

Sovereign Debt: Now What?

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The sovereign debt restructuring regime looks like it is coming apart. The regime, such as it is, emerged in the late twentieth century, anchored in institutions dominated by the Group of Seven (G-7) wealthy nations,¹ and has shaped responses to dozens of international financial crises. All along, it drew criticism for failing to deliver enough relief or fair distribution; it prevailed nonetheless in good part because “[f]or 30 years sovereign debt restructurings have gotten done.”² Changing patterns of capital flows, old creditors’ weakening commitment to past practices, and other stakeholders’ inability to take over or coalesce behind a viable alternative, have challenged the regime from the moment it came together in the mid-1990s, so that by 2016, its survival cannot be taken for granted. Crises in Argentina, Greece, and Ukraine since 2010 exposed the regime’s perennial failures and new shortcomings. Until an alternative emerges, there may be messier, more protracted restructurings, more demands on public resources, and more pressure on national courts to intervene in disputes that they are ill-suited to resolve.

Lengthy debt crises bring deadweight losses, but they also disproportionately hurt the poorest, least sophisticated debtors and creditors.³ These ultimate stakeholders of any sovereign debt

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¹ The Group of Seven (G-7) comprises Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

² Lee C. Buchheit, *Sovereign Debt Restructurings: The Legal Context*, in SOVEREIGN RISK: A WORLD WITHOUT RISK-FREE ASSETS? BIS PAPERS NO. 72 107, 110 (July 2013), <http://www.bis.org/publ/bppdf/bispap72.pdf>. For evidence that debt relief comes too late and delivers too little relief, see Rodrigo Mariscal et al., *Sovereign Defaults: Has the Current System Resulted in Lasting (Re)Solutions?* (Escuela de Negocios: Universidad Torcuato Di Tella, Working Paper 03/2015, 2015), <http://econpapers.repec.org/paper/udtwpbsdt/2015-03.htm>; LEE C. BUCHHEIT ET AL., BROOKINGS INST., COMM. ON INT’L ECON. POL’Y & REFORM, REVISITING SOVEREIGN BANKRUPTCY 5-14 (2013), <http://www.brookings.edu/research/reports/2013/10/sovereign-debt> (follow “Download the full report” hyperlink under “Download”) [hereinafter REVISITING SOVEREIGN BANKRUPTCY]; Elena Duggar, *Sovereign Defaults Series: The Aftermath of Sovereign Defaults*, Moody’s (Oct. 2013); Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts* (IMF, Working Paper No. WP/12/203, 2012), <https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf>.

³ See, e.g., FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 50-53 (2006) (summarizing economic literature on deadweight losses from sovereign debt default); Peter Fallon & Robert Lucas, *The Impact of Financial Crises on Labor Markets, Household Incomes, and Poverty: A Review of Evidence*, 17 WORLD BANK RES. OBSERVER 21, 21-45 (2002); 2 Jeffrey D. Sachs, *Introduction to*

restructuring regime—citizens, taxpayers, bank depositors and pensioners—lose their livelihoods along with their faith in domestic and international institutions.⁴ Governments lose their capacity to meet the basic human needs of their citizens and to safeguard their human rights.

Initiatives emanating from places as different as the United Nations General Assembly (UNGA), the International Monetary Fund (IMF), and the International Capital Market Association (ICMA)⁵ reflect broad-based demand for reform. The regime's apparent decline presents an opportunity to reconsider the institutional architecture of sovereign debt restructuring, along with the norms and alliances that underpin it. I argue that reform should have three objectives, addressing both the old flaws and the new challenges. First, the reformed regime should achieve sustainable outcomes generally accepted as fair. It should deliver a fresh start for debtors and finality for creditors, and treat similarly situated debtors and creditors alike. Second, to that end, the restructuring process should be comprehensive and collective. Third, this regime should be intelligible and accountable to all stakeholders. While overnight transformation is not in the cards, incremental reforms should be evaluated based on how well they advance the three objectives.

This essay proceeds as follows: Parts I and II review the current institutional arrangements for sovereign debt restructuring and the trends that have destabilized them. Part III considers three recent shocks—Argentina, Greece, and Ukraine—and what they reveal about the regime. Part IV outlines a set of contractual, statutory, and institutional measures to promote sustainable and fair outcomes, a comprehensive, collective, intelligible process, and regime accountability. I argue for more robust links among restructuring fora to deter free-riding, improve enforcement and generate shared norms, for richer, more standardized and accessible disclosure to promote accountability, and for stronger industry governance, including more contract standardization. The thrust of the argument is that any new regime, much like the old, is more likely to take hold and endure if it solves concrete problems for its diverse constituents, who understand it and have a stake in its success. Each of the proposed reforms on its own might look small-bore; this is misleading. The reform package as a whole is designed to build an infrastructure for repeated collaboration, and to infuse big norms like sustainability and fairness with consensus meaning from shared practice. It is consistent with the 2015 UNGA Resolution establishing basic

DEVELOPING COUNTRY DEBT AND ECONOMIC PERFORMANCE: COUNTRY STUDIES—ARGENTINA, BOLIVIA, BRAZIL, MEXICO 19-24 (Jeffrey D. Sachs ed., 1990) (describing the distributional effect of debt crises).

⁴ Cf. Armin von Bogdandy & Matthias Goldmann, *Sovereign Debt Restructurings as Exercises of International Public Authority: Towards a Decentralized Sovereign Insolvency Law*, in SOVEREIGN FINANCING AND INTERNATIONAL LAW: THE UNCTAD PRINCIPLES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING 39 (Carlos Espósito, Yuefen Li & Juan Pablo Bohoslavsky eds., 2013) (arguing that the effects of sovereign debt restructuring fall on the public and should be governed by public law).

⁵ *Infra* notes 211-213 and the accompanying text.

principles for sovereign debt restructuring,⁶ and harnesses existing institutions—the IMF, national courts, industry and civil society groups, and market infrastructure—to advance them.

I. *Fin de Something: Sovereign Debt Restructuring circa 2000*

Any sovereign debt restructuring regime must account for two distinctive features of sovereign debt that are so well-rehearsed in the academic literature that they no longer strike anyone as weird.⁷ First, the debt contracts are unenforceable in any conventional sense.⁸ Short of gunboats, there are few ways for creditors to make governments pay. Despite the dramatic erosion of sovereign immunity over the course of the twentieth century, foreign courts normally cannot seize public property, liquidate a country, or compel public officials to do their bidding.⁹ Second, the debt does not go away. Governments have no access to bankruptcy relief, partly because none would submit to a binding process that they do not control.¹⁰ While occasional default and restructuring inhere in sovereign commitment, there is no debt discharge, no fresh start as a matter of right; as a result, debt relief has come from bargaining between a government and its creditors.¹¹ This tension between weak enforcement and no discharge frames sovereign borrowing *ex ante* and sovereign debt restructuring *ex post*.

Twentieth century restructuring institutions partly overcame the enforcement constraint by controlling borrowing governments' access to external financing.¹² More than asset seizures,

⁶ G.A. Res. 69/319 (Sept. 10, 2015).

⁷ I elaborate on the peculiar nature of unenforceable-yet-nondischargeable debt in Anna Gelpern, *Policy Brief 13-21: Sovereign Damage Control*, PETERSON INST. INT'L ECON. (May 2013).

⁸ For canonical accounts, see Jonathan Eaton & Mark Gersovitz, *Debt with Potential Repudiation: Theoretical and Empirical Analysis*, 48 REV. ECON. STUDIES 289 (1981) (reputation); Jeremy Bulow & Kenneth Rogoff, *Sovereign Debt: Is to Forgive to Forget*, 79 AM. ECON. REV. 43 (1989) and Jeremy Bulow & Kenneth Rogoff, *A Constant Recontracting Model of Sovereign Debt*, 97 J. POLIT. ECON. 155 (1989) (enforcement); MICHAEL TOMZ, REPUTATION AND INTERNATIONAL COOPERATION: SOVEREIGN DEBT ACROSS THREE CENTURIES (2007) (reputation).

⁹ W. Mark C. Weidemaier, *Sovereign Immunity and Sovereign Debt*, 2014 U. ILL. L. REV. 67 (2014); Pierre-Hugues Verdier & Erik Voeten, *How Does Customary International Law Change? The Case of State Immunity*, 59 INT'L STUD. Q. 209 (2014).

¹⁰ See, e.g., Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299, 346-47, 352, 391 n. 250 (2005); Jérôme Sgard, *How the IMF Did It—Sovereign Debt Restructuring Between 1970 and 1989*, 11 CAP. MKTS. L.J. 103 (2016).

¹¹ Even in his fervent advocacy of debt repayment, Alexander Hamilton acknowledged that repayment in full and on time is sometimes impossible and inadvisable. See ALEXANDER HAMILTON, FIRST REPORT ON PUBLIC CREDIT (1790) (“Every breach of the public engagements, whether from choice or necessity, is, in different degrees, hurtful to public credit. When such a necessity does truly exist, the evils of it are only to be palliated by a scrupulous attention, on the part of the Government, to carry the violation no further than the necessity absolutely requires, and to manifest, if the nature of the case admit of it, a sincere disposition to make reparation whenever circumstances shall permit.”).

¹² *Infra* notes 39-43 and accompanying text [*Cross-Conditionality and Inter-Group Discipline*]. See also, REVISITING SOVEREIGN BANKRUPTCY, *supra* note 2.

debtors had to worry about getting cut off from public and private sources of foreign exchange.¹³ To recover from an immune debtor, creditors had to stick together. A mix of regulatory, reputational, and contract sanctions to promote inter-creditor cooperation emerged in response to particular historical problems.

Changes in international trade and capital flows, the decline of absolute sovereign immunity, post-colonial and post-Soviet upheavals each periodically called for new debt management and restructuring tools, and forced the old ones to adapt. Growth in bilateral trade finance from the rubble of World War II created demand for coordination among government-to-government creditors. The Paris Club, a regular informal gathering of official bilateral creditors, was born in the 1950s.¹⁴ The 1970s saw a spike in syndicated loans to poor and middle-income countries, made by banks in major financial centers. The crises and restructurings that followed in the 1980s required a mechanism to coordinate commercial banks. Bank advisory committees, or the London Club process, emerged in response.¹⁵ G-7 finance officials were just backstage with moral suasion, funding and regulatory incentives, because the health of their financial systems depended on the success of the process: banks took nearly a decade to build up enough capital and reserves to absorb losses from debt reduction.¹⁶ Meanwhile, sovereign debt kept growing.¹⁷

Starting in 1989, banks exchanged unpayable loans for tradable bonds at a discount. Developing countries reduced their debt to foreign banks by a third or more.¹⁸ Bonds quickly eclipsed loans as the funding instrument of choice for most sovereigns, as they had been in the late nineteenth and early twentieth centuries.¹⁹ New defaults hit the sovereign bond market in the late 1990s,

¹³ The mechanism could be either reputation (no new lending) or enforcement (blocked payments). In either case, defaulting sovereigns face disruptions in cross-border trade and financial flows. *Supra* note 8. *See also, e.g.*, Willem Buiter & Ebrahim Rahbari, *Why do Governments Default, and Why Don't They Default More Often?* 28, CEPR Discussion Paper No. 9492 (May 2013) (discussing liquidity shocks in countries with debt denominated in foreign currency).

¹⁴ THOMAS M. CALLAGHY, *THE MISUNDERSTOOD ORIGINS OF THE PARIS CLUB* (2008) (unpublished manuscript) (on file with author).

¹⁵ LEX RIEFFEL, *RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD-HOC MACHINERY* 95-131 (2003) (describing the London Club process).

¹⁶ WILLIAM R. CLINE, *INTERNATIONAL DEBT REEXAMINED* 72-73 (1995) (describing changes in the financial position of banks and developing country debt stocks throughout the 1980s); RIEFFEL, *supra* note 15. *See also*, JOSEPH KRAFT, *THE MEXICAN RESCUE* (1984) (a journalistic account of the beginning of the Third World Debt Crisis and the bank coordination process). For a description of sovereign debt restructuring as a three-party negotiation including the debtor, the creditor, and creditors' governments, *see* Jeremy Bulow & Kenneth Rogoff, *Multilateral Negotiations for Rescheduling Developing Country Debt: A Bargaining-Theoretic Framework*, 35 IMF STAFF PAPERS 644 (1988).

¹⁷ CLINE, *supra* note 16.

¹⁸ *See, e.g.*, Serkan Arslanalp & Peter Blair Henry, *Is Debt Relief Efficient?* 60 J. Fin. 1017 (2005).

¹⁹ Ross Buckley, *The Facilitation of the Brady Plan: Emerging Markets Debt Trading From 1989 to 1993*, 21 FORDHAM INT'L L.J. 1802, 1804-18, 1820-22 (1997).

and called for bondholder coordination.²⁰ Designing the right coordination machinery was a challenge because late twentieth-century bonds traded more widely and actively than their distant ancestors, and because modern-day bondholders did not normally have enduring ties to governments. Creditor committees, which had led bond restructuring negotiations a century earlier and commercial bank negotiations a decade earlier, played a relatively small role in contemporary bond exchanges. For the most part in the late 1990s and early 2000s, debtors and their advisers drove distressed sovereign bond exchanges, which resembled new securities offerings more than the deals brokered by bank advisory committees or bondholder councils of yore.²¹

Chronically poor countries cut off from private markets borrowed from governments and multilateral institutions such as the IMF, the World Bank, and regional development banks to finance economic reform and development programs. Many of these programs failed to deliver thanks to some combination of bad design, bad implementation, and bad luck. By the late 1990s, some countries' debts had grown and their economies had deteriorated so much that stretching out repayments (rescheduling) and even substantial debt reduction by Paris Club creditors could not put them on a sustainable path: their debts would keep growing in perpetuity. In response to a global civil society campaign, the G-7 unveiled new dedicated debt relief programs, the Heavily Indebted Poor Countries (HIPC) initiative in 1996 and the Multilateral Debt Relief Initiative (MDRI) in 2005. Throughout the 1990s and into the 2000s, a mix of outside pressure, creditor country politics, new research and policy experience produced a succession of program changes to deliver more relief in exchange for more reform. In the end, multilateral debt of the world's poorest countries would be cut for the first time along with bilateral debt, with relief tied to policy and governance conditionality.²²

²⁰ Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Restructuring Sovereign Debt: Lessons from Recent History*, in FINANCIAL CRISES: CAUSES, CONSEQUENCES, AND POLICY RESPONSES 593 (Stijn Claessens et al. eds., 2014).

²¹ For accounts of bondholder committees in the 19th and early 20th centuries, see Marc Flandreau, *Sovereign States, Bondholders Committees, and the London Stock Exchange in the Nineteenth Century (1827–68): New Facts and Old Fictions*, 29 OXFORD REV. ECON. POL. 668 (2013), Rory Macmillan, *Towards a Sovereign Debt Work-out System*, 16 NW. J. INT'L L. & BUS. 57 (1995). On the development of contemporary sovereign bond restructuring practices, see NOURIEL ROUBINI & BRAD SETSER, BAILOUTS OR BAIL-INS? RESPONDING TO FINANCIAL CRISES IN EMERGING ECONOMIES (2004); STURZENEGGER & ZETTELMEYER, *supra* note 3; Ran Bi, Marcos Chamon & Jeromin Zettelmeyer, *The Problem that Wasn't: Coordination Failures in Sovereign Debt Restructurings* (IMF, Working Paper No. WP/11/265, 2011), <https://www.imf.org/external/pubs/ft/wp/2011/wp11265.pdf>; Ugo Panizza, Federico Sturzenegger & Jeromin Zettelmeyer, *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LIT. 651 (2009).

²² Technically, the debt was paid off on the debtors' behalf by donor countries. Martin A. Weiss, *The Multilateral Debt Relief Initiative*, CRS Report No. 22534 (Jun. 11, 2012), Martin A Weiss, *Debt Relief for Heavily Indebted Poor Countries: Issues for Congress*, CRS Report No. RL33073 (Apr. 18, 2006), NANCY BIRDSALL & JOHN WILLIAMSON, DELIVERING ON DEBT RELIEF: FROM IMF GOLD TO A NEW AID ARCHITECTURE (2002); IMF, *Factsheet: The Multilateral Debt Relief Initiative* (updated Sep. 17, 2015), <https://www.imf.org/external/np/exr/facts/mdri.htm>; IMF, *Factsheet: Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative* (updated Sept. 17, 2015), <http://www.imf.org/external/np/exr/facts/hipc.htm>; Joshua

Different fora, practices, and techniques—the Paris and London Clubs, bond exchanges, and HIPC—could be mixed and matched to suit particular debtors, creditors, and debt stocks. By the late 1990s, sovereign debt restructuring was the work of a reasonably integrated regime, even if it was not recognized as such.

The IMF established itself as the foundation of this restructuring regime beginning in the 1980s.²³ It delivered temporary liquidity for the debtor and used its lending instruments and policies to coordinate disparate creditor groups. By the turn of the century, this role was well-understood by a small core of repeat players: finance officials in debtor and creditor countries, staff and management at multilateral institutions, experts at credit rating agencies, big law and financial firms, and smaller, specialized investors.²⁴ A country that could not pay its debt first turned to the IMF, which typically offered financial support for up to three years, conditioned on economic reform.²⁵ The IMF indicated what budget savings the country could achieve, which implied a “financing gap” to be filled by new lending and debt relief from other creditors. By default, the IMF also became a gatekeeper: if the gap could not be filled, the program could not go forward. Without IMF funding, the country and its creditors faced the prospect of disorderly default.²⁶

For debtors and creditors, there were few good alternatives to negotiation. Throughout the 1980s and 1990s, national courts chipped away at sovereign borrowers’ defenses to paying their debts.²⁷ Yet most government property remained beyond creditors’ reach, either safe inside debtors’ borders or covered by still-potent central bank, military and diplomatic immunities.²⁸ Governments that could not or would not pay their foreign creditors had to choose between

Busby, *Is There a Constituency for Global Poverty? Jubilee 2000 and the Future of Development Advocacy*, in *GLOBAL DEVELOPMENT 2.0: CAN PHILANTHROPISTS, THE PUBLIC AND THE POOR MAKE POVERTY HISTORY?* 85 (Lael Brainard & Derek Chollet eds., 2008).

²³ Sgard puts the start of this role for the IMF in the 1970s; it developed more fully during the Third World Debt Crisis in the 1980s. Sgard, *supra* note 10.

²⁴ See Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L. REV. 1627 (2006) (an interview-based study of sovereign bond contract reform, describing different parts of the sovereign debt restructuring community); MITU GULATI & ROBERT E. SCOTT, *THE 3 1/2 MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* (2012) (describing and interviewing lawyers in New York and London); cf. YVES DEZALAY & BRYANT G. GARTH, *DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER* 10 (1996) (describing the tightly-knit international arbitration community).

²⁵ Lee Buchheit, *The Role of the Official Sector in Sovereign Debt Workouts*, 6 CHI. J. INT’L L. 333 (2005).

²⁶ *Id.* at 341-42. Buchheit points out that this IMF role was not well understood by the private sector. While this may have been true of the private sector in general or investor groups new to the sovereign debt restructuring scene, it was not true of insiders like him, who numbered in the dozens. *Supra* note 24.

²⁷ For U.S. jurisprudence, see, e.g., *Argentina v. Weltover, Inc.*, 504 U.S. 607 (1992) (U.S. courts have jurisdiction over domestic-law bonds payable in New York; debt issuance is commercial activity outside the scope of sovereign immunity); *Allied Bank Int’l v. Banco Credito Agricola de Cartago*, 757 F.2d 516 (2d Cir. 1985) (eliminating the Act of State Doctrine as a defense to sovereign default), *Elliott Assocs. v. Banco de la Nacion*, 194 F.3d 363 (2d Cir. 1999) (effectively eliminating the champerty defense in sovereign debt).

²⁸ The “ARA Libertad” Case (Argentina v. Ghana), Case No. 20, Order of Dec. 15, 2012, 12 ITLOS Rep. 332, https://www.itlos.org/fileadmin/itlos/documents/cases/case_no.20/C20_Order_15.12.2012.corr.pdf.

compromise and a lifetime of hiding assets and rerouting payments, which made it hard to pursue international trade and finance.²⁹ Meanwhile, creditors with judgments against sovereigns could spend years scouring the world for morsels of attachable property and hassling debtors into settlement. A scant few could play this game; hardly anyone else found it appealing.³⁰

The old regime as described so far had three key features that helped manage sovereign debt distress just well enough to survive, without statutory, court-supervised bankruptcy, robust contract enforcement, or strong shared norms. It was modular, relied on cross-conditionality among creditor groups, and featured repeat players invested in its practices. I discuss them in turn below.

Modularity and Intra-Group Discipline. Creditors with common interests and similar claims restructured together, in more-or-less self-contained groups, which could be assembled in a modular fashion to produce a mix of reform and relief—like a building out of Lego blocks (Figure [1]).

Paris Club and London Club lenders, foreign bondholders, multilateral institutions, and domestic residents each had distinct motives for lending, and distinct sources of legal, political, and economic leverage over the sovereign. For example, bilateral and multilateral creditors lent above all to advance policy objectives; they relied on diplomatic and institutional pressure to collect. Foreign commercial banks generally lent for profit, but often had a complex web of dealings with a sovereign borrower, and optimized returns across the relationship. A bank might arrange loans for a sovereign to gain regulatory favors for its branch network in the country, even if it lost money on the loans.³¹ Banks could take their contracts to court, or draw on ties with regulators in their own and debtor countries for repayment and regulatory favors. Non-bank bondholders as a rule sought to profit from the bond, not the relationships. They had fewer non-contractual means to recover, and correspondingly fewer inhibitions about suing sovereigns. This did not necessarily make litigation the default option. In distress, bondholders tended to sell or settle, not sue, because suing immune sovereigns was time-consuming, uncertain, expensive, and inconsistent with most funds' investment strategies.³² Lastly, domestic banks, pension funds and

²⁹ Compare stylized description of enforcement in Bulow & Rogoff, *Is to Forgive to Forget* and *A Constant Recontracting Model*, *supra* note 8.

³⁰ For game-theoretic analysis of sovereign debt restructuring episodes, *see, e.g.*, VINOD K. AGGARWAL, *DEBT GAMES: STRATEGIC INTERACTION IN INTERNATIONAL DEBT RESCHEDULING* (1996).

³¹ *E.g.*, RIEFFEL, *supra* note 15 at 38: “Accordingly, banks have a ‘relationship’ interest in sovereign borrowers that is totally absent among bond investors. Banks may participate in a loan to a sovereign borrower, even when the prospective return is not commensurate with the risk, if they can gain a business advantage by doing so.” *See also*, Charles Lipson, *Bankers’ Dilemmas: Private Cooperation in Rescheduling Sovereign Debts*, in *COOPERATION UNDER ANARCHY* 200, 207 (Kenneth A. Oye ed., 1986); Jill Fisch & Caroline Gentile, *Vultures or Vanguard: The Role of Litigation in Sovereign Debt Restructuring*, 53 *EMORY L.J.* 1043, 1058-59 (2004).

³² *See* ROSS BUCKLEY, *EMERGING MARKETS DEBT: AN ANALYSIS OF THE SECONDARY MARKET* 294-95 (J.J. Norton & Christos Hadjiemmanuil eds., 1999).

insurance firms sometimes lent to the sovereign under direct or implicit pressure.³³ In crisis, they bargained over their share of pain from austerity (“adjustment”) policies alongside other domestic interest groups; their fate would depend in important part on domestic politics.

Creditor groups operated under distinct regulatory, tax and accounting constraints. At one extreme, sovereign debtors could simply change their own regulations to make local banks and pension funds buy their debt. Foreign governments and banks (foreign and domestic) could keep distressed sovereign loans on their books at full value under financial reporting rules applicable to them. Government accounting let some official bilateral creditors reschedule payments and reduce interest rates without booking losses or getting new legislative authority.³⁴ This created a bias against principal reduction. Regulatory accounting created a similar bias for banks.³⁵ In contrast, investment funds typically had to value cash flows and report the market value of their assets; when they “marked to market,” funds felt the impact of sovereign distress in real time. These and similar background constraints affected creditor groups’ willingness to restructure, as well as their preferences for restructuring terms.

Similarly situated creditors bargained together and exerted a measure of intra-group discipline.³⁶ They insisted on high or total participation among members as a condition for restructuring, and devised ways to make free riding unattractive.³⁷ When holdouts were small, the group might move on and settle with the debtor. This would deprive the holdout of group negotiating power; however, it also freed the debtor to pay off the holdouts quietly once the other creditors were out

³³ See, e.g., Carmen M. Reinhart & M. Belen Sbrancia, *The Liquidation of Government Debt* (IMF, Working Paper No. WP/15/7, 2015), <https://www.imf.org/external/pubs/ft/wp/2015/wp1507.pdf>. Of course, so-called financial repression is not the only or even the dominant reason domestic actors lend to their governments—they can make bad credit judgments just as well as foreign creditors.

³⁴ RIEFFEL, *supra* note 15, at 278-79 (describing legislative constraints on principal reduction by the U.S. government).

³⁵ See, e.g., Jonathan Hay & Nirmaljit Paul, *Regulation and Taxation of International Commercial Banks During Debt Crisis* (World Bank Technical Paper No. 158), http://www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/1999/09/23/000178830_98101904141457/Rendered/PDF/multi_page.pdf (cross-country survey).

³⁶ The Paris Club is the most obvious example of a “creditor cartel.” Member governments negotiate together and police compliance through regular meetings and monitoring within the group. See *Historical Development*, CLUB DE PARIS, <http://www.clubdeparis.org/en/communications/page/historical-development> (last visited Apr. 27, 2016). Group discipline became a challenge in bank syndicates when small banks refused to grant repeated concessions on par with larger banks that had higher exposure and a broader set of equities at stake in a sovereign crisis. Buckley, *supra* note 19, at 1802; see also 3 Robert S. Dohner & Ponciano Intal, Jr., *Debt Crisis and Adjustment*, in DEVELOPING COUNTRY DEBT AND ECONOMIC PERFORMANCE: COUNTRY STUDIES—INDONESIA, KOREA, PHILIPPINES, TURKEY 544 (Jeffrey D. Sachs & Susan M. Collins eds., 1989). Bond exchanges presented the biggest challenge, since the creditors were not necessarily repeat players and were not subject to regulatory suasion. Transactional techniques such as exit consents and minimum participation thresholds reduced the number of dissenters. Bi et al., *supra* note 21.

³⁷ See Bi et al., *supra* note 21 (describing exit consents and minimum participation thresholds, as well as majority amendment clauses in sovereign bonds, to explain the brisk pace of bond restructurings).

of the way. On occasion, large creditors paid off small holdouts in secret, so as not to encourage imitators.³⁸

In sum, the existence of reasonably cohesive modules, or groups of creditors with shared motives and constraints facilitated collective action among individual creditors, and negotiations between all creditors and the sovereign debtor, so that “deals got done.”

Cross-Conditionality and Inter-Group Discipline. A modular regime capable of brokering agreements within creditor groups still had to manage the problem of burden-sharing among them, and had to secure enough relief overall to revive the sovereign. With no ability to consolidate diverse claims in a single bankruptcy-style proceeding, sovereign debt restructuring fora used cross-conditionality to achieve more comprehensive, collective workouts.

IMF policies put pressure on debtors and creditors to settle, and on creditor groups to coordinate. As noted earlier, the IMF would not approve a program without assurances from the sovereign or directly from its creditors that there would be enough financing to meet the country’s expected needs during the program period. IMF-supported program conditions also secured contributions from domestic creditors as part of the sovereign’s adjustment program, whether or not they participated in debt restructuring alongside the foreign creditors. The IMF’s avowed role was to ensure that a comprehensive combination of reform, relief, and new money was in place, and that it was workable. The Fund supplied the analytical frame, assessed performance, and enforced it with its own lending.

The Paris Club required the debtor to seek “comparability of treatment” from its other public and private foreign creditors.³⁹ As the term suggests, comparability was not equality—it was burden-sharing adequate to allay economic and political concerns about free-riding on Paris Club countries’ taxpayers. A sovereign that failed to get “comparable” terms from other creditors risked derailing its Paris Club agreement. While comparability was interpreted flexibly, few creditors were willing to sacrifice an IMF program or a Paris Club deal.

Cross-conditionality could be tightened or relaxed to adjust negotiating incentives. For example, until 1989, the IMF would not finance countries in arrears to other foreign creditors.⁴⁰ This policy put pressure on sovereign debtors to stay current on their payments. When the IMF first decided to “lend into arrears”—finance governments in default on their bank loans—it loosened the ties with the London Club process, and gave debtors more negotiating leverage. The arrears policy was extended to bonds a decade later. Banks and bondholders that would not compromise

³⁸ Lee C. Buchheit, *Making Amends for Amendments*, 10 INT’L FIN. L. REV. 11 (1991) (describing the rise of small bank holdouts in syndicated loan restructuring in the late 1980s).

³⁹ *What does Comparability of Treatment Mean?*, CLUB DE PARIS, <http://www.clubdeparis.org/en/communications/page/what-does-comparability-of-treatment-mean> (last visited Feb. 29, 2016).

⁴⁰ IMF Executive Board, *Reforming the Fund’s Policy on Non-Toleration of Arrears to Official Creditors* 6-11 (Oct. 15, 2015) (describing the process by which IMF staff obtained financing assurances from government creditors).

now ran a higher risk of default; however, debtors still had to comply with IMF economic reform conditions and collaborate with creditors in good faith to receive IMF funds. The good faith criterion slightly offset debtors' gains from the arrears policy, and implicitly inserted the IMF as an arbiter into the negotiation process.⁴¹

Negotiation sequencing worked as a form of cross-conditionality. The Paris Club did not agree to grant relief until the debtor secured an IMF program. Private creditors were expected to finalize their terms after the IMF and the Paris Club.⁴² This way, they would know what official creditors had done, and what everyone else was expected to deliver for the program to go forward.

Although the sequencing practice began to break down with the advent of bond restructuring in the late 1990s, the underlying principle survived well into the 2000s: private creditors were free to maximize recovery so long as the IMF got its financing assurances and the Paris Club its comparability.

Different forms of cross-conditionality worked well enough together to assure creditor groups that the others were not free-riding on their concessions. Cross-conditionality was flexible enough to accommodate diverse stakeholders and diverse visions of inter-creditor equity. Each group negotiated within its unique parameters, so long as the others did not walk away or revolt over the result. Some contributed debt stock relief, others settled for reduced payment flows, yet others lent new money. Each creditor group could judge the fairness of the outcome for itself.

The modular sovereign debt restructuring regime did not reflect a general consensus on priorities and distribution. If a deal stood, it was “fair enough” for all practical purposes, though not necessarily just, by any shared standard. Although people find plenty to fight about in domestic corporate and personal bankruptcy, the mere existence of a statutory framework and a judiciary to enforce it reflects a measure of agreement within a political system about distributing losses from a member's insolvency. Not so in sovereign debt.⁴³

Figure [1] is a stylized depiction of the modular, cross-conditional sovereign debt restructuring regime that emerged in the mid-1990s and survived into the new century. Different building blocks representing creditor groups could be assembled based on an IMF-supported program design. The precise mix of blocks would depend on the sovereign's debt composition, and its

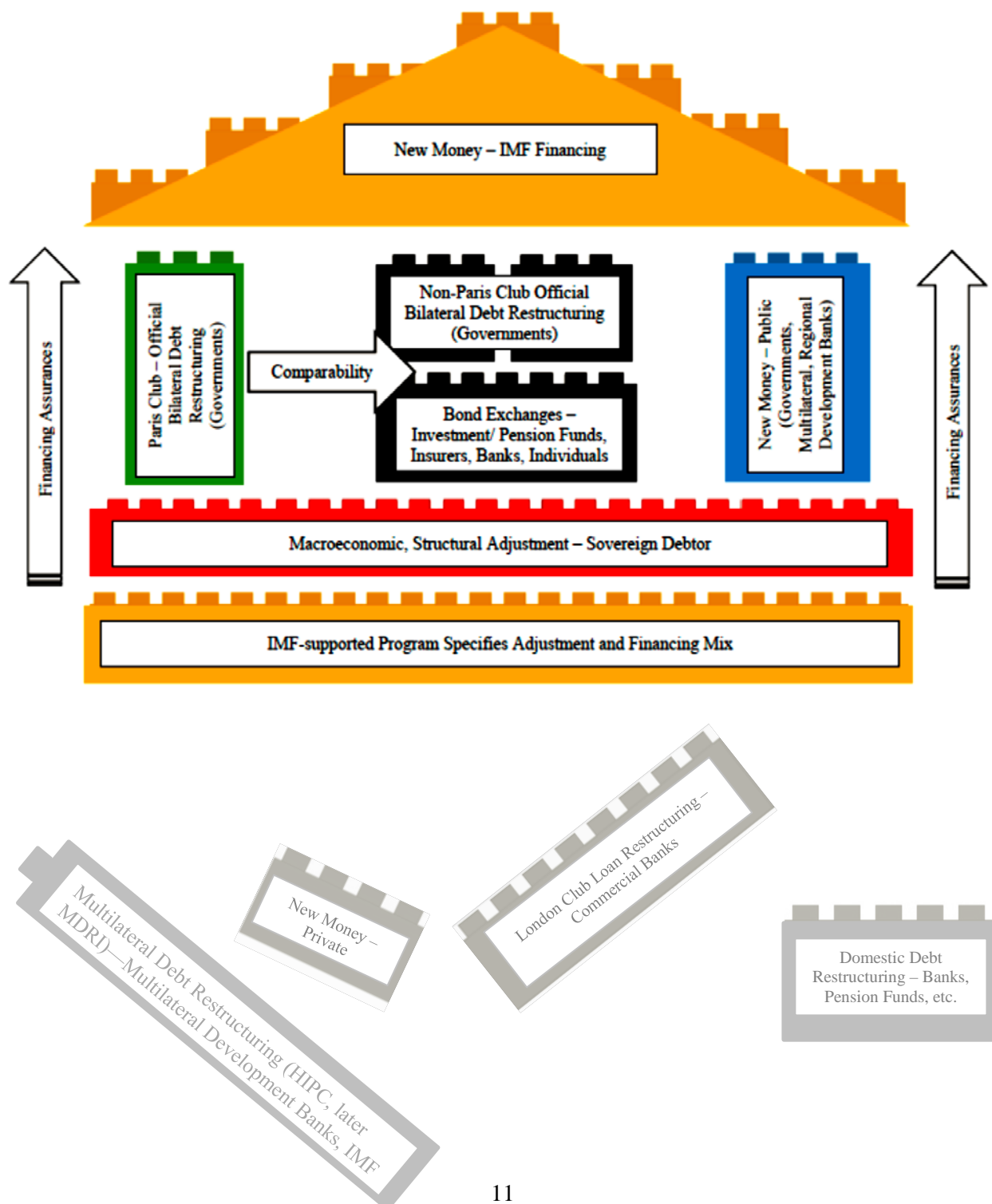
⁴¹ IMF, *Fund Policy on Lending into Arrears to Private Creditors—Further Considerations of the Good Faith Criterion* 3–9 (July 30, 2002), <http://www.imf.org/external/pubs/ft/privcred/073002.pdf> (reviewing the development of IMF policy on arrears) [hereinafter *IMF Lending into Arrears 2002*]; JAMES M. BOUGHTON, *THE SILENT REVOLUTION: THE INTERNATIONAL MONETARY FUND 1979-1989*, at 477-537 (2001) (describing the context for the emergence of the IMF's arrears policy); see also Lee C. Buchheit & Rosa M. Lastra, *Lending into Arrears—A Policy Adrift*, 41 INT'L LAW. 939 (2007).

⁴² See, e.g., JEFFREY A. FRANKEL & NOURIEL ROUBINI, *ECONOMIC AND FINANCIAL CRISES IN EMERGING MARKET ECONOMIES* 213 (Martin Feldstein ed., 2003).

⁴³ See e.g., Daniel K. Tarullo, *Rules, Discretion, and Authority in International Financial Reform*, J. INT'L ECON. L. 613 (2001) (describing an authority gap in sovereign debt), Patrick Bolton & David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?*, 53 EMORY L.J. 763 (2004) (on the consequences of having no system of priorities in sovereign debt).

political and financial constraints. For example, the hypothetical debtor in Figure [1] avoids London Club, domestic, and multilateral debt restructuring either because it has no debt in these categories, or because restructuring it is judged undesirable. These blocks, greyed out in Figure [1], might be indispensable for another debtor.

Figure [1]: A Modular Sovereign Debt Restructuring Regime *circa* 2000



Repeat Players and Routines. The old sovereign restructuring regime depicted in Figure [1] might have been informal, but it was far from chaotic. It delivered a measure of relief for debtors and impressive returns for creditors with no treaty, no statute, and no court in charge.⁴⁴ It was flexible enough to adapt to massive shifts in global politics and economics. It was also effective, potent, and accepted generally enough—just enough—to preempt far-reaching alternatives that periodically sprouted up at the United Nations, at the IMF, and among civil society groups.⁴⁵

Nonetheless, it is hard to explain the regime’s durability by its outcomes alone. Restructurings came late, and often took a long time to complete.⁴⁶ The regime delivered short-term liquidity relief, but often did not solve the underlying solvency problems.⁴⁷ Re-defaults followed within a few years of sovereign debt restructurings in nearly forty percent of the cases.⁴⁸ While causation is open to debate, some mix of ill-conceived and ill-timed relief, and bad policy, likely played a part.

The dominance of repeat players and institutions shaped by long-term political alliances may help solve the regime survival puzzle. Late twentieth century sovereign debt restructurings involved a relatively small and tight cohort of officials from a handful of countries and international organizations, a dozen or so big financial firms, and half a dozen law firms.⁴⁹ They had developed the practices described earlier through trial and error, reacting to crises. They were also invested in these practices and controlled the institutions charged with their operation. Knowing the composition of and relationships among the restructuring modules, the customary sequence of negotiations, the range of terms Paris Club creditors had accepted as “comparable,” the habitual exclusion of certain informally “preferred” claims from burden-sharing⁵⁰ was (and still is) invaluable in a world without statutory bankruptcy. Such knowledge can confer status,

⁴⁴ Carmen M. Reinhart & Christoph Trebesch, *A Distant Mirror of Debt, Default, and Relief* (Univ. of Munich, Dep’t of Econ., Discussion Paper No. 2014-49, 2014), https://epub.ub.uni-muenchen.de/21832/1/Distant_Mirror_October_27_2014.pdf; Carmen Reinhard & Christoph Trebesch, *Sovereign Debt Relief and its Aftermath*, 14 J. EUR. ECON. ASS’N 215 (2016) (debt relief figures); Michael Tomz & Mark Wright, *Empirical Research on Sovereign Debt and Default*, 2013 ANN. REV. ECON. 247; Christoph Klingens et al., *How Private Creditors Fared in Emerging Debt Markets, 1970-2000*, at 37 (IMF, Working Paper No. WP/04/13, 2004), <https://www.imf.org/external/pubs/ft/wp/2004/wp0413.pdf> (observing “sizable ex post premiums” for creditors of emerging market countries in the 1990s).

⁴⁵ See, e.g., Sgard, *supra* note 10; RIEFFEL, *supra* note 15, at 132-48 (describing the North-South Dialogue and the defeat of the International Debt Commission proposal in the 1970s); Hagan, *supra* note 10 (describing the rise and fall of the IMF’s proposal for the Sovereign Debt Restructuring Mechanism (SDRM)); see also *infra* notes 84-85 and accompanying text (discussing SDRM).

⁴⁶ See, e.g., *supra* note 2 (multiple sources citing evidence of the “too little-too late” problem in sovereign debt restructuring).

⁴⁷ See, e.g., IMF Lending Framework Annexes, *infra* note 154.

⁴⁸ Duggar, *supra* note 2.

⁴⁹ GULATI & SCOTT, *supra* note 24, at 59-61; Gelpern & Gulati, *supra* note 24, at 1634-36 (2006).

⁵⁰ Exclusion from comparability and other burden-sharing mechanisms was tantamount to a grant of seniority (“preferred creditor status”) for claims of identical legal rank. Short-term trade credits, interbank loans, and, until recently, multilateral debt, have enjoyed such informal preference—presumably based on other participants’ collective judgment that it was in their interest to consent to informal subordination. See RUTSEL SILVESTRE J. MARTHA, *Ranking of Obligations*, in THE FINANCIAL OBLIGATION IN INTERNATIONAL LAW 479 (2015).

gain a seat at the negotiating table, and even help fashion arguments for reform. Long-term investment in the regime and a measure of social cohesion among those “in the know” helped sustain it.⁵¹

On the other hand, the modules, the web of cross-conditionality, and the many negotiating practices—let alone the logic behind them—were unintelligible to ordinary people, the ultimate debtors and creditors. Public debt often appeared as a matter for private ordering, both in the legal sense (contract) and in the practical sense (behind closed doors). The regime as a whole could hardly claim to be effective, fair, or legitimate in absolute terms, if only because so few saw it as a regime, and because there was no shared standard by which to judge it.⁵² It might have delivered serviceable outcomes, but it was not worth fighting for.

II. Sovereign Debt Restructuring *circa* 2010

Three trends undermined the modular sovereign debt restructuring regime described in Part I. First, new creditors grew in importance. Countries such as China and Russia, as well as distressed bond funds and sovereign wealth funds,⁵³ among others, were not necessarily invested in the old restructuring processes and institutions. Second, cross-border capital mobility and government creditors’ participation in the private capital markets eroded the boundaries of the restructuring modules, undermining internal discipline and cross-conditionality. Third, individual creditor lawsuits filled the enforcement gap left by the weakening modules. Some of these trends were already under way in the mid-1990s, but they intensified and combined to alter the landscape during the first decade of the twenty-first century.

New Players. In the 1980s, G-7 finance officials and the world’s biggest commercial bankers, many of whom were on first-name basis, comprised the bulk of foreign creditors in sovereign debt restructurings.⁵⁴ By the early 2000s, new private and public players took center stage.

⁵¹ Compare this depiction and Pierre-Hugues Verdier, *The Political Economy of International Financial Regulation*, 88 Ind. L. Rev. 1405 (2013) (arguing that soft law and informal network governance in international financial regulation has empowered certain political actors to the detriment of financial stability).

⁵² Legitimacy here does not look solely or primarily to the authority of the parties or the restructuring forum, but rather to the terms of the debt and the restructuring process that produce it. See Marie Sudreau & Juan Pablo Bohoslavsky, *Sovereign Debt Governance, Legitimacy, and the Sustainable Development Goals: Examining the Principles on Responsible Sovereign Lending and Borrowing*, 24 WASH. INT’L L.J. 613 (2015); cf. the discussion of legitimacy above and in the text to ODETTE LIENAU, *RETHINKING SOVEREIGN DEBT: POLITICS, REPUTATION, AND LEGITIMACY IN MODERN FINANCE* (2014) (considering the function of sovereignty in sovereign debt).

⁵³ “Sovereign wealth funds (SWFs) are special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage or administer assets to achieve financial objectives, and ... [invest] in foreign financial assets.” International Working Group of Sovereign Wealth Funds (IWG-SWF), *Generally Accepted Principles and Practices—Santiago Principles*, at 3 (Oct. 2008) <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>.

⁵⁴ KRAFT, *supra* note 16 (describing coordination among bilateral and multilateral officials and money center banks in the Mexican crisis of 1982); see also PAUL BLUSTEIN, *THE CHASTENING: INSIDE THE CRISIS THAT ROCKED THE*

Investment funds, pension funds, and hedge funds took over from banks as borrowers switched from loans to bonds in the 1990s. In the 2000s, governments that had been on the periphery of global finance ran large trade surpluses and expanded bilateral lending, while the G-7 wound theirs down. Sovereign wealth funds from surplus countries invested in a growing range of international assets, including sovereign debt. Meanwhile, the G-20—a group that included both wealthy and middle-income countries—was gradually taking over global economic and regulatory coordination from the G-7.⁵⁵

The rise of sovereign bonds in the hands of atomistic creditors, presumptively unconnected to finance officials and uninterested in the public good, has drawn the bulk of critical attention in sovereign debt literature and policy since the mid-1990s.⁵⁶ When foreign bonds were a small part of the debt stock—as late as Russia’s 1998 crisis—they could be paid in full without putting overall program financing or other creditors’ participation at risk.⁵⁷ However, “bond exceptionalism” did not last: within two years of Russia’s crisis, Pakistan, Ecuador, and Ukraine each launched a bond exchange.⁵⁸ The advent of tradable bonds has had a mixed impact on crisis resolution overall. Despite predictions of mass holdouts, bonds took less time to restructure than loans thanks to a mix of creditor incentives and transactional techniques.⁵⁹ Unlike banks, mark-to-market investors could not carry distressed debt on their balance sheets at face value, and did not benefit from delay as such.⁶⁰ They had every incentive to buy bonds for fifteen cents on the dollar and quickly settle for thirty cents, pocketing a 100 percent return on investment while delivering 70 percent principal reduction to the debtor. On the other hand, funds specializing in

GLOBAL FINANCIAL SYSTEM AND HUMBLING THE IMF 175-205 (2003) (describing G-7 governments’ engagement with their financial institutions to roll over interbank loans to Korea in late 1997).

⁵⁵ The G-20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States, and European Union. The grouping originated in the policy coordination efforts after the Asian Financial Crisis of the 1997-1999, but did not assume its leadership role until 2008. *See, e.g.*, China’s G-20 website, http://www.g20.org/English/Dynamic/201606/t20160601_2291.html. China hosts the G-20 in the 2016 cycle.

⁵⁶ *See, e.g.*, Anne Krueger, First Deputy Managing Dir., IMF, International Financial Architecture for 2002: New Approach to Sovereign Debt Restructuring, Speech at the National Economists’ Club Annual Members’ Dinner (Nov 26, 2001) (transcript available at <http://www.imf.org/external/np/speeches/2001/112601.htm>).

⁵⁷ *See, e.g.*, STURZENEGGER & ZETTELMEYER, *supra* note 3, at 104. Russia spared only a subset of its foreign bonds, those issued after the fall of the Soviet Union. By exempting post-Soviet Eurobonds from restructuring, it sought to signal both that the current government would pay its debts, and that bonds were a privileged instrument. Russia’s attempt to distinguish between Soviet and post-Soviet-era debt was a reputational gambit. *Cf.* LIENAU, *supra* note 52 (regime change implies new sovereignty).

⁵⁸ STURZENEGGER & ZETTELMEYER, *supra* note 3 (case studies of early bond restructurings); *see also*, Michael Peterson, *Emerging Market Bonds: A Crash Course in Default*, EUROMONEY, Oct. 1999, at 47-50 (describing some of the features that made bonds hard to modify, and led to their exclusion from restructurings).

⁵⁹ Bi et al., *supra* note 21 (theoretical model for lack of coordination problems); Duggar, *supra* note 2, at 33 (citing 10 months on average between a government’s bond restructuring announcement and completion, compared to loan restructurings that typically took years to negotiate).

⁶⁰ *Supra* notes 34-35 and accompanying text.

distressed sovereign debt collection also grew along with bond finance. Although they were a minority of sovereign bond holders, these funds sued much more often.⁶¹

New official bilateral lenders have received much less attention in the academic and policy debates, although they quickly became very important in some countries. In the 2000s, manufacturing and commodity exporters with large stores of government savings, most notably China and the Gulf states, began investing more of their foreign currency reserves in the emerging markets.⁶² This trend accelerated after 2009, when interest rates dropped near zero in Europe and the United States post-crisis, and sent investors looking for higher returns elsewhere.⁶³ In parallel, China expanded its official bilateral lending to poor and middle income governments so dramatically that it eclipsed the original Paris Club lenders in some countries within a few years.⁶⁴

New creditors contributed to the rise in complex forms of government-to-government lending that did not quite fit Paris Club reporting conventions. For example, Venezuela began borrowing from China against future oil sales in 2007; by 2015, oil advances from China reportedly were among the scant few sources of external financing it had left; by mid-2016, it sought a debt restructuring by another name as more and more of its oil exports effectively functioned as debt

⁶¹ Julian Schumacher, Christoph Trebesch & Henrik Enderlein, *Sovereign Defaults in Court* 10-11 (Working Paper, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2189997 (showing that lawsuits abroad accompanied only five percent of sovereign defaults in the 1980s, compared to fifty percent in the 2000s, and attributing the spike in lawsuits to the growth of specialized funds).

⁶² See IMF, *Market Developments and Issues*, Global Financial Stability Report 99 (April 2006), [hereinafter IMF GFSR April 2006]; See also, e.g., *Portfolio Overview*, ABU DHABI INV. AUTHORITY (ADIA), www.adia.ae/En/Investment/Portfolio.aspx (specifies 10-20% for government bonds and 15-25% for emerging markets). ADIA's total assets under management were estimated at \$773 billion. Andrew Torchia, *Abu Dhabi fund ADIA Manages More of its Billions In-House*, REUTERS (June 2, 2015), <http://www.reuters.com/article/emirates-sovereign-funds-idUSL5N0YN3LC20150602>.

⁶³ Serkan Arslanalp & Takahiro Tsuda, *Tracking Global Demand for Emerging Market Sovereign Debt* (IMF, Working Paper No. WP/14/39, 2014), <https://www.imf.org/external/pubs/ft/wp/2014/wp1439.pdf>.

⁶⁴ For example, China became Angola's largest creditor by 2014, holding 41% of its debt, followed by the United Kingdom with 27%. IMF, *Angola Staff Report for the 2014 Article IV Consultation*, Country Report No. 14/274, at 9 (Aug. 14, 2014) <https://www.imf.org/external/pubs/ft/scr/2014/cr14274.pdf>. Some of China's exposure is secured by oil. Yun Sun, *China's Aid to Africa: Monster or Messiah?*, BROOKINGS (Feb. 2014), <http://www.brookings.edu/research/opinions/2014/02/07-china-aid-to-africa-sun>. China's lending to Congo has grown rapidly since 2006, much of it effectively secured by deposits from oil proceeds that Congo is required to keep on deposit in China. China became the dominant creditor after Congo secured HIPC and MDRI relief from wealthy countries and multilateral institutions. IMF, *Republic of Congo Staff Report For the 2014 Article IV Consultation*, Country Report No. 14/272, at 9 (July 7, 2014) <https://www.imf.org/external/pubs/ft/scr/2014/cr14272.pdf>; see also IMF, *Republic of Congo Staff Report for The 2014 Article IV Consultation—Debt Sustainability Analysis*, Country Report No. 14/272, at 2 (July 7, 2014), <https://www.imf.org/external/pubs/ft/scr/2014/cr14272.pdf> (China accounted for 63% of Congo's official bilateral debt and 15% of its overall external debt in 2010).

repayments.⁶⁵ Smaller and poorer countries such as Angola was even worse off, with no spare export capacity left after making its oil-debt payments.⁶⁶

Lending that combined features of trade, investment, development aid, and strategic alliance-building was not new, but the scale and the players were.⁶⁷ In the past, such complex, mixed-motive arrangements might have been settled quietly on the margins of Paris Club negotiations. Classifying the debt and finding a forum to renegotiate it is more of a challenge when both debtors and creditors view the prevailing regime with suspicion, and are grossly underrepresented in its institutions.⁶⁸

No More Modules? After governments relaxed restrictions on cross-border capital flows, domestic and foreign investors gained access to debt instruments that had been beyond their reach.⁶⁹ Foreign creditors could buy local currency and local-law bonds in the domestic markets of poor and middle income countries.⁷⁰ Domestic banks and pension funds could participate in foreign bond offerings side by side with foreign investors.⁷¹ Government creditors could take advantage of bigger, deeper, more liquid international markets to sell their bilateral loans.⁷² As

⁶⁵ Corina Pons, Alexandra Ulmer & Marianna Parraga, *Venezuela in Talks with China for Grace Period in Oil-for-Loans Deal*, REUTERS (Jun. 15, 2016), <http://www.reuters.com/article/us-venezuela-china-idUSKCN0Z01VH>.

⁶⁶ Libby George, *Growing Chinese Debt Leaves Angola with Little Spare Oil*, REUTERS (Mar. 14, 2016), <http://www.reuters.com/article/angola-oil-finance-idUSL5N16H3EV>.

⁶⁷ The phenomenon of deliberately ambiguous financing forms is not new. For example, the United States financed South Vietnam's military with disguised agricultural credits during the Vietnam War. See, e.g., Agreement between the Government of the United States of America and the Government of the Republic of Viet-Nam for Sales of Agricultural Commodities, 22 U.S.T. 1459, Sec. II.A.2 (June 28, 1971); Marian Nash (Leich), *Contemporary Practice of the United States Relating to International Law*, 91 AM. J. INT'L L. 697, 705–06 (1997). Vietnam refused to repay the credits when it came to the Paris Club to restructure its debt in 1993.

The difference is that the new creditors are not fully part of the institutions within which creditors negotiated how to deal with these ambiguities. For example, after the fall of Saddam Hussein, Iraq claimed that much of its "debt" to its Gulf neighbors was supposed to have been a grant, to help support Iraq in its war against Iran. Negotiations with Gulf countries, which were not part of the Paris Club, lasted for years after the Paris Club had agreed on near-total relief. MARTIN A. WEISS, CONG. RESEARCH SERV., RL33376, IRAQ'S DEBT RELIEF: PROCEDURE AND POTENTIAL IMPLICATIONS FOR INTERNATIONAL DEBT RELIEF 6 (2009).

⁶⁸ See, e.g., MARTIN A. WEISS, CONG. RESEARCH SERV., RS21482, THE PARIS CLUB AND INTERNATIONAL DEBT RELIEF 1 (2013) (China and Gulf states are not part of the Paris Club); NGAIRE WOODS, GOVERNING THE GLOBAL ECONOMY: STRENGTHENING MULTILATERAL INSTITUTIONS 2 (2008) (observing that China and Gulf states are underrepresented in the multilateral organizations, including the IMF and the World Bank).

⁶⁹ In practice, the pace of financial liberalization and integration increased dramatically for wealthy and emerging market economies like in the late 1990s. Many formal restrictions had been lifted in the 1980s. See e.g., M. Ayhan Kose, Eswar Prasad, Kenneth Rogoff & Shang-Jin Wei, *Financial Globalization and Economic Policies*, Chapter 5 in DEVELOPMENT ECONOMICS, Handbooks in Economics, vol. 5 (Dani Rodrik & Mark Rosenzweig, eds., 2010) at 4291 (Fig. 2).

⁷⁰ Wenxin Du & Jesse Schreger, *Local Currency Sovereign Risk* 2, 44 (Bd. of Governors of the Fed. Reserve Sys., International Finance Discussion Papers No. 1094, 2013), <https://www.federalreserve.gov/pubs/ifdp/2013/1094/ifdp1094.pdf>.

⁷¹ Anna Gelpern & Brad Setser, *Domestic and External Debt: The Doomed Quest for Equal Treatment*, 35 GEO. J. INT'L L. 795 (2004); see also Arslanalp & Tsuda, *supra* note 63.

⁷² See, e.g., Thomas Laryea, *Donegal v. Zambia and the Persistent Debt Problems of Low-Income Countries*, 73 L. AND CONTEMP. PROBS. 193-200 (2010) (analyzing a lawsuit brought in English courts by a private offshore fund on contracts that originated with Romania's bilateral agricultural credits to Zambia. Romania sold the loans to a private

bond investors, central banks, reserve managers, and sovereign wealth funds were not uniformly risk-averse; some made bets on the bonds of troubled countries and actively managed their sovereign debt portfolios.⁷³ Active trading moreover meant that the mix of creditors behind a debt stock could change at any time, so that not even the debtor could ever know for sure who held what debt.⁷⁴

The trends just described were fundamentally inconsistent with a modular regime based on similar creditors holding similar legal claims. The advent of bonds already raised questions about the modules' viability—bondholders were a diverse and dynamic lot—but debtors and their advisers seized coordination initiative in the late 1990s in a way that initially made bond exchanges look like just another module.⁷⁵ They conducted informal “soundings” of key bondholders before making exchange offers, and used contract modification procedures to make holding out unattractive.⁷⁶ However, as the 2000s wore on, it was no longer safe to assume that the building blocks depicted in Figure [1] represented creditors with common interests and constraints, common accounting conventions, and more-or-less identical contracts. By 2010, a single bond exchange potentially had to sweep in Latin American pension funds, U.K. banks, euro area insurers, Asian governments, Italian pensioners, and Cayman Island hedge funds managed from Connecticut, holding bonds denominated in half a dozen currencies and governed by the laws of as many jurisdictions. Some creditors might have been susceptible to informal

investor and avoided restructuring them in the Paris Club); *see also*, Felipe Ossa, *Woolly Outcome for Aries*, ASSET SECURITIZATION REPORT (July 3, 2006), http://www.asreport.com/issues/2006_27/176657-1.html (reporting Germany's securitization of its export credit loans to the Russian government).

⁷³ *See, e.g.*, IMF GFSR April 2006, *supra* note 62; Brad Setser, *Norway was against Iceland before it was for Iceland*, FOLLOW THE MONEY BLOG (May 17, 2008), <http://blogs.cfr.org/setser/2008/05/17/norway-was-against-iceland-before-it-was-for-iceland>; Andres R. Martinez, *CIC Stops Buying Europe Government Debt on Crisis Concern*, BLOOMBERG (May 10, 2012), <http://www.bloomberg.com/news/articles/2012-05-09/china-investment-stops-buying-europe-debt-on-crisis-concern-1->.

⁷⁴ While their effect in sovereign debt markets is the subject of a heated debate, at least in theory, the rise of credit derivatives can further exacerbate the divergence between creditor incentives and their contractual claims. *See* Patrick Bolton & Martin Oehmke, *Credit Default Swaps and The Empty Creditor Problem*, 24 REV. FIN. STUD. 8 (2011); David Mengle, *The Empty Creditor Hypothesis*, ISDA RES. NOTES (2009); Skylar Brooks et al., *Identifying and Resolving Inter-Creditor and Debtor-Creditor Equity Issues in Sovereign Debt Restructuring*, CENTRE FOR INT'L GOVERNANCE INNOVATION (Jan. 12, 2015), https://www.cigionline.org/sites/default/files/pb_no53.pdf; Nikki Tait & David Oakley, *Brussels Gives Sovereign CDS Trading All-Clear*, FIN. TIMES (Dec. 6, 2010), <http://www.ft.com/intl/cms/s/0/5be55b2a-016a-11e0-9b29-00144feab49a.html#axzz42Ye94mRb> (reporting the results of a European Union inquiry into credit default swaps as a potential source of speculative pressure on sovereign debt prices).

⁷⁵ *See, e.g.*, Bi et al., *supra* note 21.

⁷⁶ Researchers identified exit consents and minimum participation thresholds as particularly effective. *Id.* Exit consents are amendments to the old bonds approved by creditors just before “exiting” them for new ones. Participating creditors rarely could change the old bonds' financial terms (such changes often required unanimous consent and carried a higher risk of court challenge), but could and did strip away sovereign immunity waivers, exchange listing requirements, ranking, and other important nonfinancial terms. The old bonds became practically unenforceable, or, at best, illiquid. When sovereigns announced minimum participation thresholds in a bond exchange (typically above 90 percent), they committed not to proceed unless nearly all bondholders went along. This reassured creditors that a successful exchange would improve the debtor's finances and achieve a measure of burden-sharing, while also raising the specter of generalized default if participation fell short. *Id.*

regulatory pressure, others driven by geopolitical imperatives, yet others committed to litigate for full repayment.⁷⁷ Reputational considerations and intra-group discipline weakened.

Changes in the composition and direction of international capital flows made some modules irrelevant, disrupted sequencing, and undermined cross-conditionality. London Club bankers' committees atrophied as syndicated loans shrank. Bondholder committees failed to take over as the default coordination mechanism, although they played important roles in some crises.⁷⁸ Bond exchanges now sometimes preceded Paris Club agreements; however, cross-conditionality failed to adapt to the new era.⁷⁹ Official lenders rebuffed debtor and bondholder demands for "reverse comparability," apparently convinced that the point of comparability was to protect their taxpayers, not to let the first mover shape the overall debt restructuring deal.⁸⁰

However, The Paris Club's ability to dictate terms was eroding. The trend that began with granting countries present value debt relief in the late 1980s and debt stock reduction in the mid-1990s, culminated in agreements to write off the debts of the poorest countries at the turn of the century.⁸¹ By 2010, the club looked too small to influence other creditors, public or private. Its members had delivered near-total debt relief for some countries, such as Iraq and the poorest countries in Sub-Saharan Africa, and got full repayment from others, such as Russia. The G-7 now favored grants over loans in development aid.⁸² China and the Gulf states were slow to join.⁸³

⁷⁷ Argentina's debt exchanges in 2005 and 2010 included bonds denominated in at least six currencies, governed by the laws of eight different jurisdictions. See, e.g., *A Victory by Default?* ECONOMIST (Mar. 3, 2005), <http://www.economist.com/node/3715779>; see also, Part III, *infra*.

⁷⁸ For different views on creditor committees, see Lee C. Buchheit, *Use of Creditor Committees in Sovereign Debt Workouts*, 10 BUS. L. INT'L 205 (2009) (skeptical) and Timothy B. DeSieno, *Creditor Committees in Sovereign Debt Restructurings: Understanding the Benefits and Addressing Concerns*, in TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES (Martin Guzman, José Antonio Ocampo, & Joseph E. Stiglitz eds.) 175-186 (2016) (favorable).

⁷⁹ See, e.g., Jorge Gallardo, *Cracks in the New Financial Architecture*, EUROMONEY, Apr. 1, 2001, at 50 (describing Ecuador's failed attempt to get Paris Club creditors to grant relief comparable to its bond restructuring terms).

⁸⁰ *Id.*

⁸¹ On the evolution of Paris Club terms in the 1980s and 1990s, see, e.g., Christina Daseking & Robert Powell, *From Toronto Terms to the HIPC Initiative: A Brief History of Debt Relief for Low-Income Countries* (IMF, Working Paper No. WP/99/142, 1999), <https://www.imf.org/external/pubs/ft/wp/1999/wp99142.pdf>.

⁸² The World Bank, *Global Development Finance: The Development Potential of Surging Capital Flows* 79-103 (2006) (documenting the wholesale shift to grants in development aid, and the trend to deeper debt forgiveness in the Paris Club); Benedict Clements et al., *Foreign Aid: Grants versus Loans*, 41 FIN. & DEV. 46, 46 (2004); OECD, *Measuring Aid: 50 Years of DAC Statistics—1961-2011*, at 14 fig.8 (2011) (grants eclipse loans in official development assistance as measured by the Organization for Economic Co-operation and Development).

⁸³ Enda Curran, *China's Growing Clout Catches Eye of the Paris Club of Lenders*, BLOOMBERG (Feb. 27, 2016, 8:31 AM), <http://www.bloomberg.com/news/articles/2016-02-27/china-s-growing-clout-catches-eye-of-the-paris-club-of-lenders>. Another prominent surplus country, the Republic of Korea, did join the Paris Club in June of 2016. *The Paris Club Welcomes the Republic of Korea's Decision to Become its 21st Member*, Paris Club News Release (Jun. 6, 2016), at <http://www.clubdeparis.org/en/communications/article/the-paris-club-welcomes-the-republic-of-korea-s-decision-to-become-its-21st>.

Gaps and Gap-filling. Disappearing modules and weakening cross-conditionality left gaps in the debt restructuring architecture, such as it was. As described in Part I of this essay, the old regime promised to compensate for weak enforcement and the absence of bankruptcy discharge, and secured just barely enough relief for the debtor, and collective action and burden-sharing among creditors, to keep going. Its ability to deliver on the promises was now in serious doubt.

The IMF's role at the heart of the restructuring regime came to look awkward in the 2000s. In response to the rise of bonded debt, IMF management proposed a treaty-based sovereign debt restructuring mechanism (SDRM), just as Argentina careened to the largest foreign bond default on record in late 2001.⁸⁴ Despite support from European governments among others, SDRM suffered a humiliating defeat in 2003, blocked by the United States and large emerging markets, including Mexico and Brazil.⁸⁵ The intervening debate was often bitter, with some members, private creditors and civil society groups accusing the IMF of engaging in a power grab.⁸⁶ After the SDRM trauma, IMF staff and Executive Board members were inclined to tread gingerly in the sovereign debt space. Besides, the urgency had passed—not many mainstream policy makers could justify obsessing about debt restructuring institutions in the mid-2000s, when memories of financial crises grew faint, and the fund's coffers grew flush from countries repaying their debts.⁸⁷

Apart from such political sensitivities, the IMF's ability to anchor still-hypothetical crisis response⁸⁸ suffered from the growing gap between its resources and the scale of global capital flows, reflecting potential balance of payments vulnerabilities. Figure [2] shows IMF lending capacity against the background of capital flows in and out of the euro area and developing countries between 1999 and 2006. At the end of 1999, with much of Asia, Brazil, and Russia still in crisis, the IMF could lend up to \$86 billion of its own resources, and borrow an additional \$47 billion from wealthy member governments.⁸⁹ Even after disbursing nearly \$10 billion to Brazil, \$5.6 billion to Russia, and \$6.3 billion to Indonesia during its 1998-1999 financial year,⁹⁰ the IMF could backstop a respectable 35 percent of gross capital outflows from the developing world. By 2006, with large emerging market economies borrowing from the capital markets and

⁸⁴ See Anne Krueger, First Deputy Managing Dir., Int'l Monetary Fund, International Financial Architecture for 2002: New Approach to Sovereign Debt Restructuring, Speech at the National Economists' Club Annual Members' Dinner (Nov. 26, 2001). For the authoritative legal account by an insider, see Hagan, *supra* note 10.

⁸⁵ See, e.g., Hagan, *supra* note 10, at 327; Brad Setser, *The Political Economy of the SDRM*, in OVERCOMING DEVELOPING COUNTRY DEBT CRISIS (Barry Herman et al. eds., 2010); Gelpern & Gulati, *supra* note 24.

⁸⁶ Hagan, *supra* note 10, at 345.

⁸⁷ *One-Year Forward Commitment Capacity*, <http://www.imf.org/external/np/tre/liquid/fccchart/052903.pdf>.

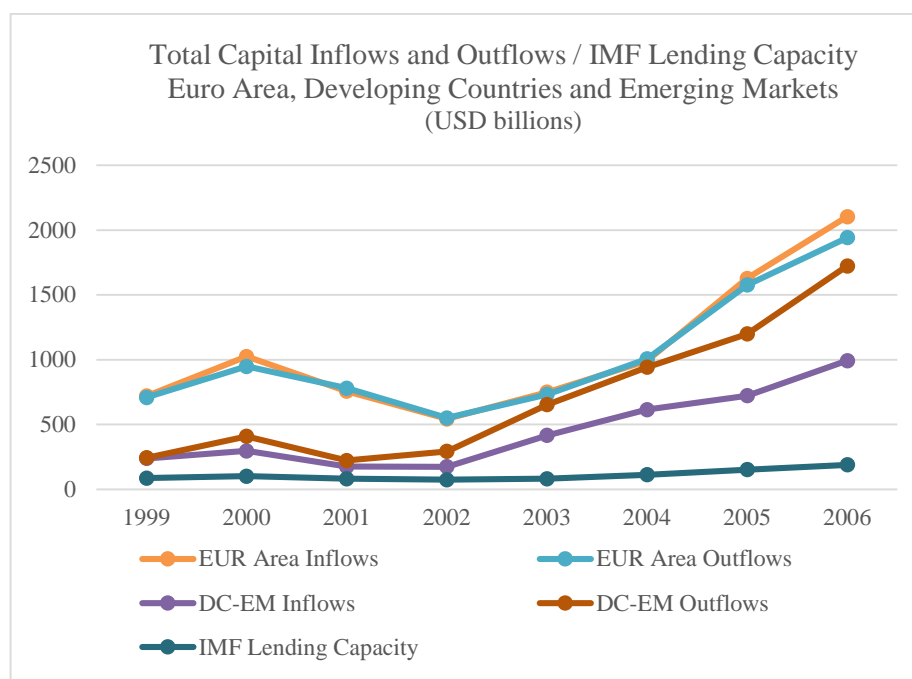
⁸⁸ PAUL BLUSTEIN, OFF BALANCE: THE TRAVAILS OF INSTITUTIONS THAT GOVERN THE GLOBAL FINANCIAL SYSTEM 1 (2013) (describing the IMF during this period of relative calm, and its efforts to prepare for a potential crisis).

⁸⁹ *IMF's Financial Resources and Liquidity Position, 1997-December 1999*, <http://www.imf.org/external/np/tre/liquid/1999/1299.htm> (Net Uncommitted Usable Resources).

⁹⁰ IMF, *Report of the Executive Board for the Financial Year Ended April 30, 1999*, Annual Report 1999, at 100-101 (Apr. 1999), <http://www.imf.org/external/pubs/ft/ar/1999/pdf/file5.pdf>. U.S. dollar amounts are based on SDR1=USD1.37.

repaying the IMF, it could lend up to \$189 billion of its own resources—but that was only eleven percent of the \$1,723.8 billion in outflows from the developing world.⁹¹ Including \$1,941.4 billion from the euro area in 2006 would put available IMF resources at five percent of the relevant capital outflows. Then again, no one had imagined in 2006 that the IMF would be disbursing \$20.6 billion to Greece and \$8.1 billion to Ireland in just four years.⁹²

Figure [2]:

Source: IMF⁹³

⁹¹ IMF resources were more impressive compared to portfolio flows. In 2006, the IMF could finance approximately 19 percent of combined euro area and developing country portfolio outflows. It could supplement this lending capacity in 2006 with \$51 billion from borrowing arrangements with members. *IMF's Financial Resources and Liquidity Position, 2004 – December 2006*, <http://www.imf.org/external/np/tre/liquid/2006/1206.htm> (One-year Forward Commitment Capacity, memorandum items for General Arrangements to Borrow and New Arrangements to Borrow); IMF, *Financial Market Turbulence: Causes, Consequences, and Policies*, Global Financial Stability Report 2007, Stat. App. Table 1, 136-37 (Oct. 2007) [hereinafter IMF GFSR October 2007], <http://www.imf.org/external/pubs/ft/gfsr/2007/02/pdf/text.pdf>. Although portfolio flows are typically considered more volatile, the distinction between portfolio and other types of capital flows may be overblown. See, e.g., UN Development Programme, *Towards Human Resilience: Sustaining MDG Progress in an Age of Economic Uncertainty* 86 (2011),

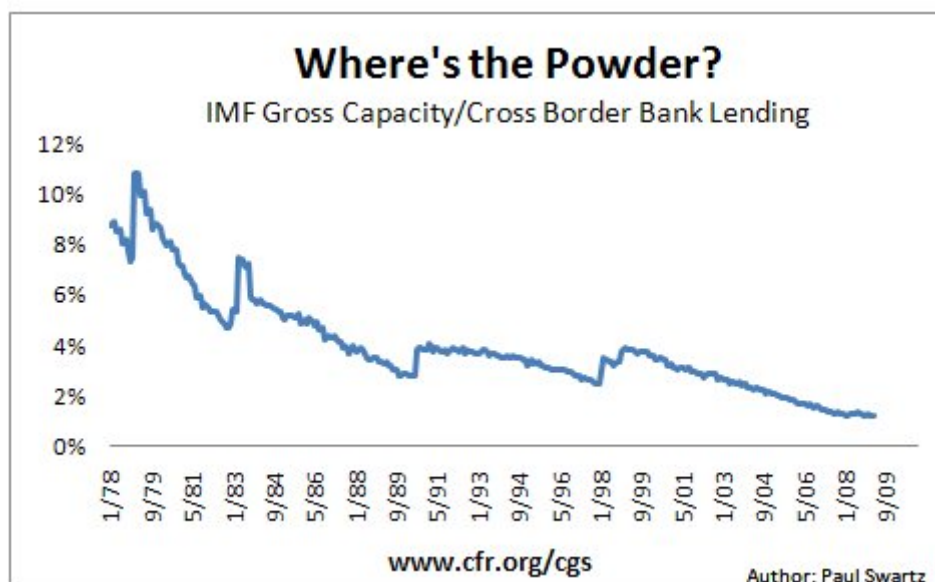
http://www.undp.org/content/dam/undp/library/Poverty%20Reduction/Towards_SustainingMDG_Web1005.pdf.

⁹² IMF, *Financial Operations and Transactions*, Annual Report 2011 App. Table II.4 (2011), <http://www.imf.org/external/pubs/ft/ar/2011/eng/pdf/a2.pdf>. U.S. dollar amounts are based on SDR1=USD1.62.

⁹³ IMF GFSR October 2007, *supra* note 91; *IMF's Financial Resources and Liquidity Position, 1997-December 1999*, *supra* note 89; *IMF's Financial Resources and Liquidity Position, 2004 – December 2006*, *supra* note 91. Figures for IMF lending capacity exclude available borrowing arrangements, which stood at \$47 billion in December 1999, and \$51 billion in December 2006. *Id.* See also, *One-Year Forward Commitment Capacity*, *supra* note 87; MARKUS JAEGER, DEUTSCHE BANK RESEARCH, DOES THE IMF HAVE SUFFICIENT RESOURCES TO BAIL OUT

Long-term decline of IMF lending capacity relative to cross-border bank lending, which can be prone to runs, paints a similar picture.

Figure [3]:



Source: Council on Foreign Relations⁹⁴

To the extent the IMF's power to set restructuring parameters and nudge the process along depended on its unique ability to mobilize enough financing quickly to stop a run, stem contagion, and keep the distressed economy afloat during the workout, this power looked likely to diminish—for better or worse.⁹⁵

The IMF's lopsided governance made matters worse. It reflected twentieth century compromises, with the G-7 and small European countries substantially overrepresented compared to the big emerging markets, whose voice and vote did not reflect the size and international importance of their economies.⁹⁶ Yet the incumbents showed few signs of either giving up control or investing in the IMF in the early and mid-2000s. As finance got bigger, powerful stakeholders spoke of the need to constrain the IMF as a source of "bailouts" and moral hazard.⁹⁷ Meanwhile, post-crisis

THE EMERGING MARKETS? (2008) (market view of IMF capacity in light of the "explosion" in net private capital flows and potential future exposure).

⁹⁴ *IMF Capacity*, COUNCIL ON FOREIGN RELATIONS (Apr. 1, 2009), <http://blogs.cfr.org/geographics/2009/04/01/imf-capacity/>.

⁹⁵ James M. Boughton, *The IMF as Just One Creditor: Who's in Charge When a Country Can't Pay?* CENTRE FOR INT'L GOVERNANCE INNOVATION 1 (Apr. 27, 2015); James M. Boughton et al., *IMF Lending Practices and Sovereign Debt Restructuring*, CENTRE FOR INT'L GOVERNANCE INNOVATION 4 (June 9, 2014).

⁹⁶ See, e.g., EDWIN M. TRUMAN, *A STRATEGY FOR IMF REFORM* (2006) (arguing for an overhaul in IMF governance and work program).

⁹⁷ See, e.g., JOHN B. TAYLOR, *GLOBAL FINANCIAL WARRIORS: THE UNTOLD STORY OF INTERNATIONAL FINANCE IN THE POST-9/11 WORLD*, at 98-110, 130-32 (2007), Hagan, *supra* note 10, at 345.

countries, particularly in Asia, accumulated vast foreign exchange reserves and put in place regional arrangements that would allow them to bypass the IMF should misfortune strike again.⁹⁸

Despite its outdated vote allocation, shrinking scale, self-insuring clients, and contested track record, the IMF remained indispensable in a debt crisis. It had the unique combination of institutional memory and analytical capacity, a record of past practice, a global membership, and a formal governance structure prescribed by treaty—which made its actions at least somewhat accessible and predictable. The IMF’s role as distressed countries’ gateway to external financing long made it a valuable lever for other actors; it rose in importance as the modular regime faded and other levers disappeared. Public and private creditors sought to use IMF lending and arrears policies to gain leverage in restructuring negotiations. Sovereign borrowers cited IMF analysis and policy conditions to bolster their position *vis a vis* foreign and domestic constituents.⁹⁹ As it was called upon to fill more coordination gaps, the IMF was at risk of becoming both underfunded and overtaxed.

Foreign courts became another important gap-filler in the declining regime. Lawsuits accompanied only five percent of all restructurings in the 1980s, but was climbing to 50 percent in the 2000s, with the poorest countries disproportionately represented among the defendants.¹⁰⁰ Sovereign debt literature generally attributes the rise of litigation since the 1990s to the rise of tradable bonds and unregulated investors in sovereign debt markets. However, bonds were but one element in the endemic weakening of the modular architecture described so far in this essay.

The challenge by 2010 was not (or not just) the odd bondholder ready to go to court to bully countries into full repayment while they struggled to feed their people and pay cooperative creditors pennies on the dollar. Hardball negotiating tactics, free-riding, and litigious investors were part of the sovereign debt landscape in the bank loan days, when much of the law governing sovereign debt was made.¹⁰¹ As the rest of the landscape changed, coordination became harder, and the courts assumed a more prominent role.

⁹⁸ See, e.g., Barry Eichengreen, *Commentary: A Blueprint for IMF Reform: More Than Just a Lender*, 10 INT’L FINANCE 153 (2007). The motives for reserve accumulation are a matter of debate, with authoritative commentary split between attributing it to self-insurance against crises and exchange rate management.

⁹⁹ See IMF, *Access Policy in Capital Account Crises*, Policy Papers 18-26 (July 29, 2002); IMF, *The Fund’s Lending Framework and Sovereign Debt—Preliminary Considerations*, Policy Papers 8-21 (May 22, 2014). See also Buchheit & Lastra, *supra* note 41; BOUGHTON, *supra* note 41; NGAIRE WOODS, *THE GLOBALIZERS: THE IMF, THE WORLD BANK AND THEIR BORROWERS* (2006) (describing emerging markets officials using the IMF as a lever in domestic reform negotiations).

¹⁰⁰ See Schumacher, Trebesch & Enderlein, *supra* note 61.

¹⁰¹ See *supra* note 27; CIBC Bank and Trust Co. (Cayman) v. Banco Cent. do Brasil, 886 F. Supp. 1105 (S.D.N.Y. 1995) (establishing the scope of permissible assignment of loan participations and inter-creditor duties in sovereign debt restructuring); Pravin Banker Assocs. v. Banco Popular Del Peru, 109 F.3d 850 (2d Cir. 1997) (applying the doctrine of comity to sovereign debt restructuring); Allied Bank Int’l v. Banco Credito Agricola de Cartago, 733 F.2d 23, 1984 U.S. App. LEXIS 23237 (2d Cir. 1984) (available on LEXIS but removed from bound Federal Reporter 2d), *vacated*, 757 F.2d 516 (2d Cir. 1985) (reversing the district court decision, limiting application of comity and act of state doctrines in sovereign debt); LNC Invs., Inc. v. Republic of Nicaragua, 115 F. Supp. 2d 358

National courts sitting in contract cases are ill-suited to the coordination task. Unlike bankruptcy courts, they do not preside over a comprehensive, collective proceeding. They decide one-off disputes that happen to be brought before them, and have limited means and limited incentives to consider the sovereign's debt comprehensively. Having rejected substantive defenses to sovereign default in the 1990s, the courts left themselves no room to award creditors less than contract principal and past-due interest.¹⁰² On the other hand, they had no new way to force sovereigns to pay. They could make a government's life difficult and pressure it to settle, but they still had no property to seize or culprit to jail.

Policy makers, judges, and academics looked to another gap-filler—standardized contract reform—to help overcome emerging coordination gaps. “Collective Action Clauses” (CACs) in sovereign bonds allow a supermajority of creditors to approve restructuring terms and bind the dissenters. CACs had been standard in the London market since the nineteenth century, but faced resistance in New York, where drafting custom required unanimous consent to amend financial terms. In 2002-2003, CACs became the most prominent market-friendly alternative to SDRM, and a subject of intense advocacy by U.S. officials.¹⁰³ After Mexico issued with CACs in February of 2003, New York custom shifted, and they became standard.¹⁰⁴

The practical operation of CACs seemed secondary next to the goal of defeating SDRM.¹⁰⁵ Lost in the successful drive for contract change was the fact that CACs were simultaneously good at boosting creditor participation in an exchange offer, *and* bad at blocking committed free-riders. Since CACs traditionally operated within individual bond issues, creditors who bought a blocking minority in a single small issue could reject the restructuring offer, see the rest of the debt stock swept into the restructuring, and then sue for preferential settlement.¹⁰⁶ This strategy works best if the free-rider is small: if everyone holds out, there is no restructuring and no side

(S.D.N.Y. 2000), *affirmed*, 228 F.3d 423 (2d Cir. 2000) (scope of sovereign immunity and effect of contractual waiver); *Elliott Assocs. v. Republic of Peru*, 948 F. Supp. 1203 (S.D.N.Y. 1996) (effectively eliminating the champerty defense in lawsuits on defaulted sovereign debt).

¹⁰² Cf. Marcus H. Miller & Dania Thomas, *Sovereign Debt Restructuring: The Judge, the Vultures and Creditor Rights*, 30 WORLD ECON. 1491, 1493 (2007) (arguing that the judge presiding over lawsuits against Argentina was fashioning a quasi-bankruptcy process within the framework of general civil procedure).

¹⁰³ See generally Gelper & Gulati, *supra* note 24.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* (arguing that SDRM adoption was improbable even before CACs took hold, and that few market participants or policy makers believed that CACs would help solve coordination problems).

¹⁰⁶ Buying a blocking stake is easiest when the sovereign's bond stock is broken up into many small issues, which trade at a deep discount when the debtor is facing a crisis. For example, if the CAC in a \$500 million bond issue requires a 75% majority to approve a restructuring, when the debt is trading at 20 cents on the dollar, would-be holdouts would have to pay just over \$25 million to force the entire issue out of the restructuring. Minimum participation thresholds could change the incentives somewhat, by holding up the entire restructuring until a pre-announced portion of the debt (say, 90 percent of the debt stock) were bound. However, the remaining holdouts—however few—could still sue to block payments on the restructured bonds. See Part III.B *infra*.

payment.¹⁰⁷ Perversely, CACs' transparent voting thresholds help the free-rider identify acquisition targets and clear the field of competitors.

Weaker discipline among creditors was not all bad for the debtors, even if it threatened to prolong the restructuring process. In a world stripped of modules and cross-conditionality, sovereigns could play creditors off against one another. If private foreign investors would not lend or restructure, a government might turn to an oil-rich neighbor; if IMF conditions seemed too onerous, it could try borrowing from domestic banks, or from China; if Paris Club relief were slow in coming, foreign bondholders might be persuaded to move first.¹⁰⁸

The upshot of these developments was a restructuring regime with limited sway over debtors or creditors. The London Club was history; the Paris Club a side show. The IMF was "just one creditor" among many, and far from the biggest—anchoring a regime where other creditors could not be counted upon to cooperate.¹⁰⁹ National courts presided over isolated claims with no mandate to consider the overall debt picture, and had no way to compel the sovereign to follow their orders. Such a regime might be able to nudge willing parties to compromise, but was not fit to host mortal combat to come.

III. Shocks in 2010-2015

A series of shocks between 2010 and 2015 in Argentina, Greece, and Ukraine publicly exposed major flaws in the modular debt restructuring regime. U.S. federal court injunctions that blocked Argentina's access to international payment systems led to wildly unequal recoveries for similarly situated creditors, rewarding the most aggressive litigation strategies.¹¹⁰ In Greece, the IMF repeatedly failed to shape debt restructuring outcomes, raising more questions about the independence of its analysis and lending decisions. Greece also demonstrated the toxic politics of government-to-government debt—reviving ugly stereotypes and stoking historical resentments—which exposed the fragility of Europe's monetary union and the political compromise at its foundation.¹¹¹ Both Argentina and Greece confirmed the weakness of then-standard bond contract terms for creditor coordination. Ukraine's debt to Russia, tangled up in the military conflict between them, showed how remnants of the old modular regime could be gamed by free-

¹⁰⁷ Compare the position of the holdout with that of entire debt categories excluded from restructuring, described in *supra* note 57 and the accompanying text (on the exclusion of still-small Eurobonds from Russia's restructuring).

¹⁰⁸ Argentina, Ecuador, Nigeria and Venezuela all successfully deployed such strategies.

¹⁰⁹ Boughton, *supra* note 95.

¹¹⁰ For real-time commentary on the case, see *Pari Passu Saga*, FT ALPHAVILLE, <http://ftalphaville.ft.com/tag/pari-passu-saga/> (last visited May 6, 2016).

¹¹¹ IMF, *Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*, Country Report No. 13 (June 2013) [hereinafter IMF Ex-Post Evaluation (Greece)].

riders—prominently including official creditors.¹¹² The exposition below is brief, as I have written about these crises elsewhere.¹¹³ I focus on their present implications for the sovereign debt restructuring regime.

Argentina. Argentina’s crisis challenged the regime from the start. After the government defaulted on \$82 billion in foreign bonds on December 24, 2001, it took three years to propose restructuring terms to its private bondholders—with no IMF program or Paris Club restructuring in sight.¹¹⁴ The offer, initially valued at approximately thirty cents on the dollar, swept in more than ninety-two percent of the defaulted debt in two bond exchanges, in 2005 and 2010.¹¹⁵ Creditors who refused to go along sued in national courts around the world, and instituted arbitration proceedings before the International Center for the Settlement of Investment Disputes (ICSID).¹¹⁶ For over a decade, successive governments refused to settle with holdouts on preferential terms—and paid them nothing.

Beginning in 2012, the U.S. federal judge presiding over multiple lawsuits brought against Argentina in New York enjoined the government from servicing its restructured debt until it paid the holdouts in full.¹¹⁷ Trial and appellate court opinions cited bond contract terms and the government’s “uniquely recalcitrant” behavior to justify the equitable remedy.¹¹⁸ Judges interpreted the *pari passu* (equal step) clause in Argentina’s old defaulted bonds as a promise to

¹¹² ANNA GELPERN, POLICY BRIEF 14-20: DEBT SANCTIONS CAN HELP UKRAINE AND FILL A GAP IN THE INTERNATIONAL FINANCIAL SYSTEM 4 (Aug. 2014).

¹¹³ For the author’s writings on Argentina, Ukraine, and Greece, *see, e.g.*, Brad Setser & Anna Gelpern, *Pathways Through Financial Crisis: Argentina*, 12 GLOBAL GOVERNANCE 465 (October 2006); W. Mark C. Weidemaier & Anna Gelpern, *Injunctions in Sovereign Debt Litigation*, 31 YALE J. ON REG. 189 (2014); Gelpern, *Sovereign Damage Control*, *supra* note 7; Anna Gelpern, *Russia’s Contract Arbitrage*, 9 CAP. MKTS. L. J. 308 (2014); Anna Gelpern & Mitu Gulati, *CDS Zombies*, 13 EUR. BUS. ORG. L. REV. 347 (2012).

¹¹⁴ REPUBLIC OF ARGENTINA, PRELIMINARY OFFERING MEMORANDUM DATED APRIL 11, 2016, at 158-163 (on file with author) [hereinafter Argentina Offering Memorandum]. Of the total, just under \$80 billion represented principal outstanding; approximately \$2 billion was accrued and unpaid interest. REPUBLIC OF ARGENTINA, GLOBAL OFFERING PROSPECTUS SUPPLEMENT (Reg. No. 333-117111) (Jan. 10, 2005), <https://www.sec.gov/Archives/edgar/data/914021/000095012305000302/y04567e424b5.htm>.

¹¹⁵ Approximately three-quarters of the bonds were exchanged in 2005; many of the participating bondholders were regulated institutions in Argentina. Participation rate topped 92 percent when the offer was reopened in 2010. *Id.* *See also, e.g.*, ANNA GELPERN, POLICY BRIEF 05-2: AFTER ARGENTINA (Sep. 2005) (describing the 2005 exchange); Theresa A. Monteleone, *A Vulture’s Gamble: High-Stakes Interpretation of Sovereign Debt Contracts in NML Capital Ltd. v. Republic of Argentina*, 8 CAP. MKTS. L.J. 149, 152-4 (2013).

¹¹⁶ A comprehensive summary of debt-related litigation around the world is in the Argentina Offering Memorandum, *supra* note 114, at 186-93. *See also*, *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5 (formerly *Giovanna a Beccara and Others v. The Argentine Republic*); Jessica Bees und Chrostin, *Sovereign Debt Restructuring and Mass Claims Arbitration before the ICSID, The Abaclat Case*, 53 HARV. INT’L L.J. 505, 505-07 (2012).

¹¹⁷ *NML Capital, Ltd. v. Republic of Argentina*, Nos. 08 Civ. 6978(TPG), 09 Civ. 1707(TPG), 09 Civ. 1708(TPG) (S.D.N.Y. Feb. 23, 2012). The injunctions were affirmed on appeal subject to clarification in *NML Capital Ltd. v. Republic of Argentina*, 699 F.3d 246 (2d Cir. 2012), and affirmed as clarified in *NML Capital v. Republic of Argentina*, 727 F.3d 230, 237-39 (2d Cir. 2013).

¹¹⁸ *Id.*

pay all foreign debt in proportion to the current contract claim.¹¹⁹ Argentina's steadfast refusal to pay the old bonds or honor court judgments, and the domestic measures it took to block holdouts from collecting, amounted to a breach. Ordering the government to pay money damages was useless under the circumstances, leaving injunctions as the only option in the eyes of the courts. Argentina could no longer make interest payments to creditors who had forgiven two-thirds of their original claims in 2005 and 2010, until it paid full principal and past-due interest to creditors who had forgiven none.¹²⁰

The injunctions operated entirely by targeting third parties who, unlike the immune sovereign, had a lot to lose in a fight with a U.S. federal court.¹²¹ Trustees, paying agents, and clearing and payment systems around the world were mentioned by name, and risked sanctions if they tried to pass Argentina's funds to the holders of restructured bonds. When the government did try to pay in the summer of 2014, the money was frozen at the Bank of New York Mellon as trustee for the bondholders,¹²² adding another \$29 billion in principal to the heap of Argentina's unpaid debt.¹²³ U.S. courts even blocked Argentina from issuing new local-law bonds in Buenos Aires, where Citibank's branch served as custodian, on the theory that such bonds would be sold to foreigners and constitute foreign debt covered by the "equal treatment" obligation.¹²⁴ The net effect was a court-imposed global financial boycott of the government.

The government of President Cristina Fernandez de Kirchner reacted to the boycott by digging in.¹²⁵ Officials continued to cast invective at the U.S. judge, placing him at the center of the country's domestic politics even after the appeals courts upheld his rulings,¹²⁶ after the U.S. Supreme Court refused to review the case,¹²⁷ and after Argentina was held in contempt.¹²⁸ The conflict did not necessarily extend to the rest of the U.S. government: at the height of the court

¹¹⁹ *Id.* at 241; *NML Capital v. Republic of Argentina*, No. 08 Civ. 6978, 2012 WL 5895784 (S.D.N.Y. Nov. 21, 2012).

¹²⁰ *Id.* By giving up their defaulted bonds, the restructured bond holders had given up their right to accelerated principal repayment and penalty interest on the old bonds. Only periodic interest payments were due under the new bonds.

¹²¹ Weidemaier & Gelpert, *supra* note 113.

¹²² *See, e.g.*, Judgment in *Knighthead Master Fund LP et al. v. The Bank of New York Mellon et al.*, Case No: HC-2014-000704, [2015] EWHC 270 (Ch) (February 13, 2015) (restructured English-law bond holders' attempt to recover the funds trapped at Bank of New York Mellon in London); Elaine Moore & Benedict Mander, *Argentina's Debt Battle Arrives in London with High Court Appeal*, FINANCIAL TIMES (Nov. 3, 2014, 8:53PM), <http://www.ft.com/intl/cms/s/0/d84f3f5e-3f24-11e4-a861-00144feabdc0.html>.

¹²³ *See, e.g.*, Kathy Gilsinan, *65 Words Just Caused Argentina's \$29 Billion Default*, ATLANTIC (July 31, 2014), <http://www.theatlantic.com/international/archive/2014/07/65-words-just-caused-argentinass-29-billion-default/375368/>.

¹²⁴ *NML Capital v. Republic of Argentina*, No. 08 Civ. 6978, 2015 WL 1087488 (S.D.N.Y. Mar. 12, 2015).

¹²⁵ Nicholas Misculin & Eliana Raszewski, *Argentina's Debt Crisis Seen Rumbling On Until 2015 Election*, REUTERS (Dec. 30, 2014, 1:41PM), <http://www.reuters.com/article/us-argentina-debt-analysis-idUSKBN0K81DL20141230>.

¹²⁶ *NML Capital v. Republic of Argentina*, 727 F.3d 230, 237-39 (2d Cir. 2013).

¹²⁷ *Id.*, *cert. denied*, 82 U.S.L.W. 3515 (U.S. June 16, 2014) (No. 13-990).

¹²⁸ *NML Capital v. Republic of Argentina*, No. 08 Civ. 6978 (Sept. 29, 2014).

battle in 2014, Argentina quietly agreed to repay the Paris Club, including the United States, \$9.7 billion over five years, with no links either to an IMF program, or to the treatment of private creditors. It was able to avoid the web of cross-conditionality by promising to pay in full.¹²⁹ Of course the Paris Club deal was entirely beyond the purview of the contract litigation, where, fourteen years after the initial default, any trust that might have existed between the sovereign debtor and the U.S. courts was long gone. The conflict had become personal, political, and ugly.

Elections in the fall of 2015 brought a new government, which made settling the case and returning to the global financial markets a top priority.¹³⁰ The quick settlement brought a bizarre distribution of gains and losses, especially when considered in light of the courts' professed commitment to inter-creditor equity.¹³¹ Argentina paid \$9.3 billion in cash to settle the case, including \$4.7 billion to four investment firms that had pursued it in courts around the world.¹³² These were some of the most dogged and creative holdouts, the first to obtain the *pari passu* injunctions. Some of their contracts paid more than 100 percent annual interest, and ultimately returned more than 900 percent on principal in the litigation settlement, which also included reimbursement of their legal expenses.¹³³ Other creditors who obtained court judgments got a fifty percent return on principal.¹³⁴ By comparison, creditors who participated in the restructurings and had their bond payments frozen for nearly two years netted a relatively modest twenty to twenty-five percent return on principal, according to market estimates.¹³⁵ Creditors who neither exchanged their bonds, nor sued before the statute of limitations had run in New York got nothing at all.¹³⁶ Argentina paid the holdout claims and its restructured bond arrears

¹²⁹ Benedict Mander, *Argentina Reaches Landmark Deal with Paris Club Creditors*, THE FINANCIAL TIMES, (May 29, 2014), <http://www.ft.com/intl/cms/s/0/212b0b1e-e722-11e3-aa93-00144feabdc0.html#axzz4ACwx9Qoq>.

¹³⁰ Benedict Mander, *Mauricio Marci Vows to End Argentina's Isolation*, FINANCIAL TIMES (Oct. 28, 2015), <http://www.ft.com/intl/cms/s/0/c77cae92-7d6b-11e5-98fb-5a6d4728f74e.html>.

¹³¹ See, e.g., Matt Levine, *Argentina's Bond Fight Comes Down to Its Worst Bonds*, BLOOMBERG VIEW (Feb. 8, 2016), <https://www.bloomberg.com/view/articles/2016-02-08/argentina-s-bond-fight-comes-down-to-its-worst-bonds>; Supplemental Memorandum of Law in Support of the Republic of Argentina's Motion at Exhibit 1, NML Capital v. Republic of Argentina, No. 08 Civ. 6978 (S.D.N.Y. Feb. 29, 2016) [hereinafter Argentina Supplemental Exhibit]

¹³² Letter from Edward A. Friedman to Hon. Thomas P. Griesa, dated March 3, 2016, attaching Agreement in Principle dated February 29, 2016 (on file with author).

¹³³ For an explanation of the Floating Rate Accrual Notes (FRANs) and their treatment in the settlement, see Levine, *supra* note 131 and Argentina Supplemental Exhibit, *supra* note 131.

¹³⁴ Taos Turner, *Argentina Reaches Deal to Settle Bond Default Lawsuit*, WALL STREET JOURNAL (Feb. 16, 2016, 6:03PM), <http://www.wsj.com/articles/argentina-reaches-deal-to-settle-bond-default-lawsuit-1455663817>. Since the biggest holdout creditors acquired their claims at a deep discount off face value, their returns on investment were likely a multiple of the disclosed return on principal.

¹³⁵ Katia Porzecanski, *Argentina's Forgotten Warrants Now a Buy at BofA as Election Bet*, BLOOMBERG BUS. (Sept. 16, 2015), <http://www.bloomberg.com/news/articles/2015-09-17/argentina-s-forgotten-warrants-now-a-buy-at-bofa-as-election-bet>; Charlie Devereux & Katia Porzecanski, *Argentine GDP Warrants Plunge as Growth Misses Trigger*, BLOOMBERG BUS. (Mar. 28, 2014), <http://www.bloomberg.com/news/articles/2014-03-28/argentine-warrant-holders-seen-losing-out-as-gdp-misses-forecast>.

¹³⁶ Argentina Supplemental Exhibit, *supra* note 131, Argentina Offering Memorandum, *supra* note 114.

from the proceeds of an oversubscribed \$16.5 billion bond offering, completed on April 19, 2016.¹³⁷

The closing chapters of Argentina's debt saga cast doubt on the ability of the prevailing restructuring regime to achieve anything close to a prompt, durable, or equitable outcome for anyone involved. After a decade of disruptive but feckless enforcement attempts (including temporary seizure of a tall ship¹³⁸), national courts commandeered global payment intermediaries for the private benefit of a small minority of creditors. Bystanders were harmed to boost returns for the free-riders. Cross-conditionality, which had been used to promote burden-sharing among restructuring modules in the 1980s and 1990s, had mutated into "equal treatment" injunctions in the hands of a national court, which produced fabulously unequal distribution. Judges got drawn into a dirty fight between a sovereign they could not control and a few sophisticated, well-resourced creditors, who took advantage of the courts' narrow purview—in stark contrast to bankruptcy's comprehensive, collective process. In the end, it was domestic elections—not foreign courts—that made settlement possible.

The deal might have been good enough for Argentina, which had been hemorrhaging foreign exchange reserves, but it was not good not for the sovereign debt restructuring regime. As the fog clears, there is no consensus on what constitutes inter-creditor equity in sovereign debt. Argentina leaves behind a confused and contested jurisprudence, which will take years to sort out. On the other hand, the transactional precedent is clear: debt settlements favor the most aggressive litigants, incomplete restructurings can be hijacked by holdouts, and not suing is the one sure path to being left out in the cold.

Greece. The Greek crisis that began in late 2009 tested multiple elements of the old modular regime, including the IMF's ability to establish overall parameters of reform and relief, its relationship with other official creditors, and the viability of existing contract tools for creditor coordination. The results were discouraging.

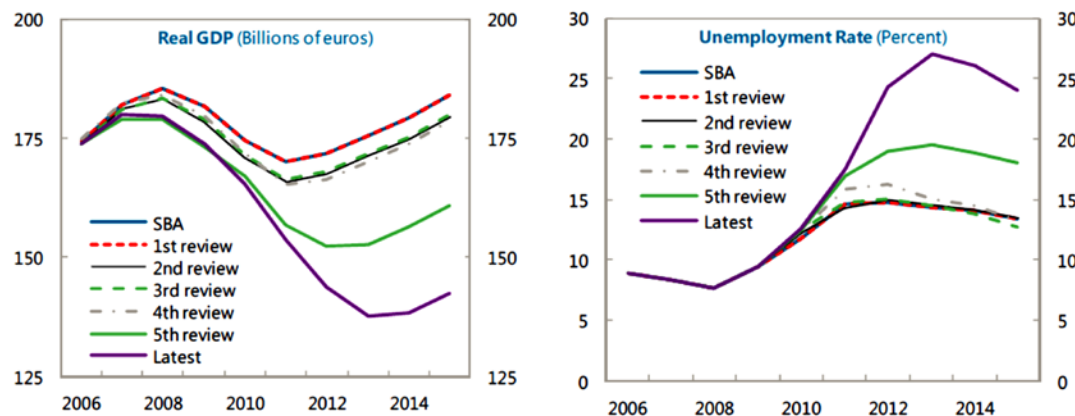
The IMF, the European Commission, and the European Central Bank (ECB) launched a €10 billion (\$145 billion) financing program for Greece on May 9, 2010. The IMF's contribution of

¹³⁷ Declaration of Matthew Dukes in *NML Capital v. Republic of Argentina*, No. 08 Civ. 6978 (S.D.N.Y. Apr. 22, 2016), Exhibit A, Schedule 2 (listing settlement payments in the aggregate amount of \$9,266,775,761). *See also*, Hugh Bronstein & Sarah Marsh, *Argentina Returns to Global Debt Markets after 15-Years*, REUTERS (Apr. 19, 2016), <http://www.reuters.com/article/us-argentina-bonds-bids-idUSKCN0XG2W0> (citing offers of \$68.5 billion, making the issue more than four times oversubscribed, and a litigation settlement amount of \$9.3 billion); Andres D'Alessandro & Chris Kraul, *Argentina Pays Off 'Holdout' Bondholders, Elevating Hopes for Economy*, L.A. TIMES, (Apr. 23, 2016), <http://www.latimes.com/world/mexico-americas/la-fg-argentina-economy-20160424-story.html> (confirming payment of \$9.4 billion to holdout creditors from the proceeds of the \$16.5 billion offering).

¹³⁸ *See supra* note 28; *see also*, Jacob Goldstein, *Why A Hedge Fund Seized an Argentine Navy Ship in Ghana*, NPR (Oct. 22, 2012, 10:13AM), <http://www.npr.org/sections/money/2012/10/22/163384810/why-a-hedge-fund-seized-an-argentine-navy-ship-in-ghana>.

€30 billion (\$40 billion) to this “troika” package was by far the largest program in its history.¹³⁹ The program went ahead despite IMF staff concerns about public debt sustainability, and based on heroic assumptions about tax collection, privatization, unemployment, economic growth, and a speedy return to the capital markets.¹⁴⁰ Figure [4], drawn from the IMF’s own ex-post evaluation of the program, illustrates.

Figure [4]: Evolution of IMF Program Projections for Greek GDP and Unemployment¹⁴¹
 (“SBA” reflects projections in the May 2010 IMF stand-by arrangement)



Early baseline projections had the debt ratio rising from 115 percent of Gross Domestic Product (GDP) in May 2010 above 150 percent in 2013, potentially reaching 220 percent in some stress scenarios.¹⁴² These projections meant that Greek debt could not be sustainable with “high probability” in the medium term, which posed a problem under the IMF’s policy barring large-scale lending to over indebted countries. As the staff saw it, the IMF had two choices: condition its participation in the troika on Greek debt relief, or ask its Executive Board to approve a policy change. Less than two years after the failure of Lehman Brothers had brought global finance to

¹³⁹ Press Release, IMF, IMF Executive Board Approves €30 Billion Stand-By Arrangement for Greece, No. 10/187 (May 9, 2010), <https://www.imf.org/external/np/sec/pr/2010/pr10187.htm>; IMF Ex-Post Evaluation (Greece) *supra* note 111, at 9.

¹⁴⁰ IMF Ex-Post Evaluation (Greece) *supra* note 111, at 8; *see also* WILLIAM R. CLINE, MANAGING THE EURO AREA DEBT CRISIS 185 (2014); David Keohane, *Greek Government Acquires More Realistic Crystal Ball*, FT ALPHAVILLE (Nov. 1, 2012), <http://ftalphaville.ft.com/2012/11/01/1241521/greek-government-acquires-more-realistic-crystal-ball/> (citing IMF and market analysis of IMF forecasts).

¹⁴¹ IMF Ex-Post Evaluation (Greece), *supra* note 111, at 13, 17, 25.

¹⁴² Paul Blustein, *Laid Low: The IMF, the Euro Zone and the First Rescue of Greece*, CENTRE FOR INT’L GOVERNANCE INNOVATION 2 (Apr. 7, 2015); IMF, *Greece: Preliminary Debt Sustainability Analysis—Updated Estimates and Further Considerations*, Country Report No. 16/130 1 (May 2016), <http://www.imf.org/external/pubs/ft/scr/2016/cr16130.pdf> [hereinafter IMF Preliminary Greek DSA May 2016] (citing public debt ratio of 115 percent of GDP, projected to top 150 percent despite policy adjustment); IMF Ex-Post Evaluation (Greece), *supra* note 111, at 16, 26-27 (citing initial projections for debt to peak at 154-156 percent of GDP in 2013, but continuing to rise above 220 percent under stress).

the brink, fear of Greece turning into “another Lehman-type event” took debt restructuring off the table.¹⁴³

The Lehman reference underscores the challenge of managing debt crises in large economies integrated in regional and global financial systems (the euro area is an extreme example). Neither the IMF nor the European Union was prepared to address contagion in 2010 with liquidity support for its likely victims. Although IMF members had agreed in 2009 to lend the Fund up to \$576 billion,¹⁴⁴ its resources remained visibly inadequate to rescue large euro area economies, certainly not two or three at the same time. The IMF’s lending capacity in April 2010, on the eve of its first Greek program, was \$255.5 billion, counting supplemental borrowing of \$253 billion.¹⁴⁵ In the next twelve months, it would approve nearly \$210 billion in new commitments, including large, front-loaded programs for Greece and Ireland.¹⁴⁶ Spain and Italy, which looked shaky, were in a different category altogether. At the end of 2009, Spain had \$815 billion in sovereign debt and Italy had \$2.5 trillion, compared to Greece’s \$431 billion. In less than two years, foreign banks reduced their Italian government debt holdings by over \$125 billion.¹⁴⁷

¹⁴³ *Id* at 27.

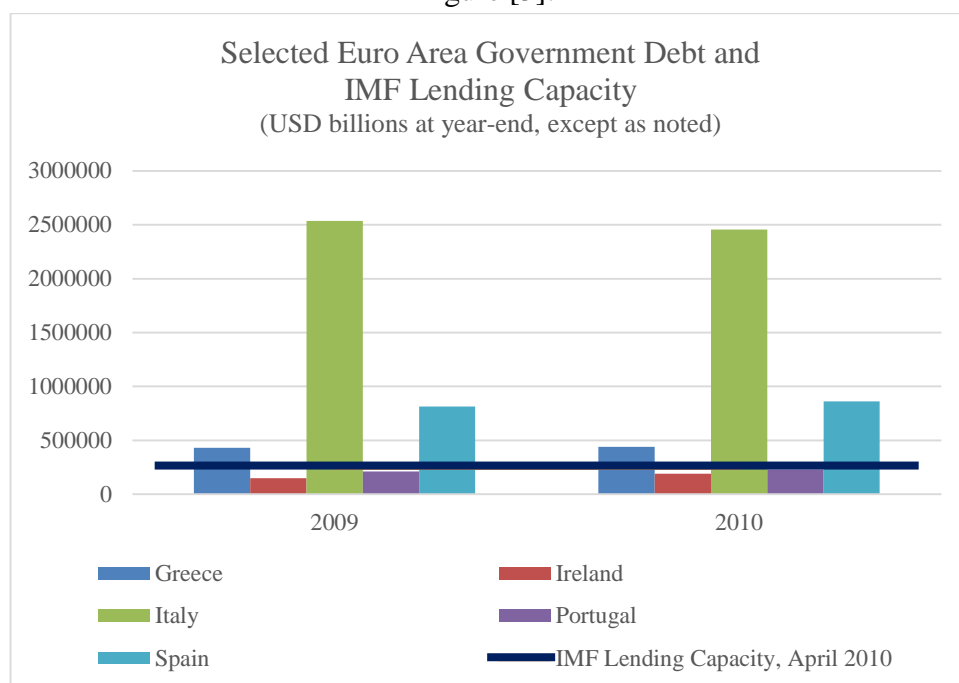
¹⁴⁴ IMF ANNUAL REPORT FY2011 at 49 (tenfold expansion and activation of New Arrangements to Borrow (NAB) between November 2009 and April 2010), <https://www.imf.org/external/pubs/ft/ar/2011/eng/pdf/ch5.pdf>; DOMENICO LOMBARDI & SARAH PURITZ MILSON, THE BROOKINGS INSTITUTION, THE EURO-AREA CRISIS: WEIGHING OPTIONS FOR UNCONVENTIONAL IMF INTERVENTIONS 4 (Dec. 2011).

¹⁴⁵ IMF’s Financial Resources and Liquidity Position, 2008 – April 2010, <http://www.imf.org/external/np/tre/liquid/2010/0410.htm> (One-Year Forward Commitment Capacity).

¹⁴⁶ IMF ANNUAL REPORT FY2011, *supra* note 144, Appendix Table II.1: Arrangements Approved during Financial Years Ended April 30, 2002-2011, and Appendix Table II.4: Purchases and Loans from the IMF, Financial Year Ended April 30, 2011, <https://www.imf.org/external/pubs/ft/ar/2011/eng/pdf/a2.pdf>. SDR=USD1.61967. IMF Financial Activities -- Update April 28, 2011, <http://www.imf.org/external/np/tre/activity/2011/042811.htm>.

¹⁴⁷ Approximately half of Italian government debt was held by non-residents, mostly in the euro area. INT’L MONETARY FUND, ITALY: SELECTED ISSUES, IMF Country Report No. 12/168 87-88 (Jul. 2012), <http://www.imf.org/external/pubs/ft/scr/2012/cr12168.pdf> (detailing Italian debt composition); IMF, *The Quest for Lasting Stability*, Global Financial Stability Report 19 (Apr. 2012), <http://www.imf.org/external/pubs/ft/gfsr/2012/01/pdf/text.pdf> (Figure 2.6, showing a reduction of foreign bank holdings by €94 billion between Q1 2010 and Q3 2011). EUR=USD1.3449 at the end of Q3 2011. Board of Governors of the Federal Reserve System (US), U.S. / Euro Foreign Exchange Rate [DEXUSEU], (retrieved from FRED, Federal Reserve Bank of St. Louis <https://research.stlouisfed.org/fred2/series/DEXUSEU>, May 31, 2016). See also IMF, *Restoring Confidence and Progressing on Reforms*, Global Financial Stability Report 30 (Oct. 2012), <http://www.imf.org/external/pubs/ft/gfsr/2012/02/pdf/text.pdf> (Figure 2.9, showing the exit of foreign private investors in Italian and Spanish government debt).

Figure [5]:



Sources: Eurostat, Board of Governors of the Federal Reserve System, IMF¹⁴⁸

If the crisis in Greece spread to Italy, contagion across the euro area, to the United Kingdom and the United States could bring back the darkest days of September 2008.¹⁴⁹ The euro area might have addressed the problem on its own—it had a powerful central bank, and strong economies at the core—but it was only beginning to develop the political consensus, legal and institutional tools to against contagion.¹⁵⁰ When the risk of contagion topped the policy agenda, it was down to the IMF, which had crisis-fighting experience and resources on standby—except not enough to support its new and potential clients, which were vastly bigger than the old ones. Unable to backstop large economies, the IMF changed its lending policy. From May 2010, countries whose

¹⁴⁸ Eurostat, Government Consolidated Gross Debt by Components - Annual Data [tipsgo11], <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&plugin=1&language=en&pcode=tipsgo11> (“Government debt is defined as total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government.”); Board of Governors of the Federal Reserve System (US), U.S. / Euro Foreign Exchange Rate [DEXUSEU], (retrieved from FRED, Federal Reserve Bank of St. Louis <https://research.stlouisfed.org/fred2/series/DEXUSEU>, May 31, 2016); IMF’s *Financial Resources and Liquidity Position, 2008 – April 2010*, <http://www.imf.org/external/np/tre/liquid/2010/0410.htm> (One-Year Forward Commitment Capacity).

¹⁴⁹ IMF, *Italy: 2012 Article IV Consultation*, Country Report No. 12/167, at 12 (2012), <https://www.imf.org/external/pubs/ft/scr/2012/cr12167.pdf>. (Box 2: Italy – Spillovers from a Potential Intensification of the Euro Area Crisis, showing cross-border borrowing by Italian banks exceeding €1.4 trillion, primarily from Germany, France, Austria, as well as elsewhere in the euro area, Eastern Europe and the United States).

¹⁵⁰ IMF, *Euro Area Policies: 2015 Article IV Consultation—Press Release, Staff Report, and Statement by the Executive Director*, Country Report No. 15/204, at 5 (July 2015), http://ec.europa.eu/justice/civil/files/insolvency/05a_imf_ea_art_iv_package_en.pdf (highlighting continuing risk of contagion from Greece despite new ECB tools).

debts were not sustainable with high probability could avoid restructuring and still get large-scale IMF support, provided there was a high risk of “systemic international spillovers.”¹⁵¹ Greece then proceeded to borrow at least in part for the sake of broader financial stability—although Greece alone would be bound to repay.¹⁵²

The IMF’s failure to insist on debt relief for Greece in 2010 was not in itself a challenge to the old sovereign debt restructuring regime—it was the IMF’s persistent inability in 2010 and 2011 to force a restructuring once it became convinced that one was necessary, and despite the risk to its own resources.¹⁵³ Finance officials had always been wary of debtor moral hazard, hurting banks, spending tax money and, more recently, undermining the “catalytic” effect of IMF lending on the debtor’s access to the private capital markets.¹⁵⁴ The modular building in Figure [1] above simply required some combination of new money, debt restructuring, and adjustment to fill the financing gap during the program period. Countries avoided restructuring in 21 out of 53 emerging market sovereign debt distress episodes identified by the IMF between 1980 and 2012.¹⁵⁵ Debt stock sustainability became a formal condition for very large (“exceptional access”) IMF programs only in 2002, as part of a campaign to limit bailouts and moral hazard.¹⁵⁶

There is no evidence that the 2002 policy made large programs any more exceptional, nor that it made debt restructuring more common. However, for as long as the IMF remained a source of some, and the gatekeeper for most external financing in crisis, the 2002 change raised the political salience of IMF staff debt sustainability analysis. A country that needed IMF rescue funds might have to restructure its debt—unless that analysis showed sovereign debt to be sustainable “with high probability.”¹⁵⁷ Market participants became big consumers of the analysis, and tough critics of the methodology.

¹⁵¹ *IMF Reforms Policy for Exceptional Access Lending*, IMF Survey, (Jan. 29, 2016), <http://www.imf.org/external/pubs/ft/survey/so/2016/POL012916A.htm>.

¹⁵² *Supra* note 140-142, 149-150 and accompanying text; *compare* lending to Greece to avoid a crisis elsewhere in Europe and lending to developing countries in the 1980s to avoid a banking crisis in New York and London, *supra* note 16 and accompanying text. The argument that Greece borrowed for lack of better tools to avoid contagion broadly is distinct from the argument that troika loans bailed out French and German banks. *See, e.g.*, Dan Davies, *2010 and All That—Relitigating the Greek Bailout (Part 1)*, BULL MKT. (Jul. 21, 2015), <https://medium.com/bull-market/2010-and-all-that-relitigating-the-greek-bailout-part-1-a889d468e8ae#.3z7p3pt8l> (considering accusations that the Greek rescue benefited German and French financial institutions).

¹⁵³ *See* Ashoka Mody, *In Bad Faith*, BRUEGEL (July 2, 2015), <http://bruegel.org/2015/07/in-bad-faith/> (arguing that the IMF acted in bad faith by letting debt relief be deferred while insisting, along with euro area governments, on crippling adjustment conditions in Greece).

¹⁵⁴ *The Fund’s Lending Framework and Sovereign Debt – Annexes*, IMF 9-20 (June 2014), <http://www.imf.org/external/np/pp/eng/2014/052214a.pdf> [hereinafter IMF Lending Framework Annexes].

¹⁵⁵ *Id.* at 28.

¹⁵⁶ The new criterion was part of an effort to limit debtor and creditor moral hazard from IMF programs, instituted just as the global financial markets entered a period of relative calm. *Id.*; TAYLOR, *supra* note 97, at 119-21, 130-32 (2007).

¹⁵⁷ IMF Lending Framework Annexes, *supra* note 154.

The IMF's capacity to leverage its analytical and financial resources to shape a country's recovery program had anchored the old modular restructuring regime.¹⁵⁸ Greece exposed the limits of this capacity. IMF staff called for debt relief early in 2011; a bond restructuring came a year later, after more than \$150 billion in private capital had fled the country and was replaced by public funds from the euro area and the IMF.¹⁵⁹ A new IMF program in March 2012 brought more loans and projections that Greek debt would fall below 120 percent of GDP by 2020—even as domestic politics deteriorated and support for the program sank.¹⁶⁰ In July 2015, the debt stock neared 180 percent of GDP and the Greek banking system was on life support from the ECB, rationing cash withdrawals. A new government was in a standoff with the troika over a third IMF program, and the IMF was at odds with its troika partners over government-to-government debt relief. In the middle of an acute political crisis, Greece threatened to abandon the euro and delayed repayment of €1.55 billion (\$1.73 billion) to the IMF ... causing new anxiety for being “the first developed country to default” on the multilateral lender.¹⁶¹ In May of 2016, Greek debt-to-GDP ratio lingered at 180 percent and euro area governments agreed to disburse €10.3 billion (\$11.5 billion) in new loans. The IMF held back, still waiting for “a clear, detailed Greek debt restructuring plan”¹⁶²—a principled position that might have produced better results had it come sooner.

IMF staff had a hard enough time negotiating Greek program parameters with euro area institutions when private investors' money was on the line; with euro area taxpayers as the direct and dominant creditors, the political challenge would become nearly insurmountable.¹⁶³ At the outset, program parameters had to be settled with euro area institutions first, leaving little room for Greek agency (or policy “ownership”)¹⁶⁴ For their part, euro area leaders had left themselves limited scope to maneuver. After telling their citizens that EU treaties categorically precluded bailouts—including public debt forgiveness—they had to choose between the prospect of outright default and a mix of transactional engineering, accounting gimmicks and wishful thinking about Greek citizens' tolerance for more austerity.¹⁶⁵ More bilateral financing was

¹⁵⁸ *Supra* notes 23-26 and accompanying text.

¹⁵⁹ IMF Ex-Post Evaluation (Greece), *supra* note 111, at 27; see also Matthew Higgins & Thomas Klitgaard, *The Balance of Payments Crisis in the Euro Area Periphery*, 20 CURRENT ISSUES ECON. & FINANCE, no. 2, 2014, at 7, https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci20-2.pdf.

¹⁶⁰ IMF exposure would remain essentially unchanged. Press Release, IMF, IMF Executive Board Approves €28 Billion Arrangement under Extended Fund Facility for Greece, No. 12/85 (Mar. 15, 2012), <https://www.imf.org/external/np/sec/pr/2012/pr1285.htm>.

¹⁶¹ See, e.g., Reuters, *Greece Becomes the First Developed Country to Default on IMF Loan*, NEWSWEEK (July 1, 2015), <http://europe.newsweek.com/greece-becomes-first-developed-country-default-imf-loan-329602>.

¹⁶² *Greece Bailout: IMF Queries Eurozone Debt Relief Deal*, BBC (May 25, 2016), <http://www.bbc.com/news/world-europe-36382973>.

¹⁶³ IMF Ex-Post Evaluation (Greece), *supra* note 111, at 21, 30-32.

¹⁶⁴ On Greek program “ownership,” see IMF Ex-Post Evaluation (Greece), *supra* note 111. Compare BLUSTEIN, *supra* note 54, with WOODS, *supra* note 99 (on economic reform and power dynamics between emerging market and multilateral officials).

¹⁶⁵ See, e.g., Ashoka Mody, *Wolfgang Schäuble, Debt Relief, and the Future of the Eurozone*, BRUEGEL (August 6, 2015), <http://bruegel.org/2015/08/wolfgang-schauble-debt-relief-and-the-future-of-the-eurozone/>; Paul Carrel, *Legal*

unpalatable, but default was still unthinkable for fear of financial and political contagion; the alternative had produced six years of crippling economic decline and political upheaval.¹⁶⁶

If the IMF proved to be a weak anchor, the Paris Club simply had no part of the Greek debt restructuring. The juxtaposition of Europe's need to handle Greece as a family affair and the growing resemblance between the Greek debt stock and those of the poorest sovereigns in the Paris Club was bitterly ironic.¹⁶⁷ To lighten Greece's debt service burden, euro area governments quietly extended repayment to between fifteen and forty years, and lowered interest rates to 1.2 percent on average—but stood firm against reducing principal claims.¹⁶⁸ This might have relieved near-term liquidity pressures, but was not enough to alter the debt trajectory, nor to stop government-to-government debt from fueling toxic political fights.¹⁶⁹

In contrast to the tortured iterations over official debt relief, the 2012 Greek bond restructuring was a brilliantly executed operation, at least on a technical level—once it was launched, the deal was done, and done quickly. It covered a record-breaking stock of debt, approximately €200 billion (\$260 billion), and reduced the private debt burden by over fifty percent.¹⁷⁰ The smooth execution was mostly attributable to the fact that more than ninety percent of the bonds were governed by Greek law and could be amended retroactively by statute.¹⁷¹ The Greek Bondholder Act enabled the government to call a single vote of all its Greek-law bond holders, with quorum and voting thresholds set low at fifty percent and 66 2/3 percent, respectively, to ensure

Gray Areas Give Scope for Greek Debt Relief If Europe Wants It, REUTERS (July 9, 2015), <http://www.reuters.com/article/us-eurozone-greece-debt-idUSKCN0PJ28G20150709>.

¹⁶⁶ See Mody, *supra* note 165.

¹⁶⁷ Both had triple-digit debt ratios and few private creditors. For example, at the end of 2012, after most of its privately held debt had been repaid or restructured, Greece had a debt-to-GDP ratio north of 150 percent and rising, while private creditors held approximately 20 percent of its debt; the rest was in the hands of other governments and the IMF. IMF Preliminary Greek DSA May 2016, *supra* note 142, at 4; compare debt composition figures cited in Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, *The Greek Debt Restructuring: An Autopsy*, 28 ECON. POL'Y 513 (2013) [hereinafter *Greece Autopsy*], and Liberia in 2007-2008, with 28 percent of the debt stock in the hands of commercial creditors, and an external debt-to-GDP ratio of 186 percent before debt relief. IMF, *Liberia: Enhanced Initiative for Heavily Indebted Poor Countries—Completion Point Document and Multilateral Debt Relief Initiative*, Country Report No. 10/192, at 32, 41 (July 2010) <http://www.imf.org/external/pubs/ft/scr/2010/cr10192.pdf>.

¹⁶⁸ IMF Preliminary Greek DSA May 2016, *supra* note 142, at 4-5 (arguing that substantial official debt relief to date is not enough to achieve sustainability); see also William R. Cline, *Policy Brief 15-12: From Populist Destabilization to Reform and Possible Debt Relief in Greece*, PETERSON INST. INT'L ECON. (Aug. 2015).

¹⁶⁹ See, e.g., Jason Hovet, *Czech President Floats Idea of Greece Paying Debts by Hosting Migrant Centers*, REUTERS (Andrew Bolton ed., Mar. 6, 2016), <http://www.reuters.com/article/us-europe-migrants-czech-president-idUSKCN0W80KJ>; Yanis Varoufakis, *Germany Won't Spare Greek Pain—It Has an Interest in Breaking Us*, GUARDIAN (July 10, 2015), <http://www.theguardian.com/commentisfree/2015/jul/10/germany-greek-pain-debt-relief-grexit>.

¹⁷⁰ *Greece Autopsy*, *supra* note 167, at 2.

¹⁷¹ *Greece Autopsy*, *supra* note 167. Retroactive legislation superimposed a majority voting mechanism on the entire stock of domestic-law bonds. Although it was enacted after consultations with creditors, it was in no way contractual – neither consensual nor market standard. The thresholds were designed to ensure that dissenting creditors would be outvoted by a combination of Greek and other euro area banks.

success.¹⁷² The voting mechanism in Greek retroactive legislation was fundamentally unlike the standard-form CACs incorporated in bond contracts *ex ante*: it was designed to prevent individual bond series from dropping out and free-riding on the rest. “Contractual” CACs had always allowed some bonds to drop out. The single stock-wide vote legislated in Greece meant that either all or none of the bonds polled were bound to restructure.

Greece got much less benefit from the standard CACs already incorporated in its foreign-law bond contracts.¹⁷³ As noted in Part II, such CACs had been held up as a bulwark against free-riders in G-7 statements and G-10 reports since the mid-1990s.¹⁷⁴ As was customary at the time, CACs in Greek bond contracts governed by English and Swiss law applied only to individual bond series. Holdouts secured blocking positions in more than half of the series by number. The restructuring vote failed for approximately forty-four percent of foreign-law principal outstanding.¹⁷⁵ Private creditors holding €6.4 billion (\$8.3 billion) in bonds kept their old bonds and have been paid on schedule since.¹⁷⁶

The 2012 restructuring stirred controversy for excluding €6.7 billion (\$73.7 billion) in bonds held by the ECB and national central banks in the euro area.¹⁷⁷ The ECB was Greece’s largest bondholder and the biggest holdout. The exclusion of central bank holdings sent the signal that some official creditors would get paid first even when their contracts were identical to those of private creditors, and threatened to make official support synonymous with subordination in the eyes of private creditors.¹⁷⁸ To diffuse market fears that could undermine its emergency interventions, the ECB later promised that its new financing would be *pari passu* with the debt owed to private creditors.¹⁷⁹ This promise has not been tested.

In sum, the Greek experience implied that the IMF was weak, the Paris Club irrelevant, government creditors paralyzed by domestic politics, and CACs mostly futile. It highlighted an peculiar structure of accountability in crisis management institutions, which allowed Greece to accumulate unpayable debt at least in part thanks to their own inability to stop contagion and

¹⁷² *Id* at 11-12

¹⁷³ *Id* at 42

¹⁷⁴ See Section II, *Gaps and Gap-filing*, *supra*.

¹⁷⁵ Greece Autopsy, *supra* note 167.

¹⁷⁶ *Id*.

¹⁷⁷ *Id*. at 15, 28.

¹⁷⁸ In addition to the Eurosystem holdings, €350 million in bonds held by the European Investment Bank (EIB) were excluded from restructuring. *Id*. On the other hand, Greek bonds held by the Norwegian sovereign wealth fund were treated alongside privately held bonds, and restructured over its objections. Richard Milne, *Norway State Fund Sells Eurozone Debt*, FIN. TIMES (May 4, 2012), <http://www.ft.com/intl/cms/s/0/1c657afa-95e5-11e1-a163-00144feab49a.html#axzz42cmRohmK>.

¹⁷⁹ Press Release, European Central Bank, Technical Features of Outright Monetary Transactions (Sept. 6, 2012) (“The Eurosystem intends to clarify in the legal act concerning Outright Monetary Transactions that it accepts the same (*pari passu*) treatment as private or other creditors with respect to bonds issued by euro area countries and purchased by the Eurosystem through Outright Monetary Transactions, in accordance with the terms of such bonds.”).

manage domestic politics. Greece took on more and more debt at least in part because the international financial architecture was unequipped to process default.

The IMF responded to the controversy surrounding its Greek programs, and to a lesser extent Argentina, with an effort to recapture policy initiative beginning in 2013.¹⁸⁰ Most importantly, in January 2016, the Executive Board did away with the systemic risk exception that had allowed the IMF to lend to Greece despite its questionable debt profile.¹⁸¹ It also expressly broadened the range of restructuring outcomes IMF staff could seek when a country's debt sustainability was in doubt—loosening the 2002 lending policy with its heavy emphasis on achieving sustainability.¹⁸² This implied that in some cases, private creditors would be asked to maintain their exposure as a condition of IMF support for the country, as it had done on several occasions before 2002. The revised policy suggested that other governments—not the IMF—should finance a country like Greece on below-market terms to stem contagion.¹⁸³ Disclaiming responsibility for fighting contagion might help reduce political pressure on the IMF to lend to over-indebted countries.¹⁸⁴ However, unless other parts of the global financial system take on the task, such pressure is likely to return in the next crisis.¹⁸⁵ As a membership organization with a crisis-fighting mandate, the IMF could find it hard to resist.

Ukraine. The political and economic crisis in Ukraine beginning in late 2013 again forced the IMF to deal with the breakdown of the sovereign debt restructuring regime. This time, the vanishing boundary between official and private debt presented the biggest problem.

The IMF approved a \$17 billion lending program for Ukraine in April 2014, soon after the ouster of former President Viktor Yanukovich and Russia's annexation of Crimea, when the eastern part of the country erupted in conflict with Russian-backed rebels.¹⁸⁶ Unlike Greece, Ukraine was unlikely to trigger contagion. Moreover, the IMF was by far the biggest source of financing for the program. The IMF did not ask for a debt restructuring this time because it judged Ukraine's debt, then less than 50 percent of its GDP, "sustainable with high probability" subject

¹⁸⁰ See *Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework*, IMF (April 26, 2013), <https://www.imf.org/external/np/pp/eng/2013/042613.pdf> [hereinafter IMF 2013 Sovereign Debt Review].

¹⁸¹ Press Release, IMF, IMF Executive Board Approves Exceptional Access Lending Framework Reforms, No. 16/31 (Jan. 29, 2016).

¹⁸² *Id.*

¹⁸³ Press Release, IMF, IMF Executive Board Approves Exceptional Access Lending Framework Reforms, No. 16/31 (Jan. 29, 2016) (reporting Board approval of the policy); IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper (Apr. 9, 2015) (policy reform proposal). Going forward, this would mean a lot more bilateral rescue packages of the sort the United States had arranged for Mexico as a temporary measure to stem the 1990s Tequila crisis.

¹⁸⁴ IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper 10-11 (Apr. 9, 2015).

¹⁸⁵ IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper (Apr. 9, 2015)

¹⁸⁶ Ian Talley, *IMF Approves \$17 Billion Emergency Aid for Ukraine's Economy*, WALL STREET J. (Apr. 30, 2014), <http://www.wsj.com/articles/SB10001424052702303948104579534140466543308>.

to “uncertainties that come from the geopolitics.”¹⁸⁷ Less than a year later, Ukraine asked its creditors for forty percent debt reduction under a new IMF program that deemed its debt patently unsustainable.

The episode underscored the risk of turning the IMF debt sustainability analysis (DSA) into a formal gateway to large-scale packages in 2002: it made complex, multi-factor calculations that mixed art and science¹⁸⁸ politically salient, and made them conform to binary determinations (lend/not lend, restructure/not restructure). The tendency to shape analysis to lending imperatives was hardly new, but the stakes were higher, and the process more visible with a mandatory, formal policy. The analysis itself grew more rigorous and elaborate; however, its most visible use was in the service of the lending policy. This fed suspicions of analytical bias especially in strategically important cases like Ukraine, or systemically important ones like Greece. It also anchored market expectations about IMF actions, and sent market participants off to construct matrices matching DSA profiles to likely IMF restructuring demands.¹⁸⁹ These efforts to map future IMF actions with precision in a world of uncertainty and discretion were bound to over-interpret, and likely to disappoint.

Having asked Ukraine to restructure its foreign bonds in 2015, the IMF became implicated in two fights: one with Ukraine’s private creditors and another with Russia. If Ukraine complied with economic reform conditionality and engaged with its creditors in good faith, but the creditors refused to restructure, the IMF could “lend into arrears” and back the government’s threat to stop paying.¹⁹⁰ But one of the biggest bondholders was Russia, an IMF member whose sovereign wealth fund had bought an entire \$3 billion Ukrainian bond issue in late 2013 to support Yanukovich.¹⁹¹ The bond was an ordinary tradable obligation governed by English law, albeit paying less than half the market interest rate at the time; it came due at the end of 2015 and represented the biggest debt payment during the IMF program.¹⁹²

In a world of pristinely compartmentalized debt restructuring modules, private bondholders might have been offered a debt exchange, while Russia might have restructured its debt in the Paris Club as part of a grand political bargain. In today’s world, Russia had initially refused to

¹⁸⁷ *Id.* (quoting IMF Deputy Managing Director David A. Lipton).

¹⁸⁸ Julian Schumacher & Beatrice Weder di Mauro, *Debt Sustainability Puzzles: Implications for Greece*, VOX-EU (July 12, 2015), <http://voxeu.org/article/debt-sustainability-puzzles-implications-greece>.

¹⁸⁹ Gregory D. Makoff, *Debt Reprofitting, Debt Restructuring and the Current Situation in Ukraine*, CENTRE FOR INT’L GOVERNANCE INNOVATION (Apr. 2015), https://www.cigionline.org/sites/default/files/cigi_paper_no.63.pdf.

¹⁹⁰ See Press Release, IMF, *IMF Executive Board Discusses reforming the Fund’s Policy on Non-Tolerance of Arrears to Official Credits*, No. 15/555 (Dec. 10, 2015); Reuters, *Ukraine Is On Track to Default on Its Russian Debt*, FORTUNE (Dec. 18, 2015, 12:50 PM), <http://fortune.com/2015/12/18/ukraine-default-russian-debt/>.

¹⁹¹ Laura Mills, *Ukraine Suspends Payment on \$3 Billion Loan from Russia*, WALL STREET J. (Dec. 18, 2015, 10:44 AM), <http://www.wsj.com/articles/ukraine-suspends-payment-on-3-billion-loan-from-russia-1450441229>; see also GELPERN, *supra* note 112, at 4.

¹⁹² Natasha Doff & Marton Eder, *After Default to Putin, What’s Next for Ukraine-Russia Bond Row*, BLOOMBERG (last updated Dec. 21, 2015, 12:19 PM), <http://www.bloomberg.com/news/articles/2015-12-20/after-default-to-putin-what-s-next-for-ukraine-russia-bond-row>; see also GELPERN, *supra* note 112, at 4.

include the \$3 billion Ukrainian bond in its Paris Club accounting—and also refused to participate in a bond exchange alongside private creditors. With any other recalcitrant bondholder, Ukraine could have taken advantage of the IMF’s policy on lending into arrears.¹⁹³ However, this policy did not apply to government creditors, for whom the rule was “non-toleration” of arrears.¹⁹⁴ IMF had tried to align the two policies from the start in 1989, but bilateral creditors who dominated its Executive Board wanted to keep it as their debt enforcer. Russia’s refusal to restructure and Ukraine’s refusal to pay Russia in full threatened to undermine the program.

Backed by the IMF’s threat to lend into arrears, Ukraine launched an exchange offer in September 2015 and convinced most of its private bondholders to settle for approximately twenty percent debt reduction, along with an extension of maturities.¹⁹⁵ Some creditors who held bonds coming due in the near term were able to extract a larger settlement amount when they threatened to use their blocking position in selected bond series and cast their CAC votes to hold out.¹⁹⁶ However, Russia was the bigger problem, since it held 100 percent of its bond issue and refused to participate altogether.¹⁹⁷

In the standoff with Ukraine, Russia had the benefit of a private bond contract, which allowed it to sue Ukraine in English courts or bringing a case against it before an arbitration tribunal. The contract itself had a number of unusual terms that gave bondholders more power over Ukraine than did any of the other Ukrainian Eurobonds. For as long as it held the bond, Russia also could take advantage of the IMF’s non-toleration policy with respect to official arrears. In other words, the bond could be private or official debt, depending on the context and the argument that Russia chose to use on any given day.¹⁹⁸

The IMF’s Executive Board voted to revise the non-toleration policy on December 8, 2015, just before the \$3 billion bond came due.¹⁹⁹ It was widely reported that the policy change was driven

¹⁹³ See IMF, *Reforming the Fund’s Policy on Non-Toleration of Arrears to Official Creditors*, Policy Paper (Dec. 2015) [hereinafter IMF Arrears 2015]; IMF Lending into Arrears 2002, *supra* note 41.

¹⁹⁴ IMF, *Status of Ukraine’s Eurobond held by the Russian Federation* (Dec. 11, 2015), <http://www.imf.org/external/pubs/ft/scr/2015/cr15344.pdf>.

¹⁹⁵ Exchange Offer Memorandum Dated 23 September 2015 as Amended and Restated to Reflect the Changes Set out in the Supplements Dated 5 October and 9 October 2015, Ukraine (2015), http://sites.dfkingltd.com/DocumentDownload.ashx?item=nTeO_K91-UCRn3TCRM74NA.

¹⁹⁶ Natasha Doff & Marton Eder, *Ukraine Bond Deal at Risk Again as Rebel Investors Demand Change*, BLOOMBERG (last updated Sept. 18, 2015, 12:23 PM), <http://www.bloomberg.com/news/articles/2015-09-17/ukraine-dissenting-bondholders-have-blocking-stake-law-firm>; compare with Greek foreign-law bonds in *supra* notes 173-176.

¹⁹⁷ Neil Buckley et al, *Legal Fight Looms over Ukraine’s \$3bn Debt to Russia*, FINANCIAL TIMES (Oct. 15, 2015, 6:57 PM), <https://next.ft.com/content/f7a04f1e-7354-11e5-bdb1-e6e4767162cc>.

¹⁹⁸ Anna Gelpern, *Russia’s Bond: It’s Official! (... and Private ... and Anything Else It Wants to Be ...)*, CREDIT SLIPS (Apr. 17, 2015), <http://www.creditslips.org/creditslips/2015/04/russias-ukraine-bond-its-official-and-private-and-anything-else-it-wants-to-be-.html>.

¹⁹⁹ *IMF Adjusts Its Policy on Arrears to Official Creditors*, IMF Survey (Dec. 10, 2015), <https://www.imf.org/external/np/pp/eng/2015/101515.pdf>.

entirely by Russia's holdings of Ukraine's bonds. As noted earlier, IMF staff had tried to align the policies on official and private creditors back in 1989, and again in the spring of 2013 (six months before Russia bought the Eurobond from Ukraine),²⁰⁰ but faced resistance from official bilateral creditors on its board. The fact that staff finally changed the policy more than a quarter century after the initial attempt speaks above all to the changing architecture of sovereign debt restructuring: the decline of the Paris Club could no longer be ignored.²⁰¹

The revised policy no longer counted on the Paris Club to deliver adequate official debt relief, either directly or through comparability. Going forward, the IMF would only rely on Paris Club restructuring assurances if the Club represented a substantial proportion of the creditors, and would seek assurances from non-members where Paris Club debt was small.²⁰² If non-member governments refused to restructure despite good-faith efforts on the part of the debtor, the IMF could lend into arrears, so long as doing so would not harm the IMF's ability to mobilize government financing in the future. The effect of the policy change is to reverse the presumption from non-toleration to lending into arrears. The proviso on the need to mobilize official funds works as a safety valve; in a future crisis, it would allow the IMF to accommodate big non-Paris Club lenders such as China.²⁰³

The upshot of the change for Ukraine was simple: once the IMF staff determined that Ukraine complied with its reform conditions and had reached out to Russia in good faith, the government could stop paying the Eurobond without fearing for its IMF program disbursements.²⁰⁴ Ukraine promptly defaulted on Russia three weeks later.²⁰⁵ In February 2016, Russia sued Ukraine for

²⁰⁰ *Id.* ("IMF staff first raised concerns about the risks inherent in the institution's policy on non-toleration of arrears to official bilateral creditors back in 1989, when IMF rules with regard to private creditors were amended. These concerns were reiterated in the May 2013 paper, before the Russian loan to Ukraine even existed. On both occasions, staff argued that protections under the policy should not automatically extend to non-contributing creditors and that the policy needed to be reformed to strengthen incentives for collective action among official bilateral creditors."). See IMF 2013 Sovereign Debt Review, *supra* note 180.

²⁰¹ IMF Arrears 2015, *supra* note 193.

²⁰² IMF, *Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors*, Policy Paper (Dec. 2015), <https://www.imf.org/external/np/pp/eng/2015/101515.pdf>.

²⁰³ *Id.*; Curran, *supra* note 83. In July 2016, IMF Managing Director Christine Lagarde shed further light on the IMF's expectations for the treatment of sovereign bonds held by governments. Bonds held "for investment purposes" would not be restructured in the Paris Club—which she characterized as a forum for restructuring "official claims extended for public policy purposes" and entitled to (*de facto*) seniority. *Paris Club 60th Anniversary—Keynote Address by Christine Lagarde, Managing Director, International Monetary Fund* (Jul. 1, 2016) at www.clubdeparis.org.

Apart from the fact that Paris Club debt seniority has been questioned and debated for decades, it is not clear whether the "investment purpose" approach is entirely workable: it can be difficult to disentangle government motives for lending or buying bonds, especially as they can change over time.

²⁰⁴ IMF, *Ukraine: Technical Assistance Report-Reforming the State Fiscal Service*, Country Report No. 16/48 (Feb. 2016), <http://www.imf.org/external/pubs/ft/scr/2016/cr1648.pdf>.

²⁰⁵ *Id.*

full repayment in an English court, claiming among other things that Ukraine did not negotiate in good faith.²⁰⁶

The lawsuit continues at this writing. In Ukraine as in Argentina, national courts sitting in one-off contract disputes are effectively asked to referee a political conflict and a macroeconomic crisis, and, in the case of Ukraine, a military confrontation, all wrapped into one. Bankruptcy courts have much more elaborate toolkits, but are rarely asked to dabble in military conflict resolution. Ukraine's most morally intuitive defense is that it should not have to pay a creditor that invaded it, and that is at least arguably responsible for its dire economic condition. Such arguments can be refashioned into claims of duress and impracticability, grounded in common law contract doctrine—which is just what Ukraine tried to do in its answer to Russia's complaint.²⁰⁷ Ukraine could also argue that the \$3 billion bond was a tainted, illegitimate transaction to prop up a kleptocratic leader friendly to Russia.²⁰⁸ In either case, judges interpreting a garden-variety Eurobond contract must implicitly rule on the legitimacy of Russia's annexation of Crimea and the extent of its military involvement in eastern Ukraine.²⁰⁹ 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.

In the old modular regime, where national courts played a relatively minor role compared to other institutional actors, such as the IMF, the Paris Club, and the London Club—and where governments did not sue each other on bond contracts—the dearth of shared norms might have been a manageable problem. Repeat players could resolve conflicts *ad hoc* in their respective modules, without explicitly invoking big ideas such as equality or good faith. The regime's failure to develop shared norms begins to bite when the informal institutional framework falls apart, and national courts take on a bigger role. In Argentina and Ukraine alike, courts could use guidance on the meaning of equality and good faith in sovereign debt practice, but such guidance is hard to come by because participants in the restructuring process often disagree on the basics.

²⁰⁶ Anna Andrianova & Natasha Doff, *Russia Sues Ukraine in London Court Over \$3 Billion Default*, BLOOMBERG (Feb. 17, 2016), <http://www.bloomberg.com/news/articles/2016-02-17/russia-files-suit-against-ukraine-in-london-over-3-billion-debt>.

²⁰⁷ Defence for Respondent, *Law Debenture Trust Corp., v. Ukraine*, [2016] EWHC FL-2016-000002 (QB) (May 26, 2016); Mark Weidemaier, *Ukraine's Defense: Russian Suit Part of a "Broader Strategy of Aggression,"* CREDIT SLIPS (May 29, 2016), <http://www.creditslips.org/creditslips/2016/05/ukraine-russian-suit-part-of-a-broader-strategy-of-aggression.html#more>.

²⁰⁸ Seema Jayachandran & Michael Kremer, *Odious Debt*, 96 AM. ECON. REV. 82 (2006) (arguing for odious debt as a financial sanctions regime); Tai-Heng Cheng, *Renegotiating the Odious Debt Doctrine*, 70 LAW & CONTEMP. PROBS. 7 (2007). See Lee C. Buchheit, G. Mitu Gulati & Robert B. Thompson *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201 (2007) (arguing for domestic law analogues); but see JEFF KING, *THE DOCTRINE OF ODIUS DEBT IN INTERNATIONAL LAW: A RESTATEMENT* (2016) (arguing that odious debt is a doctrine of public international law); Robert Howse, *The Concept of Odious Debt in Public International Law*, UNCTAD/OSG/DP/2007/4 (July 2007) (surveying practice of state nonpayment of odious debt).

²⁰⁹ W. Mark C. Weidemaier, *Contract Law and Ukraine's \$3 Billion Debt to Russia*, 11 CAP. MKTS. L.J. (Jan. 2016); Gelpern, *Russia's Contract Arbitrage*, *supra* note 113.

IV. Now What?

Sovereign debt restructuring has always been a flawed enterprise. It would be wrong to describe the 1980s and the 1990s as the halcyon days of debt relief and burden-sharing. Restructuring agreements often took years to negotiate and failed to secure a durable exit from debt crises. There were endless iterations of piecemeal relief and painful adjustment. But by the end of the twentieth century, debt crises unfolded in a regime that had its own structure and customs, and exerted a measure of discipline over its constituents within an IMF-centered analytical framework, thanks to cohesion within the restructuring modules and cross-conditionality among them. Modular structure and pragmatic focus made this regime resilient: creditors could come and go, but the overall framework would stay more-or-less as depicted in Figure [1]. Yet it was unintelligible to all but a small core of specialists and often unaccountable to the lending and borrowing public.

Restructurings in Argentina, Greece and Ukraine exposed a regime in disarray. Modules dissolved, cross-conditionality fell by the wayside, and public and private creditors showed little commitment to the old processes, practices, and institutions. Anyone could be a free-rider, and in the high-profile cases, free-riding demonstrably paid off.²¹⁰ The IMF and national courts had to manage the consequences of more coordination failures, although neither was fully equipped for the task. Debt became the focus of escalating street protests and political crises. It was high time for reform.

Reform initiatives poured in from different corners of the sovereign debt universe. The IMF launched a comprehensive review of sovereign debt restructuring in 2013, including proposals to reform its analysis and lending policies.²¹¹ The U.N. General Assembly called for the development of a multilateral sovereign debt restructuring framework in September 2014, and endorsed a set of “Basic Principles” for sovereign debt restructuring a year later.²¹² The resolutions built on a multi-year work program at the U.N. Conference on Trade and Development (UNCTAD), which also produced a restructuring “roadmap” for sovereign debtors.²¹³ ICMA proposed new contract reforms in August 2014, including stock-wide aggregated majority voting adapted from the 2012 Greek Bondholder Law. “Super-aggregated” CACs were a product of ICMA’s collaboration with other industry bodies, large emerging market debtors, and international institutions in an informal working group convened by the U.S. Treasury and the IMF.²¹⁴

²¹⁰ See Part III, *supra* (description of Argentina’s litigation settlement).

²¹¹ IMF 2013 Sovereign Debt Review, *supra* note 180.

²¹² *Supra* note 6.

²¹³ Report of UN Conf. on Trade and Dev., Sovereign Debt Workouts: Going Forward, Roadmap and Guide (Apr. 2015), http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf.

²¹⁴ *Collective Action Clauses*, INT’L CAP. MKT. ASS’N (August 2014), <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/collective-action/>; see also Anna Gelpern, Ben Heller & Brad Setser, *Count*

At least on their face, these initiatives were compatible, even complementary. Nonetheless, old rivalries threatened to block the emergence of a viable alternative to the old regime. The G-7 and a handful of other governments refused to engage in the U.N. debate for fear that it would create an opening for treaty-based bankruptcy and erode the IMF's role in sovereign debt restructuring—which some participants in the U.N. process would surely welcome, but hardly an inevitable or even a likely outcome. For some poor and middle income country governments and civil society groups, treaty-based bankruptcy and formal institutions remain the only acceptable outcome.²¹⁵ For decades, similar arguments have pitted contract against bankruptcy and the IMF against the United Nations. Meanwhile, sovereign debt restructuring remained part-contract, part-treaty, and all-pragmatism.

Reform requires re-imagining the architecture of sovereign debt restructuring as a coherent whole, but one that need not reside in a single formal institution or legal process. For example, debt restructuring at the turn of the century used modules and links among them to approximate elements of comprehensive and collective restructuring in bankruptcy, and to limit free-riding. The modular structure also made it easier to combine elements of treaty, contract, and institutional practice in a single process.²¹⁶ It failed to deliver sustainable outcomes generally accepted as fair by its constituents. A reformed regime should aim for better outcomes and a more accountable process, even as it works to make up for the deterioration of the old coordination mechanisms. I sketch out a series of contractual, statutory, and institutional reforms reflecting these objectives in the remainder of Part IV.

Sustainable and Fair Outcomes

The existing regime tends to approach debt sustainability as a fact, an ascertainable threshold: an economy's debt stock or debt service burden is either stable and payable, or doomed to keep growing in perpetuity unless restructured. As noted earlier, this threshold can be hard to calculate with precision; however, the basic idea is relatively straightforward. It is less commonly discussed, but generally understood, that sustainability is also a political judgment about distribution of resources between debtors and creditors, and among different creditors with claims on the sovereign. A sovereign debtor allocates political capital, reform efforts and budget resources across a range of priorities that might include veterans' pensions, foreign bond payments, domestic bank bailouts, girls' education, and gold statues of military leaders. A government creditor chooses to lend its crisis-stricken neighbor billions of dollars to pay its bonds, or to insist that the neighbor adjust, or restructure. From this perspective, sustainability

the Limbs: Designing Robust Aggregation Clauses in Sovereign Debt Contracts (forthcoming in TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES (Martin Guzman, José Antonio Ocampo & Joseph E. Stiglitz eds., 2016).

²¹⁵ Sixty-ninth General Assembly, 102nd Meeting (PM), Discussion of Draft Resolution on “Basic Principles on Sovereign Debt Restructuring Processes” (document A/69/L.84), September 10, 2015, <http://www.un.org/press/en/2015/ga11676.doc.htm>.

²¹⁶ For example, IMF participation was governed by treaty, banks and bondholders relied on contracts, and Paris Club creditors followed informal but regular practices.

requires political support from the government's domestic constituents and foreign creditors, since it implies distribution on a substantial scale.

IMF staff should not be the sole source of debt sustainability determinations. Because debt sustainability is such a politically sensitive judgment, it is risky to put its entire weight on the IMF, notwithstanding its analytical resources and experience. The crises in Greece and Ukraine illustrate how DSA politics can threaten the IMF's credibility, and cast doubt on its impartiality. Especially since it is no longer prudent to assume that all future restructurings would be anchored in the IMF, it is important to build consensus around debt sustainability methodology, including the range of assumptions that might go into the model, and to harness independent analytical capacity outside the Fund, which could be mobilized in crisis and be accepted by the relevant constituents.

The sustainability determination mechanism can take the form of standing or *ad hoc* expert panels, drawn from agreed lists including market, civil society, and public sector representatives. The panels may consider data and other input from IMF staff, peer governments, market and academic experts. A representative working group under the auspices of the IMF or another multilateral body can develop and periodically review the substantive methodology, and agree on rules for constituting panels. Panel determinations need not be binding. However, debtors and creditors may wish to incorporate them by reference in their contracts and policies, to reduce uncertainty in the event of a crisis.

IMF DSAs can and should continue to play an internal role at the Fund, for example, to assess the risk of a program to the IMF's own resources. This determination is distinct from whether a country should borrow or restructure, and on what terms—and would benefit from being made separately. Put differently, it is plausible for the IMF, the sovereign borrower, and its creditors to reach different conclusions about what is achievable and desirable, taking both politics and economics into account. Each may come to the table with different assessments and different normative priors. IMF staff may well decide that the sovereign's analysis does not add up. In that case, the IMF should not lend. If no other funding is available, the government may default or restructure; it may also continue to engage with the IMF to arrive at a consensus analysis. However, it is also possible that other financing sources would materialize—especially if the IMF increasingly finds itself just one of many creditors.²¹⁷ Abstaining from a program that might strain its analytical credibility should bolster the IMF's position in a more diverse field, and preserve its resources—perhaps even to fight contagion.

Sovereigns should make greater use of contingent contracts with both private and official creditors. A substantial economic literature has advocated debt contracts that link repayment to

²¹⁷ Boughton, *supra* note 95.

macroeconomic factors.²¹⁸ For sovereign borrowers, such contracts might provide for standstills and predetermined relief in a financial crisis; creditors could also get higher payments in good times. Contingent contracts can function as a form of equity capital²¹⁹ or insurance against default, where the creditors may charge in advance for giving up payments when the government is in distress. Contracts with well-designed contingency triggers can reduce the overall risk of sovereign default, benefiting creditors as a group and reducing the cost of borrowing.²²⁰

A distinct advantage of contingent contracts in sovereign debt is that they secure a measure of *ex ante* political buy-in from foreign creditors, who get an equity-like stake in a country's economy that is typically inaccessible to non-residents. At least for private creditors, contract design and price in this case could imply a view of sustainability (when a country needs relief), and an agreement on distribution of losses *ex post* (how much relief). The challenge is to design triggers that minimize incentives for the borrowing government to cheat (for example, by misreporting statistics), and a range of outcomes that would be accepted in a particular set of crisis circumstances that is hard to specify ahead of time.

Contingent sovereign debt contracts with official creditors can either mimic private contracts, or serve a different function altogether. As for the former, it may be politically difficult for a government to pre-commit its taxpayers to finance another government in crisis on a large scale. On the other hand, there is a distinct argument for tying a small portion of any policy-based loan to the achievement of the stated policy goals, or at least to the robustness of assumptions underlying the policy conditions. The role of contingency in this case is to promote accountability on the part of the lending government both to its own population, and to the borrower. In the current regime, the borrower bears the risk of poor policy design and implementation. Taking a lesson from Greece since 2010, contingent debt contracts could make it harder for an official creditor to lend on patently incredible assumptions about the borrower's ability to adjust, while telling its taxpayers that the debt was certain to be repaid. The contingent portion should be small, to minimize perverse incentives for the debtor to abandon reform and get debt relief—and so as not to discourage government-to-government lending altogether. However, even a small amount may be enough to get the attention of the lending government's constituents, and help hold it accountable.

²¹⁸ See, e.g., Martin Brooke et al., *Financial Stability Paper No. 27: Sovereign Default and State-Contingent Debt*, BANK OF ENG. (2013); Olivier Blanchard, Giovanni Dell'Ariccia & Paolo Mauro, *Rethinking Macroeconomic Policy*, IMF Staff Position Note (Feb. 2010); Olivier Blanchard, Paolo Mauro & Julien Acalin, *The Case for Growth-Indexed Bonds in Advanced Economies Today*, VOX CEPR'S POL'Y PORTAL (Feb. 16, 2016), <http://www.voxeu.org/article/case-growth-indexed-bonds>; see also Olivier Blanchard, *Ten Takeaways From the 'Rethinking Macro Policy. Progress or Confusion?'*, VOX CEPR'S POL'Y PORTAL (May 25, 2015), <http://www.voxeu.org/article/rethinking-macro-policy-ten-takeaways>; Olivier Blanchard, Giovanni Dell'Ariccia & Paolo Mauro, *Rethinking Macroeconomic Policy: Getting Granular*, VOX CEPR'S POL'Y PORTAL (May 31, 2013), <http://www.voxeu.org/article/rethinking-macroeconomic-policy-getting-granular>.

²¹⁹ Stephen Park & Tim R. Samples, *Towards Sovereign Equity*, STANFORD J. OF L. BUS. & FIN. (forthcoming 2016)

²²⁰ *Supra* note 218.

Although academics heavily favor contingent contracts, they have been rare in practice. Countries have issued debt indexed to their export commodities, as well as debt with value recovery features, issued as part of a debt restructuring.²²¹ On the other hand, sovereign debt contracts that reduce payments in response to negative macroeconomic shocks are hard to come by. In light of the strong theoretical case in favor, further research into the causes of market resistance is in order. In the meantime, policy measures to encourage contingent contracts can include exempting them from the IMF's lending into arrears policy and, where relevant, from Paris Club comparability requirements, provided they deliver relief broadly in line with the program.²²²

Sovereigns and their creditors should invest in developing shared norms for the debt restructuring regime. The demise of modules and cross-conditionality revealed a normative gap at the heart of the sovereign debt restructuring regime. Creditors in their respective modules might have shared views on what constituted equitable treatment and good faith engagement in restructuring negotiations; however, there was no such consensus for the regime as a whole. As the modules weakened, this has led to dramatically disparate recoveries by creditors holding similar claims in Argentina, but also in Greece, and Ukraine. To the extent the relationships among modules reflected an implicit priority structure in sovereign debt, it was unraveling.²²³ The rise of sovereign debt contract lawsuits in national courts exacerbated the problem: by mandate, courts pursue piecemeal resolution of contract disputes, not comprehensive resolution of financial crises. It is an inhospitable setting for the development of shared norms.

The Basic Principles for sovereign debt restructuring endorsed by the General Assembly are well-placed to fill the gap in the old regime, and to guide judicial discretion in sovereign debt lawsuits. In particular, Principles 5 and 8, along with the emphasis on majority restructuring in Principle 9, reflect substantial international consensus on equity and sustainability in restructuring. They begin to elaborate broadly-held values that should be uncontroversial, such as good faith and majority voting, inclusiveness, transparency and sustainability. They also include more specific guidance, for example, reiterating the imperative to construe exceptions to sovereign immunity narrowly. Over time, these principles can contribute to a richer understanding of equal treatment for similarly situated claims on the sovereign, and help develop a generally accepted priority structure, which could be incorporated in contracts or gradually become custom, binding on the courts. Together, these principles can help infuse the reformed restructuring regime with shared normative content—which the courts should find compelling,

²²¹ Argentina, Greece, and Ukraine each has issued GDP-indexed bonds in a debt restructuring.

²²² The relevant policies would have to specify a range of acceptable relief parameters to discourage creditors from granting nominal concessions in advance in exchange for an exemption from restructuring. On the other hand, it would probably make sense to make the range generous enough to encourage creditors to opt into the contingent relief scheme ahead of time.

²²³ Compare criticisms of the missing priority structure in sovereign debt in Bolton & Skeel, *supra* note 43; Anna Gelpern, *Building a Better Seating Chart for Sovereign Restructurings*, 53 EMORY L.J. 1119 (2004); Jeromin Zettelmeyer, *The Case for an Explicit Seniority Structure in Sovereign Debt* (Int'l Monetary Fund, Research Dep't, Working Paper, Sept. 29, 2003).

potentially even binding—but only if stakeholders (governments and their creditors, public and private), use and invoke them.

With its universal membership, the U.N. General Assembly is a familiar source of broad international legal norms, just as it would be a suboptimal source of design particulars for a sovereign bankruptcy treaty. Governments that voted against or abstained from voting on the resolution may benefit from more active engagement, and encouraging UNGA to focus on norm elaboration over operational design.

Comprehensive, Collective Process

The decline of modules and cross-conditionality has the biggest impact on creditor coordination. As noted earlier, it has opened new free-riding opportunities for public and private creditors alike, and has introduced more arbitrariness in enforcement against debtors—best illustrated by the court-imposed global boycott of Argentina for the benefit of a few holdout creditors. A new approach to inter-creditor discipline and enforcement is in order.

Financial industry groups should work with sovereign borrowers to advance contract reform and more robust standardization. There is already broad consensus in favor of ICMA proposals for robust stock-wide aggregated CACs, and for changing *pari passu* clauses in sovereign bonds so that they could not be used to impose drastic remedies of the sort seen in Argentina. The IMF, the G-20, and the U.N. General Assembly, in Principle 9 of the Basic Principles, have all endorsed these contract reforms, which can go a long way to eliminating free-riders. While new clauses have been incorporated in more than half of the new foreign-law bonds issued since the ICMA proposal, a number of sovereigns have expressed reservations about changing their contracts. New issues with enhanced contracts also represent a tiny fraction of the more than \$900 billion in foreign bonds outstanding, and nearly a third of the total do not mature for more than ten years.²²⁴ Approximately 60 percent of all new issues in the year following ICMA's recommendations used the new clauses.²²⁵ Moreover, sovereign debt contracts have never been entirely standardized. Idiosyncratic variations in both old and enhanced contracts raise the risk of interpretation error, which could undermine the goals of contract reform.²²⁶

While debtors and creditors should have the ability to negotiate non-standard contract terms, inadvertent idiosyncratic variation presents a risk to the system. The risk is higher if judges follow in the steps of recent U.S. federal court decisions against Argentina, and impose injunctions targeting third parties in an effort to influence immune sovereign debtors. ICMA and

²²⁴ *Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts*, 8-9 IMF, September 2015, <http://www.imf.org/external/np/pp/eng/2015/091715.pdf>.

²²⁵ *Id.*

²²⁶ GULATI & SCOTT, *supra* note 24 (agency problems in contract drafting, including inadvertent variation). Three of the earliest adopters of ICMA's model *pari passu* clause each introduced slight variations in the text. Anna Gelper, *ICMA CACs, New York Edition - Vietnam! - and More Un-Boilerplate*, CreditSlips, Nov. 18, 2014, <http://www.creditslips.org/creditslips/2014/11/icma-cacs-new-york-edition-vietnam-and-more-un-boilerplate.html>.

other industry groups, perhaps with support from the official sector, should explore the scope for further standardization. For example, instead of issuing a handbook of model terms that are adopted piecemeal, ICMA could follow the derivatives industry example, and publish contracts for wholesale adoption, with non-standard variations contained in side documents. Since the 1980s, the International Swaps and Derivatives Association (ISDA) has published a growing suite of such agreements, which govern relationships among participants in derivatives markets.²²⁷ In addition to creating a strong standard default option for contract design, where parties must make an effort to depart from ISDA texts, the derivatives industry approach makes it easier to deal with the outstanding debt stock. Instead of amending every contract separately, market participants can simply accede to a “protocol” issued by ISDA, which has the effect of incorporating the amendment contained in the protocol across their entire suite of ISDA documents.

An alternative approach to encouraging contract reform and standardization is to appeal to payment and clearing utilities, which have been repeatedly targeted in holdout litigation, including against Argentina. Systemically important payment and clearing institutions such as DTCC and Euroclear remain vulnerable to court injunctions from individual enforcement. They can protect themselves, for example, by charging more to clear bonds for sovereigns that do not use robust aggregated CACs or ICMA-style *pari passu* clauses. This would encourage sovereigns to turn over their debt stock more quickly by imposing transaction costs for failure to reform.

Private and official creditors should invest in developing inter-creditor norms and best practices to promote inter-creditor coordination. In addition to improving contracts, industry groups should consider non-contractual reforms to promote inter-creditor coordination. In particular, they could develop best practices for the appointment and operation of creditor committees, in cooperation with sovereign debt issuers and their advisers. A “best practices” document would add more value than contract clauses providing for creditor committees, which have been controversial,²²⁸ because it could address a broad range of contingencies, and evolve over time to address specific problems that come up in restructurings. Such a document also could serve as evidence of trade usage in the event of a court dispute involving committee operation.

Other norms and practices in need of elaboration concern bond trustees. In bonds issued under a trust indenture rather than fiscal agency agreement, the enforcement power rests with the trustee for the benefit of all bondholders. Individual bondholders cannot sue unless the trustee fails to do so after being offered adequate indemnification. As a result, sovereign bond trustees have worked well as barriers to lawsuits, but they have generally failed to facilitate engagement between the debtor and its creditors. Sovereign bond trustees have a long history of passivity that

²²⁷ Gelpern & Gulati, *supra* note 113.

²²⁸ See *supra* note 78 and the accompanying text.

have prompted creditor complaints and official reform initiatives since the 1930s.²²⁹ Investing trustees with more power and responsibility may contribute over time to the transformation of their role in sovereign debt and make them more expensive. In most cases, such insurance against individual enforcement would benefit the debtor and creditors as a group.

The breakdown of modules, where similarly-situated creditors held similar legal claims, the rise of new creditors and forms of financing that mix trade, investment, and finance, elevates the importance of consistent accounting and reporting. If recent liberalization trends continue, it will get harder and harder to categorize a debt instrument as official, private, domestic, or external. Private financial industry groups, official creditors, including the IMF and the Paris Club, but also the International Forum of Sovereign Wealth Funds,²³⁰ would benefit from comparing notes on their respective accounting conventions and reporting requirements. Unless these and other groups cooperate in this apparently mundane task, more creditors would try to replicate Russia's strategy in Ukraine, characterizing the same debt in multiple ways in order to free-ride.

Because official and private creditors are now more likely to hold identical contract claims on a sovereign—as in the case of Russia's Ukrainian Eurobond and central bank holdings of Greek government debt—both sets of creditors should invest in developing a shared understanding of how such claims would be treated in a restructuring. The experience in Greece and Ukraine suggest that creditors with fundamentally different incentives should be discouraged from participating side by side in the same bond restructuring vote. To that end, all bonds held by official creditors should either be disenfranchised, or at a minimum segregated in a their own voting pool.²³¹

Market utilities should be insulated from free-riding by creditors, and should be off limits to debtors in extreme cases of abuse. Global injunctions against Argentina have put market utilities at the center of sovereign debt enforcement, and at risk of disruption by holdout lawsuits. Treaties, regulatory norms, and national legislation should shield payment and clearing systems

²²⁹ League of Nations Report of the Committee for the Study of International Loan Contracts, Geneva 1939, at 15-20; EDWIN BORCHARD, STATE INSOLVENCY AND FOREIGN BONDHOLDERS 42-63 (1951).

²³⁰ The International Forum of Sovereign Wealth Funds is a self-governing for sovereign wealth funds. <http://www.ifswf.org/>

²³¹ In contrast, the ECB has publicly committed to vote against debt restructuring in the event CACs are invoked in any of the sovereign bonds in its portfolio, citing a treaty prohibition against financing euro area member governments. To ensure that it does not inadvertently block a restructuring, the ECB has also committed not to buy blocking positions in bond issues. However, by pre-committing to vote with the holdouts, the ECB reduces the cost holding out—they blocking stake they would have to buy is reduced by the amount of ECB holdings. Claire Jones, *Q&A: The ECJ Decision and QE*, The World Blog, The Financial Times, Jan. 14, 2015, <http://blogs.ft.com/the-world/2015/01/qa-the-ecj-decision-and-qe/>.

As an alternative to separate classification or disenfranchisement, official creditors could also commit not to trade their debt, and not to enforce it in national courts. However, such a commitment may be politically hard for official creditors to make, and hard to enforce.

from being commandeered for the benefit of individual creditors or groups of creditors.²³² Regulatory coordination fora such as the Financial Stability Board (FSB) or the Committee on Financial Market Infrastructures can put forward standards for immunizing financial market infrastructure from disruption for private debt enforcement.²³³ Such standards would address the risk of destabilizing systemically important market infrastructure for the sake of the free-rider, at the expense of creditors as a group and third parties.

However, in truly exceptional cases where a sovereign has engaged in abusive behavior or has defrauded creditors as a group, then treaty, legislative, or regulatory sanctions could put market infrastructure off limits to it—as they are off limits to illicit payment flows. Determinations of fraud and bad faith could be made by national courts or international bodies, provided, however, that they are made for the benefit of the entire body of creditors, not individual free-riders.

An Accountable Process

Sovereign debt restructuring experience must be accessible and intelligible to the public. This is entirely consistent with the principles of transparency and legitimacy endorsed by the U.N. General Assembly (Principles 3 and 7) and should be simple to implement in practice. Of all the proposals in this Part IV, this is the easiest to implement and most likely to have a significant long-term impact.²³⁴ It is also the least glamorous.

Any international organization, trade or civil society group can host a comprehensive, searchable public database of past restructurings, including financial and legal terms, the treatment of public, private, domestic and foreign claims, and any underlying assumptions—made available as soon as practicable after the agreement is finalized. The sovereign borrower should be responsible for supplying required information in standardized form within a prescribed period after a restructuring transaction is completed. At least basic summary terms should be available in English and in the language of the borrowing country. The information delivery requirement can be incorporated in standard form in debt contracts, as well as IMF and other institutional lending policies. Failure to deliver information to the repository within a reasonable period without a compelling justification could give rise to sanctions, including claw backs of restructuring concessions in extreme cases, such as fraud.

Beyond *ex post* public disclosure of restructuring experience, borrowing governments should, as a rule, disclose in advance to their creditors the restructuring terms applicable to all of their external and domestic creditors. Such disclosure would contribute to process transparency, consistent with Basic Principle 3 of the UNGA Resolution, and help identify and promote equity

²³² I have made this argument in more detail elsewhere, including in Gelpern, *Sovereign Damage Control*, *supra* note 7 and REVISITING SOVEREIGN BANKRUPTCY, *supra* note 2.

²³³ See Skylar Brooks & Domenico Lombardi, *Governing Sovereign Debt Restructuring through Regulatory Standards*, 6 J. of Globaliz'n & Dev. 287 (2015) (discussing a potential role for the FSB in sovereign debt restructuring).

²³⁴ This proposal is already part of the UNCTAD Roadmap, *supra* note 213.

among the relevant stakeholders. Standard disclosure requirements can be included in loan and bond contracts, as well as institutional policies, to promote uniformity and facilitate compliance. Sovereign compliance with disclosure requirements should form part of the IMF's good faith determination in its policy on lending into arrears.

Conclusion

Sovereign debt crises are, by definition, systemic financial and political crises in the borrowing country. They could never be orderly or predictable in the strict sense. Sovereign debt restructurings in the late 20th and early 21st centuries have had a remarkable track record of operational success and substantive failure. Deals got done, but few debtors got timely and durable relief. The informal, modular regime with the IMF at the center, which has dominated sovereign debt restructuring since the 1980s, is now under stress as a result of changing patterns of international capital flows, the rise of new creditors, and old stakeholder disinvestment. Government, market, and civil society groups have put forward a slew of reform proposals.

Reforms must address both the perennial flaws of the old regime, and the gaps left by its demise. They should strive to achieve sustainable and fair distribution, a comprehensive and collective restructuring framework, and an intelligible, accountable process. The success of any new regime will depend in important part on its stakeholders' ability to develop shared norms, perhaps starting from the Basic Principles endorsed by the U.N. General Assembly in September 2015. The IMF likely will continue to anchor sovereign debt restructurings, but its role cannot be taken for granted given the size of its resources relative to global capital flows, and uncertainty about future response to contagion.

For the foreseeable future, sovereign debt restructurings will happen in hybrid institutional arrangements, with some of the old restructuring modules potentially gaining a new lease on life, and others withering away. The regime will continue as part-statute, part-contract, guided by a mix of rules, principles, and constrained discretion. The challenge is to make the pieces add up to a reasonably coherent whole that meets the needs of its constituents—pensioners with their life savings in government bonds and workers whose taxes repay them—and convinces them to embrace its outcomes.

This essay has sketched out several incremental steps to advance this goal. Among other things, I advocate creating independent capacity for debt sustainability analysis with input from and alongside the IMF, for much greater contract standardization on the derivatives industry model, for deep coordination among public and private creditor groups to discourage free-riders, for shielding market infrastructure from enforcement for the benefit of individual creditors, and, most immediately, for standardized and publicly accessible disclosure of restructuring experience. I also argue for elaborating a common set of norms to guide national court decisions, including a richer view of equity and priority, so that judges are more likely to rule for the

benefit of a broader set of stakeholders in sovereign debt restructuring, rather than an enterprising set of plaintiffs free-riding on the rest. Taken together, these proposals describe elements of a debt restructuring regime in response to particular concerns expressed by debtors and creditors, reflecting changes in international finance and politics over the past two decades, to serve as a platform to elaborate common values.