

Steven L. Schwarcz*

Sovereign Debt Restructuring: A Model-Law Approach

DOI 10.1515/jgd-2015-0031

Abstract: Unlike individuals and corporations, countries indebted beyond their ability to pay cannot use bankruptcy laws to restructure unsustainable debt. The United Nations and the International Monetary Fund have attempted to propose treaties to enable that debt restructuring, but the political difficulties of reaching a worldwide consensus have stymied their efforts. This article argues that a model-law approach to restructuring unsustainable sovereign debt should be feasible and effective because the vast majority of sovereign debt contracts are governed by the laws of either the debtor-state or two other jurisdictions. Those jurisdictions individually could enact a model law to give struggling nations a real prospect of equitably restructuring their debt to sustainable levels. By enabling such debt restructuring, that enactment would also help to foster the norms required to facilitate the development of international treaties.

1 Introduction

Recent court decisions in the UK regarding the illegality of exit consents¹ and in the US regarding *pari passu* clauses in Argentine sovereign debt,² as well as

¹ The Chancery Division of the English High Court held, in the *Anglo Irish* case *Assénagon Asset Management S.A. v. Irish Bank Resolution Corporation Limited* (formerly Anglo Irish Bank Corporation Limited) [2012] EWHC 2090 (Ch), that exit consents are illegal, casting doubt on the effectiveness of exit consents to restructure debt under English law. See, e.g. Patrick S. Kenadjian, *The Aggregation Clause in Euro Area Government Securities*, in *Collective Action Clauses and the Restructuring of Sovereign Debt* 143 (Patrick S. Kenadjian, Klaus-Albert Bauer and Andreas Cahn, eds. 2013) (observing that the judge in the *Anglo Irish* case “held that it was not lawful for the majority to aid in the coercion of a minority by voting for a resolution which expropriates the majority’s rights for nominal consideration[,] thus cast[ing] doubt on the legality under English law of any form of exit consent that imposes less favorable conditions on those who refuse to participate in the associated exchange offer.”). Although exit consents have been severely criticized in the US, they have survived judicial challenges made by minority bondholders. See *Katz v. Oak Indus. Inc.*, 508 A.2d 873 (Del. Ch. 1986).

² *NML Capital, Ltd. v. Republic of Argentina*, No. 08–CV–6978 TPG, 2012 WL 5895786 (S.D.N.Y. Nov. 21, 2012) (holding that the *pari passu* clause in Argentina’s defaulted bonds contract

*Corresponding author: Steven L. Schwarcz, The Stanley A. Star Professor of Law and Business, Duke University School of Law, P.O. Box 90360, Durham, NC 27708-0360, USA, e-mail: schwarcz@law.duke.edu; and The Centre for International Governance Innovation (CIGI), Waterloo, Canada

the ongoing Greek debt crisis, have dramatically highlighted the risks of an inadequate legal resolution framework for restructuring unsustainable sovereign debt.³ Even those who are not adherents of sovereign “bankruptcy” believe that the status quo contractual approach is “deeply dysfunctional and produces bad law.”⁴ Unresolved sovereign debt problems are hurting individual debtor nations and their citizens, as well as their creditors.⁵ A sovereign debt default can also pose a serious systemic threat to the international financial system.⁶ Few dissent from these views.⁷

The main impediment is that the existing “contractual” approach to sovereign debt restructuring – the use of so-called collective actions clauses (“CAC”)s –

“prohibits Argentina, as bond issuer, from formally subordinating the bonds by issuing superior debt” and “prohibits Argentina, as bond payor, from paying [restructured] bonds without paying on the [holdout] Bonds”). Thus Argentina must pay all outstanding sums on its defaulted bonds simultaneously if it makes any payment on its restructured bonds. That decision was affirmed in its entirety by *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230 (2d Cir. 2013), cert. denied in *Republic of Argentina v. NML Capital, Ltd.*, 134 S. Ct. 2819 (2014).

3 For an analysis of what constitutes “unsustainable” sovereign debt, see text accompanying notes 90–93, *infra*. This article refers to a nation obligated to repay that debt as a “debtor-state.”

4 Anna Gelpern, *A Skeptic’s Case for Sovereign Bankruptcy*, in *A Debt Restructuring Mechanism for Sovereigns: Do We Need a Legal Procedure?* 262 (Christoph Paulus, ed. 2014).

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

6 See, e.g. Jay L. Westbrook, *Sovereign Debt and Exclusions from Insolvency Proceedings*, in *A Debt Restructuring Mechanism for Sovereigns: Do We Need a Legal Procedure?*, at 251 (Christoph Paulus, ed. 2014). Cf. e-mail from Eva Hüpkes, Adviser on Regulatory Policy and Cooperation at the Financial Stability Board (FSB), to the author (July 14, 2015) (observing that “doubts about the ability of states to provide additional resources can make financial institutions more fragile, in particular where there are no regimes in place that provide authorities with powers and tools to resolve financial firms without use of public funds”).

7 One prominent dissenter is Hung Tran, the executive managing director of the Institute of International Finance (IIF). Tran argues that all of the ad hoc bond restructurings since the first bond exchange of modern times (Mongolia 1997) have worked reasonably well, with the exception of Argentina in the 2000s. Hung Tran, Presentation at the Peterson Institute for International Economics (April 8, 2014), available at http://www.iie.com/events/event_detail.cfm?EventID=318. He admits that the existing market-based approach is not perfect. However, he contends that breaking contracts should not be easy to do and that making sovereign debt restructuring less costly will inadvertently increase moral hazard by motivating nations to engage in riskier borrowing; and that, in turn, would eventually lead to more defaults – which would increase the cost of sovereign debt and make the development of emerging markets more challenging. *Ibid*.

is insufficient to solve the holdout problem.⁸ CACs are clauses in debt contracts that enable a specified supermajority, such as two-thirds or three-quarters, of the contracting parties to amend the principal amount, interest rate, maturities, and other critical repayment terms.⁹ The holdout problem is a type of collective action problem in which certain creditors, such as vulture funds, refuse to agree to a reasonable debt restructuring plan that proposes to change critical terms, hoping to receive more than their fair share of a settlement.¹⁰

For several reasons, CACs are insufficient to solve the holdout problem. Notwithstanding decades of efforts to include such clauses in sovereign debt contracts, many contracts lack them, requiring unanimity to change critical repayment terms – and thus enabling any party to the contract to act as a holdout.¹¹ Even in sovereign debt contracts that include CACs, the supermajority requirement may be so high (e.g. three-quarters) that vulture funds are able to purchase vote-blocking positions that enable them to act as holdouts.¹² Finally, a CAC ordinarily binds only the parties to the particular contract that includes it. The parties to any given sovereign debt contract therefore could act as holdouts in

8 Westbrook, *supra* note 6, at 255. For a discussion of the variety of issues that cannot be solved by CACs, see Guzman, Martin and Joseph Stiglitz (2015) “Creating a Framework for Sovereign Debt Restructuring that Works.” In: *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises*, Chapter 1. New York: Columbia University Press (forthcoming).

9 Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 Cornell Law Review 956, 960 (2000), also available at http://scholarship.law.duke.edu/faculty_scholarship/508/ (hereinafter “*Sovereign Debt Restructuring*”).

10 *Ibid.* Economists regard this as a form of “rent-seeking” behavior. Kenneth M. Kletzer, *Sovereign Bond Restructuring: Collective Action Clauses and Official Crisis Intervention*, IMF Working Paper, at 4 (2003).

11 Steven L. Schwarcz, *Sovereign Debt: The Statutory Solution*, International Financial Law Review (Dec. 2014b); also available at <http://www.iflr.com/Article/3405641/Sovereign-debts-statutory-solution.html>. Cf. Text accompanying note 98, *infra* (observing that even after years of trying to include CACs, relatively few Greek debt agreements actually contained such clauses).

12 See, e.g. John A. E. Pottow, *Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign Debt Restructurings*, Law & Economics Working Papers 81 (2013), available at http://repository.law.umich.edu/law_econ_current/81 (vulture funds “may easily be able to marshal blocking positions, especially when a sovereign has issued multiple rounds of debt”). Cf. John Muse-Fisher, *Starving the Vultures: NML Capital v. Republic of Argentina and Solutions to the Problem of Distressed-Debt Funds*, 102. Cal. L. Rev. 1671, 1707 (2014) (illustrating how holdouts can “bid up the price of defaulted bonds in order to achieve a blocking position”); Molly Ryan, *Sovereign Bankruptcy: Why Now and Why Not in the IMF*, 82. Fordham L. Rev. 2473, 2502 (2014) (stating that “Greek bonds governed by UK law restructured in 2012 contained a CAC, but holdout investors successfully purchased blocking minorities in individual bond series that could not be offset by pro-restructuring majorities”).

a debt restructuring plan that requires all of a debtor-state's debt issues to agree to the plan.¹³

To attempt to address that final reason for CAC insufficiency, the International Capital Market Association (“ICMA”) in August 2014 proposed revised and updated forms of CACs, which would aggregate voting across debt issues.¹⁴ These forms of aggregate-voting CACs will have the same limitations as other CACs, most notably binding only creditors who are parties to agreements that include them.¹⁵ Even if all new sovereign debt contracts were to include aggregate-voting CACs, it will be many years before existing debt contracts, which do not include them, are paid off.¹⁶

CACs therefore been a step forward in some ways, but they are not a substitute for pursuing a more systematic legal resolution framework¹⁷ for helping debtor-states to restructure unsustainable debt.¹⁸ Such a framework would reduce

13 *Sovereign Debt Restructuring*, *supra* note 9, at 960.

14 ICMA has also proposed a new form of standard *pari passu* clause for sovereign debt securities, responding to concerns that existing *pari passu* clauses are undermining Argentina's debt-restructuring efforts. See *supra* note 2 and accompanying text. I later examine that proposed clause and show why this article's proposed Model Law would solve the problem. See Section 5.2, *infra*.

15 Cf. Stiglitz et al., *supra* note 5, at 2 (observing that ICMA's CAC aggregate-voting clauses “are improvements over the old terms, but are not sufficient to solve a variety of problems faced in sovereign debt restructurings”).

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

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

18 This article focuses on legal resolution frameworks to help debtor-states *restructure* unsustainable sovereign debt. It does not focus on *ex ante* approaches to help nations avoid incurring unsustainable debt, such as imposing borrowing restrictions on nations. Some have argued that any statutory approach to sovereign debt restructuring should consider *ex ante* approaches. See, e.g. Richard Gitlin and Brett House, A Blueprint for a Sovereign Debt Forum (CIGI Paper No. 27, at 10) (March 12, 2014), available at <http://www.cigionline.org/publications/blueprint-sovereign-debt-forum>. Gitlin and House argue that the IMF should effectively impose borrowing limits by increasing its oversight of sovereign borrowing and restricting exceptional access to its resources. *Ibid.* at 19. Other possible *ex ante* approaches might include the issuance of sovereign GDP (gross domestic product) bonds under which the payment would be a function of the debtor-state's GDP, which has been proposed by the Bank of Canada and the Bank of England. (A leading bankruptcy lawyer, Donald Bernstein, observed at the March 27, 2015 Imperial College conference, however, that such an approach might be “unworkable” because sovereigns are not subject to GAAP and their GDP is not transparent.) Viable *ex ante* approaches would, of course, complement legal-resolution-framework approaches for solving the problem of unsustainable sovereign debt.

the social costs of sovereign debt crises.¹⁹ It would also reduce the need for sovereign debt bailouts, which are costly and create moral hazard, and would reduce creditor uncertainty. Furthermore, it would reduce the risk of systemic contagion from a debtor-state's default. This article argues that a model-law approach to achieving that resolution framework should be legally, politically, and economically feasible.

Section 2 of the article explains the concept of a model law and its utility in cross-jurisdictional lawmaking. It also distinguishes model laws from conventions (or treaties), the other basic form of statutory approach to cross-jurisdictional lawmaking.

Section 3 of the article discusses the history of statutory approaches to sovereign debt restructuring. It also describes current initiatives that follow a statutory approach, explaining why they are unlikely to be feasible at this time. Finally, it explains why a model-law approach to sovereign debt restructuring should be more feasible than those initiatives. Notably, a model-law approach would not require general acceptance for its implementation. Because most sovereign debt contracts (if not governed by the debtor-state's law) are governed by New York or English law, it would be sufficient if England and New York State – and it would be valuable if merely one of those jurisdictions – enact a model law.

Section 4 of the article analyzes how a sovereign debt restructuring model law should be structured. To that end, it proposes a form of a model law and discusses its provisions. The discussion explains, among other things, what a model law should cover, what it should not cover, and why.

Section 5 assesses the legal feasibility of a model-law approach to sovereign debt restructuring. Because the article implicitly addresses legal feasibility throughout, this Section focuses on two critical questions of first impression. Because a model law would have to operate retroactively in order to bind a debtor-state's numerous existing creditors, this Section first analyzes the validity of such retroactivity. Thereafter, this Section analyzes the ability of a model law to overcome the veto power of *pari passu* clauses, which have stymied the effectiveness of existing sovereign debt restructurings efforts.²⁰

Finally, Section 6 shows that a model-law approach to sovereign debt restructuring should be economically and political feasible, as well as more feasible than alternative statutory approaches. Unlike a convention, for example, a model-law approach would not require general acceptance for its implementation. A model-law approach should also have cost advantages over the status quo, both to debtor-states and to their creditors.

¹⁹ Westbrook, *supra* note 6.

²⁰ See *supra* note 2 and accompanying text.

2 Model Law or Convention?

There are two basic forms of statutory approaches to cross-jurisdictional lawmaking²¹ – a model law, and a convention (or treaty). A model law is suggested legislation for national (and sometimes subnational²²) governments to consider enacting as domestic law in their jurisdictions.²³ Each government enacting a model law should therefore take the steps necessary to make the law effective in its jurisdiction.

To facilitate cross-jurisdictional (sometimes called cross-border) legal comparability, each government enacting a model law should, ideally, enact the same legislative text. For that reason, model laws are sometimes called uniform laws. The UNCITRAL Model Law on International Commercial Arbitration²⁴ exemplifies in an international context, and the Uniform Commercial Code (UCC) in the US exemplifies in a subnational context, model laws that have been uniformly enacted.

A convention is an agreement or compact among nations and is synonymous with a treaty.²⁵ Under a convention, each member state would be bound to adhere to the convention's requirements without requiring further action by its legislative body.

The most obvious advantage of a convention over a model law is that conventions are binding upon contracting states and may only be modified or denounced by a treaty amendment.²⁶ In contrast, model laws may be amended or denounced unilaterally by a nation without violating international law.²⁷ This more binding

²¹ By cross-jurisdictional lawmaking, I mean lawmaking that is intended to apply in two or more jurisdictions, whether or not those jurisdictions are countries or subnational jurisdictions.

²² Cf. *infra* note 69 and accompanying text (discussing the enactment of a model law as New York law).

²³ UNCITRAL, *supra* note 25.

²⁴ See *infra* note 32 and accompanying text.

²⁵ See Black's Law Dictionary 164 (4th pocket ed. 2011) (defining convention as “[a]n agreement or compact, especially one among nations; a multilateral treaty”). See also FAQ – UNCITRAL Texts, United Nations Commission on International Trade Law, available at http://www.uncitral.org/uncitral/en/uncitral_texts_faq.html (last visited March 12, 2015) (defining a convention as “an instrument that is binding under international law on States and other entities with treaty-making capacity that choose to become a party to that instrument”).

²⁶ See, e.g. George A. Bermann, *Integration Through Law: Europe and the American Federal Experience* 153 (1985) (discussing the preference of European countries for conventions as opposed to model laws) (hereinafter “Integration Through Law”).

²⁷ *Ibid.* Cf. Charles W. Mooney, Jr., *Extraterritorial Impact of Choice-of-Law Rules for Non-United States Debtors Under Revised U.C.C. Article 9 and a New Proposal for International Harmonization, in Cross-Border Security and Insolvency* 202 (eds. Michael Bridge and Robert Stevens) (2001) (arguing that the all-or-nothing nature of a convention is superior to a model law because a model law may be materially distorted by an enacting jurisdiction).

feature provides parties greater certainty that treaty-bound nations will follow through on their commitments, and not renege as political winds shift.²⁸

Nations sometimes see that greater certainty as a disadvantage, especially if they are experimenting with new proposals.²⁹ Experimentation requires flexibility, so the more relaxed nature of a model-law approach may then be more appealing.³⁰ For this reason, and also because the less formal process of developing and enacting a model law can promote open communication, a model-law approach can sometimes be more productive than a more formal treaty approach.³¹ Indeed, adoption of the UNCITRAL Model Law on International Commercial Arbitration, an area of law that had for many years struggled to realize reform, may have been successful, in part, due to its less formal structure as a model law.³²

3 Statutory Precedents

This Section begins by examining the history of statutory approaches to sovereign debt restructuring. Thereafter, it describes the current initiatives that follow a statutory approach and explains why a model-law approach should be more feasible than those initiatives.

3.1 History

The earliest discussion of a statutory approach to sovereign debt restructuring appears to have taken place at the 1933 Pan American Conference in Montevideo.³³

²⁸ Integration Through Law, *supra* note 26, at 153.

²⁹ *Ibid.* at 154.

³⁰ See *Ibid.* See also John A. E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy*, 45 Va. J. Int'l L. 936, 984–986 (2005) (hereinafter “*Procedural Incrementalism*”) (discussing possible explanations for the recent success of model laws).

³¹ Integration Through Law, *supra* note 26, at 154.

³² Jay L. Westbrook, *Creating International Insolvency Law*, 70 Am. Bankr. L.J. 563, 570–571 (1996) (noting that it was structured as a model law because “a treaty would be a greater accomplishment, but much more difficult”); *Procedural Incrementalism*, *supra* note 30 (suggesting that the model law structure is a possible explanation for the sudden and surprising reform in the area of multinational bankruptcy).

³³ See Eric Helleiner, *The Mystery of the Missing Sovereign Debt Restructuring Mechanism*, 27 Contributions to Political Economy 91, 92 (2008).

Such an approach was also proposed, in 1942, in the initial US draft for the charter of the International Monetary Fund (“IMF”).³⁴ That draft prohibited IMF member nations from defaulting “without the approval of the Fund.”³⁵ It also empowered the IMF to engage in “compulsory arbitration” of sovereign debt settlements.³⁶ The rationale for this strong IMF control was that “objective decisions on defaults [cannot] be made by the defaulting country or by the country gaining most by continued servicing of a debt.... Consideration of the pros and cons of a contemplated default by the fund would seem to promise” objectivity because the IMF represents the interests of a wide range of member nations.³⁷

The first recent call for a statutory approach to sovereign debt restructuring came from Jeffrey Sachs, then an economist at Harvard (and now at Columbia). In an unpublished paper, he argued that although almost all sovereign debt restructuring involves the IMF, there is a “*lack of standards vis-à-vis*” the IMF’s role as an international lender of last resort.³⁸ As a result, “[t]he structure of IMF-led debt restructurings has been woefully inadequate,” especially when compared to corporate bankruptcy debt restructurings.³⁹

I and others then followed Jeffrey’s challenge. In 2000, for example, I published the first comprehensive analysis of what such a statutory mechanism should look like.⁴⁰ I attempted to offer a legal theory of sovereign debt restructuring by examining how the conceptual basis of bankruptcy reorganization law could be adapted to sovereign debt restructuring.⁴¹ I began that analysis by analyzing which axioms should apply to sovereign debt restructuring.⁴² I then applied those axioms to derive a normative framework for regulation.⁴³ Thereafter, I proposed a simple set of rules for an international convention which included, most notably, supermajority aggregate voting and priority claims for financiers

³⁴ *Ibid.*

³⁵ J. Keith Horsefield, *The White Plan, in III The International Monetary Fund 1945–1965: Twenty Years of International Monetary Cooperation* 95 (1969).

³⁶ *Ibid.* at 71.

³⁷ *Ibid.* That early view of IMF objectivity contrasts with today’s more widespread view of IMF partiality. See *infra* notes 83 and 161–162 and accompanying text.

³⁸ Jeffrey Sachs, *Do We Need an International Lender of Last Resort?*, Frank D. Graham Lecture at Princeton University (1995).

³⁹ *Ibid.*

⁴⁰ *Sovereign Debt Restructuring*, *supra* note 9, at 966–967.

⁴¹ *Ibid.* at 1030.

⁴² *Ibid.* at 1031. I ultimately identified the following axioms as applicable to any sovereign debt restructuring framework: it should foster, or at least not impair, the debtor-state’s ultimate economic rehabilitation; it should minimally affect non-bankruptcy incentives; and it should require only minimal adjudicatory discretion in its administration. *Ibid.* at 980.

⁴³ *Ibid.* at 1031.

of a sovereign debt restructuring.⁴⁴ Others followed this analysis with similar and contrasting proposals.⁴⁵

Inspired and based in part on these proposals,⁴⁶ the IMF proposed its statutory Sovereign Debt Restructuring Mechanism (“SDRM”) in 2001.⁴⁷ Initially, the U.S. Department of the Treasury, under Secretary Paul O’Neill, supported the SDRM.⁴⁸ But when O’Neill (involuntarily) resigned in 2002, the Treasury Department shifted its position, apparently at the urging of Wall Street.⁴⁹ Certain emerging market countries, including Turkey, Mexico and Brazil,⁵⁰ also opposed the SDRM, concerned that it would raise interest rates on their sovereign bonds.⁵¹ Faced with this opposition, the SDRM was deferred in favor of a CAC approach.⁵²

44 *Ibid.*

45 See, e.g. Patrick Bolton, *Toward a Statutory Approach to Sovereign Debt Restructuring: Lesson from Corporate Bankruptcy Practice Around the World*, 50 IMF Staff Papers 41 (2003), available at <https://www.imf.org/external/pubs/cat/longres.cfm?sk=16253.0> (arguing that elements of current corporate bankruptcy codes and practices, including an automatic stay on debt collection, should be present in a newly adopted sovereign restructuring procedure); Hal S. Scott, *A Bankruptcy Procedure for Sovereign Debtors?* 37 Ind. L. 103 (2003) (arguing that CACs should be abandoned in favor of a “more creditor friendly” SDRM); Patrick Bolton and David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?* 53 Emory L. J. 763 (2004) (arguing for the adoption of an SDRM-like sovereign bankruptcy framework, but with, *inter alia*, a strict first-in-time priority scheme and adherence to absolute priority in the classification and voting process).

46 See, e.g. Kenneth Rogoff and Jeromin Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976–2001*, 49 IMF Staff Papers 470, 470–471, available at <http://www.imf.org/External/Pubs/FT/staffp/2002/03/pdf/rogoff.pdf>.

47 International Monetary Fund, Proposed Features of a Sovereign Debt Restructuring Mechanism, SM/03/67 (Feb. 13, 2003). The SDRM was the brainchild of IMF Deputy Managing Director Anne Krueger.

48 Brad Setser, IPD Task Force on Sovereign Debt brief, *The Political Economy of the SDRM* 1–2 (Jan. 3, 2008), available at http://www.cfr.org/content/publications/attachments/Setser_IPD_Debt_SDRM.pdf.

49 Cf. Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 Geo. J. Int’l L. 299, 391–393 (2005) (arguing that the opposition to SDRM by major financial industry associations was a critical factor behind the US reversal in position).

50 Setser, *supra* note 48, at 16.

51 *Ibid.* at 6.

52 Many believe that the SDRM, as proposed by the IMF, was flawed. See, e.g. Christoph G. Paulus, *A Statutory Procedure for Restructuring Debts of Sovereign States*, 6 Recht der Internationalen Wirtschaft 401, 402 (2003) (arguing that the SDRM had perception problems and was self-serving); Westbrook, *supra* note 6, at 256 (arguing against the SDRM’s designation of the IMF as the supervisory entity).

3.2 Current Initiatives

Nonetheless, scholars have been continuing to advocate a statutory mechanism for sovereign debt restructuring, emphasizing the limitations of the contractual approach. One such mechanism, proposed by Christoph Paulus and Ignacio Tirado, suggests the advent of “resolvency” proceedings.⁵³ Resolvency courts, similar to the Sovereign Debt Tribunals advanced in the SDRM, would help to facilitate creditor-debtor negotiations.⁵⁴ Debtor-states would be able to submit restructuring plans to be considered and approved (via majority or supermajority voting) by each class of creditors.⁵⁵ The proceedings would also allow for the participation of prospective lenders, to help debtor-states obtain financing during the debt restructuring process.⁵⁶ I also have argued that contractual approaches alone cannot solve the central problems in sovereign debt restructuring,⁵⁷ and have proposed a model international convention that has similarities to the SDRM but differs in certain important details.⁵⁸

In 2014, the United Nations General Assembly voted to begin work on a statutory approach, referred to as a “multilateral legal framework,” for sovereign debt restructuring. The resolution – originally promoted by Argentina, apparently in response to the U.S. Supreme Court’s decision to let stand a lower court ruling enforcing *pari passu* clauses in Argentine sovereign debt – was introduced by Bolivia on behalf of the Group of 77 developing nations (of which Bolivia was then the chair) and China.⁵⁹ The US again,⁶⁰ and apparently the European Union

⁵³ Christoph G. Paulus and Ignacio Tirado, “Sweet and Lowdown: A ‘Resolvency’ Process and the Eurozone’s Crisis Management Framework” *Law and Economics Yearly Review* 2013 II.2:504–559. The resolvency process should be coordinated, they argue, by the European Stability Mechanism (ESM).

⁵⁴ Paulus and Tirado, *supra* note 53, at 8.

⁵⁵ *Ibid.* at 22.

⁵⁶ *Ibid.* at 27–28.

⁵⁷ See *Sovereign Debt Restructuring Options*, *supra* note 17, at 116 (arguing that contractual approaches imperfectly address the hold-out problem and do not address the debtor-state interim funding problem).

⁵⁸ *Ibid.* at 103–104. My model international convention is largely self-administering, it does not impose a stay on litigation against the debtor-state, and claims arising thereunder are adjudicated through a simple arbitration procedure, potentially based upon the ICSID model. See Steven L. Schwarcz, “*Idiot’s Guide*” to *Sovereign Debt Restructuring*, 53 *Emory Law Journal* 1189, 1208–1211 (2004); *Sovereign Debt Restructuring Options*, *supra* note 17, at 104.

⁵⁹ See current status here: <http://www.un.org/press/en/2014/gaef3417.doc.htm>.

⁶⁰ Press Release, General Assembly, Proposal for Sovereign Debt Restructuring Framework among 6 Draft Texts Approved by Second Committee, U.N. Press Release GA/EF/3417 (Dec. 5, 2014) [“Also speaking before the vote, the representative of the US was obliged to vote ‘no’ on the draft resolution as there was ongoing work on the technically complex issue in such bodies as the International Monetary Fund (IMF), which were more appropriate venues”].

also,⁶¹ opposes this approach.⁶² The United Nations Conference on Trade and Development (UNCTAD) has been tasked with moving this approach forward. There is skepticism, however, whether any formal framework, such as a convention, is feasible – at least in the near future – without U.S. and E.U. support.

3.3 A Model-Law Initiative

A model-law approach should be more feasible than a convention or treaty because it would not require general acceptance for its implementation. The prototype of a model law could be developed by nations, institutions,⁶³ or individuals. Nations and even subnational jurisdictions, such as New York State,⁶⁴ could individually enact a model law as their domestic law. That could help “to develop consensus around ideas that are commercially sound and legally effective.”⁶⁵ A model law could also be pursued in parallel as part of an overall strategy for developing a legal resolution framework for sovereign debt restructuring.⁶⁶

Notably, a model-law approach could sidestep the U.S. and E.U. opposition to a convention that is evident in the United Nations.⁶⁷ For example, to the extent not governed by the debtor-state’s law, most sovereign debt contracts are governed by either New York or English law.⁶⁸ One or both of those jurisdictions – in the case of New York law, a subnational jurisdiction⁶⁹ – could enact legislation based on a model law. Thus, unlike the UCC, the initial goal for a sovereign-debt-restructuring model law would be enactment by just one or two jurisdictions.

⁶¹ Italy, speaking on behalf of the EU, stated that the IMF is the “primary forum to discuss sovereign debt restructuring.” *Ibid.*

⁶² None of the developed economy countries supported the resolution, although many abstained rather than vote no. See Recorded Vote at 37th meeting, Dec. 5, 2014, available at <http://www.un.org/en/ga/second/69/modalities.pdf>.

⁶³ Such as CIGI or the III. See “Article note”.

⁶⁴ See *infra* notes 68–69 and accompanying text.

⁶⁵ Oonagh Fitzgerald, CIGI Global Rule of Law Blog: “Next steps towards a multilateral debt workout process,” June 4, 2015, at 3.

⁶⁶ *Ibid.* at 4.

⁶⁷ *The Statutory Solution*, *supra* note 11.

⁶⁸ See e.g. Philip R. Wood, *Governing Law of Financial Contracts Generally*, in *Conflict of Laws and International Finance* 12 (ed. 2007); Setser, *supra* note 48, at 16 (observing that “[a]lmost all international bonds are now governed by New York law, English law, and to a lesser extent Japanese law”).

⁶⁹ Although England is technically a subnational jurisdiction of the UK, it does not have a local legislature; English law is enacted by the U.K. Parliament. Alistair Gillespie, *The English Legal System*, in *The English Legal System* 4 (ed. 2013).

Even if the US or the European Union had the power to preempt such a statute, it might refrain. Preemption by the US of such a New York statute⁷⁰ could motivate debtor-states to govern their debt contracts by English law, thereby marginalizing the importance of New York law in international finance. Similarly, preemption by the European Union of such an English statute could motivate debtor-states to govern their debt contracts by New York law, thereby marginalizing the importance of English law in international finance.⁷¹

A related question is whether the provisions of the model law would be effective under national or subnational law. The answer, of course, depends on the nature of those provisions. In this article's proposed model law,⁷² the only provision likely to raise concern would be its retroactivity, which would be valuable in restructuring the terms of existing debt contracts.⁷³ Legal retroactivity is respected under international law so long as it is neither discriminatory nor arbitrary.⁷⁴

70 The US government could preempt a sovereign-debt-restructuring model law enacted by New York State if, for example, it enacts an inconsistent federal law. Under Article VI, Clause 2, of the U.S. Constitution, federal law is the "supreme law of the land." Thus, Puerto Rico's Public Corporations Debt Enforcement and Recovery Act was recently held to be preempted by § 903(1) of the U.S. Bankruptcy Code, which provides that "a State [which is defined for this purpose to include Puerto Rico] law prescribing a method of composition of indebtedness of [its municipalities] may not bind any creditor that does not consent to such composition . . ." *Franklin Cal. Tax-Free Trust v. Puerto Rico*, Case No. 15-1218, 2015 WL 4079422 (1st Cir. July 6, 2015). It also is unlikely that US foreign policy law would preempt a sovereign-debt-restructuring model law enacted by New York State. In general, "state power must yield to the initiative of the national government to conduct foreign affairs." Joseph B. Crace Jr., *GARA-Mending the Doctrine of Foreign Affairs Preemption*, 90 *Cornell L. Rev.* 203, 217 (2004). Nonetheless, a "state regulation that affects foreign affairs but also regulates a 'traditional state responsibility' could survive" being preempted. *Ibid.* at 223. New York's enactment of the model law should represent an exercise of New York's police powers, a quintessential state responsibility. See *infra* notes 135–136 and accompanying text.

71 These preemption-related arguments implicitly assume that New York and England has each enacted the model law or is likely to do so.

72 See Section 4.1, *infra*.

73 Cf. James S. Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study on Relationship between The Fifth Amendment and The Bankruptcy Clause*, 96 *Harv. L. Rev.* 973, 1016 (1983) (observing that legislatures would want newly enacted bankruptcy legislation to be retroactive, in order to effectively reduce financial chaos by applying to all debts).

74 *Sovereign Debt Restructuring*, *supra* note 9, at 1012–1013 [citing sources including 1 Oppenheim's *International Law* 918–921 (Sir Robert Jennings and Sir Arthur Watts eds., 9th ed. 1992)]. The issue of legal risk is related to retroactivity. Legal risk refers to the risk that substantive provisions of a jurisdiction's law change after an agreement is signed incorporating that jurisdiction's law as its governing law. Legal risk is an inevitable risk in international agreements. See, e.g. Wood, *supra* note 68, at 15 (observing that "[i]t is not possible by contract to stabilise the law, e.g. that the governing law is that at the time of the contract. The fluctuating governing law must still be ascertained and will apply to this term of the contract. A change in the governing law will override.").

Nothing under English law further restricts a law's retroactivity.⁷⁵ U.S. constitutional law could, however, restrict the retroactivity of New York law. This article nonetheless concludes that it should not restrict the retroactivity of New York law based on the model law.⁷⁶

Next consider how a model law should be structured.

4 Structuring a Model Law

To analyze how a model law for sovereign debt restructuring should be structured, the Appendix sets forth a proposed form of a model law (the "Model Law"). In this Section 4, I discuss the Model Law's provisions, explaining, among other things, what the Model Law should cover, what it should not cover, and why. Where it is clearer in context, certain of the Model Law's provisions are explained by footnotes inserted into the Model Law itself. Those footnotes are not necessarily intended to be part of the Model Law.

4.1 Rationale

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

⁷⁵ Lord Rodger of Earlsferry, *Foreword*, in *Retroactivity and the Common Law* (Ben Juratowitch, ed. 2008) (observing that Parliament "can change the legal significance of past events[,] specifically, Parliamentary acts "can provide that something which was lawful when it was done should be treated as having been unlawful, or conversely, that what was unlawful at the time should be treated as having been lawful"). See also The Interpretation Act 1978 § 4 (allowing an Act of Parliament to come into force "on a particular day" if "provision is made for it); Clive Sheldon QC, *A Justified Retrospective*, in *New Law Journal* 27 April 2012, available at <http://www.11kbw.com/uploads/files/CSLegalWeekSpecialistCommercial.pdf> (observing that where the retrospective effect is clear in the sentences of the legislation, courts in England "will construe legislation as having [such] effect[.]"). These views of English law retroactivity are consistent with the view of Michael Crystal, Q.C., expressed to the author on June 15, 2015, at an International Insolvency Institute meeting in Naples.

⁷⁶ See Section 5, *infra*.

4.2 Claims Covered

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

Unlike the IMF's SDRM, which covered only long-term-maturity claims (of the types of claims it otherwise covered), the Model Law does not discriminate between, and thus covers both, long-term and short-term maturities. This recognizes that, increasingly, most sovereign debt "bailouts have come in response to the [rollover] of short-term claims."⁷⁷ Covering this important cause of a debtor-state's inability to pay will help to facilitate necessary debt relief while also reducing short-term-lender moral hazard; short-term lenders can no longer assume that their claims against a financially troubled debtor-state will be paid in full. That, in turn, will reduce rollover risk – in this context, the risk that a debtor-state will be unable to borrow sufficient new funds to repay maturing short-term debt.⁷⁸ The head of the sovereign debt restructuring practice at Cleary Gottlieb Steen & Hamilton LLP has called rollover risk one of today's most critical sovereign debt problems.⁷⁹

Article 2(2) also broadly defines "monies borrowed" to include a wide range of financing, other than trade accounts payable arising in the ordinary course of business. The Model Law's coverage does not discriminate based on the nationality of the holders of the (otherwise) covered claims or the currency in which such claims are payable.⁸⁰ Consistent with the historical norms of most sovereign debt

⁷⁷ Setser, *supra* note 48, at 4.

⁷⁸ Steven L. Schwarcz, *Rollover Risk: Ideating a U.S. Debt Default*, 55 Boston College Law Review 1, 4 (2014a).

⁷⁹ Luncheon speech of Lee C. Buchheit, March 27, 2015 Imperial College conference, See Acknowledgment. *Cf. Rollover Risk, supra* note 78 (discussing rollover risk as the most likely cause of a possible debt default by the US).

⁸⁰ Such discrimination could be problematic, not only motivating foreign creditors "to impose sanctions (usually trade-related) to punish [the] defaulting government" but also being "interpreted as a signal used by the government to communicate information to domestic and foreign agents about the [poor] fundamentals of the economy." Guido Sandleris, *Sovereign Defaults: Information, Investment and Credit*, 76 Journal of International Economics 267, 267 and 273 (2008). For example, in the Icesave dispute, Iceland's failure to assure protection for foreign creditors led to international litigation and motivated the UK to apply anti-terrorist legislation to freeze accounts of Icelandic citizens in the UK as retaliation. Jon Danielsson, *The First Casualty of the Crisis: Iceland*, in *The First Global Financial Crisis of the 21st Century Part II* 11–12 (Andrew Felton and Carman Reinhart eds., 2009); Dalvinder Singh, *U.K. Approach to Financial Crisis Management*, 19 *Transnat'l L. & Contemp. Probs.* 868, 879 (2011).

restructuring, however, the Model Law does not cover a debtor-state's internal operational debt claims, such as pension and retiree obligations, tax refunds, unpaid salaries to public employees, or social program payments. Normally these types of debts are paid in full in a later time.⁸¹

4.3 Supervisory Authority

The definition of “Supervisory Authority” in Article 2(5) of the Model Law references a “neutral international organization.” This is likely to be one of the Model Law's most controversial provisions. It currently is unclear what organization might qualify as truly neutral. Imperfect options might include, among other possibilities, a neutral committee of the IMF, the World Bank, or UNCITRAL, or even a court of the debtor-state.⁸² There are concerns, however, that existing organizations are too political or conflicted.⁸³

More generally, the very issue of the need for a supervisory authority can raise confusion. Formal sovereign debt restructuring solutions, such as a convention, are often conflated with the need for formal supervisory bodies.⁸⁴ Under the Model Law, however, no formal supervisory authority is needed to exercise discretion because disputes are adjudicated through binding arbitration.⁸⁵ The main role of a Supervisory Authority under the Model Law is in fact ministerial: to fact-check information and to oversee the creditor voting process.⁸⁶

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

82 Professor Mooney proposes, in a different context, that a court of the debtor-state could serve as a supervisory authority in a sovereign debt restructuring. Charles W. Mooney, Jr., *A Framework for a Formal Sovereign Debt Restructuring Mechanism: The KISS Principle (Keep it Simple, Stupid) and Other Guiding Principles*, 37 Mich. J. Int'l L. ___ (forthcoming 2016). The Supervisory Authority might also consist of a rotating panel of III or CIGI members whose fees and expenses would be paid for by the debtor-state invoking application of the Model Law.

83 Prof. Westbrook argues, for example, that one of the SDRM's flaws is that the IMF, the supervisor thereunder, would be conflicted, having responsibility for both funding and administering the proceeding as well as addressing rights and priorities. Westbrook, *supra* note 6, at 256. Cf. Joseph E. Stiglitz and Martin Guzman (2015), *A Rule of Law for Sovereign Debt*, available at <http://www.project-syndicate.org/commentary/sovereign-debt-restructuring-by-joseph-e-stiglitz-and-martin-guzman-2015-06> (arguing that the IMF “is too closely affiliated with creditors” to be neutral).

84 That might in part help to explain U.S. and E.U. opposition to U.N. efforts to reach a formal sovereign debt restructuring mechanism. See *supra* notes 60–62 and accompanying text.

85 Model Law Article 10. See also *Sovereign Debt Restructuring*, *supra* note 9, at 1023–1029.

86 Cf. Barry Eichengreen, *Policy Proposals for Restructuring Unsustainable Sovereign Debt*, in *The New Public Finance* 444 (2006) (arguing that a sovereign debt resolution forum need only engage in ministerial actions).

Many commentators on sovereign debt restructuring have focused on supervision of the process and resolution of disputes. Professor Paulus contends, for example, that there should be a “neutral supervisor” that would follow procedural rules for restructuring and resolution.⁸⁷ Others advocate the creation of a permanent institutional framework for supervision⁸⁸ or argue that existing institutions may serve that purpose.⁸⁹ And yet others advocate a contractually binding arbitration process.⁹⁰ The author believes, however, that if and when an

87 Paulus, *supra* note 52, at 403.

88 Two senior fellows of CIGI have proposed, for example, the creation of a Sovereign Debt Forum (SDF), which would be an incorporated non-profit, membership-based organization that would provide an independent standing body to research and preserve institutional memory on best practices in sovereign debt restructuring. Gitlin and House, *supra* note 18. The concept of the SDF was borrowed and expanded from “The Sovereign Debt Forum,” a paper that Richard Gitlin presented in 2002 at the Council on Foreign Relations. The SDF, they argue, could also serve as a venue to facilitate early engagement among creditors, debtors, and other stakeholders when sovereign nations encounter financial trouble. Gitlin and House, *supra* note 18, at 6, 18. Professor Howse, in contrast, proposes a debt workout mechanism (DWM) that ensures the participation of all relevant stakeholders. Howse, Robert. “Towards a Framework for Sovereign Debt Restructuring: What Can Public International Law Contribute?” Forthcoming in *Too Little, Too Late: The Quest of Resolving Sovereign Debt Crises*, Columbia University Press, New York, 2016.

89 See, e.g. Brooks, Skylar and Domenico Lombardi (2015) “Governing Sovereign Debt Restructuring Through Regulatory Standards.” *Journal of Globalization and Development*, 6(2):287–318. Brooks and Lombardi argue there is a governance gap for resolving debt crises that can be filled by the Financial Stability Board (FSB), which could serve as the focal institution responsible for overseeing the coordination and further development of soft law regulatory standards for sovereign debt restructuring.

90 See generally Jubilee USA Network, *Towards a Lasting Solution to Sovereign Debt Problems* (2012), available at <http://eurodad.org/1543743/>; Christoph G. Paulus and Steven T. Kargman, “Reforming the Process of Sovereign Debt Restructuring: A Proposal for a Sovereign Debt Tribunal,” *Workshop on Debt, Finance and Emerging Issues in Financing Integration* (2008), available at http://www.un.org/esa/ffd/wp-content/uploads/2008/04/20080408_Kargman-Paulus-Paper.pdf; Hugo Ruiz Diaz, “The Creation of an Arbitration Tribunal on Debt: An Alternative Solution? On The Position to Take on the CADTM” (2003). Paulus and Kargman have advocated a “fair and transparent sovereign debt arbitration process,” also known as sovereign debt tribunals (“SDT”). Paulus and Kargman, *supra* at 3. Under the SDT process, the decision to subject disputes to an arbitration panel would be based on contractual agreements between sovereign debtors and their creditors. *Ibid.* at 8. The SDT process also contemplates building trust, confidence, and legitimacy by selecting a “pool of expert arbitrators” who have knowledge and experience to handle sovereign debt disputes through a neutral institution. *Ibid.* at 5, 8. *Cf.* Jose Antonio Ocampo, “A Brief History of Sovereign Debt Resolution, and a Proposal for a Multilateral Instrument”. Forthcoming in *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises*, Columbia University Press, New York, 2016 (proposing an arbitration and mediation approach similar to the WTO dispute mechanisms, including independent bodies of arbitrators and mediators).

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

4.4 Debt Sustainability

Article 3(2)(b) of the Model Law requires a debtor-state's petition for relief to certify that the debtor-state "needs relief under this [Model] Law to restructure claims that, absent such relief, would constitute unsustainable debt of the State." Although the debtor-state itself would make the determination of debt sustainability for purposes of Articles 3(2)(b) [and also for purposes of Article 6(6)], it should be guided by the best practices in making such a determination. There does not yet, however, appear to be a universally accepted view of what constitutes debt sustainability for nations. Even the IMF framework for conducting debt sustainability analyses has been criticized for creating intercreditor inequities⁹¹ and for being ineffective in detecting sustainability problems.⁹²

4.5 The Holdout Problem

Article 7 of the Model Law addresses the most critical problem that a debt-restructuring mechanism can solve – the holdout problem.⁹³ A Model Law or other statutory approach to sovereign debt restructuring should be more effective in solving the holdout problem than a contractual approach.⁹⁴ Article 7(2), for example, legally mandates supermajority voting that (assuming the requisite percentages agree) can bind dissenting classes of claims. This eliminates the need for the

⁹¹ Brooks, Skylar, Martin Guzman, Domenico Lombardi, and Joseph E. Stiglitz. "Identifying and Resolving Inter-Creditor and Debtor-Creditor Equity Issues in Sovereign Debt Restructuring." CIGI Policy Brief No. 53, January (2015). The implementation of the Model Law should reduce the need for IMF bailouts, thereby reducing these intercreditor inequities.

⁹² See, e.g. Guzman, Martin and Daniel Heymann (2015) "The IMF Debt Sustainability Analysis: Issues and Problems," *Journal of Globalization and Development*, 6(2):387–404.

⁹³ Cf. *supra* note 8 and accompanying text (explaining the holdout problem as a type of collective action problem). It should be emphasized that the Model Law preserves the holdout threat to the extent needed to motivate debtor-states to bargain fairly, and only seeks to limit that threat for rent-seeking holdouts who try to unreasonably extract value. See *infra* notes 172–173 and accompanying text.

⁹⁴ *Sovereign Debt Restructuring*, *supra* note 9, at 1003.

contracts themselves to include CACs.⁹⁵ Article 7(3) of the Model Law, coupled with Article 6(1), also enables a debtor-state to use the Model Law to aggregate creditor voting beyond individual contracts. Aggregate-voting is critical for at least two reasons: it can prevent creditors of individual sovereign debt contracts from acting as holdouts vis-a-vis other sovereign debt contracts;⁹⁶ and it allows a debtor-state to designate large enough classes of claims to prevent vulture funds (or similar holdouts), as a practical matter, from purchasing enough claims to block a restructuring plan or otherwise control the voting.⁹⁷

In contrast, the Greek sovereign debt crisis has demonstrated that the CAC approach is insufficient to solve the holdout problem. Even after years of trying to include them, relatively few Greek debt agreements actually contained CACs, and those CACs were generally restricted to bond issues.⁹⁸ Furthermore, most of the CACs that were included in those debt agreements did not contemplate aggregate-voting and thus did not purport to bind creditors to supermajority voting beyond the individual debt issue; that enabled any given debt issue to serve as a holdout vis-a-vis other Greek debt issues.⁹⁹ In contrast, statutory supermajority aggregate voting is the tried-and-true method by which corporate insolvency law successfully, and equitably, addresses the holdout problem.¹⁰⁰

4.6 Interim Funding

Chapter IV of the Model Law addresses the critical need for a financially troubled debtor-state to obtain liquidity during its restructuring process. Although this funding

⁹⁵ Although Article 7(2) proposes supermajority percentages that have been used successfully in U.S. bankruptcy law [see 11 U.S.C. § 1126(c)], other supermajority percentages could be substituted. It should be cautioned, however, that the higher the percentages, the easier it would be (other things being equal) for a vulture fund to buy a blocking position. See *supra* note 12 and accompanying text. Cf. *infra* note 97 and accompanying text (discussing how the Model Law's aggregate-voting can also help to prevent that).

⁹⁶ *Sovereign Debt Restructuring Options*, *supra* note 17, at 109.

⁹⁷ Cf. *supra* notes 14–15 and accompanying text (indicating ICMA's efforts to introduce updated forms of CACs that attempt to aggregate voting across debt issues).

⁹⁸ Recall that the Model Law covers a much broader range of a debtor-state's debt. See *supra* note 80 and accompanying text.

⁹⁹ *The Statutory Solution*, *supra* note 11. See also *supra* note 96 and accompanying text.

¹⁰⁰ Brett W. King, *The Use of Supermajority Voting Rules in Corporate America: Majority Rule, Corporate Legitimacy, and Minority Shareholder Protection*, 21 Del. J. Corp. L. 895, 941 (1996) (noting that supermajority voting “protects the minority” and that the “tremendous growth in the size of the corporation as well as the number of shareholders probably extinguished any thought of returning to the unanimity rules ... given the obvious potential for holdout rent seeking”).

has in the past often been provided by the IMF, the “IMF’s lending policy ... is not enough to resolve the problems posed by debt burdens beyond the country’s ability to pay.”¹⁰¹ Absent the IMF, whose loans have de facto priority, no one would lend new money without obtaining a priority repayment claim. A contractual solution would be insufficient; it would be totally impractical to get all existing creditors to contractually subordinate their claims to the new money.¹⁰² But a statutory mechanism can give such new-money lenders priority over existing creditors.¹⁰³ To minimize the risk of “overinvestment,” existing creditors should have notice and the opportunity to block the new lending if its amount is too high or its terms are inappropriate.¹⁰⁴ Articles 8(2) and 8(3) of the Model Law, respectively, provide that notice and opportunity.

Recently, the IMF has been considering more flexible options in funding sovereign nations “in the context of sovereign debt vulnerabilities.”¹⁰⁵ When a troubled member nation seeks financing above its normal IMF-access limits, the IMF will have to decide whether that nation’s problems can be resolved with or without a debt restructuring. Under its current policy, “if the [IMF] determines that the member’s debt is sustainable with high probability, it may provide large scale financing without the need for a debt restructuring. However, if such a determination cannot be made, exceptional access may only be provided if a debt restructuring is pursued that is sufficiently deep to restore sustainability with high probability.”¹⁰⁶

The IMF is also exploring whether it should have a broader range of responses. For example, if a member nation is unable to obtain private-sector funding but its debt is considered (albeit not with high probability) sustainable without the need for a debt restructuring, the IMF is considering providing debt relief by extending the maturities of its own debt claims against that nation.¹⁰⁷ In my view, that would

101 Stiglitz et al. (2015), *supra* note 5, at 2.

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

103 *Sovereign Debt Restructuring*, *supra* note 9, at 988 (“granting priority should only minimally affect ex ante availability and cost of credit [] because granting priority will not lower the State’s debt rating, and also because an IMF loan already has de facto priority over other claims”).

104 *Sovereign Debt Restructuring*, *supra* note 9, at 989–990. Prof. Westbrook favors the transparent public mechanism in the SDRM that would tie budget restructuring to the granting of new finance. Westbrook, *supra* note 6, at 255. That conditionality, however, would be politically volatile and might impose harsh conditions on the citizens of the debtor-state.

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

106 *Ibid.* at 1.

107 *Ibid.*

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

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

4.7 Arbitration of Disputes

The neutral international arbitration body referenced in Article 10(2) of the Model Law might include a newly created entity designed to arbitrate sovereign debt-related disputes, such as the free-standing “Sovereign Debt Tribunal” proposed by Paulus and Kargman.¹⁰⁸ Even absent a statutory framework, the resort by sovereign-debt-restructuring parties to such a tribunal could be contractual. For example, such parties could agree – ex ante (via contractual agreement in their underlying loan documents) or ex post (by mutual agreement after the dispute has arisen) – to arbitrate sovereign debt-related disputes before the tribunal.

4.8 Stay of Enforcement Actions

The Model Law also omits certain provisions that one might otherwise associate with a legal framework for sovereign debt restructuring. For several reasons, it does not propose a stay of enforcement actions. First, a stay does not appear to be critical to resolving sovereign debt problems. A debtor-state could unilaterally decide to suspend payments. And the main purpose of a stay, to prevent a grab race, is less significant in a sovereign debt context because creditors could only attempt to grab the State’s relatively few assets located in other jurisdictions.¹⁰⁹ Second, model laws are less likely than conventions to effectively impose enforce-

¹⁰⁸ See Paulus and Kargman, *supra* note 90, at 3.

¹⁰⁹ See *Sovereign Debt Restructuring*, *supra* note 9, at 984–985. See also Setser, *supra* note 48, at 5 (observing that “[e]ffective legal action by creditors against a sovereign in default is extremely difficult”) and at 12 (observing that “neither debtor nor creditor lawyers thought the absence of a formal stay was much of a problem”) (emphasis in original). *But cf.* Eichengreen, *supra* note 86, at 444 (arguing that a statutory approach to sovereign debt restructuring should include hard restraints on litigation).

ment stays. If a creditor's claim against a debtor-state is governed by the law of a jurisdiction that has enacted the Model Law, such creditor would theoretically be prejudiced in a grab race by other creditors of that state whose claims are governed by the law of a jurisdiction that has not enacted the Model Law. That creates perverse incentives for creditors to want to have their claims governed by the law of a jurisdiction that has not enacted the Model Law. Third, a stay could be costly, leading to litigation over its scope and duration and also possibly affecting non-bankruptcy incentives, thereby increasing sovereign financing costs.¹¹⁰

4.9 Cram Down

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

Cram down has also been applied in at least one governmental debt restructuring context: the application of Chapter 9 of the U.S. Bankruptcy Code to municipal debt restructuring. In that context, a municipal debtor can cram down – or force acceptance of a debt-restructuring plan – over the objection of one or more dissenting classes of creditors if, under the plan, the creditors are “receiving all they can reasonably expect to receive under the circumstances.”¹¹¹ The application of cram down under Chapter 9 has focused on whether the municipality has

¹¹⁰ *Sovereign Debt Restructuring*, *supra* note 9, at 984–985.

¹¹¹ More specifically, Chapter 9 allows a court to confirm a proposed municipal bankruptcy plan, despite creditor objection, if the plan is “in the best interests of the creditors.” 11 U.S.C. § 943(b)(7) (“The court shall confirm the plan if . . . the plan is in the best interests of the creditors.”). In making this determination, Chapter 9 incorporates the cram-down concept of Chapter 11 of the U.S. Bankruptcy Code, which requires the court to confirm a proposed reorganization plan that is, *inter alia*, “fair and equitable, with respect to each class of claims,” despite the objection of creditors. § 901(a); §1129(b)(1); see also 6 Collier on Bankruptcy §943.03 [1][f][i][B]; *In re City of Stockton*, 478 B.R. 8, 26 (Bankr. E.D. Cal. 2012) (holding that for a plan to be confirmed as to a dissenting class of creditors, it must be “fair and equitable” and “not discriminate unfairly”). For the purposes of Chapter 9, fair and equitable has been held to mean “all [the creditors] can reasonably expect to receive under the circumstances.” See e.g. *Lorber v. Vista Irrigation Dist.*, 127 F.2d 628, 639 (9th Cir. 1942).

imposed reasonable austerity measures and has made reasonable use of taxation, so that the plan's treatment of the dissenting classes is fair and equitable.¹¹²

The difficulties with applying cram down in a governmental debt restructuring context are in determining what governmental austerity measures and levels of taxation are reasonable, in order to assess whether the creditors are receiving all they can reasonably expect under the circumstances.¹¹³ At the very least, these determinations would be complex, fact-intensive, and highly politically sensitive.¹¹⁴ In the Chapter 9 context, federal bankruptcy courts make these determinations, yet the decisions are far from consistent.¹¹⁵ In the sovereign

112 Cram down's application must be different, of course, for corporate debtors and governmental debtors. In *Newhouse v. Corcoran Irrigation Dist.*, 114 F.2d 690 (9th Cir. 1940), cert. denied, 311 U.S. 717, 61 S. Ct. 440, 85 L. Ed. 467 (1941), the court explained that the bankruptcy of a public entity is distinguishable from that of a private entity. In a public bankruptcy the entity may not be liquidated with the resulting value applied to its outstanding debts. *Ibid.* at 690–691. Therefore, the expectations of existing creditors must consider that a reorganization plan needs to account for the continued operation of the debtor. See *Ibid.* For further discussion of how the “fair and equitable” cram-down standard works under Chapter 9 of the U.S. Bankruptcy Code (regarding municipal debtors), and its potential usefulness in a sovereign restructure, see, e.g. Zack Clement and R. Andrew Black, *How City Finances Can Be Restructured: Learning from Both Bankruptcy and Contract Impairment Cases*, 88 Am. Bankr. L. J., 41–55, 72–84 (2014), and Zack Clement, *Restructuring Government Finances – In Public and in Less Than a Year*, 26 Westlaw Insolvency Intelligence 91–93 (2013).

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

114 See, e.g. *Sovereign Debt Restructuring*, *supra* note 9, at 1008–1009. Another concern with the use of cram down for sovereign debtor-states is that expectations regarding taxation and public operations among creditors may be much more varied than would be expectations in a Chapter 9 case. Compare, for example, the City of Detroit's recent Chapter 9 case with Argentina's debt crisis. Detroit's creditors are principally US organizations (e.g. pension funds and bond holders). See *Detroit's 20 Largest Unsecured Creditors*, Detroit Free Press, July 19, 2013, <http://archive.freep.com/article/20130719/NEWS01/307190029/detroit-bankruptcy-list-creditors>. By contrast, Argentina's largest creditors were public and private parties from all over the globe. Andrew F. Cooper and Bessma Momani, *Negotiating Out of Argentina's Financial Crisis: Segmenting the International Creditors*, 10 New Pol. Econ. 305, 306 (2005).

115 At least one court has held that a municipality is not required to raise taxes for a plan to be fair and equitable. In *In re Corcoran Hosp. Dist.*, 233 B.R. 449, 459 (Bankr. E.D. Cal. 1999), the court held that raising taxes is unnecessary if it would be futile, and a municipality cannot be required to do so. By contrast, a plan has been held to not be fair and equitable where a small increase in tax revenue is possible and sufficient to satisfy creditors. In *Fano v. Newport Heights Irr. Dist.*, 144 F.2d 563, 565–566 (9th Cir. 1990), the appellate court rejected the determination that the plan was fair and equitable and overturned the lower court's confirmation because there

debtor-state context, however, there is as yet no suitable judicial venue for making such determinations.

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

For these reasons, and also because including cram down at this nascent point in the model-law process could engender significant creditor opposition,¹¹⁶ the Model Law currently omits a cram-down power. Even without cram down, the Model Law would still be a major advance, from the standpoint of debtor-states, over the status quo. If, however, experience with the Model Law demonstrates that a cram-down power is needed, this article is open to its later inclusion.¹¹⁷

4.10 Creditors’ Committee

Finally, the Model Law does not provide for the formal creation of a creditors’ committee, to officially represent the debtor-state’s creditors in the debt restructuring. An official creditors’ committee does not appear to be necessary in a sovereign-debt-restructuring context because “the claims against a State are so large that many creditors, or at least a de facto committee of creditors chosen consensually, should find it economically feasible to participate in the restructuring process.”¹¹⁸ Some have even argued that an official creditors’ committee

was not a sufficient showing that the municipality’s taxing powers were inadequate to generate the revenue needed to pay the dissenting creditors. But, if an increase in tax revenues would make matters worse for the municipality than the plan the may be confirmed. In *Lorber v. Vista Irrigation Dist.*, 143 F.2d 282 (9th Cir); *cert denied*, 323 U.S. 784 (1944), the court held that because increasing taxes would cause further harm to the debtor, and the best remedy for creditors was 55 cents on the dollar, the plan was fair and equitable. *Ibid.* (finding that “55 [cents] on the dollar was the maximum that the District could reasonably pay on outstanding bonds”).

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

117 *Cf. Sovereign Debt Restructuring*, *supra* note 9, at 1009 (suggesting that cram down should be included in the Model Law if “experience later demonstrates that debtor-states and their creditors cannot reach consensual agreements without it”).

118 *Sovereign Debt Restructuring*, *supra* note 9, at 1002. *But cf.* Setser, *supra* note 48, at 7 (describing the refusal of debtor-states to agree to pay the expenses of bondholders creditors’ committees as “a seemingly small demand that looms surprisingly larger in the list of ‘rights’ [that] creditors wanted” debtor-states to respect).

might be harmful, promoting collusive behavior among creditors.”¹¹⁹ Even absent such a committee, however, the Model Law should help to create what Professor Paulus calls an “enforced community,” by including all of a debtor-state’s creditors into a resolution proceeding.¹²⁰ Creating such a community, he contends, should promote inter-creditor fairness because all of those creditors – whether domestic or foreign, private or governmental – are affected by the debtor-state’s financial condition.¹²¹

Next consider the legal feasibility of the Model Law.

5 Legal Feasibility of a Model Law

This article implicitly throughout has addressed the legal feasibility of a model-law approach to sovereign debt restructuring. To the extent debtor-states enact the Model Law, there should be no general feasibility concerns.¹²² For example, the Model Law’s principal operative provisions – supermajority aggregate voting, and the granting of priority to financiers of a debtor-state’s debt restructuring – should not be discriminatory or arbitrary.¹²³

The article next focuses, however, on two specific legal feasibility questions of first impression raised by the Model Law: the validity of its retroactively,¹²⁴ which is needed to bind a debtor-state’s numerous existing creditors; and its ability to overcome the veto power of *pari passu* clauses, which have stymied the effectiveness of existing sovereign debt restructurings efforts – especially the ongoing Argentine debt-restructuring efforts.

¹¹⁹ Stiglitz et al. (2015), *supra* note 5, at 3.

¹²⁰ Paulus, *supra* note 52, at 402.

¹²¹ *Ibid.* at 402–403.

¹²² Certain other concerns about the effectiveness of model laws may be flawed. For example, some have argued that “[n]ational legislation cannot resolve conflicts arising when bonds have been issued in different jurisdictions.” Stiglitz et al. (2015), *supra* note 5, at 4. The Model Law, however, could resolve conflicts for all bonds governed by the law of a jurisdiction that enacts it.

¹²³ Steven L. Schwarcz, *Global Decentralization and the Subnational Debt Problem*, 51 *Duke L. J.* 1179, 1227–1228 (2002). *Cf. Sovereign Debt Restructuring*, *supra* note 9, at 1012–1014 (analyzing those same types of retroactive provisions under international law and concluding that none of the provisions on “super-majority voting, discharge, and the granting of priority to financiers of the State’s debt restructuring ... discriminates based on the nationality of the bondholders ... [or] is arbitrary because all are essential to a debtor-state’s ability to restructure its debt”).

¹²⁴ See Model Law Article 1(2).

5.1 Retroactivity

Legal retroactivity is respected under international law so long as it is neither discriminatory nor arbitrary.¹²⁵ Recall, however, that the Model Law's retroactivity could raise an enforceability concern under domestic subnational law.¹²⁶ In particular, the issue is whether U.S. constitutional law would restrict the retroactivity of New York law based on the Model Law.

The "Contracts Clause" in Art. I, § 10 of the U.S. Constitution prohibits states (as opposed to the federal government) from enacting any legislation that impairs existing contractual obligations.¹²⁷ Nonetheless, New York State should be able to frame its enactment of the Model Law in such a way as to not violate the Contracts Clause.

The Contracts Clause does not extinguish a state's ability to exercise its police powers to promote or protect the public commonwealth, including protecting economic activity within its borders.¹²⁸ The U.S. Supreme Court generally defers to state economic regulation, especially during times of "emergency."¹²⁹ A state statute that substantially alters preexisting contractual obligations does not automatically violate the federal Contracts Clause.¹³⁰

The Supreme Court has articulated five factors that a court should consider when determining if a state statute violates the Contracts Clause.¹³¹ Such a statute would survive a Contracts Clause challenge if it (1) addresses a grave

¹²⁵ See *supra* note 74 and accompanying text.

¹²⁶ See *supra* notes 71–76 and accompanying text.

¹²⁷ Creditors whose debt contracts are modified, without their consent, by a supermajority vote under Article 7 of the Model Law would have standing to raise this constitutional claim. See, e.g. *Pennell v. City of San Jose*, 458 U.S. 1, 7–8 (1988). For a general discussion of the Contracts Clause, including its application to states trying to modify their own contracts, see Emily D. Johnson and Ernest A. Young, *The Constitutional Law of State Debt*, 27 *Duke Journal of Constitutional Law & Policy* 117 (2012).

¹²⁸ See, e.g. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 240–241 (1978); *Manigault v. Springs*, 199 U.S. 473, 480 (1905) ("It is the settled law of this court that the interdiction of statutes impairing the obligation of contracts does not prevent the State from exercising such powers as are vested in it for the promotion of the commonwealth, or are necessary for the general good of the public, though contracts previously entered into between individuals may thereby be affected.").

¹²⁹ See Alexander Volokh, The Reason Foundation, "The Revival of the Contract Clause" (Sept. 25 2013), available at <http://reason.org/news/show/pensions-contract-clause#sthash.LDDMTT-BM.dpuf>.

¹³⁰ See *Allied Structural Steel Co.*, *supra* note 128, at 240 [quoting *W.B. Worthen Co. v. Thomas*, 292 U.S. 426, 433 (1934)] ("literalism in the construction of the contract clause . . . would make it destructive of the public interest by depriving the State of its prerogative of self-protection").

¹³¹ See *Home Building & Loan Assn. v. Blaisdell*, 290 U.S. 398, 444–447 (1934).

temporary emergency, (2) protects a “basic societal interest, not a favored group,” (3) provides relief that is appropriately tailored to the emergency it is enacted to address, (4) imposes reasonable conditions, and (5) is limited to the duration of the emergency.¹³² More recent jurisprudence suggests even more leeway, enabling a state law to retroactively impair contracts if the impairment is reasonably necessary to further an important public purpose and also reasonable and appropriate to effectuate that purpose.¹³³ This leeway may be even greater if the contractual impairment is not substantial.¹³⁴ Moreover, the party asserting a Contracts Clause violation appears to have the burden of proving the violation.¹³⁵

New York State therefore should be able to frame its enactment of the Model Law in such a way as to not violate the Contracts Clause. Such enactment would represent an exercise of New York’s police powers to reduce a sovereign debt default that could lead to a systemic economic collapse, thereby protecting economic activity within its borders. Furthermore, the Model Law would (1) address a grave temporary economic emergency, (2) protect a “basic societal interest, not a favored group,” (3) provide relief – in the form of supermajority aggregate voting for debt relief and temporary funding – that is appropriately tailored to the emergency it is enacted to address, (4) impose reasonable conditions, and (5) be limited in its application to the duration of the economic emergency. It therefore should meet the U.S. Supreme Court’s criteria to survive a Contracts Clause challenge.¹³⁶

The Model Law’s retroactive effect should be enforceable also because any contractual impairment should not be “substantial,”¹³⁷ being limited to changes that are voluntarily agreed to by a supermajority of *pari passu* creditors based on the debtor-state’s deteriorating economic circumstances. Thus, the changes – and hence the contractual impairment – should reflect the economic reality of

¹³² *Ibid.*

¹³³ *Healthnow N.Y. Inc. v. New York State Ins. Dept.*, 110 A.D. 3d 1216, 1217 (N.Y. App. Div. 3d Dep’t 2013). This case, however, is a state court decision.

¹³⁴ *Ibid.* See also *Energy Reserves Grp. v. Kan. Power & Light Co.*, 459 U.S. 400, 411 (1983). *Cf.* *Allied Structural Steel Co.*, *supra* note 128, at 244 (holding a state law invalid under the Contracts Clause because, despite the states’ police power, “that power has limits when its exercise effects substantial modifications of private contracts”).

¹³⁵ *Shepard v. Skaneateles*, 89 N.E.2d 619 (N.Y. 1949) (holding that a party who challenges a state’s exercise of its police power carries the heavy burden of showing that no reasonable interpretation of the facts would justify the exercise).

¹³⁶ See *supra* notes 131–132 and accompanying text (setting forth these factors, as articulated by the U.S. Supreme Court, for determining whether a state statute would survive a Contracts Clause challenge).

¹³⁷ See *supra* note 134 and accompanying text (indicating more leeway for a state statute to survive a Contracts Clause challenge where the contractual impairment is not substantial).

what those creditors expect (under those changed circumstances) to receive as payment. As a result, their “reasonable expectations under the contract” should not be disrupted.¹³⁸

5.2 Pari Passu Clauses

Recall that pari passu clauses currently in sovereign debt contracts are undermining Argentina’s ongoing debt restructuring efforts.¹³⁹ These clauses effectively require that all payments to creditors under a given debt contract be made pari passu to all of that contract’s creditors.¹⁴⁰ Say, for example, that a particular debt contract with Country X has three creditors – Creditor A with a claim of \$1000, Creditor B with a claim of 2000, and Creditor C with a claim of \$3000. If Country X makes a \$1000 payment on this debt, that payment must be shared equally and ratably (i.e. on a pari passu basis) among the three creditors. Thus, Creditor A would have the right to receive its ratable share (\$1000/\$6000, or one-sixth), Creditor B would have the right to receive its ratable share (\$2000/\$6000, or one-third), and Creditor C would have the right to receive its ratable share (\$3000/\$6000, or one-half), of that \$1000 payment.

Recent U.S. federal court decisions have required that pari passu sharing of payment even when certain creditors of an original debt contract, which has a pari passu clause, exchanged their original claims for debt claims under a new debt contract.¹⁴¹ This has enabled holdouts under the original debt contract to

138 See *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 362, 368 (2d Cir. 2006) (“To assess whether an impairment is substantial,” a court should “look at ‘the extent to which reasonable expectations under the contract have been disrupted.’”) [quoting *Sanitation & Recycling Indus., Inc. v. City of New York*, 107 F.3d 985, 993 (2d Cir 1997)]. See also Steven L. Schwarcz, *A Minimalist Approach to State ‘Bankruptcy’*, 59 UCLA Law Review 322, 336–337 (Dec. 2011), also available at <http://ssrn.com/abstract=1807944>. A holdout creditor might argue that its reasonable expectations under the contract are to act as a holdout, and those expectations are substantially impaired. Any such holdout expectations, however, are not to be repaid money from the debtor-state per se; rather, they are to extract value from the other creditors. Sovereign debt contracts generally do not – or at least, do not intentionally – grant creditors holdout expectations.

139 See *supra* note 2 and accompanying text.

140 Rodrigo Olivares-Caminal, *The Pari Passu Clause in Sovereign Debt Instruments: Developments in Recent Litigation*, in 72 BIS Papers 121, 124–126 (discussing the meaning of the pari passu clause, in the sovereign debt context, in the *Bliott* case in Belgium and the *Argentina* case in New York).

141 *NML Capital, Ltd. v. Republic of Argentina*, *supra* note 2; see also *NML Capital, Ltd. v. Republic of Argentina*, No. 11–CV–4908 TPG, 2015 WL 3542535 (S.D.N.Y. June 5, 2015) (granting partial summary judgment to rule that the Republic of Argentina “violated and continues to violate the *pari passu* clause of the underlying bond agreement”).

prevent Argentina from paying holders of the exchanged debt claims unless the holdouts are paid equally and ratably.¹⁴²

In response, ICMA has proposed a new form of standard *pari passu* clause for sovereign debt instruments.¹⁴³ This new form clarifies that although claims against the debtor-state rank *pari passu* in principle, they need not be paid on an equal and ratable basis with other such debt claims – even if such other debt claims arose under the same contract:

INTERNATIONAL CAPITAL MARKET ASSOCIATION
STANDARD *PARI PASSU* PROVISION FOR THE TERMS AND CONDITIONS OF SOVEREIGN NOTES GOVERNED BY NEW YORK LAW

The Bonds constitute and will constitute direct, general, unconditional and unsubordinated External Indebtedness of the Issuer for which the full faith and credit of the Issuer is pledged. The Bonds rank and will rank without any preference among themselves and equally with all other unsubordinated External Indebtedness of the Issuer. It is understood that this provision shall not be construed so as to require the Issuer to make payments under the Bonds ratably with payments being made under any other External Indebtedness.¹⁴⁴

There are problems with ICMA's approach. Most significantly, its new form of *pari passu* clause will only apply to future debt contracts, and then only to such future debt contracts that explicitly incorporate that new form.¹⁴⁵

The Model Law, however, would implicitly solve the problem of *pari passu* clauses. Once sovereign debt claims are modified in accordance with the Model

¹⁴² *NML Capital, Ltd. v. Republic of Argentina*, 2015 WL 3542535, *supra* note 141 (holding that Argentina's post-injunction conduct of attempting to pay restructured bondholders under Argentine law without making payment to the holdout bondholders "violate the *pari passu* clause of the underlying bond agreement").

¹⁴³ See *supra* note 14.

¹⁴⁴ International Capital Market Association, *Standard Pari passu Provision for the Terms and Conditions of Sovereign Notes Governed by New York Law*, available at <http://www.icmagroup.com/assets/documents/Resources/ICMA-Standard-CACs-Pari-Passu-and-Creditor-Engagement-Provisions---May-2015.pdf>. ICMA has proposed a similar standard form of *pari passu* clause, slightly modified without relevance for this article's discussion, for sovereign debt instruments governed by English law.

¹⁴⁵ International Monetary Fund, *supra* note 16, at 32–34 (observing that the IMF needs to "encourage the introduction of the modified *pari passu* clause ... using a three-pronged approach[,] and "[e]ven if the Fund is successful in promoting the inclusion of the proposed contractual provisions in new international sovereign bond issuances, this will not affect the existing stock[,] whose extent of "undermin[ing] the debt restructuring process will depend, in large part, on how courts interpret *pari passu* clauses in future litigation[,] and this "existing uncertainty regarding the existing stock" is unlikely to "be addressed in the immediate future by promoting the accelerated turn-over of this debt").

Law's supermajority aggregate voting, their principal amounts would, as so modified, legally change. Because the restructuring is intended to restore the debtor-state to debt sustainability, it thereafter should be able to pay all of those changed debt claims.

Next consider whether the Model Law would be economically and politically feasible.

6 Political Economy of a Model Law

6.1 Economic Feasibility

The economic feasibility of the Model Law will turn on its costs and benefits, both to debtor-states and to their creditors. Certainly a nation whose debt has been restructured should be able to borrow at attractive rates. In the non-sovereign context, by analogy, lending rates to restructured companies are much lower than rates charged before the restructuring.¹⁴⁶ But would a model-law approach increase a nation's ex ante borrowing costs by making creditor claims more subject to bail-in?

Leading economists have recently argued to the contrary – that uncertainty due to the absence of an effective sovereign debt resolution framework “increases the costs of borrowing.”¹⁴⁷ However, even if such a framework would increase costs, overall sovereign borrowing rates should not be affected any more than if – as most agree would be desirable – workable collective action aggregate-voting clauses were in fact included in all sovereign debt contracts. In fact, recent empirical analysis suggests that the inclusion of those clauses does not increase, and may even decrease, sovereign borrowing rates.¹⁴⁸

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

146 *Sovereign Debt Restructuring Options*, *supra* note 17, at 110–111. This is because creditor support through participation, combined with operational restructuring that often accompanies debt restructuring, is viewed favorably by the market. The lower rates also reflect firms' lower debt-to-equity ratios. Similarly, a debtor-state should have a lower debt-to-GDP ratio and thus should be less likely to default in the future. *Ibid.*

147 Stiglitz et al. (2015), *supra* note 5, at 1.

148 See Michael Bradley and Mitu Gulati, *Collective Action Clauses for the Eurozone*, Review of Finance 1 (2013) (finding that the presence of CACs leads to a lower cost of capital).

corporate bankruptcy law should be repealed because it might increase the borrowing cost of solvent companies.

The economic feasibility of a model-law approach should also take into account its costs and benefits to creditors. Reduced uncertainty has already been mentioned as a potential benefit.¹⁴⁹ A potential cost, however, is that the Model Law would facilitate the transfer of value from creditors to a debtor-state if a class of claims agrees to a restructuring that reduces its principal amount or interest rate. That transfer of value nonetheless would be bargained for; each class of claims has the power to veto the debtor-state's restructuring plan.¹⁵⁰ Furthermore, any transfer of value from creditors to their debtor-state would be less under the Model Law than under a typical corporate bankruptcy law, because the latter gives debtors cram-down powers.¹⁵¹

6.2 Political Feasibility

This article has already observed several reasons why a model-law approach to sovereign debt restructuring should be politically more feasible than a convention. Most significantly, a model-law approach would not require general acceptance by the world's nations for its implementation.¹⁵² Only one or two jurisdictions need enact this article's proposed Model Law for it to become widely effective.¹⁵³ And once that occurs, a debtor-state whose debt contracts are governed by those jurisdictions' laws, or by its own laws, could restructure that debt without needing to amend any of those contracts.¹⁵⁴ Experience also shows that a model law's more relaxed nature, being domestic law, and (for that reason) less formal enactment process and minimal interference with sovereignty can succeed where a formal treaty approach can languish.¹⁵⁵

¹⁴⁹ See *supra* note 147 and accompanying text.

¹⁵⁰ See Model Law Article 7(1) (providing that a restructuring plan needs the agreement of each class of claims to become effective and binding).

¹⁵¹ See *supra* notes 110–117 and accompanying text (discussing that, unlike typical corporate bankruptcy law, the Model Law does not permit a debtor-state to cram down a plan over dissenting creditor classes).

¹⁵² See *supra* notes 62–67 and accompanying text. A model-law approach, unlike a treaty, thus would not face the “profound difficulties [of] building international consensus behind any sweeping change in global financial regulation.” Setser, *supra* note 48, at 3.

¹⁵³ See *supra* notes 67–71 and accompanying text.

¹⁵⁴ *Ibid.*

¹⁵⁵ See *supra* notes 26–32 and accompanying text. *Cf.* Setser, *supra* note 48, at 6 (observing that debtor-states opposed the SDRM because they were “keen to protect their sovereignty, and to prevent an international organization from gaining jurisdiction over their domestic-law debt”).

It is also informative to assess the political feasibility of a model-law approach from the perspective of the politics of the IMF's failed SDRM. As mentioned, that approach failed because it was opposed both by Wall Street and by certain emerging market countries that feared it would raise their cost of borrowing.¹⁵⁶ Section 6.1 of this article has argued, however, that a model-law approach should reduce those costs.

A model-law approach should also surmount most other reasons suggested to explain the SDRM's failure. At the time the SDRM was proposed, many believed that “[e]xchange offers, combined with the ability to amend a bond's terms[,] provide a mechanism for [sovereign] debt restructuring even in the absence of a [statutory debt restructuring] regime.”¹⁵⁷ Experience, of course, has undermined that belief.¹⁵⁸ Also at that time, “the major emerging economies – and particularly the Latin American economies – feared losing access to large scale emergency credit from the IMF in return for legal protection of only marginal value.”¹⁵⁹ The new reality is that debtor-states cannot always count on the IMF for that credit,¹⁶⁰ whereas the value of a model law's protection should be significant.

Finally, some may have opposed the SDRM because of “[s]uspicious about the role the IMF would play in a restructuring process designed by the IMF.”¹⁶¹ This appears to explain, for example, the financial industries' opposition.¹⁶² The model-law approach is not designed by the IMF, nor is the IMF necessarily part of its supervisory process.¹⁶³ Others have observed that some nations may oppose any international tribunal (even one that is otherwise neutral) interfering with sovereign political discretion.¹⁶⁴ Because this article's proposed Model Law limits

¹⁵⁶ See *supra* notes 48–52 and accompanying text.

¹⁵⁷ Setser, *supra* note 48, at 5.

¹⁵⁸ See *supra* notes 1–7 and accompanying text.

¹⁵⁹ Setser, *supra* note 48, at 5.

¹⁶⁰ See *supra* note 101 and accompanying text. See also Setser, *supra* note 48, at 5 (observing that “it is unrealistic for the major emerging economies to think that the IMF will prevent all default”).

¹⁶¹ Setser, *supra* note 48, at 17.

¹⁶² See, e.g. Hagan, *supra* note 49 (observing that the opposition to the SDRM by major financial industry associations was attributable to their suspicions regarding IMF motivation).

¹⁶³ See *supra* notes 81–82 and accompanying text. This article's proposed Model Law specifies that the Supervisory Authority must be a “neutral international organization.” Model Law Article 2(5).

¹⁶⁴ Cf. Richard Conn, Principal and Managing Dir., Innovate Partners LLC, Keynote Address at the General Assembly of the United Nations, 6th Meeting, 2nd Working Session of the Ad Hoc Committee on Sovereign Debt Restructuring Processes (April 28, 2015) (emphasizing that developed nations are concerned about international tribunals exercising what should be a nation's political discretion in a sovereign debt restructuring).

the supervisory process to ministerial actions,¹⁶⁵ the Supervisory Authority managing that process would lack authority to interfere with political discretion.

A model-law approach could also provide clear positive political benefits. By helping to privatize interim funding to a debtor-state,¹⁶⁶ it could reduce the burden on IMF creditor countries of funding IMF bailout loans.¹⁶⁷ Reducing the need for IMF funding would also reduce the conditionality that the IMF, politically, imposes on borrowing nations, which can sometimes exacerbate the nation's economic woes.¹⁶⁸ Furthermore, a model-law approach could provide a political cover for painful decisions that can be attributed by state to a supervising entity or to legal requirements.¹⁶⁹

None of this means that a model-law approach to sovereign debt restructuring, or at least this article's proposed Model Law, will be politically feasible. For example, some debtor-states might oppose the Model Law's similar treatment¹⁷⁰ of domestic and foreign claims.¹⁷¹ Some private creditors might also oppose the Model Law's supermajority aggregate voting, believing that the threat of holdouts is necessary to ensure that debtor-states will bargain fairly¹⁷² (but failing to understand that the Model Law preserves that threat to the extent necessary to motivate fair bargaining¹⁷³).

At the very least, however, this article should serve to increase a model-law approach's political feasibility by explaining the approach and its potential benefits and limitations, including its ability to equitably relieve debtor-states from

165 See *supra* note 86 and accompanying text.

166 See *supra* notes 101–108 and accompanying text; see also Model Law Articles 8 and 9.

167 Cf. Setser, *supra* note 48, at 3 (discussing that many IMF creditor countries favored the SDRM for this same reason).

168 Jayadev and Konczal, *supra* note 113. Cf. *supra* note 104 (arguing that the conditionality that would have been imposed under the IMF's SDRM would be politically volatile and might impose harsh conditions on the citizens of the debtor-state).

169 Westbrook, *supra* note 6, at 256.

170 See *supra* note 80 and accompanying text.

171 Cf. Setser, *supra* note 48, at 19 (observing that including “domestic debt” claims in the SDRM “was a bridge too far for almost everyone”).

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

173 The Model Law preserves the holdout threat to the extent needed to motivate debtor-states to bargain fairly. See *supra* note 93. Absent a fair bargain, no creditor class would have an incentive to vote to approve a debt restructuring plan – and each class has the power to veto the debtor-state's restructuring plan. See *supra* note 150 and accompanying text. The Model Law seeks to eliminate the holdout threat only for rent-seeking holdouts, who use that threat to unreasonably extract value (at least in part) from other similarly situated creditors. See *supra* note 9 and accompanying text.

unsustainable debt burdens. An incremental approach to developing norms has strong precedent in the legal ordering of international relationships,¹⁷⁴ especially “where law reformers possess limited authority and where the subject is either controversial or technical,” such as “global insolvency law reform.”¹⁷⁵

7 Conclusions

The existing contractual framework for sovereign debt restructuring is sorely inadequate. Whether or not their fault, nations sometimes take on debt burdens that become unsustainable. Until resolved, the resulting sovereign debt problem hurts not only those nations (such as Greece) but also their citizens, their creditors, and – by posing serious systemic risks to the international financial system – the wider economic community. The existing contractual framework functions poorly to resolve the problem because it often leaves little alternative between a sovereign debt bailout, which is costly and creates moral hazard, and a default, which raises the specter of systemic financial contagion.

¹⁷⁴ Cf. Oona A. Hathaway, *Between Power and Principle: An Integrated Theory of International Law*, 72 U. Chi. L. Rev. 469, 531 (2005) (observing that “states can be gradually led toward stronger legal rules . . . by starting with relatively weak international rules backed by little or no sanctions that all states feel comfortable joining, but then gradually pushing states to accept successively stronger and more challenging requirements”).

¹⁷⁵ Susan Block-Lieb and Terence Halliday, *Incrementalisms in Global Lawmaking*, 32 Brook. J. Int'l L. 851, 852 (2007). Cf. John A.E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy*, 45 Va. J. Int'l L. 935, 939 (2005) (observing that UNCITRAL's Model Law on Cross-Border Insolvency “created an opportunity to bridge the theoretical gap between universalists and territorialists . . . by appearing to be a hybrid of universalism and territorialism[,] . . . thus allow[ing] hesitant states to ‘acclimate’ to a regime of universalism”). An incremental approach to developing norms has also been valuable for addressing international environmental problems, such as climate change. See, e.g. Daniel J. Fiorino, *The New Environmental Regulation* 221 (2006) (arguing that “an incremental . . . strategy for change offers the best alternative for speeding up the transition to a new environmental regulation”); Richard B. Stewart, *A New Generation of Environmental Regulation?*, 29 Cap. U. L. Rev. 21, 133–134 (2001) (observing that “any solution to current concerns with the U.S. environmental regulatory system is likely to be and is best served by an incremental approach”); Philippa England, *Book Reviews*, 54 Int'l & Comp. L.Q. 1037, 1038 (2005) (reviewing Francis Botchway, *International Encyclopaedia of Laws, Supplement 46, in International Encyclopaedia of Laws: Environmental Law*) (“More sophisticated legal techniques are not necessarily the solution – realistic, feasible solutions driven by the political will of leaders, the general population and supported by the international community may offer a more incremental but ultimately more effective method of dealing with environmental issues”). And recently, an incremental approach to developing norms has succeeded in legalizing gay marriage. *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015).

Most observers therefore want to strengthen the legal framework for resolving sovereign debt problems. International organizations, including the United Nations, have been contemplating strengthening that framework through treaties. The political economy of treaty-making, however, makes that type of multi-lateral approach highly unlikely to succeed in the near future.

This article argues, in contrast, that a model-law approach should not only strengthen that legal framework but also should be politically and economically feasible. Model laws have long been used in cross-border lawmaking, but they are different than treaties. Unlike a treaty, a model law would not require general acceptance for its implementation. Only one or two jurisdictions, for example, need enact the text of this article's proposed model law for it to become widely effective. Once that occurs, a debtor-state whose debt contracts are governed by those jurisdictions' laws, or by its own laws, could restructure that debt without needing to amend any of those contracts.

A model-law approach should also be desirable. This article's model law, for example, would reduce uncertainty and should also achieve significant cost advantages – both to debtor-states and to their creditors – over the sovereign-debt-restructuring status quo. Because it would require only a ministerial supervisory process, the model law would not interfere with the exercise of a sovereign's political discretion. Moreover, the model law provides incentives to motivate fair bargaining on behalf of debtor-states and their creditors, while restricting rent-seeking holdouts. It also enables the type of interim funding of day-to-day debts that a debtor-state needs during its debt restructuring.

Debtor-states should therefore want (and creditors, other than rent-seeking holdouts, should want them) to enact into law this article's proposed model-law text. Regardless of whether that enactment occurs, however, the article should serve its underlying purpose: to provide a conceptual and legal analysis of how a model law could be structured and how a model-law approach could be used to solve the problem of unsustainable sovereign debt burdens, and to help develop the norms required to facilitate those goals.

Acknowledgments: For valuable comments in addition to those thanked above, the author thanks Ernest Young, ..., participants in a CIGI roundtable meeting in Naples, Italy on “Sovereign Debt Restructuring: Proposals for Reform,” participants in a faculty workshop at Duke University, and participants in a conference on sovereign debt restructuring at Imperial College, London, sponsored by its Brevan Howard Centre for Financial Analysis, the Initiative on Global Markets of the University of Chicago Booth School of Business, and the III. He also thanks Ruiyao Sun and Tashi Sun for valuable research assistance. Support is provided in part by a Fuller-Purdue grant.

Appendix: Proposed Form of a Model Law

Sovereign Debt Restructuring Model Law

Preamble

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

Chapter I: Scope, and Use of Terms

Article 1: Scope

1. This Law applies where, by contract or otherwise, (a) the law of [this jurisdiction¹⁷⁶] governs the debtor-creditor relationship between a State and its creditors and (b) the application of this Law is invoked in accordance with Chapter II.
2. Where this Law applies, it shall operate retroactively and, without limiting the foregoing, shall override any contractual provisions that are inconsistent with the provisions of this Law.¹⁷⁷

Article 2: Use of Terms

For purposes of this Law:

1. “creditor” means a person or entity that has a claim against a State;
2. “claim” means a payment claim against a State for monies borrowed or for the State’s guarantee of, or other contingent obligation on, monies borrowed; and the term “monies borrowed” shall include the following, whether or not it represents the borrowing of money per se: monies owing under bonds, debentures, notes, or similar instruments; monies owing for the deferred

¹⁷⁶ This would refer to a jurisdiction enacting this Model Law, e.g. New York, England, a nation, etc. Articles 3(3) and 11 further expand this Law’s application.

¹⁷⁷ For example, if New York enacts this Model Law, it will retroactively bind parties whose contracts are governed by New York law. Recall that legal retroactivity is respected under international law so long as it is neither discriminatory nor arbitrary. See *supra* note 74 and accompanying text. Section 5.1 analyzes the special problem of legal retroactivity under New York law.

purchase price of property or services, other than trade accounts payable arising in the ordinary course of business; monies owing on capitalized lease obligations; monies owing on or with respect to letters of credit, bankers' acceptances, or other extensions of credit; and monies owing on money-market instruments or instruments used to finance trade;

3. "Plan" means a debt restructuring plan contemplated by Chapter III;
4. "State" means a sovereign nation;
5. "Supervisory Authority" means [name of neutral international organization].

Chapter II: Invoking the Law's Application

Article 3: Petition for Relief, and Recognition

1. A State may invoke application of this Law by filing a voluntary petition for relief with the Supervisory Authority.
2. Such petition shall certify that the State (a) seeks relief under this Law, and has not previously sought relief under this Law (or under any other law that is substantially in the form of this Law) during the past [ten] years, (b) needs relief under this Law to restructure claims that, absent such relief, would constitute unsustainable debt of the State, (c) agrees to restructure those claims in accordance with this Law, (d) agrees to all other terms, conditions, and provisions of this Law, and (e) has duly enacted any national law needed to effectuate these agreements. If requested by the Supervisory Authority, such petition shall also attach documents and legal opinions evidencing compliance with clause (e).
3. Immediately after such a petition for relief has been filed, and so long as such filing has not been dismissed by the Supervisory Authority [or this jurisdiction] for lack of good faith, the terms, conditions, and provisions of this Law shall (a) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of [this jurisdiction]; (b) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of another jurisdiction that has enacted law substantially in the form of this Law; and (c) be recognized in, and by, all other jurisdictions that have enacted law substantially in the form of this Law.

Article 4: Notification of Creditors

Within 30 days after filing its petition for relief, the State shall notify all of its known creditors of its intention to negotiate a Plan under this Law.

Chapter III: Voting on a Debt Restructuring Plan

Article 5: Submission of Plan

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

Article 6: Contents of Plan

A Plan shall

1. designate classes of claims in accordance with Article 7(3);
2. specify the proposed treatment of each class of claims;
3. provide the same treatment for each claim of a particular class, unless the holder of a claim agrees to a less favorable treatment;
4. disclose any claims not included in the Plan's classes of claims;¹⁷⁸
5. provide adequate means for the plan's implementation including, with respect to any claims, curing or waiving any defaults or changing the maturity dates, principal amount, interest rate, or other terms or canceling or modifying any liens or encumbrances; and
6. certify that, if the Plan becomes effective and binding on the State and its creditors under Article 7(1), the State's debt will become sustainable.¹⁷⁹

Article 7: Voting on the Plan

1. A Plan shall become effective and binding on the State and its creditors when it has been submitted by the State and agreed to by each class of such creditors' claims designated in the Plan under Article 6(1). Thereupon, the State shall be discharged from all claims included in those classes of claims, except as provided in the Plan.
2. A class of claims has agreed to a Plan if creditors holding at least [two-thirds] in amount and more than [one-half] in number of the claims of such class [voting on such Plan¹⁸⁰] [entitled to vote on such Plan] agree to the Plan.

¹⁷⁸ Depending on the contractual terms, a debtor-state could, for example, decide to exclude claims that incorporate collective action aggregate-voting clauses from the Plan's classes of claims. The debtor-state then would have to disclose those excluded claims.

¹⁷⁹ Because the debtor-state itself makes the determination of debt sustainability (see *infra* note 86 and accompanying text), such determination could take into account whatever criteria the debtor-state deems relevant, including economic policy measures adopted by the debtor-state to help ensure the future payment of its debt.

¹⁸⁰ The Plan can be more easily approved if this alternative is selected, but reliable notice to creditors then becomes more important.

3. Each class of claims shall consist of claims against the State that are *pari passu* in priority, provided that (a) *pari passu* claims need not all be included in the same class,¹⁸¹ and (b) claims of governmental or multi-governmental entities each shall be classed separately.¹⁸²

Chapter IV: Financing the Restructuring

Article 8: Terms of Lending

1. Subject to Article 8(3), the State shall have the right to borrow money on such terms and conditions as it deems appropriate.
2. The State shall notify all of its known creditors of its intention to borrow under Article 8(1), the terms and conditions of the borrowing, and the proposed use of the loan proceeds. Such notice shall also direct those creditors to respond to the Supervisory Authority within 30 days as to whether they approve or disapprove of such loan.
3. Any such loan must be approved by creditors holding at least two-thirds in amount of the claims of creditors responding to the Supervisory Authority within that 30-day period.

Article 9: Priority of Repayment

1. The State shall repay loans approved under Article 8 prior to paying any other claims.
2. The claims of creditors of the State are subordinated to the extent needed to effectuate the priority payment under this Article 9. Such claims are not subordinated for any other purpose.

Chapter V: Adjudication of Disputes

Article 10: Arbitration

1. All disputes arising under this Law shall be resolved by binding arbitration before a panel of three arbitrators.
2. The arbitration shall be governed by [generally accepted international arbitration rules of (name of neutral international arbitration body)] [the rules

¹⁸¹ The Plan can, for example, designate one or more classes of *pari passu* creditors from multiple debt issues.

¹⁸² Among other things, this separate classification will prevent any governmental voting manipulation.

- of the International Centre for Settlement of Investment Disputes (ICSID)/ International Centre for Dispute Resolution/ICC International Court of Arbitration].
3. Notwithstanding Article 10(2), if all the parties to an arbitration contractually agree that such arbitration shall be governed by other rules, it shall be so governed. Such agreement may be made before or after the dispute arises.
 4. The State shall pay all costs, fees, and expenses of the arbitrations.¹⁸³

Chapter VI: Opt In

Article 11: Opting in to this Law

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

References

- Bermann, George A. (1985) *Integration through Law: Europe and the American Federal Experience*. Berlin: De Gruyter.
- Black's Law Dictionary, 4th pocket ed. (2011). West Group.
- Block-Lieb, Susan and Terence Halliday (2007) "Incrementalisms in Global Lawmaking," *Brookings Journal of International Law*, 32:851–903.
- Bolton, Patrick (2003) "Toward a Statutory Approach to Sovereign Debt Restructuring: Lesson from Corporate Bankruptcy Practice Around the World," *IMF Staff Papers*, 50. Available at: <https://www.imf.org/external/pubs/cat/longres.cfm?sk=16253.0>.
- Bolton, Patrick and David A. Skeel, Jr. (2004) "Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?" *Emory Law Journal*, 53:763–822.
- Bradley, Michael and Mitu Gulati (2013) "Collective Action Clauses for the Eurozone," *Review of Finance*, 1–58.
- Brooks, Skylar and Domenico Lombardi (2015) "Governing Sovereign Debt Restructuring Through Regulatory Standards." *Journal of Globalization and Development*, 6(2):287–318.

¹⁸³ This is consistent with best practices in a corporate bankruptcy case, under which the estate normally pays all costs. Alternatively, this Model Law could provide that the parties to the dispute should pay their own expenses.

- Brooks, Skylar, Martin Guzman, Domenico Lombardi and Joseph E. Stiglitz (2015) "Identifying and Resolving Inter-Creditor and Debtor-Creditor Equity Issues in Sovereign Debt Restructuring," CIGI Policy Brief No. 53, January.
- Clement, Zack (2013) "Restructuring Government Finances – In Public and in Less Than a Year," *Westlaw Insolvency Intelligence*, 26:91–93.
- Clement, Zack and R. Andrew Black (2014) "How City Finances Can Be Restructured: Learning from Both Bankruptcy and Contract Impairment Cases," *American Bankruptcy Law Journal*, 88:41–84.
- Conn, Richard, Principal and Managing Dir., Innovate Partners LLC. (2015) Keynote Address at the General Assembly of the United Nations, 6th Meeting, 2nd Working Session of the Ad Hoc Committee on Sovereign Debt Restructuring Processes, Apr. 28, 2015.
- Cooper, Andrew F. and Bessma Momani (2005) "Negotiating Out of Argentina's Financial Crisis: Segmenting the International Creditors," *New Political Economy*, 10:305–320.
- Danielsson, Jon (2009) "The First Casualty of the Crisis: Iceland." In: (Andrew Felton and Carman Reinhart, eds.) *The First Global Financial Crisis of the 21st Century Part II*. London: Centre for Economic Policy Research, pp. 11–12.
- "Detroit's 20 Largest Unsecured Creditors," *Detroit Free Press*, July 19, 2013. Available at: <http://archive.freep.com/article/20130719/NEWS01/307190029/detroit-bankruptcy-list-creditors>.
- Diaz, Hugo Ruiz (2003) "The Creation of an Arbitration Tribunal on Debt: An Alternative Solution? On The Position to Take as the CADTM." Available at: http://www.world-governance.org/IMG/pdf_013_Setting_up_an_arbitration_tribunal_on_debt.pdf.
- Eichengreen, Barry (2006) "Policy Proposals for Restructuring Unsustainable Sovereign Debt." In: (I. Kaul and P. Conceicao, eds.) *The New Public Finance*, Chapter 3. New York: Oxford University Press.
- England, Philippa (2005) "Book Reviews," *International & Comparative Law Quarterly*, 54:265–276.
- Fiorino, Daniel J. (2006) *The New Environmental Regulation*. Cambridge: The MIT Press.
- Fitzgerald, Oonagh (2015) "Next Steps Towards a Multilateral Debt Workout Process," CIGI Global Rule of Law Blog (June 4, 2015). Available at: <https://www.cigionline.org/blogs/global-rule-of-law/next-steps-towards-multilateral-debt-workout-process-part-1> and <https://www.cigionline.org/blogs/global-rule-of-law/next-steps-towards-multilateral-debt-workout-process-part-2>.
- Gelpern, Anna (2014) "A Skeptic's Case for Sovereign Bankruptcy." In: (Christoph Paulus, ed.) *A Debt Restructuring Mechanism for Sovereigns: Do We Need a Legal Procedure?* Oxford: Beck/Hart, p. 262.
- Gillespie, Alistair (2013) "The English Legal System," *The English Legal System*, 4.
- Gitlin, Richard and Brett House (2014) "A Blueprint for a Sovereign Debt Forum." (CIGI Paper No. 27, at 10) (Mar. 12, 2014). Available at: <http://www.cigionline.org/publications/blueprint-sovereign-debt-forum>.
- Guzman, Martin and Daniel Heymann (2015) "The IMF Debt Sustainability Analysis: Issues and Problems," *Journal of Globalization and Development*, 6(2):387–404.
- Guzman, Martin and Joseph Stiglitz (2015) "Creating a Framework for Sovereign Debt Restructuring that Works." In: (M. Guzman, J.A. Ocampo and J.E. Stiglitz, eds.) *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises*, Chapter 1. New York: Columbia University Press (forthcoming).
- Hagan, Sean (2005) "Designing a Legal Framework to Restructure Sovereign Debt," *Georgetown Journal of International Law*, 36:299–402.

- Hathaway, Oona A. (2005) "Between Power and Principle: An Integrated Theory of International Law," *University of Chicago Law Review*, 72:469–527.
- Helleiner, Eric (2008) "The Mystery of the Missing Sovereign Debt Restructuring Mechanism," *Contributions to Political Economy*, 27:91–113.
- Horsefield, J. Keith. (1969) "The White Plan." In: (Anne Salda, ed.) *III The International Monetary Fund 1945–1965: Twenty Years of International Monetary Cooperation*. Washington: International Monetary Fund, p. 95.
- Hüpkens, Eva (2015) Adviser on Regulatory Policy and Cooperation at the Financial Stability Board (FSB), email to the author, July 14, 2015.
- IMF Staff (2014) "The Fund's Lending Framework and Sovereign Debt-Preliminary Considerations," June 2014. Available at: <http://www.imf.org/external/np/pp/eng/2014/052214.pdf>.
- International Capital Market Association (2015) "Standard Pari passu Provision for the Terms and Conditions of Sovereign Notes Governed by New York Law," May 2015. Available at: <http://www.icmagroup.com/assets/documents/Resources/ICMA-Standard-CACs-Pari-Passu-and-Creditor-Engagement-Provisions---May-2015.pdf>.
- International Monetary Fund (2014) *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*. October 2014. Available at: <http://www.imf.org/external/pp/longres.aspx?id=4911>.
- Jayadev, Arjun and Mike Konczal (2010) "The Boom Not the Slump: The Right Time for Austerity." Economics Faculty Publication Series. Paper 26. Available at: http://scholarworks.umb.edu/cgi/viewcontent.cgi?article=1026&context=econ_faculty_pubs.
- Johnson, Emily D. and Ernest A. Young (2012) "The Constitutional Law of State Debt," *Duke Journal of Constitutional Law & Policy*, 27:117–162.
- Kenadjian, Patrick S. (2013) "The Aggregation Clause in Euro Area Government Securities." In: (Patrick S. Kenadjian, Klaus-Albert Bauer and Andreas Cahn, eds.) *Collective Action Clauses and the Restructuring of Sovereign Debt*. Berlin: Walter de Gruyter GmbH, pp. 113–149.
- King, Brett W. (1996) "The Use of Supermajority Voting Rules in Corporate America: Majority Rule, Corporate Legitimacy, and Minority Shareholder Protection," *Delaware Journal of Corporate Law*, 21:895–941.
- Kletzer, Kenneth M. (2003) "Sovereign Bond Restructuring: Collective Action Clauses and Official Crisis Intervention," IMF Working Paper.
- Mooney, Jr., Charles W. (2001) "Extraterritorial Impact of Choice-of-Law Rules for Non-United States Debtors Under Revised U.C.C. Article 9 and a New Proposal for International Harmonization." In: (Michael Bridge and Robert Stevens, eds.) *Cross-Border Security and Insolvency*. New York: Oxford University Press.
- Mooney, Jr., Charles W. (2016) "A Framework for a Formal Sovereign Debt Restructuring Mechanism: The KISS Principle (Keep it Simple, Stupid) and Other Guiding Principles," *Michigan Journal of International Law*, 37 (forthcoming).
- Muse-Fisher, John (2014) "Starving the Vultures: NML Capital v. Republic of Argentina and Solutions to the Problem of Distressed-Debt Funds," *California Law Review*, 102:1671–1726.
- Paulus, Christoph G. and Steven T. Kargman (2008) "Reforming the Process of Sovereign Debt Restructuring: A Proposal for a Sovereign Debt Tribunal." Workshop on Debt, Finance and Emerging Issues in Financing Integration. Available at: http://www.un.org/esa/ffd/wp-content/uploads/2008/04/20080408_Kargman-Paulus-Paper.pdf.
- Paulus, Christoph G. and Ignacio Tirado (2013) "Sweet and Lowdown: A 'Resolvency' Process and the Eurozone's Crisis Management Framework," *Law and Economics Yearly Review*, II.2:504–559.

- Pottow, John A. E. (2005) "Procedural Incrementalism: A Model for International Bankruptcy," *Virginia Journal of International Law*, 45:936–1015.
- Pottow, John A. E. (2013) "Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign Debt Restructurings," *Law & Economics Working Papers*, 81. Available at: http://repository.law.umich.edu/law_econ_current/81.
- Rodger of Earlsferry, Lord (2008) "Foreword." In: (Ben Juratowitch, ed.) *Retroactivity and the Common Law*. Oxford: Hart Publishing.
- Rogers, James S. (1983) "The Impairment of Secured Creditors' Rights in Reorganization: A Study on Relationship between The Fifth Amendment and The Bankruptcy Clause," *Harvard Law Review*, 96:973–1031.
- Rogoff, Kenneth and Jeromin Zettelmeyer (2002) "Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976–2001," *IMF Staff Papers*, 49:470–471. Available at: <http://www.imf.org/External/Pubs/FT/staffp/2002/03/pdf/rogoff.pdf>.
- Ryan, Molly (2014) "Sovereign Bankruptcy: Why Now and Why Not in the IMF," *Fordham Law Review*, 82(5):2473–2520.
- Sachs, Jeffrey (1995) "Do We Need an International Lender of Last Resort?" Frank D. Graham Lecture at Princeton University.
- Sandleris, Guido (2008) "Sovereign Defaults: Information, Investment and Credit," *Journal of International Economics*, 76:267–275.
- Schwarcz, Steven L. (2000) "Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach," *Cornell Law Review*, 85:956–1034.
- Schwarcz, Steven L. (2002) "Global Decentralization and the Subnational Debt Problem," *Duke Law Journal*, 51:1179–1250.
- Schwarcz, Steven L. (2004) "'Idiot's Guide' to Sovereign Debt Restructuring," *Emory Law Journal*, 53:1208–1211.
- Schwarcz, Steven L. (2011) "A Minimalist Approach to State 'Bankruptcy'," *UCLA Law Review*, 59:322–353. Available at: <http://ssrn.com/abstract=1807944>.
- Schwarcz, Steven L. (2012) "Sovereign Debt Restructuring Options: An Analytical Comparison," *Harvard Business Law Review*, 2:95–122. Available at: <http://ssrn.com/abstract=1872552>.
- Schwarcz, Steven L. (2014a) "Rollover Risk: Ideating a U.S. Debt Default," *Boston College Law Review*, 55:1–37.
- Schwarcz, Steven L. (2014b) "Sovereign Debt: The Statutory Solution," *International Financial Law Review*, 33:38–39. Available at: <http://www.iflr.com/Article/3405641/Sovereign-debts-statutory-solution.html>.
- Scott, Hal S. (2003) "A Bankruptcy Procedure for Sovereign Debtors?" *The International Lawyer*, 37:103–135.
- Setser, Brad (2010) "The Political Economy of the SDRM." In: (Barry Herman, José Antonio Ocampo and Shari Spiegel, eds.) *Overcoming Developing Country Debt Crises*. Oxford: Oxford University Press.
- Sheldon QC, Clive (2012). "A Justified Retrospective." In: *New Law Journal* (April 27, 2012). Available at: <http://www.11kbw.com/uploads/files/CSLegalWeekSpecialistCommercial.pdf> (observing that where the retrospective).
- Singh, Dalvinder (2011) "U.K. Approach to Financial Crisis Management," *Transnational Law & Contemporary Problems*, 19:868–922.
- Stewart, Richard B. (2001) "A New Generation of Environmental Regulation?," *Capital University Law Review*, 29:21–182.

- Stiglitz, Joseph E. and Martin Guzman (2015) "A Rule of Law for Sovereign Debt." Available at: <http://www.project-syndicate.org/commentary/sovereign-debt-restructuring-by-joseph-e-stiglitz-and-martin-guzman-2015-06>.
- Stiglitz, Joseph E., Martin Guzman, Domenico Lombardi, José Antonio Ocampo and Jan Svejnar (2015) "Frameworks for Sovereign Debt Restructuring," (IPD-CIGI-CGEG Policy Brief from a November 17, 2014 conference held at Columbia University).
- Thomas, Landon. "A Bold Proposal to Offer Greece Some Financial Relief," *New York Times*, July 11, 2015.
- Tran, Hung. "The IMF: What is it Good For?" Presentation at The Peterson Institute for International Economics, Washington, DC, Apr. 8, 2014. Available at: http://www.iie.com/events/event_detail.cfm?EventID=318.
- Volokh, Alexander. "The Revival of the Contract Clause." The Reason Foundation, Sept. 25, 2013. Available at: <http://reason.org/news/show/pensions-contract-clause#sthash.LDDMTTBM.dpuf>.
- Westbrook, Jay L. (1996) "Creating International Insolvency Law," *American Bankruptcy Law Journal*, 70:563–574.
- Westbrook, Jay L. (2014) "Sovereign Debt and Exclusions from Insolvency Proceedings." In: (Christoph Paulus, ed.) *A Debt Restructuring Mechanism for Sovereigns: Do We Need a Legal Procedure?* Oxford: Beck/Hart, p. 251.
- Wood, Philip R. (2007) "Governing Law of Financial Contracts Generally." *Conflict of Laws and International Finance*, 12.

Article note: Copyright ©2016 by Steven L. Schwarcz, the Stanley A. Star Professor of Law & Business, Duke University School of Law (schwarcz@law.duke.edu), and Senior Fellow, the Centre for International Governance Innovation (CIGI). In writing the Model Law contained in this article, the author has benefited greatly from discussions with colleagues on the International Insolvency Institute (III) Working Group on Sovereign Insolvencies and the Centre for International Governance Innovation ILRP Working Group on Cross-Border & Sovereign Insolvencies. Besides the author, the members of these Working Groups are, respectively, Donald Bernstein, Zack Clement, Allan Gropper, Robin Itkin, Steven T. Kargman, Kenneth N. Klee, Christopher Klein, Bruce Leonard, Charles W. Mooney, Christoph Paulus, and Ignacio Tirado; and Mona Davies, Oonagh Fitzgerald, Marcus Jewett, Bruce Leonard, John Murray, Catherine Walsh, and Miranda Xafa.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.