instability.[7] For instance, Latin American and the Caribbean countries alone implemented 25 restructurings in the past 35 years.[8] Moreover, there were periods of severe stress where the frequency of default shot up. Some prominent examples include the Latin American debt crises in the 1980s, the Argentine default of 2001, and the euro area crisis starting in 2010. Overall, as Figure 4 below illustrates, between the early 1980s and now the overall amount of sovereign debt in default has not changed markedly.

[6] Basel Committee on Banking Supervision (BCBS), 'The regulatory treatment of sovereign exposures' (December 2017) Discussion paper <https://www.bis.org/bcbs/publ/d425.pdf> accessed 22 December 2017.

[7] Odette Lienau, 'The Longer-Term Consequences of Sovereign Debt Restructuring' in Rosa Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford: Oxford University Press, 2014) 99.

[8] Andrew Powell, 'Bipolar Debt Restructuring: Lessons from LAC' (*Vox Lacea*, 24 February 2017) <http://vox.lacea.org/?q=debt-lessons-LAC> accessed 18 August 2017. Also see Figure 4 on sovereign debt in default in the recent decades.

Figure 4: Sovereign debt in default, by creditor (in USD billions) [9]



2.2. DEFINITIONS

The term 'sovereign debt restructuring' is neither defined under international nor domestic law. For sake of simplicity, we refer to it as 'the mechanism used by sovereign states to prevent or resolve debt issues and achieve debt sustainability levels.'[10] According to the economic literature, two concepts may be applied to ascertain solvency in the context of sovereign debtors. A country can be solvent when the net present value (NPV) of the government's future primary balances is at least as high as the NPV of outstanding government debt ('flow concept') or when the present value of liabilities is smaller than the present value of asset ('stock concept').[11] Sovereign borrowers are insolvent when one or both tests are negative.

[9] David Beers and Jamshid Mavalwalla, 'Database of Sovereign Defaults, 2017' (June 2017) Bank of Canada Technical Report No 101 <https://www.bankofcanada.ca/2014/02/technical-report-101/> accessed 16 August 2018.

[10] Yuefen Li, Rodrigo Olivares-Caminal and Ugo Panizza, 'Avoiding Debt Crises: Lessons from Recent Default' in Carlos Braga and Gallina Vincelette (eds), *Sovereign Debt and the Financial Crisis* (Washington D.C.: The World Bank, 2011) 245

[11] ECB, 'Debt sustainability analysis for euro area sovereigns: a methodological framework' (April 2017) Occasional Paper Series No 185, 8 <https://www.ecb.europa.eu/pub/pdf/scpops/ecbop185.en.pdf?abccaa198c0d791777fe3dfb148873f5> accessed 1 June 2017 (also pointing at the important role the government's liquidity situation plays in avoiding market hysteria and thus ensuring debt sustainability).

Assessing debt sustainability in the context of a sovereign lender can prove extremely difficult, usually requiring the assessing body to render politically contentious judgements.[12] At the international level, the IMF, notably in the context of a financial assistance programme, assesses whether a sovereign state merely faces liquidity problems or a whether its debt are no longer sustainable.[13] Based on such debt sustainability (DSA), which involves complex calculations and assumptions about numerous financial and economic variables, the IMF decides whether it can safely grant loans to a requesting state. If the DSA yields a negative result, the IMF typically requests a sovereign debt rescheduling or restructuring before a financial assistance programme is approved.[14] In the euro area, the European Commission, together with the ESM, carries out such DSA when a Member State requests financial assistance.

2.3. THE (ECONOMIC) RATIONALE FOR RESTRUCTURING SOVEREIGN DEBT

If economic crisis strikes, states suffer from output losses, unemployment rates rise and tax revenues fall. These and other economic dynamics render it increasingly difficult for the government to service its outstanding public debts. Paris and Wyplosz describe this downward spiral as follows:

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[12] Moreover, different institutions may have recourse to different methodologies to assess debt sustainability. This has become particularly evident in the wake of the Greek debt crisis, where the IMF and the European reached remarkably divergent conclusions as regards the sustainability of Greek public debt. See, for example, Julian Schumacher and Beatrice Weder di Mauro, 'Diagnosing Greek debt sustainability: Why is it so hard?' (Fall 2015) Brookings Papers on Economic Activity 280 <https://www.brookings.edu/wp-content/uploads/2016/06/SchumacherTextFall15BPEA.pdf> accessed 2 June 2017.

[13] See IMF, 'Debt Sustainability Analysis' (November 2015) <https://www.imf.org/external/pubs/ft/dsa/> accessed 9 November 2016. Also compare ECB (n 11). Also see below 2.6. for an explanation of the IMF's special role in sovereign debt restructurings. Of course, one ought not to have any illusions about the certainty and accuracy of DSAs. Political imperatives may in some cases drive the assumptions underlying the economic model, making DSAs prone to criticism from both creditors and debtors.

[14] ILA, 'State insolvency: options for the way forward' (2014) The Hague Conference Sovereign Insolvency Study Group, 4 <https://ila.vettoreweb.com/Storage/Download.aspx?DbStorageId=1451&StorageFileGuid=58bc4db7-4213-440c-93fe-978a0a2896cb> accessed 28 June 2018. Of course, requesting an upfront debt restructuring might be fiercely objected by the sovereign debtor, its creditors, other lenders of last resort, or other potentially affected states. The Greek debt crisis, and the rejection of many stakeholders to accept such upfront reduction of unsustainable debts, served as a case in point. Indeed, the IMF could not withstand the pressure and decided to amend its lending policies rather than force a debt restructuring by denying financial assistance. See below 2.6. for a discussion of the IMF's role in sovereign debt restructurings. For a discussion of the Greek debt crisis, see below chapter 5.

> '[r]ising debt alarms markets, which impose higher risk premia, which in turn raises borrowing costs and pushes the debt further up. The result is escalating interest rates that affect the whole economy, including banks and other financial institutions.'[15]

In essence, when the economic outlook significantly worsens, governments typically face two choices: grow out of their unsustainable debt levels or restructure their outstanding public debts. However, the former is often impossible, most notably since expansionary fiscal policies would require even higher (and costlier) debt financing or politically unpalatable austerity. Debt overhang effects too constrain fiscal space and render debt relief an inevitable precondition to reboot economic growth.[16] Of course, debt restructurings are not a panacea. As Lienau rightly notes, '…a restructuring may help to stabilise a given country and provide a foundation for future growth, but can hardly be considered financial salvation.'[17]

Moreover, empirical evidence suggests that sovereign default and subsequent recontracting often results in prolonged exclusion from capital markets and a positive correlation between post-default refinancing costs and the size of the debt relief achieved.[18] More specifically, exclusion from sovereign debt markets following a default lasts from four to eight years and interest rates rise by 250 to 400 basis points.[19] There is ample evidence, however, that deep and swift pre-emptive debt restructurings can make a positive contribution to the country's economic recovery.[20] On balance, however, the economic evidence regarding the positive and negative effects of debt restructurings seems inconclusive.

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[15] Pierre Paris and Charles Wyplosz, 'PADRE – Politically Acceptable Debt Restructuring in the Eurozone' (2014) Geneva Reports on the World Economy Special Report 3, 7 <http://www.icmb.ch/ICMB/Home_files/Geneva%20Special%20Report%203.pdf> accessed 1 September 2017.

[16] Lorenzo Forni, Geremia Palomba, Joana Pereira and Christine J. Richmond, 'Sovereign Debt Restructuring and Growth' (July 2016) IMF Working Paper WP/16/147, 19. Also see Paul Krugman, 'Financing Versus Forgiving a Debt Overhang' (1988) 29 Journal of Development Economics 254.

[17] Also see Odette Lienau, 'The Longer-Term Consequences of Sovereign Debt Restructuring' in Rosa Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford: Oxford University Press, 2014) 100-102.

[18] Jan Cruces and Christoph Trebesch, 'Sovereign defaults: the price of haircuts' (2013) 5(3) American Journal of Macroeconomics 85.

[19] ibid. For further evidence on potential adverse effects of debt restructuring in a currency union, such as the euro area, see Lorenzo Forni and Massimiliano Pisani, 'Macroeconomic Effects of Sovereign Debt in a Monetary Union: A Model-based Approach' (2013) IMF Working Paper WP/13/269 <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Macroeconomic-Effects-of-Sovereign-Restructuring-in-a-Monetary-Union-A-Model-based-Approach-41176> accessed 3 November 2017.

[20] See for an overview of the literature and a historical analysis on the effects of debt restructuring, eg Carmen M. Reinhart and Christoph Trebesch, 'Sovereign Debt Relief and Its Aftermath' (2016) 14(1) Journal of the European Economic Association 215 (noting that '[t]he economic landscape of debtor countries improves significantly after debt relief operations, but only if these involve debt write-offs. Softer forms of debt relief, such as maturity extensions and interest rate reductions, are not generally followed by higher economic growth or improved credit ratings.').

For instance, reducing debt levels by virtue of maturity extension or by imposing a haircut on bondholders may immediately jeopardise financial stability. In most domestic financial systems, sovereign debt is used as a benchmark for a myriad of other asset classes, as financial collateral for refinancing operations of private banks with their central bank and as capital instruments to ensure banks' resilience to credit and market risk.[21]

At the same time, it typically leads to better macroeconomic conditions over the medium to long term.[22] IMF staff has recently found that there are bad and good debt restructurings for growth.[23] If countries are allowed to exit a default spell, ie a debt restructuring that reinstalls debt sustainability, this can lead to significant improvements in growth performance in the aftermath of the debt operation, and the effect is persistent over time.[24] In other words, the lower the post restructuring debt is, the better the post restructuring growth performance for any given level of debt relief.[25] A recent paper by Reinhart and Trebesch appears to bolster this hypothesis.[26] They conclude that the economic landscape of debtor countries improves significantly after debt relief operations, provided they involve debt write-offs rather than mere debt rescheduling.[27]

Moreover, the goal of mitigating deadweight losses has also driven international efforts to render debt restructurings more efficient and orderly.[28] Deadweight losses are referred to as information problems related to the uncertainty of the debtor's willingness and ability to pay.[29] These losses are largely due to bargaining problems, which stem from asymmetric and

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[21] See, eg, Fabrizio Zampolli, 'Sovereign debt management as an instrument of monetary policy: an overview' (May 2012) BIS Papers No 65, 97-118 <https://www.bis.org/publ/bppdf/bispap65f_rh.pdf> accessed 3 November 2017 (reviewing the relevance of sovereign debt in monetary operations). This is why breaking the so-called 'sovereign-bank feedback loop', ie the link between sovereign debt and their national banking system, which often holds significant amounts of these instruments, has become such a key concern for EU policymakers. For an overview of the debate, see, eg, Giorgio Barba Navaretti, Giacomo Calzolari, and Alberto Pozzolo, 'Sovereign and bank risk: Completing the union and breaking the loop' (*VoxEU*, 15 July 2016) <https://voxeu.org/article/sovereign-and-banking-risk> accessed 2 November 2017.

[22] IMF, 'A Survey of Experiences with Emerging Market Sovereign Debt Restructurings' (5 June 2012) IMF Policy Papers <https://www.imf.org/external/np/pp/eng/2012/060512.pdf> accessed 31 May 2017.

[23] Forni et al (n 19) 21.

[24] ibid.

[25] ibid.

[26] Reinhart and Trebesch (n 20).

[27] ibid.

[28] See Barry Eichengreen, 'Restructuring Sovereign Debt' (2003) 17(4) Journal of Economic Perspectives 75, 77.

[29] ibid.

incomplete information on the debtor's commitment to repay.[30] This, ultimately, impedes efficient contracting.[31]

2.4. LEGAL AND TRANSACTIONAL ASPECTS

From a transactional perspective, countries have the option of reducing the present value of the future obligations (debt restructuring) or amending the timetable of repayments without changing their present value (debt rescheduling or 'reprofiling').[32] In contrast to the latter, a rescheduling of debt usually features the application of below-market interest rates as well as moratoriums on outstanding and forgiveness of accrued interest rates.[33] A debt restructuring entails an actual debt cut, hence forgiveness of (part of) the outstanding principal amount ('principal haircut') or a reduction of the coupon ('coupon reduction'), ie lowering the amount of interest payable under the original contractual arrangement.[34]

In addition, sovereigns have engaged in financial transactions referred to as 'debt buy-backs to reduce their debt profile. Debt buy-backs can take many forms such as acquisition of the country's own debt on the secondary market, which are traded there at a high discount.[35]

The onus of debt restructuring and rescheduling operations lies at agreeing with the holders of outstanding bonds to a reduction of these bonds' principal and/or interest payments.[36] While a state would ideally negotiate with investors and agree to a restructuring of public

[30] James A. Haley, 'Sovereign Debt Restructuring: Bargaining for Resolution' (April 2017) CIGI Papers No 124, 6 <https://www.cigionline.org/publications/sovereign-debt-restructuring-bargaining-resolution> accessed 6 April 2017.

[31] ibid.

[32] Compare Francois Gianviti, Anne O. Krueger, Jean Pisani-Ferry, André Sapir and Jürgen von Hagen, 'A European mechanism for sovereign debt crisis resolution: a proposal' (November 2010) Bruegel Blueprint 4 <http://bruegel.org/2010/11/a-european-mechanism-for-sovereign-debt-crisis-resolution-a-proposal/> accessed 14 June 2018. Also see for a comprehensive overview of debt restructuring procedures at the international level, Charlotte Rault, *The Legal Framework of Sovereign Debt Management* (Berlin: Nomos, 2017). Debt rescheduling and debt reprofiling can be used interchangeably. Since this form of debt restructuring does not involve a haircut on the claims of private holders of debt, it has recently been promoted as an alternative to a 'hard' debt restructuring, which is more prone to holdout litigation.

[33] See for an overview, eg, Rodrigo Olivares-Caminal, *Legal Aspects of Sovereign Debt Restructuring* (London: Sweet & Maxwell, 2009). Also compare Joana Dreger, 'Why is Sovereign Debt Restructuring A Challenge? The Case of Greece' (2012) Bruges European Economic Policy Briefings 24/2012, 21 <http://aei.pitt.edu/58456/> accessed 20 October 2016.

[34] See, eg, Alison Wirtz, 'Bilateral Investment Treaties, Holdout Investors, and Their Impact on Grenada's Sovereign Debt Crisis' (2015) 16(1) Chicago Journal of International Law 249, 253.

[35] For an overview, see, eg, Ross Buckley, 'Rescheduling as the Groundwork for Secondary Markets in Sovereign Debt' (1997) 26 Denver Journal of International Law and Policy 299. Of course, in the absence of strict legal definitions, some authors also consider 'sovereign debt restructuring' an umbrella term that comprises NPV cuts and reschedulings.

[36] Marcus Miller and Dania Thomas, 'Sovereign Debt Restructuring: The Judge, the Vultures and Creditor Rights' (2007) 30(10) The World Economy 1491.

debt *before* default on one or more outstanding securities, sovereigns may postpone the tough decision to ask investors for debt relief. The difficulty of remedying sovereign debt problems *after* default is that triggering default clauses gives rise to a plethora of (additional) legal problems. These are likely to undermine the success of a debt restructuring as well as the issuer's attempts to re-enter international credit markets.[37] Indeed, as Buchheit and Daly note, '[f]or so long as the payment default persists, it will remind new investors in the debtor country of the unfortunate fate of their predecessors.'[38]

2.4.1. Debt Restructuring Techniques: Sticks and Carrots

States employ a variety of techniques to increase the level of higher creditor participation in a sovereign debt restructuring.[39] The overarching goal is to induce creditors into giving a debt relief to the country and deter holdout behaviour by making the debt swap more attractive to investors than engaging in litigation with an uncertain outcome.[40]

On the one hand, states use 'carrots', such as that aim at encouraging creditor participation in an exchange of debt instruments – some also refer to them as 'sweeteners'. Such sweeteners or 'carrots' – can range from posting collateral security or collateral from creditworthy entities[41], to issuing GDP-linked bonds in exchange for the old (illiquid) bonds, or including certain terms in the exchange offer that make holding an old bond unattractive.[42] Indeed, the need to nudge creditors into a debt workout mainly stems from the fact that a sovereign is uniquely vulnerable once it is confronted with a shortage of assets to fund the liability side of

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[37] Udabir Das, Michael Papaioannou and Christoph Trebesch, 'Sovereign Debt Restructurings 1950-2010: Literature Survey, Data and Stylized Facts' (2012) IMF Working Paper WP/12/203, 4 <https://www.imf.org/external/pubs/cat/longres.aspx?sk=26190.0> accessed 2 June 2017 (noting that '[i]n most cases, restructurings occur after a default, and are known as post-default restructurings' but also that 'recent years have also seen a number of pre-emptive debt restructurings, where outstanding debt instruments are exchanged before the government misses any payments').

[38] Lee Buchheit and Elena Daly, 'Minimising Holdout Creditors: Sticks' in Lastra and Buchheit (n 17).

[39] See Ran Bi, Marcos Chamon and Jeromin Zettelmeyer, 'The Problem that Wasn't: Coordination Failures in Sovereign Debt Restructurings' (November 2011) IMF Working Paper No 11/265, 3 <https://www.imf.org/external/pubs/ft/wp/2011/wp11265.pdf> accessed 2 August 2017.

[40] Lee Buchheit, 'Sovereign Debt Restructuring: The Legal Context' (2013) BIS Papers No 72 – Sovereign risk: a world without risk-free assets? (Proceedings of a seminar on sovereign risk including contributions by central bank governors and other policy-makers, market practitioners and academics, Basel, 8–9 January 2013).

[41] ibid.

[42] See for an overview Lee Buchheit and Elena Daly, 'Minimising Holdout Creditors: Carrots' in Lastra and Buchheit (n 17) 3-13. In the Greek debt restructuring part of the exchanged debt instruments are GDP-linked notes, which promise additional coupon payments in the event of economic stabilisation. See Greg Ip, 'For Greece, GDP-linked Debt May Be More Curiosity Than Cure' *The Wall Street Journal* (New York, 3 February 2015). Similarly, GDP linked sweeteners were used in the 2015 Ukraine debt restructuring deal, see Joseph Cotterill, 'Nyet' *Financial Times Alphaville* (London, 27 August 2015) <http://ftalphaville.ft.com/2015/08/27/2138663/nyet/> accessed 10 November 2017.

its public balance sheet. Other 'carrots' include offering a menu of options for creditors[43], loss reinstatement failures, or value recovery instruments.[44]

Moreover, most debt restructurings in the past included some coercive elements too, which are referred to as the 'sticks'.[45] For instance, transactional techniques, such as exit consents[46], threats of non-payment, or minimum participation thresholds[47] allow the issuer to reduce the attractiveness of holdouts. However, these techniques are no panacea and come with considerable uncertainty, notably because courts may *ex post* consider their use as an abusive legal strategy on the sovereign debtor's side.[48]

For the purpose of the present analysis, it is important to keep in mind that issuers use sticks and carrots to avoid protracted holdout litigation. Both Argentina and Greece were only partially successful in using legal finesse to reduce holdout inefficiencies, as we show in chapters 4 and 5.[49]

2.4.2. THE ROLE OF CREDITOR RANKING

Traditionally, certain creditors enjoy 'preferred creditor status' (PCS) in debt restructurings. However, given the absence of sovereign bankruptcy rules, whether a creditor has such PCS very much depends on international custom rather than hard rules.[50] In essence, intergovernmental financial bodies, such as the World Bank, or international lenders of last resort, such as the IMF or the ESM, enjoy PCS. In practical terms, this means that they rank

[43] A menu of options to choose from gives creditors the ability to choose from a menu of restructuring options, all of which can be calibrated so as to have an equivalent net present value at the time the restructuring closes; see Buchheit and Daly (n 38) 6.

[44] ibid.

[45] ibid 7.

[46] See, eg, Bi et al (n 39) ('"Exit consents" refer to changes in the non-payment terms of the bonds, such as cross default, listing, and acceleration clauses, which can typically be undertaken with a simple majority of bondholders. These changes destroy value by impairing the liquidity and litigation prospects associated with a particular bond, and hence make it less attractive for creditors to hold out.').

[47] These thresholds condition the exchange to a critical level of creditor participation. This reassured creditors that a successful exchange would improve the debtor's finances and achieve a measure of burden-sharing, while also raising the spectre of generalized default if participation fell short. See Anna Gelpern, 'Sovereign Debt: Now What' (2016) 41(2) Yale Journal of International Law Online 45, 62.

[48] See, eg, *Assenagon Asset Management SA v Irish Bank Resolution Corp Ltd* (formerly Anglo Irish Bank Corp Ltd), 27th July 2012, United Kingdom; England and Wales; High Court [EWHC] 2090; Chancery Division [ChD]. In this case, it was found that where an issuer sought to amend existing bonds in a manner that would substantially destroy their value in order to persuade noteholders to exchange such existing bonds, the resolution passed by the majority bondholders to amend the bonds was invalid.

[49] See below in 6.2. and 6.3. for some ideas as to how the restructuring process can be made more resilient.

[50] Note however that the IMF's *de facto* PCS is for instance reflected in the ESM Treaty, which, in Recital (13), stipulates that 'Heads of State or Government have stated that the ESM loans will enjoy preferred creditor status in a similar fashion to those of the IMF, while accepting preferred creditor status of the IMF over the ESM'. See Treaty Establishing the European Stability Mechanism (European Union [EU], Brussels 2 February 2012).

above than all other creditor classes; this mitigates the official sector's risk that their claims are not repaid.[51] In the context of domestic bankruptcy procedures, the concept of conferring senior creditor status to crisis lenders is epitomised in the concept of 'debtor-in-possession financing (DIP)'. The two main reasons for conveying preferential treatment to official sector lenders are that (i) these lenders provide funds when sovereigns have lost access to other sources of (private) financing and (ii) that IFIs' loans are usually made on a concessional basis.[52]

Due to the absence of clear contractual or statutory rules, it may be challenging to ascertain whether an institution has PCS. Sovereign nations that provide financing to other sovereigns, normally in the form of bilateral loans, may also rely on a PCS. Indeed, one of the Paris Club's central objectives is to ensure a preferential – or at least comparable – treatment of bilateral and private sovereign lenders. [53] Thus, the international community has *de facto* established a hierarchy of creditors.

Empirical studies support the existence of such ranking hierarchy. For instance, Schlegl et al analyse the seniority of creditors empirically and find that a pecking order has emerged in last three decades that puts the IMF and multilateral creditors first, bondholders second, bank creditors third, and trade creditors last. A more contentious question is whether central banks and sovereign wealth funds, so-called 'quasi-sovereign creditors' may also be granted PCS, given that these institutions are either closely affiliated with the official sector or invest in sovereign bonds with a public policy objective.[54]

Overall, to analyse the holdout creditor problem, the *de facto* preferred treatment of certain creditors ought to be kept in mind. Leaving certain special cases aside[55], holdout problems typically arise among private bondholders *because* the PCS of official sector creditors is widely recognised and because it subordinates private to official lenders.[56] Indeed, carving

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[51] See below 2.6. for a discussion of the IMF's special role in international debt restructurings.

[52] For an in-depth discussion of the PCS, see, eg, Annamaria Viterbo, 'Supranational creditors: a threat to the equal status of bondholders?' (2015) 10(2) Capital Markets Law Journal 193.

[53] See below 2.5.1. for a discussion of the coordination and the PCS of sovereign lenders in the Paris Club.

[54] See Matthias Schlegl, Christoph Trebesch and Mark Wright, 'Sovereign debt repayments: Evidence on seniority' (*VoxEU*, 11 August 2015) <http://voxeu.org/article/sovereign-debt-repayments-evidence-seniority> accessed 2 November 2017.

[55] See below 3.3.3. for a discussion of official sector holdout creditors.

[56] See for a critical analysis of the IMF's PCS in Susan Schadler, 'The IMF's Preferred Creditor Status: Does It Still Make Sense After the Euro Crisis?' (2014) CIGI Policy Brief No 37 <https://www.cigionline.org/sites/default/files/cigi_pb_37_1.pdf> accessed 2 June 2018 (remarking that 'for the PCS to be viable, the IMF needs a firm framework to ensure that its members approve only lending arrangements with a high probability of success').

out the official sector from a debt deal necessitates a larger contribution from the private sector, which arguably augments financial incentives to block a debt workout.

2.5. THE EVOLUTION OF SOVEREIGN DEBT RESTRUCTURING PRACTICE

In light of the legal predicaments associated with debt workouts, it might come as a surprise that many states have successfully reduced their debt burden in the past.[57] These include Pakistan's restructuring of 1999, Belize's debt workout of 2006, or Jamaica's restructuring of 2010.[58] In Belize, for instance, the debt restructuring was characterised by a high representation of creditors in a committee, the use of CACs, as well as commitments on the government's side to augment contract enforceability in the future.[59] Box 3 provides an overview of debt restructurings, though not all of them would deserve the label 'successful'.

Box 3: Legal Characteristics of Selected Sovereign Bond Restructurings[60]

	Ecuador 2000	**Uruguay 2003**	**Dominica 2004**	**Argentina 2005**	**Belize 2007**	**Jamaica 2010**	**Greece 2012**
Dominant governing law	English	New York	English	New York	New York	Domestic	Domestic
CACs in original bonds	No	Yes	Partly	Partly	Partly	Partly	Partly
CACs used in exchange	No	Yes	na	No	Partly	No	Yes
CACs in swapped bonds	No	Yes	Yes	Yes	Yes	No	Yes
Exit consents used	Yes	Yes	Yes	Yes	Yes	No	No

[57] See, eg, Bi et al (n 39) 2-6 (arguing that creditor coordination problems have been exaggerated in the pertinent literature).

[58] See, notably, Mauro Megliani, *Sovereign Debt: Genesis, Restructuring, Litigation* (Berlin: Springer, 2015) 368-369.

[59] See, in particular, Tamon Asonuma, Gerardo Peraza, Kristine Vitola, and Takahiro Tsuda, 'Sovereign Debt Restructurings in Belize: Achievements and Challenges Ahead' (2014) IMF Working Paper WP14/32 (July 2014) <https://www.imf.org/external/pubs/ft/wp/2014/wp14132.pdf> accessed 17 September 2017.

[60] IMF (n 22); author.

percentage of holdouts	2%	7%	28%	24%	2%	1%	2%
Settlement with holdouts	Yes	Yes	Yes	Yes	Yes	Yes	Yes

As Gelpern remarks, by the late 1990s, 'sovereign debt restructuring was the work of a reasonably integrated regime, even if it was not recognised as such'.[61] Albeit informal in nature, the system relied heavily on cross-conditionality and negotiation sequencing.[62] Cross-conditionality was achieved by rendering debt relief by Paris Club members as well as private investors dependent on a package of macroeconomic reforms prescribed by the IMF.[63] Moreover, due to the Fund's strict non-toleration policy with respect to official sector arrears, the success of Paris Club negotiations and emergency liquidity assistance were closely intertwined.[64] This meant that private investors could align their expectations to the outcome of a Paris Club deal.[65] Both private and official creditors were unable to free ride on debt workouts concluded within the remit of this framework.

The core argument of this thesis is that the marked increase of litigation and arbitration has undermined the functioning of the *ad hoc* approach to debt restructuring. While this approach may have served its purpose well in the early days of modern international finance, the Argentine and Greek restructurings were 'game changers'. They tilted the sovereign debt equilibrium in favour of private bondholders. The prospect of holdouts attaching non-immune sovereign assets or courts granting far-reaching equitable remedies to uncooperative investors has become a central point of consideration for governments and international financial institutions when designing debt restructurings.

So far, this section has stressed the absence of formal (international or domestic) procedures or institutions to govern and administer debt restructuring negotiations. The Paris and the London Club are no exception to this rule. Yet they are worth mentioning in the context of sovereign debt restructuring and the holdout problem. Both 'clubs' aim to institutionalise the

[61] Gelpern (n 47) 106.
[62] ibid 110.
[63] ibid 53. See below 2.6. for an overview of the IMF's role in debt restructurings.
[64] IMF, 'Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors' (IMF Policy Paper, 2015) <https://www.imf.org/external/np/pp/eng/2015/101515.pdf> accessed 12 September 2017.
[65] Gelpern (n 47) 110 (noting that cross-conditionality was flexible enough to accommodate diverse stakeholders and diverse versions of inter-creditor equity).

process of debt restructuring by providing fora for *ad hoc* negotiations between creditors and their debtors. They have been established to achieve a minimum degree of coordination without curtailing the sovereign debtor's rights under international law or limiting the creditors' capacity to file suit.[66]

2.5.1. The Paris Club

The Paris Club provides a forum to discuss the restructuring or rescheduling of official inter-governmental obligations.[67] It is exclusively concerned with debt owed by one state to another. By separating the restructuring of private and official sector debt, bilateral lenders can afford privileged treatment to them or at least ensure that private market participants do not free-ride on their concessions.[68]

According to the Paris Club's website, its role is 'to find coordinated and sustainable solutions to the payment difficulties by debtor countries […]' and to '[…] provide debt treatments to debtor countries in the form of rescheduling…'.[69] As the IMF's Managing Director emphasised in a speech at the margins of the Club's 60th anniversary in 2016, 'the [Paris] Club has played a very special role in enabling countries' re-integration into the global economy, providing debt relief at a moment when the country is opening up after years of detachment.'[70]

The Paris Club was established in 1956, at a time when Argentina stood at the brink of default. It has since facilitated 431 agreements with 90 different debtor countries.[71] The Club is chaired by a senior French Treasury official and comprises 22 member states, which possess official creditor status.[72] However, the Paris Club has grown beyond its initial composition and has invited two states that have previously sat at the other side of the

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[66] Dyson, Kenneth H. F., *States, Debt, and Power: 'saints' and 'sinners' in European History Integration* (Oxford: Oxford University Press, 2014) 376. Also see Ross Buckley, 'The Bankruptcy of Nations: An Idea Whose Time Has Come' (2009) 43(3) The International Lawyer 1189.

[67] Dyson (n 66) 375.

[68] As Gianviti et al remark, '[d]uring the [IMF's] SDRM episode there was a discussion about whether the mechanism should apply not only to private but also to state creditors. The latter, however, strongly opposed such a possibility, preferring instead to retain their privileged treatment under the Paris Club.' See Gianviti et al (n 32) 26.

[69] Club de Paris, 'About Us' (2016) <http://www.clubdeparis.org/en/> accessed 19 August 2016.

[70] Christine Lagarde, 'Paris Club 60th Anniversary' (6 July 2016) Keynote Address by Christine Lagarde Managing Director of the IMF <https://www.imf.org/en/News/Articles/2016/07/06/17/56/SP070116-Paris-Club-60th-Anniversary-Keynote-Address-by-Christine-Lagarde-Managing-Director>.

[71] ibid.

[72] Dyson (n 66) 376.

negotiation table, ie as debtors requesting debt relief.[73] China however, one of the biggest lenders to African and South American nations, has hesitated to join the Club, seemingly reluctant to follow the French and the Japanese finance ministers' repeated invitations.[74]

Despite the Paris Club's initial objective to provide greater sympathy for low-income countries[75], the IMF programme conditionality remains a precondition for the forum to convene.[76] Accordingly, countries that both borrow from the IMF and seek debt relief from Paris Club members are required to adjust their economic policies to overcome the problems that led it to seek financial aid from the international community.[77] Since 1990, the Paris Club has strictly adhered to the principle of conditionality.

Besides the already mentioned principles of conditionality and comparability of treatment, the Paris Club relies on four additional principles: solidarity, consensus, information sharing and case-by-case treatment.[78] While the principle of solidarity requires all members of the Paris Club to act as a group in their dealings with a given debtor country, the consensus principle means that no decisions for debt relief can be taken without consensus among the participating creditors.[79] The principle of information sharing, too, aims at fostering collaboration and reciprocity between Paris Club members, especially with respect to data.[80] The Paris Club essentially offers two different types of debt treatment: (i) the rescheduling mixed with a debt relief component and (ii) prepayments.[81]

[73] Indeed, South Koreas' and Brazil's accession to the Club in 2016 reflects a rapidly changing creditor landscape, in which more and more official sector lending comes from rather than flows to the so-called BRICS countries. BRICS refers to Brazil, Russia, India, China and South Africa. The term was coined by a former investment banker, namely Goldman Sachs Asset Management chairman Jim O'Neill; see Jim O'Neill, 'Building Better Global Economic BRICS' (2001) Global Economics Paper No 66 <www.goldmansachs.com/our-thinking/archive/archive-pdfs/build-better-brics.pdf> accessed 25 January 2018.

[74] For China, membership to the Paris Club might take away some flexibility in dealing with debt crises in countries it has borrowed to. Crucially, if China remains an observer and thus a non-member, the principles the Paris Club functioning relies on, such as consensus and solidarity do not apply.

[75] Dyson (n 66) 376.

[76] ibid 375.

[77] IMF, 'IMF Conditionality' (September 2016) <https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/28/IMF-Conditionality> accessed 27 November 2017.

[78] Club de Paris, 'The six principles' (2016) <http://www.clubdeparis.org/en/communications/page/the-six-principles> accessed 28 November 2017.

[79] ibid.

[80] ibid.

[81] See Giorgia de Rosa, *The New Era of Sovereign Debt Restructuring* (PhD dissertation, University of Milan 2012).

2.5.2. THE LONDON CLUB

The London Club provides a forum for the restructuring of commercial bank debt on a structurally and institutionally similar basis, is however more informal than the Paris Club in its whole set-up.[82] According to the IMF, despite its name, the term London Club 'loosely describes the case-by-case restructuring routine developed between major Western banks and developing country governments'.[83] For instance, the BAC[84], which played a significant role in facilitating and negotiating the first large modern debt restructurings in the wake of the 1980s debt crises in South America, is one form of the London Club.[85]

While the Paris Club remains an important forum to coordinate official sector creditors, ensuring, at least to a certain degree, a comparable treatment of sovereign creditors, the London Club has *de facto* seized to exist.[86] During both the Argentine and the Greek debt crises, important private bondholders established committees to leverage their bargaining position and cultivate more effective collective creditor action.[87] However, in contrast to the London Club, these committees hardly represented a majority of investors, rendering it difficult to contain holdout behaviour in the same manner as during the syndicated loan crises of the 1980s.

In addition, market industry groups strive to emulate the London Club's key features by advocating the inclusion of creditor engagement clauses in international sovereign bonds.[88] It

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[82] Pamela Blackmon, 'Determinants of developing country debt: the revolving door of debt rescheduling through Paris Club and export credits' (2014) 35(8) Third World Quarterly 1423,1437.

[83] Das et al (n 37) 16.

[84] See above 1.3.2.

[85] This shows the vague nature of the London Club. Instead of being one statutory institution the London Club could be any group of banks that negotiates restructuring conditions with troubled creditor States. Das et al (n 37) point out that the label is rather obscure and misleading as the Bank Advisory typically held its meeting in New York not in London.

[86] Anna Gelpern, 'Hard, Soft, and Embedded: Implementing Principles on Promoting Responsible Sovereign Lending and Borrowing' (2012) Georgetown Law Faculty Publications and Other Works 1860, 13 <https://scholarship.law.georgetown.edu/facpub/1860/> access on 6 September 2018.

[87] For instance, disparate Argentine investors united under the umbrella of the Global Committee of Argentina Bondholders (GCAB) to pool negotiating leverage and demand a better deal. They represented about USD40 billion in US, European and Japanese creditors, amounting to approximately 45% of total bonds in default; see Anna Gelpern, 'After Argentina' (2012) Peterson Institute for International Economics Policy Briefs No PB05-02 <https://piie.com/publications/policy-briefs/after-argentina> accessed 21 December 2017. In Greece, several big banks, mainly of German and French origin, coordinated their negotiating position with the aid of the IIF. According to Reuters, the banks and other steering group members held about 30% of the EUR206 billion of bonds in circulation; see Alex Chambers and Lefteris Papadimas, 'Athens, creditor group turn up heat on Greek bondholders' (*London*, Reuters, 6 March 2012) <http://www.reuters.com/article/us-greece-bonds-idUSTRE82412N20120306> accessed 21 December 2017.

[88] Generally speaking, creditor engagement clauses allow for a better coordination of private sector creditors by obliging the sovereign issuer to recognise a creditor committee (that represents a certain percentage of the overall outstanding principal amount) and negotiate with this committee to achieve a mutually acceptable solution. The rationale behind such clauses is to foster more coordination on the creditors' side, for the increasing dispersion of

remains questionable whether such new coordination mechanisms always promote mutually beneficial solutions. One fear is that they may skew the system in favour of activist creditor groups that seek to leverage their position, thereby inflicting more economic pain on the debtor state than is reasonable or necessary.[89] Indeed, the IMF's refusal to endorse creditor engagement clauses that allow for the establishment of creditor committees in future debt workouts should at least raise some suspicion as regards the effectiveness and fairness of creditor engagement clauses.[90]

With the decline of informal fora for debt crisis resolution, other bodies have attained more and more significance. Chapter 3 seeks to explain why the rise of the holdout creditor problem is inextricably bound to an empowerment of national courts and the fall of opaque[91], yet effective institutions like the Paris and the London Club.[92] As the ECB[93] points out, '[t]he two Clubs have provided reasonably effective fora for standstill negotiations with other sovereign and private bank creditors', thus barring litigation attempts by holdout creditors.

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bondholders, as the Argentine and the Greek case conform, has posed great challenges to convening all creditors and negotiating a debt relief for the sovereign borrower. For and explanation of these clauses and recent initiatives by market industry groups to promote such provisions see, eg, EMTA, 'Creditor Engagement Clauses – Pro's and Con's' (2 March 2015) <http://www.emta.org/print.aspx?id=9257> accessed in 2 December 2017. See IMF, 'Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts' (2015) IMF Staff Report <http://www.imf.org/external/np/pp/eng/2015/091715.pdf> accessed 1 December 2017; ICMA, 'ICMA publishes New York governing law model collective action, *pari passu* and creditor engagement clauses to facilitate future sovereign debt restructuring' (*Press release*, 11 May 2015) <http://www.icmagroup.org/resources/Sovereign-Debt-Information/> accessed 2 December 2017.

[89] Unlike domestic bankruptcy systems – where creditor committees are ubiquitous – the non-system for sovereign debt crisis resolution does not provide for a mediator to balance creditor and debtor interests. Consequently, individual creditors may seek to free-ride on a debt deal or abuse the leverage a creditor committee may provide for their own financial benefit.

[90] See IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework' (26 April 2013) <https://www.imf.org/external/np/pp/eng/2013/042613.pdf> accessed 12 May 2018 (remarking that '[t]his paper does not discuss contractual provisions related to the process of engagement with creditors in the context of a debt restructuring').

[91] Sovereign debt restructuring procedures under the auspices of informal institutions such as the Paris Club or the London Club neither rest upon binding legal rules nor provide ex ante protection for sovereign debtors or their creditors. Transparency concerns have so far been shrugged off, in particular by the Paris Club, where officials argue that more transparency is likely to compromise the Club's effectiveness to organise confidential negotiations between lenders and borrowers.

[92] An example to which we will regularly come back is the dismal failure of European Institutions, the IMF and creditor States to quickly and orderly resolve the Greek sovereign debt crises. Compare Ashoka Mody, 'Sovereign Debt and Its Restructuring Framework in the Eurozone' (2013) 29(4) Oxford Review of Economic Policy 727.

[93] ECB, 'Managing Financial Crises in Emerging Market Economies – Experience With the Involvement of Private Sector Creditors' (2005) Occasional Paper Series No 32, 52 <https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp32.pdf> accessed 5 August 2018.

2.6. THE IMF'S ROLE IN SOVEREIGN DEBT RESTRUCTURINGS

The IMF has an important yet ambiguous role in sovereign debt restructurings.[94] To understand it, we must distinguish between official crisis lending, the IMF's key policy role, and sovereign debt restructuring, a function of its legal powers and obligations under the AoA. Sovereign debt restructuring differs from official crisis lending in three major ways: in contrast to lending, sovereign debt restructuring (i) can also address underlying solvency situations where this cannot be achieved by IMF programmes and conditionality, (ii) has profound distributional consequences, and (iii) may involve collateral damage, such as banking crises, capital flight, or reputational costs.[95]

At the Bretton Woods conference of 1944, the IMF was established to serve as the guardian of the international monetary system rather than a sovereign bankruptcy body.[96] At the same time, some scholars argue that the Fund activities have long transgressed the boundaries of its initial mandate.[97] Indeed, the lack of a predefined procedure governing sovereign debt restructurings meant that the IMF morphed into the lynchpin of debt workouts on the international plane.[98]

But how can the IMF's function be justified from a legal viewpoint?

According to Article V(3) of the AoA, the IMF needs to 'establish adequate safeguards for the temporary use of the general resources of the Fund.' The Fund's legal and strategy departments have therefore designed policies that apply if the requesting country's debt levels are deemed unsustainable. As Box 4 shows, the provision of official financial

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[94] Aitor Erce, 'Banking on Seniority: The IMF and the Sovereign's Creditors' (2014) 28(2) Journal of Policy, Administration, and Institutions 219, 222 (discussing the implications of the Fund's LIA policy for intercreditor equity in sovereign debt restructurings).

[95] See Beatrice Weder di Mauro and Jeromin Zettelmeyer, 'The New Global Financial Safety Net' (2017) 4 CIGI Essays on International Finance <https://www.cigionline.org/sites/default/files/documents/Financial%20Essay%20vol.4.pdf> accessed 2 July 2018.

[96] See Reinhart and Trebesch (n 20) 5-9 (*inter alia* pointing at the inherent conflict faced by the IMF between strengthening its role as an international lender of last resort and the demands of many member countries for serial lending, resulting in repeated programs and a perpetual state of debt 'ever greening').

[97] ibid 3 (arguing that 'the only way to preserve the unique status and the seniority of the IMF is to assure that its lending focuses on the task of providing liquidity quickly in response to short-term financial crises — that is, acting as a lending source of last resort — the central bank to central banks').

[98] See Erce (n 94). For a critical analysis, see, eg, Charles W. Calomiris, 'The IMF's Imprudent Role as Lender of Last Resort' (1998) 7(3) Cato Journal. For the IMF's own assessment of its role in debt restructuring (negotiations), see IMF, 'Dealing with Sovereign Debt—The IMF Perspective' (*IMF Blog*, 23 February 2017) <https://blogs.imf.org/2017/02/23/dealing-with-sovereign-debt-the-imf-perspective/> accessed 2 August 2017. For a historical perspective, see Daniel K. Tarullo, 'The Role of the IMF in Sovereign Debt Restructuring' (2005) 6(1) Chicago Journal of International Law 287.

assistance might be conditional upon an upfront debt restructuring to reduce the financing gap that the IMF will need to fill.[99]

<table>
<tr><th colspan="4">Box 4: IMF policies related to sovereign debt restructurings[100]</th></tr>
<tr><th></th><th>2002 Framework</th><th>2010 Framework</th><th>2016 Framework</th></tr>
<tr><td>Debt is unsustainable</td><td rowspan="3">Definitive debt restructuring/official concessional financing[101]</td><td>Definitive debt restructuring/official concessional financing</td><td>Definitive debt restructuring/official concessional financing</td></tr>
<tr><td rowspan="2">Debt is sustainable but not with high probability</td><td>Definitive debt restructuring/official concessional financing</td><td rowspan="2">Maintain non-Fund exposure (eg reprofiling or official financing) to improve debt sustainability and enhance safeguards for Fund resources</td></tr>
<tr><td>Invoke systemic exemption</td></tr>
<tr><td>Debt is sustainable with high probability</td><td>Exceptional access without debt restructuring</td><td>Exceptional access without debt restructuring</td><td>Exceptional access without debt restructuring</td></tr>
</table>

Thus, the IMF effectively guides the sovereign and her creditors in defining the perimeter of a debt restructuring.[102] While the sovereignty of nations dictates careful interventions by international financial institutions, the IMF's DSA determines the size of a debt restructuring and its policies influence who is to endure the highest losses in a debt restructuring.[103] A debt restructuring may also be required as part IMF macro-conditionality.[104] Prescribing a haircut on outstanding sovereign debt and linking it to macroeconomic adjustment efforts can comfort creditors, thereby increasing the chances of a timely return to (international) credit

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[99] See, notably, Erce (n 94).

[100] IMF, 'IMF Survey: IMF Reforms Policy for Exceptional Access Lending' (2016) News Article <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sopol012916a> accessed 5 March 2018.

[101] 'Official concessional financing' refers to special programmes for highly indebted poor countries, and would thus be irrelevant in the context of (highly developed) euro area economies. See, eg, IMF, 'IMF Support for Low-Income Countries' (8 March 2018) Factsheet <http://www.imf.org/en/About/Factsheets/IMF-Support-for-Low-Income-Countries> accessed 21 June 2018.

[102] See IMF (n 100).

[103] See above 2.2. for a brief explanation of the role the DSA plays in the context of IMF lending.

[104] For a detailed description of IMF conditionality, see, eg, Jeffrey D. Sachs, 'Conditionality, Debt Relief and Developing Country Debt Crisis in Jeffrey D. Sachs (ed), *Volume 1: The International Financial System: Developing Country Debt and Economic Performance* (Chicago: University of Chicago Press, 1989). For a critical self-assessment of the Fund's conditionality during the euro area sovereign debt crisis, see, eg, IMF, 'and Sluggish Growth' (2012) World Economic Outlook October <https://www.imf.org/external/pubs/ft/weo/2012/02/> accessed 13 June 2017 (concluding that recent efforts among wealthy countries to shrink their deficits — through tax hikes and spending cuts — have been causing far more economic damage than experts had assumed).

markets.[105] The links between debt operations and IMF financial assistance programmes are unmistakable.

At the same time, the IMF's role in debt restructuring is not clearly defined and has been discussed controversially in scholarship. Given the IMF's role as a lender of last resort to governments, conflicts of interests between its role as a super senior creditor and its role in debt restructurings cannot always be excluded. At best, the IMF assumes the function of a 'neutral arbiter' or 'delegated monitor', which guides all stakeholders to the conclusion of a mutually beneficial debt workout.[106] At worst, it steers the negotiations between the sovereign and its lenders in its own interests. Thus, it has been argued that – in the absence of an explicit mandate to determine questions of burden sharing between the sovereign debtor and its creditors – the IMF should refrain from being too active an actor in sovereign debt restructurings.[107]

In the context of safeguarding resources, the IMF's LIA policy[108] is vital too, as it defines the circumstances under which the Fund can lend to countries that have accumulated arrears vis-à-vis their creditors.[109] Most notably, if a sovereign borrower was to seek IMF assistance despite the existence of arrears to private creditors, it would have to prove that it negotiates a debt restructuring in 'good faith'.[110] While the IMF retains some flexibility as regards the definition of 'good faith', it has nurtured certain guiding principles for debt workouts. These include, among others, early dialogue between debtors and creditors, information sharing on

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[105] Naturally, from the sovereign's perspective, IMF programmes have proven highly unpopular. While the IMF cannot be compared to a trustee that supervises an insolvency procedure in a domestic context, the Fund has often been criticised for its harsh austerity programmes and the costs associated with macroeconomic adjustments for the economically weakest groups in a society. See, eg, James Raymon Vreeland, *The International Monetary Fund (IMF): Politics of Conditional Lending* (New York: Routledge, 2006).

[106] Mitu Gulati and George Triantis, 'Contracts Without Law: Sovereign Versus Corporate Debt' (2007) 75 University of Cincinnati Law Review 977, 978 (noting that '[b]anks often serve the role of delegated monitors' but that 'they were joined as delegated monitors by the International Monetary Fund', as 'investors […] value the monitoring and control of a not-for-profit, public institution, whose mission is to promote economic development and stability rather than investor returns.').

[107] See, eg, Matthias Goldmann, 'Public and Private Authority in a Global Setting: The Example of Sovereign Debt Restructuring' (2018) 25(1) Indiana Journal of Global Legal Studies 331, 343 (noting, for instance, that 'the IMF has been severely criticized for the negative human rights impact of its policies on the population concerned').

[108] See IMF, 'IMF Policy on Lending into Arrears to Private Creditors – Further Considerations' (1999) Executive Board Meeting 99/64 on 14 June 1999 <https://www.imf.org/external/pubs/ft/privcred/lending.pdf> accessed 6 April 2018. Also see IMF, 'The Fund's Lending Framework and Sovereign Debt – Preliminary Considerations' (2014) Staff Report <http://www.imf.org/external/np/pp/eng/2014/052214.pdf> accessed 20 August 2018.

[109] For an overview see, eg, Lucio Simpson, 'The Role of the IMF in Debt Restructurings: Lending Into Arrears, Moral Hazard and Sustainability Concerns' (2006) UNCTAD G-24 Discussion Paper Series No 40 <http://unctad.org/en/docs/gdsmdpbg2420062_en.pdf> accessed 6 April 2017.

[110] IMF, 'Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion' (2002) <https://www.imf.org/external/pubs/ft/privcred/073002.pdf> accessed 6 September 2017.

a timely basis, the preparation of briefings on viable economic programmes and their financial implications, as well as the opportunity for investors to give input to the design of restructuring strategies.[111]

Additionally, by setting out different LIA policies for different types of creditors, the Fund has effectively established a ladder of priorities between different types of creditors. This ladder seemingly favours official over private creditors and foreign over domestic ones.[112] The IMF has also developed different LIA policies for private and official arrears, albeit both revolve around the same 'good faith' rationale.[113] One important additional requirement of the official sector LIA policy is that 'the decision to lend into arrears would not have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases.'[114]

2.7. CHAPTER CONCLUSIONS

Building on chapter 1, which looked at the general legal features of sovereign debt, this chapter provided an overview of the most important law and policy aspects of sovereign debt restructuring.

From an economic viewpoint, states are likely to seek a restructuring of their public debts when they reach unsustainable levels. Given the adverse legal and reputational consequences, states typically avoid defaulting on their bonds – instead they restructure their debts with the support of a creditor majority. Of course, debt restructurings should remain the *ultima ratio* in deep and forlorn debt crises. As we have shown, the economic consequences and trade-offs of debt default, or renegotiation, are still not fully understood and the empirical results remain mixed. While several studies imply positive medium to long-term economic effects, the immediate impact of a debt default or restructuring, especially on the financial sector,

[111] ibid 19-20.

[112] See, eg, Erce (n 94) and Schlegl (n 54).

[113] For the IMF's recently revised LIA policy for arrears to official creditors, see IMF, 'Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors' (December 2015) IMF Policy Paper <https://www.imf.org/external/np/pp/eng/2015/101515.pdf> accessed 12 September 2017. To avoid confusion, the IMF refers to its LIA policy for arrears to official sector creditors as 'non-toleration' policy. This term is to imply that the IMF does not tolerate arrears to official creditors, except under the narrow set of circumstances defined by the IMF Executive Board, as set out in the LIA policy.

[114] ibid 17 (the two requirements for Fund lending in the case of official sector arrears are that prompt financial support from the Fund is considered essential and that the Paris Club has not provided financing assurances).

tends to be large and adverse. Overall, the consensus has emerged that sovereigns, if anything, restructure their public debts 'too little and too late'.

The legal situation is equally ambiguous. Absent contractual or statutory mechanisms to ensure orderly and efficient bankruptcy, states tend to favour conciliatory over confrontational solutions. To that end, a government has to convince a critical mass of creditors that the Treasury's coffers are indeed empty and that a debt restructuring is also in the creditor community's best interest. After all, the threat of a 100% loss usually looms larger than a 40% haircut. To achieve a high level of voluntary creditor participation, sovereigns tend to employ sticks and carrots: transactional techniques that provide (additional) incentives for participation in a debt workout. The carrots make a bond modification offer more attractive while the sticks typically leverage the sovereign's unique legal protection from creditor litigation.

We also argued that sovereign debt restructurings ought to be distinguished from debt defaults: the latter trigger 'events of default' under the pertinent contractual agreement. Such events typically bestow upon the creditors additional rights that can serve as important levers in subsequent lawsuits. Indeed, given the absence of debtor protection rules and automatic stays on litigation, sovereigns have no protection from creditor lawsuits and must reckon with prolonged exclusion from (international) debt markets. This is especially true if creditors are successful in obtaining money judgements that allow for the attachment of all (future) commercial activities within the court's geographical remit. Henceforth, sovereigns are wise to carry out pre-default rather than post-default restructurings. Of course, political short-termism and a steadfast belief that an ailing economy will make a screeching 'U-turn' have often resulted in delays, thereby driving up the costs of debt crises.

This chapter also briefly reviewed the history and evolution of debt restructurings. It argued that the *ad hoc* approach to resolving debt crises, which was characterised by informal negotiations between the sovereign and a relatively small group of lenders, has become less effective with the rise of sovereign bond financing and new market actors. Throughout the 1980s and 1990s, the Paris and the London Club have served as informal fora to coordinate bilateral lenders and large commercial lenders, respectively. Both have, to some degree, lost their grip on the management and administration of debt restructuring negotiations. First, important new bilateral lenders do not have (and do not aspire to have) membership in the Paris Club. Second, bilateral lenders, or sovereign wealth funds they control, might simply acquire sovereign bonds on the secondary market rather than relying on loans governed by international law. Therefore, their debts are not treated within the four corners of the Paris Club's framework.

This development has obfuscated an already ambiguous relationship between private and public law in the ambit of sovereign debt. For the London Club, which provided a forum for the renegotiation of commercial lenders, the rise of bond financing has reduced its effectiveness and reach. Indeed, the community of international creditors was longer just made up of large banks – it has now morphed into a diverse and heterogeneous group of sophisticated and unsophisticated, as well as domestic and foreign creditors.

Finally, the chapter analysed the role of the IMF in debt restructurings at the international level. While the IMF has no legal mandate to intervene or manage sovereign debt workouts, its policies often influence the debtor's decision to carry out a restructuring and inform the design of a restructuring operation. First, the IMF provides assistance to sovereigns in distress and might therefore require an upfront debt restructuring to reduce its own exposure to the sovereign. Second, a successful programme usually provides a seal of approval, thereby bolstering the market's confidence in the recovery path of the state. Third, the IMF's LIA policy ensures that holdout creditors cannot block an IMF programme by blocking a deal negotiated in good faith.

However, the IMF may also get involved as a *de facto* arbiter in debt restructurings, for instance by informally advising on the size of a haircut, the group of creditors that should be bailed-in or strategic aspects of the restructuring operation. For assuming this role, the Fund has been criticised by scholars, notably as the IMF's involvement could give rise to possible conflicts of interests due to its function as a creditor and its function as a mediator between the government and (other) creditors.[115]

[115] See, eg, Erce (n 94) and Tarullo (n 98).

3. THE HOLDOUT CREDITOR PROBLEM

'*We particularly condemn the perversity where vulture funds purchase debt at a reduced price and make a profit from suing the debtor country to recover the full amount owed – a morally outrageous outcome.*'[1]

–Gordon Brown, Former Prime Minister of the United Kingdom

'We use moral solutions. But the vulture funds have the rule of law on their side.'[2]

–Henry Paulson, Former US Secretary of the Treasury

3.1. INTRODUCTION

The holdout creditor problem refers to a situation where a certain percentage of the creditors to a sovereign debtor do not participate in a debt restructuring operation, thereby thwarting, or at least delaying the debt workout.[3] Holdout inefficiencies arise when recalcitrant creditors coerce benefits from the sovereign debtor, which go beyond what they are equitably entitled to.[4] The holdout creditor problem is therefore an archetypical collective action problem, in which the potential gains for individual creditors to defect from a debt workout may be higher than acting in line with the collective of creditors.[5]

The IMF describes the holdout creditor problem as follows:

> '[…] even if creditors as a group recognize that it is in their best interests to agree to a restructuring as soon as possible, individual creditors may be incentivized not to participate

[1] See for the quote, Lee Elliott, 'Stop debt vultures, demands Brown' *The Guardian* (London, 6 May 2002).

[2] Henry Paulson, 'The State of the International Financial System: Hearing before the House Committee on Financial Services' (2007) 110th Congress 39-40 (Statement of Secretary of the Treasury of the United States) <https://www.gpo.gov/fdsys/pkg/CHRG-110hhrg37558/pdf/CHRG-110hhrg37558.pdf> accessed 2 June 2017.

[3] Lee Buchheit has brilliantly described the nature of the 'problem' that arises when certain creditors hold out:

'[i]t is only by virtue of the indulgence shown by the majority of creditors that the sovereign [debtor] has the money to pay-or settle on preferential terms-the claims of the more exacting few. This resentment can be aggravated where the [vulture fund] bought [its] claim on the secondary market at a small fraction of its face value, while the original [creditors] advanced 100 cents on the dollar. It is like giving up your seat on a crowded bus to an elderly woman only to watch a teenager jump on it.'

See for the quote, Jill Fisch and Caroline Gentile, 'Vultures or Vanguards: The Role of Litigation in Sovereign Debt Restructuring' (2004) 53(1) Emory Law Journal 1047, 1093.

[4] Richard Euliss, 'The Feasibility of the IMF's Sovereign Debt Restructuring Mechanism: An Alternative Statutory Approach to Mollify American Reservations' (2003) 19(1) American University International Law Review 107, 121.

[5] See below chapters 4 and 5 for an in-depth review of collective action problems in sovereign debt restructurings.

("hold out") in the hope of recovering payment on the full contractual claim. If the perceived holdout risk is significant, creditors who would otherwise have agreed to participate in a restructuring may be unwilling to do so for inter-creditor equity and liability reasons. Full payment of these holdout creditors would also reduce the sovereign's available resources to pay the restructured creditors, thus undermining a negotiated settlement by further increasing the incentive to hold out. This coordination failure can, therefore, lead to a disorderly restructuring despite it being in the creditors' collective best interest to reach a smooth and negotiated agreement.'[6]

However, no generally accepted legal definition of the holdout creditor problem exists. A review of the pertinent literature reveals that the term encompasses different types of uncooperative creditor behaviour. Both official and private sector creditors may engage in holdout creditor strategies. Moreover, holdout creditor problems do not necessarily involve litigation or arbitration – the threat alone may sometimes compel debt repayment.[7]

The concrete motives for holding out may also differ considerably from case to case. Some investors, as was the case with many retail investors in Greece[8], may reject an out-of-court settlement, arguing that a debt cut is expropriatory, unequitable, or both.[9] Others, most notably vulture holdouts, strategically leverage their bargaining position by means of litigation. Put differently, for vultures, holdouts litigation becomes the means to an end, by contrast, retail investors often seek to merely recuperate their losses.[10]

The subsequent sections shed light on the origins of the holdout problem, the different types of holdouts, and their motives, the implications of holdout behaviour and the most important holdout trials before the crises in Argentina and Greece.

[6] IMF, 'Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring' (2014) IMF Policy Paper, 12 <https://www.imf.org/external/np/pp/eng/2014/090214.pdf> accessed 2 December 2017.

[7] The success of holdout creditors in the Greek debt restructuring served as a case in point; see below 5.3.4. At the same time, empirical evidence suggests that legal action has become a crucial means to pressure creditor countries into full repayment. Julian Schumacher, *Enforcement in Sovereign Debt Markets* (unpublished PhD thesis, Humboldt University Berlin 2015).

[8] See below chapter 5.

[9] See below 3.3.2. for a definition of 'retail holdouts'.

[10] In the US, the so-called 'champerty doctrine' prohibited the purchase of a credit instrument with the sole intent of suing the debtor and thereby extract a monetary gain. See for a discussion of this defence below 3.5.4. (discussing the *CIBC v. Banco Central do Brazil* case).

3.2. A COLLECTIVE ACTION PROBLEM

The holdout creditor problem is essentially described as a problem of lacking collective action among different creditors and different groups of creditors. Collective action problems arise when rational individual action produced suboptimal outcomes at a group level.[11] In economic and political science, the term 'collective action problem' generally describes a situation in which 'rationally acting self-interested individuals generate an outcome damaging their interests as a group'.[12] It has become an inherent feature of both corporate[13] and sovereign[14] debt markets.

As Roubini and Setser[15] remark, '[e]very individual creditor would be better off if it got paid in full while other creditors bore the burden of the restructuring.' Thus, '[a] collective action problem arises when single creditors hold out and wait for other participants "buying them out" by reducing their own claims and thereby restoring the debtor's capacity to pay'.[16] Consequently, '[holdouts] plague the readjustment of debt claims, to the detriment of the creditors as well as the debtor'.[17] Bratton contends that the incentive to hold out arises from the fact that a debt restructuring 'makes the bondholders better off as a group'.[18] This, he asserts, may encourage opportunistic bondholders to 'withhold their essential vote in hope of

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[11] Mancur Olson, *The Logic Of Collective Action: Public Goods And The Theory Of Groups* (Cambridge: Harvard University Press, 1965).

[12] Compare Lisa Brahms, 'Legitimacy of Global Governance of Sovereign Default: The Role of International Investment Agreements' (2013) Working Papers by the Center for International Political Economy No 16, 2 <http://www.polsoz.fu-berlin.de/polwiss/forschung/oekonomie/ipoe/index.html> accessed 15 June 2017.

[13] See Eric Posner and Glen Weyl, 'A Solution to the Collective Action Problem in Corporate Reorganization' (2013) University of Chicago Coase-Sandor Institute for Law & Economics Research Paper No 653 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2321904> accessed 28 September 2017 (arguing that even in the corporate context collective action problems pose serious obstacles to equitable outcomes of debt restructuring operations under Chapter 11 of the US Bankruptcy Code).

[14] Christopher Wheeler and Amir Attaran, 'Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation' (2003) 39 Stanford Journal of International Law 253, 253 (analysing the policy solution to resolve collective action problem in the sovereign lending context); Anne Krueger, *A New Approach to Sovereign Debt Restructuring* (Washington, D.C.: IMF, 2002) 2 (suggesting the implementation of a – statutory – Sovereign Debt Restructuring Mechanism to better coordinate creditors during restructuring operations); Steven Schwarcz, 'Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach' (2000) 85 Cornell Law Review 956 (proposing a comprehensive bankruptcy regime for States as a panacea to collective action issues).

[15] Nouriel Roubini and Brad Setser, *Bailouts or Bail-Ins? Responding to Financial Crises in Emerging Economies* (Washington D.C.: Peterson Institute for International Economics, 2004) 292.

[16] Steven Schwarcz, 'Idiot's Guide' to Sovereign Debt Restructuring' (2004) 53 Emory Law Journal 1189-1218.

[17] Jeffrey D. Sachs, 'Conditionality, Debt Relief and Developing Country Debt Crisis in Jeffrey D. Sachs (ed), *Volume 1: The International Financial System: Developing Country Debt and Economic Performance* (Chicago: University of Chicago Press, 1989) 6.

[18] William W. Bratton, 'Pari Passu and A Distressed Sovereign's Rational Choices' (2004) 53 Emory Law Journal 823, 829.

procuring a side payment from the transaction's proponents.'[19] A classic 'free-rider' problem emerges.

In 2002, when IMF staff proposed the introduction of a statutory Sovereign Debt Restructuring Mechanism (SDRM), the key rationale was to alleviate collective action problems. As the IMF SDRM draft treaty notes,

> '[…] difficulty in securing collective action is only one of a number of factors that have made sovereigns extremely reluctant to restructure their debt' and '[e]ven if mechanisms for debt restructuring are improved, concerns about economic dislocation, political upheaval and long-term loss of access to capital markets will make countries loath to default on their debt service obligations in all but the most extreme circumstances.'[20]

In the context of sovereign lending and borrowing, collective action problems assume an even more pivotal role than within the four corners of a domestic legal framework.[21] Domestic bankruptcy laws typically feature various mechanisms to ensure the *pari passu* treatment of all (unsecured) creditors.[22] However, even when the SDRM was discussed at the highest of international economic policymaking, few experts had anticipated that the Argentine debt saga would end with a victory of vulture holdouts.[23] Even fewer would have guessed that Greece, a member of the world's most prosperous currency union, would undergo the largest debt workout in history in 2012 and be plagued by vulture strategies.

Historical evidence suggests that ensuring collective creditor action before and after sovereign default is paramount to both avoiding deadweight losses for the debtor and ensuring intercreditor equity.[24] As shown above[25] and further below[26], the complex legal instruments many sovereigns use in order to reduce borrowing costs mean that collective action problems can arise on several levels: (i) with respect to the restructuring of individual

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[19] ibid.

[20] IMF (n 6) 2 (further noting that 'it is very unlikely that alleviating the collective action problem somewhat would significantly weaken the credit culture or create moral hazard').

[21] Lee Buchheit and Mitu Gulati, 'Sovereign Bonds and the Collective Will' (2002) 53 Emory Law Journal 1324, 1340 (analysing the history of collective action issues in both corporate and sovereign bonds).

[22] See, eg, for an analysis of domestic bankruptcy procedures, Philipp Wood, *The Law and Practice of International Finance* (London: Sweet & Maxwell, 2008).

[23] *Argentina v NML Capital Limited*, Appeal judgment, Docket No 12-842, 573 US ___ (2014), ILDC 2201 (US 2014), 134 S Ct 2250 (2014), 189 L Ed 2d 234 (2014), 16th June 2014, United States; Supreme Court [US].

[24] Compare Ousmène Jaques Mandeng, 'Intercreditor Distribution in Sovereign Debt Restructuring' (2004) IMF Working Paper, WP/04/183, 18 <https://www.imf.org/external/pubs/ft/wp/2004/wp04183.pdf> accessed 19 October 2017 (noting that 'sovereign debt restructuring does not rely on a common basis for comparing individual creditor action and proposing a code of conduct for consenting creditors to strengthen intercreditor group collective action').

[25] See above 1.3. for a review of the shift from loan to bond financing in the course of the 1980s and 1990s.

[26] See below chapters 4 and 5.

bonds; (ii) when restructuring other instruments than bonds; and (iii) with respect to the restructuring of the aggregate of outstanding debt instruments.[27] To put it in Buchheit's words: '[a]n issuer with a diverse debt stock (bonds, loans, trade credits, etc.) cannot in practice attempt to negotiate with each group [of creditors].'[28]

In the context of bond financing thus, in order to discourage individual creditors from extracting preferential treatment in the event of default, individual creditor rights ought to be subordinated.[29] While this may curtail the rights of individual creditors, it is often the only way to fend off holdout investors. The equivalent to majority voting statues in domestic bankruptcy laws are CACs, which will be subject to closer scrutiny in chapter 6.

3.3. TYPES OF HOLDOUT CREDITORS

Many scholarly contributions tend to subsume all types of uncooperative sovereign lenders under the term 'holdout' investor. This can diffuse the debate and complicate the policy response to this phenomenon.

We contend that motives, sophistication, and legal status differ markedly across different classes of holdouts. While distressed-debt funds, often based in tax havens, have gained prominence and been publicly shunned for their profit-seeking strategies, the role of small retail investors in bond restructurings has often been overlooked.[30] In addition, even official sector creditors may (involuntarily) act as holdouts. Examples include sovereign creditors that aim to attain certain geopolitical objectives or international financial institutions that are required to hold out due to their legal framework.

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[27] Nouriel Roubini and Brad Setser, *Bailouts or Bail-Ins? Responding to Financial Crises in Emerging Economies* (Washington D.C.: Peterson Institute for International Economics, 2004) 292.

[28] EMTA, 'Creditor Engagement Clauses – Pro's and Con's' (2 March 2015) <http://www.emta.org/print.aspx?id=9257> accessed in 2 December 2017.

[29] For some time in the early 20th century, US judges entertained claims of creditors that complained about unequal treatment amongst creditors in the course of sovereign debt restructurings. Compare, eg, *Hackettstown National Bank v DG Yuengling Brewing Company*, 74 F 110 (2d Cir 1896), 12th May 1896, United States; Court of Appeals (2nd Circuit) [2d Cir]. However, recent developments in court practice indicate that judges are more hostile to notions of intercreditor obligations, which in essence alleviates holdout strategies. Compare, eg, *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, Docket No 96-7183, 109 F 3d 850 (2d Cir 1997), 65 USLW 2640, 25th March 1997, United States; Court of Appeals (2nd Circuit) [2d Cir]. William W. Bratton and G. Mitu Gulati, 'Sovereign Debt Reform and the Best Interest of Creditors' (2004) 57(1) Vanderbilt Law Review 1, 70.

[30] See for this critique, eg, Martin Wolf, 'Holdouts give vultures a bad name' *Financial Times* (London, 2 September 2014).

When using a broad definition, any creditor who chooses to reject a restructuring tender from a bankrupt state acts as a holdout.[31] When holdout problems first emerged in the Latin American debt crises of the 1980s, the actors were largely homogenous. In most cases, holdouts were individual banks breaking out of a syndicate with the aim of thwarting collective action to capitalise on the concession made by other members.[32] Over time, holdout investors have transformed into a diverse and geographically dispersed group. Modern day holdouts range from specialised hedge funds to small and unsophisticated retail investors, as, for instance, evidenced by the high number of suits filed by different categories of (vulture and retail) investors against Argentina.[33]

In the past, several authors suggested that vulture holdouts are exclusively responsible for creditor coordination problems.[34] However as, Buchheit and Daly point out:

> 'holdouts may include both the opportunistic and the befuddled, the blade runners and the sheep, those trying cynically to score a windfall by exploiting a sovereign's unique legal vulnerability and those just trying to recover their meagre life savings.'[35]

By distinguishing between 'vulture holdouts', 'retail holdouts', and 'official sector holdouts', this thesis seeks to foster a better understanding of who holds out in a debt restructuring, what motives drive them, and the implications this has.[36] The reason is that the complexity inherent to the Argentine and the Greek debt restructurings warrants a more nuanced view on holdouts than much of the existing literature suggests.[37]

Moreover, distinguishing between different holdout investors is essential from a policy point of view. The extent to which holdout behaviour adversely affects the quick and orderly resolution of sovereign debt crises may vary significantly across different types of holdouts: typically, the success of holdout strategies is positively correlated to the size of the creditor's

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[31] See, eg, Schumacher (n 7); Jonathan I. Blackman and Rahul Mukhi 'The evolution of modern sovereign debt litigation: vultures, alter egos, and other legal fauna' (2010) 73(4) Law and Contemporary Problems 47; Anne Krueger, *A New Approach to Sovereign Debt Restructuring* (Washington, D.C.: IMF, 2002) 15; Jill Fisch and Caroline Gentile, 'Vultures or Vanguards: The Role of Litigation in Sovereign Debt Restructuring' (2004) 53(1) Emory Law Journal 1047, 1088.

[32] See above 1.3.

[33] Schumacher (n 7) 117 (noting that holdout rates were particularly high in securities targeted at retail investors). Holdout litigation in the wake of the Argentine restructuring is covered below in chapter 4.

[34] For an overview, see, eg, Martin Guzman, José Antonio Ocampo and Joseph E. Stiglitz (eds), *Too Little, Too Late: The Quest To Resolve Sovereign Debt Crises* (New York: Columbia University Press, 2016).

[35] See Lee Buchheit and Elena Daly, 'Minimizing Holdout Creditors – Carrots' in Rosa Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford: Oxford University Press, 2014) 5.

[36] Of course, this distinction may still be too simplistic, given the complexity of modern financial markets and their actors.

[37] While in Greece, retail investors initiated the bulk of post-PSI litigation, big US vulture funds strategically stymied the restructuring of distressed English-law bond.

stake in the debt, her legal sophistication, and the perseverance with which they pursue litigation or arbitration.[38] For a sovereign facing default, knowing and anticipating the creditors' intentions can be decisive for the success of a debt workout.

3.3.1. Vulture Holdouts

Vulture holdouts have attained great prominence in recent sovereign debt crises.[39] Vulture funds enter stage when most other (risk-averse) investors have abandoned the debt securities of a financially stricken sovereign. In this decision, they are guided by financial considerations and the quest for arbitrage opportunities arising from the drop in bond prices. To that end, vultures seek to capitalise on the predicaments facing the country whose creditors they have become, speculating that the timing of their investment decision as well as their legal finesse will ultimately cater for formidable returns.

Ex ante predicting which creditor(s) will eventually hold out from a debt restructuring remains close to impossible. It is even more difficult to gauge who will become a 'litigating holdout'. Judging from historical evidence, most investors lack the inclination and the capital resources to aggressively pursue the sovereign through litigation and thereby obtain a preferential treatment.[40] For vulture funds, a high level of creditor participation is actually desirable: while the debtor state may accept the demands of a few holdouts, it will most likely be unable to achieve the intended debt relief if it was to pay a large number of creditors in full.

Focusing on the definition of a 'vulture holdout', we can distinguish between more political notions and legalistic concepts.

The former British Prime Minister, Gordon Brown[41], describes '[v]ulture funds are companies which buy up the debt of poor nations cheaply when it is about to be written off, then sue for the full value of the debt plus interest'. Lord Philipps of the UK Supreme Court

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[38] This is not to say that holdout litigation initiated by investors other than vulture holdouts poses less significant a danger to orderly debt workouts. The analysis of holdout litigation and arbitration in chapters 4 and 5 suggests, however, that many retail investors ultimately agree to a voluntary settlement with the insolvent sovereign, for they are unable to shoulder the legal risks and costs associated with sovereign debt litigation.

[39] For many, see John A. E. Pottow, 'Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign Debt Restructurings' (2013) Law and Economics Working Paper 81, 7 <http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1191&context=law_econ_current> accessed 1 December 2017.

[40] For the definition, see Robert E. Scott, Mitu Gulati and Stephen J. Choi, 'Hidden Holdouts: Contract Arbitrageurs and the Pricing of Collective Rights' (July 2018) NYU Law & Economics Research Paper Series No 8 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3203949> accessed 2 August 2018.

[41] Merion Jones, 'Vulture funds' threat to developing world' *BBC Newsnight* (London, 14 February 2007).

notes that '[vulture funds] feed on the debts of sovereign states that are in acute financial difficulty by purchasing sovereign debt at a discount to face value and then seeking to enforce it'.[42] Megliani describes vulture funds as 'investment funds specialising in the purchase at a discounted market price of corporate or sovereign loans or bonds of debtors in distress.'[43]

Recently, as one of the first domestic legislatures, the Belgium Parliament passed a law that expressly defines 'vulture funds' and restricts their right to debt recovery through court enforcement measures.[44] The new legislation considers a sovereign creditor a 'vulture funds' if its negotiations with the debtor country are characterised by an 'immoral' strategy.[45] The rationale the Belgian Act is to help the judiciary in the determination of circumstances where actions against the debtor amount to 'insane and dangerous speculation'.[46] Thus, it focuses on the 'manifest disproportion' between the amount claimed and the nominal or face value of the debt is the first objective criteria.[47]What is considered 'immoral' is the financial gain it may obtain by buying at a discount during the crisis and being paid the full face value of the bond.

In addition to that, the law provides a set of indicative criteria that may help courts to identify vulture funds:[48]

(i) the debtor was insolvent at the time of the debt buyback;
(ii) the creditor is based in a tax haven;
(iii) the creditor has a track record in litigation;
(iv) the creditor refused to take part in debt restructuring efforts;
(v) the creditor used its position of force to obtain advantages in the proceedings or contracts;
(vi) the impact the reimbursement may have on the debtor's socio-economic situation.

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[42] See *NML Capital Limited v Argentina*, Appeal judgment, [2011] UKSC 31, [2011] 2 AC 495, [2011] 3 WLR 273, ILDC 1805 (UK 2011), (2011) 147 ILR 575, 6th July 2011, United Kingdom; Supreme Court [SC] (Lord Philipps).

[43] Mauro Megliani, *Sovereign Debt: Genesis, Restructuring, Litigation* (Berlin: Springer, 2015) 509 (further noting that '[vulture funds] do not simply refuse to take part in restructuring processes but threaten to endanger the entire outcome of a restructuring plan by seeking judicial remedies to block or attach payment of exchanged credits')

[44] Law on combating against the activities of vulture funds (Belgium [be]).

[45] See for an overview Human Rights Council, 'Draft progress report on the activities of vulture funds and the impact on human rights' (2015) Advisory Committee (15th session) A/HRC/AC/15/CRP.1 <http://www.ohchr.org/Documents/HRBodies/HRCouncil/AdvisoryCom/Session17/A_HRC_33_54.docx> accessed 21 January 2017.

[46] ibid.

[47] Increasingly granular financial markets data should allow for a better assessment as regards the actual discount holdouts paid.

[48] Law on combating against the activities of vulture funds (Belgium [be]).

The Belgian law was controversial. No doubt, it responds scholars have repeatedly called for more determined (legislative) action against vulture litigation.[49] Wozny, for example, remarks that '[t]he Belgian Laws do not resolve the problems posed by vulture funds in a thoughtful way and other countries should be sceptical in adopting a model that follows the Belgian model.'[50] The UN Human Rights Council takes a more positive stance, welcoming the fact that the Belgian law 'implements a key recommendation contained in a [Human Rights Council] resolution.'[51]

Parliaments in other jurisdictions have too adopted laws to contain sovereign debt enforcement by vulture holdouts.[52] The UK Debt Relief (Developing Countries) Act 2010 seeks to tackle the problem of a small minority of creditors taking Highly Indebted Poor Countries (HIPCs) to court and try to get back the full value of their debts, including interest and penalties for arrears.[53] However, in contrast to the Belgian law, whose scope covers all countries, the UK Act only constrains the enforcement of distressed debt issued by HIPCs. Moreover, the UK Debt Relief Act does not expressly define 'vulture holdouts' but rather approaches the issue by curtailing enforcement rights of any creditor to a HIPC country that has received debt relief under the HIPC initiative by the IMF and the World Bank.[54]

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[49] Instead of many others, see Joseph E. Stieglitz and Martin Guzman, 'A Rule of Law for Sovereign Debt' (*Project Syndicate*, 15 June 2015) <https://www.project-syndicate.org/commentary/sovereign-debt-restructuring-by-joseph-e-stiglitz-and-martin-guzman-2015-06?barrier=accessreg> accessed 28 October 2017.

[50] Lucas Wozny, 'National Anti-Vulture Funds Legislation: Belgium's Turn' (2017) 2 Columbia Business Law Review 697, 744.

[51] U.N. Human Rights Office of the High Commissioner, 'Belgian legislation against vulture funds should be preserved – UN rights expert urges' (15 June 2006) Press release <http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=20106&LangID=E> accessed 28 October 2017.

[52] For an overview, see Astrid Iversen, 'Holdout Creditor Litigation' (2015) University of Oslo Faculty of Law Legal Studies Research Paper Series No 2015-13, 35 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2613280> accessed 21 May 2017.

[53] HM Treasury, 'Government acts to halt profiteering on Third World debt within the UK' (*Press release*, 2011) <https://www.gov.uk/government/news/government-acts-to-halt-profiteering-on-third-world-debt-within-the-uk> accessed 22 April 2017. Thus, the UK Act would, for instance, not apply if vulture funds were to sue countries like Argentina and Greece.

[54] Iversen (n 52). For a recent in-depth analysis of the Belgium law against vultures, Also compare Jacques Richelle, 'Belgian 2015 Anti-Vulture Funds Law' (*Strelia Lawyers*, February 2016) <https://www.strelia.com/sites/strelia.com/files/strelia_-_belgian_2015_anti-vulture_funds_law.pdf> accessed 28 October 2017 (concluding that '[e]xcept for State debt held in the Euroclear system, the Anti-Vulture Funds Law will probably have a limited impact since (i) Belgian courts are unlikely to be competent with respect to foreign debt payment issues and (ii) attempts to enforce foreign judgements and attach foreign States' assets located in Belgium should be limited'). Also see Wozny (n 50) (noting that 'national legislatures have increasingly begun to exhibit a preference for adopting national legislative solutions to this issue').

Similar to the Belgian and the UK legislator, the UN Human Rights Council[55] sought to define vulture funds by describing their *modus operandi*. According to the Council, vulture holdouts typically engage in the following strategy:

(i) target sovereign States with distressed economies and frequently with weak capacity for legal defence;
(ii) operate and take advantage of the lack of regulation of the secondary market;
(iii) refuse systematically to participate in orderly and voluntary debt restructuring processes;
(iv) sue the country for reimbursement of the full value of the bond, plus interest and delay penalties;
(v) ‘chase’ the country to enforce the judgment;
(vi) obtain exorbitant profits; and
(vii) operate in jurisdictions where bank secrecy rules apply.

The definitions in domestic statutes and the Human Rights Council seemingly target the types of firms that took Argentina to court over its 2001 default. Figure 5 provides an overview of holdouts with the largest claims. All of the three holdouts with the largest claims against Argentina, NML Capital[56], Gramercy[57], and Aurelius Capital[58], were US-based hedge funds and notorious recidivists.

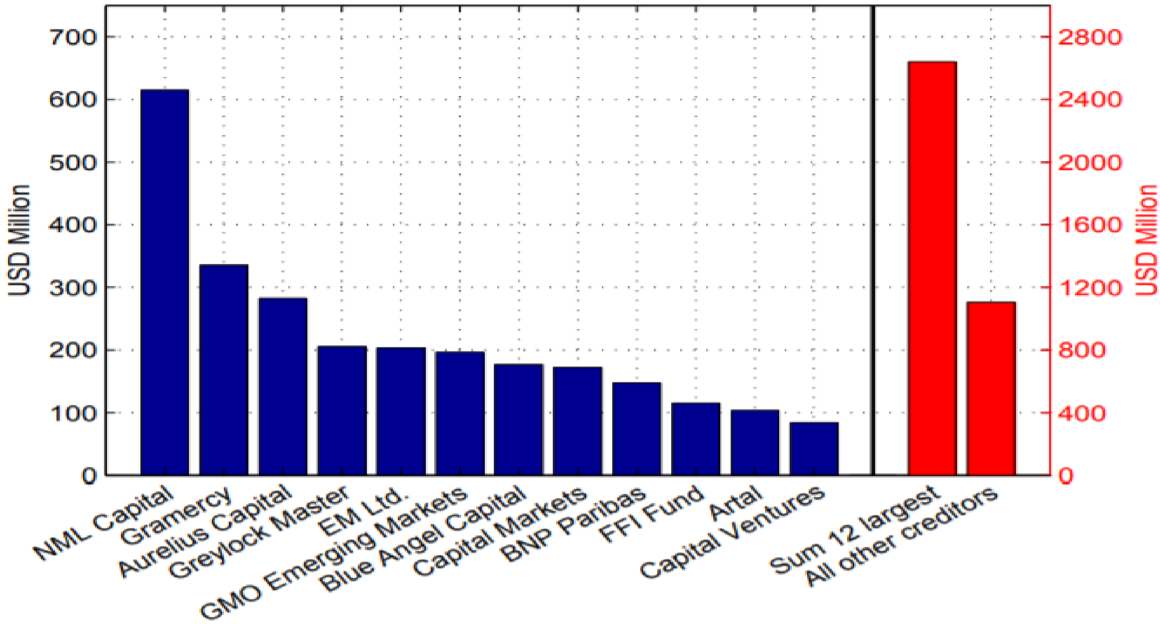
[55] Human Rights Council Advisory Committee, ‘Thirty-Third Session A/HRC/33/54’ (September 2016) <http://www.ohchr.org/EN/HRBodies/HRC/AdvisoryCommittee/Pages/VultureFunds.aspx> accessed 25 January 2018.

[56] Elaine Moore, John Paul Rathbone and Vivianne Rodrigues, ‘Argentina faces fresh default’ *Financial Times* (New York, 16 August 2014).

[57] Robin Wigglesworth, ‘Gramcery reaps Argentina bond windfall’ *Financial Times* (New York, 2 August 2016).

[58] Renae Merle, ‘How one hedge fund made $2 billion from Argentina’s economic collapse’ *Washington Post* (Washington D.C., 29 March 2016).

Figure 5: Plaintiffs with largest claims in post-restructuring litigation against Argentina[59]



The passage of the Belgian law, and to a lesser extent the UK Act, marked important steps to fight vulture litigation. Policy and lawmakers have stopped short of prohibiting all types of sovereign debt litigation. This is sensible. The *ratio legis* behind the anti-holdout laws is to avert distressed-debt speculation and enforcement rather than providing sovereigns with a free ticket to repudiate debt as they wish.

This aspect is crucial – not least since overlooking it may fuel debtor moral hazard concerns that prevent sovereign debt reform altogether.[60] Thus, individual enforcement rights must not be denied entirely in the context of cross-border government finance. Instead – as is the case in domestic bankruptcy proceedings – they ought to be limited to the extent necessary to facilitate orderly and consensus-based debt workouts. To this end, chapter 6 puts forward some additional enhancements to the current framework that policymakers may consider.

This being said, we must move beyond a purely legal perspective to understand the phenomenon of speculative holdout behaviour. Vulture funds operate in a complex and risky environment, which begs the question what motives shape their strategies. And, importantly, how the holdout business has become so lucrative.

[59] Schumacher (n 7) 145.

[60] While many authors contend that sovereign debt enforcement rights prove essential for the functioning of sovereign debt markets, few actually think that vulture litigation is unavoidable.

A financial crisis always presents some opportunities for arbitrage for some market actors. Indeed, those who are willing to take the risk may invest in sovereign debt instruments even during a downturn.

First, as long as the borrower country continues to service its debt the returns (ie coupon payments calculated on the basis of the principal) are typically very high.[61] Given the high yield on distressed-debt instruments, vulture holdouts can reap significant profits in the run-up to a sovereign default.[62]

Second, if a sovereign borrower subsequently defaults, vulture funds have several options to proceed. For instance, a country may recover from its economic tragedy, the bonds will be upgraded, and the vultures make a considerable profit by selling these papers for a premium.[63] Similarly, they could 'gamble for redemption', hoping that official sector creditors, such as central banks or the IMF, would intervene to drive up prices before default materialises.[64] The phenomenon of private sector participants relying on official sector bailouts is referred to as 'creditor moral hazard' in the sovereign debt literature.[65] Empirical evidence bolsters the existence of this phenomenon, suggesting that speculative creditors have benefited greatly from IMF bailouts in the past.[66]

Third, vulture holdouts may hold positions in credit default swaps (CDS). With such derivate financial instruments, vultures can bet on a credit event (notably a sovereign default), to the likelihood of which they themselves may contribute by engaging in a highly uncooperative manner during a sovereign debt workout.[67] Some may even litigate a sovereign, hoping that a

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[61] Just in 2014, the Argentine USD-denominated bonds rallied to a yield of more than 19%, resulting in a substantial increase of Argentina's refinancing costs. See Nicole Hong, 'Argentina's Bond Yields Lure Back Buyers' *The Wall Street Journal* (New York, 19 March 2014).

[62] Goldman Sachs, an investment bank, has been criticised for purchasing almost USD3 billion in Venezuelan debt (more specifically bonds issued by the state-owned oil company) at a moment in time when the country's default probability for the coming months is estimated to stand north of 90% (July 2017). Goldman acquired the bonds for 31 cents on the dollar, reflecting the high level of riskiness markets attach to these instruments. The Economist, 'Goldman Sachs is criticised for buying Venezuelan bonds' *The Economist* (London, 1 June 2017) (noting that protesters gathered outside Goldman's headquarters in New York, lamenting that the investment bank thereby supports a brutal and cash-strapped regime).

[63] Anna Gelpern, 'Sovereign Debt: Now What' (2016) 41(2) Yale Journal of International Law Online 45.

[64] See, eg, Katharina Pistor, 'A Legal Theory of Finance' 41(2) Journal of Comparative Economics 315 (describing how this kind of speculative investment behaviour led to the insolvency of MF Global in 2011).

[65] For the seminal paper, see Andrew Haldane and Jörg Scheibe, 'IMF lending and creditor moral hazard' (2004) Bank of England Working Paper No 216 (2004) <http://www.bankofengland.co.uk/archive/Documents/historicpubs/workingpapers/2004/wp216.pdf> accessed 27 August 2017.

[66] ibid (finding evidence that IMF interventions led to significantly higher returns for some banks during debt crises, fostering a generic form of creditor moral hazard).

[67] Anna Gelpern and Mitu Gulati, 'CDS Zombies' (2012) 13 European Business Organization Law Review 347.

judge cuts the country off from international credit markets and thereby triggers a credit event. According to the Argentine government, the vulture fund Elliott Management (parent company) also engineered the country's default before US courts to profit from CDS, albeit hard evidence is missing to support this claim.[68]

The vulture funds' main objective is to obtain a judgement that would allow execution into sovereign assets or restrain payments made by the sovereign to compliance bondholders. In that respect, vultures strongly benefit from the erosion of the sovereign immunity doctrine, alluded to in chapter 1, which typically allows them to sue (most) countries that issue international sovereign bonds.[69] The highest profit may be achieved if holdouts manage to successfully claim the full face value of the debt instruments in court, or at least pressure the sovereign borrower into a settlement that far exceeds the haircut proposed to cooperative creditors in the course of a debt workout.[70] Vulture holdouts may also threaten the sovereign with the prospect of a (technical) default by applying for injunctive remedies to block (coupon and principal) payments to restructured bondholders.[71]

As the former US Treasury Secretary Henry Paulson remarked a few years ago, while vultures may act in a morally repugnant manner, they have the rule of law on their side.[72] Of course, the fact that the US executive branch has considerable weight to influence what Paulson referred to as 'the rule of law', and has vigorously opposed several international initiatives to curb vulture behaviour in the past, is politely withheld.

3.3.2. Retail Holdouts

The rise of retail holdouts in sovereign debt workouts is a recent phenomenon, as the Greek debt the Argentine debt crises illustrate.[73] The common narrative that vulture funds make up

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[68] Daniel Bases, 'For Argentina holdout fund, a decade's pursuit may pay off' *Reuters* (London, 2 December 2012) <http://www.reuters.com/article/argentina-debt-elliott-idUSL1E8MU9NK20121202> accessed 27 August 2017.

[69] See, eg,

[70] Absent (procedural and substantive) rules for sovereign insolvency on the international or municipal level, the judge's role is limited to ascertaining whether the debtor has violated the contract or not.

[71] See Committee on International Economic Policy and Reform, 'Revisiting Sovereign Bankruptcy' (October 2013) Brookings Institution, 20 <https://www.brookings.edu/wp-content/uploads/2016/06/CIEPR_2013_RevisitingSovereignBankruptcyReport.pdf> accessed 1 July 2018 (holding that recent case law suggests that contracts have proven inadequate to mediate the tensions between the lack of enforcement and the impossibility of discharge in sovereign debt). Also compare below 4.3.3. for the *NML* case, where such injunctive remedy has been granted.

[72] See Paulson (n 2).

[73] Schumacher (n 7).

the majority of plaintiffs in sovereign debt trials is only partly true.[74] As Schumacher[75] shows, the average holdout rate in the course of the Argentine debt restructuring was 27.9% in retail bonds as compared to 17.1% in professional bonds. This suggests that retail investors may even be more inclined than professional creditors to hold out. Indeed, as Buchheit and Daly note, '[u]npersuaded (but not necessarily litigious) and unsophisticated creditors may decline to participate in a sovereign debt workout and find themselves tagged with the epithet 'holdout'.[76]

Retail investors can be referred to as 'investors who invest small amounts of money for herself rather than on behalf of anyone else'.[77] They are the opposite of institutional investors, which invest money for the clients against the payment of a fee. While this definition lacks accuracy, it captures all those litigants who are not specialised distressed-debt investors that engage in litigation (ie vulture holdouts). Therefore, retail investors are 'unspecialised creditors of sovereigns, who (i) are neither institutional investors nor hedge funds and (ii) hold small amounts of sovereign debt.'[78]

Due to the size of their investment, retail holdouts are, in most cases, unable to obstruct sovereign debt restructurings.[79] Nonetheless, with sovereign debt becoming an increasingly attractive investment for private individuals, their participation in a sovereign debt workout has gained importance. Besides the difference in size of holdings, retail investors are typically not represented in creditor committees.[80] Consequently, their bargaining power may be smaller than that of large institutional investors.

Negotiations between the IIF and Greece in the run-up to the debt swap of 2012 were a case in point for the lack of involvement of retail investors in debt restructurings. Indeed, retail investors may be incentivised to hold out because they have not been part of the broader deal agreed between the sovereign issuer and big institutional investors. Comparing the

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[74] See for this narrative, eg, Marcus Miller and Dania Thomas, 'Sovereign Debt Restructuring: The Judge, the Vultures and Creditor Rights' (2007) 30(10) The World Economy 1491.

[75] Schumacher (n 7).

[76] Lee Buchheit and Elena Daly, 'Minimising Holdout Creditors: Carrots in Lastra and Buchheit (n 35) 5.

[77] The Free Financial Dictionary, 'Retail investor' <http://financial-dictionary.thefreedictionary.com/retail+investor> accessed 23 April 2017.

[78] Retail investors often commit significant amounts of their overall savings to government bonds, some in a speculative manner but most to provide for a safe investment that offers steady returns.

[79] As discussed below, the ability to sue a sovereign debtor individually is also dependent on the specific structure of the bond contract. Under most English-law sovereign bonds, for example, trustees represent bondholders in court. See below 6.2.3.

[80] See, eg, Jeromin Zettelmeyer, Christoph Trebesch and Mitu Gulati, 'The Greek Debt Restructuring: An Autopsy' (2013) 28(75) Economic Policy 513.

organisation of plaintiffs in holdout suits against Argentina and Greece, it appears that bondholders' representation in the TFA allowed Argentine retail investors to leverage their bargaining power vis-à-vis the government as well as file mass claims before the ICSID.[81] The establishment of an Argentine Bond Restructuring Agency (ABRA) pursued similar objectives: they enabled small bondholders to surrender their bonds to ABRA in exchange for certificates issued by ABRA.[82] ABRA would then represent the participating bondholders in the restructuring negotiations, although bondholders also retained the option to reverse the exchange at any time prior to the conclusion of a restructuring agreement.[83]

Argentina ultimately decided to settle with nearly 50.000 Italian retail holdouts in April 2016, paying them 150% of the original principal amount of the defaulted bonds.[84] Conversely, in the context of the Greek PSI, retail holdouts largely filed individual claims before domestic (foreign) courts and the ICSID.[85] Notably, more than 6.000 bondholders collectively filed suit against Greece in domestic courts – a case that ended up before the ECtHR.[86] However, while the vulture funds that targeted English law bonds were paid in full, years of litigation left retail holdouts empty-handed.

In this context, the dichotomy between retail holdouts and vulture holdouts became obvious: while vulture holdouts strategically targeted those Greek debt securities that bestowed upon them a higher degree of protection, retail holdouts were stuck with Greek law bonds with weak legal remedies against the sovereign. The latter failed to anticipate the sell-off of Greek bonds, did not want to realise their losses, or underestimated the financial risks associated with holding on to the bonds.

Another reason why retail investors can end up in a holdout position is the lack of regulatory incentives to participate in voluntary debt workouts and the absence of a special relationship with the issuing government that could encourage the conclusion of a mutually acceptable

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[81] See below 4.9. (discussing the *Abaclat* mass claims arbitration against Argentina by Italian bondholders represented through the Task Force Argentina).

[82] See IMF, 'The Restructuring of Sovereign Debt – Assessing the Benefits, Risks, and Feasibility of Aggregating Claims' (September 2003) IMF Legal Department, 24 <https://www.imf.org/external/np/pdr/sdrm/2003/090303.pdf> accessed on 2 July 2018.

[83] ibid 24-25.

[84] See Task Force Argentina (TFA), 'Task Force Argentina Announces Final Argentina Settlement for Italian Bondholders' (*Press Release*, 22 April 2016) <http://www.tfargentina.it/download/TFA%20Comunicato%2022%20aprile%202016_eng.pdf> accessed 2 June 2018.

[85] See below 5.4.

[86] See below 5.5.3.

deal. Consequently, retail holdouts may be more inclined to engage in risky litigation against the sovereign borrower than institutional investors, such as banks or insurance companies.[87] In addition, as recent debt crises illustrate, many retail investors are overly confident in the abilities and benevolence of their financial advisors when buying a stake in the sovereign debt of a (foreign) state. Indeed, misinformation about credit risks and weak consumer protection have meant that retail investors often spend a significant amount of their wealth on ostensibly safe sovereign debt instruments only to realise that states may also run out of money.[88]

While further empirical evidence would be valuable, the Argentine and the Greek crises have confirmed that retail investors can be drawn into a sovereign debt restructuring because of many reasons. Rarely, however, these reasons are identical to the ones encouraging vulture holdouts to keep their firm grip on a sovereign bond.

3.3.3. Official Sector Holdouts

Official sector holdout creditors have so far not received much attention in the pertinent literature. This may be due to a number of reasons. First, the emergence of official sector holdouts is a recent phenomenon. Second, the distinction between official sector and private sector creditors, respectively, is not clear-cut. Traditionally, the official sector has been understood to comprise sovereign lenders, the IMF, and the World Bank.[89] However, no legal instrument or authority exists that defines either type of creditor or delineates the boundaries between them. A bilateral lender may have ample political or economic motives to disguise its holdings of another state's debt. Modern capital markets allow a sovereign to hold debt on its own account, through a state-owned entity or a central bank, or in multiple other ways.

For the coordination of creditors in a crisis, this can yield sub-optimal results. While there are bodies, such as the Paris Club, that limit individual state's ability to engage in holdout strategies, they rely on methods of moral suasion rather than legal coercion. In addition, the Paris Club's membership is restricted to a number of advanced countries rather than also

[87] For empirical evidence Schumacher (n 7) 119.

[88] See, eg, Luigi Oliveri, 'Italian Banks Unload Argentine Bonds in Italy; Investigation Blocked' (*Executive Intelligence Review*, 11 March 2005) <http://larouchepub.com/other/interviews/2005/3210luigi_olivieri.html> accessed 31 July 2017.

[89] See IMF (n 6). By contrast, the private sector typically comprises financial institutions, non-financials as well as households. Institutional private creditors are typically represented by the IIF, which negotiates on behalf of the private sector community with the distressed sovereign and other stakeholders.

including international financial institutions.[90] Big sovereign lenders like China have shown no intention to join the Paris Club. As the two cases of official sector holdout creditors described in the next sections illustrate, the increasing heterogeneity of sovereign creditors is yet to be fully digested by the international policymaking community.[91]

3.3.3.1. The Ukraine Case and Russia's Holdout Strategy

In the wake of the Ukraine debt crisis, a controversy emerged with regard to the nature of a Ukraine bond fully owned by Russia.[92] While the IMF declared that the USD3 billion Eurobond issued by Ukraine[93] was an official claim for the purpose of its LIA policy for official arrears, Ukraine kept insisting that the claim was commercial in nature.[94] Russia remained obnoxious and refused to participate in the debt swap of bonds held by private investors in 2015, attracting much criticism from both Ukraine as well as the international community.[95] Russia became the first official sector holdout in modern sovereign finance. As Gelpern remarks, 'Ukraine's debt to Russia showed how remnants of the old modular regime [of sovereign debt restructuring] could be gamed by free-riders, prominently including official creditors.'[96]

Leaving aside the military and political struggle between Ukraine and Russia, the key policy problem was that Ukraine could only receive emergency funding from the IMF if it had no arrears on debt owed to foreign governments.[97] With Russia blocking the debt swap, the IMF needed to amend its rules on the non-toleration of (official sector) arrears – arguably a highly political *ad hoc* decision to counter Russia's uncooperative behaviour. Ukraine remained in default to Russia. Nonetheless, seemingly unimpressed by this move, Russia filed a lawsuit

[90] See above 2.5.2. for a short summary of the Paris Club, its objectives and functions. Notably, one of the biggest bilateral sovereign lenders, China, is not a member of the Paris Club and thus not bound by its principles.

[91] Indeed, while, as chapter 6 explains, policymakers have devised certain tools to deter private holdout problems, the rise official sector holdouts will require new and creative approaches. Whether they are politically (more) feasible can however be doubted.

[92] See, eg, Joseph Cotterill, 'Is Ukraine's Russian bond 'official' or not?' *FT Alphaville* (London, 26 March 2015) <http://ftalphaville.ft.com/2015/03/26/2125037/is-ukraines-russian-bond-official-debt-or-not/> accessed 17 September 2017. For an academic analysis of Russia's holdout strategy, see Yu Hancen, 'Official Bondholder: A New Holdout creature in Sovereign Debt Restructuring after Vulture Funds' (2017) 16 Washington University Global Studies Law Review 535.

[93] The entire bond was purchased by Russia. The debt instrument was an ordinary tradeable obligation governed by English law, albeit paying less than half the market interest rate at the time.

[94] See Anna Gelpern, 'Russia's Contract Arbitrage' (2014) 9(3) Capital Markets Law Journal 308.

[95] See, eg, Natalia Zinets 'Russia is lone holdout from Ukraine debt swap deal' *Reuters* (London 15 October 2015).

[96] Gelpern (n 94).

[97] IMF, 'Status of Ukraine's Eurobond held by the Russian Federation' (11 December 2015) <http://www.imf.org/external/pubs/ft/scr/2015/cr15344.pdf> accessed 1 September 2017.

against Ukraine before English courts, *inter alia* claiming that Ukraine did not negotiate in good faith.[98] Consequently, akin to the situation in Argentina, (foreign) courts have become the prime forum to mediate between parties in an inherently political and diplomatic dispute.

In 2017, the UK High Court rejected a full trial, arguing that Ukraine has 'no justiciable defence'.[99] More specifically, the presiding Justice Blair found that Russia held a valid contractual claim against which Ukraine could not invoke defences pertaining to alleged violations of international law by the Russian government. The High Court considered them non-justiciable and to fall outside the public policy exception under English law. However, in September 2018, in a rather surprising twist, the Court of Appeal for England and Wales reversed the High Court's judgement, noting that the matters pleaded by Ukraine should be subject to further exploration, adding that English courts are 'well capable of construing treaty obligations and general obligations under international law'.[100]

While the High Court's judgement implicitly endorsed Russia's holdout strategy, the Court of Appeals was seemingly determined to stall Russia's tactics, much to the surprise of many observers. Weidemaier, for instance, notes that '[i]t would be understandable for judges and arbitrators to hesitate before weighing in on such a politically charged dispute, but Russia's insistence on acting like a private creditor leaves little choice.'[101] Similarly, Gelpern argues that 'these are precisely the sorts of questions that judges sitting in commercial cases prefer to avoid by enforcing contracts as written, questions that are especially hard to answer in a regime that lacks a shared normative core'.[102]

It is hard to anticipate the outcome of the trial before the UK Supreme Court. In any case, the recent developments have shown that English judges might not shy away from entering legally and politically treacherous waters when it comes to sovereign debt litigation. Moreover, it serves as yet another piece of evidence that the *ad hoc* system for sovereign debt

[98] Gelpern (n 94) 309-312.

[99] *Law Debenture Trust Corporation plc v Ukraine*, [2017] EWHC 655 (Comm), [2017] QB 1249, [2017] 3 WLR 667, [2017] WLR(D) 226, 29th March 2017, United Kingdom; England and Wales; High Court [EWHC]; Queen's Bench Division [QBD]; Commercial Court.

[100] See Jane Croft and Roman Olearchyk, 'Ukraine-Russia bond dispute set for full English trail' *Financial Times* (London, 14 September 2018). For a detailed discussion of the recent decision, see Mark Weidemaier, 'Ukraine Wins Appeal in Russian Bond Case' (*Credit Slips*, 14 September 2018) <http://www.creditslips.org/creditslips/2018/09/ukraine-wins-appeal-in-russian-bond-case.html#more> accessed 28 September 2018.

[101] Mark Weidemaier, 'Contract Law and Ukraine's USD3 billion debt to Russia' (2016) 11(2) Capital Markets Law Journal 244, 250.

[102] Gelpern (n 94).

restructuring is slowly but surely falling apart. Indeed, neither the IMF nor the Paris Club had a convincing solution to the legal and political conundrums created by Russia's holdout strategy – whether the English courts will fare better, is to be seen.

3.3.3.2. The ECB's Holdout Conundrum in Euro Area Sovereign Debt Crises[103]

This section briefly describes the legal and policy predicament facing the ECB, the central bank of 19 EU Member States, when it comes to a restructuring of euro area sovereign bonds. The ECB's case provides a compelling example how official sector creditors may reluctantly become holdout creditors themselves. Of course, due to the specific institutional and legal framework the ECB relies on, similar problems are unlikely to engulf other big central banks, such as the Bank of England or the Federal Reserve Bank of the US.

As of mid-2018, the ECB holds more than a quarter of all euro area sovereign bonds. Following the introduction of the Public Sector Purchase Programme (PSPP) in March 2015, the Eurosystem has become the single largest creditor of euro area governments.[104] The PSPP is the ECB's version of Quantitative Easing (QE); a monetary policy strategy that aims at fending off deflationary dynamics by engaging in open market purchases of sovereign debt securities.[105] For more than three years, the ECB, and more specifically the Eurosystem (which comprises the ECB plus 19 national central banks), has bought government bonds at a monthly pace of EUR60-80 billion and now holds EUR2.5 trillion in sovereign assets.

When buying sovereign bonds on the secondary markets, the ECB inevitably incurs the default risk of euro area governments. However, legal uncertainties exist what would actually happen if a country were to restructure its public debts. The main difficulty from an ECB perspective arises from the fact that Article 123 TFEU not only prohibits the ECB from directly financing euro area governments but also from taking actions that have an effect

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[103] This section is (partly) based on the following paper: Sebastian Grund and Filip Grle, 'The European Central Bank's Public Sector Purchase Programme (PSPP), the Prohibition of Monetary Financing and Sovereign Debt Restructuring Scenarios' (2016) 41(6) European Law Review 781.

[104] Ann-Katrin Petersen, 'QE Monitor' (2 September 2016) Allianz Global Investors <https://www.allianzglobalinvestors.de/MDBWS/doc/QE+Monitor_September+2015_e_extended+version.pdf?4bc8334c2b03239835b06160629ef69e41f64da6> accessed 12 September 2017.

[105] The underpinning rationale is that the demand created by the central bank in secondary sovereign bond markets results in an easing of credit conditions in the financial system more broadly, thereby encouraging more investment in the real economy. For an overview of how 'Quantitative Easing' ('QE') works in the euro area, see, eg, Ralph S.J. Koijen, François Koulischer, Benoît Nguyen and Motohiro Yogo, 'Inspecting the Mechanism of Quantitative Easing in the Euro Area' (2018) Banque de France Working Paper WP 601 <https://publications.banque-france.fr/sites/default/files/medias/documents/wp601.pdf> accessed 3 June 2018.

equivalent to that of a direct purchase of government bonds.[106] The question thus arose whether the ECB, by exposing itself to the risk of a debt cut on sovereign bonds acquired in the context of an asset purchase programme, engages in monetary financing of euro area governments.

On the one hand, it may be argued that debt relief granted by the ECB would amount to a transfer of funds from the central bank, of which all EU countries are shareholders, to a specific government – hence a transfer that the Treaties sought to prohibit. The German BVerfG reached the conclusion that the Bundesbank's participation in ECB asset purchase programmes may violate the German *Grundgesetz*.[107] On the other hand, in the context of the ECB's Outright Monetary Transactions (OMT) programme, the CJEU answered the question whether direct purchases in secondary sovereign debt market may violate the Treaties, to the negative. While the OMT has never been activated, it too exposes the ECB to the risk of a loss and, to that end, very much resembles the PSPP.[108]

Specifically with regard to OMT, the CJEU held that '[the risk of a debt cut] is inherent in a purchase of bonds on the secondary markets, an operation which was authorised by the authors of the Treaties.'[109] While the CJEU[110] – in contrast to the BVerfG[111] – acknowledged that the ECB has to accept certain risks when conducting its non-standard monetary policy, it has so far not weighed in on the question whether an *actual* debt cut would amount to monetary financing and thus a violation of Article 123 TFEU.

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[106] See the CJEU's ruling in *Gauweiler and ors v Deutscher Bundestag*, Judgment, reference for a preliminary ruling, Case C-62/14, ECLI:EU:C:2015:400, 16th June 2015, Court of Justice of the European Union [CJEU]; European Court of Justice [ECJ]; European Court of Justice (Grand Chamber).

[107] See *OMT-Decision*, Gauweiler, German Bundestag, represented by its President Prof Dr Norbert Lammert, MP (joining) and Federal Government, represented by the Federal Chancellor Dr Angela Merkel (joining), Constitutional complaint, reference for a preliminary ruling, 2 BvR 2728/13, 2 BvR 2729/13, 2 BvR 2730/13, 2 BvR 2731/13, 2 BvE 13/13, BVerfGE 134, 366, ILDC 2170 (DE 2014), NJW 2014, 907, EuZW 2014, 192, 14th January 2014, Germany; Constitutional Court [BVerfG].

[108] ibid [125-126]. The ECJ held that '[i]t should also be borne in mind that a central bank, such as the ECB, is obliged to take decisions which, like open market operations, inevitably expose it to a risk of losses and that Article 33 of the Protocol on the ESCB and the ECB duly provides for the way in which the losses of the ECB must be allocated, without specifically delimiting the risks which the Bank may take in order to achieve the objectives of monetary policy.'

[109] ibid [126].

[110] *Gauweiler and ors v Deutscher Bundestag*, Judgment, reference for a preliminary ruling, Case C-62/14, ECLI:EU:C:2015:400, 16th June 2015, Court of Justice of the European Union [CJEU]; CJEU [ECJ]; CJEU (Grand Chamber).

[111] *OMT-Decision*, Gauweiler, German Bundestag, represented by its President Prof Dr Norbert Lammert, MP (joining) and Federal Government, represented by the Federal Chancellor Dr Angela Merkel (joining), Constitutional complaint, reference for a preliminary ruling, 2 BvR 2728/13, 2 BvR 2729/13, 2 BvR 2730/13, 2 BvR 2731/13, 2 BvE 13/13, BVerfGE 134, 366, ILDC 2170 (DE 2014), NJW 2014, 907, EuZW 2014, 192, 14th January 2014, Germany; Constitutional Court [BVerfG].

Due to these highly divergent views on the interpretation of Art 123 TFEU, the ECB also sought to avoid any losses on its sovereign bond holdings[112] during the Greek debt restructuring by striking an exclusive deal with the government that excluded it from the haircut.[113] However, other than the Securities Markets Programme (SMP)[114], under which the ECB had acquired Greek and other government bonds, the ECB explicitly guaranteed equal creditor treatment in the conditions of the PSPP and the OMT.[115] This implies that the ECB will not grant itself preferred creditor status but accept the equal treatment of all creditors (*pari passu*). In other words, the ECB has pledged not to repeat the carve-out of bonds in a future PSI, thereby assuring markets that the official and the private sector would share the burden of a debt reduction.

Therefore, if a euro area government imposes a haircut on the claims of creditors, the ECB and NCBs may suffer losses on their respective balance sheets. Even if a government decides not to implement a debt cut unilaterally[116], private creditors might vote in favour of a debt restructuring as part of the CAC voting procedure. This would mean that the ECB is 'crammed-down' or overruled and could therefore make losses on its bond holdings – a situation it tried to avoid by all available means in the context of the Greek PSI.

Moreover, the ECB has stated in its written observations in the *Gauweiler* case that 'in the context of a restructuring subject to CACs, it will always vote against a full or partial waiver of its claims'.[117] This statement, together with the *pari passu* pledge the bank communicated

[112] The conditions of the SMP did not specify whether or not the ECB would accept *pari passu* treatment.

[113] In *Accorinti*, the EGC approved of this deal, noting that the SMP, the programme under which the ECB had acquired Greek bonds, did not promise equal creditor treatment, *Accorinti v European Central Bank*, Judgement, Case T-79/13, [2015] Court of Justice of the European Union [CJEU]; GC of the European Union [EGC].

[114] ECB, 'Decision of the European Central Bank of 14 May 2010 establishing a securities markets programme (ECB/2010/5), OJ L 124/8 <https://www.ecb.europa.eu/ecb/legal/pdf/l_12420100520en00080009.pdf> accessed 2 June 2017. The SMP was the ECB's first asset purchase programme, which had the stated objective of alleviating pressure on sovereign bonds during the euro area crisis.

[115] See Recital 8 of the PSPP Decision, stipulating that 'With a view to ensuring the effectiveness of the PSPP, the Eurosystem hereby clarifies that it accepts the same (*pari passu*) treatment as private investors as regards the marketable debt securities that the Eurosystem may purchase under the PSPP, in accordance with the terms of such instruments.' ECB, 'Decision of the ECB on a secondary markets public sector asset purchase programme' (ECB/2015/10) <https://www.ecb.europa.eu/ecb/legal/pdf/en_dec_ecb_2015_10_f_.sign.pdf> accessed 1 September 2017.

[116] There is discussion in the academic literature as to whether the Greek government forced losses upon private creditors by retrofitting CACs. A recent decision by the ECtHR approved the Greek government's measures, holding that 'the inclusion of CACs was a measure which was appropriate and necessary for the purpose of reducing the Greek debt…'; see Menelaos Markakis, 'ECtHR Rules on Greek Debt Restructuring' (*Oxford Human Rights Hub*, 30 July 2016 <http://ohrh.law.ox.ac.uk/european-court-of-human-rights-rules-on-greek-debt-restructuring/> accessed 1 September 2017.

[117] See *Gauweiler and ors v Deutscher Bundestag*, Opinion of Advocate General, reference for a preliminary ruling, Case C-62/14, ECLI:EU:C:2015:7, 14th January 2015, Court of Justice of the European Union [CJEU];

to the markets, underscore that the ECB will not actively bring about a debt restructuring but stands ready to take losses if need be. This position, which has since not been revoked, clearly deviates from the one in 2012, when the ECB and the Greek government agreed that ECB would not be subject to the haircut all private investors suffered.[118]

From all of this it follows that the ECB may become an involuntary holdout investor. Presume that a majority of 95% of non-central bank investors would accept a haircut and 5% would not. Further, assume that the Eurosystem holds approximately 25% of outstanding bonds, which reflects the level of holdings in early 2018. Since the ECB has declared not to vote in favour of a debt restructuring, it means that its holdings would have to be subtracted from the group of creditors willing to accept a restructuring deal. Suddenly, the percentage of investors who would reject the restructuring deal increases to 30%, which falls just short of the blocking minority under the Euro CAC.[119] To avoid a situation in which the Eurosystem central banks block a debt workout, the ECB's Governing Council decided to introduce an issuer limit of 33%, which means that the ECB may not buy more than 33% of outstanding securities of a single euro area Member State.

However, given the ECB's public commitment not to actively contribute to a debt restructuring, if only 3% of the 95% of creditors willing to restructure their bonds would change their mind, the bond modification proposed by the issuer would fail. Consequently, the bargaining power of minority holdouts, who seek to obstruct a debt deal, is suddenly much stronger. If, for instance, a single or a number of vulture holdouts were to buy a stake between 3 and 5% of a euro area Member State's outstanding bonds, the functioning of CACs would be seriously compromised. Since the ECB would be legally obliged to vote against the restructuring, or at least abstain, its holdings would be added to the share the vulture holdouts possess.

As discussed below, one way out of this conundrum would be to *a priori* disenfranchise the ECB in a CAC vote. Therefore, the ECB would not be allowed to vote, and would therefore not face the risk of breaching Article 123 TFEU. Disenfranchising the ECB would also be in line with the ECB's pledge to accept equal treatment with the private sector. The outcome of

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CJEU [ECJ]; CJEU (Grand Chamber) [235] (further stating that 'the ECB will not actively contribute to bringing about a restructuring but will seek to recover in full the claim securitised on the bond'].

[118] See again below chapter 5 for an overview of sovereign debt litigation after Greece.

[119] For an overview of the Euro CAC and its function, see below 6.3.2.3.

a negotiated procedure, on which bondholders would cast a vote, would then become binding on and would have to be respected by the ECB. Thus, it could no longer block a debt restructuring deal. The legality of disenfranchising the ECB also seems to comply with *Gauweiler,* which held that the ECB might take losses as part of its open market transactions.[120]

3.4. DIFFERENT PERSPECTIVES ON HOLDOUT BEHAVIOUR

This section seeks to describe and analyse the pros and cons of holdout behaviour in sovereign debt restructurings. While we essentially argue that the holdout creditor problem has impeded the quick, fair, and sustainable resolution of sovereign debt crises, it ought not to be ignored that, in the context of both corporate and sovereign finance, creditor enforcement rights are considered vital to foster legal certainty in debt markets and ensure their proper functioning.[121]

As research in the field of corporate finance suggests, strong creditor enforcement rights are typically associated with a lower cost of capital for the respective issuer.[122] Consequently, while holdout investors have gained a bad reputation, we also need to examine the views of those who deem strong creditor enforcement rights essential for the efficient functioning of sovereign debt markets.[123]

The section starts with discussing the disruptive effects of holdout litigation and arbitration before turning to a brief analysis of the potential benefits offered by holdout investors. Rather than drawing normative conclusions, the purpose of this section is to shed light on the debate surrounding the role holdouts play in international debt markets, which is largely of interdisciplinary nature. To provide a comprehensive understanding of different perspectives on the holdout creditor problem, we cannot ignore the arguments in favour of bolstering

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[120] See below 6.3.5.1. for some recommendations how to enhance the Euro CAC.

[121] See above 1.2.3. for a discussion of enforcement rights in the context of sovereign finance.

[122] For a recent study on the importance of creditor enforcement rights in reducing the cost of capital in the context of corporate finance, see Attaullah Shaha, Hamid Ali Shah, Jason M. Smith and Giuseppe Labianca, 'Judicial efficiency and capital structure: An international study' (2017) 44 Journal of Corporate Finance 255 (finding that 'efficient judicial systems are associated with lower corporate leverage ratios' and that 'stronger creditor rights alone do not explain corporate leverage without taking into account efficient enforcement of these rights').

[123] Chapter 1 already touches upon the issue, discussing the interplay of weak enforcement rights in the remit of sovereign debt finance and the absence of a bankruptcy framework for states. See, in particular, above 1.2.3.

creditors, and thus holdout rights. Indeed, drawing sound policy conclusions warrants a comprehensive and unbiased assessment of all arguments.

3.4.1. Holdouts as Disruptors and Arbitrageurs?

Complex and arduous procedures for enforcement deter most sovereign investors from seriously considering litigation and arbitration an alternative to restructuring. Most plaintiffs in sovereign debt trials belong to a marginal and highly sophisticated group of hedge funds.[124] With the emergence of a secondary market for sovereign securities[125], these investors have spotted a magnificent opportunity for arbitrage.[126]

They form the spearhead of an industry that speculates with distressed government debt.[127] In contrast to most other market participants, strategic holdouts (or vultures) aim to achieve the highest immediate return. Prior to suing the sovereign debtor, they purchase debt at very steep discounts. This strategy – if successful – provides for astronomic returns on the initial investment.[128] Of course, distressed debt markets are common corollaries of modern capital markets; indeed, the market for corporate distressed debt has grown rapidly in the past decades, peaking at approximately USD3.6 trillion during the GFC.[129]

If one creditor, however, makes an extraordinarily high return on his or her investment, someone must bear equally high losses. On the one hand, the sovereign may need to carry these losses when it fails to reach a mutually acceptable restructuring solution. On the other, the fellow creditors, who must share a smaller amount among each other, will lose out as a collective. This is why domestic insolvency and reorganisation laws mandate the equal treatment of all creditors, establish clear priorities among creditors, and halt legal action against the debtor until all assets are distributed in accordance with the prescribed procedure. The international financial system, however, lacks such process, thus providing ample

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[124] Even in the early days of sovereign debt litigation, it required specific skills or a specific business model in order to be victorious against the debtor. Hence, holding out was not considered attractive to mainstream creditors. See Bi et al (n 39).

[125] See above 1.2.2.

[126] Blackman and Mukhi (n 31) 49.

[127] For an in-depth analysis of these (interconnected) hedge-funds by a journalist compare Norbert Kuls, 'Der Verweigerer' *Frankfurt* (Frankfurter Allgemeine Zeitung, 30 July 2014).

[128] NML invested only USD48 million to acquire Argentine bonds with a full face value of USD832 million. This means that even a settlement at USD400 million (haircut of more than 50% on the original bond value) and litigation costs of USD100 million the fund would have achieved a return of 425%. See Kuls (n 127).

[129] See Edward I. Altman and Robert Benhenni, 'The Anatomy of Distressed Debt Markets' (11 October 2018) unpublished manuscript <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3251580> accessed 15 October 2018.

opportunity for arbitrage for those willing to and capable of joining the 'rush to the courthouse'.

In the case of holdout investors, the arbitrage effect originates from the difference between the price paid for the bond in the secondary market and the full face value of the security.[130] The market's assessment of sovereign default risk usually determines the price of a security on the secondary market. Rating agencies play a vital, albeit controversial role in determining the probability of countries defaulting on their repayment obligations.[131] They rate the sovereign as a borrower rather than individual debt securities by analysing traditional economic indicators, such as GDP growth, the state's debt-to-GDP ratio, current account imbalances, and unemployment.[132]

Historical evidence suggests that market sentiment, which indirectly influences sovereign's credit rating, can shift within weeks, if not days.[133] When a debt instrument is downgraded to 'junk status', distressed-debt funds enter the centre stage, buying up bonds that few other investors desire to hold.[134]

While exploiting financially attractive investment opportunities is not *per se* malignant, successful holdout behaviour can have three main negative effects:

- First, it may distort intercreditor equity by allowing a small minority of litigious creditors to extract more from a bankrupt sovereign than the rest of creditors.
- Second, it can hamper the quick and orderly restructuring of sovereign debt, thereby prolonging the negative effects of sovereign debt crises, such as deadweight losses and debt overhang effects.
- Third, it may encourage creditors who would have otherwise settled under mutually acceptable conditions with a sovereign debtor to press for a deal similar to the one struck by the holdouts (referred to as the 'free-rider problem').

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[130] Frederico Sturzenegger and Jeromin Zettelmeyer, *Debt Defaults And Lessons From A Decade Of Crises* (Cambridge: MIT Press, 2007) 24.

[131] See, eg, The Economist, 'Credit where credit's due' *The Economist* (London, 19 April 2014).

[132] Edward Altman and Herbert Rijken, 'Toward a Bottom-Up Approach to Assessing Sovereign Default Risk' (2011) 23(1) Journal of Applied Corporate Finance 20.

[133] ibid 23-24 (describing how in 1996 South Korea's credit rating dropped from one of the best credit ratings possible to a so-called 'junk' rating in just a year).

[134] Something that hedge funds are currently doing in Puerto Rico, a country that faces enormous problems of debt sustainability and is likely to default soon. See Peter Coy, 'Hedge Fund Vultures to the Rescue in Puerto Rico' *Bloomberg* (New York, 21 May 2015) <http://www.bloomberg.com/news/articles/2015-05-21/puerto-rico-hedge-fund-vultures-to-the-rescue> accessed 5 November 2017.

Thus, states will experience more difficulties in reducing unsustainable debt levels if the creditors' have a leveraged bargaining position due to legal enforcement options. Holdout issues may exacerbate chances for a quick economic recovery in both advanced and emerging market economies, since they complicate the quick and orderly resolution of debt crises.[135] The adverse effects of holdout litigation on several economic indicators are well established in the pertinent literature and are further bolstered by the evidence presented in chapters 4 and 5.[136]

3.4.2. Valuable Participants in International Debt Markets?

Real vultures play a key role in keeping the ecosystem healthy and clean. They act as scavengers feeding on the carcasses of dead animals. Some argue that vultures serve a similarly valuable role in the international credit system.[137] Evidence exists that sovereign debt litigation can act as a check on opportunistic default, which occurs when a solvent sovereign decides to default on its debt.[138] As McGill and Harris note, '[i]n the event of default, an enforceable remedy encourages sovereigns to settle rather than leaving themselves in a state of default until a new set of political leaders takes over.'[139] Therefore, as Bratton points out, a sovereign nation may default strategically if it assumes that the consequences in the credit markets carry little weight in the cost-benefit analysis.[140]

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[135] That holdout problems inform policy decision in current debt crises has been confirmed recently when the US Congress passed the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) law. This law expressly prohibits creditors from suing the insolvent country for debt repayment, anticipating holdout creditor problems in the wake of restructuring Puerto Rico's unsustainable debt. See, eg, DLA Piper, 'PROMESA becomes law: all business in Puerto Rico will be affected – top points about this sweeping rescue package' (*DLA Piper Government Affairs Alert,* 5 July 2016) <https://www.dlapiper.com/en/us/insights/publications/2016/07/promesa-becomes-law/> accessed 30 September 2017.

[136] See Schumacher (n 7), who also cites further references and Kenneth Rogoff and Jeromin Zettelmeyer, 'Bankruptcy Procedures for States: A History of Ideas, 1976-2001' (2002) 49(3) IMF Staff Papers 470.

[137] See Fisch and Gentile (n 31) 1092; Elizabeth Broomfield, 'Subduing the Vultures: Assessing Government Caps on Recovery in Sovereign Debt Litigation' (2010) Columbia Business Law Review 473, 511; Michael Pettis, *The Volatility Machine: Emerging Economies and the Threat of Financial Collapse* (Oxford: Oxford University Press, 2001) 166; David Bosco, 'The Debt Frenzy' *Foreign Policy* (Washington D.C., 13 October 2009).

[138] Fisch and Gentile (n 31) 1051. According to economic theory, sovereigns have an incentive to maintain reputation in the credit markets as they might otherwise loose access to new financing or face higher costs of capital. See, most notably, Harold Cole and Patrick Kehoe, 'Models of Sovereign Debt: Partial versus General Reputations' (1998) 39 International Economic Review 55.

[139] Matthew D. McGill and Alexander N. Harris, 'NML Capital v. Argentina: Enforcing Contracts in the Shadow of the Foreign Sovereign Immunities Act' (2015) 30(1) Maryland Journal of International Law 3, 11.

[140] William W. Bratton, 'Pari Passu and A Distressed Sovereign's Rational Choices' (2004) 53 Emory Law Journal 823, 839 (arguing that regardless of whether the sovereign defaults out of necessity or strategically, the government makes a choice, which may be informed by the drafting of the debt contract). Especially prior to the *NML* litigation, some observers were more upbeat about the role vulture funds play in debt markets, with the renowned financial journalist Salomon for instance noting that '[i]n the vast majority of situations, vulture funds buy debt from investors who, for whatever reason, no longer want to hold it' and that 'in doing so, they provide a very

Drawing a line between a genuine (political and economic) inability to repay debt and a strategic default appears difficult and prone to manipulation. A balance sheet insolvency test that can be applied to corporations by subtracting liabilities from assets seems neither feasible nor reasonable for states. Besides several other legal and factual differences, countries often use less transparent and legally more ambiguous ways to manage their finances than corporations or private individuals, making debt sustainability assessment more difficult. The recent accounting fraud in Mozambique served as a case in point.[141] The window dressing scandal that allowed Greece to pile up public debts before the euro area sovereign debt crisis was another.[142]

In such cases, so the argument goes, holdout investors can fulfil a 'controlling' function in sovereign credit markets. In contrast to most institutional investors, vulture holdouts are willing to inflict 'pain' on the defaulted debtor.[143] By taking a country to court and abandoning negotiations, vultures cross a critical line – something many risk-averse or heavily regulated institutional investors are rarely inclined to do. If vultures step in and succeed in collecting debt, countries may only venture to default if their financial situation is indeed hopeless and not, as some countries have done in rare cases[144], if it seems opportune against the backdrop of a cost-benefit analysis.

Dubbed as 'avenging angels of the debt market', holdouts invoke the rule of law.[145] Their purist view on the enforceability of contractual commitments in a court of law – regardless of whether the borrower is a state or a corporate entity – conveys at least some legitimacy and moral vindication. In addition, as argued by Chabot and Santarosa, *ex ante* committing to a mechanism of debt enforcement could make sovereign default more costly and thereby reduce the borrowing costs for sovereigns.[146] Similarly, Tran, the IIF's Chairman, notes that

useful service.' See Felix Salomon, 'In defense of vulture funds' (*Felix Salomon Blog*, 24 February 2007) <http://www.felixsalmon.com/2007/02/in-defense-of-vulture-funds/> accessed 16 December 2017.

[141] See, eg, Matt Wirz, Julie Wernau and Matina Stevis, 'Behind Credit Suisse's Soured Mozambique Deals' *Wall Street Journal* (New York, 11 August 2016).

[142] See for the story Louise Story, Landon Thomas and Nelson Schwartz, 'Wall St. Helped to Mask Debt Fuelling Europe's Crisis' *New York Times* (New York, 13 February 2010). The scandal became particular

[143] See Bosco (n 137). As Scott et al explain, 'As they further explain, 'most institutional investors will not take one the role of contract arbitrageurs due to reputational concerns, including the desire to maintain good relationships with sovereigns and the burden of justifying large front end litigation costs to their passive investors.' See Scott et al (n 40) 8.

[144] See Carmen Reinhart and Kenneth Rogoff, *This Time Is Different: Eight Centuries Of Financial Folly* (Princeton: Princeton University Press, 2009) for some historical examples.

[145] Bosco (n 137); Fisch and Gentile (n 31) 1092. Also see Paulson (n 2).

[146] Benjamin Chabot and Veronica Santarosa, 'Don't cry for Argentina (or other Sovereign borrowers): lessons from a previous era of sovereign debt contract enforcement' (2017) 12(1) Capital Markets Law Journal 9.

'[sovereign debt] litigation [by vulture holdouts] is crucial to defend creditor rights and to help achieve a balanced approach to sovereign debt crisis resolution.'[147] Thus, the existence of holdouts could also benefit other investors with an interest in reducing their potential losses in a sovereign debt workout.

Another strand in the literature argues that the problem of holdouts is overemphasised in the first place, as only two of the most recent 45 sovereign bond exchanges were hampered by holdout problems. In an IMF Working Paper, Bi et al for instance claim that '[c]ontrary to widespread expectation, debt renegotiations in the era of bond finance have generally been quick and involved little litigation.' [148] Therefore, the sole threat of litigation by uncooperative investors was enough to encourage sovereign lenders to meet the creditor's demands and find a mutually acceptable compromise.[149]

Some economists similarly contend that the prospect of output losses caused by the interference of litigious creditors is – to a certain degree – necessary for governments to have an incentive to repay.[150] If debt repudiation were without any consequence, opportunistic default would be more widespread, essentially reducing investors' risk appetite.[151] This so-called 'enforcement theory', which was first described by Bulow and Rogoff[152], focuses on indirect costs that a defaulting sovereign incurs by evading its creditors. Besides output losses, indirect costs of defaulting include the loss of access to short-term trade credit and

[147] See Hung Tran, 'The role of markets in sovereign debt crisis detection, prevention and resolution' BIS Papers No 72 – Sovereign risk: a world without risk-free assets? (Proceedings of a seminar on sovereign risk including contributions by central bank governors and other policy-makers, market practitioners and academics, Basel, 8–9 January 2013) 88 (noting that 'allowing creditor rights (including litigation rights) to be weakened, even under the exigencies of crisis resolution, would have long-term negative effects on credit markets to the detriment of all market participants, mainly by undermining the legal certainty of sovereign securities, especially in mature markets.').

[148] Bi et al (n 39) (opposing the common narrative in the scholarly literature, noting that 'with one major exception – Argentina's restructuring following its 2001 default – […] virtually all bond restructurings between 1998 and 2005 were swift, largely devoid of litigation, and achieved high participation').

[149] However, while states have managed to restructure their debt in the past, the cited studies do not address *how* this has been achieved. In most restructuring, problems arose with regard to the burden sharing between the sovereign and its creditors as well as between different groups of creditors. The Argentina and the Greek restructuring both raised questions as to whether sufficient inter-creditor equity was achieved, particularly against the backdrop of the holdouts' success in New York courts against Argentina and the full-repayment of holders of Greek sovereign bonds governed by English law.

[150] Michael P. Dooley, 'International financial architecture and strategic default: can financial crises be less painful?' (2000) 53(1) Carnegie-Rochester Conference Series on Public Policy 361; Barry Eichengreen, 'Restructuring Sovereign Debt' (2003) 17(4) Journal of Economic Perspectives 75, 80.

[151] Eichengreen (n 150) 80.

[152] Jeremy Bulow and Kenneth Rogoff, 'A Constant Recontracting Model of Sovereign Debt' (1989) 97(1) Journal of Political Economy 155. However, others have argued that there is little evidence of lender interference with the trade of defaulters; Kenneth M. Kletzer and Brian D. Wright, 'Sovereign Debt as Intertemporal Barter' (2000) 90 American Economic Review 621.

higher costs for the placement of assets abroad.[153] However, enforcement models are driven by the assumption that direct enforcement is impossible due to sovereign immunity.[154] Models based on such assumption are thus of limited use to reflect and explain sovereign debt enforcement mechanisms after Argentina and Greece.

Overall, many arguments in support of holdouts fail to convince against the backdrop of the Argentine and the Greek debt restructurings. There, the supposed benefits of holdout behaviour, which may act as a check on opportunistic defaults, clearly outweighed the costs associated with delays in restructurings.

For one, such delays create illiquidity in the debt market, as defaulted nations will only resume payments and regain access to credit markets once a solution is in place.[155] This may, consequently, affect the balance sheets of financial institutions, such as banks and other big institutional investors, potentially spreading the negative implications of sovereign distress to other sectors. Moreover, a study from 1993 by Salomon Brothers suggested that only 11% of sovereign defaults were opportunistic.[156] Hence, the value of having a check on opportunistic defaults may not be as large as suggested by some.[157]

Additionally, if holdout investors can credibly threat to *ex post* block payments on exchanged bonds, creditors will become increasingly susceptible to blackmail attempts. If contractual obligations were to be enforced strictly in the event of insolvency, rising creditor inequality and unfair asset distribution seem inevitable. Ultimately, without a sound framework of substantive law, be it enshrined in contracts or statutes, courts will remain imperfect fora to adjudicate sovereign debt dispute – a situation that vulture holdouts are going to exploit.[158]

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[153] See Bratton (n 140) 842.

[154] Jeremy Bulow and Kenneth Rogoff, 'Sovereign Debt: Is To Forgive To Forget?' (1989) 79 American Economic Review 43.

[155] Of course, economic research on the impact of sovereign debt litigation is still in its infancy. Yet, recent papers suggest that holdout litigation entails considerable negative effects for the insolvent nations; see, eg, See Benjamin Hébert and Jesse Schreger, 'The Costs of Sovereign Default: Evidence from Argentina' (2017) 107(10) American Economic Review 3119 and Marcos Chamon, Julian Schumacher, Christoph Trebesch, 'Foreign-law bonds: can they reduce sovereign borrowing costs?' (2018) ECB Working Paper Series No 2162 <https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2162.en.pdf> accessed 28 May 2018.

[156] John Purcell and Jeffrey Kaufman, *The Risks of Sovereign Lending: Lessons from History* (New York: Salomon Brothers, 1993).

[157] See, eg, Emma Kingdon, 'Leveraging Litigation: Enforcing Sovereign Debt Obligations in Nml Capital, Ltd. v. Republic of Argentina' (2014) 37(3) Boston College International and Comparative Law Review 30 (arguing that '[b]y establishing an enforcement mechanism for a creditor against a sovereign debtor, the Second Circuit increased certainty for investors by ensuring collectability and providing an incentive to invest in sovereign debt markets').

[158] See below chapter 6 for an analysis of what can be done to mitigate holdout behaviour.

3.5. A BRIEF HISTORY OF HOLDOUT LITIGATION

Before turning to the analysis of holdout litigation and arbitration in the wake of Greek debt workout of 2012 and Argentina's debt restructurings of 2005/10, the following sections elaborate on the history of sovereign debt litigation. By revisiting some of the seminal judgements, this section seeks to foster a better understanding of the core legal issues arising in holdout litigation – most of which have resurfaced in the cases of Greece and Argentina.

3.5.1. Libra Bank v. Banco Nacional de Costa Rica

On 27 August 1981, the Central Bank of Costa Rica adopted a resolution aimed at remediating the state's problems in servicing dollar-denominated debts owed to foreign creditors.[159] This resolution *inter alia* stipulated that repayments of external debt would be limited to multilateral international agencies, implying that loans owed to commercial creditors, such as international banks, must no longer be repaid by the Costa Rican central bank.[160] The government deemed such repudiation of foreign debt obligations necessary after Costa Rica's debt-to-GDP ratio had risen to one of the highest worldwide and inflation levels had exceeded 20% per annum.[161]

Only days after this moratorium, seven domestic and international commercial banks, represented by Libra Bank Limited, filed suit in the courts of New York City courts and challenged the central bank's move, which was party to the credit facilities advanced by the bank syndicate. The underlying loan ensured that US courts had jurisdiction *ratione materiae* and *personae* in the event of payment default.[162] After the plaintiffs sought to attach Banco Nacional's accounts located in New York State, they brought a motion for summary judgement[163] against Costa Rica in the SDNY in an attempt to have all assets returned instantly.[164]

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[159] *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870, 875 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY].

[160] ibid.

[161] Juan J. Taccone, 'Central American report number 1' (2000) Subregional Integration Report Series, 10 <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=33036347> accessed 20 February 2017.

[162] See for an overview Joseph B. Frumkin, 'The Act of State Doctrine and Foreign Sovereign Defaults on United States Bank Loans: A New Focus For A Muddled Doctrine' (1985) 133(2) University of Pennsylvania Law Review 469.

[163] A summary judgement may be defined as 'the procedure by which the court may decide a claim without a trial, where the claimant can show that the defendant has no real prospect of successfully defending the claim.' See, eg, *Law Debenture Trust Corporation plc v Ukraine*, [2017] EWHC 655 (Comm), [2017] QB 1249, [2017] 3 WLR

Costa Rica did not dispute that the government's actions had triggered a default on all foreign debt obligations, including those owned by the plaintiffs. Thus, the key questions for the judges to resolve in the *Libra Bank* case was whether, in light of the prevailing act of state doctrine, creditors could challenge the Costa Rican government's decision in a US court. According to the act of state doctrine, which is closely linked to the concept of foreign sovereign immunity, US courts are enjoined from rendering judgement with respect to the validity of a foreign official acts performed within the sovereign's own territory.[165] The plaintiffs submitted that the court must not resort to the act of state doctrine in the present case, for it solely applies when a foreign state expropriates property within its *own* territorial boundaries.[166] Since the situs of the debts, ie the place of performance, was located in the US, the act concerned a foreign state activity not covered by the doctrine.[167] Unsurprisingly, Costa Rica challenged this interpretation.

The SDNY essentially followed the plaintiff's proposition that the act of state doctrine was inapplicable in relation to foreign (commercial) debts.

First, it noted that the act of state doctrine was rooted in the sovereign immunity doctrine, citing the *Underhill v. Hernandez*[168] decision, in which the Supreme Court had clarified that '[…] courts of one country will not sit in judgement on the acts of the government of another done within its *own* territory'.[169] Second, the court highlighted that New York law recognised the territorial limitations of this doctrine with regard to debt instruments that are enforceable both within and outside the state's territory.[170] In the present case, however, the debtor,

667, [2017] WLR(D) 226, 29th March 2017, United Kingdom; England and Wales; High Court [EWHC]; Queen's Bench Division [QBD]; Commercial Court.

[164] *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870, 876 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY].

[165] Philip Power, 'Sovereign Debt: The Rise of the Secondary Market and Its Implication for Future Restructurings' (1996) 64(4) Fordham Law Review 2701, 2732.

[166] *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870, 876 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY].

[167] ibid.

[168] *Underhill v Hernandez*, Final appeal, No 36, 168 US 250 (1897), ILDC 1681 (US 1897), 18 S Ct 83 (1897), 42 L Ed 456 (1897), 29th November 1897, United States; Supreme Court [US].

[169] *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870, 876 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY].

[170] *Weston Banking Corporation v Turkiye Garanti Bankasi AS*, 57 NY 2d 315 (NY 1982), 16th November 1982, United States; New York; Court of Appeals [NY].

Banco Nacional, was required to make all payments to Chase Manhattan Bank's branch in New York City, which acted as the fiscal agent under the terms of the loan agreement.[171]

Consequently, the court did not consider the Costa Rican decrees, which resulted in the extinction of the plaintiff's legal right to repayment, as acts relating to 'property located *within* the territory of the US'. Rather, the situs of the property at stake, and hence the instrument's place of contractual performance, was New York City. Any expropriatory measures taken by the Costa Rican government were thus irrelevant to the validity of the creditor's claim.[172] On that basis, the SDNY granted money judgements to the plaintiffs.

3.5.2. ALLIED BANK INTERNATIONAL V. BANCO CREDITO AGRICOLA DE CARTAGO

The litigation in *Allied Bank International v. Banco Credito Agricola de Cartago*[173] had the same factual basis as the *Libra Bank*[174] case. It followed the Costa Rican government's repudiation of private and commercial debt owed to a syndicate of US banks. Allied Bank, Ltd, the leading plaintiff, acted as the agent for this syndicate of 39 banks, which sought to recover on promissory notes issued by three – government-owned – Costa Rican banks.

The *Allied Bank* case was characterised as the 'first holdout litigation in the sovereign debt context'.[175] While the case related to syndicated loans rather than bonds, it brought to the fore the problem of ensuring collective creditor action in international debt restructurings.[176] In *Allied Bank,* the SDNY initially denied all motions, stating that 'a judicial determination contrary to the Costa Rican directives could embarrass the United states government'.[177] This view reflected the act of state doctrine, described above in connection with the *Libra Bank* case, according to which foreign courts must not judge the validity of a foreign government's public legal acts.[178]

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[171] *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870, 882 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY].

[172] ibid.

[173] *Allied Bank International v Banco Credito Agricola de Cartago and ors*, Case No 225, Docket 83-7714, 757 F 2d 516 (2d Cir 1985), 77 ALR Fed 281, (1985) 24 ILM 762, 18th March 1985, United States; Court of Appeals (2nd Circuit) [2d Cir].

[174] *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY].

[175] See, among others, Broomfield (n 136) 483.

[176] See above 1.3.

[177] ibid.

[178] Power (n 165) 2732.

The Court of Appeals for the Second Circuit, however, adopted a different legal standpoint.[179] At first, it recognised the Costa Rican directives to repudiate the foreign debt as valid under the principles of comity (rather than the act of state doctrine).[180] The principle of international comity has often been invoked as a defence in relation to enforcement trials before New York courts.[181] According to this doctrine, whose exact scope remains contentious in international law[182], states are to 'respect' each other's legislative and executive acts.[183] Therefore, international comity may be described as a 'moral' rather than a legal obligation. The US Supreme Court famously framed the concept of international comity in *Hilton v. Guyot* as follows:

> '[c]omity, in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws'[184]

Comity is hence considered a 'softer' principle than sovereign immunity or the act of state doctrine, for comity considerations are based on 'neighbourliness and mutual respect' and not on actual rights conveyed to a foreign state by virtue of treaty or statute.[185] However, comity may be an important defence for states, especially given that foreign law or a foreign public interest cannot override applicable US law.[186]

In *Allied Bank*, the Court of Appeals underlined the importance of US foreign policy for the judicial assessment of comity. In an earlier decision regarding the Costa Rican debt crisis, the

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[179] *Allied Bank International v Banco Credito Agricola de Cartago and ors*, Case No 225, Docket 83-7714, 757 F 2d 516 (2d Cir 1985), 77 ALR Fed 281, (1985) 24 ILM 762, 18th March 1985, United States; Court of Appeals (2nd Circuit) [2d Cir].

[180] ibid [519].

[181] See, eg, *Hilton and ors v Guyot and Charles Fortin & Company*, Final appeal judgment, 159 US 113 (1895), ILDC 2166 (US 1895), 16 S Ct 139 (1895), 40 L Ed 95 (Sup Ct 1895), 3rd June 1895, United States; Supreme Court [US].

[182] Jasper Finke, 'Sovereign Immunity: Rule, Comity or Something Else*?'* (2011) 21(4) The European Journal of International Law 853.

[183] For an overview, see Michael Ramsey, 'Escaping "International Comity"' (1998) Iowa Law Review 893.

[184] *Hilton and ors v Guyot and Charles Fortin & Company*, Final appeal judgment, 159, 163-164 US 113 (1895), ILDC 2166 (US 1895), 16 S Ct 139 (1895), 40 L Ed 95 (Sup Ct 1895), 3rd June 1895, United States; Supreme Court [US].

[185] See Ugo Panizza, Federico Sturzenegger and Jeromin Zettelmeyer, 'The Economics and Law of Sovereign Debt and Default' (2009) 47(3) Journal of Economic Literature 651, 654 and Ian Brownlie, *Principles of Public International Law* (Oxford: Oxford University Press, 2003) 28.

[186] See, eg, *Republic of Iraq v First National City Bank, as Administrator of the Goods*, Chattels and Credits of His Majesty King Faisal II Ibn Chazi Ibn Faisal we of Iraq, deceased, Docket No 29817, No 102, 353 F 2d 47 (2d Cir 1965), 42 ILR 29, 8th November 1965, United States; Court of Appeals (2nd Circuit) [2d Cir].

Court of Appeals had approved of the government's actions, since it believed that they were 'fully consistent with the law and policy of the US'.[187] However, after the Treasury Department joined the litigation as *amicus curiae* and disputed the US courts' approach of barring US courts from reviewing the Costa Rica's acts, the Court of Appeals reversed course.[188] Judge Meskill reached the conclusion that

> '[a]cts of foreign governments purporting to have extraterritorial effect — and consequently, by definition, falling outside the scope of the act of state doctrine — should be recognized by the courts only if they are consistent with the law and policy of the United States.'[189]

The Court of Appeals moreover remarked that if it were to give effect to the Costa Rican directives, 'the decision would vitiate an express provision of the contracts between the parties'.[190]

3.5.3. REPUBLIC OF ARGENTINA V. WELTOVER

In contrast to *Libra Bank*[191] and *Allied Bank*[192], the *Weltover*[193] litigation dealt with the question whether bankrupt states may invoke state immunity as a defence against creditor enforcement action.

The plaintiffs in *Weltover* belonged to a group consisting of two Panamanian corporations and a Swiss bank, who sought repayment on their securities after Argentina had unilaterally rescheduled the terms of payment in the early 1980s. The creditors, who collectively held USD1.3 million of Bonodos, refused to accept the debt rescheduling and brought a breach-of-contract action in the SDNY, relying on the FSIA as the basis for the court's jurisdiction.[194]

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[187] *Allied Bank International v Banco Credito Agricola de Cartago and ors*, Case No 225, Docket 83-7714, 757 F 2d 516, 519 (2d Cir 1985), 77 ALR Fed 281, (1985) 24 ILM 762, 18th March 1985, United States; Court of Appeals (2nd Circuit) [2d Cir].

[188] The US government claimed that it supports debt resolution procedures under the auspices of the IMF but that it had a strong interest that all financial obligations remained valid and enforceable.

[189] *Allied Bank International v Banco Credito Agricola de Cartago and ors*, Case No 225, Docket 83-7714, 757 F 2d 516, 522 (2d Cir 1985), 77 ALR Fed 281, (1985) 24 ILM 762, 18th March 1985, United States; Court of Appeals (2nd Circuit) [2d Cir].

[190] ibid.

[191] *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY].

[192] *Allied Bank International v Banco Credito Agricola de Cartago and ors*, 566 F Supp 1440 (SDNY 1983), 8th July 1983, United States; New York; District Court for the Southern District of New York [SDNY].

[193] *Argentina and Banco Central de la Republica Argentina v Weltover Incorporated and ors*, Final appeal, Docket No 91-763, 504 US 607 (1992), ILDC 1924 (US 1992), 112 S Ct 2160 (1992), 119 L Ed 2d 394 (1992), (1995) 100 ILR 510, 12th June 1992, United States; Supreme Court [US].

[194] ibid [610].

In response to the creditors' demands, Argentina asserted that, due to its status as a sovereign state, there was no jurisdiction *ratione materiae*.[195]

Thus, applying the FSIA, the US Supreme Court had to assess whether the unilateral refinancing of the Bonodos was taken 'in connection with a commercial activity' of Argentina, and whether it had a 'direct effect in the United States.'[196] Both lower courts were of the view that, in accordance with § 1605(a)(2) FSIA, Argentina's actions were not immune from judicial review. They denied the defence, noting that 'the defendants' commercial acts caused a direct effect in the United States, therefore providing the statutorily-mandated nexus, [for] the country had acted entered a contract governed by private law with direct effects in US markets.'[197]

The Supreme Court followed Justice Scalia's opinion unanimously and confirmed the lower courts' judgements in their entirety. First, the Supreme Court elaborated on the term 'commercial activity'. Citing *Dunhill v. Cuba*[198], Justice Scalia held that the US State Department had endorsed the restrictive theory of foreign sovereign immunity in 1952.[199] Argentina's conduct clearly fell within the FSIA's notion of 'commercial activity' and it was irrelevant, for that matter, whether the country had actually made a profit by issuing debts.[200]

The court then turned to the second requirement for the applicability of § 1605(a)(2) FSIA, namely that Argentina's issuance of bonds in New York must have a 'direct effect in the US'. The Argentine government asserted that the legislative history of the FSIA required such direct effect to be both 'substantial' and 'foreseeable', which was not the case here.[201] The Supreme Court rejected this argument, holding that any effect is 'direct' if it followed as an immediate consequence of the defendant's activity.[202] The US Supreme Court argued that

[195] ibid.

[196] ibid [612].

[197] *Weltover Incorporated and ors v Argentina and Banco Central de la Argentina*, Appeal judgment, 941 F 2d 145 (2d Cir 1991), 13th August 1991, United States; Court of Appeals (2nd Circuit) [2d Cir].

[198] *Alfred Dunhill of London Incorporated v Cuba and Solano Pinera* (intervening), Docket No 73-1288, 425 US 682 (1976), ILDC 1680 (US 1976), 96 S Ct 1854 (1976), 48 L Ed 2d 301 (1976), 66 ILR 212, 24th May 1976, United States; Supreme Court [US].

[199] *Argentina and Banco Central de la Republica Argentina v Weltover Incorporated and ors*, Final appeal, Docket No 91-763, 504 US 607 (1992), ILDC 1924 (US 1992), 112 S Ct 2160 (1992), 119 L Ed 2d 394 (1992), (1995) 100 ILR 510, 12th June 1992, United States; Supreme Court [US].

[200] ibid. Also compare Lorenzo Mola, 'Sovereign Immunity, Insolvent States and Private Bondholders: Recent National and International Case Law' (2012) 11 The Law and Practice of International Courts and Tribunals 525, 541.

[201] *Argentina and Banco Central de la Republica Argentina v Weltover Incorporated and ors*, Final appeal, Docket No 91-763, 504 US 607, 617 (1992), ILDC 1924 (US 1992), 112 S Ct 2160 (1992), 119 L Ed 2d 394 (1992), (1995) 100 ILR 510, 12th June 1992, United States; Supreme Court [US].

[202] ibid.

Argentina had designated its accounts in New York as the place of payment, rendering New York the place of performance for the country's ultimate contractual obligations.[203] Thus, any rescheduling of those obligations had a 'direct effect' in the US.[204] By issuing dollar-denominated debt, Argentina had purposefully availed itself of the privileges of conducting activities in the US, which formed the basis for personal jurisdiction over the sovereign state.[205]

3.5.4. CIBC v. Banco Central do Brazil

In contrast to the three cases described above, *CIBC v. Banco Central do Brazil*[206] primarily concerned questions of intercreditor duties after a sovereign default. Indirectly, the case also dealt with the ambiguous legal relationship between sovereign debtors and their central banks. The plaintiffs belonged to a group of (nonbank) entities that held a position in the Brazilian Multiyear Deposit Facility Agreement (MDYFA).[207]

Just one year after the MDFYA was concluded, Brazil started to experience trouble in making regular payments to its creditors.[208] When things turned sour for Brazil's creditors, the Dart family, which became notorious for its holdout strategies, acquired roughly 4% of the outstanding Brazilian foreign debt by buying a sizable chunk of the MYDFA on the secondary market.[209] Debt restructuring negotiations under the eminent Brady Plan resulted in a considerable reduction of the amount outstanding under the MYDFA.[210] Creditors were granted the right to exchange their MYDFA instruments for new US debt instruments with a 30-year maturity, which immediately relieving pressure off Brazil.[211] However, CIBC was one of the two creditors who refused to participate in the debt exchange facilitated by the

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[203] ibid [619].

[204] ibid. The Supreme Court also noted that Argentina possessed 'minimum contacts' that would satisfy the constitutional test set out in the Due Process Clause of the Fifth Amendment.

[205] ibid.

[206] *CIBC Bank and Trust Company (Cayman) Limited v Banco Central do Brasil and ors,* 886 F Supp 1105 (SDNY 1995), 9th May 1995, United States; New York; District Court for the Southern District of New York [SDNY].

[207] Lee Buchheit and Mitu Gulati, 'Sovereign Bonds and the Collective Will' (2002) 53 Emory Law Journal 1324, 1340. Note that CIBC was owned by the Dart Group, a wealthy American family swathed in secrecy with a notorious inclination to make profit by means of high-risk investments in both sovereign and corporate debt markets. For the family's history see Elizabeth Lesly, 'The Darts: Fear, Loathing, And Foam Cups' *Bloomberg* (New York, 9 July 1995).

[208] *CIBC Bank and Trust Company (Cayman) Limited v Banco Central do Brasil and ors,* 886 F Supp 1105, 1106 (SDNY 1995), 9th May 1995, United States; New York; District Court for the Southern District of New York [SDNY].

[209] ibid.

[210] ibid [1107].

[211] ibid.

Brady Plan and instead insisted on the full repayment of approximately USD1.4 billion in outstanding MYDFA debt.

CIBC alleged that the Central Bank of Brazil was liable for the breach of contract for the accrued but unpaid interest and for breach of contract relating to a written correspondence between the central bank and Dart's counsel promising the immediate payment of the outstanding interest.[212] Moreover, it sought a declaration that CIBC had the right to trigger acceleration of the MYDFA principal without the consent of other creditors.[213]

Unsurprisingly, the Central Bank of Brazil – supported by an *amicus* brief submitted by the US government – dismissed the claims raised. Having learnt the lesson from *Libra Bank*[214], *Allied Bank*[215] and *Weltover*[216], Brazil's lawyers opted not to resort to the act of state doctrine, the principle of comity, or the sovereign immunity defence in the present case. Rather, the defendant raised two new defences: improper assignment and champerty. The latter was of particular importance to (thwart) the business model of vulture holdouts.[217]

The anti-champerty provision in Section 489 New York Judiciary Law provided that

> 'no corporation or association directly or indirectly, shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of a bond, promissory note, bill of exchange, book debt, or other thing in action, or any claim or demand, with the intent and purpose of bringing an action thereon.'[218]

This rule essentially barred speculative investors from acquiring debt solely for the intent and purpose of subsequently enforcing it against the debtor. The defendants argued that there was ample evidence of champertous assignment, for the debt was acquired by CIBC *after* Brazil had already ceased to service the interest payment and the lawsuit was filed on the very first business day after the waiting period mandated by the MYDFA.[219] However, the judge was

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[212] ibid [1108].

[213] ibid.

[214] *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY].

[215] *Allied Bank International v Banco Credito Agricola de Cartago and ors*, Case No 225, Docket 83-7714, 757 F 2d 516, 519 (2d Cir 1985), 77 ALR Fed 281, (1985) 24 ILM 762, 18th March 1985, United States; Court of Appeals (2nd Circuit) [2d Cir].

[216] *Weltover Incorporated and ors v Argentina and Banco Central de la Argentina*, Appeal judgment, 941 F 2d 145 (2d Cir 1991), 13th August 1991, United States; Court of Appeals (2nd Circuit) [2d Cir].

[217] *CIBC Bank and Trust Company (Cayman) Limited v Banco Central do Brasil and ors*, 886 F Supp 1105, 1108 (SDNY 1995), 9th May 1995, United States; New York; District Court for the Southern District of New York [SDNY].

[218] ibid [1109].

[219] ibid [1111].

not convinced that CIBC's behaviour was indeed champertous, arguing that it could not be inferred from the present evidence that it was the plaintiffs only purpose and intent to sue the defendant.[220]

Regarding the question whether CIBC had a right to accelerate the entire principal amount of the MYDFA, the court sided with Brazil and denied CIBC's motion. More specifically, it held that the MYDFA expressly allowed Brazil to retain and vote its share of the debt, thereby obstructing CIBC's plans to accelerate.[221] The argument that Brazil was liable for breaching an implied covenant of good faith and fair dealing through its actions did also not convince the judges. Although the obligation of good faith is implied in every contract governed by US law, the court stressed that the terms of the specific contract defined the parties' rights and obligations.[222] This was an important evolution of New York law: holdout litigation may be stayed in the case of sovereign default, albeit only for a very short time span.

3.5.5. Pravin Banker v. Banco del Popular del Peru[223]

The *Pravin* litigation concerned the enforcement of external sovereign debt against Peru, which defaulted on its debt in the 1980s. *Pravin* remains one of the few cases of successful pre-restructuring holdout litigation, inspiring other holdouts, such as Elliot Management, to purse similar legal action against Peru in 1998.[224]

The defendant, *Banco del Popular del Peru*, was a state-owned bank, which provided loans and credit to public and private companies as well as individuals in Peru by borrowing funds from various foreign financial institutions.[225] Part of this debt was owed to the Mellon Bank, N.A. of Pittsburgh, which subsequently sold it to Pravin bank, the plaintiff in the present case.[226] Peru had entered into a round of negotiations with the majority of its (private) creditors during the 1980s, who were represented in the Bank Advisory Committee[227], to

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[220] ibid.

[221] ibid [1116].

[222] ibid [1118].

[223] *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, 895 F Supp 660 (SDNY 1995), 24th August 1995, United States; New York; District Court for the Southern District of New York [SDNY].

[224] See Sturzenegger and Zettelmeyer (n 130) 33.

[225] *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, Docket No 96-7183, 109 F 3d 850 (2d Cir 1997), 65 USLW 2640, 25th March 1997, United States; Court of Appeals (2nd Circuit) [2d Cir] [851].

[226] ibid.

[227] The Bank Advisory Committee is a committee consisting of Peru's major commercial lenders and chaired by Citibank, N.A. According to Defendants, '[t]o the extent practicable, the Bank Advisory Committee is

provide a long-term solution to the country's financial crisis.[228] Eventually, Peru and most of its creditors entered into negotiations under the auspices of the Brady Plan.

Pravin, however, transformed into a holdout creditor and refused to participate in the Brady Plan negotiations.[229] Pravin brought suit against Banco Popular as well as its guarantor, ie Peru, for non-payment of the outstanding debt.[230] Rather than immediately granting a money judgement in favour of Pravin, the SDNY granted two motions for a stay on litigation to allow for the liquidation of Banco Popular, in which the court expected Pravin's claims to be satisfied.[231] The court argued that the stay was warranted under the principle of comity, as the US executive branch supported cooperative debt workouts administered by the IMF.[232]

Ultimately though, following the expiration of the six months period, the SDNY lifted the stay and passed summary judgement to Pravin.[233] The court essentially found that an indefinite stay to allow Peru to complete its efforts to renegotiate its foreign debt would prejudge US interests.[234] Open-ended negotiations could not be justified on the basis of international comity, given that it would have entirely prohibited the exercise of legal rights outside of the negotiations, the conclusion of which was (also) under Peru's discretion.[235]

3.5.6. ELLIOTT V. PERU

<u>3.5.1. Litigation in US Courts</u>

Since the 1990s, Elliott Associates Ltd. had engaged in the purchase of distressed sovereign debt.[236] Following an earlier case, *Elliott v. Panama*[237], the hedge fund made 400% return on

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representative of all Peru's commercial bank creditors. The Committee cannot bind any financial institution; it is merely advisory.' *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, 895 F Supp 660, 662 (SDNY 1995), 24th August 1995, United States; New York; District Court for the Southern District of New York [SDNY].

[228] *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, Docket No 96-7183, 109 F 3d 850 (2d Cir 1997), 65 USLW 2640, 25th March 1997, United States; Court of Appeals (2nd Circuit) [2d Cir].

[229] ibid [853].

[230] ibid.

[231] *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, 165 BR 379 (SDNY 1994), 24th February 1994, United States; New York; District Court for the Southern District of New York [SDNY].

[232] ibid [386].

[233] *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, 895 F Supp 660, 664 (SDNY 1995), 24th August 1995, United States; New York; District Court for the Southern District of New York [SDNY].

[234] ibid. Also see *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, Docket No 96-7183, 109 F 3d 850 (2d Cir 1997), 65 USLW 2640, 25th March 1997, United States; Court of Appeals (2nd Circuit) [2d Cir] [852] for the appeal court's judgement against Peru.

[235] *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, 895 F Supp 660, 665 (SDNY 1995), 24th August 1995, United States; New York; District Court for the Southern District of New York [SDNY].

[236] As the *NML* case reveals, Elliot Associates remains the largest and most successful holdout investor. See below 4.3.3. for an analysis of the *NML* litigation against Argentina.

its investment.[238] In *Elliott v. Peru*, however, the asset attachment channel seemed less attractive, given that Peru had no valuable assets on US soil.[239]

Elliott had purchased Peruvian sovereign debt at a high discount after the country experienced serious financial stress in the 1980s and 1990 and paid approximately USD11.4 million for debt with a face value of USD20.7 million.[240] Ten days before Peru was to exchange its debt instruments under the Brady Plan, Elliott filed suit and demanded full repayment of its debt by sending the debtor a notice of default.[241]

The SDNY dismissed Elliot's complaint and held that the acquisition of Peruvian debt violated the anti-champerty provision of Section 489 of the New York Judiciary Law.[242] The District Court moreover emphasised that 'Elliott's position is strong as a matter of policy in the world of commerce' but that 'the Court's role here is not to make policy assessments — to rank its preferences among contract, property, and champerty doctrines.'[243]

The Court of Appeals for the Second Circuit, however, adopted a different viewpoint with respect to the anti-champerty provision. Referring to the seminal decision in *Moses v. McDivitt*[244], it pointed out that 'the mischief Section 489 was intended to remedy did not include the acquisition of debt with the motive of collecting it […].'[245] Against this backdrop, a distinction ought to be drawn between 'an impermissible primary purpose of bringing suit' and 'a lawful secondary and contingent intent to sue'. As a result, the Court of Appeals did not consider Elliott's holdout behaviour a violation of Section 489 of the New York Judiciary Law.[246] On the one side, it found Elliott's intent to sue to be 'incidental', since the firm's primary goal was to be repaid in full rather than just suing Argentina. On the other, the intent

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[237] *Elliott Associates LP v Panama,* No 96 Civ 5514(DC), 975 F Supp 332 (SDNY 1997), 10th September 1997, United States; New York; District Court for the Southern District of New York [SDNY].

[238] See, eg, Saskia Sassem, 'A Short History of Vultures' *Foreign Policy* (New York, 3 August 2014).

[239] A similar remedy as the one granted in *Elliott v. Peru* was later issued in favour of NML, the fund that pushed Argentina into bankruptcy in 2014. See above 4.3.4. for the *NML* litigation.

[240] *Elliott Associates LP v Banco de la Nación and Peru*, 194 FRD 116 (SDNY 2000), 2000, United States; New York; District Court for the Southern District of New York [SDNY] [3]. See Bratton (n 140).

[241] Patrick Wautelet, 'Vulture Funds, Creditors and Sovereign Debtors: How to Find a Balance?' in Matthias Audit, *Insolvabilité des États et Dettes Souveraines* (Paris: LDGJ, 2011) 4.

[242] *Elliott Associates LP v Banco de la Nación and Peru*, 194 FRD 116 (SDNY 2000), 2000, United States; New York; District Court for the Southern District of New York [SDNY] [332].

[243] ibid [345].

[244] *Moses v McDivitt*, 88 N.Y. 62 (1882), 1882, United States; New York; Court of Appeals [NY].

[245] *Elliott Associates LP v Banco de la Nación and Peru*, 194 FRD 116 (SDNY 2000), 2000, United States; New York; District Court for the Southern District of New York [SDNY] [10].

[246] ibid [15].

to sue was merely 'contingent': the debtors never denied that money was owed under the credit agreement.[247]

While acknowledging that the objectives of debt restructuring under the Brady Plan and those driving Elliot's lawsuit might contradict each other, the Court of Appeals made clear that 'debts remain enforceable throughout the [restructuring] negotiations'.

Though it had the judiciary on its side, there were no assets Elliot could have attached and sold.[248] Thus, the vulture holdout employed a new legal strategy: it targeted the payments of interest made by Peru on the recently exchanged Brady Bonds to restructured creditors.[249]

<u>3.5.2. Litigation Before Belgian Courts</u>

Given that the payment structure under the debt instrument involved the transfer of funds from Peru to a payment and clearing system in Europe, namely Euroclear in Belgium, Elliott applied for an injunction against Peru in a Brussels court.[250] It claimed that Peru had violated the *pari passu* clause in the debt agreement. More specifically, Elliott asserted that this very clause required a sovereign to pay all bondholders *pro rata*, ie in equal steps and in accordance to what they are owed under their respective contractual agreement.

This 'broad' reading of the *pari passu* clause, also referred to as the 'payment interpretation', was based on a written opinion submitted by Professor Lowenfeld.[251] He argued that there was only one reasonable outcome when applying a literal interpretation of this clause, namely that 'a given debt will rank equally with other debt of the borrower, whether that borrower is an individual, a company, or a sovereign state.'[252] Most importantly, in Lowenfeld's opinion, the equal ranking also implies that a borrower faced with a *pari passu* provision must pay all creditors on the same basis (hence, *pro rata*).[253] The court in Belgium subsequently followed

[247] ibid.

[248] Wautelet (n 241) 8.

[249] ibid.

[250] Court of Appeal of Brussels *Elliott Associates*, *LP v Republic of* Peru General Docket No 2000/QR/92 (2000); Fisch and Gentile (n 31) 1086. The move to sue Peru in Brussels was motivated by the failure to block payments made in New York via the Chase Manhattan Bank (acting as an agent for Peru) as the government anticipated Elliott's attempt. See Mitu Gulati and Kenneth N. Klee, 'Sovereign Piracy' (2001) 56 The Business Lawyer 635, 636.

[251] The *pari passu* clause included in Peru's debt contract reads as follows: '[t]he obligations of the Guarantor hereunder do rank and will rank at least *pari passu* in priority of payment with all other External Indebtedness of the Guarantor, and interest thereon.' See Lee C. Buchheit and Jeremiah S. Pam, 'The Pari Passu Clause in Sovereign Debt Instruments' (2004) 53 Emory Law Review 870, 895.

[252] See Bratton (n 142) 852-853 (noting that the standard *pari passu* clause stresses the word 'payment' rather

[253] ibid 853.

this reading of the clause and blocked payments made by Peru to its bondholders on the Brady Bonds.[254] Peru decided not to risk another default and ultimately settled with Elliott.

3.6. CHAPTER CONCLUSIONS

This chapter discussed the holdout creditor problem, reviewed its origins, mapped three types of holdout creditors, showed different perspectives on holdout behaviour, and provided a brief overview of the history of holdout litigation. The overarching objective of this chapter was to explain how and why holdout creditors hamper the effective and efficient resolution of sovereign debt crises.

We drew the following conclusions.

First, holdout creditors 'hold out' from sovereign debt restructuring negotiations, ie they refuse to accept a haircut or rescheduling voluntarily, with a view at obtaining a better settlement by striking a separate deal. Extending the existing literature, we argued that holdouts are not a homogenous mass. Instead, they should be grouped in three different buckets: vulture holdouts, retail holdouts, and official sector holdouts.

Vulture holdouts can generally be described as highly specialised hedge funds that acquire distressed sovereign debt with the sole aim of making a profit by pressuring the sovereign in a favourable settlement post-restructuring. Argentina's standoff in court with the hedge fund NML Capital serves as a case in point for vulture behaviour.

Retail holdouts are typically less sophisticated creditors who tend to hold sovereign bonds as a long-term investment. They often end up as holdouts in a bucket with vultures because they sell their bond holdings too late or because they are genuinely dissatisfied with the restructuring offer. Both predicaments may encourage them to sue a sovereign in court or before an international investment tribunal; the existence of litigation finance and creditor representation groups does the rest. During the crises in Greece and Argentina, the share of retail holdouts was unprecedentedly high – this resulted in a steep rise in the number of holdout trials recorded.

The third type of holdout creditors discussed in this chapter are official sector holdouts. This group consists of (quasi-)official actors, such as states, central banks, or sovereign wealth

[254] Court of Appeal of Brussels *Elliott Associates, LP v Republic of* Peru General Docket No 2000/QR/92 (2000).

funds. They can hold out for geopolitical, economic, or legal reasons. To illustrate the problems official sector holdouts may pose to the resolution of debt crises on the international plane, the chapter explained Russia’s holdout strategy in Ukraine as well as the legal issues facing the ECB in the event of the default of a euro area Member State.

Second, to provide an unbiased and neutral assessment of the holdout creditor problem, we reviewed the potential benefits of holdout behaviour as well as its adverse effects. While some authors underscore the necessity of holdouts to impose ‘checks’ on opportunistic sovereign defaults, a large number of scholars contends that holdouts hamper efforts to resolve sovereign debt crises. We concluded that, taking into account various circumstances, holdouts pose a formidable threat – not only to the efficient and swift resolution of debt crises but also to intercreditor equity in sovereign debt restructurings. While holdouts could – in theory – perform a supervisory function by raising the costs of sovereign default, these costs are already tremendous for the sovereign debtor in their absence. Indeed, we could not find empirical studies that confirm the positive macroeconomic effects of holdout risks. On balance, the supposed disciplining effects of holdouts seem not to outweigh the risks to orderly and fair debt workouts.

Finally, this chapter provided a brief history of holdout litigation. By reviewing seminal court decisions from the period of sovereign debt defaults in the 1980s and 1990s, we sought to explain how (US) case law has shaped the legal aspects of sovereign debt management and restructuring. The seminal cases examined in this chapter lay the doctrinal foundation for the post-restructuring holdout trails in Argentina and Greece.

Indeed, several vital legal questions, *inter alia* pertaining to the sovereign’s immunity from suit, the act of state doctrine, the comity defence, and the law of champerty, were settled in the first wave of holdout litigation. Consequently, the focus in Argentina and Greece shifted towards novel legal problems, such as the enforceability of bonds by means of injunctive relief, or the jurisdiction of foreign courts in the context of domestic law bond restructurings. These and other specific legal issues will be discussed in the subsequent chapters, which focus on the debt workouts in Argentina (chapter 4) and Greece (chapter 5).

4. HOLDOUT CREDITOR PROBLEMS IN THE ARGENTINE DEBT RESTRUCTURING

‘*The compact between borrowers and lenders is that debt contracts are enforceable. If a sovereign is held to a different standard of enforceability, it vitiates the contract and erodes both the rule of law and the confidence in the US judicial system.*’[1]

–Jay Newman (Senior portfolio manager at Elliott Management)

4.1. ARGENTINA’S 2001 STATE DEFAULT

4.1.1. Introduction

Argentina’s default of 2001 heralded a new era of sovereign finance. Notwithstanding the country’s longstanding history of defaulting on government debt obligations – Argentina was unable to repay (parts of its debt) three times in the last 32 years[2] – the most recent Argentine debt crisis went down in history as the largest-ever sovereign bankruptcy. The country declared a moratorium on approximately USD95 billion of outstanding financial obligations in December 2001: more than three times the amount Russia defaulted on in 1998.[3] For Roubini and Setser it was obvious that Argentina will test the current restructuring process, ‘given that the country [was] seeking much greater debt relief than any of these [other] countries sought.’[4]

What rendered Argentina’s insolvency even more exceptional than its sheer size was the large number of individual creditors who held Argentine debt securities. Argentina had issued 152 different series of bonds, which were governed by eight different laws (51% of the debt was subject to New York, 18% to English law, 17% to German law, 11% to Argentine law,

[1] Elliot Associates L.P. made itself a name amongst financially impaired sovereigns – especially in Latin America. For Jay Newman’s quote see Laura Alfaro, Noel Maurer and Faisal Ahmed, ‘Gunboats and Vultures: Market Reaction to the ‘Enforcement’ of Sovereign Debt’ (2010) 73 Law and Contemporary Problems 39.

[2] Pola Oloixarac, ‘Argentina vs. The Vultures’ *The New York Times* (New York, 19 September 2014).

[3] See Rodrigo Olivares-Caminal, ’Sovereign bonds: A critical analysis of Argentina’s debt exchange offer’ (2008) 10(1) Journal of Banking Regulation 28, 29.

[4] Nouriel Roubini and Brad Setser, *Bailouts or Bail-Ins? Responding to Financial Crises in Emerging Economies* (Washington D.C.: Peterson Institute for International Economics, 2004) 298.

2% to Japanese law and the remainder to Italian, Spanish and Swiss law).[5] While many large emerging market economies issue bonds governed by foreign law and denominated in foreign currency[6], the crisis of 2001 can be qualified as the first major sovereign bankruptcy in the age of international government *bond* financing.[7] As was feared among experts, creditor coordination proved considerably more complex in Argentina than in previous sovereign debt workouts.[8] Concerns that holdout creditor problems could seriously undermine a quick and orderly resolution of the country's financial crisis materialised soon – ultimately, some holdouts successfully blocked Argentina's return to international capital markets for over 15 years.

The following sections briefly outline Argentina's earlier experience with sovereign default, the economic crisis of 2001 as well as the debt restructurings of 2005 and 2010, respectively. Subsequently, we compare the outcome of lawsuits across different jurisdictions that were initiated by holdout investors against the Argentine government and concerned the state default of 2001.

4.1.2. The Argentine Debt Crisis Between 1998 and 2002

Much has been written about Argentina's default in 2001. This thesis does not aim to provide a full account of the latest Argentine debt crisis – others have already done this in a compelling manner.[9] Rather, it seeks to explain why holdout problems were so pronounced in the wake of the Argentine bankruptcy, examine how they are linked to the innate deficiencies of the international financial regime for sovereign debt management and restructuring, described above in chapters 1, 2, and 3.

Prior to its default in 2001, Argentina's debt-to-GDP ratio had risen from 29 to 41% within just few years, underscoring what Mussa refers to as a 'chronic inability of the Argentine authorities to manage public finances with due diligence' as well as an 'addiction to fiscal

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[5] ibid.

[6] As described above (chapter 1), most less developed countries are heavily dependent on foreign capital, which they can only reasonably access by tapping foreign capital markets.

[7] See above 1.3. for an overview of the transition from syndicated lending to bond financing.

[8] Compare eg Steven Schwarcz, 'Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach' (2000) 85 Cornell Law Review 956, 960 (noting that 'the difficulty [of restructuring sovereign debt] is exacerbated by the collective action problem of reaching agreement *among* creditors – a problem that has worsened significantly in recent years as States have shifted their borrowing source from banks to bond investors in the lower cost capital markets').

[9] See, eg, the seminal study by Carmen Reinhart and Kenneth Rogoff, *This Time Is Different: Eight Centuries Of Financial Folly* (Princeton: Princeton University Press, 2009).

laxity'.[10] As pointed out before, Argentina's 2001 debt crisis is not merely a case of irresponsible borrowing behaviour but ought to be understood as the consequence of severe disruptions in international credit markets. As Olivares-Caminal argues, 'Argentina started to go into a severe recession mainly caused by the East Asian crises (1997-1998), the Russian crisis (1998) and the devaluation of the Brazilian Real'.[11] Kämmerer[12] notes that 'Argentina's budgetary crisis stemmed from a mix of internal and external factors' and considers domestic political and structural shortcomings the triggers of the crisis.[13]

Argentina's recession lasted from 1998 until 2002 and reached its peak in December 2001 with the President's unilateral declaration to halt all international debt repayments. Subsequently, the government adopted several decisions aimed at reducing the debt levels, such as the forcible conversion of all government debt subject to Argentine law from foreign currencies into the domestic currency at a fixed exchange rate.[14] However, since the Argentina Peso was in free fall at the time, the measures led to a costly exchange rate mismatch on the balance sheets of banks, effectively rendering the domestic banking system insolvent.[15]

While Argentina managed to reduce its debt-to-GDP ratio from approximately 120% in 2001 to 90-95% in 2004, the government irritated investors all around the world. For example, for more than a year and a half, it left creditors the country in the dark both regarding the size of its default and its intentions to repay.[16] As Porzecanski[17] critically notes, 'the Argentine government's overall approach to its default has been uncooperative, to say the least'. This defiant attitude, as will be discussed below, was regularly used as one of the argument by litigious holdout creditors to make their case against Argentina before various courts. It is

[10] Michael Mussa, *Argentina and the Fund: From Triumph to Tragedy Policy* (Washington: Peterson Institute for International Economics, 2002) 10.

[11] Rodrigo Olivares-Caminal, *Legal Aspects of Sovereign Debt Restructuring* (London: Sweet & Maxwell, 2009) 5-007.

[12] Jörg Axel Kämmerer, *Argentine Debt Crisis* in Rüdiger Wolfrum (ed), *Max Planck Encyclopaedia of Public International Law* (Heidelberg: Oxford University Press, 2007, online version).

[13] ibid. These shortcomings consisted *inter alia* of lax fiscal policies, low domestic savings, slowness of structural reforms, lack of institutional and political reforms, and corruption.

[14] Arturo Porzecanski, 'From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default' (2005) 6 Chicago Journal of International Law 311, 317.

[15] ibid 318. The so-called 'sovereign-bank nexus' is one reason for governments to delay public debt restructurings, given that a reduction in the value of sovereign debt instruments regularly undermines the financial soundness of domestic banks, which – for regulatory, economic and political reasons – tend to hold a significant chunk of the country's public debt. See for a discussion of this issue, eg Viral Acharya, Itamar Drechsler and Philipp Schnabl, 'A Pyrrhic Victory? Bank Bailouts and Sovereign Credit Risk' (2016) 69(6) The Journal of Finance 2689.

[16] Eric Helleiner, 'The Strange Story of Bush and the Argentine Debt Crisis' (2005) 26(6) Third World Quarterly 953.

[17] Arturo Porzecanski (n 14) 323.

true that Argentina demanded unprecedentedly large concessions[18], especially given its economic potency compared to less developed African states, which had also asked the international community for substantial debt relief throughout the 1990s.

Indeed, the crisis in Argentina was as much economic as it was political, triggering a considerable degree of distrust by international investors as well as massive capital flight before and after the debt moratorium was announced in late 2001.[19] However, the narratives posited by both sides – Argentina was often characterized a rogue debtor[20] by tenacious creditors and *vice versa*[21] – were by no means new or surprising. Rather, it reminded observers all too well of debt crises unsettling the economies of Argentina's neighbours throughout the 1980s.

Notwithstanding Argentina's particularly intransigent dealings with its foreign creditors, the US government sided with Argentina's government on several occasions during the early phases of the economic crisis. For instance, the Bush administration did not want the IMF to impose any particular terms of a debt restructuring deal.[22] Even more revealing was the US Treasury Department's decision to not officially object to Argentina's first debt exchange offer, which was deemed 'barbarous', 'unfair', and 'morally unacceptable' by the private sector.[23]

As the influential economist Helleiner remarks, 'the Bush administration's approach to the Argentine debt crisis was much less sympathetic to the concerns of private foreign creditors than that of previous US administrations during the debt crises of the 1980s and 1990s.'[24] He also believes that taking sides with a moderate left-of-centre government rather than international investors was consistent with its conservative anti-internationalism and the prioritisation of strategic thinking that the Bush administration exhibited at several occasions.[25]

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[18] See, eg, Christian Engelen and Johann Graf Lambsdorff, 'Hares and stags in Argentinean debt restructuring' (2009) 78 Journal of International Economics 141-148.

[19] Olivares-Caminal (n 11) 5-009.

[20] Porzecanski (n 14) 326 (arguing that Argentina's demand for massive debt relief was without precedent).

[21] According to a New York Times article, President Kirchner (successor of her husband Nestor Kirchner under whose term of office Argentina slid into insolvency) saw herself as a 'an outlaw with good intentions, the heroine who never betrayed the people and was willing to defy the capitalists', see Oloixarac (n 2).

[22] Helleiner (n 16) 954.

[23] ibid 955.

[24] ibid 959.

[25] ibid 964.

4.2. THE ARGENTINE DEBT RESTRUCTURING

4.2.1. The Challenges

The vast majority of Argentina's outstanding debt in 2001 was subject to foreign law.[26] Argentina faced the dire consequences of having borrowed substantial amounts under foreign currency and then experiencing a sudden and rapid depreciation of the exchange rate.

In addition to the economic predicaments, Argentina faced serious legal problems because of its default. First, Argentina sought to impose an unprecedentedly high haircut on the claims of international investors, which sparked outrage in this camp. Second, large vulture funds, such as Elliott Associates, saw a formidable business opportunity and refused any sort of settlement that would not compensate them for the full face value of their bonds.[27] As Blitzer remarks, 'for years both sides complained loudly and publicly about one another, without entertaining even modest proposals for a compromise'.[28]

Before however taking a closer look at the holdout litigation and arbitration in the wake of the Argentine debt crisis, the next sections will elaborate on the two debt restructuring deals struck between the government and the majority of private creditors. As shown in chapter 3, the holdout creditor problem typically arises *after* a country has found a mutually acceptable solution with a (super-)majority of creditors, albeit there have been instances where sovereigns have been sued in the period between a default and the implementation of a debt restructuring.[29]

4.2.2. The 2005 Debt Restructuring

Argentina's first debt swap in 2005 – the result of two years of arduous negotiation – was referred to as 'epic in scale' by the Economist newspaper.[30] It involved 152 varieties of paper denominated in six currencies and governed by the laws of eight jurisdictions.[31] Overall,

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[26] According to Gelpern, before the 2001 default, almost 70% (nearly all the debt owed to private creditors) was in performing foreign-currency, foreign-law bonds, see Anna Gelpern, 'Sovereign Debt: Now What' (2016) 41(2) Yale Journal of International Law Online 45, 48.

[27] Jonathan Blitzer, 'Argentina's Unending Debt' *The New Yorker* (New York, 24 April 2014).

[28] ibid.

[29] By definition, a holdout creditor must 'hold out' from a proposed debt restructuring deal. However, in order to provide a comprehensive picture of creditor litigation in the wake of Argentina's crisis, this chapter also addresses instances of bondholder litigation that were filed before the government actually came to the negotiation table. Indeed, most holdout creditors who had initiated litigation prior to 2005, when Argentina struck its first of two restructuring deals, were not willing to settle on a voluntary basis.

[30] The Economist, 'A victory by default?' *London* (Economist, 3 March 2005).

[31] ibid.

Argentina had more than 700.000 creditors scattered within the international financial community.[32] Maybe tellingly, most of the (international) debt instruments the sovereign debtor defaulted on were bonds exchanged for syndicated loans under the auspices of the Brady Plan.[33] Later, these bonds were sold on the secondary market to thousands of institutional and retail investors.[34] More than 44% of privately held government bonds were owned by retail investors (56% by institutional investors), further exacerbating *ex ante* prospects for a quick debt workout with the involvement of a London Club creditor committee.[35]

According to the TFA, a group representing retail creditors, there were more than 450.000 Italian individuals and entities who claimed to have held Argentine bonds for an aggregated nominal amount of USD12 billion.[36] The debt restructuring transaction concluded in 2005 was not only unique with regard to the high number of retail investors involved. It also included the harshest haircut private creditors on the international sovereign bond markets had ever agreed to.[37] Argentina made its first restructuring offer during the IMF/World Bank Annual Meetings in Dubai in September 2003, proposing 75% debt reduction and no recognition of past due interest rate.[38] This offer became known as the 'Dubai Guidelines' and left investors outraged about the stiff losses they would face.[39] Indeed, as a study by Cruces and Trebesch[40] shows, the average size of sovereign debt haircuts stood at 37% between 1970 and 2010, underscoring the exceptionality of Argentina's tender.

On 14 January 2005, Argentina presented an amended offer, hoping to reach a final settlement on outstanding government debt valued at roughly USD100 billion (face value

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[32] Olivares-Caminal (n 11) 6-003.

[33] What many observers had feared, namely the adverse impact bond financing may have for the orderly resolution of sovereign debt crises, became a though reality during the Argentine insolvency. William W. Bratton, 'Pari Passu and A Distressed Sovereign's Rational Choices' (2004) 53 Emory Law Journal 823, 825 (noting that creditors in the Argentine case face a coordination problem of unprecedented dimensions).

[34] ibid 825. Big retail banks in Germany, Italy and other European countries offered Argentine government bonds as a safe long-term investment opportunity.

[35] Unsurprisingly, the disparate interests between institutional and retail investors, described above in 3.3., were more pronounced and visible than in any debt restructuring before.

[36] *Abaclat and ors v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [68].

[37] Christian Engelen and Johann Graf Lambsdorff, 'Hares and stags in Argentinean debt restructuring' (2009) 78 Journal of International Economics 141.

[38] Gelpern (n 26) 48.

[39] Sebastian Edwards, 'Sovereign default and debt restructuring: Was Argentina's 'haircut' excessive?' (*VoxEU*, 4 March 2015) <http://voxeu.org/article/argentina-s-haircut-outlier> accessed 18 July 2017.

[40] Juan Cruces and Tim Samples, 'Settling Sovereign Debt's 'Trial of the Century' (2016) 31 Emory International Law Review 5, 10.

plus past due interest).[41] While the offer was accepted by a majority of investors, the proportion of holdout investors (24% of creditors), as well as the haircut size (ie 70% on a net present value basis), were historical.[42]

To encourage higher creditor participation, Argentina also passed the so-called ‘Lock Law’ (Law No 26,017). In broad terms, this law prohibited the Argentine executive branch from reopening the 2005 debt exchange without Congressional approval and any type of settlement involving untendered security that were eligible to participate in the debt swap.[43] In addition to the Lock Law, the swapped bonds also featured a so-called ‘Rights Upon Future Offers’ (RUFO) clause, which set out that Argentina could not voluntarily make an offer to the holdouts that was better than what the restructured creditors had received.[44] As discussed below[45], litigious vulture funds pointed at the Lock Law to accuse Argentina of *ex ante* refusing any settlement.[46] Indeed, had Argentina not issued this law but instead simply stopped to pay back its bonds, the saga could have taken a very different turn.

However, the government remained defiant. Following the 2005 restructuring, the crisis still lingered on. The country’s reputation suffered after the IMF criticised Argentina for breaking with the accepted guidelines of debt restructuring negotiations. The IMF had expected Argentina to make an offer that ‘would attain broad support from creditors’[47], which, in the view of most market participants, it had failed to ensure.

Most experts considered Argentina’s confrontational approach towards holdouts as risky.[48] The broad drafting of its *pari passu* clause, which essentially emulated the controversial *pari passu* language holdouts leveraged against Peru in 2000[49], left the country exposed to

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[41] John Hornbeck, ‘Argentina’s Defaulted Sovereign Debt: Dealing with the “Holdouts”’ (6 January 2013) Congressional Research Service 5.

[42] ibid. *Prima facie*, the percentage of holdouts may appear low. However, compared to previous restructuring operations, it was unprecedented.

[43] United States Securities and Exchange Commission, ‘Annual Report of the Republic of Argentina’ (2009) 153 <https://www.sec.gov/Archives/edgar/data/914021/000090342310000550/roa-18k_0927.htm> accessed 1 August 2018.

[44] See Benjamin Hébert and Jesse Schreger, ‘The Costs of Sovereign Default: Evidence from Argentina’ (2017) 107(10) American Economic Review 3119.

[45] See above 4.2.

[46] See, eg, *NML Capital Limited v Argentina,* No 08 Civ 6978 (TPG), No 09 Civ 1707 (TPG), No 09 Civ 1708 (TPG), 7th December 2011, United States; New York; District Court for the Southern District of New York [SDNY].

[47] See Laura Alfaro, Noel Maurer and Faisal Ahmed, ‘Gunboats and Vultures: Market Reaction to the ‘Enforcement’ of Sovereign Debt’ (2010) 73 Law and Contemporary Problems 39, 53).

[48] ibid 54.

[49] Elliott Associates, a vulture holdout and parent company of NML Capital, invoked this clause in a dispute with Peru and obtained injunctive relief in a Brussels court, ultimately forcing Peru to settle with the fund for highly favourable terms. See above 3.5.6. for a discussion of the case.

significant litigation risk. Moreover, as IMF data shows, the acceptance rate of 76% was driven by the acquiescence of domestic creditors, most of which were banks and pension funds.[50] Among foreign investors, which usually include litigious vulture and retail holdouts, participation rates were considerably lower.

4.2.3. THE 2010 DEBT RESTRUCTURING

Against the backdrop of a low participation rate and a uniquely high number of outstanding holdout claims, Argentina commenced another round of negotiations with bondholders in 2010. Between 2005 and 2010, Argentina repaid debt owed to the Paris Club countries (ie official sector creditors) as well as IMF loans but continued to pursue a tough stance vis-à-vis private holdout creditors.[51] Argentina launched a new public exchange offer in April 2010, which brought the total participation rate in its debt restructuring to 92%.[52]

As Box 5 indicates, the majority of holdout investors following the 2010 debt restructuring deal held bonds governed by New York law (59%). Vulture funds bought the majority of these bonds at a hefty discount on the secondary market. Conversely, the group of holdouts who rejected the first but were willing to accept the second offer mainly comprised retail holdouts in possession of bonds governed by German law. As discussed below, the decision of German investors to accept the 2010 tender was sensible, as the enforcement of their instruments proved much more intricate than of securities governed by New York law.[53]

Box 5: Holdout investors in Argentina by governing law (in %)[54]			
Law	**percentage of outstanding principal amount**		
	2005	**2010**	**Post-2010**
Argentina	13%	4%	3%
Germany	20%	32%	22%
Japan	2%	1%	0%
New York	45%	35%	59%

[50] IMF, ‘Ex Post Assessment of Longer-Term Program Engagement and Ex Post Evaluation of Exceptional Access Sovereign’ (12 July 2006) 15 (cited in Alfaro et al (n 47).

[51] Hornbeck (n 41) 5.

[52] IMF (n 50).

[53] Indeed, since only very few Argentine assets were located within the reach of German’s courts, the decision to accept the restructuring offer made more sense for holders of German law bonds than for US holdouts. For an overview of holdout litigation before German courts, see below 4.4.

[54] Cruces and Samples (n 40).

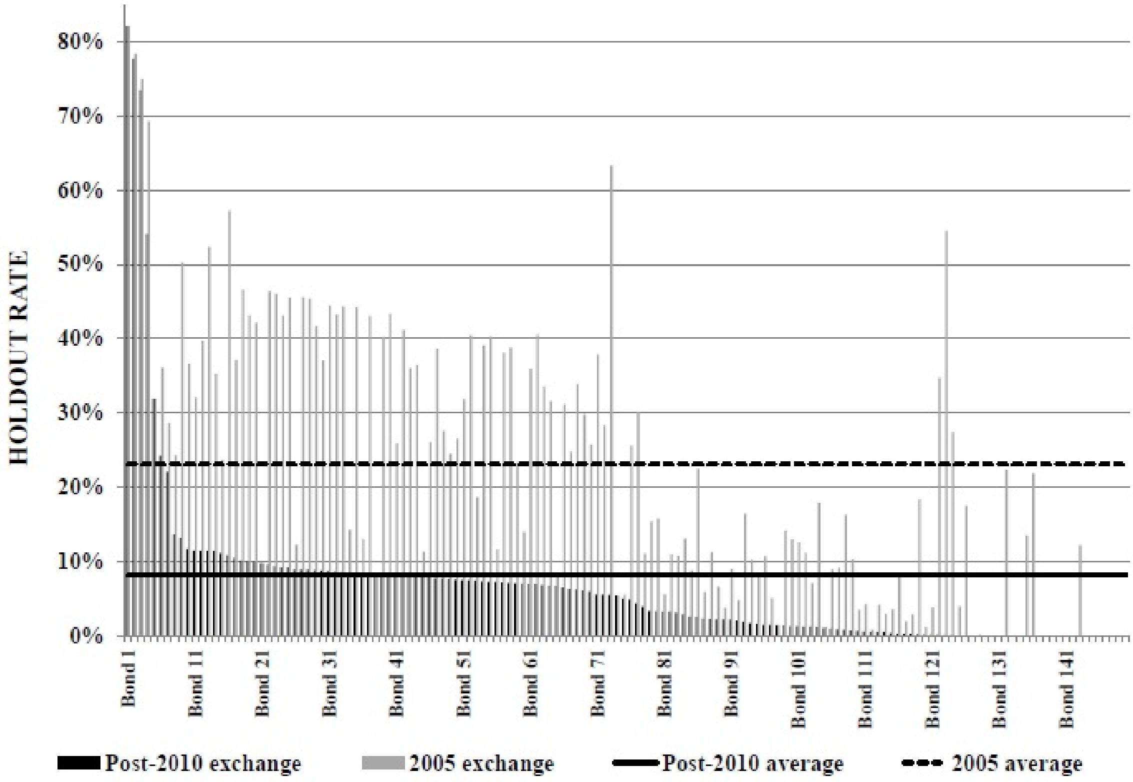
Other	1%	2%	2%
English	18%	26%	14%
Total	**USD81.26 billion**	**USD18.33 billion**	**USD6.03 billion**

Hornbeck puts forward three reasons why the Argentine government eventually decided to reopen negotiations with the private creditors it had previously shunned as 'vultures'.[55] First, Argentina had always relied on international capital markets to finance sovereign debt and its creditworthiness diminished radically in the wake of the 2005 restructuring deal. Second, the government's public debt management strategies became increasingly unsustainable after 2005, as it used much of its international reserves to pay down debts. Third, before the euro area crisis materialised in the course of 2010, market conditions were extremely favourable to place debt with very low interest rates, and enormous liquidity was available.

The increase in overall participation rate from 76% to 92% rendered the Argentine debt restructuring more comparable to debt workouts in other countries. Although the terms and conditions of the second offer were less attractive than the 2005 exchange, the low trading price of Argentine bonds and the government's persistent refusal to settle with the holdouts enticed many creditors to participate in the debt workout.[56] Moreover, arbitrageurs could make quick wins by acquiring heavily discounted bonds and subsequently accept the restructuring offer.[57] Figure 6 below quantifies the holdout creditor problem following both debt restructurings, depicting holdout rates across different Argentine bond series over time.

[55] Hornbeck (n 41) 6.
[56] Alfaro et al (n 47) 56.
[57] Drew Benson and Eliana Raszewski, 'Argentina Offers 66% Haircut on Defaulted Bonds' *Bloomberg* (New York, 15 April 2010) <http://www.bloomberg.com/news/2010-04-15/argentinaoffers-new-bonds-to-holders-of-20-bn-debt-to-end-default.html> accessed 4 August 2017.

Figure 6: 2005 and Post-2010 Holdout Rates by Bond[58]



After 2010, vulture holdouts controlling approximately 8% of outstanding Argentine debt carried on with their legal challenges against the 2005 debt restructuring. This meant that the country still owed roughly USD11.2 billion to holdouts. At this point, many of the litigious creditors had already obtained money judgements in US courts and were in the middle of debt collection proceedings.[59] Both the 'background noise' the trials created and the prospect of holdouts confiscating the proceeds from a new bond issuance made it impossible for Argentina to issue new debt instruments on US capital markets.[60] The country was *de facto* excluded from international debt markets until 2016 when it settled with all holdouts.

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[58] Cruces and Samples (n 40).
[59] One of the key judgements is discussed above 4.3.1.
[60] See Hébert and Schreger (n 44).

4.3. HOLDOUT LITIGATION BEFORE US COURTS

This section seeks to shed light on holdout litigation that has taken place in US (municipal) courts following Argentina's default on bonds governed by New York law. As indicated above, more than 50% of holdout investors after the 2010 debt restructuring deal held debt securities governed by the law of New York.

This section does not provide an exhaustive analysis of litigation in the US but focuses on the seminal judgements. A vast number of cases exist. However, most of them are generic court orders reaffirming Argentina's payment and thus not of relevance for the purpose of analysing holdout problems.

4.3.1. LIGHTWATER CORPORATION LTD. V. REPUBLIC OF ARGENTINA[61]

4.3.1.1. The Decision

In *Lightwater,* two distressed-debt funds sued Argentina to recover the principal and interest payments of bonds Argentina defaulted on in late 2001.[62] They had acquired roughly USD7 million in Argentine bonds only days before the default in December 2001.[63] Upon 1 May 2002, Lightwater and Old Castle gave notice of default and declared the acceleration of principal.[64] 16 days later, the plaintiffs filed suit in US federal court to seek summary judgments on their claims under the bonds, long before the debt restructuring negotiations even started. The plaintiffs claimed full repayment of the bonds in accordance with the contractual provision. Argentina put forward three defences against the plaintiff's motion: (i) international comity, (ii) champertous behaviour on the plaintiffs' side, and (iii) the act of state defence.

First, regarding defence of international comity, Argentina argued that it should be given an opportunity to achieve an overall debt restructuring. Given the severe economic crisis facing the government, the principles of international comity require the court to stay the plaintiff's

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[61] *Lightwater Corporation Limited v Argentina*, No 02 Civ 3804 (TPG), No 02 Civ 3808 (TPG), No 02 Civ 5932 (TPG), 14th April 2003, United States; New York; District Court for the Southern District of New York [SDNY].

[62] ibid.

[63] This fact alone points at the highly speculative nature of their investment decision as well as the hedge fund's likely intentions, ie to sue for full repayment.

[64] *Lightwater Corporation Limited v Argentina*, No 02 Civ 3804 (TPG), No 02 Civ 3808 (TPG), No 02 Civ 5932 (TPG), 14th April 2003, United States; New York; District Court for the Southern District of New York [SDNY].

actions. Relying on the principles established in *Pravin*[65], the court found that it is in the strong interest of the US (government) to ensure the enforcement of foreign debt obligations and declined to grant a stay of proceedings in order to allow for the completion of debt restructuring negotiation.[66] Since 'there is no assurance about the success timing of such [debt restructuring] negotiations', Judge Griesa saw no legitimate reason to impose a judicial standstill and thereby bar the plaintiff's actions against the defaulted sovereign.[67]

Second, the SDNY declined the applicability of N.Y. Judiciary Law § 489, also known as 'law of champerty'. As discussed above[68], the champerty provision prohibited investors under New York law from buying a bond 'with the intent and for the purpose of bringing an action of proceeding thereon'. Citing previous decisions[69], the court in *Lightwater* noted that 'where a bond is purchased with the intent to collect on that bond, the statute is *not* violated even though there is also an intention to collect by a lawsuit if necessary [emphasis added].' Indeed, in the present case '[t]he circumstances of the bond purchases by Lightwater demonstrate conclusively that these plaintiffs bought their bonds with the intention of collecting on them, even though they clearly had in mind that lawsuits might be necessary.'[70]

Finally, weighing in on the act of state defence, prominently discussed in the *Allied Bank* case[71], Judge Griesa held that '[a]n act of a nation in failing to make payments on bonds held in other countries does not constitute an act of state dealing with property located within the nation.'[72] A defaulted sovereign borrower could thus not invoke the act of state defence in instances where the situs of the bondholders is outside its territory.[73]

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[65] *Pravin Banker Assocs. v. Banco Popular Del Peru*, 109 F.3d 850, US App. 2d Cir. (25 March 1997).

[66] *Lightwater Corporation Limited v Argentina*, No 02 Civ 3804 (TPG), No 02 Civ 3808 (TPG), No 02 Civ 5932 (TPG), 14th April 2003, United States; New York; District Court for the Southern District of New York [SDNY]. It noted that 'Argentina had incurred an unconditional debt obligation, sovereign immunity had been explicitly waived and the country in fact ceased to pay the interest when it fell due'

[67] ibid.

[68] See above 3.5.6.

[69] The court cited, in particular, *Elliott Associates LP v Banco de la Nación and Peru*, 194 FRD 116 (SDNY 2000), 2000, United States; New York; District Court for the Southern District of New York [SDNY].

[70] *Lightwater Corporation Limited v Argentina*, No 02 Civ 3804 (TPG), No 02 Civ 3808 (TPG), No 02 Civ 5932 (TPG), 14th April 2003, United States; New York; District Court for the Southern District of New York [SDNY].

[71] *Allied Bank International v Banco Credito Agricola de Cartago and ors*, Case No 225, Docket 83-7714, 757 F 2d 516 (2d Cir 1985), 77 ALR Fed 281, (1985) 24 ILM 762, 18th March 1985, United States; Court of Appeals (2nd Circuit) [2d Cir]. See above 3.5.2. for a discussion of the judgement.

[72] *Lightwater Corporation Limited v Argentina*, No 02 Civ 3804 (TPG), No 02 Civ 3808 (TPG), No 02 Civ 5932 (TPG), 14th April 2003, United States; New York; District Court for the Southern District of New York [SDNY]. The court also shrugged of Argentina's claims that the investors had abused their rights by suing their bonds at a time when the issuer is having a severe economic crisis.

[73] ibid.

Consequently, the court granted the plaintiff's motion for summary judgement for more than USD700 million. However, while the District Court denied a stay on litigation, it stayed the judgement's execution in order to facilitate debt restructuring negotiations to commence without the threat of bondholder execution attempts. At the same time, the stay was only valid for one month and thus unsuitable to provide sufficient breathing space for Argentina to settle outstanding holdout claims by virtue of negotiation.[74]

4.3.1.2. Analysis

The District Court's reasoning in *Lightwater* aligns with previous decisions rendered in the context of sovereign debt crises, some of which we have described in detail above.[75] Most importantly, the *Lightwater* court affirmed the restrictive theory of sovereign immunity honed by the US judiciary in the course of the 1980s Latin American debt crises. Moreover, the court's assessment of the international comity principle reflected long-standing US case law, according to which enforcement of foreign judgements may be stayed if 'international duty and convenience warrant it.'[76] Accordingly, the judge in *Lightwater* took proper account of the potential harm executions against Argentine assets may inflict at such an early stage of the debt restructuring negotiations.[77]

Based on comity considerations, the SDNY imposed a stay on the execution of its money judgement. However, the stay was both temporary and short. The court also failed to explain how such short stay might enhance the likelihood of successful debt restructuring. Indeed, the stay was an ill-conceived and reluctant attempt by the District Court to strike a balance between the sovereign's endeavour to conclude a voluntary deal and the creditors' interest in obtaining judgements against the debtor as soon as possible after default.[78]

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[74] ibid.

[75] See above 3.5. In particular, *Argentina and Banco Central de la Republica Argentina v Weltover Incorporated and ors*, Final appeal, Docket No 91-763, 504 US 607 (1992), ILDC 1924 (US 1992), 112 S Ct 2160 (1992), 119 L Ed 2d 394 (1992), (1995) 100 ILR 510, 12th June 1992, United States; Supreme Court [US] and *Allied Bank International v Banco Credito Agricola de Cartago and ors*, Case No 225, Docket 83-7714, 757 F 2d 516 (2d Cir 1985), 77 ALR Fed 281, (1985) 24 ILM 762, 18th March 1985, United States; Court of Appeals (2nd Circuit) [2d Cir].

[76] The leading case on comity is *Hilton and ors v Guyot and Charles Fortin & Company*, Final appeal judgment, 159 US 113 (1895), ILDC 2166 (US 1895), 16 S Ct 139 (1895), 40 L Ed 95 (Sup Ct 1895), 3rd June 1895, United States; Supreme Court [US]. For a discussion of the principle in the context of Costa Rica's debt crisis, see above 3.5.1.

[77] Note that the judgement was rendered just months after Argentina's debt moratorium.

[78] Given that the *Lightwater* case is a case of pre-restructuring litigation, it epitomises the very problem that the IMF has cautioned against just a few years later in its SDRM proposal: the risk of private creditors 'rushing to the courthouse' in the wake of a sovereign default. See Anne Krueger, *A New Approach to Sovereign Debt Restructuring* (Washington, D.C.: IMF, 2002).

With respect to the act of state defence, the *Lightwater* decision reiterated the conclusions reached in *Libra Bank*[79], according to which US law recognised the 'territorial limitations of this doctrine with regard to debt instruments that are enforceable both within and outside the state's territory.'[80] Since Argentina had, like Costa Rica in the *Libra Banka* case, submitted disputes pertaining to its debt instruments New York law, the situs of the creditors' claims lay in the US rather than Argentina. It is widely acknowledged that – in order to avoid embarrassment of a government in foreign courts – the act of state doctrine is limited to acts that governments have taken within their *own* territory.[81]

However, in the remit of external debt financing, the traditional rules of the act of state doctrine have been subject to gradual erosion with the emergence of holdout litigation in New York in the late 1980s.[82] Indeed, if courts had opined that the debt's situs lay in fact in Argentina, they would have erected a significant obstacle to the enforcement of foreign law governed debt instruments in New York. As a result, the level of investor protection under local and foreign law would have likely converged, enabling the sovereign debtor to alter its obligations vis-à-vis foreign investors unilaterally.[83]

4.3.2. EM Ltd. v. Banco Central de la Republica Argentina[84]

4.3.3.1. The Decision(s)

The *EM v. BCRA* will be analysed more closely as it stands out from other debt enforcement attempts launched against Argentina in the US. The plaintiffs in this case targeted accounts held by Argentina's central bank, *Banco Central de la Republica Argentina* ('BCRA'), at the New York branch of the Federal Reserve Bank ('FRBNY'). More specifically, EM and NML, two archetypical vulture holdouts, sought declaratory judgement that BCRA was

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[79] *Libra Bank Limited v Banco Nacional de Costa Rica*, Decision on motion for summary judgment, 570 F Supp 870 (SDNY 1983), (1984) 78 AJIL 443, 6th July 1983, United States; New York; District Court for the Southern District of New York [SDNY]. See above 3.5.1. for an analysis.

[80] The German Constitutional Court, for instance, sought to ascertain whether an (economic) state of emergency in the debtor country may justify a judicial stay on litigation and enforcement. See below 4.4.2.

[81] For an overview, see, eg, Fausto de Quadros and John H. D. Stone, 'Act of State Doctrine' in in Rüdiger Wolfrum (ed), *Max Planck Encyclopaedia of Public International Law* (Heidelberg: Oxford University Press, 2007, online version).

[82] See, eg, Margaret E. Tahyar, 'The Act of State Doctrine: Resolving Debt Situs Confusion' (1986) 86(3) Columbia Law Review 594.

[83] De Quadros and Stone (n 81).

[84] *EM Limited and NML Capital Limited v Banco Central De La República Argentina and Argentina*, Appeal judgment, ILDC 2495 (US 2015), 800 F 3d 78 (2nd Cir 2015), 31st August 2015, United States; Court of Appeals (2nd Circuit) [2d Cir].

Argentina's 'alter ego' and that, therefore, BCRA was liable for Argentina's debt.[85] The plaintiffs filed suit after the Argentine government issued two emergency decrees in 2005, according to which reserves held by BCRA could be used for payments of obligations undertaken with international monetary authorities and the IMF.[86]

On 30 December 2005, the plaintiffs moved in the SDNY[87] to restrain funds held by BCRA, essentially arguing that with the two decrees Argentina had transferred the ownership of certain BCRA assets, notably funds held at the FRBNY, to the government.[88] The two vulture funds argued that, given the facts of the case, the BCRA had become the Argentine government's 'alter ego'.

The District Court[89] followed the plaintiffs' line of reasoning, holding that 'at the time of BCRA's repayment of Argentina's debt to the IMF in December 2005, BCRA was indeed Argentina's alter ego.' The Court of Appeals vacated this judgement, reaching a different conclusion. It remanded the case to the District Court for further proceedings.[90] Two legal questions lay at the core of the dispute: (a) should Argentina's waiver of sovereign immunity in its international bonds also be imputed to BCRA as its alter ego, and (b) did BCRA waive its sovereign immunity by engaging in 'commercial activity' in New York through its account at the FRBNY?[91]

With regard to the 'alter ego' theory, the Court of Appeals opined that Argentina would have had to control BCRA so extensively that 'a relationship of principal and agent was created'.[92] The Supreme Court established the standard under US federal law for the alter ego test in the

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[85] ibid.

[86] ibid [8].

[87] *EM Limited v Argentina*, No 06-0403-cv, 473 F 3d 463 (2d Cir 2007), 5th January 2007, United States; Court of Appeals (2nd Circuit) [2d Cir].

[88] *EM Limited and NML Capital Limited v Banco Central De La República Argentina and Argentina*, Appeal judgment, ILDC 2495 (US 2015), 800 F 3d 78 (2nd Cir 2015), 31st August 2015, United States; Court of Appeals (2nd Circuit) [2d Cir] [9].

[89] See *EM Limited and ors v Argentina*, Trial court judgment, 2010 US Dist LEXIS 59527 (SDNY 2010), 11th June 2010, United States; New York; District Court for the Southern District of New York [SDNY]. It is important to note that the District Court in New York concluded that the BRCA's assets held at the FRBNY were not protected by the FSIA (§ 1611(b)(1) USC.) which immunises 'property . . . of a foreign central bank . . . held for its own account.'

[90] *EM Limited and NML Capital Limited v Banco Central De La República Argentina and Argentina*, Appeal judgment, ILDC 2495 (US 2015), 800 F 3d 78 (2nd Cir 2015), 31st August 2015, United States; Court of Appeals (2nd Circuit) [2d Cir] [12].

[91] ibid [12-13].

[92] ibid [25].

Banec case.[93] According to the *Banec* test, for a central bank to be considered an 'alter ego', it:

(i) must use central bank assets like its own,

(ii) ignore the central bank's separate status,

(iii) obtain approvals for ordinary business decisions from a political actor, and

(iv) issue policies or directives that cause the bank to act directly on behalf of the sovereign state.[94]

On that basis, the Court of Appeals rejected the plaintiffs' claims. It could not find evidence supporting the claim that the sovereign used its influence over these directors to interfere with BCRA's ordinary business affairs.[95] Moreover, BCRA appeared to be a typical government instrumentality entitled to separate legal status.'[96] The court could also not detect signs of 'extensive control' of BCRA's day-to-day operations by the government branch.[97]

On the second important legal question, namely whether BCRA was to be held liable for the (numerous) judgements rendered against Argentina in New York, the court focused on the commercial activity waiver enshrined in § 1605(a)(2) FSIA.[98] While the plaintiffs had alleged that BCRA carried out such activities by purchasing dollars through their account at the FRBNY, the Court of Appeals concluded that the plaintiffs' 'capacious understanding of the commercial activity exception was inconsistent with the FSIA's presumption that foreign states and instrumentalities enjoy sovereign immunity'.[99]

Specifically, the court remarked that, if it was to follow the plaintiffs' theory, it would 'dramatically expand the scope of the commercial-activity exception to sovereign immunity'. This would imply that any wrongful use of dollars outside the US would lead to a sovereign

[93] *First National City Bank v Banco Para el Comercio Exterior de Cuba*, No 81-984, 462 US 611 (1983), 103 S Ct 2591 (1983), (1983) 22 ILM 840, 17th June 1983, United States; Supreme Court [US]. According to the Supreme Court [626]*:* '[f]reely ignoring the separate status of government instrumentalities would result in substantial uncertainty over whether an instrumentality's assets would be diverted to satisfy a claim against the sovereign, and might thereby cause third parties to hesitate before extending credit to a government instrumentality without the government's guarantee. As a result, the efforts of sovereign nations to structure their governmental activities in a manner deemed necessary to promote economic development and efficient administration would surely be frustrated.'

[94] *EM Limited and NML Capital Limited v Banco Central De La República Argentina and Argentina*, Appeal judgment, ILDC 2495 (US 2015), 800 F 3d 78 (2nd Cir 2015), 31st August 2015, United States; Court of Appeals (2nd Circuit) [2d Cir] [26].

[95] ibid [29].

[96] ibid [27].

[97] ibid [33].

[98] ibid [38-42].

[99] ibid [42].

immunity waiver, with every country or central bank conducting business in New York City being at risk of losing their sovereign immunity. Hence, it did not matter to the court that BCRA purchased the dollars to repay the loans in the US; it could have done so using any other bank account in the US or abroad.[100]

4.3.3.2. Analysis

The decision in *EM v. BCRA*[101] was important in that it delineated the boundaries of holdout litigation. The Court of Appeals made clear that vulture holdouts could not simply seize central bank assets that foreign governments and their central banks stored at the FRBNY in order to collect on money judgements. Rather, they would have to overcome the *Banec* test, as established by the Supreme Court in 1983. Given the lack of attachable sovereign assets in 'creditor-friendly' jurisdictions, foreign-held central bank funds would constitute an attractive target for holdouts. Many central banks have accounts at foreign central banks, usually to purchase foreign currency. The FRBNY in fact offers banking and financial services to about 250 central banks, governments, and international official institutions on behalf of the Federal Reserve System.[102]

In the Second Circuit's opinion, a central bank's immunity from holdout litigation must always be assessed by taking into account the respective sovereign immunity waiver in the sovereign bond documentation and, more specifically, whether such waiver also extends to the borrowing government's central bank. In this context, litigants have adopted two major strategies to try and get hold of funds deposited at the FRBNY: (i) directly exploit the legal loophole in the FSIA (stemming from the fact that central banks are engaged in commercial activities) or (ii) argue that § 1611(b)(1) FSIA does not apply to the central bank since it is the government's 'alter ego'. *EM v. BCRA* was a case in point for this strategy, though it also elucidated the limits of both arguments.

Given that the FSIA is silent on the 'alter ego' test, US courts had to rely on principles of international law and federal common law, borrowing heavily from the principle of 'veil piercing' under (Anglo-Saxon) corporate law. Essentially, the veil of a corporate entity is pierced if the corporation was 'so heavily controlled by its owner that a relationship of

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[100] ibid [41].
[101] ibid.
[102] See FRBNY, 'Services for Central Banks and International Institutions' (October 2015) <https://www.newyorkfed.org/aboutthefed/fedpoint/fed20> accessed 16 November 2017.

principal and agent is created.'[103] Nonetheless, directly applying the concept of veil piercing to central banks, as the US Supreme Court did in the *Banec* case[104], fell short of taking into account the special relationship between governments and their central banks.[105] Most importantly, the structure of the FSIA (especially the additional protection of central banks under § 1611 of the FSIA) recognised that central bank functions are sufficiently critical to warrant additional immunity.

As Foster points out, in applying the *Banec* standard, courts have declined to respect both the separate personality of a state agency and vice versa.[106] However, in the special case of central banks, Foster also stresses that the FSIA's legislative history 'indicates that Congress conferred special protection on such property to encourage foreign governments to maintain foreign currency reserves in the US, as well as to avoid tension with other countries that could result from large seizures of central bank assets.'[107] Moreover, Aizenman emphasises that 'providing a secure immunity regime is necessary to the global financial system's stability'.[108]

A glance beyond US-specific obstacles to enforcing judgements against a foreign country's central bank reveals a broadly consistent picture across major jurisdictions, albeit differences persist. For instance, in Germany the immunity of central banks from execution procedures is not enshrined in domestic law.[109] German case law requires an unambiguous and explicit waiver of sovereign immunity for central bank assets.[110] In Belgium, for instance, a vulture fund tried to attach assets of the central bank of the Democratic Republic of Congo but

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[103] *EM Limited and NML Capital Limited v Banco Central De La República Argentina and Argentina,* Appeal judgment, ILDC 2495 (US 2015), 800 F 3d 78 (2nd Cir 2015), 31st August 2015, United States; Court of Appeals (2nd Circuit) [2d Cir].

[104] *First National City Bank v Banco Para el Comercio Exterior de Cuba,* No 81-984, 462 US 611 (1983), 103 S Ct 2591 (1983), (1983) 22 ILM 840, 17th June 1983, United States; Supreme Court [US].

[105] ibid.

[106] George Foster, 'When Commercial Meets Sovereign: A New Paradigm for Applying the Foreign Sovereign Immunities Act in Crossover Cases' (2014) 52(1) Houston Law Review 361.

[107] ibid 402 (noting however that automatic protection of central bank assets is not warranted, especially with respect to 28 USC. § 1611 (b), according to which central bank assets are only protected if they are held for the bank's own account).

[108] Joshua Aizenman, 'Foreign Exchange Reserve Management' in Steven Durlauf and Lawrence Blime (eds), *The New Palgrave Dictionary Of Economics* (London: Palgrave Macmillan, 2009).

[109] See Alexander Szodruch, *Staateninsolvenz und private Gläubiger: Rechtsprobleme des Private Sector Involvement bei staatlichen Finanzkrisen im 21. Jahrhundert* (Berlin: Berliner Wissenschaftsverlag, 2010) 378-379.

[110] See, eg, Matthias J. Müller, *Staatsbankrott und private Gläubiger* (Baden-Baden: Nomos, 2015) 205.

remained unsuccessful.[111] By contrast, in Switzerland, courts have loosened the requirements to pierce the veil between the state and the central bank.[112]

Overall thus, notwithstanding that US courts have entertained very powerful remedies against sovereign borrowers to compel debt repayment[113], they respect central bank immunity and prohibit holdouts from tapping central bank assets to satisfy claims against the government. Consequently, countries need not shield their central bank accounts abroad in the run-up to a sovereign debt crisis as cautiously as they have to do with other governmental assets held abroad.[114]

4.3.3. NML Capital Ltd. v. Republic Of Argentina[115]

The *NML* case, dubbed 'sovereign debt's trial of the century' by the Financial Times[116], became prominent due to the following two reasons. First, US courts entertained an unconventional interpretation of the *pari passu* clause. Akin to the plaintiff in the *Eliott* litigation[117], NML Capital convinced the courts in all instances that Argentina had violated this provision by not paying all bondholders ratably.[118] Second, the NML decision established a new avenue for sovereign debt enforcement under New York law: creditors successfully applied for an injunctive relief instead of needing to enforce a money judgement.

Essentially, the injunction leaves a sovereign with two options: Either pay all creditors (holdout and restructured creditors) in full, or default on all debt obligations. Argentina opted for the latter and defaulted on its external debt in 2014. The holdouts ultimately got their way

[111] Patrick Wautelet, 'Vulture Funds, Creditors and Sovereign Debtors: How to Find a Balance?' in Matthias Audit, *Insolvabilité des États et Dettes Souveraines* (Paris: LDGJ, 2011) 37-40.

[112] ibid 38 (remarking that 'the Swiss Federal Tribunal ruled in the famous *Noga* saga that the creditor could seize tolls collected on behalf of the Russian authority for air control, held by IATA (International Air Transport Association)). This said, the BIS, as an international organisation, enjoys strong statutory and judicial protection; see below 4.9. for a discussion of holdout litigation in Switzerland in the context of Argentina.

[113] See above 4.3.3. (discussing *pari passu* injunctions, which US courts have granted to vulture holdouts).

[114] See below 4.8. for a case where NML attempted to attach accounts held by Argentina at the BIS.

[115] *NML Capital Limited v Argentina*, No 08 Civ 6978 (TPG), No 09 Civ 1707 (TPG), No 09 Civ 1708 (TPG), 7th December 2011, United States; New York; District Court for the Southern District of New York [SDNY] [2].

[116] Joseph Cotterill, 'Choose your own adventure, sovereign debt trial of the century edition' *Financial Times Alphaville* (London, 8 February 2013) <https://ftalphaville.ft.com/2013/02/08/1379162/choose-your-own-adventure-sovereign-debt-trial-of-the-century-edition/> accessed 2 July 2017.

[117] See *Elliott Associates LP v Panama*, No 96 Civ 5514(DC), 975 F Supp 332 (SDNY 1997), 10th September 1997, United States; New York; District Court for the Southern District of New York [SDNY], which is discussed above in 3.5.6.

[118] Compare eg Anna Gelpern, 'Contract hope and sovereign redemption' (2013) 8(2) Capital Markets Law Journal 132, 135.

when the newly elected Macri government decided to pay them off in early 2016 in an attempt to regain international investors' confidence.

4.3.3.1. Litigation Before the SDNY

The vulture holdout NML Capital became embroiled in litigation against Argentina in 2005. It had bought Argentine public debt securities for a steep discount in the wake of the Argentine default of 2001. The government bonds showed a face value of roughly USD1.6 billion, thus making up more than a fifth of all remaining holdout claims. The plaintiff refused to participate in the debt restructuring deals of 2005 and 2010, hoping that, by virtue of litigation, Argentina would be cajoled into paying more than it offered to restructured bondholders.[119] At first, NML sought to obtain money judgements from the SDNY to attach Argentine assets located in the US or other jurisdictions.[120] Litigation records indicate that the first money judgement was passed in NML's favour in May 2006.[121] Several other judgements followed.[122]

NML Capital went great lengths to seize Argentine assets with these judgements – both in the US and abroad. For example, as discussed below[123], the hedge fund convinced a court in Ghana to prevent an Argentine navy ship from leaving the country for more than 2 months.[124] The Argentine government also saw itself forced to ground the presidential plane after NML had obtained court orders to seize the jet. NML even targeted Argentine dinosaur fossils on exhibition in Europe for attachment.[125] However, most of these cases had symbolic character and failed to yield the desired monetary satisfaction on the holdout's side.

Following years of costly but relatively unsuccessful execution proceedings against Argentina[126], NML's lawyers revised their strategy. After perusing through Argentina's bond

[119] To be precise, NML sought to sue for the bonds' full face value plus outstanding interests. See, eg, The Economist, 'At last' *The Economist* (London, 5 May 2016).

[120] *NML Capital Limited v Argentina*, Plaintiff's motion for summary judgment, No 05 Civ 2434, 10th May 2006, United States; New York; District Court for the Southern District of New York [SDNY].

[121] ibid.

[122] *NML Capital Limited v Argentina*, 12th September 2008, United States; New York; District Court for the Southern District of New York [SDNY].

[123] See below 4.8.2.

[124] See David Smith, 'Seized Argentinian sailing ship leaves Ghana' *The Guardian* (London, 20 December 2012).

[125] See Michael Hiltzik, 'Argentina is Cautionary Tale as US Debates Debt Limit' *Los Angeles Times* (Los Angeles, 15 January 2013).

[126] Even if Argentina would have been able to attach the Argentine navy vessel, the presidential airplane or the central bank assets, the proceeds would never have been enough to cover the outstanding debt of over USD1 billion. See for the background story, Andrea Fontevecchia, 'The Real Story Of How A Hedge Fund Detained A Vessel In Ghana And Even Went For Argentina's "Air Force One"' *Forbes Markets* (New York, 10 May 2012)

documentation and carefully studying the history of sovereign debt litigation[127], they came up with an old but compelling idea. They realised that Argentina had relied on a arguably creditor-friendly version of the *pari passu* clause. Specifically, the *pari passu* clause used in Paragraph 1(c) of Argentina's 1994 Fiscal Agency Agreement (FAA) read as follows:

> '[t]he Securities will constitute ... direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank pari passu without any preference among themselves. The payment obligations of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness...'

From 2011 onwards, NML argued in its court submissions and pleadings that Argentina's actions were in breach of the *pari passu* clause. Judge Griesa at the SDNY eventually agreed with the plaintiff and granted a motion for partial summary judgment.[128] He declared that

> '[t]he Republic violates Paragraph 1(c) of the FAA whenever it lowers the rank of its payment obligations under NML's Bonds below that of any other present or future unsecured and unsubordinated External Indebtedness, including (and without limitation) by relegating NML's bonds to a non-paying class by failing to pay the obligations currently due under NML's Bonds *while at the same time making payments currently due to holders of other unsecured and unsubordinated External Indebtedness* or by legislative enactment.' [emphasis added][129]

By explicitly referring to Argentina's reluctance to 'make payments currently due', the court opted for a clear endorsement of the controversial 'payment' interpretation. In addition, the court clarified that the Republic unduly lowered the rank of NML's bonds in violation of the *pari passu* clause when it enacted Law 26,017 (the 'Lock Law').[130]

Importantly, the SDNY also asserted that, given Argentina's persistent violations of the *pari passu* clause, it had the authority to issue injunctive remedies against Argentina under Rule 65(d) of the US Federal Rules of Civil Procedure[131] as well as the court's inherent equitable

<http://www.forbes.com/sites/afontevecchia/2012/10/05/the-real-story-behind-the-argentine-vessel-in-ghana-and-how-hedge-funds-tried-to-seize-the-presidential-plane/> accessed 18 February 2017.

[127] For an overview see above 3.5.

[128] *NML Capital Limited v Argentina*, No 08 Civ 6978 (TPG), No 09 Civ 1707 (TPG), No 09 Civ 1708 (TPG), 7th December 2011, United States; New York; District Court for the Southern District of New York [SDNY].

[129] ibid [5].

[130] ibid [6].

[131] Rule 65(d) of the US Federal Rules of Civil Procedure outlines the contents of an order granting and injunction. Such injunction must include, *inter alia*, (a)State the reasons why it is issued; (b) State its terms

powers.[132] The court found such injunctions to be necessary to facilitate debt enforcement. Indeed, in Judge Griesa's opinion, 'NML [was] irreparably harmed by and has no adequate remedy at law for the Republic's ongoing violations of Paragraph 1(c) of the FAA [the *pari passu* clause] …'. The '*pari passu* injunction' was designed to pressure Argentina into paying holdout creditors alongside the restructured creditors.[133]

Another crucial feature of the injunction was that it also obligated third parties. Specifically, the SDNY held that 'all parties involved in advising upon, preparing, processing, or facilitating any payment on the Exchange Bonds…shall be bound by the terms of this order'.[134] This meant that paying agents, clearing houses or other financial agents involved in Argentina's bond payments would act in contempt of a US court if they were to assist the government in circumventing the *pari passu* injunction.

It was clear to the SDNY that targeting third-party payment and clearing agents would significantly leverage its judgements vis-à-vis foreign sovereigns trying to evade money judgements and other court orders.[135] Judge Griesa also prohibited any changes to the payment transfer mechanism, which relied heavily on agents located in New York City.[136] None of the third parties involved, most of which were big US banks, were keen to act in contempt of the SDNY.

Due to the ruling, Argentina's ability to service debts owed to non-holdouts was severely impaired. Unsurprisingly, Argentina immediately appealed the decision.

4.3.3.2. The Second Circuit Court of Appeal

4.3.3.2.1. The Second Circuit's Ruling of 2012

Reviewing the District Court's injunctions against Argentina, the Court of Appeals first assessed the interpretation of the *pari passu* clause in Argentina's bond indentures. Like the

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specifically; and (c) describe in reasonable detail the acts or acts restrained or required. For an online version of the Federal Rules of Civil Procedure see, eg, Cornell University Law School, 'Federal Rules of Civil Procedure' (as of 1 December 2015) <https://www.law.cornell.edu/rules/frcp> accessed 1 August 2017.

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[133] Mark Weidemaier and Anna Gelpern, 'Injunctions in Sovereign Debt Litigation' (2014) 31 Yale Journal on Regulation 189.

[134] *NML Capital Limited v Argentina*, Docket No 08 Civ 6978, 21st November 2012, United States; New York; District Court for the Southern District of New York [SDNY] [2(e)].

[135] See Natalie A. Turchi, 'Restructuring a Sovereign Bond Pari Passu Work-Around: Can Holdout Creditors Ever Have Equal Treatment?' (2015) 83(4) Fordham Law Review 2199. For a review of the *Elliott* litigation, see above 3.5.6.

[136] *NML Capital Limited v Argentina*, No 08 Civ 6978 (TPG), 23rd February 2012, United States; New York; District Court for the Southern District of New York [SDNY].

SDNY, the Second Circuit found that the two sentences of the *pari passu* clause in the FAA '[…] protect[ed] investors against any form of discrimination: the issuance of other superior debt (first sentence) *and the giving of priority to other payment obligations* (second sentence) [emphasis added].' [137] Thus, the Second Circuit, too, endorsed the 'ranking' and the 'payment' interpretation of this clause.

With respect to the *pari passu* injunction, the Second Circuit rejected Argentina's claim that 'plaintiffs cannot now rely on 'equity' to interfere with payments to third parties who have obviously developed reasonable expectation of that regular source of income.'[138] The Court of Appeals instead held that

> '[…] under New York law the equitable defence of laches requires: (1) conduct giving rise to the situation complained of, (2) delay in asserting a claim for relief despite the opportunity to do so, (3) lack of knowledge or notice on the part of the offending party that the complainant would assert the claim, and (4) injury or prejudice to the offending party as a consequence relief granted on the delayed claim.'[139]

Thus, an injunctive relief could not only be an alternative to a summary judgment but could also be granted in a situation where no adequate monetary remedy was available.[140] In the court's view, the only requirement was that the balance of equities must tip in the plaintiff's favour. [141] This was the case in the present trial, since 'monetary damages [were] an ineffective remedy for the harm plaintiffs have suffered as a result of Argentina's breach [because] Argentina will simply refuse to pay any judgments.'[142]

The Second Circuit further held that the SDNY did not, as alleged by the defendant, abuse its discretionary powers by prescribing actions that could – as a matter of fact – not be complied with. In fact, Argentina had in the meantime accumulated over USD40 billion in foreign currency reserves – several times the amount claimed by the plaintiffs.[143]

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[137] ibid [18].

[138] *NML Capital Limited v Argentina*, Opinion affirming orders of the district court, 727 F 3d 230 (2d Cir 2013), 23rd August 2013, United States; Court of Appeals (2nd Circuit) [2d Cir] [21]

[139] ibid [21-22]. In this respect, the Court cited *Krantz v Chateau* Stores of Canada Limited, 256 A.D.2d 186 (1998), 683 N.Y.S.2d 24 (1998), 22nd December 1998, United States; New York; Supreme Court Appellate Division [NY App Div].

[140] *NML Capital Limited v Argentina*, Opinion affirming orders of the district court, 727 F 3d 230 (2d Cir 2013), 23rd August 2013, United States; Court of Appeals (2nd Circuit) [2d Cir] [22].

[141] ibid.

[142] ibid [24].

[143] ibid [26].

Argentina had also asserted in its appeal that the injunction would violate § 1609 FSIA, the provision protecting property of a foreign state in the US from attachment arrest and execution. The Second Circuit replied that the injunctions at stake '[did] not attach, arrest or execute upon any property [but] direct Argentina to comply with its contractual obligations not to alter the rank of its payment obligations.'[144] Specifically, the injunctive remedies did not transfer any dominion or control over sovereign property to the court; they did not even require Argentina to pay any bondholder any amount of money or limit the other uses to which Argentina may put its fiscal reserves.[145]

Finally, the Second Circuit examined the practical effects of enabling a holdout creditor to pressure a sovereign debtor into paying the government bonds' full face value. In its *amicus brief*, the US government had argued that the equitable remedy granted by the District Court would allow 'a single creditor to thwart the implementation of an internationally supported restructuring plan.'[146] The court, however, rejected this line of reasoning, noting that it was 'up to the sovereign – not any 'single creditor' – whether it will repudiate that creditor's debt in a manner that violates a *pari passu* clause'.[147]

While it essentially approved the *pari passu* injunction, the Court of Appeals also asked the SDNY to define its scope in order to avoid that the injunction would be applied to broadly.[148] Moreover, the court demanded further clarification from Judge Griesa with respect to the exact functioning of the payment formula.[149]

4.3.3.2.2. The Second Circuit's Ruling of 2013

After the Court of Appeals for the Second Circuit remanded the injunctions granted by Judge Griesa, the District Court issued amended injunctions on 21 November 2012.[150] In its 2013

[144] ibid [25].
[145] ibid.
[146] ibid [27].
[147] ibid.
[148] ibid [22].
[149] ibid. To calculate the amount due to the holdout investors the Ratable Payment requires first determining a 'Payment Percentage,' a fraction calculated by dividing 'the amount actually paid or which the Republic intends to pay under the terms of the Exchange Bonds by the total amount then due under the terms of the Exchange Bonds.' The Payment Percentage is in turn multiplied by 'the total amount currently due to [plaintiffs],' including pre-judgment interest. Because Argentina has defaulted on all of plaintiffs' bonds, the 'amount currently due' on the FAA Bonds is the amount due under the FAA's Acceleration Clause – the entire principal amount of the bonds – plus pre-judgment interest which, according to plaintiffs, totals approximately USD1.33 billion.
[150] *NML Capital Limited v Argentina*, Docket No 08 Civ 6978, 21st November 2012, United States; New York; District Court for the Southern District of New York [SDNY].

ruling[151], the Court of Appeals reviewed these amended injunctions and allowed the defendant Argentina to propose an alternative payment formula and schedule for the outstanding bonds. However, Argentina kept its defiant stance and repeatedly stated that it 'would not voluntarily obey' the SDNY's injunctions, even if those injunctions were upheld by the appellate court.[152]

The 2013 ruling by the Second Circuit in the NML case focused, in particular, on two issues: first, the alleged ambiguity of the first payment formula and second, the circle of third parties addressed by the equitable remedy.

First, concerning the alleged injuries to Argentina, the government argued that the amended injunctions violated the FSIA by forcing Argentina to use resources that the statue protects.[153] The Court of Appeals again rejected this assertion by emphasising that '[the injunctions] do not attach, arrest, or execute upon any property'.[154] Second, the court declined Argentina's argument that the injunctions were unequitable, noting that '[…] it [was] equitable for one creditor to receive what it bargained for, and is therefore entitled to, even if other creditors, when receiving what they bargained for, do not receive the same thing.'[155] Seemingly unimpressed, the Court of Appeals made clear that it would not let Argentina dictate the availability or terms of relief under New York law by threatening third parties, most notably the restructured bondholders.[156]

As regards alleged injuries to participants in the bond exchange system, the Second Circuit further held that the injunctions only enjoined Argentina but that they automatically forbade others who act in 'active concert or participation' with the enjoined party from assisting in a violation of the order.[157] With respect to extraterritoriality, the court clarified federal courts may enjoin any conduct that 'has or is intended to have substantial effects within the US'.[158] Finally, the Second Circuit denied that the judgement would have 'cataclysmic repercussions

[151] *NML Capital Limited v Argentina*, Opinion affirming orders of the district court, 727 F 3d 230 (2d Cir 2013), 23rd August 2013, United States; Court of Appeals (2nd Circuit) [2d Cir].
[152] ibid.
[153] ibid [10].
[154] ibid [11].
[155] ibid [12].
[156] ibid [14].
[157] ibid.
[158] ibid [15-16]. Also see *United States v Davis*, No 84-1392, No 11, 767 F 2d 1025 (2d Cir 1985), 31st May 1985, United States; Court of Appeals (2nd Circuit) [2d Cir].

in the capital markets and the global economy', as argued by Argentina as well as foreign governments, market participants and renowned scholars.[159]

The court stated prosaically that 'sovereign borrowers and lenders [were] free to devise various mechanisms to avoid holdout litigation if that [was] what they wish[ed] to do.'[160]

4.3.3.3. The US Supreme Court[161]

The Supreme Court played a relatively minor role in the *NML* litigation: it denied two petitions for *certiorari* to review the Second Circuit's affirmance of the injunctions that enjoined Argentina and its agents. Consequently, in June 2014, the remedies passed by the SDNY and affirmed by the Second Circuit attained legal force. The Supreme Court's denial to hear the case was reported in newspapers around the world.[162] Given that Argentina signalled its refusal to comply with the injunction, one of the world's leading ratings agency, Standard & Poor's, downgraded Argentina to default status a few weeks after the Supreme Court's decision.[163] For the first time in history, a sovereign defaulted on its public debts due to a foreign court decision.

While the Supreme Court refused to review the injunction orders, it did look at the limits the FSIA imposed on US Courts to order extraterritorial, post-judgement discovery.[164] Argentina asserted that NML's motions to discovery of Argentina's property, affirmed by the Second Circuit, violated the FSIA.[165] The order, it submitted, transgressed the FSIA because it permitted discovery of Argentina's extraterritorial assets.[166] NML's objective was to 'locate Argentina's assets and accounts, learn how Argentina moves its assets through New York

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[159] For an overview of all *amicus briefs* submitted in the *NML* trial before the US Supreme Court, see EMTA, 'Amicus Briefs' <http://www.emta.org/template.aspx?id=2292> accessed 2 August 2016. The list includes the Brazilian, the French and the Mexican government, several clearing houses as well as Joseph Stieglitz, Anne Krueger and numerous Argentine law professors.

[160] *NML Capital Limited v Argentina*, Opinion affirming orders of the district court, 727 F 3d 230 (2d Cir 2013), 23rd August 2013, United States; Court of Appeals (2nd Circuit) [2d Cir] [24].

[161] *Argentina v NML Capital Limited*, Appeal judgment, Docket No 12-842, 573 US ___ (2014), ILDC 2201 (US 2014), 134 S Ct 2250 (2014), 189 L Ed 2d 234 (2014), 16th June 2014, United States; Supreme Court [US].

[162] See, eg, Adam Liptak, 'Argentina's Debt Appeal Is Rejected by Supreme Court' *The New York Times* (New York, 16 June 2014) <http://dealbook.nytimes.com/2014/06/16/supreme-court-denies-appeal-by-argentina/?_r=0> accessed 2 August 2017; Larry Elliott, 'Argentina debt crisis fears grow after US supreme court ruling' *The Guardian* (London, 16 June 2014); Lawrence Hurley and Sarah Marsh, 'Supreme Court rejects Argentina appeal in bond fight' *Reuters* (New York, 16 June 2014) <http://www.reuters.com/article/us-usa-court-argentina-idUSKBN0ER1MT20140616> accessed 2 August 2017.

[163] Katy Watson, 'Argentina defaults for second time' *BBC News* (London, 31 July 2014) <http://www.bbc.com/news/business-28578179> accessed 2 August 2017.

[164] Karen Halverson Cross, 'The Extraterritorial Reach of Sovereign Debt Enforcement' (2015) 12 Berkeley Business Law Journal 111.

[165] *Argentina v NML Capital Limited*, Appeal judgment, Docket No 12-842, 573 US ___ (2014), ILDC 2201 (US 2014), 134 S Ct 2250 (2014), 189 L Ed 2d 234 (2014), 16th June 2014, United States; Supreme Court [US].

[166] ibid [3].

and around the world, and accurately identify the places and times when those assets might be subject to attachment and execution'.[167] Both lower courts held that, since Argentina expressly waived its immunity in the debt instruments, the concerns expressed dealing with jurisdictional discovery under the FSIA were not relevant.[168]

Rules of post-judgement discovery under US law are complex and largely irrelevant for the subject matter of this thesis. What should however be taken away from the Supreme Court's decision in *NML v. Argentina* is that private creditors have strong rights to identify foreign sovereign property under US law. The Supreme Court confirmed that holders of government debt governed by New York law have a right to information necessary to locate executable assets both in the US and abroad. Crucially, the Supreme Court remarked that 'there [was] no provision in the FSIA limiting or forbidding discovery in aid of execution of a foreign-sovereign judgement debtor's assets.'[169]

Argentina argued that the prohibition to execute a judgment against certain property (eg diplomatic or military assets) also forbade the discovery of information pertaining to that property.[170] It asserted that 'the discovery order would force his client to divulge even assets that could never be executed upon.'[171] However, Justice Scalia, who delivered the Supreme Court's opinion, made clear that the 'silence' in the FSIA with respect to a scenario where a discovery order may extend to immune assets must not be interpreted to the creditors' disadvantage. In fact, he noted, NML had sought to identify property because it did not know which executable Argentine assets were located where.

The Supreme Court acknowledged that the plaintiff might take a different view than the sovereign as regards the immunity of certain assets.[172] However, the court also opined that this question would have to be settled in a court of law and could not be decided unilaterally by the sovereign debtor. With this opinion, the Supreme Court rejected the US government's stance on the interpretation of the FSIA, which it had presented in an *amicus* brief.[173]

[167] ibid [2].
[168] Halverson Cross (n 164) 127.
[169] *Argentina v NML Capital Limited*, Appeal judgment, Docket No 12-842, 573 US ___ (2014), ILDC 2201 (US 2014), 134 S Ct 2250 (2014), 189 L Ed 2d 234 (2014), 16th June 2014, United States; Supreme Court [US] [8].
[170] ibid [9-10].
[171] See, eg, Joseph Cotterill, 'The injunction has landed: the 'Black Eagle', pari passu and sovereign debt enforcement' (2014) 9(3) Capital Market Law Journal 277.
[172] ibid [8].
[173] Brief for the United States as Amicus Curiae in Support of Petitioner, *Republic of Argentina v. NML Capital, Ltd.*, 134 S. Ct. 2250, 2256 (2014) (No 12-842).

In this brief, the US government had argued that '[…] discovery […] may extend only to assets as to which there is reasonable basis to believe that an exception to execution immunity under Section 1610 [of the FSIA] applies'.[174] It had also stated that 'US courts would issue orders that constitute an affront to foreign states' coequal sovereignty'.[175] The Supreme Court shrugged these concerns off, saying that the government should amend the FSIA rather than criticise the Second Circuit and the Supreme Court for filling gaps in the law.[176]

<u>4.3.3.4. Analysis</u>

With their decisions in *NML v. Argentina*, US courts have created strong incentives for creditors to delay debt restructuring with a sovereign debtor and hold out for a better deal.[177] As argued by the US Ministry of Justice in its *amicus brief* to the Second Circuit, the ruling in *NML v. Argentina* 'undermined a system of cooperative resolution of sovereign debt crises' and rendered future voluntary debt restructurings even more difficult.[178]

<u>*4.3.3.4.1. The Pari Passu Injunction*</u>

While money judgements have allowed vulture funds to attach certain sovereign assets[179], the *pari passu* injunction considerably bolsters their ability to exert pressure on a defiant sovereign borrower. Virtually any payment made by a debtor country to bondholders that passes through New York City can be blocked by virtue of this remedy. Moreover, a careful reading of the SDNY's order suggests that all payments extended to restructured bondholders (coupon and principal) by Argentina would trigger payment of all amounts due to bonds held by holdouts (coupon *and* principal).[180] Given the remedy's reach, any financial institution

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[174] ibid [17].

[175] ibid [20].

[176] *Argentina v NML Capital Limited*, Appeal judgment, Docket No 12-842, 573 US ___ (2014), ILDC 2201 (US 2014), 134 S Ct 2250 (2014), 189 L Ed 2d 234 (2014), 16th June 2014, United States; Supreme Court [US] [11] ('These apprehensions are better directed to that branch of government with authority to amend the Act—which, as it happens, is the same branch that forced our retirement from the immunity-by factor-balancing business nearly 40 years ago').

[177] Lee C. Buchheit and G. Mitu Gulati, 'Restructuring sovereign debt after *NML v Argentina*' (2017) 12(2) Capital Markets Law Journal 224 (arguing that *NML v. Argentina* upset the strategic balance between sovereign debtors and creditors that has encouraged both to negotiate rather than litigate).

[178] *NML Capital Limited v Argentina*, Order, Docket No 12-105, 1st March 2013, United States; Court of Appeals (2nd Circuit) [2d Cir].

[179] See above 3.5. for a short history of holdout litigation.

[180] Lee C. Buchheit and G. Mitu Gulati, 'Restructuring sovereign debt after *NML v Argentina*' (2017) 12(2) Capital Markets Law Journal 224.

involved in the payment and clearing process for sovereign bonds would risk acting in contempt of the court.

Reactions among market participants, international institutions, and leading scholars confirmed that 'sovereign debt's trial of the century' has heralded a new era of sovereign finance. Both the unorthodox interpretation of the *pari passu*[181] provision and the (injunctive) remedy it accommodated have severely shaken the foundations of sovereign finance and upset the sovereign debt equilibrium referred to above.[182]

The outrage notwithstanding, experts hold different views on the actual impact of this alteration in New York law. For example, Ku contends that '[…] it is still possible, even with a favourable *pari passu* clause interpretation, for a sovereign to continue to park assets in the United States while the holdout creditors attempt to collect from third-party intermediaries', which would in turn 'allow sovereigns like Argentina to offload their costs onto those third parties.'[183] Similarly, Porzecanski, who is well known for criticising the Kirchner administration's confrontational approach towards the holdouts, believes that 'much of the academic and policy making literature has ignored the realistic possibility that rogue sovereign *debtors*, rather than rogue private creditors, are the ones that pose the greatest threat to the integrity and efficiency of the international financial architecture [emphasis added].'[184]

Müller, too, takes a relaxed view at the outcome of the *NML v. Argentina* litigation, contending that New York courts have found a 'pragmatic' and 'flexible' way to balance the interests of litigious creditors and a sovereign in financial distress.[185] He supports the New York courts' broad interpretation of *pari passu* as *ultima ratio* to compel sovereign debt repayment and fulfil the role of bankruptcy courts in the event of debtor liquidation.[186]

That such unconditional support for Judge Griesa's judgement is rare among the seasoned scholars in the field is not without reason. As noted elsewhere, the payment interpretation of

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[181] Sovereign bonds with a value of more than USD900 billion contain *pari passu* terms similar to the Argentine bonds that were subject to the dispute in *NML v Argentina*. See Weidemaier and Gelpern (n 133).

[182] See above 1.2.3. for a definition of this equilibrium. Many authors made similar arguments. See, eg, Mark Weidemaier, 'Sovereign debt after NML v Argentina' (2013) 8(2) Capital Markets Law Journal 123; Jesse Kaplan, 'Collective Action and the Competence of Courts: The Lessons from *NML v. Argentina*' (2014) 1 Stanford Journal of Business and Finance Law 30; Buchheit and Gulati (n 177); Weidemaier and Gelpern (n 133).

[183] Julian G. Ku, 'Don't Cry for Sovereign Debtors: Why Argentina's Defeat in US Courts Does Not Justify a Sovereign Debt Treaty' (2014) 36 University of Pennsylvania Journal of International Law 433, 456.

[184] Porzecanski (n 14).

[185] Müller (n 110) 317.

[186] ibid.

the *pari passu* clause is simply unworkable. If applied strictly, it renders debt restructurings impossible. Why would any creditor agree to a debt restructuring if the door to a *pari passu* injunction remained wide open? Arguing that the decision in *NML v. Argentina* in fact recognised the sovereign borrower's interest in restructuring, as Müller for instance does, seems rather unfounded, also in light of the fact that Judge Griesa himself backtracked from his order and, months before he passed away, narrowed the meaning of *pari passu* under New York law in a subsequent trial.[187]

Moving forward, the pressing question is whether a *pari passu* injunction would also be applicable to other cases of sovereign debt restructuring. This answer is anything but straightforward and entails a speculative element. On the one hand, the ubiquitous use of *pari passu* clauses in international sovereign bonds means that the New York courts' interpretation matters for many sovereign issuers around the globe. On the other hand, Argentina's *pari passu* clause was drafted in a particularly ambiguous manner and more recent sovereign bond prospectuses have explicitly discarded Judge Griesa's understanding of *pari passu*.[188] In addition, New York courts have recently clarified that sovereign debtors may under certain circumstances pay their creditors selectively.[189] What the *pari passu* clause undoubtedly prohibited was the subordination of some (holdout) creditors' claims by virtue of law (formal subordination).

Additional legal uncertainty comes from the Second Circuit's repeated reference to Argentina as a 'uniquely recalcitrant' debtor.[190] In the court's view, Argentina's resistance to paying the holdouts justified the injunction due to considerations of equity. However, it is arguably difficult to ascertain what kind of behaviour renders a sovereign debtor 'uniquely recalcitrant'. While it is true that few countries had so persistently refused to pay its debts[191],

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[187] See *White Hawthorne LLC v Argentina*, 2016 US Dist LEXIS 177895, 2016, United States; New York; District Court for the Southern District of New York [SDNY].

[188] See for an overview of recent changes to boilerplate *pari passu* clauses below 6.2.2.

[189] See below 4.3.3.4.3.

[190] Halverson-Cross (n 164) 131.

[191] Enderlein et al similarly argue that 'the well –known case of Argentina from 2001 to 2005 displays an exceptional degree of coerciveness, as the government officially declares default, sticks to the proclaimed moratorium by stopping all payments to its bondholders for four years, freezes foreign assets, and rejects any meaningful negotiations.' Henrik Enderlein, Christoph Trebesch and Laura von Daniels, Sovereign Debt Disputes: A Database on Government Coerciveness during Debt Crises (2012) 31(2) Journal of International Money and Finance 250, 261. Tran notes that 'Argentina was a unique example of a sovereign debtor pursuing a unilateral and coercive approach to debt restructuring, wilfully ignoring its own obligations to official creditors and international financial institutions…'; see Hung Tran, 'The role of markets in sovereign debt crisis detection, prevention and resolution' BIS Papers No 72 – Sovereign risk: a world without risk-free assets? (Proceedings of a seminar on sovereign risk

the concept of unique recalcitrance is defined neither by case law nor by statute(s). Thus, it a nifty holdout may revert to the clause in a future sovereign debt restructuring.

Indeed, it is recalled that policymakers rely on the concepts of exceptionality and uniqueness rather frequently in the context of financial crises. For instance, to justify their unprecedented interventions, euro area governments were quick to underscore how 'exceptional' and 'unique' the Greek debt restructuring of 2012 was.[192] Translating 'unique' and 'exceptional' circumstances or crisis resolution measures into legal concepts is arbitrary at best and dangerous at worst.

Judge Griesa's concept of 'unique recalcitrance' is a poor yardstick to assess whether equipping holdouts with a *pari passu* injunction is equitable or not. Most sovereign debt crises are in fact unique, for they threaten the very survival of a nation and warrant extraordinary action on the government's and often the international community's part.

Most notably, neither the SDNY nor the Second Circuit presented a benchmark against which the legitimacy of debt adjustment programs under New York law could be ascertained. The court ignored the fact that a government might become unable to repay all its creditors in full. In fact, by reasoning that the uniqueness of the Argentine case demanded a unique response from the US judiciary, the judges exposed the arbitrariness they seemed to apply to instances of holdout litigation.

This left some crucial questions unanswered with respect to future holdout litigation and attempts by vulture holdouts to invoke the *pari passu* injunction against other sovereign borrowers. Would any sovereign debtor insisting on not paying holdout investors be considered 'recalcitrant'? What makes certain behaviours 'unique'? Would, for instance, Greece's emergency measures of retroactively introducing CACs to 'cram-down' holdouts and implement a debt restructuring against the will of a significant chunk of bondholders have fallen under this category?

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including contributions by central bank governors and other policy-makers, market practitioners and academics, Basel, 8–9 January 2013) 95.

[192] See, eg, Matina Stevis, 'IMF Debt Restructuring Proposal Finds Criticism, Resistance' *The Wall Street Journal* (New York, 27 November 2013) <https://blogs.wsj.com/brussels/2013/11/27/imf-debt-restructuring-proposal-finds-criticism-resistance/> accessed 16 September 2017 (noting that 'Euro-area governments, on the other hand, want nothing to do with that approach, having declared Greece's debt restructuring 'unique and exceptional.').

4.3.3.4.2. NML v. Argentina and Potential Implications for International Bond Markets

The Second Circuit's referral to undefined and ambiguous categories of governmental conduct renders the *pari passu* injunction a dangerous device, warranting an extremely cautious approach for countries seeking to restructure unsustainable debts. Indeed, the Second Circuit did not specify what governmental actions (excessive haircut, debt moratorium, or delay of negotiations) motivated its ruling in the holdouts' favour. This ambiguity harms legal certainty for sovereigns when negotiating debt restructuring, providing much ammunition to holdouts who seek to thwart a restructuring deal *a priori*.

The Second Circuit failed to explain if any payment to restructured creditors or merely the legal subordination of the holdout creditors' claims would amount to a violation of *pari passu*.[193] Although the judges confirmed that Argentina's Lock Law subordinated the claims of holdout bondholders, thereby violating the widely recognised 'ranking' interpretation of *pari passu*, it also endorsed Judge Griesa's 'ratable payment' order. The so-called 'payment' interpretation suggests that a sovereign must pay all equally ranking debts at the same time.

Most leading scholars reject this view.[194] Buchheit and Pam even argue that – if this interpretation was true – 'changes the patterns of international finance.'[195] Along similar lines, the Financial Markets Law Committee[196] (comprising renowned English lawyers and academics) deems the payment interpretation of *pari passu* both 'uncommercial and unworkable'. Even ICMA, the largest private association representing sovereign debt traders, contends that the Second Circuit got it wrong by requiring issuers to make ratable payments to restructured creditors and holdouts.[197]

Moreover, as Gelpern et al note, those who argue that these injunctions do not matter because Argentina was 'unique' should observe market reactions more closely.[198] These reactions underscored the danger of the *pari passu* injunction. For instance, most bond prospectuses

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[193] Lee Buchheit and Mitu Gulati, 'Restructuring Sovereign Debt After Argentina' (2017) 12 (2) Capital Markets Law Journal 224.

[194] For an overview see Bratton (n 33).

[195] See Lee C. Buchheit and Jeremiah S. Pam, 'The Pari Passu Clause in Sovereign Debt Instruments' (2004) 53 Emory Law Review 870.

[196] Financial Markets Law Committee (FMLC), 'Pari Passu Clauses – Analysis of the Role, Use and Meaning of Pari Passu Clauses in Sovereign Debt Obligations as a matter of English Law' (April 2015) 8 <http://www.fmlc.org/uploads/2/6/5/8/26584807/fmlc_paper_analysing_the_role,_use_and_meaning_of_pari_passu_clauses_in_sovereign_debt_obligations_as_a_matter_of_english_law.pdf> accessed 3 December 2017.

[197] ICMA (n 88).

[198] Anna Gelpern, '*NML Capital, Ltd. v. Republic of Argentina* and the Changing Roles of the *Pari Passu* and Collective Action Clauses in Sovereign Debt Agreements' (2015) 53 Columbia Journal of Transnational Law 396, 422 (further noting that the injunction upended the balance at the foundation of sovereign debt restructuring).

now disclose US federal court judgements as a risk factor, specifically referring to the *NML* case.[199] Indeed, in Gelpern's opinion, markets have understood that '[the] new enforcement path complicates life for debtors *and* creditors in future restructurings [emphasis added]'.[200]

Looking at possible future debt crises, one could argue that Venezuela's current strategy of delaying an urgently needed debt workout is – at least partly – motivated by fears that holdouts could leverage the *pari passu* injunction against it. Hedge funds have acquired a huge stake in Venezuela's public debt over the past years.[201] They seemingly hope that the government might eventually succumb to the unmistakable calls of its population to prioritise their survival over the risk of being considered a 'uniquely recalcitrant' debtor in a foreign court. Similarly, Greece's decision to pay vulture holdouts with English law bonds in full reflected a growing awareness on the sovereign's side that protracted litigation could have long-lasting effects on its ability to re-access markets.[202]

4.3.3.4.3. Post NML v. Argentina Developments: Pari Passu Undone?

On 22 December 2016, roughly five years after Judge Griesa had unsettled sovereign debt markets with his unconventional *pari passu* interpretation, the same judge reversed course. In *White Hawthorne, LLC v. Republic of Argentina*[203], he clarified the nature of Argentina's 2011 breach of the FAA *pari passu* provisions, which had puzzled so many experts in the field.[204] Specifically, Griesa held that '[n]onpayment on defaulted debt alone [was] insufficient to show are breach of the pari passu clause.'[205] Rather, the *pari passu* clause

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[199] See, The Republic of Argentina, 'U.S.$1,750,000,000 4.625% Bonds Due 2023' Prospectus Supplement to Prospectus Dated October 27, 2017 <https://www.bourse.lu/security/US040114HQ69/260591> accessed 2 June 2018 (stating that 'U.S. federal court decisions addressing the meaning of ranking provisions in the context of Argentina's litigation with the holdout creditors could potentially reduce or hinder Argentina's ability to restructure its debt').

[200] Anna Gelpern, 'Sovereign Damage Control' (2013) Peterson Institute of International Economics Policy Brief 13-12 <https://piie.com/publications/pb/pb13-12.pdf> accessed 6 September 2017.

[201] See Ben Bartenstein, 'Hedge Fund Plows Half Its Money Into Venezuelan Bond and Wins Big' *Bloomberg* (New York, 8 March 2016) <http://www.bloomberg.com/news/articles/2016-03-08/hedge-fund-plows-half-its-money-into-venezuela-bond-and-wins-big> accessed 31 August 2017.

[202] See below 5.3.4.

[203] *White Hawthorne LLC v Argentina*, 2016 US Dist LEXIS 177895, 2016, United States; New York; District Court for the Southern District of New York [SDNY].

[204] For an in-depth discussion of the Hawthorne case and its main take-aways, see James Blakemore and Michael Lockman, 'Pari Passu Undone: Game-Changing Decisions for Sovereigns in Distress' (2017) 3 Emerging Markets Restructuring Journal <https://www.clearygottlieb.com/~/media/cgsh/files/2017/publications/emrj-spring-2017/pari-passu-undone-gamechanging-decisions-for-sovereigns-in-distress.pdf> accessed 25 August 2017.

[205] *White Hawthorne LLC v Argentina*, 2016 US Dist LEXIS 177895, 2016, United States; New York; District Court for the Southern District of New York [SDNY] [7]. The District Court made a reference to the Court of Appeals' judgement in *NML Capital Limited v Argentina,* Opinion affirming orders of the district court, 727 F 3d 230 (2d Cir 2013), 23rd August 2013, United States; Court of Appeals (2nd Circuit) [2d Cir], which said that a sovereign does not necessarily breach the *pari passu* provision when it pays creditors selectively. However, the

ought to be understood as a protection against domestic laws that discriminate against certain creditors.

Argentina's Lock Law served as a case in point, for it prohibited the country's executive branch to pay holdout investors who had declined its restructuring offers.[206] Given that Argentina's Parliament repealed the Lock Law and settled with the (majority of) holdout creditors, the plaintiffs in *White Hawthorne* had insufficient legal grounds to establish a breach of the *pari passu* clause.[207] Overall thus, 'the 'combination' and the 'course of conduct' [ie recalcitrance] that formerly constituted a breach of the *pari passu* clause no longer exist.'[208]

As Box 6 illustrates, the *White Hawthorne* case allowed Judge Griesa to refine his heavily criticised interpretation of the FAA *pari passu* covenant.

Box 6: Timeline of Argentina's *pari passu* saga[209]					
***NML* Case**					***White Hawthorne* Case**
Dec. 2011	**Feb. 2012**	**Oct. 2012**	**Nov. 2012**	**Aug. 2013**	**Dec. 2016**
District Court finds breach of *pari passu* clause	District Court orders injunctions: Argentina cannot service restructured debt unless it also pays holdouts	Second Circuit affirms breach and injunction	District Court makes a number of technical amendments to injunctions	Second Circuit affirms amended injunction relying on 'extraordinary behaviour' of Argentina	District Court rules in *White Hawthorne*
Payment of some creditors but not others is a preach	Unprecedented finding – chaos in the sovereign debt market	Arguably broad interpretation becomes federal law in	Narrowed scope of injunctions	Payment of some creditors but not others continues to be a violation of *pari passu* but ruling premised	Payment of some creditors but not others is NOT a *pari passu* violation

Court of Appeals' decision left considerable ambiguity in this respect (see above 4.3.3.2.2.), which Judge Griesa sought to resolve.

[206] *White Hawthorne LLC v Argentina*, 2016 US Dist LEXIS 177895, 2016, United States; New York; District Court for the Southern District of New York [SDNY] 8. For a discussion of the Lock Law, see above 4.2.2. and 4.3.3.2.

[207] ibid [8].

[208] ibid.

[209] Blakemore and Lockman (n 204).

of *pari passu*		New York		on extraordinary behaviour of debtor	(UNLESS the debtor is 'recalcitrant'

Perhaps the end of the *pari passu* saga was emblematic. New York courts went full circle from unsettling global sovereign bond markets in 2011 to supporting the Argentine government's endeavour to return to international credit markets in 2016. It seemed as if Judge Griesa eventually responded to the concerns voiced by policymakers and scholars, who harshly condemned his decision to entertain an unconventional, arguably even unworkable, interpretation of the infamous clause.

However, one should not forget that the SDNY only recoiled from its extreme position *after* the new Macri administration reached a settlement with all holdouts. Indeed, by explicitly referring to Macri's 'resolve to settle with creditors', Judge Griesa made clear that his more benevolent interpretation of the *pari passu* clause was motivated by the government's compliance with the holdouts' demand.[210]

With this, the dangerous precedent set by the SDNY has not disappeared. Notably, it endorsed and encouraged the type of 'buy-litigate-blackmail' practice that NML Capital and other hedge funds regularly employ. Of course, as Lockman and Blakemore, who have served as Argentina's counsellors for years, point out, '*White Hawthorne* sensibly rejected an application of the *pari passu* clause that would unravel the clause itself'.[211]

However, this recognition followed a settlement that benefited vulture holdouts at the expense of those bondholders who rejected Argentina's tenders in 2005 and 2010. Moreover, *White Hawthorne* left the concept of 'unique recalcitrance' undefined, as well as the relationship between a sovereign's conduct during debt restructuring negotiations and the functioning of the *pari passu* clause. In this context, the problems and ambiguities cultivated by Judge Griesa will persist until the Second Circuit adjudicates a similar case.

[210] *White Hawthorne LLC v Argentina*, 2016 US Dist LEXIS 177895, 2016, United States; New York; District Court for the Southern District of New York [SDNY].

[211] Blakemore and Lockman (n 204) (further noting that '*White Hawthorne* takes seriously the Second Circuit's view that NML was an exceptional case').

4.4. HOLDOUT LITIGATION BEFORE GERMAN COURTS

This section focuses on two seminal decisions rendered by German courts in the wake of the Argentine default of 2001. According to Schumacher, 648 individual retail investors filed suit in Germany against Argentina.[212] The two cases discussed herein were representative for the outcome of the vast majority of these lawsuits. Most of the German plaintiffs fell into the category of retail holdouts, as defined above.[213] Indeed, their individual claims were relatively small, most of them were private persons rather than (financial) corporations, and most had acquired their bonds long before the crisis erupted.

4.4.1. BVerfG Judgement of 8 May 2007[214]

The BVerfG is the supreme constitutional court of Germany. It is located in Karlsruhe and focuses on the interpretation of Germany's constitution (the *Grundgesetz*) and the compliance of all governmental institutions with the constitution. It became involved in the post-Argentina litigation after a number of holdouts had sued Argentina before German civil courts to enforce their claims. In the context of these lawsuits, Argentina invoked the defence of necessity under customary international law.[215] Given that Article 25 of the *Grundgesetz* transposes the general rules of international law into German law, the BVerfG was competent to ascertain whether the principle of necessity, as enshrined in international law, was applicable to Argentina's 2001 default.[216]

4.4.1.1. The Majority Decision

The central legal question the BVerfG had to address in this trial was whether Argentina's debt moratorium of 2001 complied with international law and, specifically, whether Argentina's measures could be justified on the grounds of economic necessity.[217] The

[212] Julian Schumacher, *Enforcement in Sovereign Debt Markets* (unpublished PhD thesis, Humboldt University Berlin 2015).

[213] See above 3.3.2.

[214] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG].

[215] ibid [4-7].

[216] For an English version of the *Grundgesetz*, see Christian Tomuschat and David P. Currie, 'Basic Law for the Federal Republic of Germany' (2014) Unofficial Translation <https://www.gesetze-im-internet.de/englisch_gg/englisch_gg.html#p0135> accessed 2 July 2017.

[217] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06,

necessity defence is enshrined in Article 25(1) of the ILC Draft Articles on State Responsibility (the 'ILC Draft Articles')[218]. The provision states that necessity can be invoked to preclude the wrongfulness of an act if it (i) is the only way to safeguard an essential interest against a grave and imminent peril and (ii) does not seriously impair an essential interest of the state towards which the obligation exists, or the international community as a whole. Moreover, Article 25(2) of the Draft Articles stipulates that a state cannot invoke necessity if it has contributed to the emergence of the peril.

The plaintiffs claimed that Argentina could not rely on the necessity defence for the following reasons. First, when the plaintiffs filed suit Argentina had no longer found itself in a state of emergency.[219] Second, Argentina had itself contributed to the situation of necessity, which would exclude the applicability of the defence.[220] Third, other municipal courts also held that the debt moratorium was not justified under international law.[221]

Argentina rejected this reasoning, explaining that the debt moratorium was vital for Argentina to avert imminent peril during a state of emergency.[222] Such state of emergency, Argentina contended, not only occurred when the state's very existence has threatened but also when essential state functions could no longer be exercised. The grave financial crisis of 2001/02 that culminated in a default affected state functions on all levels and thus forced Argentina to suspend its payment obligations stemming from government bonds.[223]

In its majority decision, the BVerfG concluded that there was no general rule of international law according to which a state was entitled to suspend its repayment obligations vis-à-vis private individuals in the event of a state emergency.[224]

BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG] [4-7].

[218] Draft Articles on Responsibility of States for Internationally Wrongful Acts, adopted by the Commission at its fifty-third session in 2001 (Final Outcome) (International Law Commission [ILC]) UN Doc A/56/10, 43, UN Doc A/RES/56/83, Annex, UN Doc A/CN.4/L.602/Rev.1, GAOR 56th Session Supp 10, 43.

[219] ibid [15].

[220] ibid.

[221] ibid.

[222] ibid [18]. In a press release, Argentina asserted that the acts it had adopted during the 2001/02 crisis had the 'public purpose [...] of protecting the primary need of economic survival of the population in a historical context of very serious national emergency.' See Beatrice Bonafè, 'State Immunity and the Protection of Private Investors: The Argentine Bonds Case Before Italian Courts' (2006) 16(1) The Italian Yearbook of International Law 165, 166.

[223] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG] [18].

[224] ibid [29].

The court's legal assessment was based on the following considerations. First, there were no rules for sovereign insolvency and the legal consequences of state default were hardly regulated by international customary law or the general rules of international law.[225] Second, while states could have recourse to the defence of necessity in inter-state disputes, necessity did not apply in private legal relationships.[226] Here, the BVerfG referred to ICSID practice and found that both state practice and *opinio iuris* were missing to prove the existence of the defence of necessity in private legal relationships.

In *CMS v. Argentina*[227], for instance, an ICSID tribunal assessed the necessity defence with regard to international obligations arising from the US-Argentina BIT rather than a private bond contract.[228] Similarly, in two seminal international law cases, the *Serbian Loans*[229] case and the *French Company of Venezuelan Railroads*[230] case[231], the tribunals had to assess whether necessity could be applied in intra-state relationships rather than a private creditor and a sovereign.

Similarly, the BVerfG's analysis of national case law did not yield evidence for an internationally recognised rule that would endorse Argentina's claims.[232] Finally, taking into account the existing legal literature[233], the court found that the majority view in the literature

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[225] ibid [32].

[226] ibid [33]. The BVerfG noted that the *opinio iuris sive necessitatis* for such a rule to become legally binding under customary international law is absent.

[227] *CMS Gas Transmission Company v Argentina,* Application for annulment and request for stay of enforcement of arbitral award, ICSID Case No ARB/01/8, IIC 66 (2005), 8th September 2005, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[228] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG] [52]. The BVerfG reached the same conclusion after reviewing the arbitration in *LG&E Energy Corporation and ors v Argentina,* Award, ICSID Case No ARB/02/1, IIC 295 (2007), despatched 25th July 2007, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[229] Payment of Various Serbian Loans Issued in France, *France v Kingdom of the Serbs, Croats, and Slovenes*, Judgment, Judgment No 14, PCIJ Series A No 20, ICGJ 260 (PCIJ 1929), 12th July 1929, League of Nations (historical) [LoN]; Permanent Court of International Justice (historical) [PCIJ].

[230] French Company of Venezuelan Railroads Case, *France v Venezuela,* (1962) X RIAA 285, 31st July 1905, Mixed Claims Commission (France-Venezuela).

[231] Also see for a background analysis in Beate Rudolf and Nina Hüfken, 'Joined Case Nos. 2 BvM 1-5/03 & BvM 1-2/06' (2007) 101(4) The American Journal of International Law 857.

[232] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG] [50].

[233] See, eg, Rudolf Dolzer, 'Staatliche Zahlungsunfähigkeit: Zum Begriff und zu den Rechtsfolgen im Völkerrecht' in Jürgen Jekewitz (ed), *Des Menschen Recht zwischen Freiheit und Verantwortung: Festschrift für Karl Josef Partsch zum 75. Geburtstag* (Berlin: Duncker & Humblot, 1989) 550.

rejected the existence of a legal basis for necessity in the relationship between states and their private creditors.[234]

4.4.1.2. The Dissenting Opinion by Judge Lübbe-Wolff

Judge Lübbe-Wolff advanced a remarkably different legal view in her dissenting opinion. She emphasised that the majority decision, which rejected the necessity defence, ignored core principles of international law. Crucially, she held that, according to Article 38 of the ICJ Statute, Argentina's right to suspend payment obligations may not only emanate from the customary international law but also from the general principles of law recognised by civilised nations. In contrast to the majority opinion, Judge Lübbe-Wolff noted that the necessity defence was accepted under both customary international law (for inter-state relationships) *and* the general principles of law (for private legal relationships).[235]

To substantiate her arguments, she cited several decisions by international courts and tribunals. For example, in the *Russian Indemnity Case*, the PCIJ held that '…however little the responsibility may imperil the existence of the state; it would constitute a case of *force majeure* which could be pleaded in public international law as well as by a private debtor.'[236] On that basis, she concluded that necessity might not only be invoked in inter-state relationships but also under private law.[237] Similarly, in cases where there was no explicit reference to private legal relationships, such as the *French Company of Venezuelan Railroads*[238], the necessity defence had in her view always been recognised as a general principle of law and was not *per se* limited to inter-state disputes.[239]

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[234] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG] [62].

[235] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG] [79-94].

[236] Russian Claim for Interest on Indemnities (Damages Claimed by Russia for Delay in Payment of Compensation Owed to Russians Injured During the War of 1877-1878), *Russia v Turkey*, Award, (1961) XI RIAA 421, ICGJ 399 (PCA 1912), (1912) 1 HCR 547, 11th November 1912, Permanent Court of Arbitration [PCA].

[237] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG] [62].

[238] French Company of Venezuelan Railroads Case, *France v Venezuela*, (1962) X RIAA 285, 31st July 1905, Mixed Claims Commission (France-Venezuela).

[239] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007,

On the question whether an economic crisis would justify invoking the necessity defence, Judge Lübbe-Wolff too referred to international case law.[240] In contrast to the majority opinion, she found that a debt moratorium was one form of state act that could be defended as a 'necessary' state measure.[241] Furthermore, she remarked that a majority of scholars believed that private bondholder rights vis-à-vis a debtor country could offer more protection than the rights, which sovereigns possessed in international relations.[242] The majority decision's understanding of necessity, namely that states were less protected vis-à-vis private foreign creditors than vis-à-vis other states, would undermine both objective and purpose of the defence.

Finally, Judge Lübbe-Wolff contended that municipal courts in certain jurisdictions have stayed enforcement attempts against Argentina to ensure the success of the debt restructuring.[243] While she admitted that these courts had not directly referred to the concept of necessity, the rationale of staying creditor litigation to facilitate a debt workout was strikingly similar to the rationale underpinning the necessity defence.[244]

4.4.1.3. Analysis

The BVerfG's decision pertained to a central question that arises in most sovereign debt disputes: can a country justify a debt moratorium or default because this is (economically) necessary? The German constitutional court answered with a resounding 'no' by concluding that necessity could only preclude the wrongfulness of an act violating an international obligation rather than an obligation rooted in private law. However, as Judge Lübbe-Wolff's opinion illustrated, the issue was anything but straightforward.

Germany; Constitutional Court [BVerfG] [83]. In Judge Lübbe-Wolff's opinion these decisions conformed that the 'object and purpose of necessity would not support that a debtor State would be less protected against its foreign private creditors as against another State'. Also see Stephan Schill, 'Der völkerrechtliche Staatsnotstand in der Entscheidung des BVerfG zu Argentinischen Staatsanleihen – Anachronismus oder Avantgarde?' (2008) 68 ZaöRV 45.

[240] For instance, *Société Commerciale de Belgique, Belgium v Greece*, Judgment, PCIJ Series A/B No 78, ICGJ 331 (PCIJ 1939), 15th June 1939, League of Nations (historical) [LoN]; Permanent Court of International Justice (historical) [PCIJ].

[241] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG] [83-84].

[242] ibid [86].

[243] ibid [93] (referencing for instance *Pravin Banker Associates Limited v Banco Popular del Peru and Peru*, 895 F Supp 660 (SDNY 1995), 24th August 1995, United States; New York; District Court for the Southern District of New York [SDNY]).

[244] See, eg, *Lightwater Corporation Limited v Argentina*, No 02 Civ 3804 (TPG), No 02 Civ 3808 (TPG), No 02 Civ 5932 (TPG), 14th April 2003, United States; New York; District Court for the Southern District of New York [SDNY]. For an analysis of the case, see above 4.3.1.1.

The same can be said for the scholarly responses to the judgement. In a powerful critique of the majority decision, Rudolf and Hüfken[245] argue that the court should have investigated whether 'the legal orders of the world recognise the defence that fulfilment of an obligation may be refused if required protecting a paramount interest of the debtor.' This would have allowed the BVerfG to review the rules in domestic legal systems that authorise private persons to suspend their financial obligations.

Thereby, 'the court would have avoided the inconsistency of emphasizing that the concept of necessity is inherent in domestic legal orders and international law, but refusing to apply it as a general principle of law due to lack of state practice.'[246] They applaud Judge Lübbe-Wolff's dissenting opinion, noting that she rightly condemned the BVerfG's formalist distinction between obligations in inter-state relations under public international law and those under domestic law is artificial…[since] the substantive interests at stake in investment disputes are identical.'[247]

Schill[248] also notes that the conclusion reached by the BVerfG is unsatisfying. He argues that the distinction drawn by the court between the inter-state and the private legal relationship does not adequately reflect contemporary international law.[249] Conversely, he endorses Judge Lübbe-Wolff's dissenting opinion, which follows the ICJ's modern approach to diplomatic protection cases. This view, Schill argues, 'understands inter-state dispute settlement in diplomatic protection cases more as a procedural prolongation of the original dispute between state and foreign investor than as a wholly independent cause of action resulting from the inter-state relations.[250] Müller, too, rejects the majority decision, contending that a German judge does not have to directly apply a foreign necessity rule but should rather give effect to it by rejecting the holdout investors' claims as 'currently unsubstantiated'.[251]

Others however support the BVerfG's majority decision. Mayer for instance argues that the protection states enjoy under domestic law may indeed differ from the protection they enjoy

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[245] Rudolf Dolzer, ‚Staatliche Zahlungsunfähigkeit: Zum Begriff und zu den Rechtsfolgen im Völkerrecht' in Jürgen Jekewitz (ed), *Des Menschen Recht zwischen Freiheit und Verantwortung: Festschrift für Karl Josef Partsch zum 75. Geburtstag* (Berlin: Duncker & Humblot, 1989) 863.
[246] Rudolf and Hüfken (n 231) [864].
[247] ibid.
[248] Schill (n 239).
[249] ibid 48.
[250] ibid 66.
[251] Müller (n 110) 343.

under public international law, as suggested by the BVerfG.[252] Only because states may rely on the necessity defence under international law, they should not automatically be able to invoke it against private creditors under the same circumstances.[253] After all, the relationship between states and private persons in the ambit of sovereign debt is, absent any rules to the contrary, governed in its entirety by domestic law.

Moreover, Mayer contends that since states expressly waive their sovereign immunity in modern sovereign bond contracts, it would be conceptually wrong to then thwart creditor enforcement attempts on the grounds of necessity – a privilege conferred upon sovereigns through public international law.[254]

Reinisch, who submitted an expert opinion at the BVerfG's request, concludes that a suspension of payment obligations vis-à-vis private creditors in the event of state default is not (yet) recognised under customary international law.[255] While from a policy perspective, the necessity defence could provide a flexible instrument to safeguard debt restructuring negotiations, the *opinio iuris sive necessitates* to endorse this interpretation could not be ascertained, especially in light of US jurisprudence.[256] At the same time, Reinisch doubts that municipal courts are the appropriate forum to resolve sovereign debt crises and advocates for a sovereign debt restructuring mechanism rooted in an international treaty.[257]

The BVerfG's decision certainly illustrates why so many academics and policymakers have stressed the need for a sovereign bankruptcy mechanism.[258] Adopting a highly dualist approach, the court seemingly struggled to integrate principles of public international law in the domestic legal order governing the bond contracts at stake. In addressing the question whether necessity may also be applied to private (contractual) legal relationship, the BVerfG was reluctant to explore whether German civil law or other legal orders know similar legal figures. This would have enabled the BVerfG to sensibly discuss whether necessity is a general principle of law in the sense of Article 38(1)(c) of the ICJ Statute. As the dissenting

[252] Christian Mayer, 'Staateninsolvenz nach dem Argentinien-Beschluss des Bundesverfassungsgerichts: Eine Chance für den Finanzplatz Deutschland?' (2008) Wirtschafts und Bankrecht Heft 10 425, 426.

[253] ibid.

[254] ibid 427.

[255] August Reinisch, 'Sachverständigengutachten zur Frage des Bestehens und der Wirkung des völkerrechtlichen Rechtfertigungsgrundes "Staatsnotstand" (2008) 68 Zeitschrift für ausländisches öffentliches Recht und Völkerrecht 3, 37-38.

[256] ibid 38.

[257] ibid 39.

[258] See above chapter 2 for a broader discussion.

opinion rightly stressed, Article 25 of the *Grundgesetz* requires that the German judiciary respect all sources of international law, customary law, treaties, and general principles of law.

Moreover, the BVerfG wrongly dismissed other cases where states had successfully invoked 'financial necessity'[259] and argued that the principles established therein found no application in private legal relationships. In the BVerfG's judgement, the dichotomy between public and private law in the realm of modern sovereign debt markets, and the associated difficulties in disentangling the two spheres, became particularly apparent. International law has not yet caught up with the realities of modern sovereign bond financing, where the sanctity of private contracts is deemed a *condition sine qua non* for the smooth functioning of the market.[260]

4.4.2. BGH JUDGEMENT OF 24 FEBRUARY 2015[261]

Between 2003 and 2014, numerous retail holdouts[262] had filed suit against Argentina in German courts. After the BVerfG's decision opened the (constitutional) door to bondholder claims, the highest civil court in Germany, the BGH, was asked to assess the validity and enforceability of private bondholders' claims against Argentina.

4.4.2.1. The Decision

The plaintiff in this case had acquired Argentine government bonds with a face value of DM50.000 in late 1997; German law governed the securities and the competent *forum* was the District Court of Frankfurt.[263] After the bondholder had successfully sued for the outstanding principal payment under the bonds, the plaintiff subsequently claimed past due interest amounting to roughly EUR3.300.[264]

Rejecting the plaintiff's claim, Argentina argued that, according to the pertinent rules of international law, it could refuse debt repayments to holdouts who had not participated in the restructuring negotiations of 2005 and 2010.[265] The District Court upheld the plaintiff's

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[259] See, eg, French Company of Venezuelan Railroads Case, *France v Venezuela*, (1962) X RIAA 285, 31st July 1905, Mixed Claims Commission (France-Venezuela)..

[260] That the BVerfG's view was not shared universally was shown by the Italian *Corte di Cassazione's* judgement on Argentine bondholder claims; see below 4.5.1. for a review of the case.

[261] BGH, Urteil vom 24.02.2015 - XI ZR 193/14, XI ZR 193/14, NJW 2015, 2328, 24th February 2015, Germany; Federal Court of Justice [BGH].

[262] For the definition of 'retail holdouts', see above 3.3.2.

[263] BGH, Urteil vom 24.02.2015 - XI ZR 193/14, XI ZR 193/14, NJW 2015, 2328, 24th February 2015, Germany; Federal Court of Justice [BGH] [2]. Overall, Argentina had issued government bonds with a face value of DM1 billion at German capital markets in order to attract foreign investment in Argentine financial assets.

[264] ibid [4].

[265] ibid.

action and ordered the defendant Argentina to pay past due interest owed under the government debt securities.[266] The lower court's decision was subsequently endorsed by the Court of Appeals, the OLG Frankfurt. In its statement of grounds, the OLG noted that customary international law provided no rules that entitled a sovereign debtor to repudiate debt obligations vis-à-vis holdout investors.[267]

The BGH sided with the lower courts and upheld the plaintiff's claim. The decision first looked at Argentina's claim that international law would allow insolvent countries to halt debt repayments to investors who acted in an uncooperative fashion during debt restructuring negotiations. Although the BGH explicitly denounced holdout tactics, it held Article 25 of the *Grundgesetz*, in conjunction with customary international law, did not *per se* prohibit such (holdout) behaviour.[268] Citing the BVerfG's seminal ruling on necessity[269], the BGH concluded that there was neither a codified bankruptcy system for states nor a general rule of international law that would allow for the suspension of debt repayments to holdout creditors.[270]

Argentina had also asserted that the global financial crisis of 2007/08 as well as the euro area crisis of 2010-2012 made the BVerfG's judgement from 2007 redundant. The measures adopted by European countries and policymakers to rescue Greece and Cyprus have, in Argentina's view, cultivated a rule of international law that required states' private creditors to accept debt cuts if an economic state of emergency was to occur.[271] Until such debt reorganisation agreement was reached, sovereign debtors might delay debt repayments if the objective was to stabilise their domestic economies.[272]

The BGH was not convinced. It stressed that both the BVerfG as well as the UN General Assembly made clear that – *de lege lata* – states could not rely on a debt restructuring mechanism, or any other mechanism of such kind. After all, the UN had passed a resolution

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[266] ibid.

[267] ibid [8]. Argentina commissioned two professors of international law to investigate whether customary international law allows for a debt repudiation vis-à-vis holdout creditors.

[268] ibid [13].

[269] Argentine Necessity Case, *K and ors v Argentina* (represented by President Néstor Kirchner), Order of the Second Senate, 2 BvM 1/03, 2 BvM 2/03, 2 BvM 3/03, 2 BvM 4/03, 2 BvM 5/03, 2 BvM 1/06, 2 BvM 2/06, BVerfGE 118, 124, ILDC 952 (DE 2007), NJW 2007, 2610, (2010) 138 ILR 1, (2007) 4 AJIL 857, 8th May 2007, Germany; Constitutional Court [BVerfG]. See more generally above 4.3.1.

[270] BGH, Urteil vom 24.02.2015 - XI ZR 193/14, XI ZR 193/14, NJW 2015, 2328, 24th February 2015, Germany; Federal Court of Justice [BGH] [17-18].

[271] ibid [21].

[272] ibid.

in 2014 with the very purpose of establishing a sovereign debt restructuring mechanism in the long run.[273] The BGH also pointed at sovereign debt arbitration cases before ICSID tribunals and litigation in New York courts between Argentina and its international creditors. Referring to the *Abaclat v. Argentina* case before the ICSID, the BGH reiterated that the suspension of payments was deemed illegal under international (investment) law.[274] US courts did not even discuss the issue of financial necessity and the lawfulness of debt moratoria under international law.[275]

The BGH reviewed Professor Goldmann's expert opinion in support of Argentina's appeal but concluded that he had misconstrued the development of international law in the realm of sovereign debt. Sovereign borrowers and lenders have so far favoured the market-oriented approach by including CACs in their sovereign debt instruments rather than establishing a bankruptcy system for states.[276] The Argentine bonds held by the plaintiff had no CACs, which meant that there were no legal means to bind bondholders to a majority-approved restructuring. Their enforcement rights were thus left untouched.[277] Consequently, the BGH upheld the holdout's claim.

4.4.2.2. Analysis

This BGH decision received news coverage in both the German and the international press.[278] However, despite the holdouts' victory in court, the decision was of limited value: there were simply no attachable (commercial) Argentine assets in Germany.[279]

With respect to the BGH's legal assessment, some scholars have raised criticism. Weller and Grotz for instance contend that the BGH focused excessively on the necessity defence under

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[273] ibid [25]. The same applies to the UNCTAD Principles (Principles on Promoting Responsible Sovereign Lending and Borrowing (United Nations Conference on Trade and Development [UNCTAD]). Article 7 of these Principles states that '[i]n circumstances where a sovereign is manifestly unable to service its debts, all lenders have a duty to behave in good faith and with cooperative spirit to reach a consensual rearrangement of those obligations.' However, it is undisputed that these Principles have 'soft law' character. Hence, they bind neither sovereigns nor their creditors.

[274] BGH, Urteil vom 24.02.2015 - XI ZR 193/14, XI ZR 193/14, NJW 2015, 2328, 24th February 2015, Germany; Federal Court of Justice [BGH] [27].

[275] ibid [28].

[276] ibid. The BGH then elaborated on the origins of CACs and explained that euro area Member States must incorporate CACs into their new sovereign debt issues.

[277] ibid [39].

[278] See, eg, NT-V, 'BGH-Grundsatzurteil – Argentinien soll deutsche Anleger zahlen' *N-TV News* (*Frankfurt*, 24 February 2015) <http://www.n-tv.de/wirtschaft/Argentinien-soll-an-deutsche-Anleger-zahlen-article14579026.html> accessed 9 August 2017.

[279] Here, the enforcement conundrum' comes into play once again. See above 1.2.3. for an in-depth analysis.

public international law.[280] Even though they agree with the court's judgement that necessity must not be applied to private legal relationships, Weller and Grotz argue that German law provides for a (corresponding) right to refuse contractual performance under certain exceptional circumstances.[281] According to § 275(3) of the German Civil Code (*Bürgerliches Gesetzbuch*), the obligor may refuse performance if she is to render the performance in person and, when the obstacle to the performance of the obligor is weighed against the interest of the obligee in performance, performance cannot be reasonably required of the obligor.' It could thus have been argued that since Argentina faced a high risk of default, the creditor's interest in contractual performance under the bonds did not surpass the sovereign's interest in securing its very (economic) existence.[282] Contractual performance could therefore not have been demanded from Argentina.[283]

At first glance, this critique rightly points at the flaws in the international financial architecture to deal with holdouts, namely the absence to take appropriate account of the state's interests when it comes to contract enforcement. However, it remains questionable whether an analogy with the necessity defence under German civil law, obviously tailored to private legal relationships would be proportionate and adequate to address holdout problems. The BGH's decision indicates its unwillingness to engage in legal engineering of this kind to fix policy mistakes made in the past. The analogy suggested by Weller and Grotz appears far-fetched, especially since § 275(3) BGB refers to 'performance in person' rather than to monetary claims.

Surprisingly, the BGH abstained from discussing whether Argentina enjoyed immunity from suit. Of course, one could say that it did not have to, given the immunity waivers included in the Argentine bonds.[284] However, the fact that no reference whatsoever was made to sovereign immunity may strike the learned observer of sovereign debt disputes as odd. In other cases of holdout litigation, notably following the Greek PSI, German courts focused a

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[280] Marc-Philippe Weller and Pauline Grotz, 'Staatsnotstand bei Staatsanleihen' (2015) 20 Juristenzeitung 989.

[281] The authors refer to the legal concept of '*Persönliche Unmöglichkeit'*. Hence, § 275 BGB only covers contracts where one party owes a specific 'personal performance', such as employment contracts. This provision is ill-suited to address the inherent complexity of sovereign bankruptcy and was obviously not crafted to regulate the legal relationship between States and private individuals. Moreover, a government bond requires the debtor to pay a specified amount of money rather than perform a particular (physical or legal) action.

[282] Weller and Grotz (n 280) 991-993.

[283] ibid. Indeed, protecting its existence is a fundamental duty owed by a state to its own citizens as defined in Jaques Rousseau's social contract.

[284] See, eg, Christian Tietje, 'Die Argentinien-Krise aus rechtlicher Sicht: Staatsanleihen und Staateninsolvenz' (2005) 37 Beiträge zum Transnationalen Wirtschaftsrecht 1.

great deal on the country's immunity.[285] Similarly, national courts in other jurisdiction discussed Argentina's immunity in spite of explicit contractual waivers.[286] For instance, the Italian *Corte di Cassazione* rejected the claims of Italian retail holdouts suing Argentina in 2005 solely on the grounds of immunity.[287]

Though the judgement creditors did not manage to locate attachable assets, their fortunes turned to the better when Argentina's administration changed in 2016. According to newspaper reports, the new Macri government agreed to pay the German creditors who obtained a money judgement in Germany 150% of the face value of their bonds while the haircut for the restructured creditors amounted to 70%.[288] Surely, the BGH decision leveraged the bargaining position of German bondholders. Indeed, for Argentina, the BGH decision posed a major obstacle to re-enter international debt markets and conduct business in Germany – a result that confirmed the aforementioned 'embargo' hypothesis.[289]

4.5. HOLDOUT LITIGATION BEFORE ITALIAN COURTS

In the post-restructuring litigation before Italian courts, the majority of plaintiffs can be qualified as retail holdouts.[290] According to Schumacher, 13 retail holdout cases were filed in Italian courts.[291] This section focuses on the analysis of the most prominent trial, in which the highest Italian civil court thwarted attempts by creditors to obtain enforceable judgements against the Argentine Republic.

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[285] In contrast to Argentina, Greece issued its government bonds under its domestic law and did not include a sovereign immunity waiver; see below 5.4.

[286] See most notably the French case law discussed below in 4.7.

[287] See *Borri v Argentina, Request for a ruling on jurisdiction,* Case No 11225, Order No 6532/2005, ILDC 296 (IT 2005), (2005) 88 Riv Dir Int 856, 27th May 2005, Italy; Supreme Court of Cassation. See below 4.5.1. for a discussion of this decision.

[288] Carolina Millan, 'Argentina Haunted by Default Legacy as German Suit' *Bloomberg* (New York, 27 September 2016) <https://www.bloomberg.com/news/articles/2016-09-27/argentina-still-haunted-by-default-legacy-as-german-suit-looms> accessed 2 July 2017 (highlighting that some German investors were still not satisfied, arguing that based on the German court rulings they should receive a payments that is around 250% of the bond's face value).

[289] See, eg, Lyubov Pronina and Charlie Devereux, 'Argentina Returns to Euro Bond Market For 1st Time Since 10' *Bloomberg* (New York, 5 October 2016) <https://www.bloomberg.com/news/articles/2016-10-05/argentina-returns-to-euro-bond-market-first-time-since-2010> accessed 29 August 2017.

[290] See above 3.3.2. for the definition.

[291] Schumacher (n 212) 68.

4.5.1. Luca Borri v. Republic of Argentina[292]

4.5.1.1. The Decision

The Italian Supreme Court first presented the facts of the case. The plaintiff was an Italian citizen who had purchased Argentine government bonds with a value of approximately EUR183.000 in 1998.[293] When Argentina suspended its payments to international creditors, the plaintiff sued Argentina in Italy, claiming the non-performance of the bond contract. Subsequently, several lower Italian courts issued injunctions that obligated Argentina to pay a certain fraction of the total outstanding face value of the Argentine bonds.

Argentina appealed to these injunctions, invoking its immunity from suit under international law. More specifically, the government argued that the debt moratorium was based on domestic Argentine legislation,[294] which ought to be considered an *actus iure imperii* by foreign judiciaries. Additionally, Argentina claimed that the specific contractual provisions in the bond documentation conferred jurisdiction exclusively upon the courts of New York and Argentina, rather than those in Italy.[295]

The plaintiff countered the claim by contending that Argentina's bond sales on the New York capital market were fiscal acts, and hence of commercial nature (*acta iure gestionis*).[296] Consequently, according to well-established principles of customary international law, any dispute between the sovereign issuer and the creditors could be reviewed by a foreign court. The plaintiff further asserted that the EU Council Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ('Brussels I Regulation'[297]) provided for the jurisdiction of Italian courts.[298]

Reviewing the plaintiff's claims, the Italian Supreme Court first declared that state immunity indeed constituted a principle of customary international law directly applicable under Article 10(1) of the Italian Constitution. In order to establish jurisdiction, courts must identify

[292] *Borri v Argentina, Request for a ruling on jurisdiction,* Case No 11225, Order No 6532/2005, ILDC 296 (IT 2005), (2005) 88 Riv Dir Int 856, 27th May 2005, Italy; Supreme Court of Cassation.

[293] ibid.

[294] For a discussion of the debt moratorium, see above 4.1.1.

[295] *Borri v Argentina, Request for a ruling on jurisdiction,* Case No 11225, Order No 6532/2005, ILDC 296 (IT 2005), (2005) 88 Riv Dir Int 856, 27th May 2005, Italy; Supreme Court of Cassation [F2].

[296] ibid.

[297] Council Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Council of the European Union) 44/2001/EC, [2001] OJ L12/1.

[298] ibid [F3].

whether acts of foreign states were performed under *iure imperii* or *iure gestionis.*[299] Referring to Italian case law, the court noted that reference must be made to the legal acts' nature *and* purpose, respectively.[300] On this basis, in accordance with well-established principles of customary international law, it held that the issuance of bonds on international market amounted to a commercial legal act for which Argentina may not invoke immunity before municipal courts.[301]

However, the court also remarked that Argentina suspended repayments to bondholders by passing legislative acts, namely Argentine Laws 25,561 and 25,565. Both were national budget laws that had the explicit public purpose of safeguarding basic needs of the Argentine population. Therefore, they exhibited 'clear signs of the exercise of sovereign power', thus qualifying as *acta iure imperii*. Consequently, they could not be subject to scrutiny by a foreign municipal court.[302]

The second central legal issue addressed by the *Corte di Cassazione* concerned possible violations of human rights by the Argentine government. Applying a rather unconventional reasoning, the court observed that foreign state jurisdictional immunity could, in principle, be denied when a defendant state was accused of international crimes and gross violations of human rights.[303] More specifically, even if Argentina's emergency laws were considered public acts (*acta iure imperii*), Argentina could not have invoked its immunity if the legislation would have interfered with 'universal values of respect for human dignity that transcend the interests of individual state communities.'[304] However, overall, the court found

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[299] ibid [D2].

[300] Moreover, the Supreme Court remarked that Art 2(2) of the UN Convention on Jurisdictional Immunities of States and Their Property of 2 December 2004 makes clear that – for the purpose of ascertaining the commercial or sovereign nature of a legal act – 'reference should be made primarily to the nature of the transaction, but its purpose should be taken into account'. See Convention on Jurisdictional Immunities of States and their Property (United Nations [UN]) UN Doc A/RES/59/38, Annex, UN Doc A/59/508.

[301] *Borri v Argentina, Request for a ruling on jurisdiction,* Case No 11225, Order No 6532/2005, ILDC 296 (IT 2005), (2005) 88 Riv Dir Int 856, 27th May 2005, Italy; Supreme Court of Cassation [D2].

[302] ibid [D4.2]. Ultimately, while the Italian courts were reluctant to delve into the intricacies of the issue, the question whether a hierarchy exists under international law between the opposing interests of investors and citizens has been subject to comprehensive discussions in pertinent scholarship.

[303] ibid [D2] and [D4.3]. It referenced the *Ferrini* case (*Ferrini v Germany*, Appeal decision, Decision No 5044/2004, ILDC 19 (IT 2004), (2004) 87 Riv Dir Intern 539, (2005) 99 AJIL 242, (2006) 128 ILR 658, 11th March 2004, Italy; Supreme Court of Cassation. In this decision, the Italian Supreme Court held that 'while customary law prescribes immunity from jurisdiction of a foreign state for acts, which are the expression of its sovereign authority, such immunity should be lifted when such acts amount to international crimes.'

[304] *Borri v Argentina, Request for a ruling on jurisdiction,* Case No 11225, Order No 6532/2005, ILDC 296 (IT 2005), (2005) 88 Riv Dir Int 856, 27th May 2005, Italy; Supreme Court of Cassation [D2].

that Argentina had adopted the laws with a view at protecting the fundamental rights of its citizens.[305]

While the foreign bondholders' property rights also fell squarely into the category of human rights, the Supreme Court found that curtailing them did not impinge on the 'universal values of human dignity'.[306] Adding a caveat, the Italian Supreme Court clarified that its assessment was rendered in light of an unprecedented economic crisis that Argentina had faced when passing the emergency legislation. Under such circumstances, and only then, it considered the protection of basic human rights to be superior to the protection of investor rights.

4.5.1.2. Analysis

Among the numerous holdout lawsuits between Argentina and its bondholders following the debt default in 2001, the *Borri v. Argentina* litigation in Italy stood out.

For one, the Italian Supreme Court adopted a markedly different stance on the interpretation of sovereign immunity than most other municipal courts. In contrast to the bulk of decisions rendered by courts in New York, the UK, and Germany, the Italian judiciary considered Argentina immune from holdout litigation. For another, human rights considerations played an important role in the court's assessment, and specifically for the qualification of Argentina's emergency legislation as either *acta iure gestionis* or *acta iure imperii*. In sum, the Italian Supreme Court held that Argentina's measures were sovereign acts due to their underlying public interest aim, which was the protection of fundamental rights of its domestic population.

Borri v. Argentina offered a distinctive judicial assessment on the holdout creditor problem. Notably, it challenged the conventional approach, which tends to favour creditor protection over the preservation of citizens' fundamental rights. According to Italy's highest court, the protection of basic economic rights of citizens in a bankrupt state may, under certain circumstances, outweigh the proprietary rights of government creditors. It should not surprise that the ruling attracted much scholarly interest. Italy had long been considered a special case

[305] ibid [D4.3].
[306] ibid [D4.3].

when compared to other jurisdictions, given that no statutory basis for sovereign immunity exists under Italian law.[307]

While the *Corte di Cassazione* opened up vital legal questions for future discussions on the reform of the international financial architecture, it ought to be criticised in certain respects. Indeed, its progressive interpretation of the sovereign immunity doctrine disregarded some key developments in international law that took place in the late 20th century. Most municipal courts and international tribunals had moved from qualifying public debt issuances as *acta iure imperii* to considering them commercial legal that may be subject to foreign court review.[308] Similarly, domestic legislatures in most countries followed suit and introduced statutes to this end.

Against this backdrop, Bröhmer[309] finds the court's reasoning unconvincing. He notes that '[i]t makes no sense to treat the issuance of bonds as commercial act only to turn around and qualify the decision not honour these bonds as a sovereign act.'[310] This, as he argues, is just 'poorly disguised attempt [by the Italian court] to revive the purpose test' since the only distinction between the decision to issue public debts and the decision not to pay them lies in the potential public purpose of the former.[311]

Bonafe[312] essentially agrees with Bröhmer, noting that '[while] the Italian courts have recognised that the *issuance* of the global bonds was a commercial activity on the part of Argentina, […] Italian courts have adopted two different criteria to establish whether Argentina was entitled to claim immunity from jurisdiction'. On the one hand, they have

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[307] See Andrea Atteritano, 'Immunity of States and Their Organs: The Contribution of Italian Jurisprudence Over the Past Ten Years' (2008) Contribution to the Annual Conference of the Italian Association of Law and Economics <http://www.sidi-isil.org/wp-content/uploads/2010/12/1_02_atteritano1.pdf> accessed 2 November 2017.

[308] See generally above 1.4. In the leading decision by the US Supreme Court, *Argentina v. Weltover* , it was established that the issuance of sovereign bonds on foreign debt markets amounts to an *actus iure gestonis*; see *Argentina and Banco Central de la Republica Argentina v Weltover Incorporated and ors*, Final appeal, Docket No 91-763, 504 US 607 (1992), ILDC 1924 (US 1992), 112 S Ct 2160 (1992), 119 L Ed 2d 394 (1992), (1995) 100 ILR 510, 12th June 1992, United States; Supreme Court [US]. Also compare § 1603(d) FSIA which reads as follows: 'The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction, rather than by reference to its purpose'.

[309] Jürgen Bröhmer, 'Immunity and Sovereign Bonds' in Anne Peters, Evelyne Lagrange, Stefan Oeter and Christian Tomuscha (eds), *Immunities in the Age of Global Constitutionalism* (The Hague: Brill Nijhoff, 2014) 190.

[310] ibid 191. The Italian Supreme Court held that the acts adopted by the Argentine government in order to reschedule the debt had the 'public purpose […] of protecting the primary need of economic survival of the population in a historical context of very serious national emergency.'.

[311] *Borri v Argentina, Request for a ruling on jurisdiction,* Case No 11225, Order No 6532/2005, ILDC 296 (IT 2005), (2005) 88 Riv Dir Int 856, 27th May 2005, Italy; Supreme Court of Cassation.

[312] Beatrice Bonafè, 'State Immunity and the Protection of Private Investors: The Argentine Bonds Case Before Italian Courts' (2006) 16(1) The Italian Yearbook of International Law Online 167.

regarded the issuance of global bonds as an *acta iure gestionis* according to the *nature* of this financial transaction.[313] On the other hand, the Italian Supreme Court regarded the moratorium of Argentina's public debt and the payment rescheduling as *acta iure imperii* according to the *purpose* of such government activity.[314] Bonafe argues that this approach 'would ultimately reverse the development of the state immunity rule that has taken place under customary law, thus restoring the old rule of absolute state immunity.'

Both Bröhmer's and Bonafe's criticisms of the Argentine bondholder case boil down to a conundrum that arises in the context of 'mixed' state activities. A state engages in a mixed activity if it initially concludes a commercial contract with private bondholders (*actum iure gestionis*) but subsequently breaches the contract through executive or legislative orders (*acta iure imperii*).[315] Against the backdrop of the restrictive concept of sovereign immunity, the question as to whether states can ever again claim immunity *after* they have signed an undoubtedly commercial contract inevitably arises. To resolve this time inconsistency, scholars and courts distinguish between the nature and the purpose of the respective state activity. While, according to Bankas, 'the borderline between the nature and the purpose test is fraught with uncertainties', it gives judges some guidance as to how they may address a 'mixed activity' case.[316]

Pointing at the ambiguity in the UNCSI, Bonafe[317] rightly notes that 'it is far from clear which state activity should be regarded as determinative – the prior act *iure gestionis* or the subsequent act *iure imperii.*' So which activity should be decisive: the issuance of a bond or a subsequent debt moratorium or default?[318]

The Italian Supreme Court opted for the latter. However, as much as this view bestows a strong level of protection from disruptive holdout litigation upon sovereign debtors, there is insufficient evidence that this legal reasoning complies with the rules of customary international law. As Reinisch and Binder point out, the Italian Supreme Court's decision not

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313 ibid 169.

314 ibid.

315 Ernest K. Bankas, The State Immunity Controversy in International Law – Private Suits Against Sovereign States in Domestic Courts (Berlin: Springer, 2005) 218.

316 ibid. Also see below 5.4.2. for a discussion of the mixed activity conundrum in the context of the Greek debt restructuring and subsequent litigation in Austrian courts.

317 Bonafè (n 312) 172.

318 In this context, Atteritano for instance notes that '[i]n *Borri*, the Court did not consider the nature of the contract for the sale of bonds, but the nature of the measure taken by Argentina in order to face its financial crisis'; compare Atteritano (n 309) 42.

only disregarded the fact that the initial bond issuance was a commercial activity, but it also ignored the express waivers of immunity in the bond issuance conditions.[319]

The decision thus clearly deviated from other rulings rendered in the wake of the Argentine debt crisis, such as the German bondholder case described above.[320] While the BVerfG elaborated in great lengths on the necessity defence, it shrugged off sovereign immunity concerns given the unequivocal immunity waiver in the bonds. Similarly, in the *NML* case[321], the SDNY considered that the existence of a waiver meant that the immunity defence could not be raised. In contrast to the Italian Supreme Court, it did not matter to the courts in the US and Germany whether Argentina's emergency legislation was in fact a sovereign act that superseded the private contract, or whether the protection of basic rights might justify the suspension of debt obligations.

The decision in *Borri v. Argentina* also differed from previous cases on mixed state activities, such as the decision in *Trendtex v. Nigeria*[322]. In this case, the Court of Appeal of Wales and England essentially ruled that Nigeria had no immunity in respect of commercial transactions. Trendtex had sued Nigeria for damages for the non-payment of imported cement as well as the non-acceptance of outstanding shipments after the government ordered the Nigerian Central Bank that no further payment must be made to the international trader Trendtex. Siding with the plaintiff, the Court of Appeal denied immunity on the basis that the original legal relationship between Trendtex and the Central Bank of Nigeria was a purely commercial transaction.[323] Neither the purpose (protecting Nigeria from default) nor the nature of the law (*actum iure gestionis*) mattered to the English court.[324]

What the Italian case law showed is that different approaches to dealing with the holdout creditor problem exist. *De lege ferenda*, the decision provides a starting point to discuss how judicial bodies may support policymakers' objective to ensure quick and orderly sovereign debt workouts by barring harmful creditor litigation. Indeed, the Italian Supreme Court

[319] August Reinisch and Christina Binder, 'Debts and State of Necessity' in Juan Pablo Bohoslavsky and Jemej Letnar Cernic (eds), *Making Sovereign Financing and Human Rights Work* (London: Bloomsbury, 2014) 118.

[320] See above 4.3.1.

[321] See above 4.2.1.

[322] *Trendtex Trading Corporation v Central Bank of Nigeria,* Appeal decision, ILDC 1735 (UK 1977), [1977] 1 QB 529, [1977] 1 All ER 881, [1977] 2 WLR 356, (1979) 64 ILR 111, 13th January 1977, United Kingdom; England and Wales; Court of Appeal [CA]; Civil Division [EWCA Civ].

[323] Bonafe (n 312) 173.

[324] *Trendtex Trading Corporation v Central Bank of Nigeria,* Appeal decision, ILDC 1735 (UK 1977), [1977] 1 QB 529, [1977] 1 All ER 881, [1977] 2 WLR 356, (1979) 64 ILR 111, 13th January 1977, United Kingdom; England and Wales; Court of Appeal [CA]; Civil Division [EWCA Civ].

brought into play a new and important element by taking account of the protection of citizens' human rights. Of course, the inherent problem to integrating human rights and sovereign debt enforcement, as most instances of holdout litigation illustrate, lies in the soft-law nature of most human rights covenants and treaties. After all, states have so far been reluctant to take appropriate account of human rights considerations in international financial crises: neither the IMF's AoA nor any other binding international treaties provide substantive laws that courts could rely on when assessing holdout claims.

By contrast, within the framework of the ECHR, a very recent decision by the ECtHR[325] concerning the violation of bondholders' property rights in the wake of the Greek debt restructuring of 2012 set new standards. As will be discussed below, the ECtHR found that the Greek debt workout did not unduly interfere with the property rights granted to European citizens under the ECHR.[326] While the Greek government forced bondholders to participate in the debt restructuring, the measures were legitimate in order to attain the objectives of preserving economic stability and restructuring public debts.

4.6. HOLDOUT LITIGATION BEFORE ENGLISH COURTS

4.6.1. NML CAPITAL V. REPUBLIC OF ARGENTINA (UK)[327]

The UK Supreme Court's decision in *NML Capital v. Republic of Argentina (UK)* was closely connected to the *NML* litigation in US courts discussed above.[328] Unlike decisions rendered by other (European) courts in the wake of Argentina's crisis, *NML v Argentina (UK)* primarily concerned the recognition and enforcement of foreign judgements against sovereign states in the UK.[329] NML applied for the recognition of the US money judgements

[325] *Mamatas v Greece*, App No 63066/14, App No 64297/14, App No 66106/14, 21st July 2016, European Court of Human Rights [ECHR].

[326] Menelaos Markakis, 'ECtHR Rules on Greek Debt Restructuring' (*Oxford Human Rights Hub*, 30 July 2016 <http://ohrh.law.ox.ac.uk/european-court-of-human-rights-rules-on-greek-debt-restructuring/> accessed 1 September 2017.

[327] *NML Capital Limited v Argentina*, Appeal judgment, [2011] UKSC 31, [2011] 2 AC 495, [2011] 3 WLR 273, ILDC 1805 (UK 2011), (2011) 147 ILR 575, 6th July 2011, United Kingdom; Supreme Court [SC].

[328] See above 4.2.1.

[329] Immunity from suit played a lesser role in UK jurisprudence pertaining to the Argentine default. Indeed, UK courts, based on pertinent legislature, had long established that the issuance of sovereign debt qualifies as a 'commercial transaction'; see, eg, *AIC Ltd v Federal Government of* Nigeria [2003] EWHC 1357 (QB).

in order to enforce it in the UK, thereby broadening the scope of potentially Argentine (commercial) assets to such located in London.[330]

4.6.1.1. The Decision

NML had obtained summary judgement in a federal court of New York with respect to (defaulted) Argentine bonds that it had bought between June and September 2001.[331] The overall sum Argentina was due to pay to NML exceeded USD280 million.[332] Trying to collect on this judgement, NML brought action in the UK. NML succeeded before the English Commercial Court but the Court of Appeal reversed the decision.[333]

On appeal, NML turned to the UK Supreme Court, which had to address the following questions:[334]

(1) whether the present proceedings for the recognition and enforcement of the New York court's judgment were 'proceedings relating to a commercial transaction' within the meaning of section 3 of the UK SIA;
(2) whether Argentina was prevented from claiming state immunity in respect of the present proceedings by Section 31 of the Civil Jurisdiction and Judgments Act 1982;
(3) whether the bonds contained a submission to the jurisdiction of the English court;
(4) whether, having regard to the answers to the above questions, Argentina is entitled to claim state immunity in respect of these proceedings.

(1) Recognition and enforcement of the New York court's judgment

With respect to the question of recognition and enforcement, Lord Phillips, the presiding justice, first held that judicial immunity did not apply to commercial transaction under both pertinent case law[335] and the UK SIA.[336] Moreover, he clarified that whether Argentina was immune from the claims depended on the nature of the underlying transaction that has given

[330] A possible advantage of having the judgement recognised is that UK courts have been more restrictive than US courts when it comes to the enforcement of sovereign debt claims. See for an overview, eg Stephen Schwarcz, 'Sovereign Debt Restructuring and English Governing Law' (2017) 12 Brooklyn Journal of Corporate, Financial & Commercial Law 73.

[331] *NML Capital Limited v Argentina*, Appeal judgment, [2011] UKSC 31, [2011] 2 AC 495, [2011] 3 WLR 273, ILDC 1805 (UK 2011), (2011) 147 ILR 575, 6th July 2011, United Kingdom; Supreme Court [SC].

[332] ibid.

[333] ibid.

[334] ibid [7].

[335] The leading decision under English law with respect to the state immunity from suit was *Trendtex Trading Corporation v Central Bank of Nigeria* [1977] QB 529.

[336] According to Section 3(1) of the SIA, '[a] state is not immune as respects proceedings relating to – (a) a commercial transaction entered into by the state'. Section 3(3)(b) defines 'commercial transaction' as including 'any loan or other transaction for the provision of finance...'.

rise to the claim, not upon the nature of the process by which the claimant is seeking to enforce the claim.[337]

On this point, Lord Phillips noted that the SIA did not make provision for the enforcement of foreign judgments.[338] It simply stipulated that states lack immunity for proceedings 'relating to commercial transactions' rather than extending this principle to foreign judgments that related to commercial transactions. This omission in the SIA was, however, made good by section 31 of the UK Civil Jurisdiction and Judgments Act of 1982 (the 'Act').[339] According to Lord Philips, 'it is NML's case that section 31 provides comprehensively for the recognition and enforcement of the foreign judgment to which it applies.'[340]

In Lord Phillip's view, section 31 of the 1982 Act replaced the exemptions from immunity contained in the SIA, which 'provides an alternative scheme for restricting state immunity in the case of foreign judgments'.[341] He thus concluded as follows:

> 'state immunity cannot be raised as a bar to the recognition and enforcement of a foreign judgment if, under the principles of international law recognised in this jurisdiction, the state against whom the judgment was given was not entitled to immunity in respect of the claim.'[342]

(2) Submission in the Argentina bonds to the jurisdiction of the English court

The court further assessed whether it could be implied that Argentina had agreed to the enforcement of judgements passed by New York courts in foreign jurisdictions, such as England.[343] In the first instance, the Commercial Court inferred Argentina's consent to the enforceability of a judgment in all other courts in which it might be amenable to a suit on the

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[337] ibid.

[338] ibid [34].

[339] ibid [44]. Section 31 of the 1982 Act reads as follows:

' (1) A judgment given by a court of an overseas country against a state other than the United Kingdom or the state to which that court belongs shall be recognised and enforced in the United Kingdom if and only if...(a) it would be so recognised and enforced if it had not been given against a state; and (b) that court would have had jurisdiction in the matter if it had applied rules corresponding to those applicable to such matters in the United Kingdom in accordance with sections 2 to 11 of the State Immunity Act 1978.'

[340] *NML Capital Limited v Argentina*, Appeal judgment, [2011] UKSC 31, [2011] 2 AC 495, [2011] 3 WLR 273, ILDC 1805 (UK 2011), (2011) 147 ILR 575, 6th July 2011, United Kingdom; Supreme Court [SC] [45].

[341] ibid.

[342] ibid [49]. In other words, since the issuance of government bond is considered an *acta iure gestionis* under English law, Argentina may not invoke the immunity defence when holdout investors apply for the recognition of a foreign judgement.

[343] According to section 2(2) of the SIA, 'A State may submit after the dispute giving rise to the proceedings has arisen or by a prior written agreement; but a provision in any agreement that it is to be governed by the law of the United Kingdom is not to be regarded as a submission.'

judgment from the choice-of-forum provision.[344] The Court of Appeals disagreed on this point and held that 'the agreement that the New York judgment could be enforced in any other courts was neither a waiver of jurisdiction nor a submission to the jurisdiction of the English court.'[345]

Again, deviating from the Court of Appeal's decision and siding with the Commercial Court, Lord Phillips held that '[…] Argentina agreed that the bonds should bear words that provided for the widest possible submission to jurisdiction for the purposes of enforcement […].'[346]

He further remarked that 'if state immunity was the only bar to jurisdiction, an agreement to waive immunity is tantamount to a submission to the jurisdiction'[347] and that England was a country in which the plaintiff could sue.[348] Therefore, the submission clause contained a clear waiver of immunity as well as a submission to the jurisdiction of English (and all other) courts. Consequently, all requirements set out in section 2(2) of the SIA to establish international jurisdiction of UK courts were met.

(3) State immunity and recognition of a foreign judgement

The majority view, represented by Lord Philipps, also held that suits relating to judgements issued by foreign courts must be distinguished from legal action that included a review of the merits in English court.[349] As elaborated above, the issue at stake was not whether the English court had jurisdiction to entertain proceedings on the bonds, but whether the New York judgement could be recognised and enforced.[350]

The court found that, according to the SIA, English judges had no legal power to (re)investigate whether a foreign court had rightly concluded that a state activity was 'commercial'.[351] Accordingly, the English court could choose to accept the foreign court's assessment of the commercial nature of a foreign state act.[352] In sum, the majority decision refused to grant immunity to Argentina. While there were no execution proceedings in British

[344] ibid [58].
[345] ibid [59].
[346] ibid [62].
[347] ibid.
[348] ibid.
[349] ibid [85].
[350] ibid [28].
[351] ibid.
[352] See, eg, Hazel Fox and Philippa Webb, *The Law of State Immunity* (Oxford: Oxford University Press, 2013) 219 (also remarking that the minority view was in fact endorsed by the ICJ as the correct position in international law, according to which a third party national court must ask itself whether it would have reached the same conclusion as the deciding court as regards the merits of the case).

courts, NML relied on the UK Supreme Court's decision to seize an Argentine navy vessel in Ghana.[353]

4.6.1.2. Analysis

The decision in *NML v Argentina (UK)* made clear that holdouts could rely on US judgements to enforce (foreign) government bonds in the UK. The judgement, at least theoretically, expanded the scope of attachable assets and strengthened the holdouts' bargaining position vis-à-vis the sovereign debtor. A full trial before an English court, which could take a much stricter view than the SDNY, may therefore not be necessary to enforce the bonds of a foreign sovereign on English soil.

As Gyner for instance notes, the principles established in *NML v Argentina (UK)* allow investors to use another route to lift immunity.[354] Since the decision gave effect to the broadly drafted clause choice-of-forum clause, future holdout litigants now have a considerable advantage with respect to the cross-border enforcement of sovereign debt contracts.[355] Hence, even if sovereigns were to submit disputes related to their debt instruments to a specific foreign jurisdiction, they should be mindful that holdout creditors might approach an English court to attach assets located in London.

The UK Supreme Court's judgement seemed particularly relevant in light of the different interpretations of the *pari passu* clause under New York and English law, respectively.[356] Given that English scholars and courts favour the narrower 'ranking' interpretation, holdouts are unlikely to obtain a *pari passu* injunction from English courts. However, with the possibility of having a judgement by the SDNY recognised in England, these constraints may not matter all that much.

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[353] See below 4.8.2. for a discussion of this judgement. Also see Craig Allen, 'Law of the Sea tribunal Resoundingly Affirms the Sovereign Immunity of Warships and Orders Ghana to Release Argentine Tall Ship ARA Libertad' (*Opinio Juris*, 15 December 2012) <http://opiniojuris.org/2012/12/15/law-of-the-sea-tribunal-resoundingly-affirms-the-sovereign-immunity-of-warships-and-orders-ghana-to-release-argentine-tall-ship-ara-libertad/> accessed 16 November 2017.

[354] Oliver Gayner, 'Case Comment: NML Capital Limited v Republic of Argentina [2011] UKSC 31' (*UKSC Blog*, 22 July 2011) <http://ukscblog.com/case-comment-nml-capital-limited-appellant-v-republic-of-argentina-respondent-2011-uksc-31/> accessed 1 September 2017.

[355] Norton Rose Fulbright, 'UK Supreme Court: sovereign immunity judgement' (August 2011) Client Briefing <http://www.nortonrosefulbright.com/knowledge/publications/54793/uk-supreme-court-sovereign-immunity-judgment> accessed 18 September 2017.

[356] See below 6.2.2.2. See, notably, FMLC (n 196) for a discussion of the interpretation of the *pari passu* clause in sovereign bond instruments under English law.

4.7. HOLDOUT LITIGATION IN FRENCH COURTS

In its worldwide hunt for assets, the vulture fund NML Capital also sought to attach Argentine assets located in France. The judgements rendered by French courts focus, in particular, on the question what type of assets foreign creditors may attach if a sovereign debt issuer has waived its immunity from enforcement. As mentioned above, all Bonodos (international sovereign bonds) issued by the Argentine government in the 1990s contained sovereign immunity waivers.[357] Overall, despite Argentina's express waivers, the French Supreme Court (*Cour de cassation*) dismissed a series of execution measures launched by the vulture holdout NML between 2009 and 2013.

4.7.1. NML CAPITAL V. FRANCE I

This first case before French courts in the Argentina litigation saga concerned an appeal by NML to a judgement by the Paris Commercial Court, which denied the attachment of receivables held by a commercial bank against the Argentine government. These receivables pertained to monies deposited in a bank account owned by Argentina's diplomatic missions in France. The key question at stake was whether Argentina's waiver, which exhaustively stipulated the types of assets protected from creditor enforcement measures, would also extend to diplomatic assets.

The French Supreme Court considered the protection of foreign diplomatic missions vital to ensure the receiving state's due representation in France.[358] The lower courts had previously sided with the plaintiff, arguing that the 1994 FAA also covered diplomatic assets. Referring to the Vienna Convention on Diplomatic Relations 1961 (the 'Vienna Convention')[359], the Court of Appeals emphasised that sums deposited in the embassy's bank accounts were not protected under international law if the receiving country had expressly waived immunity

[357] The waiver reads as follows: '[t]o the extent that the Republic or any of its… assets… shall be entitled… to any immunity from… jurisdiction... from attachment prior judgment, from attachment in aid of execution of judgment, from execution of a judgment… the Republic has irrevocably agreed not to claim and has irrevocably waived such immunity to the fullest extent permitted by the laws of such jurisdiction.' See Elie Kleiman and Julie Spinelli, 'NML v Argentina: Supreme Court tightens waiver of sovereign immunity test' (July 2013) Freshfields Bruckhaus Deringer Client Briefing <http://www.internationallawoffice.com/Newsletters/Litigation/France/Freshfields-Bruckhaus-Deringer-LLP/NML-v-Argentina-Supreme-Court-tightens-waiver-of-sovereign-immunity-test> accessed 2 June 2017.

[358] See, eg, *NML Capital Limited v Argentina*, Appeal judgment, Case No 09-72 057, 867, (2012) 139 JDI 668, 28th September 2011, France; Court of Cassation [Cass]; Civil Division [1(4°)].

[359] Vienna Convention on Diplomatic Relations (United Nations [UN]) 500 UNTS 95, (1972) 23 UST 3227, TIAS No 7502, UN Reg No we-7310.

from enforcement. This principle applied even if such waiver was of general nature and did not explicitly mention certain assets targeted by the creditor.[360]

The French Supreme Court, however, rejected this interpretation. In its judgement of 28 September 2011, it held that a sovereign immunity waiver, in order to be effective, must expressly specify the types and categories of diplomatic assets exempted from the general immunity set out in Article 32 of the Vienna Convention.[361] The French Supreme Court argued that a special regime existed under customary international law, which required waivers to be both specific and explicit.[362] Moreover, the court noted that French law only permitted an express waiver with regard to taxes owed to the debtor state. [363] This was not the case in the Argentine FAA, which did not refer to 'taxlike' debts.[364]

In a second plea, the plaintiff argued that the enforcement judge had imposed a disproportionate burden on the creditor by requiring him to identify whether the sums deposited in a foreign state's bank account had in fact been assigned to diplomatic purposes.[365] The French Supreme Court also rejected this claim, arguing that the funds' ultimate use was irrelevant to assessing their possible protection under the rules of international law. The fact that these funds were attributable to Argentina's diplomatic representation in France was sufficient to shield them from enforcement attempts by private creditors.[366] In the court's view, it should have been obvious from the name stated on the account, namely 'Embassy of Argentina', that the funds could not be subject to enforcement measures in France due to the principle of diplomatic immunity.[367]

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[360] *NML Capital Limited v Argentina*, Appeal judgment, Case No 09-72 057, 867, (2012) 139 JDI 668, 28th September 2011, France; Court of Cassation [Cass]; Civil Division [1(1°)].

[361] ibid [3].

[362] ibid. The court also referred to the French law on execution procedures (Loi n° 91-650 du 9 juillet 1991 portant réforme des procédures civiles d'exécution), according to which enforcement measures cannot be undertaken against legal or natural persons that enjoy immunity.

[363] See Alexander Blumrosen and Fleur Maelt-Deraedt, 'NML Capital Ltd. v. Republic of Argentina' (2013) 107(3) The American Journal of International Law 638, 640.

[364] The Belgian Supreme Court reached the same conclusion when NML sought to attach Argentine bank accounts used for diplomatic purposes, stating that an express waiver that specifies the assets that are not immune is required. See Belgium, Cour de cassation, 22 November 2012, *République d'Argentine v NML Capital*, n C.11.0688.F <http://www.coe.int/t/dlapil/cahdi/Source/state_immunities/Belgium_2013_Caselaw3.pdf> accessed 5 March 2014.

[365] *NML Capital Limited v Argentina*, Appeal judgment, Case No 09-72 057, 867, (2012) 139 JDI 668, 28th September 2011, France; Court of Cassation [Cass]; Civil Division [2].

[366] ibid [3].

[367] ibid. The court added that '[e]ven if a certain amount of the monies deposited in the bank accounts were not directly used for the day-to-day running of the embassy, a presumption of public utility existed for such assets.'

4.7.2. NML CAPITAL V. FRANCE II

In three decisions published on 28 March 2013, the French *Cour de Cassation* expanded the requirement of an asset-specific waiver to public assets that were not owned by a foreign state's diplomatic representation in France. All decisions related to enforcement actions by NML against Argentina and concerned debts owed by French companies to Argentina. Specifically, the assets NML sought to attach pecuniary claims of the Argentine government vis-à-vis BNP Paribas – a French bank, Air France – the state-owned airline, and Total Austral – an oil company. Again, the *Cour de Cassation* examined of the Argentine waiver allowed for the attachment of these receivables.

The court first clarified that, according to the UNCSI, 'immunity may be waived only expressly and specifically by mentioning the property or class of property for which the waiver is granted.'[368] In the FAA, however, the waiver was of general nature and did not encompass a list of attachable assets.[369] Given that Argentina's claims against the aforementioned French corporations, which included tax, social and oil royalties, were not (explicitly) included in the waiver, they could not be attached by NML. Moreover, the *Cour de Cassation* emphasised that the protection of an asset under international law depended on its use rather than its origin.[370] As the claims at stake were 'taxlike' debts, they clearly had a 'sovereign' origin and should be protected under international law.

Finally, the French Supreme Court held that the restriction of debt enforcement measures was not in breach of Article 6 of the ECHR (right to a fair trial), as the court's legal assessment was based on generally recognised rules of international law laid down in the UNCSI.[371]

[368] *Société NML Capital Limited v Argentina and Air France*, No 11-13-323, 28th March 2013, France; Court of Cassation [Cass]; Civil Division. See for the translation Freshfields Bruckhaus Deringer, 'NML v Argentina: Supreme Court tightens waiver of sovereign immunity test' (2 July 2013) Client Briefing <http://www.lexology.com/library/detail.aspx?g=3b63767e-0978-452e-a447-20ff566c92b4#15> accessed 25 May 2017. The court also cited cases by the ECtHR, such as *Al-Adsani v United Kingdom*, Merits, App No 35763/97, ECHR 2001-XI, IHRL 2981 (ECHR 2001), [2001] ECHR 761, (2002) 34 EHRR 11, (1987) 12 BHRC 88, (2003) 123 ILR 24, 21st November 2001, European Court of Human Rights [ECHR]; Grand Chamber [ECHR].

[369] The waiver reads as follows: 'Argentina will irrevocably waive and agree not to plead any immunity from the jurisdiction of any such court to which it might otherwise be entitled (including sovereign immunity and immunity from pre-judgment attachment, post-judgment attachment and execution) in any action based upon the Securities.'

[370] ibid.

[371] Here, it cited Article 19 and 21 of the UNCSI.

4.7.3. Analysis

The French Supreme Court supported an unconventional understanding of sovereign immunity to public debt enforcement proceedings.[372] One explanation might be that France had not enacted a comprehensive statute on sovereign immunity at the time of the judgement.[373] This has changed in the meantime: in early 2017, France adopted a new law that codifies parts of the UNCSI and therefore aligns the French legal framework for state immunity with those in the US and the UK.[374]

Moreover, the French *Cour de Cassation* introduced a new and uncommon requirement for holdouts to attach foreign sovereign assets located in France, namely an asset-specific waiver.[375] The reactions to this expansion of the immunity doctrine were mixed. As suggested by Cuniberti, both the French Supreme Court's interpretation of Article 19 UNCSI[376] and its qualification of the UNCSI as customary international law seemed to contradict the majority view.[377] In his view, it remains difficult to follow the Supreme Court's reasoning that a waiver must 'mention the property or class of property for which the waiver is granted' in light of Article 19 UNCSI. Indeed, earlier French judgements merely required a waiver to be 'specific' rather than 'asset-specific'.[378]

While from a policy point of view, it would be desirable to constrain holdout creditors' enforcement rights in foreign courts, the French Supreme Court's reasoning was far from convincing. In fact, resorting to Article 19 UNCSI as a legal basis for an asset-specific waiver makes little sense. As Audit rightly remarked, '*[o]r, à lire ce traité international il est*

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[372] See Matthias Audit, 'Sovereign bonds and national relativism: can New York law contracts safely cross the Atlantic?' (2014) 9(2) Capital Markets Law Journal 177, 185.

[373] Blumrosen and Maelt-Deraedt (n 363) 641.

[374] See for an overview Victor Grandaubert, 'France Legislates on State Immunity from Execution: How to kill two birds with one stone?' (*EJIL:Talk*, 23 January 2017) <https://www.ejiltalk.org/france-legislates-on-state-immunity-from-execution-how-to-kill-two-birds-with-one-stone/> accessed 20 July 2018.

[375] Also see Mauro Megliani, *Sovereign Debt: Genesis, Restructuring, Litigation* (Berlin: Springer, 2015) 418 for a brief discussion of the judgement.

[376] Article 19 UNCSI stipulates that '[t]he State has *expressly consented* to the taking of such measures as indicated: (i) by international agreement; (ii) by an arbitration agreement or in a written contract; or (iii) by a declaration before the court or by a written communication after a dispute between the parties has arisen. [emphasis added]'.

[377] Gilles Cuniberti, 'French Supreme Court Upholds Argentina's Immunity despite Waiver' (*Conflict of Laws.net*, 2 April 2013) <http://conflictoflaws.net/2013/french-supreme-court-upholds-argentinas-immunity-despite-waiver/> accessed 25 May 2017.

[378] See, eg, *Sté Qwinzy v Republic of Congo*, 96/80066, 27th June 1997, France, Paris, Regulational Court of Appeal [CA]. Also see *Sté Connecticut v Republic of Congo*, No 04-13.108, 7th February 2007, France, Court of Cassation [Cass]; Civil Division.

manifeste qu'il ne dit rien de cette nature.'[379] Moreover, even if the court's expansive interpretation of sovereign immunity was valid under customary international law, the French Supreme Court failed to quote pertinent scholarship, let alone examples of state practice or *opinion iuris* to support its concept of an asset-specific waiver.

In trying to explain the decisions in France, Blumenrosen and Malet-Deraedt point out that 'state revenue is problematic precisely because it may not have been allocated for any specific purpose, or may be mixed purpose, that is, in part allocated for governmental purposes and in part for commercial activities.'[380] They contend that Article 19(c) UNCSI does leave some room for interpretation by merely stating that measures of constraint are prohibited if 'the property is specifically in use or intended for use by the State for other than government non-commercial purposes.'

Article 21 UNCSI further specifies Article 19. It includes a non-exhaustive list on property, which is deemed non-commercial and thus protected from execution. It seems that the *Cour de Cassation* subsumed 'taxlike' assets under the category of non-commercial assets as defined in Article 21 UNCSI. Effectively thus, the *Cour de Cassation* added a new category of immune property to the list under Article 21 UNCSI, namely tax and social claims owed by a company to the foreign state.

Finally, as mentioned above, it should be noted that France introduced specific rules on execution proceedings against states in 2016, partly as response to the litigation between NML and Argentina in French courts.[381] Article 60 of the French Law Against Breaches of Probity (*Loi De La Lutte Contre Les Manquements À La Probité*)[382], significantly restricts the enforcement of foreign judgements in France. More specifically, it bars (i) execution against states that are the beneficiaries of development aid and (ii) the execution of judgements relating to bonds that were acquired after default. Following a challenge by a vulture fund, the French Constitutional Council found that the new law does not unduly interfere with the right to the free enjoyment of property.[383] As a result, the audacious

[379] Matthias Audit, 'La Cour de cassation française au secours de l'Argentine' (*Les Echos Blog*, 5 April 2013) <http://blogs.lesechos.fr/market-makers/la-cour-de-cassation-francaise-au-secours-de-l-argentine-a12761.html> accessed 23 August 2017.

[380] Blumrosen and Maelt-Deraedt (n 363) 642.

[381] See Grandaubert (n 374).

[382] Act No 2016-1691 of 9 December 2016 on the Fight Against Missing Morality (*Loi De La Lutte Contre Les Manquements À La Probité*) (France [fr]).

[383] Decision No 2016-741 DC of 8 December 2016, French Constitutional Council (*Le Conseil Constitutionnel*).

expansion of the sovereign immunity doctrine by the Supreme Court will no longer be needed to stop holdout litigation in French courts.

4.8. HOLDOUT LITIGATION IN OTHER JURISDICTIONS

4.8.1. NML CAPITAL V. BIS BEFORE THE SWISS FEDERAL SUPREME COURT[384]

The decision *NML v. BIS* revolved around the attempted attachment of Argentine assets held at the BIS, an international financial institution that is sometimes referred to as the 'central bank of central banks'.[385] The BIS was a sensible target for NML: it accepts deposits from central banks on current or deposit accounts, and thus manages and stores a considerable amount of hard currency. At the same time, as an international organisation, the BIS enjoys special immunities to safeguard foreign countries' assets from debt enforcement measures of (Swiss) courts.[386] In *NML v. BIS*, NML sought to attach roughly CHF290 million of Argentine monies deposited with the BIS. The application for asset attachment was based on two decisions by the SDNY that obliged Argentina to repay in full bonds that have not been included in the two debt restructurings.[387]

4.8.1.1. The Decision

In November 2009, Basel's Debt Enforcement Office ordered the freezing of all assets held by Argentina at the BIS upon the request of the vulture fund NML Capital. NML invoked Article 271(1)(4) of the Swiss Code of Debt Enforcement and Bankruptcy[388], which stipulates that creditors may request the attachment of assets owned by a debtor who has no residence in Switzerland if there is a sufficient connection between the claim on which the action is based in Switzerland. Basel's Debt Enforcement Office subsequently held that the requirements for a temporary freeze of all Argentine assets stored at the BIS were met.[389] In

[384] BGer, Urteil vom 12.07.2010 - 5A.360/2010, *NML Capital Limited and EM Limited v Bank for International Settlements and Debt Enforcement Office Basel-Stadt*, Final appeal judgment, 5A.360/2010, BGE 136 III 379, ATF 136 III 379, ILDC 1547 (CH 2010), 12th July 2010, Switzerland; Federal Supreme Court [BGer].

[385] 60 central banks from countries that make up about 95% of world GDP are members of the BIS. See BIS, 'About the BIS – overview' <https://www.bis.org/about/index.htm?m=1%7C1> accessed 24 April 2017.

[386] See, eg, August Reinisch, *The Privileges and Immunities of International Organisations in Domestic Courts* (Oxford: Oxford University Press, 2011) 20.

[387] See above 4.3.1. and 4.3.2. for two pertinent decisions by the SDNY.

[388] Swiss Code 281.1 of 11 April 1889 on Debt Enforcement and Bankruptcy (*Bundesgesetz über Schuldbetreibung und Konkurs*) (Switzerland) [ch]).

[389] BGer, Urteil vom 12.07.2010 - 5A.360/2010, *NML Capital Limited and EM Limited v Bank for International Settlements and Debt Enforcement Office Basel-Stadt*, Final appeal judgment, 5A.360/2010, BGE 136 III 379, ATF 136 III 379, ILDC 1547 (CH 2010), 12th July 2010, Switzerland; Federal Supreme Court [BGer].

its view, Argentina had illegally transferred large sums to the BIS in the wake of its 2001 crisis with the objective of evading debt enforcement measures, thereby abusing the BIS' immunity.[390]

As a response, the Swiss Foreign Office submitted a letter to the Supervisory Committee of Basel's Debt Enforcement Office, insisting that the BIS enjoyed immunity in Switzerland as regards assets stored on behalf of foreign entities.[391] Subsequently, the Supervisory Committee voided the orders of Basel's Debt Enforcement Office.[392] NML appealed against the decision to the Swiss Federal Supreme Court (SFSC), *inter alia* asserting that it violated the plaintiff's right of access to court under Article 29a of the Swiss Constitution and Article 6 ECHR.[393]

The SFSC reviewed the arrest order in light of the immunity guaranteed to the BIS by Article 55(2) Statute of the BIS[394] and Article 4 of the BIS Headquarters Agreement[395]. It remarked that according to Article 4(1)(a) of the Headquarters Agreement, the BIS enjoyed immunity from jurisdiction and execution, 'save to the extent that such immunity is formally waived'.

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[390] See Reinisch (n 386).

[391] BGer, Urteil vom 12.07.2010 - 5A.360/2010, *NML Capital Limited and EM Limited v Bank for International Settlements and Debt Enforcement Office Basel-Stadt*, Final appeal judgment, 5A.360/2010, BGE 136 III 379, ATF 136 III 379, ILDC 1547 (CH 2010), 12th July 2010, Switzerland; Federal Supreme Court [BGer] [381].

[392] ibid.

[393] For a discussion of the decision, see Dimitij Euler, 'Switzerland's Department of Foreign Affairs endorsed BGH decision (BGE 136 III 379) not to lift Bank of International Settlement's (BIS) immunity due to an attempt of NML Capital to freeze USD300m (£186m) on Argentina's bank accounts' (*Young ICCA Blog*, 3 December 2012) <http://www.youngicca-blog.com/switzerlands-department-of-foreign-affairs-endorsed-federal-supreme-court-decision-bge-136-iii-379-not-to-lift-bank-of-international-settlements-bis-immunity-due-to-an-attempt-of/#_ftn9> accessed 25 April 2017.

[394] See Convention respecting the Bank for International Settlements 104 LNTS 441 ('Statute of the BIS). Article 55 BIS Statutes reads as follows:

'(1) The Bank shall enjoy immunity from jurisdiction, save:

(a) to the extent that such immunity is formally waived in individual cases by the Chairman of the Board, the General Manager, the Deputy General Manager, or their duly authorised representatives; or

(b) in civil or commercial suits, arising from banking or financial transactions, initiated by contractual counterparties of the Bank, except in those cases in which provision for arbitration has been or shall have been made.

(2) *Property and assets of the Bank shall, wherever located and by whomsoever held, be immune from any measure of execution* (including seizure, attachment, freeze or any other measure of execution, enforcement or sequestration), except if that measure of execution is sought pursuant to a final judgment rendered against the Bank by any court of competent jurisdiction pursuant to sub-paragraph 1(a) or (b) above. [emphasis added].'

[395] Agreement between the Swiss Federal Council and the Bank for International Settlements to determine the Bank's legal status in Switzerland of 10 February 1987 (text as amended effective 1 January 2003 by the exchange of letters of 18 December 2002/13 January 2003) ('Headquarters Agreement'). Article 4 stipulates the following:

'1. The Bank shall enjoy immunity from jurisdiction, save:

(a) to the extent that such immunity is formally waived in individual cases by the President,2 the General Manager of the Bank, or their duly authorised representatives;

(b) in civil or commercial suits, arising from banking or financial transactions, initiated by contractual counterparties of the Bank, except in those cases in which provision for arbitration has been or shall have been made;

(c) in the case of any civil action against the Bank for damage caused by any vehicle belonging to or operated on behalf of the Bank.'

However, as the Supreme Court stressed that the BIS had expressly denied the existence of such formal waiver in the case before the Supervisory Committee.[396] The SFSC moreover remarked that central bank deposits at the BIS were, according to the Headquarters Agreement, protected from debt enforcement attempts by private creditors.[397] Indeed, given its functions as a 'central bank for central banks', an attachment order against funds held by the BCRA at the BIS would undermine the institution's core functions and organisational purpose.[398] Consequently, funds held at the BIS enjoyed absolute immunity from enforcement and not, like states more generally, only with regard to commercial property.

Regarding the question whether the transferral of funds to the BIS amid an economic crisis constituted an abuse of the institution's immunity[399], the SFSC remained silent and granted a wide margin of discretion to the BIS.[400] The SFSC emphasised that municipal courts ought not to decide independently which activities undertaken by an international organisation were necessary for its functioning or – as asserted by the plaintiff – constituted an abuse of law.[401] Rather, courts should be guided by the international organisation's internal assessment:[402] Given that the BIS declined to rescind its immunity, the SFSC dismissed the plaintiff's claim against the BIS.

Finally, the SFSC weighed in on Article 6 ECHR[403], which – according to the plaintiff – was violated by the decision to decline an application for execution against assets deposited at the BIS. The Supreme Court first agreed that Article 6 ECHR encompassed a right to a fair

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[396] BGer, Urteil vom 12.07.2010 - 5A.360/2010, *NML Capital Limited and EM Limited v Bank for International Settlements and Debt Enforcement Office Basel-Stadt*, Final appeal judgment, 5A.360/2010, BGE 136 III 379, ATF 136 III 379, ILDC 1547 (CH 2010), 12th July 2010, Switzerland; Federal Supreme Court [BGer] [384-385].

[397] ibid.

[398] ibid [387-388]. The immunity of international organisations is deemed vital to safeguard their independent operation in the host state. However, for such immunity to be justified, all actions must be closely linked to its organisational purpose. See Sam Muller, *International Organizations and Their Host States: Aspects of Their Legal Relationship* (Amsterdam: Martinus Nijhoff, 1995) 151.

[399] BGer, Urteil vom 12.07.2010 - 5A.360/2010, *NML Capital Limited and EM Limited v Bank for International Settlements and Debt Enforcement Office Basel-Stadt*, Final appeal judgment, 5A.360/2010, BGE 136 III 379, ATF 136 III 379, ILDC 1547 (CH 2010), 12th July 2010, Switzerland; Federal Supreme Court [BGer] [388].

[400] See for a discussion in Thore Neumann and Anne Peters, 'Switzerland' in Reinisch (n 386) 250.

[401] BGer, Urteil vom 12.07.2010 - 5A.360/2010, *NML Capital Limited and EM Limited v Bank for International Settlements and Debt Enforcement Office Basel-Stadt*, Final appeal judgment, 5A.360/2010, BGE 136 III 379, ATF 136 III 379, ILDC 1547 (CH 2010), 12th July 2010, Switzerland; Federal Supreme Court [BGer] [387].

[402] ibid [388].

[403] Article 6(1) ECHR reads as follows: '[i]n the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly but the press and public may be excluded from all or part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice.'

execution proceeding. However, a state may restrict the party's free enjoyment of property if this was both legitimate and proportionate.

Referring to the ECtHR decision in *Waite and Kennedy v. Germany*[404], the Swiss Supreme Court clarified that the privileges and immunities granted to the BIS pursued a legitimate public interest aim, given its function as international global payments platform (*Zahlungsdrehscheibe*).[405] For the act to be deemed proportionate, it was crucial that there was no reasonable alternative to ensure a necessary and adequate level of protection to international organisations in the host state.[406]

In this regard, the SFSC also sided with the BIS. It held that the operations of the BIS would be severely impaired if Swiss courts were to render judgements on the legitimacy of central bank deposits from a monetary policy perspective.[407]

4.8.1.2. Analysis

With a balance sheet of roughly SDR250 billion (USD342 billion), of which SDR213 billion make up deposits by its customers, the BIS administers a considerable amount of foreign public assets.[408] Similar to the FRBNY, the BIS makes for an interesting target for holdout creditors' debt enforcement attempts in their worldwide 'hunt for assets'. While, as explained above[409], the FRBNY is exclusively protected by US law, the BIS enjoys the privileges and immunities of an international organisation under international law.

While doctrinally different, the decision in *NML v. BIS* reflected the same legal policy considerations as the US Second Circuit's judgement in *EM v. BCRA*[410]. By barring debt enforcement into funds held by foreign central banks on BIS accounts, the host state, Switzerland, protected the BIS in order to facilitate smooth payments flows between central

[404] *Waite and Kennedy v Germany*, Merits, App No 26083/94, ECHR 1999-we, IHRL 3200 (ECHR 1999), OXIO 272, [1999] ECHR 13, (1999) 30 EHRR 261, (1999) 118 ILR 121, [1999] 6 BHRC 499, 18th February 1999, European Court of Human Rights [ECHR]; Grand Chamber [ECHR].

[405] BGer, Urteil vom 12.07.2010 - 5A.360/2010, *NML Capital Limited and EM Limited v Bank for International Settlements and Debt Enforcement Office Basel-Stadt*, Final appeal judgment, 5A.360/2010, BGE 136 III 379, ATF 136 III 379, ILDC 1547 (CH 2010), 12th July 2010, Switzerland; Federal Supreme Court [BGer] [390].

[406] ibid.

[407] ibid [391] (further arguing that granting attachment orders to private market participants would, too, not be in the interest of international financial stability).

[408] See BIS, 'Financial statements' (22 November 2016) <http://www.bis.org/banking/balsheet.htm> accessed 29 April 2017.

[409] For a discussion see above 4.3.2.

[410] *NML Capital Limited and EM Limited v Banco Central de la Republica Argentina*, 652 F 3d 172 (2d Cir 2011), 5th July 2011, United States; Court of Appeals (2nd Circuit) [2d Cir]. See above 4.3.2. for a discussion of the judgement.

banks and to maintain currency reserves for various international transactions.[411] To this end, the SFSC adopted a relatively broad interpretation of the immunity of international organisations.[412]

According to Neumann and Peters, the distinction drawn between state immunity, which is restrictive in nature, and immunity of international organisations, which remains quasi-absolute, was justified by the fact that the latter do not dispose of any territorial basis.[413] At the same time, to justify this increased level of immunity, all acts by an international organisation must *per se* relate closely to the organisation's functional character of its legal personality, as for instance clarified by the Swiss courts in the *CERN*[414] case.

However, as Neumann remarks, by focusing on the functional necessity doctrine to narrow down the scope of organisational immunities, the SFSC 'missed a chance to provide a more substantial argumentative underpinning of, and to explain more thoroughly, its traditional, heavily treaty-oriented absolute immunities concept.'[415]

Two considerations are important in this context. On the one hand, safeguarding the BIS's function warrants bestowing upon it a high level of organisational and functional immunity. On the other hand, by granting absolute immunity without assessing the specific circumstances of the case, domestic courts run the risk of providing states with a 'carte blanche' as regards the protection of certain assets from debt enforcement. As the plaintiff had asserted, governments may abuse the absolute immunity provided by the BIS Headquarters Agreement. This could encourage states close to default to transfer funds to Switzerland in the wake of an economic crisis, thereby circumventing the enforcement of valid debt contracts.

While the SFSC was correct in barring the attachment of Argentine assets by vulture funds, it failed to elaborate why the functional approach was insufficient to safeguard the BIS's

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[411] This understanding of the BIS' role reflects Article 3 of the BIS Statutes, which states that '[t]he objects of the Bank are: to promote the co-operation of central banks and to provide additional facilities for international financial operations; and to act as trustee or agent in regard to international financial settlements entrusted to it under agreements with the parties concerned.

[412] Most notably *Groupement d'Entreprises Fougerolle v European Organization for Nuclear Research (CERN)*, BGE 118 Ib 562, 21st December 1992, Switzerland; Federal Supreme Court [BGer].

[413] Neumann and Peters (n 400) 246.

[414] *Groupement d'Entreprises Fougerolle v European Organization for Nuclear Research (CERN)*, BGE 118 Ib 562, 21st December 1992, Switzerland; Federal Supreme Court [BGer] [1(a)].

[415] Thore Neumann, 'NML Capital Ltd and EM Limited v Bank for International Settlements and Debt Enforcement Office Basel-Stadt' (2010) Oxford Reports on International Law in Domestic Courts (ILDC) 1547. Also see Sandrine Giroud, 'Enforcement against State Assets and Execution of ICSID Awards in Switzerland: How Swiss Courts Deal with Immunity Defences' (2012) 30 ASA Bulletin 4/2012, 758.

operations. By applying a strict textual interpretation of the Headquarters Agreement rather than clearly delineating the boundaries of organisational immunity under international law, it nurtured a sense of political opportunism in its judgement. While in practice, most acts by an international organisation relate to its functions, there should be exceptions to cater for situation of blatant abuse of the law by states that seek to shield their funds from creditor enforcement actions. Indeed, holdout creditor problems should be dealt with in a framework that respects general principles of law, thereby ensuring an adequate balance between the risks of abuse and the need to protect the immunity of international organisations.

Regarding the alleged breach of Article 6 ECHR, the SFSC's decision seemed uncontroversial, albeit some commentators criticise the court's examination and conclusions regarding proportionality.[416] One concern is that while the plaintiffs had no recourse to adequate alternative legal remedies to challenge the decision of the BIS, denying the organisation's immunity on human rights grounds may undermine the immunity of international organisations more generally. One could easily think of several other situations where no alternative means for private debt enforcement against international organisations exist. The UN, which enjoys immunity from all civil law proceedings in their host country, would be a case in point.[417]

Neumann and Peters also contend that the SFSC's was flawed because it failed to identify and evaluate the particular interests of the vulture holdout in having the BIS's immunity reviewed.[418] In their view, the Swiss court ignored that, as a rule, the ECtHR[419] first examines whether an applicant may resort to alternative dispute settlement mechanisms. Only afterwards, it addresses the question of immunity.[420] In response to the critique by Neumann and Peters, one could however argue that an international organisation can only function satisfactorily if its independence is guaranteed by virtue of law.

[416] Giroud (n 415) 758.

[417] See, eg, *Waite and Kennedy v Germany*, Merits, App No 26083/94, ECHR 1999-we, IHRL 3200 (ECHR 1999), OXIO 272, [1999] ECHR 13, (1999) 30 EHRR 261, (1999) 118 ILR 121, [1999] 6 BHRC 499, 18th February 1999, European Court of Human Rights [ECHR]; Grand Chamber [ECHR], 72 (stating 'the proportionality test could not lead to an international organization being subjected to domestic jurisdiction').

[418] Neumann and Peters (n 400) 246.

[419] For instance in *Waite and Kennedy v Germany*, Merits, App No 26083/94, ECHR 1999-we, IHRL 3200 (ECHR 1999), OXIO 272, [1999] ECHR 13, (1999) 30 EHRR 261, (1999) 118 ILR 121, [1999] 6 BHRC 499, 18th February 1999, European Court of Human Rights [ECHR]; Grand Chamber [ECHR].

[420] Anne Peters, 'Die funktionale Immunität internationaler Organisationen und die Rechtsweggarantie; zugleich Anmerkung zur Entscheidung des schweizerischen Bundesgerichts zur Immunität der Bank für Internationalen Zahlungsausgleich (BIZ) vom 12 Juli 2010 (BGE 136 III 379, 5A 360/2010)' (2011) 21 Revue suisse de droit international et européen 397, 422.

Thus, with regard to the proportionality test, states should enjoy a wide margin of appreciation, even if alternative means for dispute resolution do not exist. This logic should apply in particular to holdouts who seek to undermine international monetary policies and laws for their own financial gain and without due regard to key principles of international economic cooperation.

4.8.2. THE 'ARA LIBERTAD' CASE BEFORE THE ITLOS

The *ARA Libertad* case[421] before the ITLOS epitomised the vulture holdouts' relentlessness in hunting for enforceable assets as well as the Argentine government's uncompromising stance vis-à-vis the international investor community. Unsurprisingly, the legal dispute – which concerned an Argentine navy vessel arrested by Ghanaian authorities – attained significant international news coverage.[422] Indeed, as many observers highlight, the attempt to arrest a military ship in an African port was primarily a sign of power than a genuine effort to satisfy an outstanding monetary claim. As Paul Singer, the CEO of NML Capital, shrewdly admitted, he 'did not purchase [Argentinian] debt in order to acquire a ship too large to sail in Long Island Sound.'[423]

4.8.2.1. The Decision

The tribunal first reviewed the facts of the case. The Argentine training navy vessel 'ARA Libertad' had arrived at the Ghanaian port of Tema on 1 October 2012 for an official visit.[424] Just one day later, NML filed a Statement of Claim in the High Court of Accra, Ghana's capital, with the ostensible objective of enforcing money judgements rendered by New York courts against Argentina. The Ghanaian court subsequently made an order to detain the ship and prohibited the crew to leave the country as long as Argentina has not posted collateral with a value of at least USD20 million.[425] Argentina failed to challenge the decision on a local level: the Ghanaian High Court saw no reason to set the injunction aside.

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[421] 'ARA Libertad' Case, *Argentina v Ghana*, Order, request for the prescription of provisional measures, ITLOS Case No 20, [2012] ITLOS Rep 21, ICGJ 454 (ITLOS 2012), 15th December 2012, International Tribunal for the Law of the Sea [ITLOS].

[422] See, eg, Joseph Cotterill, 'Ghana shall forthwith and unconditionally release the frigate ARA Libertad' *FT Alphaville* (New York, 15 December 2012) <https://ftalphaville.ft.com/2012/12/15/1309492/ghana-shall-forthwith-and-unconditionally-release-the-frigate-ara-libertad/> accessed 30 April 2017.

[423] Michelle Celarier, 'Singer takes victory lap in debt feud' *New York Post* (New York, 30 October 2012).

[424] 'ARA Libertad' Case, *Argentina v Ghana*, Order, request for the prescription of provisional measures, ITLOS Case No 20, [2012] ITLOS Rep 21, ICGJ 454 (ITLOS 2012), 15th December 2012, International Tribunal for the Law of the Sea [ITLOS] [7].

[425] ibid [8].

Argentina thus appealed to the ITLOS, where it questioned the legality of the Ghanaian court order under the international law of the seas. Specifically, Argentina argued that Ghana's acts violated the United Nations Convention on the Law of the Sea (UNCLOS)[426], to which both Argentina and Ghana were parties. It put forward that Ghana had violated its obligations to respect the immunity of military vessels according to Article 32 of the UNCLOS[427], Article 3 of the 1926 International Convention for the Unification of Certain Rules Concerning the Immunity of State-Owned Vessels[428], and customary international law.[429]

Argentina moreover asserted that its rights were suffering 'irreparable damage,' with dire consequences to the sovereignty and dignity of the state.[430] On that basis, Argentina applied for the following remedies: (1) the release of the Libertad, (2) 'adequate compensation for all material losses caused' as a result of the detention, (3) the offer of a 'solemn salute to the Argentine flag as a satisfaction for the moral damage caused by the detention,' and (4) disciplinary sanctions for the Ghanaian officials who were 'directly responsible' for the claimed violations of international law.[431]

Ghana countered Argentina's claim by arguing that Argentina had waived its immunity from suit and enforcement. Ghana did not dispute the fact that warships sailing on the high seas were protected under customary international law, and that, therefore, the country had no right to hold the ship seized therein. Its contention was rather that the dispute was beyond the jurisdiction of the ITLOS, notably since Argentina had expressly waived its immunity with regard to the debt obligations that NML sought to enforce. Moreover, Ghana argued that the dispute was one of general international law and thus not justiciable under the UNCLOS, which exclusively related to the law of the sea.[432]

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[426] Convention on the Law of the Sea (United Nations [UN]) 1833 UNTS 3, UKTS 81 (1999), UN Doc A/Conf.62/122, UN Reg No I-31363 ('UNCLOS').

[427] Article 32 UNCLOS states that '[…] nothing in this Convention affects the immunities of warships.'

[428] International Convention for the Unification of Certain Rules of Law relating to Bills of Lading (as amended) 120 LNTS 155, Reg No LoN-2764.

[429] 'ARA Libertad' Case, *Argentina v Ghana*, Order, request for the prescription of provisional measures, ITLOS Case No 20, [2012] ITLOS Rep 21, ICGJ 454 (ITLOS 2012), 15th December 2012, International Tribunal for the Law of the Sea [ITLOS] [31].

[430] See *ARA Libertad*, Public sitting, Doc. ITLOS/PV.12/C20/1, (29 November 2012) [1].

[431] See Thomas E. Robinson, 'The Peculiar Case of the ARA Libertad: Provisional Measures and Prejudice to the Arbitral tribunal's Final Result' (2015) 20 Harvard Negotiation Law Review 265, 274.

[432] *ARA Libertad*, Written Statement of the Republic of Ghana, app. 3 (28 November 2012). In Ghana's view, 'Article 32 of the [UNCLOS] Convention refers to the immunity of warships in the territorial sea and *does not refer to any such immunity when in internal waters* and that it was understood that the regime of ports and internal waters was excluded from the 1982 Convention. [emphasis added]'.

In its twentieth case, the ITLOS focused on assessing and defining the immunity of military ships under UNCLOS as well as customary international law. In accordance with Article 290(5) UNCLOS, the tribunal considered Argentina's claim on *a prima facie* basis, thus without assessing its merits. [433] The tribunal held that the Libertad fell under the definition of a warship pursuant to Article 29 UNCLOS[434] due to its functions in Argentina's navy. The tribunal further remarked that such warships 'enjoy[ed] immunity under general international law, including in internal waters'.[435] Thus, the Ghanaian court order, which barred the vessel from leaving the country, violated the immunity of warships under the pertinent rules of international law.

The ITLOS tribunal also held that the proceedings for interim measures were appropriate as the attempt of Ghanaian authorities to board the Libertad 'demonstrated the gravity of the situation and underlined the urgent need for measures pending the constitution of the Annex VII arbitral tribunal.'[436] The urgency of the situation thus required the tribunal to act in accordance with Article 290(5) UNCLOS and prescribe that 'Ghana shall forthwith and unconditionally release the frigate ARA Libertad'.[437] Following the ITLOS decision, Ghana immediately revoked the arrest warrant and the Libertad left the port of Tema on 19 December 2013.

4.8.2.2. Analysis

The *ARA Libertad* case concerned one of the more obscure attempts of vulture holdouts to enforce money judgements against Argentina. It was nonetheless widely discussed, notably since the ITLOS broached fundamental questions pertaining to the immunity of state assets under customary international law as well as international treaty law.[438] The public interest in

[433] On this basis, the ITLOS may grant provisional (interim) measures in order to protect sovereign assets and minimise the losses to the respective party before a final order on merits was rendered. More specifically, Article 290(5) UNCLOS allows for prima facie jurisdiction if 'the urgency of the situation so requires in the sense that action prejudicial to the rights of either party is likely to be taken before constitution of the Annex VII arbitral tribunal.'

[434] According to Article 29 UNCLOS, 'warship' means a ship belonging to the armed forces of a State bearing the external marks distinguishing such ships of its nationality, under the command of an officer duly commissioned by the government of the State and whose name appears in the appropriate service list or its equivalent, and manned by a crew which is under regular armed forces discipline.'

[435] 'ARA Libertad' Case, *Argentina v Ghana*, Order, request for the prescription of provisional measures, ITLOS Case No 20, [2012] ITLOS Rep 21, ICGJ 454 (ITLOS 2012), 15th December 2012, International Tribunal for the Law of the Sea [ITLOS] [93].

[436] ibid [99].

[437] ibid [108].

[438] See, eg, Robinson (n 431); James Kraska, 'THE "ARA LIBERTAD" (*Argentina v. Ghana*). ITLOS Case No 20 Provisional Measures' (2013) 107 The American Journal of International Law 1; Ted L. McDorman,

the trial was high. The New York Times even went as far as noting that 'European debtor nations might see in this story a cautionary tale', thereby connecting the case with the ongoing euro area sovereign debt crisis.[439] There should be little doubt that the *ARA Libertad* case will remain exceptional and unique, marking the tip of the iceberg in an unprecedented standoff between Paul Singer's hedge fund(s) and a defiant Argentine government under President Kirchner.

From a dogmatic point of view, the case buttressed the immunity of warships and set an important precedent for the rule of international customary law in domestic ports.[440] As Robinson for instance notes, the ITLOS tribunal endorsed in *ARA Libertad* the principle of sovereign immunity of military assets from judgement: 'a nearly inviolate concept in international law'.[441]

In addition, the ITLOS decision made clear that even if states had waived their immunity in their sovereign debt securities, certain cogent rules of international law would always override the state's contractual consent. Naturally, the ITLOS did not assess whether the warship had actually served a 'sovereign' purpose. Indeed, it is presumed under customary international law that property of a military character used, or intended for use for military purposes shall not be considered as property specifically in use or intended for use by the state for other than government non-commercial purposes.[442]

In future debt crisis, the immunity of ships owned by a sovereign but used for commercial purposes will be more important than that of military vessels. While the ITLOS decision in *ARA Libertad* provided more legal certainty as regards the protection of warships anchored in foreign ports, trade ships may still be arrested for the purpose of debt execution, as they are

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'Sovereign Immune Vessels: Immunities' in Henrik Ringbom (ed), *Jurisdiction over Ships: Post-UNCLOS Developments in the Law of the Sea* (Amsterdam: Brill, 2015) 82; B.M. Dimri, 'The Arrest of Argentine Warship 'ARA Libertad': Revisiting International Law Governing Warships, Sovereign Immunity, and Naval Diplomatic Roles' (2013) 7(3) Journal of Defence Studies 97; Luke Peterson, 'Argentina and Ghana announce settlement of arbitration over detained warship' (*Kluwer Arbitration Blog*, 28 September 2013) <http://kluwerarbitrationblog.com/2013/09/28/argentina-and-ghana-announce-settlement-of-arbitration-over-detained-warship-ara-libertad/> accessed 17 May 2017.

[439] Daniel Politi, 'Liberty or Debt' *The New York Times* (New York, 17 October 2012) <https://latitude.blogs.nytimes.com/2012/10/17/holders-of-argentinas-defaulted-debt-hold-up-a-frigate-in-ghana/> accessed 17 May 2017; also see Cotterill, 'Ghana shall forthwith and unconditionally release the frigate ARA Libertad' *Financial Times Alphaville* (London, <https://ftalphaville.ft.com/2012/12/15/1309492/ghana-shall-forthwith-and-unconditionally-release-the-frigate-ara-libertad/> accessed 17 May 2017.

[440] Kraska (n 438) 7.

[441] Robinson (n 431) 287.

[442] As the ILC states in its commentary to the UNCSI, the word 'military' includes the navy, air force and army. See Commentaries to Draft Articles on Jurisdictional Immunities of States and Their Property adopted by the International Law Commission at its forty-third session in 1991 [[1991] II(2) UNYBILC 13] 59.

not covered by the UNCLOS. Take for instance Venezuela, which has a whole fleet of oil tankers. Given the ongoing economic and political crisis in the country, its ships are likely to become the first target of holdout creditors, should the country ultimately default.[443]

4.9. HOLDOUT ARBITRATION BEFORE THE ICSID

This section analyses three cases of holdout arbitration before the ICSID against Argentina over the alleged violation of different BITs. As this section shows, international investment arbitration provides an additional channel for holdout creditors to obtain an enforceable decision against a state that has restructured its public debts.

4.9.1. ABACLAT AND OTHERS V. ARGENTINE REPUBLIC[444]

The *Abaclat* arbitration was special for two reasons. First, the ICSID tribunal suggested that – aside from constituting a violation of sovereign debt contracts – sovereign default was likely to breach the terms of a BIT signed by the sovereign issuer. Second, the tribunal allowed investors to pursue mass claim arbitration, which meant that individual bondholders could apply for an award collectively, thereby capitalising on the synergies from pursuing class action.

While suing a country in the ICSID remains very expensive for the individual bondholder, mass claim arbitration could allow retail holdouts to distribute financial risks and thereby considerably increase their pressure on a sovereign to settle on favourable terms. This is the story told by the *Abaclat* case.

4.9.1.1. Decision on Jurisdiction and Admissibility

The decision on jurisdiction and admissibility of the claims in *Abaclat* spanned across 284 pages and provided a compelling insight into the legal aspects of sovereign default, the controversial definition of 'investment' under Article 25 of the ICSID Convention, as well as

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[443] Robert Kahn, 'Venezuela on the Edge' (*Council of Foreign Relations Blog*, 23 February 2013) <https://www.cfr.org/blog/venezuela-edge> accessed 20 August 2017. One problem that remains is that Venezuela's oil tankers are owned by PDVSA, the state's oil company. Creditors would probably have to prove that PDVSA acts as Venezuela's alter ego if they were to successfully seize an oil tanker. For a discussion of this specific issue, see Mark Weidemaier, 'Venezuela is Like…PDVSA's Alter Ego, and Vice Versa?' (*Credit Slips*, 17 August 2017) <http://www.creditslips.org/creditslips/2017/08/venezuela-is-like-any-other-shareholder.html#more> accessed 20 August 2017.

[444] *Abaclat and ors v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

the admissibility of mass claims to investment arbitration. In this section, we will look at the central conclusions reached by the ICSID in *Abaclat*.

The total number of claimants in this case exceeded 180.000, most of which were Italian bondholders represented by the TFA.[445] The Italian claimants had already filed their request for arbitration in 2006, shortly after the first Argentine restructuring offer in 2005, which many claimants deemed insufficient and unfair. The ICSID tribunal was constituted in February 2007 and the first sessions were held in 2008.

In essence, the claimants contended that they were deprived of the value of their investment because of Argentina's debt moratorium.[446] Specifically, they alleged that (i) Argentina had repudiated its obligations and pursued a unilateral, punitive exchange offer targeting, (ii) Argentina had enacted legislation to the same effect, thus destroying the value of their investment, and (iii) Argentina had acted as a rogue debtor by breaching its international treaty obligations.

Argentina rejected this view, arguing that (a) the conditions for ICSID jurisdiction were not fulfilled as the ICSID Convention did not permit collective claims, (b) the tribunal lacked jurisdiction *ratione personae*, and (c) the claims depended fundamentally on contractual obligations rather than the Argentina-Italy BIT.[447]

Against this backdrop, the tribunal focused on two legal questions. First, did the sovereign bonds fall under the definition of 'investment' in international investment law and, second, were mass claims admissible to arbitration under the rules of the ICSID Convention?

4.9.1.1.1. Sovereign bonds as 'Investment'

First, in assessing its competence to review the claims on merit, the tribunal focused on two legal sources: Article 25 ICSID Convention and the Argentina-Italy BIT. According to the prevailing 'double-barrelled' test, the investment at stake must fit into both the definition of investment under the applicable BIT and the definition set out in the ICSID Convention. The tribunal first clarified that the concept of investment as contemplated by the ICSID Convention related to the contribution made by the investor. There was no specific definition

[445] ibid [1-4].
[446] ibid [238-243].
[447] ibid [234].

of investment in the Convention, which is why several ICSID tribunals have sought to specify the concept of investment over the years.[448]

In 2001, the *Salini* tribunal laid down several criteria to determine the nature of an investment.[449] According to the *Salini* test, a specific economic transaction or operation must include (a) a substantial contribution of the investor, (b) a certain duration, (c) the existence of an operational risk, (d) a certain regularity of profit, and (e) a contribution to the economic development of the host state.[450] The definition thus focused on the nature of the contribution rather than the rights and values deriving therefrom.[451]

The tribunal in the *Abaclat* case found that applying the *Salini* criteria to Argentina would not be the correct approach.[452] In its view, such application 'would be contradictory to the ICSID Convention's aim, which is to encourage private investment while giving the Parties the tools to further define what kind of investment they want to promote.'[453] Thus, only a reading of the ICSID Convention that subsumed bonds under the concept of 'contribution to the host state' would be in line with the parties' objective of protecting the value generated through the sale of debt instruments.[454]

In a second step, the tribunal clarified that the investors' rights set out in the Argentine bond contracts were also protected by the Argentina-Italy BIT.[455] More specifically, it held that Article 1(1)(c) of the BIT, according to which investments in the host state included 'obligations, private or public titles or any other right to performances or services having economic value, including capitalized revenue', also extended to government bonds.[456] This was because lit (c) of the BIT explicitly mentioned 'financial instruments', which were any fungible, negotiable instruments representing financial value, and 'public titles', which

[448] ibid [347].

[449] *Salini Costruttori SpA and Italstrade SpA v Morocco,* Decision on jurisdiction, ICSID Case No ARB/00/4, IIC 206 (2001), (2004) 6 ICSID Rep 398, (2003) 42 ILM 609, (2002) 129 Clunet 196, 16th July 2001, despatched 23rd July 2001, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[450] ibid [52]. Also see *Abaclat and ors v Argentina*, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [341].

[451] *Abaclat and ors v Argentina*, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [348].

[452] ibid [363].

[453] ibid [364].

[454] ibid.

[455] ibid [355-360].

[456] ibid [355].

referred to debt obligations issued by the sovereign.[457] Therefore, the tribunal had *ratione materiae* over the claims.[458]

4.9.1.1.2. Mass Claims Arbitration

In a second step, the ICSID tribunal decided on its jurisdiction *ratione personae.* Specifically, it reviewed whether 'mass claims' would be compatible with the spirit of the ICSID framework.[459] Argentina had rejected the admissibility of such mass claim, arguing that this would 'encourage hold-outs' and 'go against the current efforts to modernise foreign debt restructuring processes'. [460] The tribunal did not follow the respondent's line of argumentation. It opined that the silence in the ICSID Convention as regards mass claim proceedings was a 'gap' rather than a 'qualified (and hence intended) silence'. Thus, the tribunal found that it had the power under Article 44 ICSID Convention to fill such gap, albeit only to the extent necessary to deal with specific problems arising in the respective proceedings.[461]

Due to the high number of claimants, the tribunal considered it impossible assess the merits of each individual claim. Thus, as long as the claims were 'sufficiently homogenous', the tribunal was willing to review them collectively.[462] This was the case, given that the same BIT protected all securities, that they were subject to the debt restructuring of 2005 and that the breach of the BIT affected all claimants.[463]

Finally, the ICSID tribunal found that the policy arguments invoked by Argentina were 'inapposite' for the ICSID: the tribunal could not reject the admissibility of claims based on a controversial and speculative threat to the stability and fairness of sovereign debt restructurings by holdout creditors.[464] Policy reasons ought to be considered at the stage of negotiating and signing a BIT rather than *ex post*. The tribunal thus declined its competence to 'repair an inappropriately negotiated or drafted BIT.'[465]

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[457] ibid.

[458] ibid [356-361].

[459] ibid [507].

[460] ibid [512] (Claimants contented that 'the present mass proceedings are within the jurisdictional limits of ICSID, the question of its management being a question of mere procedure covered by Article 44 ICSID Convention and thereby within the power of the tribunal').

[461] ibid [521-526].

[462] ibid [540].

[463] ibid.

[464] ibid [549].

[465] ibid [550].

4.9.1.2. The Dissenting Opinion by Abi-Saab

In a comprehensive dissenting opinion, Professor Georges Abi-Saab rejected the majority's view regarding the definition of sovereign bonds as 'investment'.[466] Moreover, he argued that the ICSID Convention's silence as regards the admissibility of mass claims should be construed in favour of Argentina.[467]

First, with respect to the definition of investment under the ICSID Convention, Abi-Saab noted that the '[t]he purpose for using the term 'investment' in Article 25(1) was to set objective outer-limits to the types of disputes that can be treated within the ICSID'.[468] Consequently, Article 25 was not 'infinitely elastic' and 'had a hard-core that cannot be waived even by agreement of States parties to a BIT.'[469] To that end, Article 25 ICSID Convention ought to be seen in light of the Convention's key objective, namely 'to encourage investment that contributes to the economic development of the host country, ie to the expansion of its productive capacity, a contribution that presupposes a commitment to this task not only of economic resources, but also in terms of duration in time and the taking of risk, with the expectation of reaping profits and/or revenue in return.'[470]

Abi-Saab then elaborated on the status of sovereign debt instruments in the remit of international investment law. While portfolio investments were not *per se* excluded from the definition of 'investment' enshrined in the ICSID Convention, he argued that it should be decided on a case-by-case basis whether certain instruments issued by a state fell under the type of investment protected by the Convention.[471] According to Abi-Saab's opinion, the territorial link or nexus between the alleged investment and the host country was decisive. Indeed, the 'whole idea behind the [ICSID] Convention was to encourage the flow of private foreign investment to developing countries by offering an international guarantee in the form of an alternative neutral adjudication of disputes arising out of such investment in the territory of the host States, typically subject to its laws and courts.'[472]

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[466] *Abaclat and ors v Argentina*, dissenting opinion of Georges Abi-Saab, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [34-117].
[467] ibid [120-273].
[468] ibid [45].
[469] ibid [46].
[470] ibid [50].
[471] ibid [60-61].
[472] ibid [74].

The alleged investment, ie security entitlements held by the Italian bondholders, were not located in Argentina. On the one hand, they had been sold in international markets outside the country (the *situs* of the debt) and, on the other, the forum selection clause conferred jurisdictions upon the courts of New York City rather than Argentina.[473] According to Abi-Saab, the majority view ignored the fact that this contractual design purposefully located the rights of the bondholders outside Argentina to ensure enforceability in New York courts.[474]

With respect to the *Salini* test, Abi-Saab argued that the majority view ignored the lack of traceability of the alleged investment to an underlying specific economic project or operation that took place in the territory of Argentina.[475] He contended that 'not all funds made available to governments are necessarily used as 'investment' in in projects or activities contributing to the expansion of the productive capacities of the country.'[476]

On the admissibility of mass claims, Abi-Saab voiced concern that ICSID tribunals would be 'producing a monster'. Essentially, he deemed the concept of mass proceedings flawed.

First, it was simply impossible for the tribunal to evaluate a treaty claim for compensation without knowing for each individual asset when it was acquired, what price was paid for it and what currency it was denominated in.[477] Second, while the 'level of homogeneity' resulting from the circumstances may have been sufficient to aggregate and register them for purposes of pre-trial management, it was clearly insufficient to examine them as if they were one claim either in fact or in law.[478] Third, the 'qualified silence' in the ICSID Convention could be intentional due to disagreement between the drafters of the Convention.[479] Fourth, under international law, courts and tribunal have typically required special or secondary consent to mass arbitration.[480]

4.9.1.3. The Settlement

The ICSID tribunal in *Abaclat* never formally issued an award that claimants could have executed under the rules of the New York Convention[481]. However, with the election of a

[473] ibid [81-83].
[474] ibid [84].
[475] ibid [109].
[476] ibid [113].
[477] ibid [143].
[478] ibid [144].
[479] ibid [161].
[480] ibid [190].
[481] Convention on the Recognition and Enforcement of Foreign Arbitral Awards (United Nations [UN]) 330 UNTS 3, 21 UST 2517 ('New York Convention').

new Argentine President in 2016, the tedious dispute was settled in a matter of months.[482] The TFCA, which represented approximately 50.000 Italian retail investors that held on average USD25.000-50.000 in Argentina bonds, agreed to an offer by the new Argentine administration to pay USD1.35 billion in cash to the holdouts.

This payment equalled 150% of the value of the bonds Argentina defaulted on in 2001.[483] The Argentine Senate approved the deal, which was part of a greater bargain between the government and the remaining holdouts, in March 2016, together with a USD12.5 billion bond sale to international investors to finance it.[484] Following the deal, the *Abaclat* tribunal decided on 15 December 2016 that the Settlement Agreement signed by the TFA and the Argentine Republic would be an enforceable award on the agreed terms.[485] With this consent award, the *Abaclat* arbitration came to conclusion.

4.9.2. AMBIENTE UFFICIO SPA AND OTHERS V ARGENTINE REPUBLIC[486]

The *Ambiente Ufficio* arbitration concerned the treaty-based rights of Italian nationals who held Argentine bonds. The number of claimants in the present case was much lower than in the *Abaclat* case – 90 individuals applied for an award. While the facts of the both cases were largely congruent, the findings in *Ambiente Ufficio* somewhat differed from *Abaclat.* Again, the meaning of 'investment' under the Argentina-Italy BIT and Article 25 ICSID Convention stood at the centre of the dispute.

First, the tribunal elaborated on the application of the double-barrelled test, holding that the BIT and the Washington Convention had to be consulted for the definition of protected investments.[487] Regarding Article 25 ICSID Convention, it noted that – in application of Article 31 VCLT – the provision was to be given a 'broad meaning, hence with jurisdictional limits arising from this provision only at the outer margins of economic activity.'[488] The

[482] See, eg, Benedict Mander, 'Argentina to pay Italian 'holdout' creditors' *Financial Times* (London, 2 February 2016).

[483] ibid.

[484] Vinod Sreeharsha, 'Argentina's Senate Allows Payment to Bondholders' *The New York Times* (New York, 31 March 2016). For an in-depth analysis of the settlements, see Cruces and Samples (n 40).

[485] *Abaclat and ors v Argentina*, Consent award, ICSID Case No ARB/07/5, IIC 905 (2016), despatched 29th December 2016, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[486] *Ambiente Ufficio SpA v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/08/9, IIC 576 (2013), 8th February 2013, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[487] ibid [437].

[488] ibid [470].

Convention's *Travaux Preperatoires* were considered inconclusive this regard, which is why the 'object and purpose' approach in Article 31 VCLT was to be employed.

Against this backdrop, the tribunal found no reason why sovereign bonds should *per se* not fall under jurisdiction of the ICSID, 'if and to the extent that there is evidence that the States parties, ie Argentina and Italy, considered those to be investments to be protected, in view of which they both gave their advance and irrevocable consent that any dispute [on this basis] may be submitted to arbitration' (Article 8(3) of the Argentina-Italy BIT).'[489]

Delving deeper into the controversy that revolved around the qualification of sovereign bonds as investment, the tribunal pointed to the *Salini*[490] criteria as well as the principles established in the *Fedax*[491] case.[492] In *Ambiente Ufficio,* the tribunal argued that the *Salini* decision had 'introduced a peculiar and amplified version of the double-barrelled test.'[493] Following Professor Schreuer's approach, the tribunal concluded that the *Salini* test 'must not be perceived as expressing jurisdictional requirements *stricto sensu*' but rather as useful guidelines, that should be applied in conjunction and in a flexible manner.[494]

Relying on a flexible and wide interpretation of the *Salini* criteria, the tribunal found that

(i) the bonds issued amounted to a 'substantial contribution on the investor's part',

(ii) duration of the investment was sufficient,

(iii) the claimants assumed a commercial risk by purchasing Argentine bonds, (iv) the investors received regular profits and returns, and

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[489] ibid [472].

[490] *Salini Costruttori SpA and Italstrade SpA v Morocco,* Decision on jurisdiction, ICSID Case No ARB/00/4, IIC 206 (2001), (2004) 6 ICSID Rep 398, (2003) 42 ILM 609, (2002) 129 Clunet 196, 16th July 2001, despatched 23rd July 2001, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[491] *Fedax NV v Venezuela*, Award, ICSID Case No ARB/96/3, IIC 102 (1998), (2002) 5 ICSID Rep 200, (1998) 37 ILM 1391, (1999) XXIVa YB Com Arb 39, 9th March 1998, World Bank; International Centre for Settlement of Investment Disputes [ICSID]. According to the tribunal in *Fedax* '[t]he important question is whether the funds made available are utilized by the beneficiary of the credit, as in the case of the Republic of Venezuela, so as to finance its various governmental needs' It further noted that '[i]t is not disputed in this case that the Republic of Venezuela, by means of the promissory notes, received an amount of credit that was put to work during a period of time for its financial needs' Overall thus, the tribunal found that '[t]here is clearly a significant relationship between the transaction and the development of the host State, as specifically required under the Law for issuing the pertinent financial instrument.'

[492] ibid [43]. In *Fedax,* the main question was whether promissory notes would qualify as investment under the ICSID Convention, which the ICSID tribunal ultimately affirmed on due to the 'public law' nature of the promissory notes at stake.

[493] *Ambiente Ufficio SpA v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/08/9, IIC 576 (2013), 8th February 2013, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [478].

[494] ibid [481]. While Schreuer initially proposed the test, which the *Salini* tribunal employed, he later criticised the tribunal for transforming the legal character of these criteria from a 'descriptive' to a 'normative' one.

(v) the claimants made a significant contribution to the development of the host country.[495]

Henceforth, the bonds at stake were to be deemed 'investments' under Article 25 ICSID Convention. With regard to the meaning of 'investment' under Article 1(1) of the Argentina-Italy BIT, the tribunal – akin to the *Abaclat* tribunal – focused on lit (c), which classified 'obligations' as protected investment.[496] The *Ambiente Ufficio* tribunal left no doubt that the bonds issued by Argentina in the 1990s were also covered by the BIT, given their nature as financial obligations.[497]

Another issue broached by the *Ambiente Ufficio* tribunal were *prima facie* treaty claims.[498] More specifically, the tribunal considered it necessary that the facts alleged by the claimants would be capable of constituting a breach of the applicable BIT.[499] In this context, it was of particular concern whether the acts performed by Argentina in the wake of its default were of sovereign nature. If the latter was the case, then claims were not just of contractual but also of treaty nature.[500]

Similar to the *Abaclat* case, the *Ambiente* tribunal considered that the Emergency Law passed by Argentina in 2001 had the effect of unilaterally modifying Argentina's payment obligations. Since these actions were based on a legislative act, they were outside of a contractual framework and thus an 'expression of State power and not of rights or obligations Argentina had as a debtor under a specific contract'.[501] Bondholders may, therefore, not only pursue legal action on the basis of their bond contracts but may also have recourse to the dispute settlement regime provided by the ICSID.

4.9.3. CMS v. Argentine Republic[502]

The *CMS v. Argentina* arbitration was not directly linked to Argentina's sovereign default but related to a number of different measures adopted by the government in the wake of the 1998-2002 economic crisis. Moreover, the claimant did not act as a holdout in the typical sense, given that the investment in state assets was not rendered at a discount and that the

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[495] ibid [482-487].
[496] ibid [488-495].
[497] ibid [493] (the tribunal essentially adopted the *Abaclat* tribunal's reading of Article 1(1) Argentina-Italy BIT).
[498] ibid [535].
[499] ibid [541].
[500] ibid [543].
[501] ibid [544].
[502] ibid.

request for arbitration was filed *before* Argentina ceased to repay its international financial obligations. However, the tribunal *CMS v. Argentina* case thoroughly examined the role of international investment arbitration in the wake of sovereign debt crises, which is why we will briefly discuss the findings in this section.

The *CMS v. Argentina* case, together with the factually similar *LG&E v. Argentina*[503] arbitration, received much attention for its in-depth review of the necessity principle under customary international law with respect to a sovereign debt default. CMS Gas Transmission Company had requested ICSID arbitration over the alleged suspension by Argentina of a tariff adjustment formula for gas transportation.[504] When the peso significantly depreciated after 1998, the Argentine authorities rejected the tariff adjustment mechanism, which resulted in losses for CMS. Moreover, Argentina's Emergency Law prohibited public utilities to adjust tariffs according to the US Purchase Power Index (PPI).[505] This, according to the claimant, resulted in a 75% decrease of its tariff revenues.[506]

CMS based its claim on the Argentina-US BIT of 1991. The ICSID tribunal first decided on objections to jurisdiction and found that the 'dispute was within the jurisdiction of the Centre and the competence of the tribunal.'[507] It noted that CMS's losses arose directly from the investment, that the jurisdiction of local Argentine courts over certain (related) contractual arrangements did not bar the assertion of jurisdiction by an ICSID tribunal, and that the Calvo doctrine[508] had been rendered inapplicable through the signature of the Argentina-USA BIT.[509]

In the subsequent decision on the merits of the claims, the ICSID tribunal held that Argentina (i) had expropriated CMS without compensation, (ii) violated the fair and equitable treatment obligation, (iii) applied arbitrary and discriminatory measures, and (iv) violated the umbrella

[503] *LG&E Energy Corporation and ors v Argentina*, Award, ICSID Case No ARB/02/1, IIC 295 (2007), despatched 25th July 2007, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[504] *CMS Gas Transmission Company v Argentina*, Application for annulment and request for stay of enforcement of arbitral award, ICSID Case No ARB/01/8, IIC 66 (2005), 8th September 2005, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [5].

[505] ibid [65].

[506] ibid [70].

[507] ibid.

[508] The Calvo doctrine requires that aliens submit disputes arising in a country to that country's local courts. See, eg, Alwyn V. Freeman, 'Recent Aspects of the Calvo Doctrine and the Challenge to International Law' (1946) 40(1) American Journal of International Law 121.

[509] *CMS Gas Transmission Company v Argentina*, Application for annulment and request for stay of enforcement of arbitral award, ICSID Case No ARB/01/8, IIC 66 (2005), 8th September 2005, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

clause. Importantly, the tribunal also assessed whether Argentina could rely on the necessity defence. For this purpose, it focused on Argentina's security interest and examined the gravity of Argentina's crisis with a view at ascertaining whether the suspension of payments was 'essential' to avoid a 'major breakdown', as set out in Article 25 of the ILC Draft Articles.[510]

The tribunal found that the economic crisis was indeed 'severe', though it added that 'situations of this kind are not given in black and white but in many shades of grey.'[511] While the tribunal proved reluctant to decide on what would have been best policy options for Argentina in the moment of crisis, it found that the '[adopted] policies and their shortcomings significantly contributed to the crisis.'[512]

Moreover, the tribunal said that Argentina's Emergency Law was not the 'only way' to safeguard its interest but that other steps were available, such as dollarization of the economy or granting direct subsidies to the affected population.[513] Since, according to the *Gabcíkovo-Nagymaros* case[514], all conditions governing necessity must be 'cumulatively' satisfied, the tribunal rejected the necessity altogether.[515] The tribunal found that 'a severe crisis cannot be equated with a situation of total collapse'[516] and that the clause was 'not self-judging'.[517] Thus, it rejected Argentina's defence and issued an award in favour of the applicant.

4.9.4. Analysis

This section analyses the three cases of holdout arbitration before the ICSID following the two Argentine debt restructurings of 2005 and 2010. While an exhaustive analysis of the legal issues would go beyond the scope of this thesis, we point at some specific problems that may emerge in future sovereign debt restructurings.

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[510] *CMS Gas Transmission Company v Argentina*, Application for annulment and request for stay of enforcement of arbitral award, ICSID Case No ARB/01/8, IIC 66 (2005), 8th September 2005, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [319-320].

[511] ibid [321].

[512] ibid [329] (further holding that 'while exogenous factors did fuel additional difficulties they do not exempt the respondent from its responsibility in the matter').

[513] ibid [323-324].

[514] *Gabčikovo-Nagymaros Project, Hungary v Slovakia*, Merits, ICJ GL No 92, [1997] ICJ Rep 7, ICGJ 66 (ICJ 1997), (1998) 37 ILM 162, 25th September 1997, International Court of Justice [ICJ].

[515] *CMS Gas Transmission Company v Argentina*, Application for annulment and request for stay of enforcement of arbitral award, ICSID Case No ARB/01/8, IIC 66 (2005), 8th September 2005, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [330].\

[516] ibid [354].

[517] ibid [374].

4.9.4.1. The Definition of 'Investment'

In his seminal work on the origins and the evolution of sovereign debt arbitration before international courts and tribunals, Waibel cautioned that '[i]ncreased creditor protection via ICSID could shake up the crisis arsenal of defaulting countries and derail efforts by the international community to resolve debt crises in an orderly manner.'[518] The decisions in *Abaclat* and *Ambiente Ufficio* seemed to have confirmed some of his fears.[519] Crucially, ICSID tribunals became more open to the idea of subsuming sovereign bonds under the definition of investment under international investment law. Indeed, the *Abaclat* tribunal's rejection of the *Salini*[520] test, which was previously used to determine whether sovereign bonds qualify as investment under Article 25 of the ICSID Convention, marked a fundamental shift in the ICSID's practice.

Against this background, this section focuses on three controversial aspects of the *Salini* test: (i) significance of an investment for the host state's development, (ii) duration of the investment, and (iii) risk-sharing elements.[521] In addition, we also discuss the criterion of a territorial link between the place of investment and the governing law of the sovereign bond.

4.9.4.2. Contribution to the Development of the Host State

The requirement that an investment must contribute to the economic development of the host state flowed from the *Salini* decision and was further refined in subsequent decisions.[522] In the case of financial instruments, such as government bonds or notes, proving the existence of such contribution remains challenging.[523] Prior to *Salini*, the *Fedax* tribunal had opined that investors made a substantial contribution to Venezuela's development by acquiring promissory notes. According to the tribunal, 'the transactions involved in this case were not

[518] ibid [317].

[519] It should be noted at this point that – to the surprise of many commentators – the ICSID tribunal in *Postova banka* again reversed this development by excluding Greek bonds from the definition of 'investment' under the Washington Convention. See below 5.5.1.

[520] According to the *Salini* test for a transaction or activity to qualify as ―investment in the sense of Article 25 ICSID Convention, it would require (i) a contribution, (ii) of a certain duration, (iii) of a nature to generate profits or revenues, (iv) showing a particular risk, and (v) of a nature to contribute to the economic development of the Host State.

[521] Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration' (2007) 101 American Journal of International Law 711.

[522] *Salini Costruttori SpA and Italstrade SpA v Morocco*, Decision on jurisdiction, ICSID Case No ARB/00/4, IIC 206 (2001), (2004) 6 ICSID Rep 398, (2003) 42 ILM 609, (2002) 129 Clunet 196, 16th July 2001, despatched 23rd July 2001, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[523] In *Salini*, the investors' contribution was unambiguous, for the Italian investors had constructed a specific building in Morocco.

ordinary commercial transactions and indeed involved a fundamental public interest.'[524] The notes were not merely short-term, occasional financial arrangements (hence 'volatile capital') but rather long investments in the public sector of Venezuela's economy.[525] *Salini* narrowed down the scope of 'contributions' as defined by the *Fedax* decision[526].

The *Abaclat* tribunal again reversed course by noting that private bondholders' 'contributions' can take different forms and shall not be limited by the criteria set out in *Salini.*[527] In *Abaclat*, the tribunal argued that a strict application of *Salini* would not give the claimants the procedural protection afforded by the ICSID Convention'.[528] Thus, instead of contributing to a specific project[529], the investment had to merely create a certain 'value' for the host state.

This approach was criticised as too wide. Garcia-Bolivar for instance contends that '[the ICSID] has a mission that needs to be consistent with the multilateral entities with which it is associated — and that purpose cannot be detached from the promotion of the economic development of host states.'[530] Along similar lines, Dolzer and Schreuer stress that '[i]n case of an investment lawfully admitted and implemented, the very consistency of the project with the legal order of the host state should indicate the contribution to the development of the host state'[531]

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[524] *Fedax NV v Venezuela*, Award, ICSID Case No ARB/96/3, IIC 102 (1998), (2002) 5 ICSID Rep 200, (1998) 37 ILM 1391, (1999) XXIVa YB Com Arb 39, 9th March 1998, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [42].

[525] See Waibel (n 521) for an overview.

[526] More specifically, as outlined by Viterbo, the Salini-test identifies the following elements as indicative of an 'investment' for the purposes of the ICSID Convention: (i) the contribution of the investor, (ii) the duration over which the project is implemented, (iii) the sharing of operational risks, and (iv) the contribution to the host state's development. See Annamaria Viterbo, *International Economic Law and Monetary Measures – Limitation to State's Sovereignty and Dispute Settlement* (Cheltenham: Edward Elgar Publishing, 2012) 240.

[527] *Abaclat and ors v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [364-365]. Although ICSID tribunals are generally not bound by precedents they take into account previous arbitral awards and justify deviations in their reasoning.

[528] ibid [364]. Other decisions followed the approach taken by the *Abaclat* tribunal; see *Alemanni and 74 others v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/8, IIC 666 (2014), despatched 17th November 2014, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [100] (noting that 'as to the '*Salini* test' itself and the five conditions which the respondent derives from it, the Counter-Memorial submits that some tribunals have attached undue weight to them, citing in particular the more flexible approach taken by the *CSOB, MCI v Ecuador, and Biwater Gauff* tribunals').

[529] As for instance required by the tribunal in *Československa obchodní banka AS v Slovakia,* Decision on objections to jurisdiction, ICSID Case No ARB/97/4, (1999) 14 ICSID Rev-FILJ 251, IIC 49 (1999), (2002) 5 ICSID Rep 330, 24th May 1999, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[530] Omar Garcia-Bolivar, 'Defining an ICSID Investment: Why Economic Development Should be the Core Element' (*Investment Treaty News*, 13 April 2012) <https://www.iisd.org/itn/2012/04/13/defining-an-icsid-investment-why-economic-development-should-be-the-core-element/> accessed 28 May 2017.

[531] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford: Oxford University Press, 2012) 69.

Some argue that the post-Argentina arbitration cases have undermined the symmetric treatment of host state and investor under the ICSID framework.[532] Giving up the contribution requirement leads to a convergence between the meaning of 'investment' under the ICSID and its meaning according to the financial law taxonomy. Such alignment is not desirable. It fosters a system in which any creditor can claim to have invested in the host state and avail himself of the strong level of protection granted by international investment law. Moreover, it contradicts the ICSID Convention's stated purpose of protecting 'development'. Indeed, as convincingly stated by Abi-Saab in his dissenting opinion in the *Abaclat* case, 'funds [raised through bond issuance] can be used to finance wars, even wars of aggression, or oppressive measures against restive populations, or even be diverted through corruption to private ends.'[533]

4.9.4.3. Duration

According to the ICSID Convention, an investment must entail the long-term transfer of financial resources.[534] In other words, short-term financial flows are not covered by the definition of investment according to Article 25 of the Convention. Of course, one may debate what renders an investment 'long-term'. The *Abaclat* tribunal refrained from entering this debate – it merely held that the claimant's (bond) investment was of 'certain' duration.[535] In a similarly cryptic manner, the *Fedax* decision noted that the ICSID Convention did not capture investments that 'come in for quick gains and leave immediately thereafter'.[536] The

[532] See Waibel (n 521) 724 ('[t]o avoid asymmetrical treatment of host state and investor, the actual, present impact in the host country arguably needs to be given equal weight, reflecting the twofold objective of the ICSID Convention: first, to increase investor protection, and second, to ensure that investments perform an essential economic and social service in developing countries.').

[533] *Abaclat and ors v Argentina*, dissenting opinion of Georges Abi-Saab, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [113] (further noting that '[t]his is why, for such loans to constitute investments under the ICSID Convention, they have to be concretely traced, even at several removes, to a particular productive project or activity in the territory of the host country; and not merely by postulating a stop-gap abstract assumption that does not hold its ground.').

[534] Waibel (n 521) 726.

[535] *Abaclat and ors v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [342].

[536] *Fedax NV v Venezuela*, Award, ICSID Case No ARB/96/3, IIC 102 (1998), (2002) 5 ICSID Rep 200, (1998) 37 ILM 1391, (1999) XXIVa YB Com Arb 39, 9th March 1998, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [43] (coining the term 'volatile capital').

first draft of the ICSID Convention was stricter, requiring an investment to have a duration of 'not less than five years.'[537] In *Salini*, 32 months were deemed 'sufficient'.[538]

However, with the rise of global finance, sovereign debt has become a liquid asset class that could easily be traded in the blink of an eye with someone at the other side of the globe. It is unlikely that the founders of the ICSID framework foresaw this development. The standard developed by the *Abaclat* tribunal, which required an investment of 'certain duration', integrated the increased liquidity of sovereign bonds into the definition of investment.

While introducing a minimum duration requirement would unduly constrain the ICSID's ability to respond flexibly to the evolution of (debt and equity) markets, abandoning the duration criteria, as *Abaclat* suggests, would go too far. Indeed, from a legal policy point of view, tribunals should require bondholders to prove that ownership was maintained for a certain amount of time before default.[539] This would deter speculative secondary market purchases by prospective holdouts that hope to capitalise on the ICSID dispute settlement mechanism as an additional avenue for debt enforcement.

4.9.4.4. Risk-Sharing

The third important element of the *Salini* test related to the risk assumed by the investor. This risk, according to *Salini*, should not be a mere default risk but the risk of success or failure of a specific commercial undertaking.[540] In Waibel's view, there must thus be a certain degree of risk sharing between the investor and the host state: the default risks as such 'does not in itself indicate the presence of risk-sharing', for the 'mere presence of such [default] risk is not enough.'[541] In *Fedax*, promissory notes issued by Venezuela were deemed to inherit more than just a 'commercial [default] risk', notably since the notes were issued under Venezuela's Public Credit Law'.[542] By contrast, in *Abaclat* and *Ambiente Ufficio*, the risk-sharing

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[537] Michael Waibel, *Sovereign Debt before International Courts and tribunals* (Cambridge: Cambridge University Press, 2011) 235.

[538] *Salini Costruttori SpA and Italstrade SpA v Morocco,* Decision on jurisdiction, ICSID Case No ARB/00/4, IIC 206 (2001), (2004) 6 ICSID Rep 398, (2003) 42 ILM 609, (2002) 129 Clunet 196, 16th July 2001, despatched 23rd July 2001, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [54].

[539] Waibel (n 521) 726.

[540] Josef Ostransky, 'Sovereign Default Disputes in International Treaty Arbitration: Jurisdictional Considerations and Policy Implications' (2015) 3(1) Groningen Journal of International Law 27, 48. Waibel (n 521) 726. 'Commercial risk' refers to a risk on non-performance, which is represented by a state default.

[541] Waibel (n 521) 726.

[542] *Fedax NV v Venezuela*, Award, ICSID Case No ARB/96/3, IIC 102 (1998), (2002) 5 ICSID Rep 200, (1998) 37 ILM 1391, (1999) XXIVa YB Com Arb 39, 9th March 1998, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [43].

requirement appeared irrelevant. The tribunals rejected the view that the investment made by Italian creditors had to be linked with a definable project or economic activity.

This shift seemed unwarranted. After all, the ICSID Convention seeks to strengthen partnership between countries in the cause of economic development.[543] Public debt, while being essential for the host state's economic development, represents a generic asset class that can finance various state activities – such that are important for the country's development but also those that are not.[544]

Indeed, as Abi-Saab rightly pointed out in his dissenting opinion, Argentina's sovereign bonds could only be connected with the country's general treasury activities rather than specific (development) projects.[545] Others were also critical of the shift in arbitration practice. Ostransky forcefully rejected the abandoning of the risk-sharing element as an 'erroneous public interest test' that is 'manifestly absurd and unreasonable, as it makes every commercial dealing with a government an investment.'[546] Perhaps most convincingly, Professor Torres Bernandez, who wrote the dissenting opinion in *Ambiente Ufficio*, argued that Argentina was acting as a commercial actor and did thus not 'host' any investment but merely sold a financial product.[547]

4.9.4.5. Territorial Link

Finally, the Argentine arbitration cases discussed the requirement of a territorial link between the alleged investment and the host country.[548] The requirement of a territorial link is understood to emanate from Article 25(1) of the ICSID Convention, which states that disputes must arise 'directly out of an investment'.[549] In the context of sovereign debt, the territorial link requirement is of particular relevance since bonds are tradable financial instruments where the investor's personality may change from one moment to another.

[543] See Preamble to the ICSID Convention.

[544] For a critical assessment of recent trends in the realm of international investment law, see Julian David Mortenson, 'The Meaning of 'Investment': ICSID's Travaux and the Domain of International Investment Law' (2010) 51(1) Harvard International Law Journal 257.

[545] *Abaclat and ors v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [180-189].

[546] Ostransky (n 540) 48.

[547] *Ambiente Ufficio SpA v Argentina*, Decision on jurisdiction and admissibility; dissenting opinion of Santiago Torres Bernárdez, ICSID Case No ARB/08/9, 2nd May 2013, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[548] *Abaclat and ors v Argentina*, dissenting opinion of Georges Abi-Saab, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [74-76].

[549] Ostransky (n 540) 45; Waibel (n 537) 218.

Therefore, whenever a contractual right is a protected investment, it must be legally located in the host state.[550]

The *Abaclat* and the *Ambiente Ufficio* tribunals applied different tests to establish a territorial link, essentially arguing that the place of performance was decisive rather than the *situs* of the debt.[551] Following the *situs* approach, which the majority view seems to support[552], would have meant that there was no territorial link between the Italian investors and the Argentine issuer; after all the bonds were governed by New York law.[553]

By giving up on the territorial requirement, the ICSID has blurred the lines between treaty claims and contractual claims in the realm of sovereign bonds. This development could have undesirable policy implications: bestowing upon holdouts the full protection of international investment law is unequitable at best and dangerous at worst. Indeed, when states issue sovereign debt, they confer jurisdiction to (foreign) municipal courts rather than to the ICSID in Washington.[554] The latter comes into play when two or more states have signed BITs or FTAs, which are international treaties.

4.9.4.6. The Admissibility of Mass Claims

Mass claim sovereign bond arbitration is particularly relevant in the context of the retail holdout problem.[555] Here, small investors may leverage their power and create cost synergies by launching collective ICSID proceedings.[556] While most domestic civil law frameworks provide for class action, international investment arbitration was traditionally designed as a

[550] Ostransky (n 540) 45; Zachary Douglas, ‘Property, Investment and the Scope of Investment Protection Obligations’ in Zachary Douglas (ed), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press, Oxford, 2014) 23.

[551] *Abaclat and ors v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [397] (opining that ‘forum selection clauses are clauses of a procedural nature aiming to determine the place of settlement of a dispute […] [t]hey have nothing to do with the place where a party is supposed to perform its obligations’).

[552] For a discussion, see Waibel (n 537) 239, Zachary Douglas, *The International Law of Investment Claims* (Cambridge University Press, 2009) 171.

[553] Given the fact that the Argentine bonds were governed by New York law, the debt’s *situs* would have no doubt been outside the territory of Argentina: the choice-of-law and forum clauses subjected these instruments to a foreign legal system and judiciary. Also see for a similar argument, *Abaclat and ors v Argentina*, dissenting opinion of Georges Abi-Saab, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [87].

[554] Waibel (n 521) 733-734. Umbrella clauses are the exception to the rule since they elevate all contractual to treaty clams.

[555] See, eg, Nicolas Costabile, ‘Argentina: from international market isolation to promising opportunities for investors’ (*Commercial Dispute Resolution News*, 27 September 2016) <https://www.cdr-news.com/categories/arbitration/6733-argentina-from-international-market-isolation-to-promising-opportunities-for-investors> accessed 20 August 2017.

[556] For a detailed analysis, see Stacie Strong, *Class, Mass, and Collective Arbitration in National and International Law* (Oxford: Oxford University Press, 2013).

two party rather than a multiparty process.[557] The *Abaclat* tribunal expanded ICSID jurisdiction over mass claims by affirming that the ICSID Convention accommodated mass arbitration proceedings.

While one may argue that the letter of the Convention does not prohibit mass claim arbitration, one should not underestimate the potential adverse policy implications of opening up the ICSID of retail holdout action. Waibel for instance warns that admitting mass claims to ICSID arbitration 'could imperil the host state's or the investor's due process rights.'[558] He also points at the difficulties of coordinating hundreds of thousands of bondholders through an ICSID arbitration procedure.[559] Indeed, like national courts, ICSID tribunals have no legal or political authority to broker a deal between the retail holdouts and the host state; their role is to identify whether the actions of the host state breached the BIT and not substitute international financial institutions.

Of course, not all scholars share Waibel's negative view. Sushama for instance notes that the *Abaclat* majority view rightly realised that 'the rejection of the rights of the bondholders would be an unacceptable denial of justice to the claimants.'[560] However, this view seemingly ignores that every individual investor may well apply to the ICSID for an award against the host country. Mass claim arbitration would simply aggregate the rights of individual investors rather than create them. The potential negative effects of enabling hundreds of thousands of retail holdouts to challenge a debt restructuring before an ICSID tribunal arguably outweigh the benefits of providing them with easier access to legal remedies. Concluding with a positive note, the ICSID seemed to have taken seriously some of the concerns heeded by experts in the wake of the Argentine bondholder arbitration when adjudicating claims of Greek bondholders.[561]

[557] See, eg, Katarzyna Barbara Szczudlik, 'Mass Claims Under ICSID' (2015) 4(2) Wroclaw Review of Law, Administration & Economics 70. Also see, eg, Jessica Beess und Chrostin, 'Sovereign Debt Restructuring and Mass Claim Arbitration before the ICSID, The Abaclat Case' (2012) 53(2) Harvard International Law Journal 505

[558] Michael Waibel, 'Coordinating Adjudication Processes' (January 2014) Cambridge University Legal Studies Research Paper Series, Paper No 6/2014, 15.

[559] ibid 16.

[560] Deepu Jojo Sushama, 'Mass Claims in Investment Arbitration – The Need of the Hour' (*Kluwer Arbitration Blog*, 4 March 2015) <http://kluwerarbitrationblog.com/2015/03/04/mass-claims-in-investment-arbitration-the-need-of-the-hour/> accessed 20 August 2017.

[561] See below 5.6.

4.10. CHAPTER CONCLUSIONS

This chapter analysed instances of holdout litigation and arbitration in the period between Argentina's default of 2001, its restructurings of 2005 and 2010, as well as the settlement with international creditors in 2016. Resolving Argentina's debt crises was one complex operation that challenged several domestic governments, kept courts around the world busy for more than a decade, and led to critical changes in the legal regime for sovereign debt restructurings.

In this chapter, we first explained the economic, political, legal, and transactional aspects of the Argentine default and the two subsequent debt restructurings. Argentina has become a serial defaulter – it has recorded eight sovereign defaults in the past century. The 2001 default was the largest of its kind, resulting in unpaid financial obligations of roughly USD100 billion. Argentina defaulted on bonds governed by the laws of eight different jurisdictions and denominated in at least four currencies – the country had embraced the financial bonanza of the 1990s like few others.

The sobering awakening came in the early 2000s, when the necessity of a deep haircut became obvious to Argentina and its creditors. With some delay, Argentina imposed a haircut north of 70% on foreign bondholders in 2005. Unsurprisingly, at 75%, the debt deal had one of the lowest participation rates when compared to previous restructurings. In the 2010 bond swap, the participation threshold increased to roughly 90% of outstanding claims. However, the remaining 10% of holdouts exhibited stamina and relentlessly pursued Argentina in various courts for the full repayment of its debts.

These legal actions were described in detail. We reviewed instances of holdout litigation before courts in the US, in Germany, in Italy, in England, in France, in Switzerland, as well as disputes in the ITLOS and the ICSID. These trials were representative for the thousands of individual cases.

The cases analysed in this chapter touched upon the following legal issues, many of which were for the first time adjudicated in the wake of Argentina's default:

- the interpretation of the *pari passu* clause,
- injunctive remedies to compel debt repayment,
- sovereign immunity from suit and enforcement under international law,
- central bank immunity from holdout claims,

- the necessity defence under international law,
- rules of customary international law regulating sovereign default,
- human rights obligations and sovereign default,
- the scope of sovereign immunity waivers,
- the immunity of international financial institutions from debt enforcement;
- the immunity of warships according to the law of the seas,
- the qualification of sovereign bonds as 'investments' under international investment law, and
- the admissibility of mass arbitration claims against defaulted sovereigns.

We concluded that the post-Argentina litigation and arbitration cases revealed stark jurisdictional divergences in addressing these legal questions. Indeed, while we observed some common themes, such as widespread support for a relative concept of sovereign immunity, the overall level of judicial cross-fertilisation remained low. Indeed, notwithstanding the high degree of contractual standardisation in international sovereign bonds described in chapter 1, the interpretation of these contracts seemed to vary considerably depending on the jurisdiction in which holdouts filed suit.

US courts for instance followed an approach of strict textual interpretation – they did not shy away from entertaining the holdouts' claims and pushing Argentina into another default by endorsing far-reaching injunctions against Argentina and third parties. English and German courts were equally dismissive of Argentina's defences, albeit they did not go as far as issuing injunctions. They rather granted enforceable money judgements to holdouts, thereby effectively blocking Argentina's access to these markets.

Conversely, courts in France and Italy bent the rules of customary international law to protect Argentina from holdout litigation. While the Italian Supreme Court put the onus on the protection of debtor countries' citizens, the French Supreme Court restricted the enforcement of foreign judgements. The highest Swiss courts too decided to protect international reserves at the BIS from attachment attempts by holdouts. The High Court in Ghana arrested an Argentine warship to satisfy creditors' demands, but was later overruled by the ITLOS.

The decisions of three ICSID tribunals discussed herein have opened up an additional avenue for holdout creditors' debt enforcement endeavours. By subsuming sovereign bonds under the definition of investment in the ICSID Convention and admitting mass arbitration, they blurred the boundaries between contract and treaty claims. Consequently, the threat of holdout arbitration will continue to loom large in future sovereign debt restructurings.

In 2016, Argentina surrendered to the holdouts that had obtained (enforceable) judgements in national courts or awards in ICSID arbitration proceedings. For most holdouts, their persistence paid off and they were rewarded loyally. The price for Argentina to reaccess international bond markets was high, and only two years after the settlement another economic crises appeared on the horizon.[562] As this chapter demonstrated, during and after the Argentine debt crisis, the holdout creditor problem was alive and kicking. Whether the efforts by international policymakers to eliminate holdout problems in future crises were sufficient, will be subject to in-depth analysis in chapter 6.

[562] For an overview of the 2018 economic crisis in Argentina, see, eg, Luc Cohen, 'Argentina's economic crisis explained in five charts' *Reuters* (London, 28 August 2018) <https://www.reuters.com/article/us-argentina-economy/argentinas-economic-crisis-explained-in-five-charts-idUSKCN1LD1S7> accessed 8 September 2018.

5. HOLDOUT CREDITOR PROBLEMS IN THE GREEK DEBT RESTRUCTURING[1]

'A debt restructuring, or exiting the euro, would be like the death penalty – which we have abolished in the European Union.'

–Lorenzo Bini Smaghi, ECB Executive Board Member (2011). [2]

'*As a general proposition, it is important that the Member States preserve their ability to honour at all times their commitments, also with a view to ensuring financial stability. The case of the Hellenic Republic is exceptional and unique*.'

–ECB Opinion of 17 February 2012 on the terms of securities issued or guaranteed by the Greek State.[3]

5.1. INTRODUCTION

Greece was the first advanced economies to restructure its public debt since the end of World War II. The government – supported by the so-called 'troika' (consisting of the IMF, the EU Commission, and the ECB) – successfully restructure a bulk of its outstanding debt obligations in early 2012.

Yet, the outcome of the Greek debt restructuring operation has raised may (old and) new questions about intercreditor equity, the relevance of debt issued under foreign law and, most importantly, the lack of creditor coordination in sovereign debt restructurings.[4] The holdout creditor problem appeared in two forms during the Greek debt crisis: first, holders of English law debt held out from the restructuring and were royally rewarded; second, a small percentage of bondholders with Greek law securities challenged the government's retroactive introduction of CACs.

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[1] Parts of this chapter were published in the Capital Markets Law Journal, the Maastricht Journal of European and Comparative Law, and in the Austrian Review of International and European Law.

[2] Ralph Atkins, 'Interview transcript: Lorenzo Bini Smaghi' *Financial Times* (London, 29 May 2011).

[3] ECB, 'Opinion of the European Central Bank of 17 February 2012 on the terms of securities issued or guaranteed by the Greek State' (CON/2012/12) <https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2012_12_f_sign.pdf> accessed 3 April 2018.

[4] Some of the parallels as well as differences to the Argentine restructuring are discussed below in 6.1.

5.2. THE GREEK SOVEREIGN DEBT CRISIS OF 2009-2015

The crisis in Greece, a member of both the EU and the euro area, has been exceptionally severe, even compared to the crisis in Argentina. As Gourinchas et al show, Greece's drop in output is deeper and more persistent than in almost any crisis on record.[5] Real GDP per capita declined from EUR22.600 in 2008 to EUR17.000 by 2014 and the unemployment rate rose from 7.8% to 26.6% over the same period.[6]

Of course, the global financial crisis of 2008-09 played an essential role in exacerbating the Greek debt crisis, hitting the Greek economy through three interlinked shocks: (a) a sovereign debt crisis, (b) a banking crisis and (c) a sudden stop.[7] When economic activity snapped in the wake of the global financial crisis of 2008, confidence in government finance eroded and advanced European economies, such as Ireland, Greece, Iceland, and Portugal, suddenly lost access to international capital markets.[8]

This section focuses, in particular, on the sovereign debt crisis, which was mainly caused by an instant loss of investor confidence in the sustainability of Greek public debt.[9] Figure 7 provides a chronological overview of the Greek debt crisis, matching notable events and policy decisions with the rise in the spread between German bunds and Greek bonds.

[5] Pierre-Oliver Gourinchas, Thomas Philippon and Dimitri Vayanos, 'The Analytics of the Greek Crisis' (2016) 31(1) NBER Macroeconomics Annual 1.

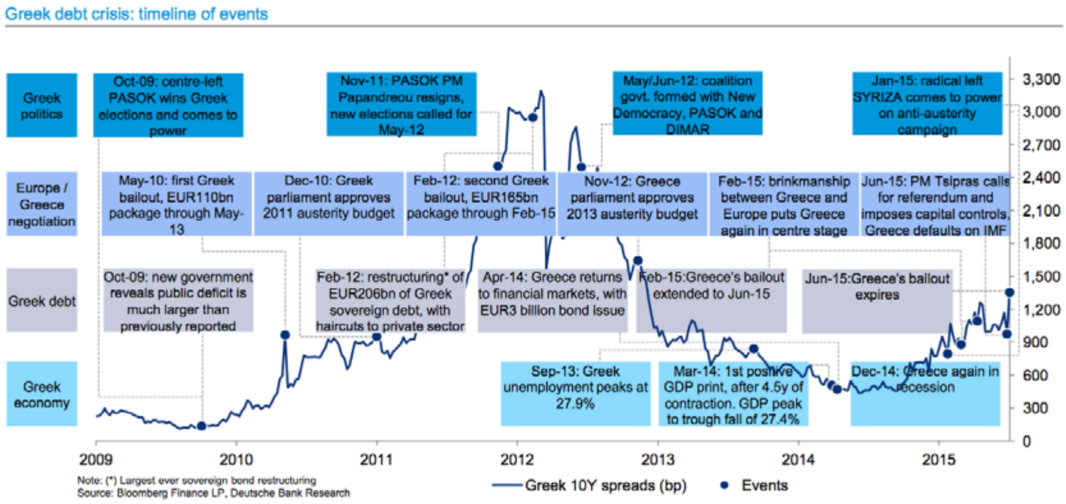
[6] ibid 2.

[7] ibid.

[8] See Carmen M. Reinhart and Christoph Trebesch, 'The International Monetary Fund: 70 Years of Reinvention' (2016) 30(1) Journal of Economic Perspectives 3, 10 (*inter alia* explaining the IMF's involvement in the euro are sovereign debt crisis). For a compelling overview of the crisis, and especially the links between the global financial crisis and the European sovereign debt crisis, see Adam Tooze, *Crashed: How a Decade of Financial Crises Changes the World* (New York: Penguin Random House, 2018).

[9] This is evidenced by the spreads of Greek sovereign bond over other euro area sovereign bonds; see Heather D. Gibson, Stephen G. Hall and George S. Tavalas, 'The Greek financial crisis: growing imbalances and sovereign spreads' (2012) 31(3) Journal of International Money and Finance 498.

Figure 7: Timeline of the Greek sovereign debt crisis (2010-2015)[10]



The start of the Greek debt crisis can be traced back to one fateful day in late 2009, almost exactly a year after one of the world's largest investment bank, Lehman Brothers, collapsed. On 4 October 2009, George Papandreou's Pan-Hellenic Socialist Movement (PASOK) won power in Greece following a snap election.[11] Few days later, after Papandreou's staff had perused the financial accounts, the new Prime Minister announced that the budget deficit is going to surpass 12% of the country's GDP in 2010.[12]

This stark deviation from the previously anticipated debt deficit of roughly 3% raised red flags among market participants and EU policymakers. As it turned out, the US investment bank Goldman Sachs played a key role in assisting Greece to mask its real level of debt for a long period.[13] In the months following the revelation, the country's debt-to-GDP ratio deteriorated massively and skyrocketed from just under 120% in 2010 to more than 170% in

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[10] Deutsche Bank, 'The House View – Greece: Take it or break it' (*DB Research*, 9 July 2015) <http://dbresearch.com/PROD/RPS_EN-PROD/PROD0000000000358526/TheHouseView_%3A_Greece%3A_Take_it_or_break_it.PDF> accessed 22 July 2018.

[11] Greaeme Wearden, 'Greece debt crisis: timeline' *The Guardian* (London, 5 May 2010).

[12] This led to an upward revision of the deficit projection by Eurostat from 3.7 to 12.5%, compare Eurostat, 'Provision of Deficit and Debt Data for 2008 - Second Notification' (October 2009) Newsrelease Euroindicators <http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-22102009- AP/EN/2-22102009-AP-EN.PDF> accessed 4 June 2017.

[13] See Beat Balzli, 'How Goldman Sachs Helped Greece to Mask its True Debt' *Spiegel Online* (Hamburg, 8 February 2010) <http://www.spiegel.de/international/europe/greek-debt-crisis-how-goldman-sachs-helped-greece-to-mask-its-true-debt-a-676634.html> accessed 31 October 2017; Louise Story, Landon Thomas and Nelson Schwartz, 'Wall St. Helped to Mask Debt Fuelling Europe's Crisis' *New York Times* (New York, 13 February 2010). The journalists essentially assert that a huge debt deal between Greece and private investors was hidden from public view since it was treated as a currency trade rather than a loan (thus not being accounted for under the pertinent EU Stability and Growth Pact).

2012.[14] While markets had previously taken a very benign view on individual sovereign risk following the introduction of the common currency, investors feared that the solidarity between euro area governments might dwindle in a full-blown crisis. Small and large investors pulled vast amounts of capital out of Greece in a matter of weeks after Papandreou's confession.[15] This 'sudden stop' of capital flows dramatically heightened the rollover risk, hence the danger that Greece might no longer be able to issue new debt to repay the principals of maturing bonds.[16]

The initial inertia among public sector officials, coupled with irrational hysteria among private bond investors, exacerbated the Greek debt situation. In mid-2010, the EU, supported by the IMF and the ECB, finally reacted to the looming threat of a full-blown sovereign debt crisis in Europe by passing its first rescue package to Greece.[17] Despite a mammoth EUR 110 billion cash injection, however, financing conditions for the country further deteriorated in the course of the following months.[18] Additional external financial rescue measures became inevitable to avert the imminent financial collapse. At the same time, leaders were slowly waking up to the option of debt restructuring.

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[14] Yanis Varoufakis, 'The Greek Debt Denial' in Martin Guzman, Jose Antonio Ocampo and Joseph E. Stiglitz (eds), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (New York: Columbia University Press, 2016) 85. The former Greek finance minister Varoufakis noted that very mention of debt restructuring was considered 'inadmissible and a cause for ridicule'. Varoufakis also notes that just a year later, the same politicians and policymakers who 'hurled vilification' at those who had suggested a haircut announced the biggest sovereign debt restructuring in history.

[15] Ample evidence exists with regard to the underappreciation of sovereign risk in the euro area in the run-up to the crisis as well as excessive pricing in times of distress; see, eg, Hans Dewachter, Leonardo Iania, Marco Lyrio and Maite de Sola Perera, 'A macro-financial analysis of the euro area sovereign bond market' (2015) 50 Journal of Banking & Finance 308 (finding that shocks unrelated to the fundamental component of the spread have played an important role in the dynamics of bond spreads since the intensification of the sovereign debt crisis in the summer of 2011).

[16] See, eg, Philip Lane and Gian Maria Milesi-Ferretti, 'International Financial Integration in the Aftermath of the Global Financial Crisis' (2017) IMF Working Paper WP/17/115 <https://www.imf.org/en/Publications/WP/Issues/2017/05/10/International-Financial-Integration-in-the-Aftermath-of-the-Global-Financial-Crisis-44906> accessed 2 December 2017.

[17] See IMF, 'Europe and IMF Agree €110 bn Financing Plan With Greece' (IMF Survey online, 2 May 2010) <http://www.imf.org/external/pubs/ft/survey/so/2010/car050210a.htm> accessed on 28 June 2017. For more details on the Eurogroup's First Economic Adjustment Programme for Greece, which totalled EUR80 billion to be disbursed over a period of 3 years see The European Commission, 'The Economic Adjustment Programme for Greece' (2010) Occasional Papers 61 <http://ec.europa.eu/economy_finance/publications/occasional_paper/2010/pdf/ocp61_en.pdf> accessed 5 June 2017.

[18] Greek sovereign bonds spreads vis-à-vis German government bonds ('Bunds'), used to measure the tightness of financing conditions for states, rose to unprecedented levels. Compare Roberto A. De Santis, 'The Euro Area Sovereign Debt Crisis – Safe Haven, Credit Rating Agencies and the Spread of the Fever From Greece, Ireland and Portugal' (2012) ECB Working Paper Series No 1419 <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1419.pdf?20b5463a06e46d4321d81b1f8fb1990f> accessed 2 June 2018.

During the Euro Summit held in Deauville in October 2010, the French President and the German Chancellor agreed on a PSI. The idea of PSI was that financial assistance provided by the public sector to a euro area country should be linked to a parallel reduction in the value of the debt held by private creditors.[19] Outstanding liabilities to official sector creditor, such as the European Commission, the ECB, or the IMF, should not become subject to a haircut.[20]

However, notwithstanding the agreement in principle on private sector creditor bail-in[21], contagion risks were perceived too great a threat to financial stability in the euro area for a swift implementation of this option.[22] Fears stemmed, in particular, from potential disruptions in the banking sector, with major European financial institutions holding sizeable amounts of Greek debt.[23] European policymakers considered avoiding a disorderly default of the Greek state a high priority objective – the potential negative consequences seemed too formidable.

Another complicating factor was the risk that some CDS sellers were overexposed to a Greek credit event. As the case of the insurance company AIG showed, those insuring against the default of an asset class may end up going bankrupt themselves.[24] It was indeed not clear prior to the Greek PSI whether a debt restructuring could trigger a high number of CDS

[19] Lorenzo Bini Smaghi, 'The European debt crisis' (17 October 2011) Speech by Mr Lorenzo Bini Smaghi, Member of the Executive Board of the European Central Bank, at the Atlantik-Brücke event, meeting of Regional Group Frankfurt, Frankfurt am Main <https://www.bis.org/review/r111026c.pdf> accessed 15 July 2018.

[20] As explained above in chapter 2, official sector debt is typically restructured under the auspices of the Paris Club. In the Greek case, big euro area lender countries strictly opposed the Club's involvement, fearing that a 'direct' bailout may further upset electorates in other euro area states. Making banks pay – rather than taxpayers – sounded like a politically appealing alternative, though the eventual costs for European taxpayers are yet to be fully determined. Moreover, Jean-Claude Trichet, ECB President at the time, headed the Paris Club for years and did not become reluctant to reiterate that the Club was a forum to support developing countries, not euro area economies.

[21] It may be useful to note at this stage that Germany and France had very different views as to how a crisis within a monetary union may be resolved. While German policymakers emphasise the importance of enforcing discipline through market mechanisms, the French approach to dealing with crises appears more lenient on

[22] Contagion became buzzword in the policy debate and serious financial stability risks as corollary to the so-called sovereign-bank doom loop, which refers to the close interlinkages between banks' and sovereigns' solvency, loomed large. For a highly insightful discussion on the different views and solutions German and French policymakers took and proposed in the course of the euro area debt crisis, see Markus Brunnermaier, Harold James and Jean-Pierre Landau, *The Euro and the Battle of Ideas* (Princeton: Princeton University Press, 2016).

[23] With the benefit of hindsight, it became clear that the EU rules on capital requirements for banks insufficiently reflected the riskiness of assets. Most notably, all euro area debt securities are considered 'risk-free', which means that banks do not have to balance risk stemming from such instruments with safe(r) assets or equity. From an accounting perspective, German bunds and Greek government bonds had the same risk weight, namely zero.

[24] See for an analysis of the AIG case in William Sjostrom, Jr., 'The AIG Bailout' (2009) 66 Washington & Lee Law Review 94.

instruments, thereby jeopardising the stability of the derivatives sector.[25] However, as it turned out later, total net payments due under outstanding CDS contracts were insignificant (under USD3 billion) compared to the overall amount of restructured debt, suggesting that policymakers' fears of a systemic shock were vastly overstated.[26]

Possible holdout problem were, of course, an additional argument to avoid a Greek PSI.[27] The imperative was that a 'voluntary' solution had to be found. The official sector was appalled by the idea of a unilateral debt repudiation à la Argentina unacceptable. As discussed in more detail below, to forestall holdout creditor problems, the Greek Parliament retroactively introduced CACs into the terms and conditions of all government bonds governed by Greek law.[28] This measure sought to ensure that a (super-)majority of bondholders (holding 66 1/3% of outstanding claims) could overrule a minority of holdouts.[29] While the debt swap was eventually successful and private investors voluntarily agreed to Greece's swap tender, thousands of investors decided to launch legal action against the retroactive amendments to their contracts.[30]

The legal actions against Greece will be the focal point of this chapter. It provides an overview of the most important holdout lawsuits between Greece and its creditors following the 2012 debt restructuring across different courts as well as the ICSID. While many scholars have studied the PSI[31], very little comparative research exists on the outcome of pertinent litigation and arbitration.[32] This mainly stems from the fact that until early 2016, many cases regarding claims of bondholders against the Greek government as well as European institutions have not yet come to conclusion.

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[25] Paolo Manasse and Giulio Trigilia, 'The fear of contagion in Europe' (*VoxEU*, 6 July 2011) <http://voxeu.org/article/fear-contagion-europe> accessed 15 June 2017 (qualifying the claim made by banks and some politicians that a Greek debt restructuring would produce a disruptive 'rush out of Europe').

[26] Anna Gelpern and Mitu Gulati, 'CDS Zombies' (2012) 13 European Business Organization Law Review 347, 348.

[27] Lawyers involved in the Greek PSI emphasised the risk of holdout investors undermining the success of a PSI from the very beginning of the crisis. See, eg, Mitu Gulati and Jeromin Zettelmeyer, 'Making a voluntary Greek debt exchange work' (2012) 7(2) Capital Markets Law Journal 169.

[28] ibid.

[29] See below 5.3. for an in-depth analysis of the CAC retrofit.

[30] ibid.

[31] See the seminal work by Jeromin Zettelmeyer, Christoph Trebesch and Mitu Gulati, 'The Greek debt restructuring: an autopsy' (2013) 29 Economic Policy 513.

[32] Some authors have discussed potential legal avenues for investors against the Greek state. See, eg, Andreas Witte, 'Greek Bond Haircut: Public and Private International Law and European Law Limits to Unilateral Sovereign Debt Restructuring (2012) 9(3) Manchester Journal of International Law 307; Otto Sandrock, 'The Case For More Arbitration When Sovereign Debt Is To Be Restructured: Greece As An Example' (2012) 23 The American Review of International Arbitration 507. Creditor litigation is also partly discussed in Jeromin Zettelmeyer, Christoph Trebesch and Mitu Gulati, 'The Greek debt restructuring: an autopsy' (2013) 29 Economic Policy 513.

5.3. THE GREEK DEBT RESTRUCTURING OF 2012

5.3.1. Debt Restructuring Negotiations: the Role of the Troika and the IIF

First, it ought to be acknowledged that the Greek debt restructuring of 2012 was the result of an intricate process of negotiation at the highest level between EU Institutions, EU Member States, and the IMF. Crucially, in May 2010 the IMF Executive Board approved a decision to provide exceptional access financing to Greece *without* seeking pre-emptive debt restructuring.[33] This stood in stark contrast to previous IMF programmes, in which countries did not receive access to Fund resources when their debt was not sustainable with a high probability.[34]

In one of its ex post evaluations of the European sovereign debt crisis, the IMF emphasised that '[w]hile the costs of delaying restructuring are well recognised, authorities' concerns about financial stability and contagion could exert pressures to delay; delays were sometimes caused by the incentives of official creditors who have interest in accepting, and pressuring the Fund to accept, sanguine debt sustainability assessments.'[35]

The IEO openly criticised the Fund's decision during the crisis. With the benefit of hindsight, it complained about the high degree of political pressure exerted on the IMF's staff. Specifically, the IEO remarked that

> '…the decision not to seek pre-emptive debt restructuring fundamentally left debt sustainability concerns unaddressed, magnified the required fiscal adjustment, and thereby—at least in part—contributed to a large contraction of output and a subsequent loss of Greek public support for the program.'[36]

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[33] Eg Susan Schadler, 'Living with Rules: the IMF's Exceptional Access Framework and the 2010 Stand-By Arrangement with Greece' (8 July 2016) IEO Report <http://www.ieo-imf.org/ieo/files/completedevaluations/EAC__BP_16-02_08__Living_with_Rules_-_The_IMF_s_Exceptional_Framework_and_the_2010_SBA_with_Greece.PDF> accessed 31 October 2017 (elaborating on the basis for the decision to amend the criteria [for the Greek programme], the procedural aspects of seeking Board approval of the amendment, the quality of the assessment of compliance with the four criteria as amended, and the follow-up on those assessments through program reviews in 2010–11).

[34] For an overview, see Charles Wyplosz, 'When the IMF evaluates the IMF' (*VoxEU*, 17 February 2017) <http://voxeu.org/article/when-imf-evaluates-imf> accessed 23 September 2017.

[35] IEO, 'The IMF's Role in Greece in the Context of the 2010 Stand-By Arrangement' (2016) Background Paper BP/16-02/11 <http://www.ieo-imf.org/ieo/files/completedevaluations/EAC__BP_16-02_11__The_IMFs_Role_in_Greece_in_the_Context_of_the_2010_SBA.PDF> accessed 25 January 2017.

[36] ibid. Also see IEO, 'The IMF and the Crises in Greece, Ireland, and Portugal: An Evaluation by the Independent Evaluation Office' (8 July 2016) IEO Report <http://www.ieo-imf.org/ieo/pages/CompletedEvaluation267.aspx> accessed 21 August 2017.

Especially the ECB was heavily opposed to a debt restructuring within the euro area. In a speech given in 2011 Lorenzo Bini Smaghi, former Member of the Executive Board of the ECB, noted that ‘the problem emerges when debt restructuring is carried out not as the last resort but as a preventive tool […]’.[37] According to reports, the former ECB President Jean-Claude Trichet shouted at a French delegation after the French and the German President had agreed on a Greek PSI in mid-2010: he was certain that a PSI inside the euro area ‘would destroy the euro.’[38] In a Monthly Bulletin article of October 2011, ECB staff argued that previous PSI experiences are not a reliable guidance for sovereign debt restructurings in the euro area and took a highly critical stance.[39]

Moreover, the IIF played an important – yet contentious – role in mitigating the fallout of the PSI to the financial sector.[40] As noted previously, most issuers offering a debt swap seek to increase creditor participation by offering ‘sweeteners’ or ‘carrots’.[41] In Greece, the situation was no different. Indeed, the IIF pressured Greece into tendering a range of options for private investors to choose from, allowing the latter to select a write-down option that would be most preferable in terms of their investment strategy.[42]

Moreover, the IIF managed to convince euro area authorities to utilising large amounts of public money (primarily through the EFSF notes that were offered as ‘sweeteners’[43]) while the larger private creditors progressively migrated out of Greek government bonds.[44] Certainly, a genuine fear of contagion on the official sector’s side certainly also played into the IIF’s hands.[45]

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[37] Lorenzo Bini Smaghi, ‘Private sector involvement: From (good) theory to (bad) practice’ (6 June 2011) Speech by Mr Lorenzo Bini Smaghi, Member of the Executive Board of the European Central Bank at the Reinventing Bretton Woods Committee, Berlin <https://www.ecb.europa.eu/press/key/date/2011/html/sp110606.en.html> accessed 22 August 2017.

[38] See Tooze (n 8).

[39] ECB, ‘Private Sector Involvement and Its Financial Stability Implications’ (October 2011) ECB Monthly Bulletin, 43-44 <https://www.ecb.europa.eu/pub/pdf/other/mb201110_focus05.en.pdf?b5d740db72355e4b15f3302e8ca5a42a> accessed 17 June 2018.

[40] See for an overview, eg, Giuseppe Bianco, *Restructuring Sovereign Debt: Private Creditors and International Law* (PhD thesis, University of Oslo 2017).

[41] See above 2.2.4.1.

[42] Manolis Kalaitzake, ‘The Political Power of Finance: The Institute of International Finance in the Greek Debt Crisis’ (2017) 45(3) Politics & Society 389, 400.

[43] For an overview of transactional techniques that may be used to encourage higher bondholder participation, see above 2.4.1.

[44] Kalaitzake (n 42) (noting that ‘European officials tolerated such a circumstance as most of these larger creditors were core European banks‘).

[45] See, eg, for a critique of the IIF’s role in Kalaitzake (n 42). For an overview, also compare Bianco (n 40).

While most economists now agree that a Greek debt restructuring should have come earlier, the ECB's reluctance to jeopardise financial stability in the euro area and the IIF's resistance against any cuts to bonds held by banks, delayed the inevitable by several months. Of course, a debt restructuring had never been implemented in an advanced economy, let alone in a Member State of the euro area, where the level of financial, economic, and political integration resembles that of a federal nation state.

Contagion became a buzzword. That the PSI eventually took place was largely due to the German government's insistence that big institutional investors should also carry some of the burden of adjustment. In the wake of a global financial crisis that cost taxpayers trillions of USD and EUR this was a popular policy stance, not only in Germany but worldwide.[46]

5.3.2. THE 'INVITATION MEMORANDUM'

On 24 February 2012, Greece outlined the conditions of its offer made to private holders of its government bonds in an 'Invitation Memorandum'.[47] Guided by the so-called 'Troika' (consisting of the ECB, the IMF and the European Commission)[48], the Greek government proposed to restructure 96.9% of the EUR205.5 billion face amount of outstanding government bonds held by private investors.[49] The ECB as Greece's single largest bondholder did not participate in the PSI, arguing that this would violate the EU Treaties.[50] This – arguably unequal – treatment of official and private sector creditors was challenged in EU courts.[51]

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[46] See for compelling insights into the political economy of the euro area crisis in Paul Blustein, *Laid Low: Inside the Crisis That Overwhelmed Europe and the IMF* (Waterloo: CIGI Press, 2016) and Tooze (n 8).

[47] Sandrock (n 32) 512. For the original text of the Invitation Memorandum see Hellenic Republic, 'Invitation Memorandum' (24 February 2012) <http://ftalphaville.ft.com/files/2012/02/Reg_S_Invitation_Memorandum.pdf> accessed 15 June 2017.

[48] Buchheit et al note that Greece restructured its privately-held government debt largely at the insistence of the IMF, see Lee Buchheit, Mitu Gulati and Ignacio Tirado, 'The Problem of Holdout Creditors in Eurozone Sovereign Debt Restructurings' (January 2013) unpublished manuscript <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2205704> accessed 9 September 2017.

[49] Porzecanski, Aturo C., 'Behind the Greek default and restructuring of 2012' (2014) MPRA Paper No 44166, 9 <https://mpra.ub.uni-muenchen.de/44166/1/Behind_the_Greek_Default_and_Restructuring_of_2012.pdf> accessed 8 June 2018.

[50] See, eg, Paul Craig and Menelaos Markakis, 'Gauweiler and the Legality of Outright Monetary Transactions' (2016) 41(1) European Law Review 241.

[51] See *Accorinti v European Central Bank*, Judgement, Case T-79/13, [2015] Court of Justice of the European Union [CJEU]; GC of the European Union [EGC]. For a detailed analysis of this judgement see below 5.5.2.

As Box 7 shows, a steering group of 12 banks, insurers, and asset managers represented a larger group of 32 creditors, which, in total, held approximately 30-40% of Greece's privately owned debt.[52]

Box 7: Composition of bondholder committees in the Greek debt restructuring[53]			
Steering Committee Members	Holdings (EUR billion)	**Further Members of the Creditor Committee**	Holdings (EUR billion)
Allianz (Germany)	1.3	Ageas (Belgium)	1.2
Alpha Eurobank (Greece)	3.7	Bank of Cyprus	1.8
Axa (France)	1.9	Bayern LB (Germany)	na
BNP Paribas (France)	5.0	BBVA (Spain)	na
CNP Assurances (France)	2.0	BPCE (France)	1.2
Commerzbank (Germany)	2.9	Credit Agricole (France)	0.6
Deutsche Bank (Germany)	1.6	DekaBank (Germany)	na
Greylock Capital (USA)	na	Dexia (France)	3.5
Intesa San Paolo (Italy)	0.8	Emporiki (Greece)	na
LBB BW (Germany)	1.4	Generali (Italy)	3.0
ING (France)	1.4	Groupama (France)	2.0
National Bank of Greece	13.7	HSBC (UK)	0.8
		MACSF (France	na
		Marathon (USA)	na
		Marfin (Greece)	2.3
		Metlife (USA)	na
		Piraeus (Greece)	9.4
		RBS (UK)	1.1
		Société General (France)	2.9
		Unicredit (Italy)	0.9

[52] Zettelmeyer et al (n 32) 9. In contrast to other recent debt restructurings, the establishment of this creditor committee rendered creditor coordination more straightforward and made it easier to contain hold-out behaviour.
[53] ibid.

In exchange for their debt instruments, creditors were offered three categories of new bonds with a reduced face value as well as different maturities and rates of interest.[54] More specifically, Greece offered bonds with a face value equal to 31.5% of the exchanged bonds' value. In addition, investors could choose highly rated ESFS notes with a maturity date of two years or less from the PSI settlement date as well as detachable GDP-linked securities with notional amount equal to the face value of each holder's new bonds.[55] Overall, according to calculations by Zettelmeyer et al, bondholders who accepted the debt swap offer incurred losses of approximately 59%.[56]

The 'Invitation Memorandum' also stated that Greece would not repay any of its debts to creditors who refused to participate in the restructuring.[57] The threat of unilaterally swapping bonds was the 'stick' element[58] in the Greek PSI and clearly designed to discourage potential holdouts. From a legal viewpoint, the design of the PSI very much resembled the proposal advanced by Buchheit and Gulati in 2010, at the onset of the crisis, entitled 'Restructuring a Nation's Debt'.[59]

Moreover, the Invitation Memorandum included a minimum participation threshold, according to which the debt swap would only be executed if it captured a certain proportion of investors. This threshold served three purposes.[60] First, it signalled to the creditor group that unless most of them accept the offer, none of them will be taken out and the status quo will remain in place. Second, it assured participating creditors that they would not be left with illiquid bonds if only a small number of holders joined the exchange. Third, it indicated that, for the issuer, a partial solution was worse than no solution.

However, rendering threats vis-à-vis creditors through these 'sticks' was considered insufficient to exclude the risk of a much-feared disorderly Greek default. Most importantly, to limit holdout behaviour, Greece chose to introduce CACs retroactively.[61] This legal

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[54] For a detailed overview compare Sandrock (n 32) 513.

[55] ibid.

[56] Zettelmeyer et al (n 32). However, using the average exit yields for discounting, the haircut amounts to 64.6%.

[57] Sandrock (n 32) 513.

[58] See Lee Buchheit and Elena Daly, 'Minimising Holdout Creditors: Sticks' in Rosa Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford: Oxford University Press, 2014).

[59] Lee Buchheit and Mitu Gulati, 'Restructuring a Nation's Debt' (2010) 29 International Financial Law Review 46.

[60] For a discussion, see, eg, Ran Bi, Marcos Chamon and Jeromin Zettelmeyer, 'The Problem that Wasn't: Coordination Failures in Sovereign Debt Restructurings' (November 2011) IMF Working Paper No 11/265 <https://www.imf.org/external/pubs/ft/wp/2011/wp11265.pdf> accessed 2 August 2017. Also compare above 2.4.1.

[61] See for their proposal in Buchheit and Gulati (n 59).

technique, as the following section explains, was crucial to provide Greece with a strong defence in court. Indeed, had Greece simply repudiated (part of its) debts, the chances of creditors successfully claiming compensation for expropriation would have been considerably higher.[62]

5.3.3. Restructuring Greek Law Bonds

The CACs were inserted retroactively into the terms and conditions of Greek government bonds governed by Greek law. The GBA served as the legal basis of the PSI, as it enabled the government and the central bank to invite creditors to the vote and subsequently exchange the old for new bonds, even against their will.[63] Greek law bonds made up roughly 93% of all bonds issued by Greece – English law governed most of the remaining 7% of bonds.[64] The restructuring of Greek law bonds was a success.[65] 86% of private investors, holding bonds with a face value of roughly EUR177 billion, accepted the proposed changes.[66] This majority easily met the required voting threshold of 66 2/3 % in the CAC to overrule the remainder of holdouts.

The fact that the bulk of Greece's debt was issued in domestic currency (euro) and under domestic law alleviated some of the legal challenges countries face in a debt restructuring. As explained above, due to the 'local law advantage', Greece could decide to change its bond contracts unilaterally. While other cases exist in which states used legislation to suspend debt repayment obligations[67], the Greek PSI was the first time in history that a sovereign nation rewrote local law to ensure the success of its debt restructuring operations. The central legal

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[62] The ECtHR's ruling in *Mamatas v Greece* confirms just that. While bondholders were indeed forced to accept losses, these losses were not a direct consequence of an executive action by the Greek government. Rather, a majority of bondholders (hence not the Greek government) had voted in favour of the restructuring, making the deal binding upon all dissenting creditors. See *Mamatas v Greece*, App No 63066/14, App No 64297/14, App No 66106/14, 21st July 2016, European Court of Human Rights [ECHR].

[63] For the bill compare Andreas Koutras, 'A better translation of Bondholders Act 4050' (*Andreas Koutras Blog,* March 2012) <http://andreaskoutras.blogspot.com.au/2012/03/better-tarnslation-of-bondholders-act.html> accessed 4 June 2018.

[64] Miranda Xafa, 'Lessons from the 2012 Greek debt restructuring' (*VoxEU, 25* June 2014), <http://voxeu.org/article/greek-debt-restructuring-lessons-learned> accessed 2 June 2018.

[65] From an economic point of view, however, it remains disputed whether the PSI was sufficient to address Greece's debt problems. Given serious delays in implementing the macroeconomic adjustment conditions attached to the financial assistance programmes, Greece started a debt buyback programme to further reduce the amount of privately held bonds. See for further details Miranda Xava, 'Life after Debt – The Greek PSI and its aftermath' (2013) 14(1) World Economics 81.

[66] ibid.

[67] Eg Argentina's debt moratorium on roughly USD155 billion of public foreign-currency debt, declared on December 23rd 2001. See The Economist, 'Argentina's default – Foreign creditors join the pyre' *The Economist* (London, 3 Jan 2002).

question for Greece's lawyers was whether such retroactive changes to contracts signed by the government would comply with national constitutional as well as EU law. Indeed, as the holdouts did not actually consent to the debt reduction, they subsequently argued that the procedure chosen by Greece amounted to 'consent by coercion'.[68]

It remains hotly debated in academic circles whether the legislative technique applied by the Greek Parliament to facilitate was in fact 'coercive'[69] and 'arbitrary'[70] or rather a 'legitimate exercise of sovereign power'[71] to resolve its debt crisis. This holds true even after the Greek PSI had been litigated in different courts, as we discuss below.[72]

5.3.4. RESTRUCTURING FOREIGN LAW BONDS

Approximately 7% of all outstanding Greek government bonds were governed by foreign law, most of them by English law.[73] In contrast to local law bonds, English law bonds contained CACs at the time of issuance. However, the restructuring of English law bonds was still not entirely successful, notably because the CACs only allowed for a series-by-series vote.[74] By contrast, the retroactively introduced Greek CAC had aggregation features, which meant that bondholders casted a single vote across all series. Only 17 of the 36 foreign law bonds were successfully restructured.[75] The remainder resulted in holdout claims amounting to roughly EUR6.4 billion.[76]

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[68] ibid. Similarly, Porzecanski describes the retroactive implementation of CACs as a clear violation of the 'sanctity of contracts', see Porzecanski (n 49) 8. The Economist has described it as a tool that 'forced investors holding out for a better deal to swallow the loss', see The Economist, 'An illusory haven – What lessons should investors learn from the Argentine and Greek restructurings? *The Economist* (London, 20 April 2013).

[69] This view is supported *inter alia* by Sandrock (n 32); Porzecanski (n 49) and Witte (n 37).

[70] Martin Guzman, Jose Antonio Ocampo and Joseph E. Stiglitz (eds), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (New York: Columbia University Press, 2016) 164.

[71] Marcus Miller and Dania Thomas, 'Eurozone sovereign debt restructuring: keeping the vultures at bay' (2013) 29(4) Oxford Review of Economic Policy 745, 753.

[72] For an overview of the cases before Greek courts, see, eg, Dimitris Tsibanoulis and Iakovos Anagnostopoulos, 'The Greek PSI and the Litigation Surrounding It' (2014) 2 International Review of Financial Services 18. Litigation before Greek courts will not be separately analysed in this studies for the following reasons: first, language barriers render it difficult to review primary sources of law; second, holdouts were generally unsuccessful before Greek courts; third, the ECtHR analysed the constitutionality of the Greek Bondholder Act in light of the ECHR (this judgement will indeed be below in 5.5.3.)

[73] Miller and Thomas (n 71) 747.

[74] More specifically, CACs under English law lacked aggregation features, meaning that a 75% of creditors had to accept the proposed amendments in each individual series of bonds. This made it easier for hold-outs to thwart restructuring efforts by acquiring a blocking position in just one of the series and then sue for repayment of the full face value of the bonds.

[75] Miller and Thomas (n 71) 747.

[76] See, eg, Renee Matezou, 'In about-face, Greece pays bond swap holdouts' *Reuters* (London, 15 May 2012) <http://www.reuters.com/article/us-greece-bond-idUSBRE84E0MY20120515> accessed 15 July 2017.

Other than most Greek law bonds, English law securities issued by Greece also contained several additional clauses to protect bondholders' rights.[77] For instance, as Posner et al highlight, English law bonds contained cross default clauses, making it easier for creditors to 'exit a crisis situation (where Greece is beginning to default on some of its bonds) at much earlier stage than the holders of the Greek-law bonds.'[78]

Fearing decade-long litigation à la Argentina, the Greek government decided to pay holdouts with foreign law instruments in full.[79] This move severely undermined the intercreditor equity in the Greek PSI and outraged many smaller investors that were also not part of the IIF negotiations. With respect to future debt crises, it highlighted the varying degrees of investor protection under bonds with different governing laws: indeed, the owners of local law bonds took a 50% haircut while the holders of foreign law government bonds received 100 cents in the euro.[80]

In emerging market debt crises, where most of the debt was external, the discrimination between domestic and external debt holders was a lesser problem. In Greece, it was obvious. Strikingly, a single hedge fund that had invested in foreign law bonds realised a profit of roughly USD200 million.[81] Overall, holdout investors with English law bonds extracted more than EUR6 billion in face value payments from the Greek state. This was several times the amount they had paid on the market, underscoring the lucrative nature of 'vulturing'.[82]

5.4. HOLDOUT CREDITOR LITIGATION BEFORE MUNICIPAL COURTS

Given that Greece used CACs in its restructuring, holdouts had to first challenge the legality of the GBA. After all, there was no clear breach of contract, as these were amended by an affirmative majority vote of investors under the retroactively introduced CACs. As a result,

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[77] See Lee Buchheit and Mitu Gulati, 'Greek Debt: The Endgame Scenarios' (April 2011) unpublished manuscript <http://scholarship.law.duke.edu/faculty_scholarship/2380/> accessed 27 April 2017.

[78] Stephen J. Choi, Mitu Gulati and Eric A. Posner, 'Pricing Terms in Sovereign Debt Contracts: A Greek Case Study with Implications for the European Crisis Resolution' (2011) 6(2) Capital Markets Law Journal 163, 175.

[79] ibid.

[80] According to news reports by Reuters, private creditors who accepted the haircut were furious, calling the decision to pay the holdouts 'scandalous', see Matezou (n 76).

[81] See Thomas Landon, 'Bet on Greek Bonds Paid Off for 'Vulture Fund' *New York Times* (New York, 15 May 2012).

[82] Zettelmeyer et al (n 32) 527.

the nature of the litigation in Greece and Argentina differed in respect of both procedural and substantive law aspects.[83]

First, holdouts could not 'hold out' in the strict sense, ie block the restructuring. Only after the PSI was implemented could bondholders challenge it in court: there was no default or moratorium before the restructuring operation like in the case of Argentina. Second, Greek bonds had no choice-of-forum clauses, which raised complex questions of international jurisdiction. Indeed, the default assumption by most municipal courts was that the competent forum lay in Greece. Third, in contrast to Argentina, the courts not only had to assess whether the state had breached its contractual obligations. Rather, the sequence of measures taken by the Greek government that led to the bondholders' losses complicated the legal assessment. Greece had first passed a law, then executed a bondholder vote, and, on that basis, swapped the old bonds for new bonds by changing the record in the Greek central bank's registry.

5.4.1. HOLDOUT CREDITOR LITIGATION IN GERMANY

5.4.1.1. BGH Judgement of 8 March 2016[84]

The plaintiffs in this case were three German retail holdouts who had bought Greek government bonds in 2010 and 2011 with a face value of EUR110.000, EUR50.000, and EUR8.000, respectively.[85] The bonds were governed by Greek law and did not contain CACs at the time of the acquisition.[86] The plaintiffs had purchased the Greek government bonds through a commercial bank acting as an agent.[87] Since this agent was not a member of the Greek cheque system, the bank had to acquire the respective bonds on the secondary rather than the primary market.[88]

The plaintiffs refused to accept the offer made by Greece in the Invitation Memorandum. The Greek National Bank nonetheless exchanged the plaintiffs' bonds for new debt instruments with a reduced face value. The plaintiffs then filed suit in Germany and demanded

[83] In addition, most of the plaintiffs in the Greek litigation were retail holdouts. See above 3.3.2. for a discussion of the differences to vulture holdouts.

[84] BGH, Urteil vom 08.03.2016 - VI ZR 516/14, VI ZR 516/14, NJW 2016, 1659, 8th March 2016, Germany; Federal Court of Justice [BGH].

[85] ibid [5]

[86] ibid.

[87] ibid. This modus of transferring property rights to the investors by registering them with the Greek central bank is laid down in the Greek law 2198/1994.

[88] BGH, Urteil vom 08.03.2016 - VI ZR 516/14, VI ZR 516/14, NJW 2016, 1659, 8th March 2016, Germany; Federal Court of Justice [BGH] [5].

compensation from the Hellenic Republic for damages that arose from the PSI. The plaintiffs' main argument was that the retroactive implementation of CACs amounted to a violation of their property rights, notably since they had never consented to the bond swap.[89]

Both lower courts, the District Court of Frankfurt and the OLG Frankfurt, rejected the plaintiff's case on grounds of sovereign immunity.[90] The highest German court in civil law matters essentially followed their legal reasoning.

First, it stressed that sovereigns enjoyed immunity from suit if they have acted in a 'sovereign capacity' (*acta iure imperii*).[91] Other 'non-public', 'commercial' legal acts (*acta iure gestionis*) were not protected under international law and may thus not be subject to the assessment of a foreign court.[92] According to the BGH, the distinction between public and non-public legal acts was to be assessed by looking at the nature of the GBA.[93] In other words, the classification of a sovereign act as 'public' or 'private' depended on whether the state had acted with the unique powers of a sovereign or merely entered into a legal relationship under private law, which any other natural or juridical person could have concluded too.[94]

Second, the BGH remarked that the issuance of government bonds was – in general – considered a non-public legal act (*acta iure gestionis*) and may thus be subject to a lawsuit before the courts of another state.[95] However, in the present case, the plaintiffs challenged the involuntary withdrawal and exchange of their bonds by the Greek government. Their claim was therefore based on the violation of property rights *in* the sovereign debt papers rather than the violation of rights to repayment arising *from* the debt instruments.[96] This debt swap and the subsequent withdrawal of the plaintiffs' bonds from the Greek central bank's deposits were based on a Greek law.

Consequently, the BGH held that the legal measure taken by the Greek government must be qualified as *acta iure imperii* that cannot be subject to review in German courts. States were

[89] ibid [10].
[90] ibid [12]. See for the judgement of the Court of Appeals in OLG (Frankfurt), Urteil vom 18.09.2014 - 16 U 41/14, 18 September 2014, Germany; Hesse; Frankfurt am Main; Higher Regional Court [OLG].
[91] ibid [16].
[92] ibid.
[93] ibid [18].
[94] ibid.
[95] ibid. This assessment aligns with case law in the US and the UK, compare, eg, Mark Weidemaier, 'Sovereign Immunity and Sovereign Debt' (2014) 1 University of Illinois Law Review 68.
[96] BGH, Urteil vom 08.03.2016 - VI ZR 516/14, VI ZR 516/14, NJW 2016, 1659, 8th March 2016, Germany; Federal Court of Justice [BGH] [22].

always 'masters of their domestic law'.[97] While some courts followed the BGH's assessment[98], a number of German Court of Appeals (OLGs) came to a different conclusion with respect to Greece's immunity for the CAC retrofit.[99]

5.4.1.2. OLG Oldenburg Judgement of 15 April 2016

The judgement by the OLG located in the small German city of Oldenburg was remarkable as it rebutted big parts of the legal assessment by the superordinate BGH just one month earlier. As in the BGH decision, the OLG Oldenburg's ruling related to claims brought by German citizens, who had acquired Greek government bonds between 1998 and 2010.[100] The plaintiffs argued that the GBA had unlawfully forced losses upon them by binding them to a restructuring plan. This, in the plaintiffs' view, resulted in a breach of contract by the Greek government as well as an unlawful expropriation.[101]

Like the BGH, the OLG Oldenburg focused on the question whether Greece enjoyed immunity from suit. First, it held that the issuance of bonds by the Greek government was to be considered an *actus iure gestionis*. However, with regard to the assessment of the GBA, the OLG Oldenburg clearly deviated from the BGH's assessment. Crucially, it noted that 'a legal relationship that was once considered private cannot lose this character as a consequence of subsequent public acts'.[102] In other words, the Hellenic Republic must not 'immunise' sovereign debt contracts through retroactively changing the applicable statute. Thus, while the BGH considered Greece to be the 'master of its domestic law', the OLG Oldenburg argued that retroactive legislative changes were not covered by the doctrine of sovereign immunity. Rather, the Hellenic Republic was to be treated like any other private debtor who refused to repay its debts on grounds that they have been revoked by virtue of legislation.[103]

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[97] ibid [29]. The BGH however noticed that many voices in literature assume that the principle of sovereign immunity does not apply to legislative measures that disturb the contractual relationship between a state and its counterparty. See, eg, Alexander Szodruch, *Staateninsolvenz und private Gläubiger: Rechtsprobleme des Private Sector Involvement bei staatlichen Finanzkrisen im 21. Jahrhundert* (Berlin: Berliner Wissenschaftsverlag, 2010) 379.

[98] See, eg, OLG (Schleswig), Urteil vom 07.07.2016 - 5 U 84/15, 7th July 2016, Germany; Schleswig-Holstein; Higher Regional Court [OLG].

[99] See, most notably the OLG Oldenburg's decision of 15 April 2016, which is discussed below in 5.4.1.2.

[100] OLG (Oldenburg), Urteil vom 15.04.2016 - 13 U 43/15, 15 April 2016, Germany; Lower Saxony; Oldenburg; Higher Regional Court [OLG] [7].

[101] ibid [9-10].

[102] ibid [21]. Translation by the author.

[103] ibid.

However, to avoid a blatant divergence between its legal assessment and the one by the BGH from March, it made a caveat. The OLG held that the plaintiffs asserted their contractual right to repayment under the Greek debt securities.[104] Conversely, in the BGH case, the plaintiffs had for damages resulting from the alleged expropriation. The OLG Oldenburg noted that only a contractual claim arising from the non-performance on the Greek state's side could be subject to a review on merits. Other claims, such as the alleged expropriation of German bondholders or the involuntary exchange of bonds by means of governmental actions, must be rejected on grounds of sovereign immunity.[105]

Moreover, the OLG rejected the plaintiffs' claims, as it did not have international jurisdiction under the Brussels I Regulation. Notably, the 'place of performance' of the contractual obligation, was not in Germany but in Greece.[106] If the bonds' place of performance, ie the location where Greece had to make the coupon and principal payment, would have been in Germany, the OLG could have asserted its jurisdiction under Art 5(1) of the Brussels I Regulation.

5.4.1.3. OLG Köln Judgement of 12 May 2016

In this case, the plaintiff, a German citizen, had bought Greek government bonds between November 2011 and January 2012 with a face value of roughly EUR10.000.[107] The bonds were governed by Greek law and did not contain CACs. The plaintiff argued that this debt swap was 'coercive'. He had neither accepted a debt reduction nor consented to the retroactive implementation of CACs.[108] The OLG Köln focused on two legal questions. First, the court examined whether Greece could invoke the defence of sovereign immunity against the plaintiff's claims. [109] Second, it assessed the jurisdiction of German Courts in this cross-border lawsuit under the Brussels I Regulation.

Addressing the question of sovereign immunity, the OLG held that the legislative measures adopted by the Greek Parliament did not affect the fiscal nature of the Greek debt issuances. Siding with the OLG Oldenburg, the OLG Köln rejected the defence of sovereign immunity

[104] ibid [22].
[105] ibid [22-23].
[106] ibid [31].
[107] OLG (Köln), Urteil vom 12.05.2016 - 8 U 44/15, 8 U 44/15, ZIP 2016, 40, WM 2016, 1590, 12th May 2016, Germany; North Rhine-Westphalia; Cologne; Higher Regional Court [OLG] [4].
[108] ibid [15].
[109] ibid [64–81].

for the Greek law adopted to retrofit CACs.[110] It therefore too went against the spirit of the BGH decision in March of the same year, which had bestowed full immunity from suit upon Greece.[111]

The second part of the judgment dealt with the question of jurisdiction under the Brussels I Regulation that applies to cross-border civil and commercial litigation in the EU. The OLG Köln first noted that the issuance of debt capital fell under the definition of 'civil and commercial', as stipulated in Article 1 of the Brussels I Regulation.[112] However, it found that none of the conditions to establish German court's jurisdiction under this Regulation were fulfilled. The bondholder was neither a consumer in the sense of Article 15(1)(c) nor could he rely on Article 5(1)(a) Brussels I Regulation, which allowed a party to sue the other at the 'place of contractual performance'.[113] Following, the OLG Oldenburg, the OLG Köln clarified that, according to the bonds, the Greek National Bank was the paying agent. As the Bank has its headquarters in Athens, courts in Germany could not exercise jurisdiction *ratione materiae*.[114]

5.4.1.4. BGH Judgement of 19 December 2017

Plaintiffs appealed to the judgements by the OLGs Oldenburg and Köln. The highest German civil court ultimately settled the Greek bondholder disputes in December 2017.[115]

The BGH again clarified that, according to customary international law, states enjoyed immunity with respect to public or sovereign activities (*acta iure imperii*), but not when they engaged in commercial activities (*acta iure gestionis*). The distinction between sovereign and non-sovereign activities was not based the purpose of the state act but rather on its nature and was to be made in accordance with the laws applicable in the jurisdiction where the action is brought.[116]

While the issuance of sovereign debt fell under the category of *acta iure gestionis*, the CAC Retrofit was, in the court's view, based on a legislative action, and could therefore not be

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[110] ibid.
[111] See above 5.4.1.1.
[112] OLG (Köln), Urteil vom 12.05.2016 - 8 U 44/15, 8 U 44/15, ZIP 2016, 40, WM 2016, 1590, 12th May 2016, Germany; North Rhine-Westphalia; Cologne; Higher Regional Court [OLG] [84].
[113] ibid [85].
[114] ibid [101].
[115] BGH, Urteil vom 19.12.2017 - XI ZR 796/16, 19th December 2017, Germany; Federal Court of Justice [BGH].
[116] ibid [17].

subject to review on merits.[117] Otherwise, the court would have had to assess the legality of the GBA. The assessment of public acts by foreign sovereign would however not be reconcilable with the principle under public international law that equals must not have authority over one another (*par in parem non habet imperium*).[118]

The court further found that its view did not contradict the CJEU's decision in *Fahnenbrock and Others v Hellenische Republik*[119] in which the EU court clarified that, in the context of the service of judicial and extrajudicial documents, the issuance of sovereign bonds was to be considered a 'commercial' activity. In the BGH's view, this decision should be interpreted narrowly, given that it only pertained to the delivery of documents and sought to enable the general assessment of the case based on a successful delivery and not the nature of bond issuance activities as such.[120]

German courts' jurisdiction could also not be inferred from Article 10(1) UNCSI, according to which a state could not invoke immunity from jurisdiction in a proceeding arising out of a commercial transaction.[121] This was because the UNCSI had neither entered into force in Germany nor in Greece. Moreover, even if the Convention was deemed to reflect customary international law, its provisions on sovereign immunity did not restrict the court's interpretation of Greece's immunity in the present case, also since the Convention requires the court to actually have international jurisdiction over the dispute.[122]

Therefore, the court dismissed all claims invoked by the plaintiffs, as Greece enjoyed immunity from suit with respect to the GBA. Extending its first decision on Greek bondholder claims[123], the court explained that, in order to determine sovereign immunity, the type of legal claim brought against a sovereign is not relevant. Consequently, regardless as to whether bondholders invoke their right to contractual performance, claim damages or

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[117] ibid [17-18].

[118] ibid [25].

[119] *Fahnenbrock and ors v Greece*, Judgment, reference for a preliminary ruling, Case C-226/13, Case C-245/13, Case C-247/13, Case C-578/13, ECLI:EU:C:2015:383, [2015] OJ C270/2, 11th June 2015, Court of Justice of the European Union [CJEU]; CJEU [ECJ]; CJEU (1st Chamber). For a review of the judgement, see below 5.5.3.

[120] BGH, Urteil vom 19.12.2017 - XI ZR 796/16, 19th December 2017, Germany; Federal Court of Justice [BGH] [30].

[121] United Nations General Assembly Resolution 59/38: United Nations Convention on Jurisdictional Immunities of States and Their Property (United Nations General Assembly [UNGA]) UN Doc A/RES/59/38, UN Doc A/59/49, 486. See above 1.4. for a general discussion of sovereign immunity and the UNCSI.

[122] BGH, Urteil vom 19.12.2017 - XI ZR 796/16, 19th December 2017, Germany; Federal Court of Justice [BGH] [30-32].

[123] BGH, Urteil vom 08.03.2016 - VI ZR 516/14, VI ZR 516/14, NJW 2016, 1659, 8th March 2016, Germany; Federal Court of Justice [BGH].

demand compensation for expropriation, the state remains immune with regard to debt restructuring measures that are based on legislative acts.

This is because affirming any of the bondholders' claims would inevitably require the court to assess the unlawfulness of the foreign state's legislation. This would, however, not be reconcilable with the principle of equality of nations under international law and the resulting legal principle that states may not sit in judgement on each other (*par in parem non habet imperium*).[124]

5.4.2. Holdout Creditor Litigation in Austrian Courts

In this section, we will review three seminal judgements by the highest civil court in Austria, the OGH. Akin to the German bondholder cases, the OGH examined (i) whether Greece enjoyed sovereign immunity for both the issuance of government bonds and the subsequent legislation to amend the initial contractual terms and (ii) whether Austrian courts had jurisdiction *ratione materiae* or *personae* over the claims.

5.4.2.1. OGH Judgments of 20 May 2014[125] and 16 January 2016[126]

The plaintiffs in these two connected cases before the OGH had acquired Greek sovereign bonds through an Austrian retail bank.[127] They claimed that the Greek government had failed to pay its debts in full at the point of maturity.[128] While the lower courts rejected the plaintiff's claims on grounds of sovereign immunity, the OGH came to a more nuanced assessment of the bondholders' claims.

First, the OGH noted that the GBA was a legislative measure and must therefore be considered a 'public' act (*actus iure imperii*) under international law.[129] At the same time, the Greek State had appeared to investors much like a private debt-issuing corporation.[130] However, the OGH proved reluctant to further investigate the relationship between the GBA

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[124] BGH, Urteil vom 19.12.2017 - XI ZR 796/16, 19th December 2017, Germany; Federal Court of Justice [BGH] [25-26].

[125] *RB and TB v Hellenic Republic I*, Interlocutory appeal judgment, 4Ob227/13f, ILDC 2214 (AT 2014), 20th May 2014, Austria; Supreme Court of Justice [OGH].

[126] *RB and TB v Hellenic Republic II*, Appeal judgment, 4 Ob 163/15x, 16th January 2016, Austria; Supreme Court of Justice [OGH].

[127] *RB and TB v Hellenic Republic I*, Interlocutory appeal judgment, 4Ob227/13f, ILDC 2214 (AT 2014), 20th May 2014, Austria; Supreme Court of Justice [OGH] [2].

[128] ibid.

[129] ibid [5].

[130] *RB and TB v Hellenic Republic I*, Interlocutory appeal judgment, 4Ob227/13f, ILDC 2214 (AT 2014), 20th May 2014, Austria; Supreme Court of Justice [OGH] [5].

as a sovereign act and the issuance of government bonds as a commercial act. Instead, it shifted to the assessment of its jurisdiction under the pertinent EU rules.

Regarding its jurisdiction *ratione materiae*, the OGH held that the bondholders' claims pertained to a civil procedure in the sense of Article 1(1) Brussels I Regulation.[131] While German courts had uniformly decided that none of the conditions to establish jurisdiction under the Brussels I Regulation applied to the Greek bondholder claims[132], the OGH refrained from jumping to fast conclusions.[133] Rather, it held that it was the sovereign's responsibility to prove the absence of a legal basis for the jurisdiction of Austrian courts under the pertinent EU rules.[134]

After Greece provided this evidence, the OGH confirmed that its jurisdiction could not be justified based on the Brussels I Regulation. First, the plaintiffs did not qualify as 'consumers' in the sense of Article 15(2), which would have allowed them to sue Greece in the country where they are domiciled.[135] After all, they had acquired their claims through an intermediary rather than directly from the sovereign. Second, the conditions set out in Article 5(3) Brussel I Regulation, which define the place of jurisdiction for claims pertaining to non-contractual liability, were also not met.[136] Importantly, the subject matter of the dispute did not relate to tort, delict or quasi-delict – instead, it concerned a (quasi-)contractual

[131] ibid [6]. This was also the view taken by the CJEU in *Fahnenbrock*. See *Fahnenbrock and ors v Greece*, Judgment, reference for a preliminary ruling, Case C-226/13, Case C-245/13, Case C-247/13, Case C-578/13, ECLI:EU:C:2015:383, [2015] OJ C270/2, 11th June 2015, Court of Justice of the European Union [CJEU]; CJEU [ECJ]; CJEU (1st Chamber). Also see below 5.5.3. for a full review of this case.

[132] OLG (Oldenburg), Urteil vom 15.04.2016 - 13 U 43/15, 15 April 2016, Germany; Lower Saxony; Oldenburg; Higher Regional Court [OLG].

[133] *RB and TB v Hellenic Republic I*, Interlocutory appeal judgment, 4Ob227/13f, ILDC 2214 (AT 2014), 20th May 2014, Austria; Supreme Court of Justice [OGH] [6].

[134] ibid. More specifically, it noted that the jurisdiction of Austrian Courts in the present case may be based on Article 15(1) in conjunction with Article 16(1) Brussels I Regulation. This however means that the plaintiff has to prove that it is a consumer in the sense of EU law in its contractual relationship with Greece. This, as German case law indicates, may prove difficult if the bondholder has acquired his debt instrument through third party. See OLG (Oldenburg), Urteil vom 15.04.2016 - 13 U 43/15, 15 April 2016, Germany; Lower Saxony; Oldenburg; Higher Regional Court [OLG].

[135] See *RB and TB v Hellenic Republic IV*, Appeal judgment, 4 Ob 163/15x, 16th January 2016, Austria; Supreme Court of Justice [OGH]. Article 15(2) of the Brussels I Regulation states the following:

'2. Where a consumer enters into a contract with a party who is not domiciled in the Member State but has a branch, agency or other establishment in one of the Member States, *that party shall*, in disputes arising out of the operations of the branch, agency or establishment, *be deemed to be domiciled in that State*. [emphasis added]'

[136] *RB and TB v Hellenic Republic IV*, Appeal judgment, 4 Ob 163/15x, 16th January 2016, Austria; Supreme Court of Justice [OGH] [5-7]. As the second OGH judgement in this case was rendered after two other claims of Austrian bondholders against Greece had been rejected, the key reasons as to why Art 15 Brussel we Regulation is not to be applied will be discussed below, see below 5.4.2.1. and 5.4.2.2. Also see for a very similar conclusion in *RB and TB v Hellenic Republic III*, Appeal judgment, 8 Ob125/15p, 25th November 2015, Austria; Supreme Court of Justice [OGH]

relationship between Greece as debtor and the bondholder as creditor.[137] However, the OGH considered that Article 5(1) of the Brussels I Regulation might provide the necessary legal basis to establish Austrian courts' jurisdiction.[138]

Yet, the plaintiffs had not invoked this provision of the Brussels I Regulation. This, as it seemed, was not so much a mishap on the side of the plaintiffs' legal counsels but part of the litigation strategy. Indeed, the lower courts' decisions implied that the 'place of performance', as stipulated by Article 5(1) Brussel Regulation, presumably lay in Greece and not in Austria.[139] The case was thus dismissed by the OGH.

5.4.2.2. OGH Judgment of 25 April 2017[140]

In its most recent judgement from April 2017, the OGH decided to request a preliminary ruling from the CJEU under Article 267 TFEU regarding its international jurisdiction for bondholder litigation under Brussels I Regulation (recast).[141] This is a notable development given that CJEU judgements would not only bind Austrian courts but any other court in the EU that was to adjudicate sovereign bond disputes going forward.

The facts were identical to those of the previous cases before the highest Austrian courts. The plaintiffs had asserted that, according to Article 7(1)(a) of the Brussels I Regulation (recast)[142], Austrian courts had jurisdiction *ratione materiae*.[143] Specifically, they asserted that place of performance of the Greek bonds was situated in Austria, given that the Greek government had to made payments to Austrian bank accounts owned by the plaintiffs. At first, the OGH voiced doubts as to whether the place of performance could be situated in

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[137] *RB and TB v Hellenic Republic IV*, Appeal judgment, 4 Ob 163/15x, 16th January 2016, Austria; Supreme Court of Justice [OGH] [6].

[138] ibid [10]. Article 5(1) of the Brussels I Regulation stipulates that 'a person (herein the Hellenic Republic) may be sued in another Member State in matters relating to a contract, in the Courts for the place of the performance of the obligation […]'.

[139] ibid. The plaintiff's reluctance to argue in favour of Art 5(1) Brussels Regulation stems from the difficulty of proving that Austria rather than Greece was the place of performance for principal and interest payments on Greek government bonds. Essentially, the failure to rebut Greece's claim that such payments are to be made by the Greek National Bank, and therefore in Greece, also led to the rejection of the claims made by bondholders in German Courts. See, eg, above 5.4.1.2.

[140] *RB and TB v Hellenic Republic V*, Appeal judgment, 10 Ob34/16x, 25 April 2017, Austria; Supreme Court of Justice [OGH].

[141] Article 267 of the Treaty on the Functioning of the European Union conveys jurisdiction to the ECJ to give preliminary rulings concerning (a) the interpretation of the Treaties; and (b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union.

[142] Regulation of the European Parliament and of the Council on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (European Parliament) (Council of the European Union) 1215/2012/EU, [2012] OJ L351/1.

[143] *RB and TB v Hellenic Republic V*, Appeal judgment, 10 Ob34/16x, 25 April 2017, Austria; Supreme Court of Justice [OGH] [7-8].

Greece.[144] Citing Article 321 of the Greek Civil Code, the OGH remarked that – as a rule – a monetary claim has to be paid at the place where the creditor was domiciled when the claim fell due.[145] Given that the creditor was an Austrian retail investor, this reading of the Greek law could have given rise to the jurisdiction of Austrian courts.

However, due to the primacy of application of Union law, the OGH then focused on Article 7(1)(a) Brussels I Regulation.[146] The court then found that there might be scope for the jurisdiction of courts of the country where the contractual obligation is factually performed.[147] Given the absence of a precedent under EU law, the OGH requested a preliminary ruling of the ECJ with regard to three questions concerning the interpretation of Article 7(1)(a) Brussels I Regulation:

1. Do multiple assignments of a sovereign bond alter its place of performance?
2. Do coupon payments rather than principal payments suffice to establish a factual place of performance under Article 7 Brussels I Regulation?
3. If the underlying contract sets out a place of performance, could another place of performance be established in the country where the contract is actually performed?

The ECJ has yet to answer the OGH's questions, which may several months. In July 2018, the Advocate General of the ECJ issued his opinion, which serves as a guidance for the Chamber of the CJEU. The Advocate General essentially denied the jurisdiction of Austrian courts. He clarified that the place of performance was located in Greece, given that the paying agent was located in Greece and given that all decisions on the modalities of payment were regulated by Greek laws – first the Greek Act No 2198/1994 and subsequently the GBA.[148] In the Advocate General's view, neither the assignment of the claim nor the actual payment to a foreign bank account could alter the contractually defined place of performance.[149]

[144] See, eg, OLG (Köln), Urteil vom 12.05.2016 - 8 U 44/15, 8 U 44/15, ZIP 2016, 40, WM 2016, 1590, 12th May 2016, Germany; North Rhine-Westphalia; Cologne; Higher Regional Court [OLG] (discussed above in 5.4.1.3.).

[145] *RB and TB v Hellenic Republic V*, Appeal judgment, 10 Ob34/16x, 25 April 2017, Austria; Supreme Court of Justice [OGH] [9].

[146] This provision states that '[a] person domiciled in a Member State may be sued in another Member State: […] in matters relating to a contract, in the courts for the *place of performance* of the obligation in question [emphasis added]'.

[147] ibid [10-11].

[148] *Kuhn v Hellenic Republic*, Opinion of the Advocate General, Case C-308/17, [2018], 4th July 2018, Court of Justice of the European Union [CJEU]; European Court of Justice [ECJ] [104-110].

[149] ibid [110].

5.4.3. ANALYSIS

If bondholders had been successful in challenging the Greece PSI in Austrian or German courts, the political ramifications would have been tremendous. At best, it would have resulted in serious political resentment between EU Member States; at worst, it would have pushed Greece into outright default.

Naturally, enforcement actions against Greece would have raised additional legal and practical problems. For instance, Article 34 of the Brussels I Regulation provides that judgements shall not be recognised if this would be manifestly contrary to the public policy in the Member State in which recognition is sought. This provision could have complicated the attachment of Greek assets located in Austria or Germany.[150]

Nonetheless, despite the rejection of bondholder claims, the rulings allude to fundamental legal questions arising in the context of sovereign debt restructuring as well as holdout litigation. In contrast to the German courts, the Austrian OGH adopted a narrower interpretation of sovereign immunity, which rejected the notion that states may alter the nature of their commercial acts by virtue of legislative actions. In that sense, the Austrian courts, at least *obiter,* denied Greece the freedom to amend its laws as it saw it fit.[151] Thereby, the OGH reading accommodated the *pacta sunt servanda* principle to local law bonds, providing investors with the certainty that the issuer may not unilaterally modify amendments to original contractual terms.

Given that the legal challenges against the Greek PSI have not been concluded yet, it may be early too early to draw conclusions with respect to the economic policy implications. However, one consequence of the legal aftermath of the Greek PSI is already obvious: the measurable increase in the rate of interest Greece has to pay for bonds governed by local law.[152] While we still don't know how quickly markets will 'forgive and forget', the fact that the Greek government has exclusively used English law for newly issued debt securities over the past six years speaks for itself.

[150] See Tolek Petch, *Legal Implications of the Euro Zone Crisis* (Amsterdam: Kluwer, 2014) 135.

[151] See, eg, Hayk Kupeylants, *Sovereign Defaults Before Domestic Courts* (Cambridge: Cambridge University Press, 2018) 5.04-5.06.

[152] See Marcus Chamon, Julian Schumacher, and Christoph Trebesch, 'Foreign law bonds: can they reduce sovereign borrowing costs?' (2018) ECB Working Paper Series No 2162 <https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2162.en.pdf> accessed 29 June 2018.

Of course, Greece was not the first country to exploit the advantages of domestic law debt.[153] For instance, Russia and Uruguay successfully restructured their domestic law bonds in 1998 and 2003 respectively.[154] However, the PSI showed that the advantages from going into a crisis with a large proportion of domestic law might well be limited to a single debt restructuring operation. Afterwards, investors are likely to insist on foreign law to reduce future default risks. Thus, the use of local law bonds could decline further. Moreover, yields between local and foreign law bonds issued by euro area sovereigns may diverge in the run-up to a sovereign debt crisis.[155]

5.5. HOLDOUT LITIGATION BEFORE EUROPEAN COURTS

This section analyses three cases before EU and European courts in the context of the Greek debt restructuring. While the sovereign debt instruments restructured by Greece did not explicitly confer jurisdiction to these courts, the primacy of EU law as well as the CJEU's and the ECtHR's respective monopolies to interpret the Treaties and the ECHR meant that some cases landed before them.

5.5.1. ACCORINTI AND OTHERS V. ECB

In *Accorinti and Others v ECB*[156], the EGC[157] reviewed the ECB's position during the Greek PSI. As mentioned above, the ECB pre-empted a haircut on its Greek bonds by virtue of an exclusive arrangement with the Greek government.[158] This agreement was criticised by

[153] Perhaps unsurprisingly, a country's ability to issue debt governed by domestic law for a reasonable price has thus always mirrored potential default risks. For instance, Europe's biggest and most potent economies, such as Germany, France and the UK have no foreign law issues outstanding while smaller and less developed countries, such as Lithuania, Poland and Latvia show the highest proportions of foreign-law debt in the EU, see Clare, Andrew and Nicholas Schmidlin, 'The Impact of Foreign Governing Law on European Government Bond Yields' (10 March 2014) unpublished manuscript <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2406477> accessed 2 June 2018.

[154] Buchheit and Gulati (n 77). However, bonds in both countries were denominated in local currency while Greece is part of a monetary union, sharing the euro as a currency with 18 other countries.

[155] See, eg, Elena Carletti, Paolo Colla, Mitu Gulati, and Steven Ongena, 'The Price of Law: The Case of Eurozone Collective Action Clauses' (2017) SFI Working Paper N°17-35 <http://sfi.ch/node/883??doc=5941> accessed 25 June 2018. For another study finding similar results, see Chamon et al (n 152).

[156] *Accorinti v European Central Bank*, Judgement, Case T-79/13, [2015] Court of Justice of the European Union [CJEU]; GC of the European Union [EGC].

[157] The EGC is a constituent court of the CJEU and hears actions taken by individuals and Member States against the EU. However, certain matters are reserved for the ECJ.

[158] ibid [17]. As mentioned above, on 15 February 2012 the ECB and the NCBs of the Eurosystem agreed on the exchange of their Greek debt securities for new Greek debt securities with equal payment conditions. Conversely, private creditors took a haircut of approximately 53.5% of the outstanding principal.

journalists[159], private sector market participants[160], as well as experts[161]. The ECB had argued that its participation in the Greek PSI would amount to monetary financing, which is illegal under Article 123 TFEU.

In the applicant's view, the ECB's decision to swap its Greek sovereign bonds for new securities with equal repayment conditions[162] while private creditors were forced to participate in a debt swap violated the central bank's inter-creditor duties under customary international law to accept *pari passu* treatment.[163] Thus, the ECB had illegally granted preferred creditor status to itself, to the detriment of the private sector.[164] The ECB, the applicant argued, was also bound to the *pari passu* rule owing to the general principle of non-discrimination enshrined in Article 10 TFEU and Article 20 and 21 of the CFR.[165] By purchasing Greek government bonds, the ECB and the NCBs became private law creditors of the Hellenic Republic bound by the rule of non-discrimination under EU law.[166]

The ECB countered that there was neither a rule of international law prescribing the equal treatment of creditors in sovereign debt restructurings nor a contractual obligation according to which the ECB must be ranked *pari passu* with other bondholders.[167] Crucially, the ECB claimed that it had bought Greek bonds solely in the exercise of the public mandate conferred on it by Article 127(1) TFEU.[168] The ECB must therefore be considered a different type of creditor, as the decision to buy Greek government bonds was in accordance with the ECB's principle objective of maintaining price stability.[169]

The EGC sided with the ECB on all points. Most importantly, the EGC rejected the applicant's claim that the ECB had violated the principle of non-discrimination under Article 20 and 21 CFR by conferring preferential creditor status upon itself through the exclusive

[159] Eg, Ralph Atkins, 'ECB avoids forced losses on Greek bonds' *Financial Times* (London, 16 February 2012).
[160] Paul Dobson and Abigail Moses, 'ECB Greek Plan May Hurt Bondholders While Triggering Debt Swaps' *Bloomberg* (London, 17 February 2012), <http://www.bloomberg.com/news/articles/2012-02-17/ecb-plan-to-shield-its-greek-bonds-may-subordinate-some-holders-ubs-says> accessed 16 June 2017 (quoting several banks that vowed to challenge the ECB's seniority status).
[161] Witte (n 32) 335.
[162] *Accorinti v European Central Bank*, Judgement, Case T-79/13, [2015] Court of Justice of the European Union [CJEU]; GC of the European Union [EGC] [17].
[163] ibid [85].
[164] ibid.
[165] ibid [85].
[166] ibid [85].
[167] ibid [86].
[168] ibid [17].
[169] ibid [86].

debt exchange agreement with Greece.[170] In the EGC's opinion, the applicant made an erroneous assumption by claiming that all individuals who acquired Greek bonds were 'private' creditors of the Hellenic Republic.[171] In fact, the ECB, in contrast to the applicant, purchased Greek bonds to exercise its basic task of maintaining price stability pursuant to Article 127(1) and 2 TFEU and Article 18(1) of the Statute.[172] According to the court, the applicant was therefore in an entirely different situation as it purchased Greek bonds exclusively for private purposes.[173]

5.5.2. FAHNENBROCK V. HELLENISCHE REPUBLIK

In *Fahnenbrock*[174], the ECJ[175] had to answer a request for preliminary ruling according to Article 267 TFEU by the German District Court in Kiel as regards the interpretation of Article 1(1) of Regulation (EC) No 1393/2007.[176] In the course of German bondholder proceedings against Greece, the German court had to ascertain whether these legal actions concern civil or commercial matters in the sense of Article 1(1) of Regulation No 1393/2007[177] or rather actions or omissions in the exercise of state authority.

Fahnenbrock thus broached a central legal question, namely if the GBA ought to be considered a public or a commercial legal act. The ECJ first noted that Regulation No 1393/2007 was not applicable to disputes where a public authority acted in the exercise of state authority.[178] Second, the ECJ remarked that 'the issue of bonds does not necessarily

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[170] ibid [88].
[171] ibid.
[172] ibid.
[173] ibid [94].
[174] *Fahnenbrock and ors v Greece*, Judgment, reference for a preliminary ruling, Case C-226/13, Case C-245/13, Case C-247/13, Case C-578/13, ECLI:EU:C:2015:383, [2015] OJ C270/2, 11th June 2015, Court of Justice of the European Union [CJEU]; CJEU [ECJ]; CJEU (1st Chamber).
[175] Like the EGC, the ECJ belongs to the CJEU. The CJEU deals primarily with preliminary rulings from national courts, certain actions for annulment as well as appeals to judgements by the EGC. See for an overview EU, 'Court of Justice of the European Union (CJEU)' (2018) About the EU <https://europa.eu/european-union/about-eu/institutions-bodies/court-justice_en> accessed 28 August 2018.
[176] Regulation of the European Parliament and of the Council on the service in the Member States of judicial and extrajudicial documents in civil or commercial matters (service of documents), and repealing Council Regulation (EC) No 1348/2000 (European Parliament) (Council of the European Union) 1393/2007/EC, [2007] OJ L324/79.
[177] Article 1(1) of Regulation of the European Parliament and of the Council on the service in the Member States of judicial and extrajudicial documents in civil or commercial matters (service of documents), and repealing Council Regulation (EC) No 1348/2000 (European Parliament) (Council of the European Union) 1393/2007/EC, [2007] OJ L324/79, which states that '[t]his Regulation shall apply in civil and commercial matters where a judicial or extrajudicial document has to be transmitted from one Member State to another for service there. It shall not extend in particular to revenue, customs or administrative matters or to liability of the State for actions or omissions in the exercise of state authority (*acta iure imperii*).'
[178] *Fahnenbrock and ors v Greece*, Judgment, reference for a preliminary ruling, Case C-226/13, Case C-245/13, Case C-247/13, Case C-578/13, ECLI:EU:C:2015:383, [2015] OJ C270/2, 11th June 2015, Court of Justice of the European Union [CJEU]; CJEU [ECJ]; CJEU (1st Chamber) [50].

presuppose the exercise of powers falling outside the scope of the ordinary legal rules applicable to relationships between individuals, hence the rules of private law.'[179] Third, while the judges acknowledged the GBA's nature as a legislative act to manage public finances, they made clear that using a law to facilitate a debt restructuring was, in itself, not decisive to establish state authority.[180]

However, the ECJ ambiguously held that 'it is not obvious that the adoption of the GBA led directly and immediately to changes to the financial conditions of the securities in question and therefore caused the damage alleged by the applicants.'[181] Those changes were effected by a decision of a majority of the bondholders because of the retrofitted CACs.[182] This, as the court concluded, confirmed Greece's intention to keep the management of the bonds within a regulatory framework of a civil law nature.[183]

Therefore, 'Article 1(1) of Regulation No 1393/2007 must be interpreted as meaning that legal proceedings for compensation for disturbance of ownership and property rights, contractual performance and damages.'[184] Thus, the claims of Greek bondholders fell 'within the scope of that regulation in so far as it does not appear that they are manifestly outside the concept of civil or commercial matters.'[185]

5.5.3. MAMATAS AND OTHERS V. GREECE

The *Mamatas* litigation was the crucial missing piece in the juridical workup of the Greek crisis. The case originated from three applications by 6.320 Greek nationals who had acquired bonds with a face value between EUR10.000 and EUR1.510.000 and had challenged the lawfulness of the debt exchange before Greek national courts. Most of them were archetypical retail holdouts[186], though, in comparison to the Austrian and German bondholders, they were domestic creditors. As Europe's highest human rights court and the ultimate authority to interpret the ECHR, the ECtHR had to weigh in after the applicants

[179] ibid [53.].
[180] ibid [55-56.].
[181] ibid.
[182] ibid.
[183] ibid.
[184] ibid [59].
[185] ibid.
[186] See above 3.3.2. for the definition.

appealed to a judgement passed by the Greek Council of State. The highest administrative court in the country had previously rejected their claims for compensation.[187]

In Greek courts, the PSI was challenged as breaching the Greek Constitution. In the domestic proceedings, the bondholders had alleged a breach of the rule of law (Article 5 of the Greek Constitution), the principle of equality (Article 4 of the Greek Constitution) and property rights more generally (Article 17 of the Greek Constitution).[188]

In its dismissal, the Greek Council of the State concluded that an investment in government bonds was not exempt from the risk of losses, especially if the issuer's capacity to repay its debt becomes severely constrained because of an unprecedented financial crisis.[189] According to the Greek judiciary, the measures taken by the Greek government and Parliament to resolve the crisis were of preeminent public interest, for they served the substantial national public interest as well as the common interest of the Euro area.[190] They were moreover adequate and necessary to forestall a Greek default, which, in any case, would have further deteriorated the state's capacity to honour its financial obligations.[191] The only remaining remedy was an appeal to the ECtHR, which has the power to overrule national courts and bind the Member States of the Council of Europe to its decisions.

In their submissions to the ECtHR, the applicants asserted an infringement of their legitimate expectations to be repaid. They argued that both Greek and European authorities maintained in their official communication before the restructuring that natural persons would not be affected by a possible debt cut and that the burden of the debt adjustment would be shared between institutional investors and the government debtor.[192] They essentially argued that the Parliament's decision to retrofit CACs to the entirety of Greek bonds without involving retail bondholders in prior negotiations wrongfully interfered with their legitimate expectations, thus infringing upon their property rights protected under Article 1 of Protocol No 1 ECHR.[193]

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[187] Also see for an overview of the case Kupeylants (n 151) 164-165.

[188] ibid. The authors note that two challenges against the PSI had been filed at the ECtHR, both of which had been rejected as inadmissible.

[189] Tsibanoulis and Anagnostopoulos (n 86) 10-12. Also see Kupeylants (n 151).

[190] See *Mamatas v Greece*, App No 63066/14, App No 64297/14, App No 66106/14, 21st July 2016, European Court of Human Rights [ECHR] [26-36].

[191] ibid.

[192] ibid [36] (noting that about 1% of Greece's overall debt was held by such natural persons).

[193] ibid.

The ECtHR first assessed whether the GBA had in fact interfered with bondholders' property rights protected under the Charter.[194] Siding with the applicants, the court held that investors in Greek debt could legitimately expect to have their claims met in accordance with the (budgetary) law specifying the contractual arrangements between bondholders and issuer. More specifically, by rewriting local law, Greece '[had] altered the conditions governing the bonds, binding all bondholders to a cut in the nominal value of their claims.'[195] This, the ECtHR opined, 'amounted to an interference with [the applicants'] right to the enjoyment of their property.'[196]

However, such interference may still be lawful under Article 1 Protocol No 1 ECHR if it pursued a legitimate public interest aim and was, in pursuing this aim, proportionate.[197] The ECtHR first elaborated on the public interest aim. It found that Greece had faced a serious political, social, and economic crisis in early 2012 when it implemented the expropriatory measures.[198] The GBA's main objective was to reduce the Greek debt burden and thereby avert imminent financial collapse. It thus pursued a legitimate aim that aligned with the public's interests.[199]

Reviewing the criterion of proportionality, the ECtHR focused on the extent to which Greek investors could rely on the original, ie unmodified, payment terms for Greek government bonds.[200] First, the court held that the change to the repayment terms was necessary to avert imminent insolvency. Second, the chamber remarked that the debt cut did not equate to a '[total] extinguishment' of their rights. Rather, it resulted in a reduction of their claim of around 50%.[201] Crucially, the ECtHR found that the 'nominal value of a bond was the actual market value at the time of enactment of the impugned legislation [rather than the face

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[194] The protection of peaceful enjoyment of possessions in the European human rights framework requires courts to conduct a two-step test: First, did the state interfere with the individual's property rights? Second, did the interference pursue a legitimate (public interest) aim and was it appropriate?

[195] *Mamatas v Greece*, App No 63066/14, App No 64297/14, App No 66106/14, 21st July 2016, European Court of Human Rights [ECHR] [90-95].

[196] ibid.

[197] With regard to the limitation of the protection of property, Article 1 of Protocol No 1 ECHR sets out the following:

'The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties'.

See Convention for the Protection of Human Rights and Fundamental Freedoms, as amended by Protocol No 11 (Council of Europe) 213 UNTS 222, ETS No 5, UN Reg No I-2889.

[198] *Mamatas v Greece*, App No 63066/14, App No 64297/14, App No 66106/14, 21st July 2016, European Court of Human Rights [ECHR] [101-105].

[199] ibid.

[200] ibid [106-120].

[201] ibid.

value]'. The securities' real value had been diminishing through the markets' anticipation of a Greek insolvency, thereby reflecting the Greek government's inability to honour its obligations under the original repayment terms.[202]

Against the backdrop of this real depreciation of the bonds' market value, the retroactive insertion of CACs was an 'appropriate and necessary means of reducing Greek public debt and saving the respondent state from bankruptcy.' The Greek state neither upset the fair balance between the public interest and the protection of the applicants' property nor inflicted an 'individual and excessive burden on them'.[203]

5.5.4. Analysis

5.5.4.1. Sovereign Immunity in Europe

As was the case for many lawsuits in the aftermath of the Argentine crisis, the question of state immunity played an important role in Greece. In this context, the ECJ's decision in *Fahnenbrock*[204] was instructive. Given that the CJEU enjoys the monopoly of interpreting EU law, the decision had direct effects on the admissibility of bondholders' claims against Greece in Austrian and German courts. Most importantly, by qualifying the proceedings against the Greek State as 'civil and commercial' matters, the CJEU opened up to the Greek GBA to holdout litigation in (foreign) domestic courts.

However, the EU court's decision did not translated into tangible victories of holders of Greek debt. In fact, the decision in *Fahnenbrock* was arguably at odds with the two leading German decisions[205]. Indeed, the German BGH[206] considered that the GBA reflected a direct exercise of state power, inaccessible to the review of a foreign court. By contrast, the Austrian OGH[207] stuck to *Fahnenbrock* and concluded that, notwithstanding the GBA, bond issuances remained commercial acts.

[202] ibid [118].

[203] ibid [141-142].

[204] *Fahnenbrock and ors v Greece*, Judgment, reference for a preliminary ruling, Case C-226/13, Case C-245/13, Case C-247/13, Case C-578/13, ECLI:EU:C:2015:383, [2015] OJ C270/2, 11th June 2015, Court of Justice of the European Union [CJEU]; European Court of Justice [ECJ]; European Court of Justice (1st Chamber).

[205] See BGH, Urteil vom 08.03.2016 - VI ZR 516/14, VI ZR 516/14, NJW 2016, 1659, 8th March 2016, Germany; Federal Court of Justice [BGH] and BGH, Urteil vom 19.12.2017 - XI ZR 796/16, 19th December 2017, Germany; Federal Court of Justice [BGH]. See above 5.4.1.1. and 5.4.1.4., respectively.

[206] ibid.

[207] See in particular *RB and TB v Hellenic Republic II*, Appeal judgment, 8 Ob 67/15h, 30 July 2015, Austria; Supreme Court of Justice [OGH].

5.5.4.2. The Constitutional Barriers to Unilateral Bond Modifications

Both the *Accorinti* judgement by the EGC and the *Mamatas* decision by the ECJ set important precedents for future debt restructuring operations in Europe: they clarified the official sector's scope for interference with private bondholders' property rights in the context of an economic crisis. Given the absence of a well-established body of case law, the *Mamatas* decision will certainly guide governments in designing government bond modifications. The *Accorinti* case will shape the ECB's future behaviour in debt crises, especially with respect to bonds held on its own balance sheet.[208]

Zooming in on the *Mamatas* decision, it appears that the ECtHR granted a wide margin of discretion to the sovereign issuer in amending its contractual framework during economic emergencies. This aligns with the court's general stance on the of property rights.[209] Indeed, an interference with property rights is generally deemed lawful if it was 'appropriate for achieving its aim and not disproportionate thereto'.[210]

Specifically, three important observations can be made when putting the *Mamatas* case into perspective. First, the ECtHR clarified that sovereign bonds fell under the scope of 'possessions', as stipulated in Article 1 of Protocol No 1 of the ECHR. The court has traditionally relied on a very broad interpretation of what constitutes a possession, subsuming under the term all types of rights *ex contractu* and rights *in rem*.[211]

Second, the ECtHR concluded that the insertion of CACs was what saved Greece from defaulting on its sovereign debt. Crucially, the CACs empowered the bondholders to decide whether the government's restructuring offer was 'fair' and 'proportionate'. They had the last

[208] See above 3.3.3.2. for a discussion of the risk that the ECB may become an involuntary holdout. Also compare for an overview of the debate Sebastian Grund and Filip Grle, 'The European Central Bank's Public Sector Purchase Programme (PSPP), the Prohibition of Monetary Financing and Sovereign Debt Restructuring Scenarios' (2016) 41(6) European Law Review 781.

[209] See, eg, *James and ors v United Kingdom*, Merits, App No 8793/79, Case No 3/1984/75/119, A/98, IHRL 55 (ECHR 1986), [1986] ECHR 2, (1986) 8 EHRR 123, [1986] RVR 139, (1987) 75 ILR 396, 21st February 1986, European Court of Human Rights [ECHR].

[210] For an overview of the ECtHR's standard of review as regards property rights, see Aida Grgir, Zvonimir Mataga, Matija Longar and Ana Vilfan, 'The right to property under the European Convention on Human Rights' (2007) Human Rights Handbooks of the European Council No 10 <https://rm.coe.int/168007ff5> accessed 29 July 2018.

[211] See, eg, *Bramelid and Malmström v Sweden*, Admissibility, App No 8588/79, App No 8589/79, (1982) 29 DR 76, [1982] ECHR 16, (1983) 5 EHRR 249, (1983) 5 EHRR CD278, (1986) 8 EHRR 116, 12th October 1982, European Commission on Human Rights (historical) [ECHR].

say, not the government. As a result, Greece's interference was not tantamount to a (total) depravation of the bondholders' property rights.[212]

Third, and most interestingly, the *Mamatas* judgement introduced a risk-based approach to the proportionality assessment. The court mirrored the element of sovereign credit risk in its legal assessment, arguing that the reduced market value also implied a reduced level of property right protection.[213] This approach markedly deviated from comparable cases, as courts have so far not taken account of the difference between the face value and the market value of a bond. Given that the vulture holdouts' business model relies on the arbitrage effects stemming from the difference between the securities' face value and their actual value[214], Europe's human rights courts took a clear stance against speculative practices in the context of sovereign financial distress.[215]

5.6. HOLDOUT ARBITRATION BEFORE THE ICSID

In this section, we look at the role of holdout arbitration during the Greek PSI. So far, only two applications[216] by Greek creditors were submitted to ICSID: one under the 1992 Cyprus-Greece BIT and the other one under the Greece-Slovakia BIT. The latter one, the *Poštová banka* v. *Hellenic Republic* arbitration, will be discussed in more detail due to its relevance for the future of investment arbitration in sovereign debt restructurings. In sum, Greece has signed 38 BITs, including BITs with Cyprus and Germany but excluding some important advanced economies.[217] Most existing Greek BITs[218] seemed to include sovereign debt in the

[212] The ECtHR held that Russia had deprived the bondholders of their rights during the debt restructuring of 1998*Malysh and ors v Russian Federation*, Admissibility, App No 30280/03, 11th February 2010, European Court of Human Rights [ECHR].

[213] A similar logic is for instance behind recent legislative initiatives to curb vulture holdout litigation, which limit the amount recoverable from the insolvent debtor state to the price paid by the claimant for the bond on the secondary market. See above 3.3.1. for a discussion of the Belgian law against vulture funds.

[214] See above 3.3.1. for a discussion of the vulture holdouts' business model.

[215] See for a further analysis of the judgement below in 6.1.5.

[216] Marfin Investment Group Holdings SA, Alexandros Bakatselos and others v Republic of Cyprus, ICSID Case No ARB/13/27, Notice of Dispute (23 January 2013) (not publicly available); Poštová banka as and Istrokapital SE v Greece, Award, ICSID Case No ARB/13/8, IIC 679 (2015), despatched 9th April 2015, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[217] Sandrock (n 32) 526. Greece has however not entered into BITs with the US or the UK Consequently, US based hedge funds that have a remarkable track record in litigating against bankrupt nations around the globe, are unlikely to initiate arbitral proceedings against Greece.

[218] Compare, eg, Article 1(1) Greek-Slovak BIT of 1991 <http://investmentpolicyhub.unctad.org/Download/TreatyFile/3515> accessed 2 February 2017, which states that 'investment' means every kind of asset and in particular,…c) loans, claims to money or to any performance under contract having a financial value. The Chinese-Greek BIT for instance uses exactly the same definition of 'investment' see Chinese-Greek BIT of 1992 <http://investmentpolicyhub.unctad.org/Download/TreatyFile/738> accessed 2 February 2017.

definition of 'protected investment'. Thus, following the creditor-friendly interpretation of the Washington Convention in the wake of Argentina's default, it was expectable that holdouts would also have recourse to the ICSID following the Greek PSI.

5.6.1. Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic[219]

The main claimant in this case was a Slovak Bank (Poštová banka); the Hellenic Republic (Greece) was the respondent. The claimant asserted that Greece's retroactive implementation of CACs had resulted in a significant erosion of the value of their investment in Greek government bonds. As a legal basis for their action, the claimant referred to the Greece-Slovakia BIT, the Cyprus-Greece BIT as well as the ICSID Convention.[220] The request for arbitration was made in May 2013 and the ICSID tribunal was constituted on 21 October 2013.[221] The ICSID rendered its decision on 9 April 2015.

The bonds at stake belonged to five series of Greek government bonds, all of which governed by Greek law and had not contained CACs at the time of issuance.[222] Poštová banka had acquired its interest in Greek government securities on the secondary market in early 2010, thus after the government revealed its formidable budget deficit of more than 12%.[223] Given the arguably speculative nature of such investment, the claimant's strategy to some degree resembled that of a vulture holdout.[224]

The tribunal focused in its decision on its jurisdiction *ratione materiae* according to the BIT and the ICSID Convention. Poštová banka argued that the Greece-Slovakia BIT encompassed sovereign bonds[225] in its definition of investment, and that the rights to that bond were taken

[219] *Poštová banka as and Istrokapital SE v Greece*, Award, ICSID Case No ARB/13/8, IIC 679 (2015), despatched 9th April 2015, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[220] ibid [1-4].

[221] ibid [17].

[222] ibid [51-58].

[223] ibid [51]. This suggests some speculative behaviour on Poštová banka's side as the bonds' rating was already much lower than a year before and the spread to other European government bonds had risen to significant levels.

[224] At the same time, in contrast to most vulture funds, the Slovak retail bank Poštová banka was not located in a tax-haven, had no track record in holdout litigation or arbitration, and had no specific legal or economic expertise in the field of sovereign debt. Also see above 3.3.1. on the definition of 'vulture holdouts'.

[225] It was also disputed between the parties whether or not the purchase on the secondary market had an impact on the tribunal's jurisdiction due to the lack of a direct contractual relationship. Moreover, the respondent asserted that the tribunal lacks jurisdiction *ratione personae.* See ibid [134]. Also compare for an overview of all of Greece's arguments against the jurisdiction in Jonathan Chevry, '*Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic*, ICSID Case No ARB/13/8 (Poštová banka v. Greece)' (2016) 15 World Trade Review 169, 171.

away by Greece's 'forced surrender of the bonds'.[226] Greece rejected such broad reading of the BIT. It held argued that neither the Greece-Slovakia BIT nor the Cyprus-Greece BIT expressly included sovereign debt instruments.[227]

The tribunal then reviewed the legal merits of the respective positions.

On the definition of investment, the ICSID tribunal noted that the examples of 'investment' provided by the Greece-Slovakia BIT[228] must be interpreted narrowly. Otherwise, the list of protected investments laid down in Article 1 of the BIT would be 'unnecessary, redundant or useless'. [229] This stood in contrast to the *Abaclat*[230] arbitration, where the underlying BIT between Italy and Argentina expressly included government bonds in the definition of 'investment'.[231] In addition, the tribunal found that there was no contractual privity between the claimant and the defendant. Thus, Poštová banka's investment could also not be subsumed under the definition of a 'loan' in the BIT.[232] Consequently, the tribunal refrained from further assessing whether the investment would fall into Article 25 of the ICSID Convention, merely stating that 'this is a controversy that this Tribunal does not need to resolve.'[233]

In sum thus, the tribunal rejected its jurisdiction *ratione materiae*. In September 2016, the tribunal rejected an annulment procedure, initiated by the claimant under Article 52(3) of the ICSID Convention.[234] The high threshold for annulment under Article 52(1)(e) of the ICSID

[226] *Poštová banka as and Istrokapital SE v Greece*, Award, ICSID Case No ARB/13/8, IIC 679 (2015), despatched 9th April 2015, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [127].

[227] ibid.

[228] Article 1 of the Slovakia-Greece BIT comprised a (non-exhaustive) list of what rights are to be considered an 'investment': 'the definition of 'investment' contained 'every kind of asset and in particular, though not exclusively, […] (c) loans, claims to money or to any performance under contract having a financial value'.

[229] *Poštová banka as and Istrokapital SE v Greece*, Award, ICSID Case No ARB/13/8, IIC 679 (2015), despatched 9th April 2015, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [276].

[230] *Abaclat and ors v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[231] ibid [304]. The tribunal opined that '[t]he language in the Slovakia-Greece BIT'[…] is significantly different from the one that led the *Abaclat* and *Ambiente Ufficio* tribunals to conclude that government bonds were investments under the Argentina-Italy BIT.'

[232] ibid [339].

[233] ibid [359] [adding that '[t]he Tribunal has considered both approaches, but does not need to choose between the "objective" approach, which would give the term "investment" an inherent meaning, and a "subjective" approach based on the will of State parties, as expressed in the BIT.'].

[234] *Poštová banka as and Istrokapital SE v Greece*, Decision on Poštová Banka's Application For Partial Annulment Of The Award, ICSID Case No ARB/13/8, IIC 679 (2015), despatched 29 September 2016, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

Convention was not satisfied, especially because the legal reasoning of the tribunal was 'not fundamentally contradictory'.[235]

5.6.2. Analysis

Similar to the *Abaclat*[236] and *Ambiente Ufficio*[237] decision, the *Poštová banka*[238] arbitration focused on the interpretation of 'investment' under the applicable rules of international investment law. However, *Poštová banka* marked a return to a more restrictive interpretation of sovereign debt instruments under international investment law. Tellingly, it concluded that '[r]isk is inherent in life and cannot per se qualify what is an investment.'[239]

More specifically, the *Poštová banka* tribunal saw no scope to subsume Greek government bonds under the definition of 'loans' in the applicable BIT. One could however critically ask whether this reading also reflected the spirit of the Greece-Slovakia BIT. After all, the treaty was signed in 1991 when bonds had only started to replace loans as the public debt instrument of choice for Treasuries around the globe.[240] Put differently, it may well be the case that the drafters of the Greece-Slovakia BIT had intended to protect holders of government debt; they just had not anticipated the evolution of government debt markets.[241] To that end, the ICSID tribunal could have investigated the *telos* of the treaty and elaborated on the legal specificities on instruments of sovereign indebtedness.

Instead, the *Poštová banka* tribunal opted for a strict textual interpretation of the BIT. It justified this standpoint by highlighting differences between the Greece-Slovakia BIT and the Italy-Argentina BIT; the latter had explicitly referred to '*public* titles/obligations' as protected investment.[242]

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[235] ibid [160].

[236] *Abaclat and ors v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[237] *Ambiente Ufficio SpA v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/08/9, IIC 576 (2013), 8th February 2013, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[238] *Poštová banka as and Istrokapital SE v Greece*, Award, ICSID Case No ARB/13/8, IIC 679 (2015), despatched 9th April 2015, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

[239] ibid [367].

[240] See above 1.3.1.

[241] Historical OECD data on Greek sovereign bonds is only available until 1998, indicating that Greece had no outstanding bonds at the time of the conclusion of the Slovakia-Greece BIT; see OECD, 'Main Economic Indicators - complete database' (2015) <http://dx.doi.org/10.1787/data-00052-en> accessed 15 August 2017.

[242] *Poštová banka as and Istrokapital SE v Greece*, Award, ICSID Case No ARB/13/8, IIC 679 (2015), despatched 9th April 2015, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [331-333]. See for the text of the Italy-Argentina BIT in *Ambiente Ufficio SpA v Argentina*, Decision on jurisdiction and

The tribunal also denied the existence of a contractual relationship between the claimant and the defendant, which the Greece-Slovakia BIT required.[243] While the claimant held an *in rem* title against Greece, she had no contractual relationship with the sovereign issuer – such relationship only existed between Greece and the agents that distributed the bonds on the secondary market.[244]

Regarding the definition of investment under Article 25 of the Washington Convention, the tribunal held that sovereign bonds need to make a substantial contribution to the host state's economy in order to fall under the ICSID Convention.[245] As Montanaro states, '[t]his conception of the 'substantial contribution' requirement differs radically from that in *Ambiente Ufficio*, where the majority decision did not link the contribution to a productive activity.'[246] In that sense, the *Poštová banka* tribunal revived the *Salini* test, which required investors to 'make a substantial contribution to a specific project in the host state'.[247]

Overall, the post-PSI arbitration seemingly limited investors' rights under international investment law related to sovereign bond default.[248] This obvious renunciation from the Argentine arbitration cases puzzled some commentators.[249] While, from a policy perspective, the decision should be supported, the ICSID decision failed to properly explain why it refused to apply the legal reasoning of the *Abaclat*[250] and the *Ambiente Ufficio*[251] tribunals in

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admissibility, ICSID Case No ARB/08/9, IIC 576 (2013), 8th February 2013, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

243 The text of Article 1(1)(c) of the Slovakia-Greece BIT considers as an investment 'claims to money or to any performance *under contract having a financial value*' (emphasis added); *Poštová banka as and Istrokapital SE v Greece*, Award, ICSID Case No ARB/13/8, IIC 679 (2015), despatched 9th April 2015, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [343].

244 Note that the exact nature of the relationship between bondholders and the issuer is controversial in the pertinent literature. See, eg, Edwin Borchard and Justus S. Hotchkiss, *State Insolvency and Foreign Bondholders: General Principles* (New Haven: Yale University Press, 1951) 23; Marcel Kahan, 'Rethinking Corporate Bonds: The Trade-Off Between Individual and Collective Rights' (2002) 77 New York University Law Review 1040.

245 *Poštová banka as and Istrokapital SE v Greece*, Award, ICSID Case No ARB/13/8, IIC 679 (2015), despatched 9th April 2015, World Bank; International Centre for Settlement of Investment Disputes [ICSID] [371].

246 Francesco Montanaro, 'Case Comment *Poštová Banka SA and Istrokapital SE v Hellenic Republic* – Sovereign Bonds and the Puzzling Definition of 'Investment' in International Investment Law' (2015) 30(3) ICSID Review 549, 554.

247 *Salini Costruttori SpA and Italstrade SpA v Morocco,* Decision on jurisdiction, ICSID Case No ARB/00/4, IIC 206 (2001), (2004) 6 ICSID Rep 398, (2003) 42 ILM 609, (2002) 129 Clunet 196, 16th July 2001, despatched 23rd July 2001, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

248 The fact that Argentina ultimately settled with Italian bondholders who obtained ICSID awards showed that arbitration can serve as a powerful avenue for indirect sovereign debt enforcement.

249 See, eg, Kei Nakajima, 'Parallel Universes of Investment Protection? A Divergent Finding on the Definition of Investment in the ICSID Arbitration on Greek Sovereign Debts' (2017) 15(3) The Law & Practice of International Courts and Tribunals 472 and Montanaro (n 246).

250 *Abaclat and ors v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/07/5, IIC 504 (2011), despatched 4th August 2011, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

Greece. Indeed, increasing divergence in ICSID decisions relating to sovereign bond restructurings after Argentina and Greece elevates the level of legal uncertainty, especially if different tests are applied to the same factual problems. Going forward, ICSID tribunals should consistently promote the *Salini* criteria when it comes to sovereign bond investments – this would reduce incentives to hold out but also strengthen the ICSID's role in promoting development.

5.7. CHAPTER CONCLUSIONS

This chapter reviewed the Greek debt restructuring of 2012 and its legal aftermath. In particular, we focused on holdout creditor problems.

First, we zoomed in on the Greek debt crisis, which started in late 2009. The new government had shocked financial markets and the European official sector by announcing a budget deficit north of 12% of GDP, thereby breaching the EU's fiscal rules by a wide margin. Between 2009 and 2012, the Greek debt situation deteriorated at a breakneck pace and the debt-to-GDP ratio reached roughly 180%. The European official sector, together with the IMF, decided to grant financial assistance to Greece. However, the official sector did not insist on an upfront private sector debt restructuring: the fear of uncontrollable contagion within the euro area paralysed policymakers. A political divide between France and Germany, and a technocratic divide between the ECB and the IMF, delayed the inevitable by at least two years.

Second, we analysed the Greek PSI of 2012, on which policymakers finally agreed in late 2011. The PSI marked the largest government debt restructuring operation in history, involving claims with a face value of more than EUR200 billion. Overall, the Greek government imposed a haircut of approximately 53.5% on private bondholders. Though the transactional obstacles loomed large, the Greek government enjoyed what is commonly referred to as the 'local law advantage'. In contrast to Argentina, a large share (93%) of its government bonds were subject to local or domestic rather than foreign law.

To ensure the success of the PSI, the Greek government retroactively introduced contractual mechanisms that bound a minority of (potential) holdouts to a majority-approved

[251] *Ambiente Ufficio SpA v Argentina*, Decision on jurisdiction and admissibility, ICSID Case No ARB/08/9, IIC 576 (2013), 8th February 2013, World Bank; International Centre for Settlement of Investment Disputes [ICSID].

restructuring. This CAC Retrofit was achieved through the implementation of a Greek budget law, the Greek Bondholder Act (GBA, for short). This law essentially amended the contractual terms by inserting a CAC in each single security. The retrofitted clauses featured a 66 2/3% voting threshold and were fully aggregated. This meant that the modification of *all* outstanding series was decided in a single vote by investors instead of a series-by-series vote. Ultimately, more than 90% of all investors asked to vote approved the proposed bond modifications, resulting in a closure of the debt workout.

Greece nonetheless suffered from holdout creditor problems in three dimensions.

First, holdout creditors, most of were retail holdouts, challenged the GBA in foreign, domestic and European courts. This resulted in numerous judgements, the most important of which were covered in this chapter. Overall, these *ex post* holdout creditors remained unsuccessful. Ultimately, the jurisdiction of German and Austrian courts was declined under the pertinent EU rules. This left investors with the option of pursuing local remedies – records show that thousands of holdouts took that path. Greek national courts threw out their claims and ruled that the CAC Retrofit was constitutional. Concluding the domestic litigation, the ECtHR held that Greece had appropriately balanced the creditors' property rights with the public interest in carrying out a government debt restructuring.

Second, vulture holdouts targeted foreign law bonds and blocked the proposed modifications for 17 of 36 series of English law securities. While these bonds featured CACs, they belonged to the first generation of CACs. In contrast to the clauses that were retrofitted to local law bonds, the English law CACs required a separate investor vote in each series of outstanding bonds. Aware of this vulnerability, a number of vulture holdouts undertook to purchase blocking minorities in smaller bond series and obstructed their modification. The Greek government, mindful of holdout litigation risks, reluctantly paid these creditors in full. Thereby, it *de facto* subordinated domestic law instruments to those governed by foreign laws.

Third, at least one holdout investor challenged the PSI for allegedly violating the Slovakia-Greece BIT before the ICSID. In contrast to the Argentine holdout arbitration[252], the ICSID tribunal rejected the applicant's claim. The tribunal essentially held that the applicable BIT did not qualify sovereign bonds as investments.

[252] See above 4.9. for an overview of the Argentine bondholder arbitration.

Overall, domestic, European, and international courts vindicated the Greek debt restructuring and the strategy of retrofitting a CAC to local law securities. However, akin to Argentina, fighting off holdouts had a cost. For one, Greece paid several vulture holdouts that had acquired foreign law bonds in full, thereby encouraging similar speculative holdout strategies in future sovereign debt workouts. For another, the CAC Retrofit, as useful as it might have been to bring about a quick and clean restructuring, was a one-off strategy. Since the PSI of 2012, Greece has not been able to place domestic law bonds on the primary market. It has exclusively issued foreign law bonds, the holders of which are evidently better protected in possible future debt crises.

In the subsequent chapter, we compare the outcomes of holdout litigation and arbitration in the Argentine and the Greek debt restructurings, respectively. We distil commonalities as well as differences to make a number of policy recommendations at the end of chapter 6.

6. WALKING BACK FROM ARGENTINA AND GREECE: HOW TO RESOLVE THE HOLDOUT PROBLEM?

'[S]overeign debt is a complex political institution, which cannot be reduced to creditor coordination or any other contract problem.'

–Anna Gelpern (2017)[1]

Because of irreconcilable political and economic interests, states have failed to implement policies and laws that satisfactorily balance creditor and debtor rights and interests in the event of sovereign default. Many scholars lament that the failure to regulate sovereign insolvency effectively has weakened the international financial architecture.[2] Specifically, the absence of a sovereign debt workout mechanism has, in their view, harmed inter creditor equality, upset financial markets and – most importantly – caused great human anguish in the debtor state.[3]

The holdout creditor problem, albeit not being the sole source of chaos, elucidated the inherent vulnerability of the *ad hoc* approach to government debt restructurings. In this context, the Argentine and the Greek debt crises serve as powerful cautionary tales. As this thesis shows, the *ad hoc* system has nurtured unfair and economically illogical outcomes for most stakeholders involved. Crucially, a system in which a few holdouts can push a country to the brink of default seems questionable at best and troubling at worst.

The aim of chapter 6 is to advance some modest proposals aimed at eliminating, or at least mitigating, the holdout creditor problem. In order to take account of the legal, economic, and political specificities that characterise government debt issued in different jurisdictions and under different laws, we propose two separate frameworks: one applicable to the international

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[1] Anna Gelpern, 'The Strained Marriage of Public Debts and Private Contracts' (2018) 117(795) Current History 22.

[2] For a recent critique, see Martin Guzman, Jose Antonio Ocampo and Joseph Stieglitz (eds), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (New York: Columbia University Press, 2016).

[3] See Anne Krueger, *A New Approach to Sovereign Debt Restructuring* (Washington, D.C.: IMF, 2002). Compare, however, former US Treasury Secretary John Snow's response to proposals by IMF to introduce a debt restructuring mechanism for states, who made his repulsion more than clear, rendering a market-based approach the only viable option to resolve sovereign debt crises; John Snow, 'Statement by Secretary John W. Snow, United States Treasury' (Meeting of the International Monetary and Financial Committee, Washington D.C., 12 April 2003) <https://www.imf.org/external/spring/2003/imfc/state/eng/usa.htm> accessed 31 October 2017.

sovereign bond market and the other one for debt issued by euro area governments. Two considerations motivate this dichotomy:

- First, the international sovereign bond market is characterised by a relatively high degree of contractual standardisation and boilerplate language. Moreover, New York and English law govern the vast majority of outstanding international sovereign bonds.[4] Therefore, credible and effective mechanisms to curtail holdout litigation should target weaknesses in standard bond documentation under these two jurisdictions. Of course, far-reaching changes to the legal structure of this market should remain a long-term objective of policymakers. At the current juncture, however, the political apathy to sweeping reform leaves little scope for solutions rooted in international law. Thus, we advocate that smart improvements to the contractual framework for international sovereign bonds might be the only and best option to eliminate some of the holdout inefficiencies that this thesis has highlighted.[5]
- Second, the domestic law of the issuer typically governs euro area sovereign bonds. This means that insolvent countries enjoy the local law advantage, making them less vulnerable to holdouts.[6] At the same time, the legal framework for restructuring euro area sovereign debt is underdeveloped, ambiguous, and opaque. In order to make the current crisis management framework under the ESM more resilient, and to make credible and effective restructurings a realistic policy options when debt becomes unsustainable, we propose a set of revised EU rules on sovereign debt. The unprecedented degree of financial, political, and economic integration and convergence within the currency area should allow for a more progressive approach to resolving deep public debt crises than on the international level. Crucially, rather than needing to rely on new international law instruments, the euro area could resort to EU law or the ESM Treaty, an international treaty, to bring about meaningful changes to the debt restructuring framework. What changes may be considered is further discussed below.

Ultimately, to inform the sovereign debt reform agenda, this chapter strives to make normative propositions that take due account of the political economy obstacles swirling

[4] See above 1.2.5. for a discussion of the governing law of international sovereign bonds.
[5] See above chapter 4.
[6] See above chapter 5.

around in the sovereign debt universe. While most of the proposals set forth in this study are not entirely new, they integrate the lessons from recent jurisprudence into the ongoing dialogue in the academic as well as the policy literature.

6.1. JUXTAPOSING ARGENTINA AND GREECE

Before discussing solutions, we take stock of the outcomes of holdout litigation and arbitration relating to the two debt restructurings covered in this study. Complementing chapters 4 and 5, this section focuses on the most important and most contentious legal questions[7] that these cases touched upon. We zoom in on the following aspects (i) the relevance of contracts and statutes, respectively, as the basis for a debt instrument, (ii) the relevance of governing law(s), (iii) the sovereign immunity conundrum, (iv) the issue of jurisdiction, (v) and the protection of bondholders' property rights.

We argue that seemingly integrated and harmonised sovereign bond markets starts to look oddly fragmented once courts in different jurisdiction get involved. This holds true both on the international level as well as in the euro area. Holdouts have in the past – and will in the future – exploit the regulatory shortcomings and legal loopholes in the sovereign debt market. Unfortunately, as we have shown in chapters 4 and 5, some judicial authorities have become complicit in this endeavour.

6.1.1. CONTRACT V. STATUTE

As Audit points out, sovereign bonds may rely on a contractual structure or a (national) law, decree, or order.[8] A few highly developed states, which are typically referred to as 'elite sovereigns', are so creditworthy that they can essentially rely on domestic statutes as the legal basis for their sovereign bonds. While the legal bond between the issuer and its creditors still resembles a contractual relationship, there is often no bond documentation.

Rather than a 300-page bond prospectus, some elite issuers rely on cursory budget laws that authorise their finance ministries to issue instruments that have more resemblance with IOUs

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[7] Of course, sometimes the two categories overlap to some degree, as discussed later below; see 6.1.2.

[8] See Matthias Audit, 'Sovereign Bonds by Law: Can a State Debt be Non-Contractual?' (Presentation at the Interdisciplinary Sovereign Debt Research and Management Conference, Geneva, 5-6 October 2017) <https://www.dropbox.com/s/5wv34c4cxz0u8sj/3C_Matthias%20Audit_Debtcon2%20-%20Non%20contractual%20state%20debt%20%206%20oct%202017.%20V3%20pptx.pdf?dl=0> accessed 20 June 2018. A similar study was carried out by Gulati and Triantis; see Mitu Gulati and George Triantis, 'Contracts Without Law: Sovereign Versus Corporate Debt' (2007) 75 University of Cincinnati Law Review 977.

than modern debt securities. Greece, at least up until the implementation of the PSI, belonged to this group of elite sovereigns: it issued its sovereign bonds based on a statute, the Greek law 2198/1994. This meant that the Greek bonds subject to the 2012 PSI did not feature any of the standard contract provisions used in international sovereign bonds, ranging from negative pledge clauses, sovereign immunity waivers, choice-of-forum provisions to definitions of default, acceleration clauses, and – most notably – CACs.

Conversely, the FAA of 1994 that governed Argentina's bonds relied on standard boilerplate language. It featured several contractual clauses tailored to protect the creditors' interests. Some of these contractual provisions, such as the *pari passu* clause, allowed vulture funds to exert considerable pressure on the government to settle for an exclusive deal. Moreover, broad sovereign immunity waivers in these bonds helped the TFA, which represented thousands of retail holdouts, to threaten the attachment of Argentine assets by virtue of ICSID awards. Ultimately, retail and vulture holdouts succeeded when Argentina's newly elected government settled all outstanding claims in early 2016.[9]

As the Greek PSI showed, the fact that sovereign debt can be non-contractual can have legal implications.

First, in none of the post-PSI litigation could holdout creditors successfully invoke contractual provisions. Rather, their only claim was that their right to be repaid in full and on time was violated by the CAC Retrofit. As Audit points out, if states rely on laws, decrees, or orders to define their own and the investors' rights and obligations, there is a higher risk that these rights and obligation are amended unilaterally and retroactively by the issuer's Parliament.[10] Indeed, by refraining from *ex ante* committing to treating bondholders in a certain way, the issuer retains maximum flexibility should a debt restructuring become necessary.

This leads us to a second important issue, which Carletti et al touch upon[11]. They argue that 'although in theory it is still possible for a local government to change its law and disregard

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[9] Of course, it is also recalled that in some (European) countries, courts had no inclination to entertain the vultures' claims for repayment and refused to pass judgements against Argentina that could have been used to attach assets located there. Here, the Italian and the French courts should be mentioned in particular. See above 4.5. for Italy and 4.6. for France.

[10] Audit (n 8) 10.

[11] Elena Carletti, Paolo Colla, Mitu Gulati, and Steven Ongena, 'The Price of Law: The Case of Eurozone Collective Action Clauses' (2017) SFI Working Paper N°17-35 <http://sfi.ch/node/883??doc=5941> accessed 25 June 2018.

contract terms, reneging on the CAC provisions is likely to be more difficult, from a legal perspective, than defaulting on bonds without CACs as this would clearly violate investors' expectations'.[12] However, one could also say that it is irrelevant for the holdouts' potential success in certain jurisdictions if a bond features CACs or not. What arguably matters is whether the instrument is statute-based or contract-based.[13] Both theories are difficult to prove, as the body of case law is paltry.

What holdout litigation in German courts showed, however, is that judges pay close attention to the legal basis of a government bond.[14] The BGH for instance referred to the Greek law 2198/1994 and the GBA of 2012 several times[15] to describe the legal nature of the Greek bonds and assess Greece's immunity from suit.[16] The exact content of the Greek statutes, for example whether the bond contained a CAC, was largely irrelevant, especially at the early stages of the trial. While the issue is closely related to the role of governing law[17], the fact that there may be important legal differences between the restructuring of non-contractual and contractual sovereign debt, especially in the euro area, should deserve closer attention by scholarship.

Of course, for Argentina and its creditors, the 'contract v. statute' distinction was of lesser relevance: all of the bonds it restructured were contract-based and foreign law governed. Courts in New York City, and to some extent those in England, made their commitment to enforcing *contractual* provisions, letter by letter, very clear. They refrained from further investigating the legal basis of the Argentine sovereign bonds under Argentina's domestic laws – and, given the existence of a contract, they did not have to. Looking ahead, markets might start to pressure certain (former) elite issuers into moving away from statute-based

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[12] Of course, it should not be forgotten that the Greek bonds that included CACs, namely 36 series of foreign law, were not restructured successfully. See above 5.3.4.

[13] For a discussion of the issue, see, eg, for a discussion Sebastian Grund, 'Restructuring government debt under local law: the Greek case and implications for investor protection in Europe' (2017) 12(2) Capital Markets Law Journal 253.

[14] See above 5.4.2.

[15] See for a discussion of the Greek laws above 5.3.3.

[16] The CJEU, in the *Fahnenbrock* case, seemed to deviate a bit from this concept by stating that the CAC Retrofit 'confirms the intention of the Greek State to keep the management of the bonds within a regulatory framework of a civil nature'. See *Fahnenbrock and ors v Greece*, Judgment, reference for a preliminary ruling, Case C-226/13, Case C-245/13, Case C-247/13, Case C-578/13, ECLI:EU:C:2015:383, [2015] OJ C270/2, 11th June 2015, Court of Justice of the European Union [CJEU]; European Court of Justice [ECJ]; European Court of Justice (1st Chamber) [57].

[17] See, eg, Lee Buchheit, 'Use of the Local Law Advantage in the Restructuring of European Sovereign Bonds' (9 April 2018) unpublished manuscript <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3159665> accessed 24 June 2018. Also see below 6.1.2.

towards contract-based sovereign debt. Indeed, as discussed above[18], Greece has exclusively issued contract-based (foreign law) bonds after the PSI to keep its borrowing costs under control. In revealing the uncomfortable truth that a contractual scaffolding can provide more protection to bondholders than a statute-based instrument, holdout creditor litigation could have a lasting effect on the legal structure of sovereign bond markets, especially in Europe.

6.1.2. THE ROLE OF GOVERNING LAW(S)

The perhaps most important question of sovereign debt management and restructuring relates to the law governing a given bond. In this regard, one can broadly distinguish between external and domestic sovereign debt.[19] External or foreign law bonds take away the issuer's power to alter repayment obligations unilaterally while domestic law instruments bestow ample legal power upon the sovereign debtor in a crisis.[20] The Argentine and the Greek debt restructuring have confirmed both assumptions.[21]

Before further discussing the specific role of governing law in the two debt restructurings, it is useful to delineate the boundaries between the 'contract v. statute' discussion[22] and the one on governing law.[23] The vast majority of bonds issued by elite issuers are statute-based and governed by the issuer's own laws.[24] For non-elite sovereigns the situation is different. They mostly use contract-based bonds that are typically governed by external law. However, there is no strict rule and sovereigns are free to choose whatever combination of different legal variables (statute/contract/governing law/listing location). For example, Italy and Austria, two elite issuers, use contract-based bonds governed by domestic law bonds in addition to their statute-based bonds.[25] With this strategy, elite issuers seek to attract an even wider audience of domestic *and* foreign investors.[26]

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[18] See above 5.3.4.
[19] See above 1.4.
[20] See above 1.2.5.
[21] See, in particular, above 4.3. and 4.4.
[22] See the previous section, 6.1.1.
[23] Carletti et al (n 11).
[24] Audit (n 8) 7 (citing the example of French sovereign bonds, where the state's obligations are set out by a governmental decree).
[25] See for Italy: The Republic of Italy, 'USD2,000,000,000, 5.375% Notes due 2017' (2007) Prospectus Supplement to Prospectus dated 18 January 2006 <https://www.bourse.lu/security/US465410BS63/115975> accessed 24 June 2018. For Austria, see, eg, The Republic of Austria, 'EUR 30,000,000 Medium Term Note Programme for the issue of Notes from 7 days to 70 years from the date of issue' (19 December 2012) Offering Circular <https://www.bourse.lu/security/US052591AT11/83620> accessed 2 June 2018.
[26] See, eg, Jeromin Zettelmeyer, Christoph Trebesch and Mitu Gulati, 'The Greek debt restructuring: an autopsy' (2013) 29 Economic Policy 513, 539 (noting that 'Greek-law bondholders who had just experienced the

Looking at the two cases studies, it becomes clear that governing laws were crucial in determining the success of holdouts. Argentina had a debt management strategy throughout the 1990s that was common among emerging market issuers. It sought to reap the full benefits of financial globalisation.[27] The Argentine government went on international roadshows, waived its immunity from suit and enforcement, and agreed to have disputes settled in foreign courts. And indeed, many *foreign* courts stood ready to enforce contracts against Argentina. By contrast, Argentina's *domestic* courts were reluctant to undermine the decisions of its legislative and executive branch at the height of the economic crisis of the early 2000s.

Thousands of retail and vulture holdouts lined up in foreign courts to sue the defaulted sovereign until a new government bent to their demands for full repayment.[28] Of course, some courts accepted public policy defences[29] or constrained the attachment of Argentine assets in their respective jurisdictions.[30] But this was not foreseeable. Gradually, we have come to realise that the decade-long meddling of litigious holdouts resulted in a marked development of both domestic and public law. The two debt crises forced jurisdictions with very different legal customs and traditions to respond to the same factual situation: namely, the breach of a sovereign bond contract (or statute, in the case of Greece).

Absent well-established customary law or international treaties, the level of judicial cross-fertilisation remained relatively low. Courts in several countries, notably France, Italy, and Germany, seemed opposed to the idea of taking into account the substantial body of case law on sovereign bond litigation in (Anglo-Saxon) jurisdictions, such as England or New York. Instead, they entertained hitherto unconventional interpretations of sovereign immunity to fend off holdout investors. As stated above, while this may have served laudable public policy objective, several judgements rest on a shaky legal foundation that arguably undermines the courts' authority. This put pressure on the legislatures to respond to holdout problems. And indeed, France, Belgium and the UK did respond.[31]

power of the local legislature to change contract provisions retroactively would find some comfort in the fact that English law bonds would preclude a change of their contractual rights through legislative fiat').

[27] See above 4.2.2.

[28] See, eg, Juan Cruces and Tim Samples, 'Settling Sovereign Debt's 'Trial of the Century' (2016) 31 Emory International Law Review 5.

[29] See above 4.5.

[30] See, eg, the French courts' broad interpretation of enforcement immunity above 4.7.

[31] See above 5.3.3. and 5.3.4.

For Greece, the role of governing law became particularly obvious with regard to the divergent treatment of local and foreign law bonds. Of course, Greece opted for a less confrontational approach in handling the demands of vulture holdouts than Argentina. Still, it faced the same conundrum: the threat that foreign courts, or investment arbitration tribunals for that matter, would issue orders in the holdouts' favour – orders that could be executed against the debtor or resulted in a *de facto* exclusion from international credit markets for a sustained period. However, as also discussed before, with respect to its domestic law bonds, Greece treaded less carefully and fully capitalised on the 'local law advantage'.[32]

6.1.3. Sovereign Immunity – Quo Vadis?

The principle of sovereign immunity remains the central legal doctrine in the context of sovereign debt management and restructuring.[33] Sovereign immunity is a corollary of the fundamental principle of international law: *par in parem non habet imperium*. In both debt restructurings analysed herein, the immunity from suit as well as enforcement[34] posed considerable obstacles to the enforcement of holdouts' monetary claims.

Nonetheless, a closer look at the judgements rendered by courts around the globe in the wake of the Greek and the Argentine restructurings reveals a remarkable evolution of the traditional understanding of the immunity doctrine in the realm of international finance. While the judicial review of Argentina's approach to resolving its debt crisis culminated in a complete erosion of sovereign immunity, the measures taken by the Greek state were widely considered immune from holdout litigation. The rest of this section assesses whether the stark contrast between the two debt crises was justified in light of the legal features of the respective debt workouts.

First, in contrast to securities issued by Argentina, Greek government bonds exchanged as part of the PSI did not include sovereign immunity waivers. This was largely because the Greek bonds were statute-based and domestic law governed while Argentina's debt instruments featured the typical legal characteristics of external sovereign debt: governed by foreign law and denominated in a foreign currency.[35] Thus, when adjudicating holdout disputes, foreign courts had to assess Greece's immunity on the basis of (customary)

[32] Buchheit (n 17).
[33] See above 1.4. for an analysis of the law of sovereign immunity in the context of sovereign finance.
[34] See above 1.4.3.2. and 1.4.3.3., respectively.
[35] See above 6.1.2.

international law. In contrast to the US and the UK, where a number of seminal judgements in the 1980s and 1990s delineated the scope of state immunity, German or Austrian courts had little experience in reconciling the immunity of states with creditors' enforcement rights.[36]

Indeed, as the analysis of post-Greek holdout litigation underscores[37], judicial authorities struggled with the unique situation where an insolvent state had not surrendered its immunity from suit at the time of issuance. For instance, when the German BGH had to decide on the validity of holdout claims against Argentina, which had waived its immunity in line with standard market practice, it essentially followed US jurisprudence and granted money judgements to holdouts. However, in its decisions relating to Greek bondholder claims, the BGH did not make a single reference to the Argentina case and refuted the plaintiffs' case on the grounds of sovereign immunity.[38] By contrast, Austrian courts adopted a much narrower interpretation of sovereign immunity, arguing that *acta iure gestionis* may not *ex post* become protected from suit by virtue of sovereign intervention.

Both outcomes appear extreme. Bestowing upon Greece absolute immunity ignores the fact that the issuance of sovereign bonds is indeed considered an act *iure gestionis*, as for instance reflected in Article 10 UNCSI.[39] Rather than capitalising on the rare opportunity to clarify the relationship between commercial and sovereign acts in the context of sovereign debt restructuring measures under German law, the BGH advanced a very simplistic view that enjoyed little backing in scholarship or case law. The Austrian OGH, too, failed to assess the 'mixed activity conundrum' convincingly, let alone the question how it may be resolved. Given that the BGH rendered its first decision on Greek bondholder before the OGH, and in light of a long-standing tradition to cite German judicial authorities, the OGH could have explained why, other than the BGH and two German Courts of Appeals[40], it considered *ex post* legislative amendments to Greek bonds irrelevant for the immunity test. Yet another

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[36] For an overview of these early holdout litigation cases in US courts, see above 3.5.

[37] See above 5.4.

[38] It was telling, in this context, that the German BGH made not a single reference to its decision on Argentina's bonds, which it rendered just two years before. Given the infrequent nature of sovereign defaults, and the absence of case law on debt restructurings in Germany, it surprises that the BGH showed no inclination whatsoever to juxtapose the Argentine and the Greek case.

[39] Which states the following: '[i]f a State engages in a commercial transaction with a foreign natural or juridical person and, by virtue of the applicable rules of private international law, differences relating to the commercial transaction fall within the jurisdiction of a court of another State, the State cannot invoke immunity from that jurisdiction in a proceeding arising out of that commercial transaction.'

[40] See above 5.4.1.

unconventional view on the 'mixed activity conundrum' was offered by the Italian *Corte di Cassazione*, which considered it legitimate for Argentina to impose a debt moratorium on foreign bondholders on the basis of its citizens' human rights.[41]

A common feature in bondholder suits against Greece and Argentina was that several judgements referred to the UNCSI as reflecting customary international law. At the same time, the fact that the UNCSI had not yet entered into force, as well as the courts' disagreement regarding the interpretation of some core provisions in the UNCSI, meant that the legal relationship of sovereign immunity and sovereign debt has become even more ambiguous. One straightforward – though incomplete – explanation would be that holdouts compelled judiciaries around the globe to weigh in on legal questions that came with profound political and economic implications. Even if they had wanted to, courts could not rely on rules of substantive law under domestic statutes or international treaties.

Moreover, while the UNCSI could have served as an anchor for national courts, the French *Cour de Cassation*[42] as well as the *Corte di Cassazione*[43] deviated in such strong manner from the common reading of the UNCSI that the hope for a uniform approach to sovereign immunity quickly faded. As Audit notes, the solution found by the French Supreme Court is 'unworkable' going forward. In his view, French courts have 'tried to shut the doors to vulture holdouts regardless of their obligation to engage in proper legal reasoning'.[44] As stated above, while the policy objective of deterring holdout litigation may be laudable, it must not be attained at the expense of a sound legal reasoning that respects applicable rules of domestic and international law.

US courts, too, neglected crucial aspects of the sovereign immunity doctrine. In contrast to European courts, however, they did so with the goal of *supporting* the vulture holdouts' endeavours.[45] Notably, the SDNY's decision in *NML v. Argentina*[46], which was endorsed by the US Supreme Court, ignored pertinent rules of customary international law by equipping vulture holdouts with far-reaching injunctions against Argentina and its agents. With these injunctions, holdouts were able to circumvent the obstacles to attaching sovereign assets laid

[41] See above 4.5.
[42] See above 4.7.
[43] See above 4.5.
[44] See Matthias Audit, 'Sovereign bonds and national relativism: can New York law contracts safely cross the Atlantic?' (2014) 9(2) Capital Markets Law Journal 177, 188.
[45] Which was a strategy that worked in the holdouts' favour; see above 4.3.
[46] See above 4.3.3.

down in the FSIA and the UNCSI, thereby eventually pressing Argentina to settle on their terms. While neither the ILC Draft Articles[47] nor the UNCSI clarify the scope of injunctions in the context of sovereign debt enforcement, US courts did not attempt to analyse how injunctive legal remedies may interfere with well-established rules of state immunity or explain why they would not.[48]

Still, one should not just blame domestic judges for their attempts to insulate sovereigns from aggressive holdout litigation by reinterpreting the UNCSI. Equally, it would be too easy to fault only them for entertaining adventurous legal remedies that allow some market actors to make astronomic profits. Ultimately, it is up to the legislative and executive branches at national level to support international efforts aimed at mitigating the inefficiencies arising from the holdout creditor problem. While one may welcome the empowerment of supposedly independent judiciaries in the field of sovereign debt litigation, the risks associated with this development still outweigh the benefits. Buchheit summarises the conundrum compellingly:

> '[j]udges, powerful as they may be within the four walls of their own courtrooms, are ill-equipped and ill-positioned to decide how the discomfort of a financial crisis should be apportioned among the citizens of the debtor country and the various classes of its creditors. Judges can only hand down judgments saying that, as a matter of law, the sovereign is bound to pay. They cannot prescribe the nature or the degree of the sacrifices that the sovereign would need to impose on its other stakeholders in order to make those payments or satisfy those judgments.'[49]

As discussed below[50], coordinated international measures could support the objective of reconciling the interests of actors involved in debt restructurings. Bestowing upon judges the task of resolving sovereign debt disputes without giving them the appropriate legal tools may severely undermine the legitimacy, efficiency, and fairness of international efforts to mitigate the adverse effects of sovereign debt crises. Indeed, sovereign immunity is too blunt a legal

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[47] Draft Articles on Jurisdictional Immunities of States and Their Property adopted by the Commission at its forty-third session in 1991 (Final Outcome) (International Law Commission [ILC]) UN Doc A/46/10, 13, (1991) II(2) UNYBILC 13.

[48] See for a discussion as to whether the FSIA forbids injunctions against foreign sovereigns in Mark Weidemaier and Anna Gelpern, 'Injunctions in Sovereign Debt Litigation' (2014) 31 Yale Journal on Regulation 189, 199 (while the authors assume with the courts that the FSIA does not categorically forbid injunctions, they also note that this 'conclusion buttressed by some of the statute's legislative history').

[49] Lee Buchheit, 'Sovereign Debt in the Light of Eternity' in Rosa Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford: Oxford University Press, 2014) 466.

[50] See below 6.2.

fiction to balance the interests of markets and sovereigns sufficiently and in an adequate manner.

6.1.4. JURISDICTIONAL UNCERTAINTIES

In 1991, the ILC made the following observations with regard to municipal courts' jurisdiction over sovereign debt disputes:

> '[j]urisdiction may be exercised by a court of another State on various grounds, such as the place of conclusion of the contract, the place where the obligations under the contract are to be performed, or the nationality or place of business of one or more of the contracting parties.'[51]

As the ILC suggested at the time, establishing jurisdiction of a municipal court, or indeed an international arbitration court, in a sovereign debt dispute depends on several variables – some of which are more predictable than others. The legal workup of the Argentine and the Greek crises illustrated that jurisdictional questions can become critical to the success of holdout investors. In that respect, we can make a few high-level observations, specifically on the relevance of jurisdictional questions for holdout creditor problems in sovereign debt restructurings.

First, when sovereign bonds are issued under foreign laws and traded on international stock exchanges, they are typically based on lengthy prospectuses that identify the competent judicial authority *ex ante* by virtue of choice-of-forum provisions. This was, in essence, the case for Argentina's and Greece's external indebtedness. For foreign law bonds thus, jurisdictional uncertainties are eliminated by virtue of contractual arrangements at the time of issuance. Indeed, the majority of Argentine bonds included choice-of-forum provisions that aligned the governing law with the competent forum.[52] For disputes pertaining to German-law governed bonds, jurisdiction lay with German courts[53]; for Italian-law governed bonds, it lay with the Italian judiciary.[54]

By contrast, Greek local law bonds contained no choice-of-forum clauses. Consequently, the question of jurisdiction gained centre stage in national court proceedings against Greece. The

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[51] Commentaries to Draft Articles on Jurisdictional Immunities of States and Their Property adopted by the International Law Commission at its forty-third session in 1991 [[1991] II(2) UNYBILC 13] 34.

[52] Jurisdictional uncertainties remained of course with respect to investment arbitration tribunals, as discussed above 4.9.

[53] See above 4.4.2.

[54] See above 4.5.1.

question of jurisdiction was complicated by the fact that, given Greece's membership in the EU, specific rules applied with respect to the jurisdiction of national courts over bondholder disputes. As clarified by the CJEU in *Fahnenbrock v. Greece*, bondholder litigation against EU sovereigns must be considered a 'civil and/or commercial' matter in the sense of the Brussels I Regulation rather than a purely 'sovereign' matter, for which EU rules would not apply.[55]

Of course, one can doubt that the EU legislator anticipated that the Brussels I Regulation would find application in a sovereign debt crisis on the continent. While the national courts held that Greek rather than foreign courts were to adjudicate bondholder disputes, the Austrian OGH had asked the CJEU to clarify where the 'place of performance' of euro area sovereign bonds lay pursuant to the Brussels I Regulation.[56] The Advocate General Opinion in this case implied that, regardless of the nationality of the bondholder or secondary market trading of the instrument, the place of performance always remained the same: the location of issuance.[57] In the case of Greece, the location of issuance was Greece. Whether the CJEU will follow the Advocate General's legal reasoning is yet to be seen; the chances are high, judging from EU court practice. This would close a chapter and cement the local law advantage of euro area issuers.

6.1.5. Property Right Protection and Other Substantive Law Aspects

The perhaps most contentious yet fascinating legal question in a sovereign debt restructuring pertains to the lawfulness of the sovereign issuer's interference with its creditors' property rights. Given its economic goals, a debt restructuring inevitably leads to the reduction of investors' claims against the sovereign. At the same time, due to the lack of a bankruptcy framework for sovereigns, the boundaries for such interference are fuzzy under international law, if not indistinct. Holdouts tend to invoke their right to full repayment under the contract, which is in principle a property right, in order to obtain a preferential treatment over non-holdouts. Sovereigns, if not shielded by immunity or any other (procedural) defence, typically assert their inability to repay all debts in full due to the grave economic and financial circumstances they find themselves in. The tension is obvious.

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[55] See above 5.5.2.
[56] See above 5.4.2.4.
[57] See *Kuhn v Hellenic Republic*, Opinion of the Advocate General, Case C-308/17, [2018], 4th July 2018, Court of Justice of the European Union [CJEU]; European Court of Justice [ECJ].

Most decisions by domestic courts do not even reach the stage of assessing whether the debt cut was unjust, illegal, or otherwise unlawful. At the same time, there were a few cases where courts did a deep dive into the substantive law aspects of the Argentine and the Greek debt workouts. These decisions showed that the degree to which municipal courts and international tribunals take account of investors' property rights, or indeed assess the proportionality of a debt restructuring, differs markedly across jurisdictions. Rather, it remains fragmented along national lines, fuelling legal uncertainty for foreign investors and impeding the quick and orderly resolution of international debt crises. Worst of all, it invites bondholders to engage in foreign shopping and opens the gate for jurisdictional arbitrage.

Against this backdrop, we will make a few specific observations on the substantive law aspects of the two case studies.

First, we recall that judgements rendered by common law courts against Argentina, such as the US or the UK, focused primarily on the enforceability of the sovereign bond in accordance with the relevant contractual agreements. Perhaps because the SDNY looks back at a long and consistent history strict textual interpretation of sovereign bond indentures[58], the decision against Argentina largely ignored the context of the dispute or indeed the tension between the litigating parties' rights. This became particularly evident when the SDNY endorsed the 'payment' interpretation of Argentina's *pari passu* clause. Rather than reflecting on the practical implications of this legal view or investigating the substance of Argentina's defence, its sole objective was to accommodate the holdouts' right to repayment.

By contrast, albeit reaching different conclusions, German and Italian courts involved in holdout litigation against Argentina went great lengths to locate and apply the few substantive domestic and international rules applicable to state insolvencies.[59] Especially the Italian courts entertained unconventional legal arguments to fend off holdout claims; as discussed above, the fact that Italy had not codified the rules of sovereign immunity gave considerable discretion to the judges in 'engineering holdout claims away'. The *Corte di Cassazione* was then accused, perhaps rightfully so, of not having used this discretion diligently and intelligently enough.[60]

[58] See above 3.5. for an overview of SDNY judgements rendered before the Argentine debt crisis.
[59] See above chapter 4 for an overview.
[60] See above 4.7. for a discussion and analysis of the case.

Of course, some scholars have repeatedly pointed out legal pathways to better accommodate human rights concerns in national court decisions on sovereign debt matters. Goldmann for instance argues that respecting human rights in sovereign debt workouts does not amount to denying the validity of contractual commitments.[61] Rather, he asserts, it would make sovereign debt restructurings fairer and prevent cases of excessive hardship. The legal basis for courts to show regard for human rights would be the UN Covenant on Economic, Social and Cultural Rights (ICESCR), which, in Article 22, lays down the entitlement of everyone to 'realization […] of the economic, social and cultural rights indispensable for his dignity and the free development of his personality'.[62]

These rights may be affected if creditors successfully intercept payments, thereby obstructing a debt reduction granted by non-holdout investors. However, akin to the Italian Supreme Court in *Borri v. Argentina*, Goldmann also acknowledges that private bondholders also enjoy certain human rights, such as the protection of property in Article 1 of the First Protocol to the ECHR.[63] He reaches the conclusion that insolvency is 'one of the risks inherent in any investment', thus legitimising adequate debt reduction measures vis-à-vis private bondholders.[64]

With respect to the assessment of substantive law questions, the Greek debt restructuring of 2012, and its judicial aftermath, provided unique insights into the limitation of property rights during sovereign debt crises. Although foreign courts did not assess the merits of the holdouts' claims, the ECtHR, which holds the monopoly to interpret the ECHR, rendered a seminal judgement on the scope of interference with the property rights of bondholders.

The *Mamatas* case marked a caesura in the field of international financial law. It will guide the national courts of all 47 Member States of the Council of Europe should they be confronted with sovereign bondholder claims in the future. Notwithstanding some weaknesses in the legal reasoning[65], the ECtHR judgement shifted away from applying mechanical methods of textual interpretation. At the same time, the *Mamatas* court steered clear from entering the slippery slope of conflating well-established rules of international

[61] Matthias Goldmann, 'Human Rights and Sovereign Debt Workouts' (April 2014) unpublished manuscript <https://www.academia.edu/5561607/Human_Rights_and_Sovereign_Debt_Workouts> accessed 23 August 2017.
[62] ibid 4.
[63] ibid 8.
[64] ibid 9.
[65] See above 5.5.3.

customary law to accommodate certain public policy objectives, such as curtailing holdout behaviour.[66] Instead, it assessed the proportionality and the necessity of the government's interference with the (contractual) rights of holders of Greek debt securities. This approach ensured a high degree of transparency for all parties involved, thereby considerably boosting the legitimacy of the debt workout.

At least in theory, the great advantage of the ECtHR's approach to assessing the legality of debt restructuring measures lies in the comprehensive manner in which it balances the interests of investors and the debtor state, respectively. One the one hand, the court introduced a legal 'check' on opportunistic default by introducing qualitative limits to the state's scope in carrying out debt restructuring measures. Market participants should cherish the increase of transparency and the delineation of legal boundaries that a sovereign debtor may not cross. [67] On the other hand, by taking into account the grave economic crisis that Greece experienced and by acknowledging that the debt restructuring measures were indispensable to forestall imminent and disorderly state default, the *Mamatas* court seemingly understood the economic dimension of the case.[68]

The challenge for (quasi-)constitutional courts like the ECtHR when they are getting drawn into the legal netherworld of sovereign debt restructuring operations is to maintain their reputation as independent and legitimate arbiters. As Vanberg and Gulati note with respect to the *Mamatas* case, '[e]ven if the judges believed that the government had blatantly violated the rule of law, they could not expect that a decision to declare the restructuring invalid would be honoured.'[69] Indeed, a court's strength and effectiveness as a dispute settlement authority for holdout litigation must be judged upon its ability to render both positive and negative decisions. One can safely say, however, that a judgement in favour of the plaintiffs would have had devastating political and economic implications for Greece and EU

[66] Of course, the judgement's relevance for the restructuring of international bond contracts remains limited, given that the ECHR has only been signed by European states and given that most international sovereign securities are governed either by New York or by English law.

[67] See above 3.5.1. and 3.5.2. Also note that economic theories on sovereign default and subsequent market exclusion seem inconclusive; compare for an overview of the discussion Ugo Panizza, Federico Sturzenegger and Jeromin Zettelmeyer, 'The Economics and Law of Sovereign Debt and Default' (2009) 47(3) Journal of Economic Literature 651.

[68] See above Buchheit (n 49).

[69] See Mitu Gulati and George Vanberg, 'Paper Tigers (or How Much Will Courts Protect Rights in a Financial Crisis?)' (2018) SSRN <https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=365684> accessed on 25 July 2018 (the authors note that '[a]s an international court, staffed by foreign judges, the ECHR enjoyed little public support in Greece' and that '[i]t is unlikely that a decision by the Greek government not to comply with an adverse judicial decision would have imposed domestic political costs on the government').

policymakers alike. If the PSI were to be unwound, creditors would have bombarded Greece with legal claims and another default could have been the consequence.

While, *de lege ferenda*, the approach taken by the ECtHR provided a compelling blueprint for the resolution of future holdout disputes, it would be naïve to believe that it could, once and for all, disentangle the legal from the political economy aspects inherent to sovereign debt restructurings. Of course, any credible attempt to balance the different interests at stake within the traditional framework of constitutional and human rights law seems preferable to the type of legal engineering that several municipal courts engaged in during the Argentine crisis. However, the ECtHR's ruling has not made the case for reform weaker. It has only offered a glimpse into a world of legal utopia where the multitudinous legal aspects of international debt crises can be reviewed without surrendering some central legal principles.

As discussed further below, one idea for the euro area would be the creation of a special dispute resolution mechanism, which would replace the inefficient system of national court proceedings in the realm of sovereign debt crises. On the international plane, however, municipal courts are likely to retain their role as contract enforcers. As the subsequent section argues, while not providing a panacea to the holdout creditor problem, continuous contractual reform that is promoted by the official sector and accepted by the markets, can significantly reduce incentives for disruptive litigation and arbitration by vulture and retail holdouts alike.

6.1.6. CONCLUSIONS

As this thesis shows, different types of holdout lawsuits exist. However, the increasing variety of case configurations has complicated the documentation and analysis of the holdout creditor problem. The Greek and the Argentine debt restructuring gave rise to a number of formidable legal problems that arguably overwhelmed judges and arbitrators.

To conclude our analysis of holdout problems in Argentina and Greece, Box 8 categorises the seminal holdout cases covered in this thesis, illustrating the most common types of legal claims raised against a sovereign debtor, and matching them with judgements discussed.

Box 8: Categories of holdout lawsuits against (insolvent) sovereigns[70]

[70] See for a similar categorisation Regis Bismuth, 'The Emerging International Law of Sovereign Debt Restructuring – Recent Developments' in ILA, 'Committee on International Monetary Law – Annual Report' (2018) Sydney Conference, 15 <http://www.ila-hq.org/images/ILA/DraftReports/DraftReport_MonetaryLaw.pdf> accessed on 2 August 2018.

Type of lawsuit	Main characteristics	Forum(s)	Examples
Litigation initiated post-default	• concerns external sovereign bonds with choice-of-forum clause and waiver of immunity	• foreign municipal courts (mostly SDNY)	• *Libra Banka v. Banco Nacional de Costa Rica*[71] • *Lightwater v. Argentina*[72]
Litigation initiated by holdout bondholders for breach of the *pari passu* clause	• holdout bondholders invoke violation of *pari passu* clause on the basis of payments made to restructured bondholders • remedy based on equity as otherwise enforcement of clause would not be possible	• foreign municipal courts (mostly SDNY)	• *Elliott v. Peru*[73] • *NML v. Argentina*[74]
Litigation between holdout bondholders and the debtor State for a sovereign decision affecting contractual rights	• challenging the retroactive change of domestic law bonds • claim to contractual performance or damages	• municipal courts of the debtor state • foreign municipal courts • ECtHR	• Hellenic Council of State, 21 March 2014, No 1116/2014 • *Mamatas and Others v. Greece*[75] • BGH Judgement of
Litigation against EU institutions regarding the extra contractual liability	• claiming compensation from official sector due to preferential treatment in debt restructuring	• CJEU	• *Accorinti and Others v. ECB*[76]
Litigation related to measures of enforcement	• action aimed at enforcing money judgement	• foreign municipal courts	• *Borri v. Argentina*[77] • BGH Judgement of 24 February 2015[78]

[71] See above 3.5.1.
[72] See above 4.3.1.
[73] See above 3.5.6.
[74] See above 4.3.3.
[75] See above 5.5.3.
[76] See above 5.5.1.
[77] See above 4.5.1.
[78] See above 4.4.2.

requested by holdout bondholders	obtained in foreign municipal court		• *NML Capital v. Republic of Argentina* (UK)[79] • *NML Capital v. France I*[80] & *II*[81]
Arbitration initiated by holdouts post-default or post-restructuring	• claiming compensation for violation of BIT	• ICSID tribunals	• *Abaclat and Others v. Argentine Republic*[82] • *Ambiente Ufficio SpA and Others v. Argentine Republic*[83] • *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic*[84]

6.2. RESOLVING HOLDOUT PROBLEMS AT THE INTERNATIONAL LEVEL

Given that sovereign debt crises have become a recurring phenomenon, scholars of law and economics have put forward proposals to end the inefficient ways of sovereign insolvencies are addressed at the current juncture. It is neither feasible nor rational to revisit all of them here. Rather, by drawing upon the experiences made in the Argentine and the Greek debt restructurings, this section seeks to complement the existing literature with the lessons learned from the instances of holdout litigation across different jurisdictions. We also discuss whether the reforms in response to the emergence of holdout problems are sufficient and conclude that more needs to be done.

When discussing solutions to holdout problems, the literature distinguishes between the contractual and the statutory approach. While policymakers[85] and market participants have

[79] See above 4.6.1.
[80] See above 4.7.1.
[81] See above 4.7.2.
[82] See above 4.9.1.
[83] See above 4.9.2.
[84] See above 5.6.1.
[85] Eg IMF, 'Strengthening The Contractual Framework To Address Collective Action Problems In Sovereign Debt Restructuring' (2014) IMF Policy Papers <https://www.imf.org/external/np/pp/eng/2014/090214.pdf> accessed 26 July 2017.

typically favoured contractual solutions[86], many renowned academics have argued in favour of a comprehensive statutory framework for debt restructurings.[87] The contractual approach encompasses all types of legal techniques that aim at addressing and mitigating holdout problems by virtue of contractual instruments.[88] These mechanisms are agreed *ex ante* between the sovereign borrower and the respective lender in order to facilitate a more orderly and efficient crisis resolution *ex post*. By contrast, the statutory approach refers to the establishment of a genuine (multilateral) legal framework under international law, such as an international treaty about sovereign bankruptcy.[89]

As Gitlin and House[90] rightly note, both approaches have their strengths and weaknesses. They opine that none of the two approaches 'provides a perfect combination of optimal results, efficiency, and political feasibility; zero-sum-style advocacy for one approach to the exclusion of the other is likely to delay rather than accelerate reform.'[91] At the current juncture, however, the statutory approach remains too contentious for many powerful actors in the sovereign debt market. The lack of political agreement will hamper efforts to implement broad-based solution under the auspices of international law, at least until the next crisis reveals new shortcomings or reinforces the old ones. Therefore, we argue that, over the short to medium term, policymakers should throw their political weight behind enhancements of bond contracts that can render holdout strategies legally impossible or at least financially unattractive. Indeed, ignoring the political economy underlying sovereign debt issues would be as wrong as denying the need for reform altogether.[92]

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[86] Compare, eg, ICMA, 'Sovereign Debt Information' (2014) <http://www.icmagroup.org/resources/Sovereign-Debt-Information/> accessed 16 November 2017 and Institute of International Finance, 'Views On the Way Forward For Strengthening the Framework For Sovereign Debt Restructuring' (2014) Report by Special Committee on Financial Crisis Prevention and Resolution <https://www.iif.com/file/7072/download?token=NHmgu6tb> accessed 16 November 2017.

[87] See, eg, Christoph Paulus (ed), *A Debt Restructuring Procedure for Sovereigns – Do We Need a Legal Procedure?* (London: Hart, 2014); Lastra and Buchheit (n 49); Guzman et al (n 2).

[88] According to Lanau, '[t]he contractual approach addresses the inefficiencies by introducing new clauses in debt contracts'; see Sergi Lanau, 'The contractual approach to sovereign debt restructuring' (2011) 51(1) Bank of England Working Paper No 409 <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2011/the-contractual-approach-to-sovereign-debt-restructuring.pdf> accessed 2 June 2017.

[89] See for an overview, see, eg, Jonathan Sedlak, 'Sovereign Debt Restructuring: Statutory Reform Or Contractual Solution' (2004) 152 University of Pennsylvania Law Review 1483.

[90] Richard Gitlin and Brett House, 'Contractual and Voluntary Approaches to Sovereign Debt Restructuring' in Guzman et al (n 2).

[91] ibid.

[92] Some authors seem to imply that the common narrative on the holdout creditor problem exaggerate its severity. See Ran Bi, Marcos Chamon and Jeromin Zettelmeyer, 'The Problem that Wasn't: Coordination Failures in Sovereign Debt Restructurings' (2011) IMF Working Paper No 11/265 <https://www.imf.org/external/pubs/ft/wp/2011/wp11265.pdf> accessed 2 August 2017.

While some contend that the contractual approach is purely market-driven and thus biased towards safeguarding creditor rights[93], we believe that contract design matters. Contracts can fulfil public policy objectives and provide fairer and more effective ways out of debt crises.[94] The IMF seemed to agree when it endorsed single-limb CACs as a response to the Argentine litigation saga.[95] Moreover, virtually all scholars agree that these clauses have great potential to curtail the power of vulture holdouts during and after debt restructuring negotiations.[96] At the same time, notwithstanding the obvious progress in enhancing contractual standards, further refinements are needed to ensure that sovereign bond contracts sufficiently cater to the public policy objective of reducing holdout problems. The subsequent section will explore what these improvements could look like.

6.2.1. Collective Action Clauses

6.2.1.1. Definitions

CACs ensure financial democracy in international sovereign bond contracts. They enable the majority of bondholders to overrule a minority of holdouts by binding them to the agreed debt swap. Defined broadly, CACs are provisions in sovereign debt instruments that require the interaction of bondholders in order to achieve a certain predefined outcome. Strictly speaking, the term CAC encompasses different types of clauses, such as

(i) collective representation clauses,
(ii) majority action clauses,
(iii) sharing clauses, and
(iv) acceleration clauses.[97]

Different definitions for CACs exist in the scholarly literature. For instance, Elderson and Perassi define CACs as follows:

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[93] See, eg, Martin Guzman and Joseph Stieglitz, 'Creating a Framework for Sovereign Debt Restructuring that Works' in Guzman et al (n 2) 4-15.

[94] Régis Bismuth, 'The Path Towards an International Public Policy for Sovereign Debt Contracts' (2014) IX Brazilian Yearbook of International Law 122.

[95] See below 6.2.1.2. for a discussion of single-limb CACs.

[96] See below 6.2.3. for a discussion of trustee structures and their role in mitigating holdout inefficiencies.

[97] See, eg, Rodrigo Olivares-Caminal, 'Rethinking Sovereign Debt Restructuring' (June 2013) Presentation at the Queen Mary University, London <http://faculty.london.edu/mjacobides/assets/documents/Rethinking_Sovereign_Debt_Restructuring.pdf> accessed 19 October 2017. In a similar fashion, Bradley and Gulati point out, CACs comprise not only provisions on voting thresholds to enable a majority to approve modifications but also on mandatory meetings, aggregation, acceleration, reverse acceleration and collective representation clauses. See Michael Bradley and Mitu Gulati, 'Collective Action Clauses for the Eurozone' (2013) 18(6) Review of Finance 1, 29.

> '[c]ollective action clauses are the denominator usually given to a number of different clauses found in various forms and to a varying degree in bond contracts under the laws of various jurisdictions which have in common, principally, that they enable a majority of bondholders to bind a minority against their will to the amendment of the terms of the contract and to a number of other actions in relation to the bonds.'[98]

The ECB[99] defines CACs in the following way:

> 'CACs are designed to ensure orderly sovereign debt restructuring [and] provide an effective means for a supermajority of bondholders (66 ⅔% or 75%) and the debtor to restructure outstanding bonds (eg modify key payment terms, or convert or exchange bonds). Such restructuring usually applies to a single bond series, but it can also apply across multiple bond series using 'aggregation clauses' (which are used by sovereign issuers such as Uruguay and Argentina).'

Gelpern and Gulati[100] state that 'CACs enable creditor majorities to bind potential holdouts in a debt restructuring vote…' further noting that '[such] terms that limit the power of holdouts are valuable to sovereigns, which cannot restructure their debts in bankruptcy and must rely on sovereign immunity and contractual mechanisms to manage debt distress.'

The latter definition implies that CACs are particularly advantageous for the sovereign debtor. However, they also benefit the majority of creditors who will be able to negotiate the terms and conditions of a debt deal, increasing their collective welfare.[101] In addition scholars and policymakers sometimes equate CACs with majority action clauses, which is why the two terms will be used interchangeably here.[102]

CACs have a long history. From their first incorporation in English railway bonds of the 19th century[103], these clauses have found their way into the boilerplate language of most sovereign debt issuances around the world.[104] The author of the first CAC, which was first used in English railway bonds in 1879, described its objective as follows:

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[98] Frank Elderson and Marino Perassi, 'Collective Action Clauses in Sovereign Foreign Bonds; Towards a More Harmonised Approach' (2003) European Banking and Financial Law Journal 239, 241.

[99] ECB, 'The European Stability Mechanism' (July 2011) Monthly Bulletin, 80 <https://www.ecb.europa.eu/pub/pdf/other/art2_mb201107en_pp71-84en.pdf> accessed 1 October 2017.

[100] Anna Gelpern and Mitu Gulati, 'The Wonder-Clause' (2013) 41 Journal of Comparative Economics 367, 370.

[101] Stephen J. Choi, Mitu Gulati and Eric A. Posner, 'Pricing Terms in Sovereign Debt Contracts: A Greek Case Study with Implications for the European Crisis Resolution' (2011) 6(2) Capital Markets Law Journal 163.

[102] See, eg, IMF, 'The Design and Effectiveness of Collective Action Clauses' (6 June 2002) Policy Paper, 14 <https://www.imf.org/external/np/psi/2002/eng/060602.pdf> accessed 9 August 2018.

[103] ibid (the authors provide a historical analysis of CACs).

[104] Bradley and Gulati (n 97).

'[t]he objective of conferring this power on the majority is to protect it against unreasonable conduct on the part of the minority, and to prevent a deadlock happening when unanimity cannot be obtained. Unless the majority is thus enabled, in special circumstances, to determine what is to be done on behalf of the whole body, the minority is placed in a position to dictate to the majority, and the whole of the majority, however large, may be placed in peril by the stupidity, fraud or greed of an insignificant minority, or by the delay which would result if it were necessary to obtain the consent of every debenture or stock holder.'[105]

CACs have only become ubiquitous clauses in international sovereign bonds after a determined intervention by the official sector in the early 2000s. The Rey Report recommended their inclusion in the wake of Mexico's 1994 default, which revealed major shortcomings in the existing international approach to resolving debt crises. The Rey Report was the outcome of a G10 review of the international financial architecture entitled 'The Resolution of Sovereign Liquidity Crises'. It essentially covered three themes that reflected the following problems:

'[f]irst, the broader and stronger linkages among domestic and international financial markets mean that crises can erupt much more quickly in today's markets and can be far larger in scope than in the past. Second, flows of capital to emerging market economies in the form of purchases of securities have increased greatly in size over the years and have substituted for other types of private capital. Third, when a crisis occurs new finance is unlikely to be forthcoming from those who undertook the original lending.'[106]

Based on the recommendations in the Rey Report, international policymakers decided to include G10 model CACs in all international sovereign bonds.[107] The relevance of CACs has further increased since enhanced CACs were included not only in bonds governed by New York law and English law but also in securities also in government securities of euro area Member States.[108] Nonetheless, leaving aside Greece, CACs have so far played a negligible role in debt crises. This is due to the fact most debt workouts concerned bonds governed by New York law[109], in which CACs were absent before 2003. According to the IMF[110], Belize

[105] Lee Buchheit and Elena Daly, 'Sticks' in Lastra and Buchheit (n 49) 22.
[106] See Deborah Zandstra, 'New Aggregated Collective Action Clauses and evolution in the restructuring of sovereign debt securities' (2017) 12(2) Capital Markets Law Journal 180, 182-183.
[107] See below for an overview of English law CACs in 6.2.1.
[108] ibid (inter alia pointing out that empirical research on CACs has been hampered by the differences between New York and English law bonds more generally). These differences will be studied in greater detail below 6.2.3. and 6.2.4.
[109] Such as Argentina (2005 and 2010), Uruguay (2002) and Mexico (1994).

was the first country to use a CAC to amend the payment terms of bonds in its 2007 sovereign debt restructuring; the Greek PSI of 2012 marked the most important case of CACs being successfully employed against holdouts.[111]

6.2.1.2. Types of CACs Used in International Sovereign Bonds

In essence, two types of CACs can be distinguished: single-limb and double-limb CACs. CACs that incorporate a single-limb voting procedure allow for the modification of bonds belonging to more than one series based on a single vote of investors across all relevant instruments. The minimum required consent varies from clause to clause, but is typically at least 75 % of the aggregate outstanding principal of all affected series. By contrast, CACs with double-limb voting mechanisms require that two consent thresholds to be met: one vote for all outstanding bonds, and another one (generally with a lower mandatory threshold) for each individual series of bonds.

The precise drafting of CACs still varies across bonds traded in international debt markets.[112] This is partly a result of jurisdictional divergences but mainly due to the gradual contractual evolution of these clauses. Most notably, CACs were not included in New York law debt issuances before 2003. The Argentine debt crisis then prompted policymakers to endorse CACs as a moderate alternative to a fully-fledged SDRM.[113] Conversely, the first English law sovereign bond with a CAC was already issued in 1922 by Czechoslovakia.[114] Bonds

[110] Tamon Asonuma, Gerardo Peraza, Kristine Vitola, and Takahiro Tsuda, 'Sovereign Debt Restructurings in Belize: Achievements and Challenges Ahead' (2014) IMF Working Paper WP/14/132, 12 <https://www.imf.org/external/pubs/ft/wp/2014/wp14132.pdf> accessed 3 November 2017.

[111] For the Greek PSI and the restructuring of Greek law bonds, see above 5.3.3.

[112] For an overview, see, eg, Anna Gelpern, 'The importance of being standard' (ESCB Legal Conference, Frankfurt, 6-7 October 2016) 23-45 <https://www.ecb.europa.eu/pub/pdf/other/escblegalconference2016_201702.en.pdf> accessed 27 July 2018.

[113] This shift in New York law bonds from unanimity clauses (where each individual bondholder has to consent to a modification of the contractual terms) to CACs around the year 2003, has been studied extensively by scholars and was deemed one of the most progressive advancements in the realm of sovereign debt in past decades. See for an overview Randal Quarles, 'Herding Cats: Collective-Action Clauses in Sovereign Debt — The Genesis of the Project To Change Market Practice in 2001 Through 2003' (2010) 73 Law and Contemporary Problems 29. Also see, eg, Mark Gugiatti and Anthony Richards, 'The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers' (2003) 35 Georgetown Journal of International Law 815; Stephen Choi, Mitu Gulati and Eric Posner, 'The Dynamics of Contract Evolution' (2013) 88(1) New York University Law Review 135 and, more recently, Anna Gelpern, Ben Heller, and Brad Setser, 'Count the Limbs – Designing Robust Aggregation Clauses in Sovereign Bonds' in Guzman et al (n 2) 109.

[114] Mark Weidemaier and Mitu Gulati, 'The Relevance of Law to Sovereign Debt' (2015) 11 Annual Review of Law and Social Science 395. The bond stipulated that 'any proposal which may be made to them by the Czechoslovak Government …, the decision of the holders of the majority in nominal value of Bonds present at such meeting, either in person or represented by proxy, shall be binding upon all Bondholders…'.

issued under Japanese laws have traditionally included CACs – they were for example used during the restructuring of Uruguayan bonds in 2003.[115]

CACs are usually not inserted into government debt instruments issued under domestic law. Since 2013, the euro area has marked an important exception to that rule. For euro area Member States, the inclusion of clauses designed to deal with default scenarios seemed obsolete – after all, senior European policymakers had long regarded sovereign debt restructuring as a developing country syndrome.[116] However, CACs became mandatory in the currency union after the Greek debt crisis: all sovereign bonds issued after 1 July 2013 with a maturity of more than one year need to include them, regardless of their governing law.[117]

To distinguish between different types of amendments, CACs define certain modifications as 'reserved matter'; whether a matter is reserved usually depends on the potential impact on the creditors' legal position. Modifications of reserved matters typically feature higher voting thresholds, thereby providing a higher level of bondholder protection than non-reserved matter modifications.[118]

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[115] See, eg, Federico Sturzenegger and Jeromin Zettelmeyer, *Debt Defaults and Lessons from a Decade of Crises* (Cambridge: MIT Press, 2007) 258.

[116] See Jean Pisani-Ferry, *The Euro Crisis and Its Aftermath* (Oxford: Oxford University Press, 2014).

[117] See, eg, Christian Hoffmann, 'Sovereign-Debt Restructuring in Europe Under the New Model Collective Action Clauses' (2014) 49 Texas International Law Journal 383, 388 and David Billington, 'European Collective Action Clauses' in Lastra and Buchheit (n 49).

[118] Therefore, qualifying certain amendments as 'reserved matter' allows the contracting parties to calibrate how 'difficult' it will be to alter specific bond terms in a debt restructuring. Note that not all CACs entail the same definition of reserved matters, though, as a general rule, reserved matters relate to modifications that could considerably affect the creditors' legal position in the respective contractual document. The ICMA Standard CAC of 2014, for instance, defines the following modifications as 'Reserved Matters':

(i) to change the date, or the method of determining the date, for payment of principal, interest or any other amount in respect of the Notes, to reduce or cancel the amount of principal, interest or any other amount payable on any date in respect of the Notes or to change the method of calculating the amount of principal, interest or any other amount payable in respect of the Notes on any date;

(ii) to change the currency in which any amount due in respect of the Notes is payable or the place in which any payment is to be made;

(iii) to change the majority required to pass an Extraordinary Resolution, a Written Resolution or any other resolution of Noteholders or the number or percentage of votes required to be cast, or the number or percentage of Notes required to be held, in connection with the taking of any decision or action by or on behalf of the Noteholders or any of them;

(viii) to change the legal ranking of the Notes [or other specified substantive covenants as appropriate, to be determined on a case-by-case basis];

(ix) to change any provision of the Notes describing circumstances in which Notes may be declared due and payable prior to their scheduled maturity date, set out in Condition [•] (*Events of Default*) [if any];

(x) to change the law governing the Notes, the courts to the jurisdiction of which the Issuer has submitted in the Notes, any of the arrangements specified in the Notes to enable proceedings to be taken or the Issuer's waiver of immunity, in respect of actions or proceedings brought by any Noteholder, set out in Condition [•] (*Governing Law and Jurisdiction*). See ICMA, 'ICMA Standard CACs' (August 2014) <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/collective-action/> accessed 1 September 2017.

The calibration of CAC voting thresholds has important distributional implications. Assume, for instance, that a CAC requires 50% of bondholders (measured by the value of their claims) to agree to a modification. Another one requires consensus among 85% of bondholders. In the former case, a simple majority may alter the terms and conditions for the other 50% of bondholders. Conversely, if 85% of bondholders must consent, it will be easier for minority bondholders to block a deal.

From a market perspective, higher thresholds tend to be more desirable: they require the sovereign to propose modifications that a majority of creditors is willing to accept. At the same time, higher thresholds essentially encourage holdout behaviour, as they make it easier to acquire blocking minorities.

Finally, CACs often include disenfranchisement clauses, which seek to avoid conflict of interests between certain bondholders and the issuer by 'disenfranchising' certain entities with a close (legal) relationship to the issuer from the vote. This means that their votes are not counted while the outcome of the vote will still be binding for the disenfranchised creditors. A typical disenfranchisement clause reads as follows:

> '[f]or the purposes of (i) determining the right to attend and vote at any meeting of Noteholders, or the right to sign or confirm in writing, or authorise the signature of, any Written Resolution […], any Notes which are for the time being held by or on behalf of the Issuer or by or on behalf of any person which is owned or controlled directly or indirectly by the Issuer or by any public sector instrumentality of the Issuer shall be disregarded and be deemed not to remain outstanding […].'[119]

Disenfranchisement clauses seek to avoid a scenario whereby governments buy their own bonds to influence the CAC voting process.[120] Some sovereign bond issuers include their central bank in the definition of 'public sector instrumentality'[121] while others only refer to departments, agencies, or ministries of the state.[122] To conclude, Box 9 provides an overview

[119] ibid.

[120] See above 3.5.4. for a holdout lawsuit that concerned such scenario where the Brazilian central bank acquired its government bonds to tilt the outcome of a bondholder vote.

[121] See, eg, Bolivarian Republic of Venezuela, 'Listing Memorandum: U.S.$4,200,000,000 11.95% Amortizing Bonds due 2031' (5 August 2011) Listing Memorandum <https://www.bourse.lu/security/USP17625AD98/179060> (stating that '"public sector instrumentality" means Banco Central, any department, ministry or agency of the federal government of Venezuela or any corporation, trust, financial institution or other entity owned or controlled by the federal government of Venezuela or any of the foregoing.')

[122] See, eg, The Republic of Argentina, 'U.S.USD2,750,000,000 6.250% Bonds Due 2019, U.S.USD4,500,000,000 6.875%, Bonds Due 2021 U.S.USD6,500,000,000, 7.500% Bonds Due 2026, U.S.USD2,750,000,000 7.625%, Bonds Due 2046' (4 May 2016) Offering Memorandum

of the most important legal features of different model CACs used in international sovereign bonds.

Box 9: Specific legal features of different Model CACs			
	G10 Model CAC (2002)	**Euro Area Model CAC (2011)**	**ICMA Model CAC (2014)**
Governing law	Primarily New York law but also suitable for other foreign laws	Any domestic euro area or foreign law	New York and English law
Voting mode	Non aggregated voting: (i) Vote must be conducted series-by-series (ii) Holdouts may block smaller series by purchasing blocking minorities	Partially aggregated voting: (i) A majority of bondholders must accept proposed modifications in each series as well as on the aggregate of outstanding bonds (ii) Holdouts could buy smaller blocking minorities in individual series	Fully aggregated voting: (i) A majority of bondholder must accept the proposed modifications on the aggregate but not within each of the series (ii) Holdout would need to buy large blocking minorities
Reserved matter threshold at bondholder meeting	75% in each series of outstanding bonds	66.67% in each series and 75% on the aggregate of outstanding bonds	75% on the aggregate of outstanding bonds
Reserved matter threshold for written resolution	66.67% in each series of outstanding bonds	50% in each series 66.67% on the aggregate of outstanding bonds	75% on the aggregate of outstanding bonds

<https://www.bourse.lu/security/USP04808AE45/236989> accessed 2 December 2017 (stipulating that '"public sector instrumentality" means any department, secretary, ministry or agency of the Republic.').

Events of default and acceleration	(i) Principal repayment can be accelerated by 25% of bondholders in each series (ii) De-acceleration by 50% or 75% of bondholders	No acceleration features	(i) Principal repayment can be accelerated by 25% of all bondholders (ii) De-acceleration by 50% of bondholders
Disenfranchisement provisions	Bonds owned or controlled directly or indirectly, by the issuer or any of its public sector instrumentalities (according to the G10 recommendations, this could be negotiated on a case-by-case basis)	Bonds held by entity that (a) is then controlled by the Issuer or by a department, ministry or agency of the Issuer; (b) has in response to an enquiry from the Issuer reported to the Issuer that it is then the holder of one or more Bonds; and (c) does not have autonomy of decision in respect of its Bond holdings.	Notes which are for the time being held (i) by or on behalf of the Issuer or (ii) by or on behalf of any person which is owned or controlled[123] directly or indirectly by the Issuer or by any public sector instrumentality of the Issuer.

6.2.1.3. Further Enhancing CACs – Some Proposals for Reform

In response to the Argentine and the Greek debt crises, policymakers, in liaison with private market participants, have promoted the inclusion of a new generation of fully aggregated single-limb CACs in all sovereign bonds governed by English and New York law.[124] To deter holdouts from buying blocking positions in individual series of bonds, the new ICMA Model CAC allows for a single vote across all series rather than mandating one for each individual

[123] 'Control' means actual influence by the issuer. The term 'public sector instrumentality' may be identified by the issuer itself. See ICMA (n 118).

[124] ICMA (n 118).

series.[125] Governments across the globe seemingly welcomed the updated clause: according to a recent IMF report, 87 % of the nominal principal amount of new issuances includes enhanced CACs.[126]

It is widely acknowledged that CACs are no panacea but constitute a compromise solution between those advocating for an international bankruptcy framework and those insisting that credible 'checks' on opportunistic sovereign defaults are vital for the market's efficient functioning.[127] Overall, policymakers and scholars should welcome the move towards fully aggregated CACs, as it is likely to reduce significantly the attractiveness of pursuing holdout strategies. Nonetheless, some further technical amendments to the ICMA CAC may be considered to further mitigate holdout risks and reduce the inherent to the latest CAC models.

First, CACs rely on the proper functioning of the market. They require a certain majority of investors to agree to a proposed bond modification. The revised ICMA CAC has *de facto* increased the voting thresholds for bondholder modifications to be successfully adopted. In contrast to the double limb CAC, it requires an affirmative vote of 75% of all bondholders in both a bondholder meeting *and* a written resolution. Moreover, in contrast to the G10 Model Clause, the revised ICMA CAC has no fall back option with reduced voting thresholds in case the modification is not approved by at least 75% of bondholders. Both features make it easier for holdouts to acquire blocking minorities, especially when they act in concert.

By way of example, if a country like Bolivia was to restructure its external debts, which currently amount to approximately USD11 billion, holdouts would have to acquire bonds with a face value of USD2.75 billion.[128] Considering that holdouts acquired Greek foreign law debt with a face value north of EUR6 billion, the 75% voting threshold enshrined in the ICMA CAC may be too high to effectively discourage holdouts. Put differently, even if the new CAC does not require a series-by-series modification, certain vulture holdouts may still

[125] As discussed above, the restructuring of foreign law bonds during the Greek PSI became impossible after vulture holdouts had strategically bought into smaller series of Greek bonds, forcing the government to pay them out in full. See above 5.3.4.

[126] IMF, 'Third Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts' (12 December 2017) IMF Report <https://www.imf.org/en/Publications/Policy-Papers/Issues/2017/12/15/pp113017third-progress-report-on-cacs> accessed 29 July 2018.

[127] See, eg, Mark Weidemaier, 'A People's History of Collective Action Clauses' (2013) 54 Virginia Journal of International Law 51 (also noting that 'CACs have become a talisman, invoked seemingly to imply that such small tokens can ward off the great problems associated with massive sovereign borrowing in interconnected global markets.')

[128] The market value on the secondary market in the run up to a crisis is likely to be significantly lower than this number, as investors will try to sell distressed debt instruments, thereby creating downward pressure on the bond prices.

have the financial means to acquire close to or even more than 25% of the aggregate of outstanding debt securities.

Thus, some smaller issuers could consider reducing the CAC thresholds to 66 2/3% or even 50% in order to reduce the risk of interference by holdouts. In this context, it is recalled that both the Euro CAC (for written modifications) as well as the CAC retrofitted to Greek bonds in the 2012 PSI have a 66 2/3% voting threshold. The chance that holdouts acquire positions of up to 33 1/3, or even 50% of the entire debt stock, seems very low. Ideally, the official sector would back any such measures to reduce first-mover risks. The ICMA/IMF initiative of 2014 could serve as a valuable blueprint in that respect.

Second, we still observe fragmentation in the standard contract language for international sovereign bonds across jurisdictions.[129] For example, euro area governments have not followed the ICMA model. Rather, they have introduced a partially aggregated two-limb CAC for bonds governed by domestic and foreign law.[130] As further discussed below, in order to establish a level playing field in international sovereign bonds markets and enhance legal certainty for private market participants, closer alignment between the two (most) important CAC standards seems warranted.[131]

Moreover, one could consider including CACs in domestic law bonds of other advanced economies too. Default probabilities are certainly lower is most of these countries when compared to emerging market issuers. At the same time, hardly anyone anticipated the Greek PSI and the existence of CACs in the original bonds would have reduced the pressure on EU policymakers to find a legal fix at the peak of the crisis. Thus, to further integrate sovereign debt markets, align legal standards, and sow the seeds for a genuine sovereign bankruptcy framework over the long term, big elite issuers could follow the euro area in tweaking their sovereign bonds by inserting CACs.

Third, to ensure that all bondholders aggregated in a single voting class will be subject to the same treatment, the ICMA CAC requires the exchanged bonds to have terms that are 'uniformly applicable'.[132] In other words, the terms of the bonds offered by the sovereign must be the same for all investors involved in the debt workout. As pointed out by the IMF,

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[129] See Gelpern et al (n 113). See below 6.3.5.1.

[130] See below 6.3.5. for a discussion on how the contractual framework for euro area government bonds may be improved.

[131] ibid.

[132] See IMF (n 85).

however, the 'uniformly applicable' safeguard does not guarantee that the economic effect of the modification will be the same for each series affected.[133]

Consequently, some bondholders, especially the less sophisticated ones, may accept an option from a menu proposed by the issuer that is detriment to their economic interest. Therefore, one could consider introducing an obligation to ensure that all investors are subject to the same net present value (NPV) cut, a mathematical measure typically used to determine the losses bondholders incur because of a debt restructuring. Of course, a CAC mandating an equal economic impact on issuers would have to take account of the different maturities of the bonds subject to a haircut. To this end, policymakers may consider obligating a sovereign to apply the same 'exit yield' to all bondholders. While this involves some computing on the sovereign's side, it would reduce the risk of unfair treatment in an aggregated voting procedure.

Fourth, aggregation of bonds governed by different laws may be challenging, given that national courts could apply different interpretations of aggregation clauses.[134] Indeed, the laws of eight different jurisdictions governed bonds issued by Argentina prior to its default. Greece predominantly used its own laws.

The more bonds contain the same model CAC, the easier it would be to reach full aggregation, thereby killing two birds with one stone. On the one hand, holdouts would have fewer incentives to target bonds issues under certain laws. On the other hand, investors would not have to fear that the legal specificities of their debt instrument work to their detriment in the event of a sovereign default. In this sense, aggregation across jurisdictions would foster an international level playing field, enhance intercreditor equity, and reduce the risk of regulatory arbitrage. Of course, given that sovereigns are free to issue bonds under whichever law they deem appropriate, ensuring aggregation across bonds with different governing laws may be technically challenging and highly dependent on the specific debt structure of a sovereign.

[133] ibid 21 (to demonstrate this, the IMF notes that 'if a qualified majority of bondholders voted to accept the same long-term instrument in a restructuring, the impact on those bondholders with relatively short residual maturities when compared with original contractual terms would be greater than that on those holding claims with relatively long residual maturities.').

[134] See, eg, IMF, 'The Restructuring of Sovereign Debt – Assessing the Benefits, Risks, and Feasibility of Aggregating Claims' (3 September 2003) IMF Legal Paper, 19 <https://www.imf.org/external/np/pdr/sdrm/2003/090303.pdf> accessed 2 July 2018.

Overall, while the outlined technical amendments of the ICMA CAC would be desirable, the recent joint ICMA/IMF initiative[135] has already reduced the threat of holdout behaviour in future debt restructurings. Moreover, the fact that the vast majority of issuers have positively responded to the initiative, and actually incorporated the enhanced provisions in their bonds, is a noteworthy success.[136] It shows that the cooperation between the private and the official sector in the realm of international finance can work.[137]

Of course, contractual reforms will always battle with transition problems, and, consequently, bonds lacking enhanced CACs will keep haunting the secondary market for some time. In addition, it is clear that reforming CACs alone will be insufficient to eliminate holdout problems. For one, recent insights from the field of law and economics suggest that the dynamics behind CAC voting procedures, and thus the design of thresholds, are more complex than many earlier studies have suggested.[138] For another, the effectiveness of a CAC remains a function of the holdouts' financial firepower. As the history of sovereign debt restructurings suggests, their firepower can increase over time. Thus, we propose additional contractual improvements in the following two sections.

6.2.2. Untangling the Pari Passu Puzzle

6.2.2.1. Background

Pari passu clauses[139] have attained an ill-famed status following a number of contentious holdout cases. In *Elliott v. Peru*[140], the Court of Appeals in Brussels set an important precedent for the interpretation of the *pari passu* clause, which also featured prominently in

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[135] For an overview compare IMF, 'Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring' (2014) IMF Policy Paper <https://www.imf.org/external/np/pp/eng/2014/090214.pdf> accessed 2 December 2017.

[136] See IMF, 'Third Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts' (December 2017) IMF Staff Paper <http://www.imf.org/~/media/Files/Publications/PP/2017/pp113017third-progress-report-on-cacs.ashx> accessed 30 July 2018.

[137] ibid. At the same time, as Weidemaier and Gulati point out, there was 'no case where official sector actors have introduced a novel contract term into a bond market', which implies that contractual innovation was always a product of collaboration between the official and the private sector; see Weidemaier and Gulati (n 114) 84.

[138] See, notably, Robert E. Scott, Mitu Gulati and Stephen J. Choi, 'Hidden Holdouts: Contract Arbitrageurs and the Pricing of Collective Rights' (July 2018) NYU Law & Economics Research Paper Series No 18-27 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3203949> accessed 2 August 2018.

[139] For a definition and discussion of the functioning of *pari passu* clauses in the context of sovereign debt instruments, see above 1.2.4.2.

[140] *Elliott Associates LP v Banco de la Nación and Peru*, 194 F 3d 363 (2d Cir 1999), 20th October 1999, United States; Court of Appeals (2nd Circuit) [2d Cir]. Also see above 3.5.

NML v. Argentina case.[141] The broad payment interpretation of the *pari passu* endorsed by these decisions has been criticised by many scholars. They consider it a dangerous precedent, which is likely to encourage more holdout litigation.[142] Gulati and Klee for instance argue that, from an *ex ante* bargaining perspective, sovereign debtors would be 'crazy' to agree to a 'broad' interpretation of the *pari passu* clause.[143] If *pari passu* was to mean that everyone must be paid *pro rata*, cash-strapped sovereigns could not choose whom to pay first, thereby surrendering the most important 'stick' in a restructuring negotiation.[144]

On the other side of the academic spectrum are those who deem the payment interpretation the only appropriate reading of *pari passu* in the context of sovereign default. Professor Lowenfeld famously explained the functioning of the *pari passu* clause by resorting to the following metaphor:

> '[a] borrower from Tom, Dick, and Harry can't say 'we will pay Tom and Dick in full, and if there is anything left over we'll pay Harry.' If there is not enough money to go around, the borrower faced with a *pari passu* provision must pay all three of them on the same basis … But if the borrower proposed to pay Tom [everything], Dick [something] and Harry nothing, a court could and should issue an injunction at the behest of Harry. The injunction would run in the first instance against the borrower, but we believe (putting jurisdictional considerations aside) to Tom and Dick as well.'

Similar to Lowenfeld, Cohen has shown a clear preference for the payment interpretation. He believes that it makes eminent sense for a lender to a sovereign to demand equal treatment protection.[145] A mere right not to be subordinated is of limited value in the absence of a bankruptcy procedure for sovereigns.[146]

Overall, the true meaning of *pari passu* remains contentious.[147] Even the famous sovereign counsel, Lee Buchheit – who has consistently exhibited a preference for the 'narrow'

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[141] See above 4.3.

[142] Eg Mitu Gulati and Kenneth N. Klee, 'Sovereign Piracy' (2001) 56 The Business Lawyer 635, 638 (noting that the Brussels court's interpretation was wrong and should be disregarded); William W. Bratton, 'Pari Passu and A Distressed Sovereign's Rational Choices' (2004) 53 Emory Law Journal 823. Court of Appeal of Brussels *Elliott Associates, LP v Republic of* Peru General Docket No 2000/QR/92 (2000).

[143] Gulati and Klee (n 142) 639.

[144] ibid 641 (holding that, if one was to apply the 'broad interpretation' a sovereign debtor could not make exclusive payments to the IMF or the World Bank).

[145] Robert A. Cohen, 'Sometimes A Cigar Is Just A Cigar': The Simple Story of Pari Passu' (2011) 40 Hofstra Law Review 11, 17. Note, however, that Cohen acted as counsel for hedge funds in several holdout cases.

[146] ibid.

[147] For instance Rodrigo Olivares-Caminal, 'The pari passu clause in sovereign debt instruments: developments in recent litigation' (2013) BIS Papers No 72 – Sovereign risk: a world without risk-free assets? (Proceedings of a seminar on sovereign risk including contributions by central bank governors and other policy-

interpretation of *pari passu* – admits that 'no one seems quite sure what the clause really means'.[148] Gulati and Scott have committed large parts of their book *The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design* to the investigation of the 'true' meaning of this infamous clause.[149] Yet no scholar has so far been able to dispel the *pari passu* myth and courts have done their part in amplifying the confusion.[150]

Additionally, issuers seem not to always rely on rational design choices when it comes to *pari passu* clauses. They are influenced by their legal advisors' preferences or the prevailing drafting standards at the time of issuance. As Choi et al show, this can result in random mutation of these clauses. This mutation can in turn enable holdout investors to leverage them against the sovereign issuer.[151]

6.2.2.2. *Pari Passu* Clauses under English and New York Law

As discussed above, the Brussels Court of Appeals[152] and the SDNY[153], respectively, shocked international financial markets when they held that *pari passu* clauses restrain the sovereign from making selective payments after default.[154]

However, it appears that the meaning of *pari passu* in sovereign finance depends on whether a bond is governed by English or New York law, respectively.

In a seminal paper from 2005, the English Financial Markets Committee (FMLC), a group of legal and financial experts, rejected the payment interpretation of the *pari passu* clause under English law.[155] The FMLC paper notes that the payment interpretation would not be acceptable to debtors and to creditors since it would 'offend 'business common sense' principles used by English courts when construing a contract.'[156] It further remarks that

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makers, market practitioners and academics, Basel, 8–9 January 2013); Bratton (n 142); Lee Buchheit, 'The Pari Passu Clause in Sovereign Debt Instruments' (2004) 53 Emory Law Journal 869; Mark Weidemaier, Robert Scott, and Mitu Gulati, 'Origin Myths, Contracts and the Hunt for Pari Passu' (2013) 38(1) Law & Social Inquiry 72.

[148] Lee C. Buchheit, 'The Pari Passu Clause Sub Specie *Aeternitatis*' (1991) International Financial Law Review 11.

[149] The authors interviewed numerous sovereign debt lawyers and analysed more than one thousand sovereign debt *contracts just to find out that 'no one has attempted to clarify the imprecise language of the clause'*. See Mitu Gulati and Robert E. Scott, *The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design* (Chicago: Chicago University Press, 2012).

[150] For an in-depth discussion, see above 4.3.3.4.

[151] See Stephen Choi, Mitu Gulati and Eric Posner, 'The Dynamics of Contract Evolution' (2013) 88(1) New York University Law Review 135.

[152] See above 4.3.3.1.

[153] See above 3.5.6.

[154] See above 4.3.3.

[155] See Financial Markets Law Committee, 'Pari Passu Clauses' (February 2005) Issue 79 <http://www.fmlc.org/uploads/2/6/5/8/26584807/79.pdf> accessed 17 September 2017.

[156] ibid 2.

English rules of contract construction give words their ordinary and natural meaning, which, in the case of *pari passu* requires a 'rank' of the claim rather than an equal payment.[157] Lachlan[158] similarly argues that 'there is almost no risk that English courts, faced with similar facts to *NML v. Argentina*, would adopt the 'payment' interpretation.' He believes that English law approaches the interpretation of contracts by looking at background information and the parties' intention at the moment of closing the contract rather than merely considering the wording of the provision.[159]

However, as discussed above, the judgement in *NML v Argentina (UK)* implies that it might not be necessary to convince an English court of the payment interpretation of *pari passu*. Provided the facts are similar to the ones in the Argentine case, holdouts may rely on the cross-border enforceability of sovereign debt and collect on New York court money judgements in England.[160] Of course, it is not clear from the case law whether an injunction by the SDNY could be recognised by English courts in the same manner as a money judgement. As the Brussels court decision in *Elliot v. Peru* shows, English courts would not be the first ones in Europe to adopt the payment interpretation.

To alleviate the risk of broad interpretations of *pari passu* clauses, ICMA, supported by the IMF, has recently proposed an amended *pari passu* clause to be inserted in new issuances of sovereign bonds governed by English and New York law. The ICMA Model *Pari Passu* Clause[161] reads as follows:

> '[t]he Notes are the direct, unconditional and unsecured obligations of the Issuer and rank and will rank *pari passu*, without preference among themselves, with all other unsecured External Indebtedness of the Issuer, from time to time outstanding, provided, further, that the Issuer shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due on the Notes and vice versa.'

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[157] ibid.

[158] Lachlan Burn, 'Pari passu clauses: English law after NML v Argentina' (2014) 9(1) Capital Markets Law Journal 2, 9.

[159] ibid 6.

[160] Jürgen Bröhmer, 'Immunity and Sovereign Bonds' in Anne Peters, Evelyne Lagrange, Stefan Oeter and Christian Tomuscha (eds), *Immunities in the Age of Global Constitutionalism* (The Hague: Brill Nijhoff, 2014) 190.

[161] ICMA, 'New York and English Law Standard CACs, Pari Passu and Creditor Engagement Provisions' (May 2015) <https://www.icmagroup.org/assets/documents/Resources/ICMA-Standard-CACs-Pari-Passu-and-Creditor-Engagement-Provisions---May-2015.pdf> accessed 1 September 2017.

It is clear from this drafting that the payment interpretation supported by the SDNY in the *NML* case no longer finds any backing in the contract language.[162] This significantly reduces the risks that *pari passu* clauses inhibit the successful conclusion of a bond modification. What it leaves is an obligation on the issuer's side not to subordinate certain claims by law or otherwise. Selective payments, which may become necessary to create a credible threat of non-payment against holdouts, will not amount to a violation of the *pari passu* clause.

In addition, some issuers have explicitly stated in their bond offering memorandums that the new ICMA clauses intend to avoid a broad interpretation of *pari passu*. Belize's bond documentation states, for instance, that '[a] contractual provision similar, but not identical, to para 1(c) has been the subject of on-going litigation in US federal courts in a case captioned *NML Capital, Ltd v Republic of Argentina*' and further clarifies that 'Belize does not understand para 1(c) of the Terms and Conditions of the New Bonds, or any comparable provision in any other debt instrument of Belize, to require Belize to pay all items of its Public Debt on a ratable basis.'[163]

Of course, stocks of legacy bonds with outdated *pari passu* provisions will not disappear. Sovereigns have shown no inclination to engage in buy-back operations to update contractual standards – the fear of sending the wrong signals to the market prevails.[164] Therefore, *pari passu* clauses, especially the more ambiguous models, may still be invoked in future cases of holdout litigation.[165] Moreover, while the New York judiciary has somewhat softened its stance in the meantime, the Court of Appeals for the Second Circuit is yet to reverse its 2013 legal opinion on the Argentine *pari passu* clause.[166]

6.2.2.3. *Pari Passu* Clauses in Domestic Law Bonds

So far, *pari passu* clauses have played a negligible role in the discussions about holdout problems in the restructuring of domestic law government bonds. Most such bonds, notably in the euro area, lack *pari passu* clauses as well as other standard boilerplate provisions in international sovereign bonds. The reasons for this contractual gap are likely to be historical:

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[162] See above 4.3.3.

[163] See Lee Buchheit and Sophia Martos, 'What to Do about *Pari Passu*' (2014) 29(8) Butterworth's Journal of International Banking and Financial Law 491, 493.

[164] See IMF (n 135).

[165] This is because some government bonds have very long maturities, which means that the new contractual clauses cannot be included unless the sovereign buys back the respective security or retroactively amends the contract terms by law. Both may trigger a strong negative reaction, as it could signal a loss in the sovereign's creditworthiness and a higher likelihood for default.

[166] See above 4.3.3.4.3.

a default on domestic law and statute-based bonds was considered highly unlikely. Moreover, the local law advantage euro area issuers enjoy made it somewhat redundant to pencil in bondholder protection clauses.

At the same time, foreign law bonds issued by euro area nations do feature *pari passu* clauses.[167] This confirms that, once a sovereign enters a foreign sovereign debt market, it will adjust to the prevalent drafting standards, regardless of its creditworthiness or ability to raise funds with domestic law securities.

Thus, if more euro area sovereigns will resort to foreign law bonds, the importance of *pari passu* clauses will increase correspondingly. This might raise new and complex legal questions. For instance, the relationship between foreign law bonds with *pari passu* clauses and domestic law bonds without them, remains equivocal.

6.2.2.4. The Future Role of *Pari Passu* Clauses in Sovereign Bonds

Similar to the revision of CACs, recent international reforms directly respond to risk that poorly drafted *pari passu* clauses undermine debt restructurings. Of course, in contrast to CACs, *pari passu* clauses are not meant to facilitate creditor coordination. CACs give the issuer the right to propose a modification while *pari passu* provisions protect the bondholders from certain sovereign measures.

As Buchheit and Martos explain, following the *NML* saga, several options were tabled on how to proceed with the *pari passu* conundrum.[168] The 2014 reform disavowed the ratable payment interpretation. Other options that were considered ranged from abandoning the clause entirely to focusing on the problematic injunctive remedy developed by the SDNY in the *NML case*.[169] Rating agencies, such as Moody's[170], were critical about the usefulness of the enhanced provision. They argued that it 'strips the *pari passu* clause from the only

[167] See, eg, The Hellenic Republic, 'EUR 1,000,000,000, 5.20% Bonds due 2034' (29 April 2004) Offering Circular <https://dl.bourse.lu/dl?v=ADyMFy5zxNFitbuuk6wDBuMZXSTIzof83NW3u+Y5PZ2sZtA9JymecKUsr/FqMglwM4tW9JngDoYnjEVw/tyQunKp+Nm3bJohiJU0veTcq2vRM+xvcf2uDkMqOIXNJPm+l5ZL7oVOCfIU3fpagCuIGw==> accessed 23 June 2018 (stating that 'The Bonds rank *pari passu* with all other unsecured and unsubordinated obligations of the Republic outstanding on 30 April 2004 or issued thereafter without any preference granted by the Republic to one above the other by reason of priority of date of issue, currency of payment, or otherwise'). The existence of a *pari passu* clause in English law bonds restructured by Greece in 2012 may have contributed to the government's decision not to take a chance in English courts

[168] See Buchheit and Martos (n 163).

[169] ibid 491-493.

[170] See Moody's Investor Service, 'Announcement: Moody's Answers Frequently Asked Questions on New ICMA Sovereign Bond Clauses' (17 March 2015) https://www.moodys.com/research/Moodys-answers-frequently-asked-questions-on-new-ICMA-sovereign-bond--PR_320871/> accessed 9 August 2018.

language that has been tested in court', implying that the ranking interpretation is merely a product of scholarly fantasy. However, as the first issuance of Mexican sovereign bonds with enhanced *pari passu* clauses underscored, markets seem not to penalise sovereigns for using the enhanced clause.[171]

Overall, the fact that the meaning of *pari passu* in the context of sovereign debt remains disputed supports the case for abandoning the clause. From a creditor's perspective, given that the new ICMA CAC only prohibits the *statutory* subordination of other bondholders, the *pari passu* clause may no longer be a powerful instrument. Indeed, a government could discriminate certain lenders by virtue of governmental measures other than passing a statute. From a sovereign issuer's perspective, if the idea behind the recent ICMA/IMF initiative was to redefine creditor and debtor rights in a broader manner, as Buchheit and Martos suggest[172], an ambiguous and contentious provision like the *pari passu* clause might not be the best tool.

Indeed, while investors should be protected against undue and discriminatory treatment during a debt restructuring, this objective may also be achieved through other contractual means, as discussed below.[173] After the *pari passu* clause was the legal lynchpin of two debt workouts, the risk that yet another aberrative interpretation of the *pari passu* clause could again unsettle international debt markets might not be worthwhile.[174]

One should thus serious consider the abolition of the *pari passu* clause for future bond issuances, given that the potential risks seemingly outweigh the benefits of protecting (a few litigious) investors.

6.2.3. THE CASE FOR BONDHOLDER REPRESENTATION CLAUSES

6.2.3.1. Background

An important legal aspect of a sovereign bond is how the bondholders are represented and which rights they can exercise individually and which as a collective. Broadly speaking, we

[171] Mark Sobel, 'Strengthening Collective Action Clauses: Catalysing Change—the Back Story' (2016) 11(1) Capital Markets Law Journal 3, 10. Also compare Alejandro Díaz de León, 'Mexico's adoption of new standards in international sovereign debt contracts: CACs, pari passu and a trust indenture' (2016) 11(1) Capital Markets Law Journal 12 (noting that 'Mexico's experience with the introduction of the new contractual standards has been positive, with strong investor acceptance that resulted in a series of debt issuances characterized by large bid-to-cover ratios, historically low costs and ultra-long tenors of up to 100 years').

[172] Buchheit and Martos (n 163).

[173] See below 6.2.4.

[174] Abandoning the *pari passu* clause will of course require some explanation and backing by the official sector to mitigate negative signalling effects.

can distinguish between trust structures and fiscal agency agreements.[175] While the former are typically used in sovereign bonds issued by English law[176], the latter are common under New York law[177] governed instruments. The IMF concluded that approximately 45% (in nominal principal amount) of international sovereign bonds issued between 1 October 2014 and 31 October 2016 used trust structures.[178] However, not all bonds issued under English law are necessarily based on a trust deed. As is the case for Poland[179] or Lithuania[180], while English law governs some of their government bonds, they are based on a FAA.

Essentially, the trustee represents the interests of bondholders, while the fiscal agent represents the interests of the issuer.[181] This has implications for holdout investors. Given that the trustee acts on behalf of the bondholders as a group, the rights of individual bondholders to engage in 'go-alone' litigation against an issuer are limited.[182] By contrast, under an FAA, no such constraints on the bondholders' side exist. Rather, depending on the precise contractual provisions, the bondholder can exercise her contractual rights individually, without involving the fiscal agent, or indeed any other bondholder.[183]

Thus, several authors have discussed the value of promoting trustee structures instead of FAAs for international bonds governed by New York law as a way of mitigating the holdout

[175] See G10, 'The Resolution of Sovereign Liquidity Crises' (Report, Basel, May 1996) 49-65 <http://www.bis.org/publ/gten03.pdf> accessed 17 October 2016.

[176] The English-style trust deed is a contract between the issuer and the trustee which specifies the extensive ways in which the trustee is obliged to serve the interests of the bondholders. The trustee has both the power and the duty to monitor the debtor's compliance with the terms of the instrument, and to take remedial measures in case the debtor fails to meet its contractual obligations. See Sönke Häseler, 'Trustees versus fiscal agents and default risk in international sovereign bonds' (2012) 34(3) European Journal of Law and Economics 425, 426.

[177] ibid. Häseler also explains that New York-style trust indentures generally follow the requirements of the US Trust Indenture Act of 1939, even though the act applies only to corporate bonds. The Act stipulates that "each bondholder has an unqualified right to bring an individual enforcement action to recover her share of any amounts of principal and interest not paid on their respective due dates.

[178] IMF, 'Second Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts' (January 2017) <https://www.imf.org/external/np/pp/eng/2017/122716.pdf> accessed 28 April 2017.

[179] Eg, The Republic of Poland, 'EUR 60,000,000,000 Euro Medium Term Note Programme' (8 March 2018) Base Prospectus <https://dl.bourse.lu/dl?v=ADyMFy5zxNFitbuuk6wDBuVxaSORb8TfhuxwtSwJ2LlmgbFs+D+1jiD2nbc0QsNqo4M5Yzu4GRj+JHJgli2yu+2PTAHU5+97+34LlfFLdeynAFsAQnPIcqRcyyEaybexfjS3xJxkMiuFpu5FW23ZAg==> accessed on 13 July 2018.

[180] The Republic of Lithuania, 'Euro Medium Term Note Programme' (17 May 2017) Offering Circular <https://www.bourse.lu/programme/Programme-Lithuania/14055> accessed 10 August 2018.

[181] Giuseppe Bianco, *Restructuring Sovereign Debt: Private Creditors and International Law* (PhD thesis, University of Oslo 2017).

[182] See, eg, IMF (n 135).

[183] Lee Buchheit, 'Trustees versus fiscal agents for sovereign bonds' (2018) Capital Markets Law Journal (forthcoming, on file with author).

creditor problem.[184] As Buchheit points out, '[d]espite efforts to educate issuers and their legal counsel about the benefits of using trust structures, many financial professionals did not understand, or did not care, that the instrument by which a bond is constituted can affect how the bond is handled in a time of financial distress.'[185] The next section further explores the merits of this idea.

6.2.3.2. Trustee Structures As a Way To Mitigate Holdout Problems

In the discussion on bondholder representation clauses, and how they can reduce holdout problems, four advantages of trustee structures over FAAs are frequently mentioned.

First, any amounts recovered by the trustee by means of litigation would have to be distributed *pro rata* among all investors.[186] This 'sharing feature' makes the bond unsuitable for holdout strategies. After all, the holdout investor seeks to gain preferential treatment compared to her fellow creditors by assuming litigation risks.[187]

Second, under a trust deed (English law) or trust indenture (New York law), the right to accelerate the debt and the right to initiate legal proceedings against the debtor rest exclusively with the trustee.[188] Holdouts typically accelerate the bonds after a default or a debt restructuring in order to recover the outstanding principal. However, given that the trustee is obligated to act in the interest of all bondholders, the lack of individual acceleration rights should discourage holdouts.[189]

Third, if the trustee discharges her duties in a responsible and diligent manner, trust structures may promote collective creditor action and support smooth debt restructuring negotiations.

[184] For an overview of the debate and arguments, see Robert Auray, 'In Bonds We Trustee: A New Contractual Mechanism To Improve Sovereign Bond Restructurings' (2013) 82(2) Fordham Law Review 899.

[185] Buchheit (n 183).

[186] See, eg, IMF, 'The Design and Effectiveness of Collective Action Clauses' (6 June 2002) 14 <https://www.imf.org/external/np/psi/2002/eng/060602.pdf> accessed 9 August 2018.

[187] Also see, eg, See Anna Gelpern, 'Sovereign Debt: Now What' (2016) 41(2) Yale Journal of International Law Online 45, 92.

[188] Häseler (n 176) 430 (noting however that '[a]n exception lies in the case where the trustee fails to take action despite being prompted to do so by a certain percentage of bondholders.').

[189] Of course, in order to avoid inertia on the trustee's side, many trust structures also include certain collective action procedures that enable a certain percentage of bondholders, typically 25%, to compel the trustee to take certain actions in the common interest of the bondholders. This became necessary, for instance, after the Ecuadorian default of 2008. As Buchheit and Gulati describe, to compel the trustee to take action, '[t]he holders of one series eventually mustered the 25% vote needed to force the trustee to accelerate that series, but the authors understand that the second series missed the 25% voting threshold by just a small amount.' See Lee Buchheit and Mitu Gulati, 'The Coroner's Inquest: Ecuador's Default and Sovereign Bond Documentation' (2009) 28 International Financial Review 22. Similarly, the Greek government bonds issued as part of the PSI in 2012 state that 'the Trustee shall not be bound to take an Enforcement Action […] unless directed or requested to do so in writing by the Holders for the time being of at least 25 per cent. of the Outstanding Securities of the relevant Class […]'.

Indeed, a trustee can call and coordinate bondholder meetings, ensuring that the community of bondholder speaks with a single voice to the issuer.[190] By contrast, the fiscal agent would have no obligation or incentive to perform such additional tasks. While it is true that the trustee's coordination functions are rather informal, common representation can be critical to ensure fair and efficient debt workouts. Notably, they reduce the risk of side agreements between the sovereign and opportunistic investors, which is particularly challenging to control in out-of-court debt workouts.

Fourth, as Buchheit points out, trustees can be of important to shield funds paid as debt service on the securities from attachment by third party creditors of the issuer.[191] Arguably, payments received by the trustee on behalf of the issuer become the bondholders' property. Consequently, third party creditors of the sovereign issuer could not attach such payments through legal action against the sovereign issuer.[192] In practice, this means that attempts by holdouts to attach payments flowing from the sovereign to restructured bondholders would have to be dismissed – the sovereign has surrendered all rights of ownership. Recent case law endorses this view. In 2017, the SDNY concluded that a sovereign no longer had any proprietary interest in bond payments once they were in the hands of the trustee.[193]

This said, one may also argue that the choice between a trustee and a fiscal agent makes little practical difference in workouts of foreign debt governed by US law, as trustees have no financial incentive to take independent action. This is because they are potentially liable to debt holders for any breach of their fiduciary duties. As a result, they are generally reluctant to take any substantive decision concerning a bond workout without instruction from a large majority of debt holders.

To provide such financial incentives, one may consider devising standard trust deeds and indentures for international sovereign bonds, as was done by ICMA with respect to CACs and *pari passu* clauses. Indeed, to limit potential abuses of trust structures, there needs to be a common understanding among the international community of trustees regarding trustees' responsibilities in a debt restructuring.[194] To this end, one could provide additional incentives

[190] Buchheit and Martos (n 163) 401.
[191] Buchheit (n 183).
[192] ibid 4.
[193] *Commissions Import Export SA v Republic of the Congo*, 17 Misc 246 (PGG), 22nd August 2017, United States; New York; District Court for the Southern District of New York [SDNY].
[194] See Buchheit (n 183) 5.

for trustees to safeguard bondholders' interests. In light of the possible advantages trustee structures can provide in deterring holdouts, policymakers should view them as an expedient advancement. After all, the financial benefits from reducing disruptive will often exceed the costs of ensuring appropriate representation through a trustee.

6.3. RESOLVING HOLDOUT PROBLEMS AT THE EUROPEAN LEVEL: A EUROPEAN SOVEREIGN DEBT RESTRUCTURING FRAMEWORK[195]

6.3.1. INTRODUCTION

In this section, we argue that the euro area sovereign debt crisis has revealed a need to build a more resilient and effective crisis resolution architecture. More specifically, the European Sovereign Debt Restructuring Framework (ESDRF) proposed herein aims at addressing the core legal and financial challenges of sovereign debt restructurings in the euro area. The ESDRF would directly respond to the shortcomings observed during the Greek PSI while also taking account of the broader international framework of sovereign debt management and restructuring. The ESDRF would be a (quasi-)statutory framework that goes beyond the pure contractual approach. Notably, it would include certain institutional features, such as a dispute settlement function for post-restructuring litigation. While mitigating holdout inefficiencies would be a central objective of this framework, it also seeks to address other shortcomings of the existing crisis resolution mechanism in the euro area.

The idea of creating a framework to deal with sovereign debt crisis in the monetary union is by no means new. To complement the existing literature, the ESDRF proposal takes account of the legal aspects of the Greek debt restructuring, especially post-PSI litigation, as well as the rapidly evolving policy discussion on the reform of the Economic and Monetary Union (EMU). This section is structured as follows. First, we analyse existing proposals on a euro area sovereign debt restructuring mechanism, also explaining the underlying economic and political rationales. Second, we review the potential legal basis of the ESDRF. Third, we look into the institutional aspects of the ESDRF as well as design issues.

Given that the ESM now acts as the euro area's lender of last resort to sovereigns, the ESDRF should be tied into the ESM's operational and institutional architecture and guide its

[195] This chapter is partly based on an article written together with Mikael Stenström, which is has been accepted for publication in the Fordham International Law Journal and is forthcoming in early 2019.

lending decisions. While the IMF serves as a blueprint for the ESDRF, we duly consider the legal, economic and political particularities of the euro area. Therefore, the IMF's mandate and functions should not simply be replicated.

Throughout the past decade, a number of authors have argued that EMU governance still does not contain the requisite tools to remedy the sovereign debt problem in Member States.[196] Against the backdrop of existing proposals, as well as the authors' own analysis, the subsequent sections seek to explain how a better debt restructuring framework could be designed, focusing, in particular, on its legal features and functions.[197] For the sake of clarity, it is noted that the term 'ESDRF' is neither equivalent to the ESM nor to the proposed European Monetary Fund (EMF).[198] Rather, the ESDRF should be understood as an umbrella term comprising a set of rules with the shared objective of rendering debt restructurings more orderly, transparent, and fair.[199] Moreover, the ESDRF would by no means 'force' countries into debt restructurings[200] but rather clarify the mechanics of crisis lending when debt is assessed as unsustainable by the ESM and the European Commission. Whether or not debt should be restructured remains, at all times, the sovereign's independent decision.

6.3.2. Existing Proposals

Most of the existing proposals for a debt restructuring mechanism in the euro area focus on the potential economic benefits of a more transparent and rule-based procedure.[201] At the

[196] Charles Wyplosz, 'The six flaws of the Eurozone' (2016) 31 Economic Policy 559. For a recent analysis of the status of sovereign debt restructuring in the euro area from a legal perspective, see Lee C. Buchheit and G. Mitu Gulati, 'Sovereign Debt Restructuring in Europe' (2018) 9(1) Global Policy 65.

[197] A review of the pertinent literature revealed a paucity of in-depth analyses of the legal framework that may underpin such mechanism. Here, we aim to make a serious contribution to scholarship that should serve as a starting point for future work and research.

[198] The EMF has been proposed as an enhanced ESM anchored in Union law by the European Commission in December 2017; see European Commission, 'Proposal for a Council Regulation on the establishment of the European Monetary Fund of 6 December 2017' COM(2017) 827 final <https://ec.europa.eu/info/sites/info/files/economy-finance/com_827.pdf> accessed 19 June 2018.

[199] In the given context, an orderly debt restructuring is one where holdouts' interference is reduced and a fair debt restructuring is one where the burden of adjustment is appropriately shared between the private and public sector.

[200] As the ECB held in 2012 in the context of the Greek PSI, 'it remains the sole responsibility of the Government of the Hellenic Republic to take the necessary action that will ultimately ensure its debt sustainability.' See ECB, 'Opinion of the European Central Bank of 17 February 2012 on the terms of securities issued or guaranteed by the Greek State' (CON/2012/12) <https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2012_12_f_sign.pdf> accessed 3 April 2018.

[201] Jochen Andritzky, Désirée I. Christofzikk, Lars P. Feld and Uwe Scheuering, 'A mechanism to regulate sovereign debt restructuring in the euro area' (2018) International Finance (forthcoming. The debate is closely linked to the establishment of the EMF. See, eg, Marcel Fratzscher, 'Why a Franco-German Bargain Will Help Secure the Euro' *Financial Times* (London, 9 August 2017). See Thomas Mayer and Daniel Gros, 'Towards a Euro(pean) Monetary Fund' (2010) CEPS Policy Brief No 202 <https://www.ceps.eu/publications/towards-european-monetary-

centre of an enhanced legal framework lies the objective of restoring the sustainability of public debt levels and, in doing so, ensuring a fair level of burden-sharing between private creditors and the sovereign debtor.[202] A more transparent and efficient framework for debt restructuring in the euro area, so the argument goes, may considerably enhance the ESM's effectiveness, as the need for ESM liquidity, ie bailouts, will likely be lower. Box 10 provides an overview of the most prominent proposals from the pertinent law and economics literature.

The majority of proposed frameworks entail a pre-positioned crisis resolution mechanism for sovereign default. Most proposals seek to combine *ex ante* market discipline[203] with an *ex post* procedure to deal with holdout creditors. With regard to the legal basis, it appears that the majority of commentators favour the intergovernmental over the Union approach, which means the enhanced debt restructuring framework would be governed by the ESM Treaty and hence outside the four corners of EU law.[204] Agreement also seems to exist on the need to enhance the current design of Euro CACs, which entail a two-limb voting procedure that is more prone to holdout strategies than the ICMA single-limb standard for international sovereign bonds.[205]

Box 10: Existing Proposals for an ESDRF				
Proposal	**Legal basis**	**Dispute settlement process**	**Interim financing**	**Restructuring process**
ECRM European Crisis Resolution Mechanism	EU Treaties	• Separate chamber at the CJEU to initiate and supervise negotiations • No further details on the set-up	• European Financial Stability Facility as a permanent institution (which is part of today's	• Debtor country launches negotiations • Moratorium of payments and stay on litigation • No further

fund> accessed 9 September 2017. For a more crticial view, see, eg, Laurence Boone and Shahin Vallée, 'Europe Needs True Fiscal Integration, Not Its Own IMF' *The Economist* (London, 9 May 2017).

202 See, notably, Agnès Bénassy-Quéré, Markus K Brunnermeier, Henrik Enderlein, Emmanuel Farhi, Marcel Fratzscher, Clemens Fuest, Pierre-Olivier Gourinchas, Philippe Martin, Florence Pisani, Hélène Rey, Isabel Schnabel, Nicolas Véron, Beatrice Weder di Mauro and Jeromin Zettelmeyer, 'Reconciling risk-sharing with market discipline: A constructive approach to euro area reform' (2018) CEPR Policy Insight No 91 <https://cepr.org/active/publications/policy_insights/viewpi.php?pino=91> accessed 2 July 2018. For a focus on debt restructuring, see recently Jeromin Zettelmeyer, 'Managing Deep Debt Crises in the Euro Area: Towards a Feasible Regime' (2018) 9(1) Global Policy 70.

203 Market discipline, it is argued, may be reinforced by providing creditors with clarity about the fate of their investments in the event of sovereign default, namely that the provision of ESM bailout funds may be linked to PSI. For this argument, see, in particular, Andritzky et al (n 201).

204 For a discussion of the potential legal basis of an ESDRF, see below 6.3.3.

205 See below 6.3.5.1. for ways to improve the resilience of CACs used in the euro area.

(Gianviti et al, 2010)			ESM) • ESM financial assistance (linked to conditionality)	details on haircut size etc.
EMF European Monetary Fund (Mayer/Gros, 2010)	EU Treaties	• Not specified	• Provided by the EMF (similar to the ESM)	• Liquidity measures in a first step • Restructuring of debt in a second step to a level of 60% of GDP (akin to a Brady deal)
ESDRF European Sovereign Debt Restructuring Framework (Bagchi, 2013)	ESM Treaty	• Arbitration under the auspices of an independent European Sovereign Debt Restructuring Council • Procedure guided by UNIDROIT Principles of Transnational Civil Procedure	• Not specified	• ESDRF is activated after debt is deemed unsustainable by the ESM • Dispute settlement body oversees ESDRF proceedings and related matters • Moratorium on creditor payments and immunity from creditor enforcement
ESDRR European Sovereign Debt Restructuring Regime (Committee on International Economic Policy Reform, 2013)	ESM Treaty	• Not specified	• ESM lending conditional upon debt restructuring • Seniority of liquidity provision	• Aggregated majority voting • ESM funds immunised from holdout litigation • Restructuring with the aim of decreasing debt to 90% of GDP (liquidity crisis) or 60% of GDP (insolvency)
VIPS Viable Insolvency Procedure for Sovereigns (Fuest et al,	ESM Treaty	• Not specified	• ESM provides shelter loans for 3-year period • Seniority of liquidity provision	• Trigger based on the DSA • Restructuring not below 60% debt-to-GDP ratio • Aggregated majority voting

2015)				
MRSDR Mechanism to Regulate Sovereign Debt Restructuring (German Council of Economic Experts, 2016)	ESM Treaty	• Not specified	• ESM financing includes maturity extension	• DSA-based trigger • Debt restructuring only as a second step if maturity extension insufficient • Aggregated majority voting

6.3.3. The Legal Basis

This section analyses a potential legal basis for an ESDRF and focuses on two options: EU law and the ESM Treaty (international law).

EU law is the *sui generis* system of laws operating within the 28 Member States of the EU, which takes precedence over rules of national law. EU law can roughly be split into primary law and secondary law. An ESDRF could be rooted either in primary law or secondary law, with the important limitation that rules of secondary law may not contradict the normatively higher rules of primary law.

The ESM Treaty is an intergovernmental treaty governed by international law and signed and ratified by the 19 Member States of the euro area. Its objective is to ensure the financial stability of the euro area. The strong interrelation within the euro area made it necessary to establish a central European body to provide emergency financial assistance to single Member States if the financial stability of the euro area as a whole is at danger. In that sense, the ESM has a fiscal character. At the same time, transfers are subject to strict conditionality to reduce incentives for debtor states to draw on its funds.

6.3.3.1. EU Law

As Ioannidis points out, '[i]n the field of debt, neither creditors nor Member States should expect solidarity.'[206] Indeed, the current Treaty framework is centred around a market-based paradigm, which subjects euro area Member States to market forces by constraining central bank intervention (Article 123(1) TFEU)[207] or inter-country financial assistance (Article 125(1) TFEU).[208] From the viewpoint of EU primary law, the main question when it comes to government debt restructuring within the euro area is whether the economic constitution prohibits, allows, or even encourages it.

In this regard, one ought to consider that the no-bailout clause limits official financial assistance and that the framework for sovereign debt in the euro area relies on market logic. As stated by the CJEU in the *Pringle* case, compliance with market discipline contributes at Union level to the attainment of a higher objective, namely maintaining the financial stability of the monetary union.[209] The maxim of Articles 123 and 125 TFEU is thus to preserve the incentives for Member States to pursue sound budgetary policies.[210] This rationale has to be respected not just in good times but especially during economic downturn, where ESM support may become necessary. In the context of ESM lending, debt restructuring ensures that the role of markets is preserved, which is already reflected in the current Recital (12) of the ESM Treaty.[211]

[206] Michael Ioannidis, 'Debt restructuring in light of Pringle and Gauweiler – flexibility and conditionality' (ESCB Legal Conference, Frankfurt, 6-7 October 2016) <https://www.ecb.europa.eu/pub/pdf/other/escblegalconference2016_201702.en.pdf> accessed 19 June 2018.

[207] Article 123(1) TFEU stipulates that: 'Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as "national central banks") in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.'.

[208] Article 125(1) TFEU reads as follows: 'The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.' Of course, as explained above, the *Pringle* decision somewhat eroded the strict no-bailout principle.

[209] *Pringle v Government of Ireland and ors*, Judgment, reference for a preliminary ruling, Case C-370/12, ECLI:EU:C:2012:756, [2013] OJ C26/15, ILEC 053 (CJEU 2012), 27th November 2012, Court of Justice of the European Union [CJEU]; European Court of Justice [ECJ] 135.

[210] ibid [136-139].

[211] Of course, it remains within the remit of the sovereign's discretion to make the arguably complex decision in favour or against such measure; see Vassilis Paliouras, 'The Right to Restructure Sovereign Debt' (2017) 20 Journal of International Economic Law 115.

A preliminary conclusion is that the current framework for sovereign debt restructuring under the auspices of the ESM Treaty could be transferred into Union law without raising serious legal concerns. Also with respect to an enhanced ESDRF, the legal assessment should not result in a different conclusion. First, giving a stronger role to the ESM with respect to debt sustainability analyses would follow the market discipline logic of Article 125 TFEU. Second, enhanced contractual provisions to mitigate holdout problems would make PSIs more orderly and should therefore serve the more general Union objective of maintaining financial stability. Third, the creation of a dispute resolution function would mitigate *ex post* creditor coordination failures, thereby ensuring that the adverse effects of debt restructurings would be minimised to the greatest extent possible.

With regard to a concrete legal basis for a crisis resolution mechanism under EU law, Article 352 TFEU has been mentioned.[212] The 'flexibility clause' provides for subsidiary powers[213] that enable the Union legislator to adopt an act of secondary legislation, if necessary to attain the objectives laid down in the Treaty.[214] The application of Article 352 TFEU in respect of the establishment of an ESDRF poses challenges in light of the conditions that must be met in order for it to be activated: (i) the action must be necessary to attain one of the Union's objectives, (ii) no existing provision of the Treaty provides for action to attain the objective, and (iii) the envisaged action must not lead to the EU's competences being extended beyond those provided for by the Treaties.[215] Finally, the ESM would then become one of the many EU agencies, without its own statute, its own capital, or a strong legal status.

This analysis suggests that the optimal legal basis for an improved crisis resolution mechanism – that includes the enhanced framework for sovereign debt restructuring – would be the EU Treaties.

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[212] See, eg, Jean-Victor Louis, 'The Future of Economic Governance in the EU: Volume II: Evidence' (House of Lords, European Union Committee, 12th Report of Session 2010-2011) 113 <https://publications.parliament.uk/pa/ld201011/ldselect/ldeucom/124/124ii.pdf> accessed 2 June 2018 (noting, however, 'that it is very difficult to build [a sovereign debt restructuring mechanism] under secondary [EU] law').

[213] The principle of subsidiarity, as set out in Article 5 TEU, stipulates that the EU may not take action unless such action is more effective in attaining the Union's objective than action taken at national, regional or local level.

[214] Article 352 requires the European Commission to propose a certain act, which the Council of the European Union has to adopt unanimously and to which the European Parliament has to consent. National Parliaments, too, need to be involved in the legislative process under Article 352 TFEU, albeit their consent is not required.

[215] Moreover, resorting to Article 352 TFEU means that all actions taken by the ESM and/or EMF must comply with the so-called *Meroni* doctrine, which essentially constrains the Union legislator in respect of the creation of agencies or bodies that enjoy large discretion. See for an overview of the issues, see Pieter Van Cleynenbreugel, 'Meroni Circumvented? Article 114 TFEU and EU Regulatory Agencies' (2014) 21 Maastricht Journal of European and Comparative Law 64.

First, as mentioned above, there are no obstacles in the current Treaty to devise new rules and mechanisms for government debt restructurings. Just like the current Treaty framework defines procedures to remedy excessive debt levels in EU Member States, EU primary law could provide for a pre-defined mechanism that is triggered if states request financial assistance from the ESM. Second, the ESM has no basis in the Treaties yet. Regardless of whether crisis lending involves a restructuring of public debt, an important body like the ESM must, sooner or later, become part of the EU's institutional legal framework.

Of course, Treaty change remains a long-term objective, notably since politicians throughout Europe have become much more cautious in openly advocating for more and deeper integration. Against this backdrop, the next section argues that – over the short-term – the ESM Treaty may be a more realistic legal basis for an enhanced debt restructuring framework.

6.3.3.2. ESM Treaty

Given the current political stalemate, it may be necessary to capitalise on the existing legal framework to enhance the current framework for debt restructuring. As proposed for instance by the Committee on International Economic Policy and Reform, the ESM Treaty could be amended to effect certain contractual changes aimed at further alleviating holdout inefficiencies.[216] An amendment of the ESM Treaty would require unanimous agreement of all ESM Members (19 euro area Member States) and ratification, approval or acceptance of such amendment by these members, in accordance with their national constitutional requirements (which includes the involvement of national Parliaments in some Member States).

While, therefore, the process entails some delicate political steps, amending the ESM Treaty still poses fewer obstacles than revising the EU Treaties. This is because the latter requires public referenda to be conducted in several euro area Member States. By contrast, the barriers under national constitutional law to change the ESM Treaty are typically lower.[217] Of course,

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[216] Committee on International Economic Policy and Reform, 'Revisiting Sovereign Bankruptcy' (October 2013) Brookings Institution, 40 <https://www.brookings.edu/wp-content/uploads/2016/06/CIEPR_2013_RevisitingSovereignBankruptcyReport.pdf> accessed 1 July 2018. See also, eg Yves Mersch, 'Reflections on the Feasibility of a Sovereign Debt Restructuring Mechanism in the Euro Area' (ESCB Legal Conference, Frankfurt, 6-7 October 2016) 6 <https://www.ecb.europa.eu/pub/pdf/other/escblegalconference2016_201702.en.pdf> accessed 19 June 2018.

[217] This is why many scholars consider the ESM Treaty to be the better vehicle for sovereign debt reform; see Lee Buchheit, Mitu Gulati and Ignacio Tirado, 'The Problem of Holdout Creditors in Eurozone Sovereign Debt

introducing an ESDRF via the ESM Treaty means that its scope of application would be restricted to euro area countries. Thus, the concerns inherent to relying on an intergovernmental arrangement for crisis resolution, which operates outside the Treaty framework, would linger on. Hence, Treaty change should be the preferred legal vehicle for policy and lawmakers to enhance the functioning and resilience of EMU.

6.3.3.3. The Proposal to Establish a European Monetary Fund

While not directly relevant for the discussion about an ESDRF, it is recalled that European Commission has released plans to transform the ESM into an EMF.[218] As part of this proposal, the European Commission suggested an EU Regulation under Article 352 TFEU to establish the EMF.[219] The European Commission has signalled that strengthening the EMU should be pursued progressively and, importantly, within the existing EU law framework.[220]

On substance, however, the proposal leaves many essential aspects of dealing with sovereign debt crises aside, most notably mechanisms to ensure smooth and orderly debt restructurings.[221] It even backtracks from the existing rules on debt restructuring and introduces additional ambiguity. First, the European Commission proposes not to transfer Recital (12) of the ESM Treaty into Union law, according to which an adequate and proportionate form of debt restructuring may be considered in exceptional cases.[222] Second, the European Commission decided not to replicate the obligation for Member States under

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Restructurings' (January 2013) unpublished manuscript <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2205704> accessed 9 September 2017.

[218] European Commission (n 204).

[219] ibid.

[220] ibid. Article 352(1) TFEU states the following:

'[i]f action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures. Where the measures in question are adopted by the Council in accordance with a special legislative procedure, it shall also act unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament.'

[221] Perhaps surprisingly, the European Commission's proposal is even more muted on the issue of government debt restructuring than the ESM Treaty: in Recital (12), the ESM Treaty states that '[i]n accordance with IMF practice, in exceptional cases an adequate and proportionate form of private sector involvement shall be considered in cases where stability support is provided accompanied by conditionality in the form of a macro-economic adjustment programme.' Conversely, the EMF Statute makes no reference whatsoever to the possibility of a debt restructuring; European Commission, 'Annex to the Proposal for a Council Regulation on the Establishment of the European Monetary Fund of 6 December 2017' COM(2017) 827 final, <https://ec.europa.eu/info/sites/info/files/economy-finance/com_2017_827_annex.pdf> accessed 26 June 2018 [hereinafter 'Annex to the EMF Regulation'].

[222] Recital (12) of the Treaty Establishing the European Stability Mechanism (European Union [EU], Brussels, 2 February 2012) [henceforth 'ESM Treaty'].

the ESM Treaty to insert CACs in domestic government bonds.[223] Without further delving into the politics of the ongoing discussions, it should be noted that the EMF proposal would nurture an even higher degree of uncertainty with respect to the ESM's crisis management functions, specifically for the case of a debt sustainability crisis.

6.3.4. Institutional Aspects

In our proposal, the ESDRF would have four different features that build on and complement each other. These four features are allocated to two different functions, namely a financial and a legal function, as explained in Box 11.

Box 11: Matching the ESDRF's features and functions			
Feature	**Function**	**Description and objective(s)**	***Status quo***
1. Activation of ESDRF in case of negative DSA	Financial function[224]	The activation of the ESDRF, and thus a government debt restructuring, should be required in exceptional cases as part of an ESM lending programme, if the Member State's debt is deemed unsustainable by the ESM Board of Governors (in line with existing IMF practices). It remains within the requesting government's discretion to activate the ESDRF. In other words, there should be no automatic debt restructuring.	Very weak link between debt restructuring and ESM financial assistance programme (Recital (12) ESM Treaty)
2. Enhanced majority voting complemented by an emergency procedure if a CAC vote fails	Legal function[225]	A (super-)majority of creditors must be in a position to approve or reject a debt restructuring plan against the will of a minority of holdouts. In exceptional cases, if a CAC vote fails, the Member State would use the power to override existing contractual arrangements in line with	Current Euro CACs lack full aggregation feature and no emergency procedure is in place in case a

[223] Rather, the European Commission noted in a Recital (52) of the EMF Regulation that '[T]his Regulation should not affect the commitment agreed between the Contracting Parties to the Treaty establishing the ESM pursuant to Article 12(3) of that Treaty, namely that collective action clauses must be included in all new euro area government securities, with a maturity above one year, in a way which ensures that their legal impact is identical.' However, it can be argued that, once the ESM Treaty ceases to be in force, no obligation exists under international or Union law to insert CACs in euro area government bonds. While the European Commission has not further explained why it chose to propose the deletion of Article 12(3) of the ESM Treaty, its decision seems to reinforce the negative sentiment vis-à-vis PSI, given that CACs are the most effective means to secure debt relief.

[224] See below 6.3.4.1.

[225] See below 6.3.4.2.

		existing constitutional legal limits, subject to review by the ESDRF legal function.	CAC vote fails (repeatedly).
3. Statutory immunisation of ESM funds	Legal function[226]	ESM funds disbursed to Member States should be protected from litigation by immunising them from attachment orders by national courts. This would significantly reduce the attractiveness for litigious holdouts to attack debt restructurings that are accompanied by ESM financial assistance programs.	No legal safeguards exist to protect ESM funds from creditor attachment attempts.
4. Dispute settlement process	Legal function[227]	All vertical (creditor-debtor) and horizontal (inter-creditor) disputes, for instance on the equal application of the haircut size across different types of debt instruments, shall be settled by the ESDRF legal function, ie of a separate chamber at the CJEU, or an arbitration tribunal.	Disputes are currently resolved by national courts and international investment tribunals, resulting in highly fragmented judicial review procedures across the euro area.

6.3.4.1. Financial Function

Pursuant to Article 12(1) of the ESM Treaty, '[i]f indispensable to safeguard the financial stability of the euro area as a whole and of its Member States, the ESM may provide stability support to an ESM Member subject to strict conditionality.' The ESM's lending decisions are the result of an intricate coordination procedure between different institutions, as set out in Article 13 of the ESM Treaty.[228] However, the provisions of the ESM Treaty concerning government debt restructuring are characterised by 'constructive ambiguity'. This approach,

[226] ibid.
[227] ibid.
[228] More specifically, stability support can only be granted after an assessment by the European Commission, in liaison with the ECB, of: (a) the existence of a risk to the financial stability of the euro area as a whole or of its Member States; (b) sustainability of public debt (wherever appropriate and possible, such an assessment is expected to be conducted together with the IMF); (c) the actual or potential financing needs of the ESM Member concerned. Ultimately, however, the ESM's Board of Governors has the sole decision-making authority to grant stability support to an ESM Member.

albeit being the result of a deliberate political decision at the height of the crisis, may – in the medium to long-term – undermine the reliability and credibility of the crisis resolution mechanism. The lack of formal or informal rules and practices to address situations when the Member State's debt is deemed unsustainable, could increase uncertainty, result in 'gambles for redemption', and overburden the ESM in the case of large countries.

When juxtaposed to IMF practices[229], the ESM lending framework essentially differs on two points:

- First, the IMF plays a catalytic, albeit informal, role as facilitator of debt restructuring negotiations. While the IMF AoA do not require countries seeking to access Fund assistance to restructure their debts, the IMF's encourages a member – wherever possible – to restructure unsustainable debt without a default.[230] Indeed, as explained by IMF staff, '[w]here the debts being restructured are claims held by the private sector, the debt restructuring is normally implemented at the outset of the programme or as a condition for the programme's first review.'[231]
- Second, the IMF's LIA policy limits Fund assistance to Member States that have not cleared arrears to private[232] or official creditors[233]. Through the LIA policy, the IMF can influence debt restructuring by (i) requiring a 'haircut' on investors' debt as part of the required domestic adjustment and (ii) playing an active role in encouraging restructuring negotiations.[234]

Closer alignment with the IMF's long-standing practices in sovereign debt restructurings could improve the euro area crisis management framework. For one, additional clarity may allow investors to better anticipate the actions of the ESM. For another, the burden stemming from a debt crisis in the euro area may be shared more evenly between the ESM as

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[229] For an overview of the IMF's role in sovereign debt restructurings, see above 2.1.1.

[230] See IMF, 'Dealing with Sovereign Debt—The IMF Perspective' (*IMF Blog*, 23 February 2017) <https://blogs.imf.org/2017/02/23/dealing-with-sovereign-debt-the-imf-perspective/> accessed 2 August 2017.

[231] ibid.

[232] IMF, 'IMF Policy on Lending into Arrears to Private Creditors – Further Considerations' (1999) Executive Board Meeting 99/64 on 14 June <https://www.imf.org/external/pubs/ft/privcred/lending.pdf> accessed 6 April 2018. The LIA policy aims at reducing private investors' leverage in a debt restructuring deal by allowing the Fund to lend to countries even if arrears are outstanding.

[233] IMF, 'Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors' (December 2015) IMF Policy Paper <https://www.imf.org/external/np/pp/eng/2015/101515.pdf> accessed 12 September 2017.

[234] Aitor Erce, 'Sovereign Debt Restructurings and the IMF: Implications for Future Official Interventions' (2013) Federal Reserve Bank of Dallas, Working Paper No 143, 3-4 <https://www.dallasfed.org/~/media/documents/institute/wpapers/2013/0143.pdf> accessed 24 June 2018.

contributor of liquidity assistance and the private sector's contributions by agreeing to debt relief measures.

Specifically, we suggest a three-pronged reform. First, as an alternative to the current language, a clear procedure could be introduced to clarify that countries' debt levels need to be sustainable for the ESM to provide financial assistance. In this respect, an earlier draft of the ESM Treaty appears like an appropriate benchmark.[235]

Article 12(2) of the draft ESM Treaty stated the following:

> 'An adequate and proportionate form of private sector involvement shall be sought on a case by case basis where financial assistance is received by an ESM Member, in line with IMF practice. The nature and the extent of this involvement shall depend on the outcome of a debt sustainability analysis and shall take due account of the risk of contagion and potential spill over effects on other Member States and third countries. If, on the basis of this analysis, it is concluded that a macro-economic adjustment program can realistically restore the public debt to a sustainable path, the beneficiary Member State shall take initiatives aimed at encouraging the main private investors to maintain their exposure. Where it is concluded that a macro-economic adjustment program cannot realistically restore the public debt to a sustainable path, the beneficiary Member State shall be required to engage in active negotiations in good faith with its creditors to secure their direct involvement in restoring debt sustainability. In the latter case, the granting of financial assistance will be contingent on the Member State having a credible plan for restoring debt sustainability and demonstrating sufficient commitment to ensure adequate and proportionate private sector involvement. Progress in the implementation of the plan will be monitored under the programme and will be taken into account in the decisions on disbursements.'

While there should be no mechanical link between certain debt levels and a debt restructuring, clarifying that the ESM cannot lend to a country with unsustainable debt levels seems politically warranted and economically reasonable. Notably, it would safeguard ESM resources, shift the burden of adjustment to the private sector, and ensure the political legitimacy of ESM operations in all euro area countries.

Second, by introducing a LIA policy for the ESM, financial assistance could be restricted when a Member State has defaulted on some or all of its outstanding public debts, similar to the IMF framework. The ESM would no longer be able to lend to countries with arrears that

[235] See Draft Treaty on Establishing the European Stability Mechanism (18 October 2011) <http://www.haoui.com/newsletter/2011/octobre18/exclusivite/mes_anglais.pdf> accessed 9 June 2018.

negotiate in 'bad faith'. In turn, countries have more incentives to negotiate in good faith with creditors while a workout could not be blocked by a few opportunistic holdouts. Moreover, akin to the IMF, the ESM LIA policy could differentiate between arrears to official and private creditors, respectively.[236]

Third, to formalise the ESM's role in debt restructurings, its function in analysing the sustainability of a requesting Member State's debt public debt could be strengthened.[237] In the recent *Meseberg* declaration between Germany and France of June 2018 on the future of EMU, it was recalled that any decision to provide ESM stability includes a DSA.[238] Specifically, according to Article 6 of Regulation (EU) 472/2013, the ESM and the Commission, in liaison with the ECB, and where possible with the IMF, must assess the debt sustainability of a Member State that requests financial assistance from the ESM. The legislation also tries to de-politicise the DSA by stating that '[t]he assessment of the sustainability of the government debt shall be based on the most likely macroeconomic scenario or a more prudent scenario and budgetary forecasts using the most up-to-date information […]'.

However, this provision is problematic in two respects. First, this DSA procedure is not mirrored one-to-one in the ESM Treaty, which leaves open whether the ESM, as an institution based on an inter-governmental agreement, may conduct its own DSA to safeguard its resources.[239] Second, the involvement of four different institutions, which all conduct DSAs according to their own internal methodological framework, led to contradicting figures, political stand-offs and deep mistrust between the institutions during the last crisis.[240] Though politically difficult, sticking to the *status quo* risks that the collective action problems

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[236] See above 2.6. for an overview of the IMF's LIA policy.

[237] Note that the current Article 13(1) of the ESM Treaty already requires the European Commission, in liaison with the ECB, to assess whether the public debt of a Member State requesting financial assistance is sustainable. However, it still differs from the rules of Union law (see below n 244).

[238] Regulation of the European Parliament and of the Council on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (European Parliament) (Council of the European Union) 472/2013/EU, [2013] OJ L140/1.

[239] Indeed, while Article 2 of the ESM Guideline on Loans requires the ESM to assess whether public debt is sustainable, the Guideline makes no reference to secondary EU legislation. In fact, the ESM Guideline does not explicitly mandate that the ESM must be involved in the DSA; it rather confers this task to the Commission, in liaison with the ECB. See ESM, Guideline on Loans (9 October 2012) <https://www.esm.europa.eu/content/esm-guideline-loans> accessed 3 May 2018.

[240] As ECB staff explains in a paper, all of these institutions have establish their own DSA methodologies; see ECB, 'Debt sustainability analysis for euro area sovereigns: a methodological framework' (April 2017) Occasional Paper Series No 185 <https://www.ecb.europa.eu/pub/pdf/scpops/ecbop185.en.pdf?abccaa198c0d791777fe3dfb148873f5> accessed 1 June 2017. As Schumacher and di Mauro note with regard to Greece,

among official sector bodies re-emerge in the next crisis. Thus, going forward, policymakers should consider conferring the power to authoritatively decide on a DSA to a single institution – in this respect, the ESM seems most appropriate, as its funds are put at risk in lending operations.

Finally, we recall that the concept of burden-sharing among debtors and creditors is not unique to the world of sovereign debt crises. Rather, it has been at the centre of the post-crisis reform of the banking sector, in Europe and beyond. In this regard, the principal objective was to reduce the need for large taxpayer funded bailouts for banks that were deemed 'too-big-to-fail'. Concretely, the FSB, which advises the G20 on international financial reform, has adopted the 'Key Attributes for Effective Resolution Regimes for Financial Institutions', which set out the core elements for an effective resolution regime for banks.[241]

Notably, the KAs recommend the inclusion of 'bail-in' frameworks in national legislation that would allow resolution authorities to reduce the value of claims held by the private sector against the failing institution. In simple terms, bail-in can be considered a bank-dedicated PSI regime.[242] The establishment of a bail-in regime for financial institutions under EU law underscores that the idea of burden-sharing between the private and the public sector is anything but revolutionary.[243] The EU's Banking Recovery and Resolution Directive (BRRD)[244], which resembles Title II of the US Dodd-Frank Act, connects the use of public funds in a bank resolution conditional upon the bail-in of bank creditors.

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[241] FSB, 'Key Attributes of Effective Resolution Regimes for Financial Institutions' (2014) <http://www.fsb.org/wp-content/uploads/r_141015.pdf> accessed on 2 June 2018. Also for an overview of the problems associated with financial institutions that are considered 'too-big-to-fail' in Alan D. Morris, 'Systemic risks and the 'too-big-to-fail' (2011) 27(3) Oxford Review of Economic Policy 498.

[242] See Tobias H. Tröger, 'Too Complex to Work A Critical Assessment of the Bail-in Tool under the European Bank Recovery and Resolution Regime' (2017) Institute for Monetary and Financial Stability, Working Paper Series No 116 <https://www.imfs-frankfurt.de/fileadmin/user_upload/IMFS_WP_116.pdf> accessed 5 June 2018.

[243] For an overview of the European framework for bank resolution, which has become fully operational in 2016, see, eg, World Bank Group, 'Bank Resolution And "Bail-In" in the EU: Selected Case Studies Pre and Post BRRD' (2016) Financial Sector Advisory Center (FinSAC) <http://pubdocs.worldbank.org/en/120651482806846750/FinSAC-BRRD-and-Bail-In-CaseStudies.pdf> accessed on 9 July 2018. For a critical reflection of the new rules on creditor bail-in, see Emilios Avgouleas and Charles Goodhart, 'Critical Reflections on Bank Bail-ins' (2015) 1(1) Journal of Financial Regulation 3 (noting that 'bail-in regimes will not eradicate the need for injection of public funds where there is a threat of systemic collapse, because a number of banks have simultaneously entered into difficulties, or in the event of the failure of a large complex cross-border bank, unless the failure was clearly idiosyncratic.').

[244] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 , [2014] OJ L 173/190 [henceforth 'BRRD'].

Of course, sovereigns are different animals than banks. However, like bank creditors, those lending to sovereign states incur a certain credit risk. The risk of sovereign default is real[245] and ought to be reflected in the legal framework. The ESDRF's financial function would operate on the BRRD rationale, namely that the use of the ESM, as a taxpayer-funded body, would be conditional upon the bail-in of sovereign bondholders. However, to mitigate financial stability risks, a PSI would only become mandatory if the DSA was to yield a negative result.

6.3.4.2. Legal Function

The existing crisis resolution mechanism under the auspices of the ESM lacks a legal function.[246] To ensure an independent review of debt restructuring measures by the legal function, the dispute resolution function should not be allocated to the financial function.

Thus, a legal function could be established. One important lesson from the Greek PSI was that bondholder claims were reviewed in a de-central manner at national level. Judges at civil or commercial courts in Germany, Austria, and Greece, as well as investment arbitrators at the ICSID, were asked to assess the legality and proportionality of a debt restructuring that was part of the EU's common response to the crisis and one of the conditions of continued financial assistance. Moreover, the judgements rendered after the Greek PSI suggest that national courts are ill-equipped to address the intricate legal questions that arise in sovereign debt restructurings, notably because they lack the mandate, the knowledge, as well as the

[245] See, eg, ECB President Draghi's statement that risk free sovereign debt is an illusion. See Mario Draghi, 'The interdependence of research and policymaking' (23 August 2017) Speech by Mr Mario Draghi, President of the European Central Bank at the Lindau Nobel Laureate Meeting, Lindau <https://www.bis.org/review/r170824b.htm> accessed 7 August 2018.

[246] Out of the proposals referred to in Box 11, the ECRM proposed by Gianviti et al provides the most detailed description of a potential legal function an ESDRF could entail. It notes the following in this context:

'The legal body would have the authority to open a debt-restructuring procedure upon the request of a euro-area sovereign borrower and upon approval by the economic body that the debtor's debt is actually unsustainable. It would be a common judicial organ capable of sorting out and assessing claims by the parties, of ruling on disputes between creditors or between a creditor and the debtor, and of enforcing the decisions taken by the parties within the framework of the mechanism.'

See Francois Gianviti, Anne O. Krueger, Jean Pisani-Ferry, André Sapir and Jürgen von Hagen, 'A European mechanism for sovereign debt crisis resolution: a proposal' (November 2010) Bruegel Blueprint 4 <http://bruegel.org/2010/11/a-european-mechanism-for-sovereign-debt-crisis-resolution-a-proposal/> accessed 14 June 2018. Moreover, Bagchi elaborates on the legal framework for a debt restructuring mechanism in Europe, concluding that the ESM Treaty would provide the best legal basis for further reform; see Kanad Bagchi, 'Proposals on a Future European State Bankruptcy Law' (2015) Saar Blueprints 02/2015 <http://jean-monnet-saar.eu/wp-content/uploads/2013/12/Proposals-for-a-future-European-State-Bankruptcy-law.pdf> accessed 7 September 2017.

legitimacy to mediate between parties affected by a foreign government's debt restructuring.[247]

Krueger[248] in 2002 and Gianviti et al[249] in 2010 proposed the establishment of an independent legal body tasked with resolving both creditor-debtor and creditor-creditor disputes that arise in the course of a debt restructuring.[250] In the same vein, this section presents two options for a dispute resolution mechanism for debt restructurings in the euro area: (i) a separate chamber at the CJEU or (ii) an independent arbitration mechanism at a newly established body.

Such dispute resolution mechanism would be competent for disputes relating to private bondholders' claims and would not allow the CJEU to second-guess judgments made by creditors regarding the viability of a restructuring.[251] A dispute resolution would *inter alia* be confronted with the following types of claims:

(i) verification of claims for the CAC vote;

(ii) bondholder claims for performance of contract or damages in restructuring of non-CAC bonds or if CACs fail;

(iii) inter-creditor disputes that arise from an alleged discrimination against specific bondholder classes; and

(iv) disputes relating to the interpretation and application of a CAC as well as other clauses, such as *pari passu* clauses or bond acceleration clauses.

6.3.4.2.1. Dispute Resolution Before the CJEU

The CJEU, as the court of the EU, could adjudicate cross-border disputes that emerge in the wake of a debt restructuring in the euro area.[252] The CJEU is enshrined in Union law and

[247] See, eg, for an analysis of post-PSI litigation in Germany, Sebastian Grund, 'The legal consequences of sovereign insolvency – a review of creditor litigation in Germany following the Greek debt restructuring' (2017) 24(3) Maastricht Journal of Comparative and European Law 399. Among the many reasons as to why municipal courts and investment tribunals have a very mixed track-record are the lack of expertise, the lack of authority as well as the lack of rules that would allow these bodies to balance the creditors' right to repayment with the debtor's need to reduce the level of debt – indeed the central question of bankruptcy law.

[248] Anne Krueger, *A New Approach to Sovereign Debt Restructuring* (Washington, D.C.: IMF, 2002).

[249] Gianviti et al (n 257).

[250] Also see Bagchi (n 257), who advocates an arbitration-like dispute resolution procedure.

[251] See for rationale behind these limits in Sean Hagan, 'Designing a Legal Framework to Restructure Sovereign Debt' (2005) 36 Georgetown Journal of International Law 299, 382-390 (2005) and Gianviti et al (n 256).

[252] André Sapir and Dirk Schoenmaker, 'We need a European Monetary Fund, but how should it work?' (Bruegel Blog, 29 May 2017) <http://bruegel.org/2017/05/we-need-a-european-monetary-fund-but-how-should-it-work/> accessed 23 June 2018; Louis (n 219). Such a separate chamber may be established by virtue of Article 257 TFEU, which sets out the following: '[t]he European Parliament and the Council, acting in accordance with the

enjoys strong statutory independence; in addition it benefits from a high level of legitimacy as well as a sound governance framework. Considering the type of disputes that the CJEU would have to resolve as part of the ESDRF, a separate chamber, which would be established *ad hoc* and comprise experts in the field of sovereign debt, would seem most appropriate.[253]

At the current juncture, the CJEU only has jurisdiction over disputes pertaining to the interpretation of the ESM Treaty.[254] However, this leads to gaps. First, the ESM Treaty only includes the requirement for the signatories to include CACs as agreed by the Economic and Financial Committee (EFC) – it does not set out the details of the CAC.[255] Second, the ESM Treaty lacks provisions that would assign jurisdiction over disputes between the parties involved in a debt restructuring to the CJEU, or any other (quasi-)judicial authority – this choice is left with the Member States, which tend to choose their own courts as dispute settlement fora.[256] Given that any ESM programme involves financial assistance from all 19 Member States and taking account of the bondholders' multiple nationalities, there are merits in establishing a central dispute resolution forum at the CJEU rather than letting national courts in various Member States deal with legal aftermath of a government debt restructuring.

The main objective of such dispute settlement mechanism would be to mitigate negative externalities stemming from protracted private bondholder litigation.[257] Virtually all sovereign debt restructurings entail some expropriatory element, for the debtor country needs to renegotiate or unilaterally amend contractual agreement with its bondholders.[258] Thus, delicate questions pertaining to the protection of the creditors' property rights arise in the context of sovereign insolvency, which require the state's public interest in attaining debt

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ordinary legislative procedure, may establish specialized courts attached to the General Court to hear and determine at first instance certain classes of action or proceeding brought in specific areas.'

[253] For some inspiration regarding the establishment of such a specialist chamber; see Daniel Sarmiento, 'The Reform of the General Court: Unleashing the Forces of Change' (*EU Law Analysis*, 15 December 2015) <http://eulawanalysis.blogspot.de/2015/12/the-reform-of-general-court-unleashing.html> accessed 2 June 2018. Whether changes to the Treaty would be required to cater for the establishment of a separate chamber cannot be answered conclusively.

[254] See Article 37 of the ESM Treaty. Also see, eg, Federico Fabbrini, 'The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective' (2014) 32(1) Berkley Journal of International Law 64.

[255] Antonio Sainz de Vicuña, 'Identical Collective Action Clauses for Different Legal Systems: A European Model' in Patrick Kenadijan, Klaus-Albert Bauer and Andreas Cahn (eds), *Collective Action Clauses and the Restructuring of Sovereign Debt* (Berlin: De Gruyter, 2013) 15-24.

[256] See Sebastian Grund, 'Restructuring government debt under local law: the Greek case and implications for investor protection in Europe' (2017) 12(2) Capital Markets Law Journal 25.

[257] As stated above, the question of dispute settlement would only apply in the event of CACs failing to bind holdouts to a restructuring deal.

[258] See, eg, Julian Schumacher, Christoph Trebesch & Henrik Enderlein, 'Sovereign Defaults in Court' (2018) ECB Working Paper Series No 2135 <https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2135.en.pdf> accessed 2 September 2018.

relief to be balanced against the investors' contractual right to be satisfied in full and on time. Ultimately, a judicial authority at the European level should address these questions.[259]

With respect to the substantive law, relevant national as well as EU laws could be applied in those disputes. In this context, it is recalled that European (constitutional) laws have a common denominator, which could be relied on to circumscribe the legal perimeter for debt restructuring measures: the ECHR. The Convention sets a certain minimum standard for the protection of bondholders' (property) rights and was transposed into the domestic laws of all euro area Member States.[260] Another potential basis for the judicial review of debt restructuring measures could be the EU CFR, which forms part of EU primary law and is thus directly enforceable against all EU Member States. However, the CFR only applies when EU law is implemented or applied by national authorities. Under the current framework, which leaves sovereign debt restructuring operations completely under Member States' discretion, the scope of applicability would be very limited for the CFR. Of course, if the ESDRF was to be enshrined in EU law, presumably as part of bringing the ESM under the Union law framework, then the CFR may also become relevant for disputes pertaining to sovereign debt restructurings.

The judicial review of official sector measures taken during the European sovereign debt crisis yielded some important and useful insights as regards the boundaries for governments' and/or EU institutions' interference with private property rights. Notably, one decision by the ECtHR and two by the ECJ shone light on the legal relationship between private investors and sovereigns (as well as their central banks).[261]

First, following the Greek PSI[262], the ECtHR was confronted with several thousands of bondholder claims for compensation for the haircut imposed by Greece. In the seminal

[259] See for a similar reasoning Hagan (n 262) 382-390 (2005). Many European courts have adopted a broad interpretation of sovereign immunity while US courts tend to look exclusively at the contractual agreement underpinning the debt instrument and award money judgements or injunctive remedies to any investors who undertakes to sue the insolvent sovereign. For US case law, see above 3.5.6. (pre-Argentina) and chapter 4 (post-Argentina). With respect to post-restructuring litigation against Greece, see above chapter 5.

[260] For disputes not related to bondholders' property rights, the ESM Treaty, which would then be transposed into national law, could set out certain rules, for instance on the verification of creditor claims for the CAC vote.

[261] For a recent and compelling overview of the CJEU's jurisprudence on sovereign debt programs during the euro area debt crisis, see Claire Kilpatrick, 'The EU and its sovereign debt programmes: The challenges of liminal legality' (2017) European University Institute Working Papers, LAW 2017/14 <http://cadmus.eui.eu/bitstream/handle/1814/48205/LAW_2017_14.pdf?sequence=1> accessed 22 March 2018.

[262] See above chapter 5 for an overview of the Greek debt restructuring.

Mamatas v. Greece[263] case, the ECtHR clarified important constitutional legal limits for signatories of the ECHR, holding that a haircut on privately held government debt is necessary and proportionate if there is an imminent risk of default and the haircut does not place an excessive burden on private investors.[264] Second, in *Accorinti v. ECB*[265], bondholders challenged the ECB's carve-out from the PSI of 2012. The EGC decided that the ECB's preferential treatment in a debt restructuring was justified since it had acquired the bonds in the public interest.[266] Third, in *Ledra Advertising v. European Commission and ECB*[267], the ECJ had to decide whether EU institutions could be held liable for a haircut on Cypriot depositors, which they had mandated as part of the financial assistance conditions.[268] The CJEU found that while EU institutions must comply with the CFR[269], and hence respect the right to property, such a right is not absolute and can be limited on grounds of public interest provided that the limitations do not constitute a disproportionate and undue interference with the very substance of the right guaranteed.[270]

With respect to the procedural rules applicable to bondholder challenges, the Rules of Procedure of the CJEU[271] should, in principle, provide a sufficient basis. While small amendments to these Rules of Procedure may be necessary, a solid procedural mechanism already exists, on the basis which disputes between sovereigns and their creditors may be settle. Of course, further technical and practical details would have to be considered, such as

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[263] *Mamatas v Greece*, App No 63066/14, App No 64297/14, App No 66106/14, 21st July 2016, European Court of Human Rights [ECHR]. More specifically, the judgement takes account of the fact that the market value of bonds has typically dramatically deteriorated in the run-up to a sovereign debt restructuring, implying that the face value should no longer serve as a benchmark for the creditors' property rights.

[264] For a discussion of the judgement, see Grund (n 266).

[265] *Accorinti v European Central Bank*, Judgement, Case T-79/13, [2015] Court of Justice of the European Union [CJEU]; GC of the European Union [EGC].

[266] ibid [92].

[267] *Ledra Advertising Limited v European Commission and European Central Bank*, Judgment, Case C-8/15 P, Case C‑9/15 P, Case C-10/15 P, ECLI:EU:C:2016:701, OXIO 191, 20th September 2016, Court of Justice of the European Union [CJEU]; European Court of Justice [ECJ]; European Court of Justice (Grand Chamber).

[268] The legal basis for the challenge was under Article 340 TFEU. The investors' challenged the decision by the two EU institutions to require the Cypriot government to impose the respective losses on depositors as part of the EU's conditions to grant financial assistance to Cyprus.

[269] Charter Of Fundamental Rights Of The European Union (European Union [EU]) [2000] OJ C364/1, [2007] OJ C303/1, [2012] OJ C326/391.

[270] *Ledra Advertising Limited v European Commission and European Central Bank*, Judgment, Case C-8/15 P, Case C‑9/15 P, Case C-10/15 P, ECLI:EU:C:2016:701, OXIO 191, 20th September 2016, Court of Justice of the European Union [CJEU]; European Court of Justice [ECJ]; European Court of Justice (Grand Chamber) [74] (stating that 'In view of the objective of ensuring the stability of the banking system in the euro area, and having regard to the imminent risk of financial losses to which depositors with the two banks concerned would have been exposed if the latter had failed, such measures do not constitute a disproportionate and intolerable interference impairing the very substance of the appellants' right to property').

[271] Rules of Procedure of the Court of Justice of the European Union [2012] OJ L265/1. In particular, one would need to consider amending Chapter 7 of the Rules of Procedure, which pertain to the different formations of the Court.

the enforceability of judgements against Member States that just experienced a financial crisis. At the same time, not all of these details would have to pencilled into the ESM Treaty or an EU Regulation; they could either be developed through case law or become the subject of soft law instruments, such as European Commission Guidelines.[272]

6.3.4.2.2. A Sovereign Debt Arbitration Mechanism For the Euro Area

Another potential forum for the settlement of sovereign debt related disputes is an independent arbitration tribunal. The late Professor Sandrock for instance advocated in favour of a stronger role for international arbitration in the settlement of sovereign debt disputes against the backdrop of the Greek crisis.[273] He contended that international arbitration has unjustifiably been dismissed by policymakers as a means of dispute resolution when sovereign debt is to be restructured.[274] Other scholars have discussed the potential advantages of arbitration in the context of the recent Puerto Rican debt restructuring.[275]

But how could such arbitration mechanism be designed in the context of an ESDRF? First, a specialised arbitral institution for sovereign debt disputes may be established at the ICSID, which has a long-standing history in adjudicating investment-related disputes. At the very minimum, the ICISD's rules of procedure, as set out in Chapters II-V of the ICSID Convention, should be emulated to this end.[276] For instance, arbitrators could be selected from a preconceived list of experts in the field, as is the procedure for ICSID arbitration. In addition, one may consider requiring a panel to consist of arbitrators from the country which executed a debt restructuring as well as arbitrators whose nationality is identical to that of the claimants'.

Of course, for certain specific elements of the legal function, such as the verification of bondholder claims or the settlement of disputes that arise between bondholders, procedures

[272] See, notably, Hagan (n 262) 385 (noting that '[a]s work on the SDRM proposal progressed, it became increasingly clear that, no matter how streamlined its design, there would need to be a number of technical rules that it would be inappropriate to specify in the treaty itself').

[273] Otto Sandrock, 'The Case for More Arbitration When Sovereign Debt is to Be Restructured: Greece as an Example' (2012) 23(3) American Review of International Arbitration 507.

[274] Others have been less positive and warned that subsuming sovereign bonds under the definition of 'investment' may incentivize holdout investors to leverage their bargaining position by invoking Bilateral Investment Treaties (BITs) against countries that seek to restructure their debts. For a many, see Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration' (2007) 101 American Journal of International Law 711.

[275] Melika Hadziomerovic, 'An Arbitral Solution: A Private Law Alternative to Bankruptcy for Puerto Rico, Territories, and Sovereign Nations' (2017) 85 George Washington Law Review 1263.

[276] A different view is offered by Sandrock (n 284) 543. Waibel (n 274) generally rejects the role of investment arbitration in sovereign debt restructurings.

would have to be devised and tailored to the types of proceedings the legal function would oversee.

This brings us to the next aspect, namely the substantive law provisions that the specialised arbitral tribunal would have to apply.[277] In this context, recent FTAs, such as the Comprehensive Economic and Trade Agreement (CETA)[278], could serve as a source of inspiration, given that they entail explicit provisions on sovereign debt restructurings. CETA for example protects 'negotiated restructurings'[279], ie restructurings that were approved by 75% of investors, from arbitration in investor-state tribunals.

This provision in CETA allows for two conclusions. First, CETA limits investor-state arbitration to cases where the debt exchange did not attract sufficient investor support, introducing a 'check' on states not to restructure opportunistically. Crucially, the protection of negotiated restructurings is independent from the success of a potential CAC vote, implying that the state may also resort to other (contractual or statutory) measures as long as this is in agreement with a supermajority of investors. Second, the CETA implicitly acknowledges that investor-state arbitration may be a means to resolve disputes related to sovereign debt restructuring where contractual or other mechanisms have failed. Consequently, under certain conditions, a CETA tribunal could – on the basis of the CETA text – decide whether debt restructuring measures have unduly expropriated sovereign debt holders.

While an in-depth review of the merits of sovereign debt arbitration would go beyond the scope of this section, it is clear that policymakers have recognised a potential role for arbitration in balancing the investors' and the states' interests during economic and financial crisis. In the euro area, establishing such tribunals, which could convene on *ad hoc* and consist of experts in the field of sovereign debt management, might help to reduce the inefficiencies and uncertainties resulting from protracted litigation in national courts.

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[277] For some a discussion of issues that may arise in this regard, see, eg, Gregory D. Makoff, 'Simplifying Sovereign Bankruptcy – A Voluntary Single Host Country Approach to SDRM Design' (2015) CIGI Papers No 76 <https://www.cigionline.org/sites/default/files/cigi_paper_76_0.pdf> accessed 21 November 2017.

[278] Comprehensive Economic and Trade Agreement between Canada, of the One Part, and the European Union [and its Member States] of the Other Part [2017] OJ L11/23 (hereinafter 'CETA').

[279] According to Annex 8-B CETA, a 'negotiated restructuring means the restructuring or rescheduling of debt of a Party that has been effected through (a) a modification or amendment of debt instruments, as provided for under their terms, including, their governing law, or (b) a debt exchange or other similar process in which the holders of no less than 75 per cent of the aggregate principal amount of the outstanding debt subject to restructuring have consented to such debt exchange or other process'.

6.3.5. ENHANCING THE CONTRACTUAL FRAMEWORK

6.3.5.1. Enhancing the Euro CAC

To make debt restructurings more orderly, the current Euro CAC could be revised.[280] The ICMA CAC, which is used for international sovereign bonds[281], may serve as a blueprint in that regard. The key rationale of enhancing the Euro CAC would be to ensure the success of a debt restructuring *ex post* by reducing the *ex ante* incentives for holdout creditors. This does not mean that debt restructuring would become more likely but rather that, if the decision to restructure debt is taken, the operation could be carried out in a smooth manner. The different contractual enhancements presented in the following sections all cater to this very objective.

6.3.5.2. Introducing Aggregation Features and a Single-Limb Voting Procedure

To align the Euro CAC with the existing international standard, it would have to be equipped with more robust aggregation features, designed to alleviate holdout inefficiencies. The two-limb voting process of the current Euro CAC, which requires the debtor to achieve majority approval in each individual series *and* for the aggregate of outstanding bonds, would be replaced by a single-limb mechanism.[282] As a result, a proposed bond modification, and hence the restructuring plan, would have to be approved by a (super-)majority of the aggregate principal amount of the outstanding bonds.[283] This would reduce the likelihood of holdouts acquiring smaller series of sovereign bonds with a view to blocking the modification of these series under a double-limb voting mechanism.

Moreover, while the Euro CAC allows for 'partial cross-series modifications', aimed at avoiding the blocking of small series, the procedure seems overly complex and difficult to use in practice.[284] In essence, this type of cross-series modification rests on a legal fiction, according to which the modification of certain blocked series is deemed successful if, within a pre-defined amount of certain other series, the required majorities are reached. However, this only applies to the bonds of investors who have accepted the deal. While this provision

[280] See above for an analysis of CACs more generally above 6.2.1.2.
[281] ICMA (n 161).
[282] See Mersch (n 216) and Bundesbank, 'Ansatzpunkte zur Bewältigung von Staatsschuldenkrisen im Euro-Raum' (2016) Monatsbericht 43 <https://www.bundesbank.de/Redaktion/DE/Downloads/Veroeffentlichungen/Monatsberichtsaufsaetze/2016/2016_07_staatsschuldenkrisen.pdf?__blob=publicationFile> accessed 14 December 2017.
[283] See ICMA (n 161).
[284] See Article 2.4 of the Euro CAC in Economic and Financial Committee of the EU (EFC), 'Model CAC – Common Terms of Reference (Brussels, 17 February 2012) <https://europa.eu/efc/sites/efc/files/docs/pages/cac_-_text_model_cac.pdf> accessed 2 September 2017.

allows the debt restructuring to go ahead, some holdouts will still maintain the original claim and are thus not bound to the debt restructuring deal.[285] Including full aggregation features would resolve this shortcoming of the current Euro CAC.

The ICMA Model CAC, in contrast, does not need such complex legal fictions to resolve the holdout problems in individual series; it simply binds all dissenting bondholders to the proposed modifications. With the objectives of increasing transparency, decreasing complexity and ensuring the integrity of the CAC voting procedure, it seems warranted to also move to a single-limb, fully aggregated CAC standard in the euro area. Indeed, as Sobel has recently noted, '[s]ingle-limb CACs will help tackle the hold-out creditor problem and limit ensuing litigation, which have often bedevilled restructurings' and '[e]uro area governments would be well advised to modernise the CACs in their sovereign bonds by including the single-limb feature'.

At the same time, as suggested above, lower thresholds provide higher protection from holdouts, even if votes are aggregated.[286] Thus, we suggest sticking to the current 66 2/3% threshold for the modification of reserved matters in the Euro CAC for any enhanced clause. While this threshold would be lower than that of the ICMA Model CAC, which is set at 75%, an updated Euro CAC should be as resilient as possible, also to avoid the need of changing the clause again in a few years. Moreover, as elaborated above, lower thresholds in the Euro CAC would mitigate possible official sector holdout problems posed by the ECB.[287]

Those opposing contractual reform typically voice concerns with respect to the enforceability of a single-limb CAC, when compared to the double-limb voting mechanism. Given that the single-limb CAC does not allow investors to vote in their respective series, but only on the aggregate, investors might find themselves in a group of creditors with highly heterogeneous interests. Moreover, small investors' rights may be diluted as the weight of their vote is reduced when all votes are aggregated across all outstanding bonds.

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[285] See for an explanation of this feature in Allen & Overy, 'Government bond restructuring "made in Germany": the rise of anti-holdout clauses' (A&O Recent developments, 2012) <http://www.allenovery.com/SiteCollectionDocuments/Government%20bond%20restructuring.pdf> accessed 5 March 2018.

[286] See above 6.2.1.

[287] See above 3.3.3.2 for a discussion of the ECB's holdout conundrum.

However, one could also argue that, if designed appropriately, an enhanced Euro CAC can guarantee a sufficient level of investor protection.[288] In the euro area, all countries have ratified the ECHR, which means that the same minimum level of protection of property rights applies in the whole currency union. In this regard, the ECtHR has recently confirmed the legality of applying a single-limb CAC with full aggregation features in a sovereign debt restructuring inside the euro area.[289] Against this backdrop, it seems excessive to dismiss the enforceability of CACs on constitutional grounds.[290]

Moreover, single-limb voting features might not require a change of the ESM Treaty, which only requires that the CACs used by euro area governments have an identical legal impact.[291] The ESM Treaty does not explicitly mandate the inclusion of double-limb CACs – this design choice was taken by the Economic and Financial Committee's Sub-Committee on EU Sovereign Debt Markets (ESDM). The same body could decide that the current CAC is outdated and too vulnerable to holdout strategies, thus no longer fulfilling its core objective.

6.3.5.3. Majority Voting on Bond Acceleration

An enhanced Euro CAC should also restrict the acceleration of the bond's principal payment in the event of default to a predefined majority of investors. The ICMA CAC already entails majority voting requirements with respect to the acceleration, requiring 25% of bondholders to consent. With respect to euro area government bonds, some have suggested that this threshold could be set even higher, e.g. at 50%.

Therefore, holdout investors would be discouraged from buying distressed debt. In past debt crises, holdouts frequently pushed countries into default, e.g. by litigating against them, as this allows them to accelerate the principal repayment. If acceleration becomes subject to

[288] Regarding the enforceability of CACs in Europe, compare, eg, *Assenagon Asset Management SA v Irish Bank Resolution Corp Ltd* (formerly Anglo Irish Bank Corp Ltd), 27th July 2012, United Kingdom; England and Wales; High Court [EWHC] 2090; Chancery Division [ChD] (in this decision, the High Court of England and Wales concluded that in certain, extreme cases, resolutions passed by the majority of bondholders to expropriate minority bondholders may be illegal under English contract law).

[289] See *Mamatas v Greece*, App No 63066/14, App No 64297/14, App No 66106/14, 21st July 2016, European Court of Human Rights [ECHR]. For a discussion of the case, see above 5.5.3.

[290] Indeed, the aggregated CAC retrofitted to local-law bonds in the Greek PSI featured a 66.67% threshold for bond modifications to pass. This means minority investors' rights were affected even more strongly than under the 75% threshold we propose in this paper (and which has become the standard for international sovereign bonds).

[291] See Article 12(3) ESM Treaty.

approval by a certain number of investors, the appeal to engage in such tactics is reduced significantly.[292]

The ESDM that negotiated the Euro CAC in 2011 found that such provisions may run into serious legal difficulties in some euro area Member States, without however further specifying the nature and extent of these problems.[293] Given that the ICMA standard requires a critical mass of bondholders to (de-)accelerate a bond or file for legal action, and is deemed consistent with English and New York law, there is little evidence to suggest that such provisions would be deemed illegal in certain Member States. Of course, further analysis may be required to confirm this assumption. However, the fact that the threshold to approve such common bondholder action is lower than the one necessary to effect other contractual modifications, suggests that these clauses are, if anything, less problematic with regard to the protection of individual investors' rights.

6.3.5.4. Majority Voting for Stays on Enforcement

As proposed by the IMF in 2002 in the context of the SDRM, an enhanced Euro CAC could enable a majority of all bondholders, eg 50% across all series, to impose a stay on enforcement proceedings by individual bondholders. Stays are ubiquitous in domestic insolvency law in order to prevent a 'rush to the courthouse' by creditors trying to attach the debtor's (remaining) assets. In the sovereign context, a stay on an enforcement action is no doubt contentious and should be circumscribed narrowly in order to mitigate any adverse effects on financial transactions, especially those pertaining to derivative contracts, most notably CDSs.

At the same time, as the Greek PSI illustrated, even if a country opts for a market-friendly approach by retrofitting CACs CDS are likely to be triggered.[294] If a majority of creditors decides to impose an enforcement moratorium with the objective of facilitating negotiations, the biggest threat would stem from the size of the CDS exposures, given that they could bankrupt the CDS protection seller.[295] Again though, as the Greek case illustrated, the CDS

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[292] A holdout creditor could only sue for the (immediate) repayment of coupon payments, which is dwarfed by the principal amount. Holding out would therefore become even more risky and financially unattractive, as the holdout would have to either buy a much larger stake in the sovereign's debt stock or convince other investors to join forces.

[293] See EFC (n 284) 7.

[294] See Anna Gelpern and Mitu Gulati, 'CDS Zombies' (2012) 13 European Business Organization Law Review 347. See above 5.2. for a discussion of the role CDS played during the Greek debt crisis.

[295] ibid.

exposures may be overestimated, as well as the contagion risks inherent to a default event being triggered in a single country of the euro area.[296]

In any event, a stay on enforcement, agreed upon by a certain majority of investors, could significantly increase the prospect of a successful negotiation outcome, for uncooperative investors have little incentive to launch asset attachment attempts if their claims are, by virtue of contract, not enforceable for a certain limited period. Some lessons may also be learnt from the handling of very recent cases of sovereign debt distress. The law adopted by the Congress of the United States to address Puerto Rico's debt crisis goes even further and imposes an automatic stay on all creditor action with the objective of facilitating an orderly debt restructuring.[297] While Puerto Rico cannot be compared to a euro area Member State, given the ambiguous constitutional relationship with the US, the stay serves as an insightful example as to how holdout inefficiencies can be deterred *ex ante*.[298]

In a monetary union of highly developed economies, like the euro area, more subtle and less invasive methods to achieve the objective of a stay may be preferable. In this respect, the United Kingdom's Debt Relief Act (DRA) 2010 could serve as a blueprint for European lawmakers. In essence, the DRA limits the amount recoverable in respect of a claim against the sovereign debtor to the level agreed internationally as part of a debt relief deal.

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[296] For an analysis, see, notably, Grzegorz Halaj, Tuomas Peltonen and Martin Schleicher, 'How did the Greek credit event impact the credit default swap market?' (2018) 35 Journal of Financial Stability 136 (finding very little discernible direct impact of the Greek credit event on CDS spreads overall, which provides evidence that the credit event was well anticipated by most market participants). If anything, the main lesson from the Greek crisis has been to better regulate sovereign CDS. In this context, compare Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swap (OJ L 86, 24.3.2012, p 1). This Regulation essentially prohibits certain speculative transactions with sovereign CDS, referred to as 'naked' or uncovered' short selling.

[297] For an overview of Puerto Rico's debt restructuring, see Lorraine McGowen, 'The Impact of the New Restructuring Law on Puerto Rico Creditors' (Harvard Law School Forum on Corporate Governance and Financial Regulation, 20August 2017) <https://corpgov.law.harvard.edu/2016/08/20/the-impact-of-the-new-restructuring-law-on-puerto-rico-creditors> accessed 29 July 2018 (noting that 'the automatic stay operates as a general moratorium and court-ordered injunction, and no court order is necessary as the injunction is automatically triggered by the enactment of PROMESA').

[298] More specifically, §405 of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) imposes a stay on acts, such as:

- the commencement or continuation of any action or proceeding against the Government of Puerto Rico that was or could have been commenced prior to the enactment of PROMESA;
- the enforcement of any judgment against the Government of Puerto Rico or its property;
- any act to obtain possession of property of, or exercise control over, the Government of Puerto Rico or its property; and
- any act to create, perfect, or enforce any lien against property of the Government of Puerto Rico.

See for further analysis, eg, Michael Cooley, 'PROMESA Shields Puerto Rico Behind a New Automatic Stay' (*Bryan Cave Leighton Paisner*, 21 July 2016) <http://bankruptcycave.com/promesa-shields-puerto-rico-behind-a-new-automatic-stay/> accessed 30 April 2018.

Consequently, holdouts may not force a country into paying more than it had paid to the restructured creditors, thereby *ex ante* reducing the appeal of engaging in speculative litigation. While the DRA applies to countries that have participated in the Highly Indebted Poor Countries (HIPC) initiative, its technique could be emulated in the ESM Treaty framework. For instance, one may consider stipulating in the ESM Treaty that creditors shall not recover more than the market value of their bonds at the time of the restructuring offer being accepted by creditors. This would discourage holdout litigation in the euro area.

6.3.5.5. Immunising ESM Funds from Holdout Attachment

In 2013, Buchheit et al. put forward an elegant and straightforward proposal to improve the euro area crisis resolution mechanism, which may complement the legal framework for sovereign debt restructuring.[299] In essence, they propose to insert a new provision into the ESM Treaty, which immunises the assets of a euro area country from creditor attachment if that country was engaged in an ESM-supported adjustment programme.[300]

As the authors outline, inserting such a provision would ensure that (i) financial support provided by the ESM is not diverted to the repayment of existing debt obligations, (ii) beneficiary states can deflate the expectations of holdouts to extract preferential treatment and (iii) the euro area becomes a safe harbour for recipient states to hold assets and conduct their financial affairs during times of crisis.[301]

Such immunisation of ESM funds would provide for an additional layer of protection, complementing other elements of the ESDRF and with the overall goal of minimising holdout inefficiencies and legal uncertainty. Given that the insertion of such a provision would simply require an amendment to the ESM Treaty and given that there are international

[299] See Buchheit et al (n 217). A similar proposal has been put forward by Bagchi (n 257).

[300] Committee on International Economic Policy and Reform (n 216) 34. They suggest adding the following Article to the ESM Treaty:

'Immunity from judicial process

1. The assets and revenue streams of an ESM Member receiving stability support under this Treaty which are held in, originate from, or pass through the jurisdiction of an ESM Member shall not be subject to any form of attachment, garnishment, execution, injunctive relief, or similar forms of judicial process, in connection with a claim based on or arising out of a debt instrument that was eligible to participate in a restructuring of the debt of the beneficiary ESM Member after the effective date of this Treaty.

2. The immunities provided in the preceding paragraph shall automatically expire when all amounts due to the ESM from the beneficiary ESM Member have been repaid in full.'

[301] Buchheit et al (n 217) 8-9. For a more detailed discussion of aspects related to the immunization of ESM funds, also Committee on International Economic Policy and Reform (n 216) 34-35.

precedents for using such technique in the context of debt restructurings[302], we strongly support the proposal.

6.4. CHAPTER CONCLUSIONS

The purpose of this chapter was two-fold. First, it sought to compare the outcomes of holdout trials against Greece and Argentina, respectively. Second, it aimed to provide guidance to policymakers on how to (further) reduce holdout inefficiencies.

In the first part of the chapter, the commonalities and distinctions between the Argentine and the Greek debt workout were analysed through five different dimensions: (i) the relevance of contracts and statutes, (ii) the role of governing law(s), (iii) the issue of sovereign immunity, (iv) jurisdiction of national courts, and (v) substantive law/property rights considerations.

In sum, while both Argentina and Greece faced holdout creditor problems, the distinct legal situations the respective countries found themselves in resulted in diverging judicial assessments. Most notably, its heavy reliance on contracts as the legal basis for its indebtedness, the high share of foreign law bonds, and choice-of-law clauses in favour of creditor-friendly jurisdictions, exposed Argentina to holdout litigation. Greece, by contrast, relied on statues for its indebtedness that were governed by local law (*sic!*) and over which Greek courts had jurisdiction.

Arguably, the review of case law related to Argentina and Greece confirmed investors' expectations and bolstered the rule of law in the sovereign debt sphere. At the same time, this 'rule of law', as argued throughout this thesis, has serious flaws. Ensuring it might therefore not be conducive to achieving the appropriate societal objectives. In this light, the second part of the chapter discussed and advanced some modest reform proposals.

This chapter refrained from opening the debate about an international bankruptcy framework for states under international law – enough has been said here. Rather, the chapter concentrated on some technical amendments to the contractual framework for international sovereign bonds. The ICMA/IMF initiative of 2014 provided a good starting point.

However, more still needs to be done to augment the resilience of sovereign bond restructurings from disruptive holdout litigation. Specifically, CAC thresholds could be

[302] Buchheit et al (n 217) 10 (noting that the EU immunized Iraqi assets in 2003 in order to facilitate a debt restructuring in Iraq without interference by holdout investors).

lowered, the introduction of CACs in domestic law bonds could be considered, a new benchmark for uniform applicability be introduced and aggregation mechanisms across different types of debt instruments should be reviewed. We also argued that the *pari passu* clause may be abandoned – the benefits of keeping it do no longer outweigh the risks of abuse. Finally, in line with other authors, we made a case for an increased use of trustee structures in international bond contracts. If done right, a move towards more trustee-based bonds could discourage go-alone litigation by holdouts while safeguarding an adequate representation of the creditor community.

The chapter also sought to contribute to the discussion on EMU reform by proposing an enhanced framework for sovereign debt restructuring. While several proposals have been put forward by experts, the legal intricacies associated with such mechanisms have so far not received enough attention. A well-designed framework for euro area sovereign debt restructurings could fulfil several functions.

On the one hand, it may cater for a more rational and comprehensive approach to address debt sustainability crises, replacing a regime that is fraught with ambiguity that is dangerous rather than constructive. On the other hand, it could promote an orderly process and reduce the costs of sovereign debt restructuring by shielding sovereigns from disruptive legal action whilst ensuring an appropriate degree of protection for holder of euro area debt securities.

From a technical point of view, euro area governments may resort to existing statutory instruments, such as the ESM Treaty, or indeed EU law, to mandate the inclusion of enhanced contractual clauses in government bonds. Complementing these contractual improvements, this section also discusses two options for a dispute settlement mechanism: a separate chamber at the CJEU or an arbitral tribunal.

One should not fall prey to the illusion that inefficiencies, risks, and deadweight losses associated with government debt restructurings can be ‘regulated away’. However, an informed discussion about enhancing the existing framework seems indispensable to ensure a more resilient, transparent, and legitimate framework to address sovereign debt crises in the currency union.

GENERAL CONCLUSIONS

This thesis provided a comprehensive analysis of what is referred to as the 'holdout creditor problem' in sovereign debt restructurings. The holdout creditor problem describes a situation in which one or more creditors refuse to enter negotiations with an insolvent sovereign issuer and instead seeks to attain a financially more attractive treatment, often by resorting to litigation and/or arbitration against the sovereign. The present thesis analysed the problem against the backdrop of a plethora of domestic court decisions and several international arbitral awards, which were rendered in the wake of the debt crises in Greece and Argentina – the two largest sovereign bankruptcies in history. While the topic has received much scholarly attention in recent years, this study provided the first comprehensive comparative legal analysis of these lawsuits.

Chapter 1 provided an overview of the legal framework underpinning modern sovereign debt instruments. The chapter showed that sovereign debt is embedded in a contractual framework, which is heavily influenced by Anglo-Saxon securities and corporate law as well as its practice. It also shed light on the key legal characteristics of sovereign debt instruments as well as their history. It concluded that bonds have replaced syndicate loans as the prime form of sovereign debt finance, that sovereign immunity continues to play a central role, and that the absence of a bankruptcy regime for sovereigns has hampered the quick and orderly resolution of sovereign debt crises.

Chapter 2 focused on the law and policy aspects of the existing regime to restructure sovereign debt, which is characterised by its *ad hoc* nature and the informal involvement of different actors and institutions, such as the IMF, the Paris Club, and the IIF. The rise of bond financing has complicated the resolution of sovereign debt crises by undermining the official sector's ability to ensure collective action among private creditors. In line with the majority view, chapter 2 concluded that the current framework provides many opportunities for arbitrage by specialised private creditors, most notably vulture holdouts.

Chapter 3 defined the holdout creditor problem, finding that the process of global financial integration has resulted in an expansion of the types of investors that may become holdouts. These range from the archetypical vulture holdout, which acquires debt with the purpose of extracting a preferential treatment during a debt restructuring, to official sector holdouts, which hold sovereign debt for public policy purposes, such as central banks or sovereign wealth funds. The chapter also discussed the rising importance of retail holdouts. These investors tend to hold a sizeable share of the sovereign's outstanding debt. Typically, they have purchased the instruments when they still traded at price levels close to their face value. As described in chapter 3, the increasing heterogeneity of different holdout classes poses new challenges to policymakers, making it even more difficult to nurture effective collection action and, at the same time, safeguard essential and legitimate investor rights.

Chapters 4 and 5 analysed the most seminal decisions rendered by domestic courts and international investment tribunals in the wake of the Argentine and the Greek debt restructurings, respectively. We covered lawsuits in eight different jurisdictions. The chapters highlighted that holdouts have filed legal action against the two sovereigns in various jurisdictions, with a mixed degree of success.

In Argentina, vulture holdouts ultimately convinced a judge in New York City to block all payments made on the restructured bonds, forcing the country into bankruptcy in 2014. While the judgement was to some extent overturned by the same judge in 2016, considerable legal uncertainty remains for future sovereign debt workouts.

In Greece, retail holdouts failed to obtain enforceable judgements in municipal and international courts, albeit the sword of Damocles of holdout litigation nudged the government into paying a number of vulture holdouts in full. The chapter showed that while, in principle, external sovereign debt remains more vulnerable to holdout strategies, *ex post* judicial review – and with it the holdout problem – has become an essential feature of local law debt restructurings in the euro area. In both Greece and Argentina, cases of holdout arbitration flanked litigation in domestic courts. However, in contrast to holders of Argentine debt, holdouts who sued Greece were much less successful. This was largely due to Greece's local law advantage, which allowed it to retroactively insert CACs in the terms of outstanding bonds, thereby constraining widespread holdout behaviour.

Chapter 6 comparatively analysed the outcomes of holdout litigation and arbitration following the crises in Greece and Argentina. It concluded that several factors determine the potential success of holdouts. These factors *inter alia* include the debt instruments' governing law, the application of the sovereign immunity doctrine, the specific rules on domestic courts' jurisdiction, as well as the protection of bondholder rights under domestic and international law. Subsequently, the chapter discussed mechanisms and tools to reduce holdout inefficiencies. Drawing upon the findings of chapter 4 and 5, it proposed two distinct approaches.

With regard to international sovereign bonds, policymakers should continue to pursue contractual reform, capitalising on the close cooperation forged between the official and the private sector in the aftermath of the Argentine litigation saga. The enhancements proposed respond directly to the holdout problems documented by this thesis in the context of the Argentine debt restructuring. These modifications should eliminate most of the risks associated with holdouts in the context of emerging market debt crises.

Given the deeper level of legal, political, and economic integration in the euro area, a more progressive, quasi-statutory approach to the restructuring of government bonds issued by euro area states should be considered. For the euro area, drawing upon the lessons from the Greek debt restructuring, a progressive reform of the current European crisis resolution mechanism is suggested. The framework would be centred on a financially potent ESM and entail clear rules that require debt restructurings if the requesting Member State's debts are deemed unsustainable. The effectiveness of such restructurings would be guaranteed through enhanced contractual provisions. Finally, we advocate for the establishment of a dispute settlement mechanism to deal with the legal fallout of a debt restructuring and adjudicate bondholder disputes in Europe.

This thesis had no intention to provide an exhaustive and all-encompassing analysis of a problem that falls squarely into several areas of law, ranging from international financial law to basic national contract law. At the same time, by applying methods of comparative legal research, it distils commonalities as well as differences across the main jurisdictions in which sovereign debt disputes are adjudicated. It reaches two key conclusions. On the one hand, the level of cross-fertilisation remains relatively low in the realm of sovereign debt. On the other hand, the increasing integration of regional legal and constitutional frameworks, for instance in the EU, as well as international efforts to make sovereign debt contracts more resilient, have reduced the fragmentation in the legal framework.

The resolution of sovereign debt crises will remain a formidable endeavour to the lawyers, economists, and politicians involved in the process. The defunct and patchy legal framework that they have to work with cannot be fixed in a matter of months and years, perhaps not even decades. At the same time, silver linings have appeared on the horizon. The international community has engaged in some concerted efforts to render sovereign debt contracts more resilient and is certainly heading in the right direction. Going forward, the momentum for reform generated by the two biggest sovereign debt restructurings in history should be kept high. Continuous adjustments and improvements to the law governing debt instruments will be indispensable to curtail holdout investors' negative impact on the orderly resolution of sovereign debt crises.

As President Obama's Chief of Staff, Rahm Emanuel, famously noted, '[y]ou never want a serious crisis to go to waste […].'[303] This thesis showed that the two crises were indeed serious. Now it is high time to take care of the 'not going to waste' part.

[303] Rahm Emanuel, 'Shaping the New Agenda' (2008) Interview to the Wall Street Journal <https://www.youtube.com/watch?v=_mzcbXi1Tkk> accessed 2 September 2018.

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ANNEX

ABSTRACT (IN ENGLISH)

This doctoral thesis analyses the 'holdout creditor problem' in international financial law. This problem emerges when sovereign borrowers seek to restructure their public debts but fail to convince all or a sufficient amount of creditors to participate in the workout.

Given the absence of an international bankruptcy regime, states need to convince holders of their debt instruments to voluntarily agree to contractual modifications. Holdouts, as their name implies, refuse to accept such modifications. Instead, they pressure the sovereign debtor into full repayment by means of litigation and arbitration after solvency has been restored. While their behaviour can be driven by genuine dissatisfaction with a restructuring offer, or even geopolitical reasons, most holdouts aim at making a financial gain by blocking a government debt restructuring.

After chapters 1 and 2 review the cornerstones of the legal framework underpinning the management and restructuring of sovereign debt, chapter 3 focuses on holdout creditor problems in the wake of the restructuring operations in Argentina and Greece, respectively. This study finds that holdouts have benefitted from and exploited the lack of a rule of law in the context of sovereign lending and borrowing. They leverage contracts against a sovereign debtor, engage in forum-shopping, and impose *de jure* and *de facto* embargos on sovereign borrowers by threatening the attachment of commercial asset. To foster an understanding of their motives and *modi operandi*, chapter 3 also categorises holdout investors into three different categories: vulture holdouts, retail holdouts, and official sector holdouts.

Focusing on sources of primary law, chapters 4 and 5 examine the holdout problem in light of numerous court judgements and arbitral awards rendered against Argentina and Greece. Notwithstanding a relatively high degree of standardisation in sovereign bond contracts, the case law reviewed in this thesis reveals significant fault lines regarding the enforceability of sovereign debt as well as the interplay between public and private law.

Overall, the success of holdouts in several countries has accentuated the danger they may pose to the quick and orderly resolution of government debt crises. Thus, chapter 6 provides recommendations to policymakers on the way forward. It broadly distinguishes between the international level and the euro area. As regards international sovereign bonds, which are predominantly governed by New York or English law, targeted enhancements of existing

contractual provisions are proposed. These suggestions respond directly to the holdout problems documented by this thesis in the context of the Argentine debt restructuring. These modifications should eliminate most of the risks associated with holdouts in the context of emerging market debt crises.

For the euro area, drawing upon the lessons from the Greek debt restructuring, a more progressive reform of the current European crisis resolution mechanism is suggested. The framework would be centred on a financially potent European Stability Mechanism and entail clear rules that require debt restructurings if the requesting Member State’s debts are deemed unsustainable. The effectiveness of such restructurings would be guaranteed through enhanced contractual provisions. Finally, we advocate the establishment of a dispute settlement mechanism to deal with the legal fallout of a debt restructuring and adjudicate bondholder disputes in Europe.

ABSTRACT (IN GERMAN)

Diese Arbeit untersucht das so-genannte ‚Holdout Creditor Problem' im internationalen Finanzrecht. Das Holdout Creditor Problem tritt auf, wenn einzelne Gläubiger eines zahlungsunfähigen Staates einer Restrukturierung der von ihnen gehaltenen Schuldtitel nicht zustimmen (they ‚hold out') und stattdessen versuchen einen vorteilhafteren bilateralen Vergleich mit dem Schuldnerstaat abzuschließen. Dieses Verhalten zielt in erster Linie auf eine Reduktion der Verluste in einer Staateninsolvenz ab, kann aber in vielen Fällen auch zu beträchtlichen Gewinnspannen bei den Holdout Creditors führen. Die Spannen ergeben sich aus der Differenz zwischen dem reduzierten Preis der Staatsanleihe am Sekundärmarkt und dem (höheren) Nennwert der Anleihe.

Um den Schuldnerstaat zu einem solchen Vergleich zu bewegen, bedienen sich diese Gläubiger dem Rechtsweg und klagen den Schuldnerstaat regelmäßig in nationalen Gerichtsverfahren sowie internationalen Schiedsgerichtsverfahren auf die Zahlung des vollen Nennwertes der Anleihe. Da der Staat aber gerade durch die Reduktion des Nennwertes der ausstehenden Anleihen versucht, seine Schuldentragfähigkeit wiederherzustellen, kann ein (außer-)gerichtlicher Erfolg von Holdout Creditors die erfolgreiche Lösung einer Staatsschuldenkrise verzögern oder sogar verhindern.

Die vorliegende Arbeit beleuchtet das Holdout Creditor Problem aus einer rechtsvergleichenden Perspektive durch die Analyse der wichtigsten Verfahren vor nationalen Gerichten in den USA, Großbritannien, Deutschland, Italien, Frankreich und Österreich, vor europäischen und internationalen Gerichten sowie vor dem Internationalen Zentrum zur Beilegung von Investitionsstreitigkeiten. Dabei konzentriert sich die Studie auf Verfahren, die im Zusammenhang mit den zwei größten Staatsschuldenkrisen der Geschichte stehen: der argentinischen Insolvenz von 2001 und der griechischen Umschuldung von 2012. Sowohl Argentinien und Griechenland sahen sich mit tausenden von Anlegerklagen konfrontiert, nicht zuletzt weil die globale ‚Finanzialisierung' es ihnen ermöglichte, Anleihen in verschiedenen Jurisdiktion und auf unterschiedlichen Kapitalmärkten zu begeben.

Wie diese Arbeit zeigt, spielt das Holdout Creditor Problem inzwischen eine zentrale Rolle bei der Lösung von internationalen Finanz-und Wirtschaftskrisen. Einerseits hat die Erosion der absoluten Staatenimmunität Gläubigern erleichtert, eine international akkordierte Umschuldung im Staateninsolvenzfall zu blockieren. Andererseits haben können Staaten ihre Vermögenswerte international verschieben und zu einem gewissen Grad auch dem Zugriff

von Investoren entziehen. Darüber hinaus ist festzustellen, dass sich die nationale Gerichtspraxis nach wie vor stark variiert und entscheidende Rechtsfragen etwa zur Interpretation gewisser standardisierter Klauseln in Anleiheverträgen, zur Ausgestaltung von Kreditgeberrechten, und im Hinblick auf die völkerrechtliche Behandlung der Zahlungsunfähigkeit ungeklärt bleiben. Als Beispiel sei etwa genannt, dass Frankreich und Italien die Staatenimmunität im Bereich der Fiskalpolitik sehr weit interpretieren, die anglo-sächsische Rechtstradition aber strikt dem Prinzip der relativen Staatenimmunität folgt. Daraus ergibt sich, dass das anzuwendende Recht beziehungsweise der örtliche Gerichtsstand eine entscheidende Rolle für die Erfolgschancen einer Umschuldung von Staatsschulden spielt.

Die vorliegende Arbeit erweitert die bestehende Literatur in dreierlei Hinsicht.

Erstens inkludiert sie eine umfassende rechtsvergleichende Analyse der wichtigsten Verfahren nach den Krisen in Argentinien und Griechenland. Dies umfasst die Analyse von Gerichtsurteilen sowie international Schiedsgerichtsentscheidungen in mehr als 10 verschiedenen Jurisdiktionen. Viele der Urteile wurden bisher nur in isoliertem Kontext oder – aufgrund ihrer Neuheit – noch gar nicht in der Literatur behandelt. Diese Arbeit befasst sich als erste erschöpfend mit der judiziellen Aufarbeitung der beiden größten Staatsschuldenkrisen der Geschichte und versucht sowohl die rechtlichen Gemeinsamkeiten wie auch die Unterschiede zwischen Griechenland und Argentinien durch die Analyse von Primärrechtsquellen herauszuarbeiten. Im Ergebnis zeigt sich, dass der informelle Mechanismus den die internationale Gemeinschaft zur Lösung von Staatsschuldenkrisen entwickelt hat nicht mehr mit der Rechtsentwicklung Schritt halten kann.

Zweitens wird die in der Literatur gängige Definition von Holdout Creditors erweitert und nuanciert. Insbesondere untersucht diese Arbeit nicht nur das Phänomen von hochspezialisierten Hedge-Fonds, die in spekulativer Absicht Staatsschulden kurz vor oder während der Krise kaufen und dann den Schuldnerstaat auf Zahlung klagen. Sie behandelt auch die Rolle der ‚Retail Holdouts'. Diese Gläubiger weisen kaum Finanzexpertise auf, besitzen oft nur einen sehr kleinen Anteil an der Gesamtstaatsschuld und handeln selten spekulativ. Das typische Beispiel für solche Investoren sind Sparer, denen von ihrer Hausbank eine höhere Rendite beim Kauf von Staatsschulden versprochen wurde. Sowohl in Argentinien als auch in Griechenland haben Retail Holdouts ihre vertraglichen Rechte geltend gemacht und entscheidend zur Weiterentwicklung des Rechts der Staatsschulden beigetragen. Zuletzt wird auch die Kategorie der ‚Official Sector Holdouts‘ beleuchtet. Zu diesen zählen internationale Finanzorganisationen, wie etwa Zentralbanken oder staatlich kontrollierte Investmentfonds, sowie Staaten selbst. Obwohl diese Akteure selten finanzielle Interessen verfolgen, so kann sich die Blockade einer Restrukturierung der Schulden eines anderen Staates als geopolitisch opportun oder rechtlich notwendig erweisen.

Drittens schlägt die Arbeit vor, dass die bestehenden Mechanismen zur Eindämmung des Holdout Problems vor dem Hintergrund der Forschungsergebnisse unzureichend sind. Konkret werden zwei unterschiedliche rechtspolitische Konzepte präsentiert, um die negativen Effekte von Holdout Creditors zu reduzieren: gezielte Änderungen der vertraglichen Basis von internationalen Anleiheverträgen und eine umfassendere Reform des rechtlichen Rahmens zur Lösung von Staatsschuldenkrisen in der europäischen Währungsunion. Da ein völkerrechtlich kodifiziertes Insolvenzrecht für Staaten nach wie vor am politischen Dissens scheitern wird, sollten politische Entscheidungsträger ihren Fokus auf die sukzessive Verbesserung des vertraglichen Rahmens von Staatsanleihen legen und den durch den Internationalen Währungsfonds im Jahr 2014 eingeleiteten Reformprozess unterstützen.

Der Autor beschreibt in diesem Zusammenhang einige gezielte technische Veränderungen der vertraglichen Grundlage von Staatsanleihen. Diese sollten das Geschäftsmodell von Holdout Creditors unattraktiver machen, ohne dabei die fundamentalen Rechte der Kreditgeber übermäßig zu beschneiden. So sollten die Abstimmungserfordernisse bei Collective Action Clauses weiter gesenkt werden, Individualklagen durch Treuhandstrukturen werden und die pari passu Klausel in internationalen Anleiheverträgen überarbeitet oder sogar abgeschafft werden. Die hier vorgeschlagenen vertraglichen Entwicklungen müßten dann von nationalen Gerichten bei der Vertragsinterpretation unmittelbar angewandt werden.

Eine andere Herangehensweise wird im Zusammenhang mit Krisen innerhalb der europäischen Währungsunion empfohlen, da hier die rechtliche, politische und ökonomische Integration und Konvergenz der 19 Mitgliedsstaaten progressivere Lösungen erlaubt. Insbesondere wird eine Reform des Europäischen Stabilitätsmechanismus (ESM) angeregt, die nicht nur das Holdout Creditor Problem adressieren würde, sondern mit der auch generell die Transparenz in Situationen erhöht wird, in denen ein Mitglied der Währungsunion zahlungsunfähig wird. Neben einem transparenteren Prozess für Situationen in denen die

Schuldentragfähigkeit nicht gegeben ist, wird die Verbesserung von europäischen Collective Action Clauses diskutiert sowie die Immunisierung von ESM Mitteln in Gerichtsverfahren. Zudem kann die Schaffung eines europäischen Streitbeilegungsmechanismus für Streitigkeiten zwischen Staaten und ihren Gläubigern die im Rahmen der Griechenlandkrise entstandene Rechtsunsicherheit weiter minimieren.