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THE PATH TOWARDS AN INTERNATIONAL PUBLIC POLICY FOR SOVEREIGN DEBT CONTRACTS

Régis Bismuth[1]

ABSTRACT

Recent times have been rich in events highlighting the shortcomings of mechanisms for dealing with sovereign debt crises, especially when they involve private creditors. Both the Greek financial debacle and the spate of litigation arising from Argentina's 2001 default have exposed the obstacles to both the successful implementation of restructuring plans and the attempts to block the legal actions brought by private creditors not willing to participate in the restructuring of sovereign debt. Given this seeming disarray and the impediments to the establishment of sovereign insolvency proceedings, the loan contract emerged as one of the most suitable instrument to ensure an orderly resolution of sovereign insolvency issues. In this context, it seems reasonable to examine the possible emergence of an "international public policy" for sovereign debt, the cornerstone of which would be the loan contract concluded between the State and its creditors.

Keywords: Collective Action Clauses (CACs) – European Stability Mechanism (ESM) – International pubic policy – Sovereign febt – Vulture funds

The year 2012 will no doubt go down in history in the annals of sovereign debt given the record value of the Greek debt restructuring implemented through debt exchange of more than two-hundred billion euros[2]. The unprecedented magnitude and intensity of the debt crisis faced by the euro area has even led some of its member states to seek the financial assistance of the IMF[3], an option considered shameful a few weeks before the adoption of the first aid package for Greece[4].

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2 ZETTELMEYER Jeromin, TREBESCH Christoph, GULATI Mitu, *The Greek Debt Exchange: An Autopsy*, September 2012, p. 16, available at <http://papers.ssrn.com>; INTERNATIONAL MONETARY FUND, *Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework*, April 2013, p. 6.

3 On the financial assistance of the IMF to the euro zone member States, see, BISMUTH Régis, "L'assistance financière du FMI aux États membres de la zone euro : De l'inconcevable au conventionnel (ou comment «conventionnaliser» l'inconcevable)", *Revue des Affaires Européennes*, 2012, n° 4, pp. 747-757.

4 Replying to a question asking whether there was something preventing Greece from "knock[ing] on the door of the IMF", Jean-Claude Trichet, the former Governor of the European Central Bank, replied:

> I do not want to enter into some kind of fantasy scenario […]. [We] are, in a way, in a system which is very different from the usual environment. When you are inside the

While the euro zone may have been at the center of the world's attention, the Greek crisis should not eclipse other developments that have been particularly informative about the treatment of sovereign insolvency. Indeed, recent years have also been marked by the litigation arising out of the Argentinean default of 2001, which has given a comprehensive overview of possible legal strategies adopted by private creditors in order to recoup as much of their investments as possible. Some of these creditors declined Argentina's exchange offers and referred the matter to the courts of the State of New York that had jurisdiction pursuant to the agreement regulating sovereign bond issues[5] or decided to initiate arbitral proceedings under the auspices of the ICSID Convention[6]. Measures of enforcement or of constraint against Argentina's assets were also sought in Belgium, France and the United Kingdom[7]. The litigation has even reached the International Tribunal of the Law of the Sea which ordered the release of an Argentine frigate detained in Ghana following a successful application by one of Argentina's creditors[8]. This multifaceted and disorderly litigation stemming from the Argentinean default is indicative of the absence of a formal and centralized sovereign bankruptcy mechanism and clearly shows that sovereign debt crises cannot be treated as mere extensions of financial crises[9].

A comparison between the legal framework regulating sovereign insolvency and private insolvency reveals three key areas in which differences should

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euro area, you are helped by the very fact of belonging to the euro area, and you are helped considerably; EUROPEAN CENTRAL BANK, Introductory Statement with Q&A – Press Conference, 4 March 2010, available at <www.ecb.europa.eu>.

The aid package for Greece was eventually concluded in early May 2010. See, INTERNATIONAL MONETARY FUND, *IMF Reaches Staff-Level Agreement with Greece on €30 Billion Stand- By Arrangement*, Press Release No. 10/176, 2 May 2010.

5 On this litigation, see *infra* I.A.2.

6 *Abaclat and others v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, 4 August 2011; *Ambiente Ufficio S.p.A. and others v. Argentine Republic*, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, 8 February 2013. See also, *Giovanni Alemanni and others v. Argentine Republic*, ICSID Case No. ARB/07/8.

7 See, Cass. (1ère ch.), 22 November 2012, C.11.0688F (Belgium *Cour de Cassation*); Cass. Civ. 1ère, 28 September 2011, n° 09-72.057; Cass. Civ. 1ère, 28 March 2013, n° 10-25.938, 11-10.450 et 11-13.323 (French *Cour de Cassation*); *NML Capital Limited (Appellant) v. Republic of Argentina (Respondent)* [2011] UKSC 31.

8 ITLoS, *"ARA Libertad" (Argentina v. Ghana)*, Case No. 20, Request for the prescription of provisional measures, Order, 15 December 2012.

9 On the links between financial and sovereign debt crises, see, REINHART Carmen M., ROGOFF Kenneth S., "From Financial Crash to Debt Crisis", *American Economic Review*, vol. 101, n° 5, 2011, pp. 1676-1706. It is noteworthy to mention that, to some extent, the financial industry is linked to sovereign debt. This is the case for valuation techniques such as the "Capital Asset Pricing Model" (CAPM) according to which the risk-free interest rate should be based on government bonds (JENKINSON Tim, "Regulation and the Cost of Capital", in CREW Michael, PARKER David (eds.), *International Handbook on Economic Regulation*, Cheltenham/Northampton, Edward Elgar, 2006, p. 147). This is also the case for Basel prudential banking standards (BISMUTH Régis, "La réforme de l'encadrement prudentiel des banques par le Comité de Bâle, reflet des tensions entre les différents espaces de régulation financière", in DELION André, VIDAL Laurent (dir.), *Annales de la Régulation – Les réformes des régulations financières*, Paris, IRJS Editions, 2013, pp. 173-195).

be noted[10]. Firstly, there is no preventative mechanism (*ex ante* regulation) or multilateral rule of international law limiting sovereign borrowing, such as prudential regulations restricting the level indebtedness of financial institutions. Apart from balanced-budget constitutional rules relevant at the domestic level[11] and the fiscal compact[12] adopted by the member states of the euro area[13] with a solely regional outreach, the principles recently adopted by UNCTAD aimed at the promotion of responsible sovereign lending and borrowing[14] constitute the only (soft law) achievement in this field. Secondly, there is no international institution with the competences to act as a genuine lender of last resort in a situation of sovereign insolvency, in the way that central banks at the domestic (or European) level intervene against a potential drying up of liquidity in situations of market turmoil. The IMF is not vested with such authority to unilaterally intervene in the markets and its financial assistance is accessible after the conclusion of an agreement with one of its members. Third, there is no curative mechanism (*ex post* regulation) establishing a formal and centralized procedure addressing the consequences of sovereign insolvencies, and potentially leading to receivership or compulsory liquidation[15]. Despite several proposals[16], the establishment of such procedures is unlikely to occur since it would involve the decision for States to transfer core sovereign competences in the fields of public finance and tax policy to an international body. Consequently, under international law, a sovereign State cannot be in liquidation or bankruptcy – it can only default on its debt. The default constitutes a critical event from which creditors will seek to recoup their investment through more or less centralized processes. The prevalent disorder in sovereign insolvencies is mainly the result of the uncoordinated coexistence of different classes of creditors (banks, investment funds, individuals, international financial institutions,

10 For a different perspective, see, BOLTON Patrick, *Toward a Statutory Approach to Sovereign Debt Restructuring: Lessons from Corporate Bankruptcy Practice Around the World*, IMF Working Paper, WP/03/13, January 2003, p. 19 *et seq*.

11 JEAN-ANTOINE Benoît, "La règle d'équilibre ou 'règle d'or', approche compare", *Revue Française de Finances Publiques*, n° 117, 2012, p. 55 *et seq*.

12 The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

13 ALLEMAND Frédéric, MARTUCCI Francesco, "La nouvelle gouvernance économique européenne", *Cahiers de Droit Européen*, 2012, n° 2, pp. 407-455.

14 UNCTAD, *Principles on Promoting Responsible Sovereign Lending and Borrowing*, 10 January 2012, available at <www.unctad.info>. See also, GOLDMANN Matthias, *Responsible Sovereign Lending and Borrowing: The Views From Domestic Jurisdictions*, February 2012, available at <www.unctad.info>.

15 It was already noted in one of the first courses at the Hague Academy:

> la position particulière de l'État s'oppose à celle d'un individu, ou à celle d'une entité corporative qui ne jouit d'aucune autorité publique, devra être prise en considération. Un État ne peut être mis en faillite comme un individu, et ses biens répartis entre ses créanciers ? Un État ne peut être liquidé comme une société de commerce, et on ne peut mettre fin à son existence, simplement parce qu'il est insolvable. Un État […] existe dans le but de remplir envers ses membres des devoirs qui sont inaliénables";

FISCHER WILLIAMS John, "Le droit international et les obligations financières internationales qui naissent d'un contrat", *Recueil des Cours*, vol. 1, 1923, p. 342-343.

16 For some recent proposals, see, IMF, *supra* note 2, p. 37.

States, etc.) with different lending policies and objectives (financial performance for private creditors, financing for development or structural adjustment program for public creditors).

It should not be inferred from this complex picture that there is a complete lack of regulatory processes aimed at an orderly management of sovereign debt crises. Some international institutions (including the IMF) or informal bodies (such as the Paris Club or the London Club) have occasionally led some level of debt restructuring. However, this institutional framework remains too diffuse and decentralized to feasibly constitute the framework of consistent collective insolvency proceedings for sovereign States[17]. The most effective and promising avenue for managing sovereign debt crises seems to lie in the loan contract itself, the terms of which crystallize the creditors concerns[18]. Besides, the evolution of contract practices following sovereign defaults, in particular through the integration or amendment of clauses on renegotiation and restructuring, is clearly evidence that the loan contract constitutes the keystone of the borrowing process[19]. Therefore, in the absence of a satisfying collective mechanism, it is through the loan contract that an orderly management of sovereign debt crises is conceivable.

Within this framework, the notion of "public policy" (and, by extension, the notion of "public policy for sovereign debt contracts") adequately encapsulates this need for a more disciplined approach to sovereign debt crises. The notion of "public policy" – also known in French as "*ordre public*" – fulfills different functions according to the context in which it is used. In the field of contract law or treaty law, freedom of contract or of treaty-making is restricted by public policy (known as *jus cogens* in international law)[20]. In administrative law, the exercise of fundamental freedoms is subject to public policy objectives[21]. In private international law, the "public policy exception" allows a court to bar the recognition of a foreign judgment or disregard the rules of the foreign law applicable by virtue of the conflict-of-law rule, whereby the foreign judgment or the application of the foreign law would be contrary to the public policy of the forum[22]. This notion also exists in the field of international arbitration in which it is referred to as "international" or "transnational public policy"[23].

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17 However, see, VON BOGDANDY Armin, GOLDMANN Matthias, "Sovereign Debt Restructurings as Exercises of International Public Authority: Towards a Decentralized Sovereign Insolvency Law", 2013, 36 p., available at <http://papers.ssrn.com>.

18 For an in-depth study of contract practices, see, CHOI Stephen J., GULATI Mitu, POSNER Eric. A., "The Evolution of Contractual Terms in Sovereign Bonds", *Journal of Legal Analysis*, vol. 4, n° 1, 2012, pp. 131-179.

19 *Ibid.*, p. 152 *et seq*.

20 For instance, in contract law, Article 6 of the French Civil Code indeed provides that "statutes relating to public policy and morals may not be derogated from by private agreements". According to the 1969 Vienna Convention on the Law of Treaties, "a treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law" (Article 53).

21 WALINE Jean, *Droit administratif*, Paris, Dalloz, 22e éd., 2008, p. 325 *et seq*.

22 MAYER Pierre, HEUZÉ Vincent, *Droit international privé*, Paris, Montchrestien, 10e éd., 2010, p. 149 *et seq*., p. 287 *et seq*.

23 LALIVE Pierre, "Ordre public transnational (ou réellement international) et arbitrage international",

These different functions of "public policy" are of special interest in the context of sovereign debt insofar as they allow for the identification of three key characteristics of their orderly management. First, the notion of "public policy", which refers to the requirement to maintain the public order and the fundamental values of a given society or social body[24], involves the consideration of compelling interests that are not necessarily those of the contractors (and particularly the creditors) when it comes to sovereign insolvency issues. Second, "public policy" also restricts the freedom of contract and such restrictions are externally defined by the legislator or identified by the judge, thereby limiting the possibility of requesting the enforcement of the loan contract in case of default. Third, the content of the "public policy" varies depending on both time and space. It also varies across time because it is progressively shaped by the legislator and the judge in response to the new requirements of the social body. It varies also across space since the values and interests that the public policy reflect are not necessarily shared by all legal orders.

Therefore, it could be useful to determine whether new public policy objectives applicable to sovereign debt contracts have emerged. An analysis of the current legal framework raises some doubts as to the existence of a *de jure* "public policy for sovereign debt contracts" externally defined by the legislator or identified by the judge to ensure an orderly management of sovereign debt crises (I.). However, this should not overshadow several initiatives aimed at the integration of such public policy objectives into sovereign debt contracts (II.).

I. THE UNCERTAIN EXISTENCE OF AN EXTERNAL *DE JURE* "PUBLIC POLICY FOR SOVEREIGN DEBT CONTRACTS"

The existence of public policy objectives imposing an orderly management of sovereign insolvencies would allow the courts to disregard some contractual provisions or to interpret them in a manner consistent with such objectives. An analysis of the relevant case law reveals that domestic courts have been reluctant to identify a public policy that could potentially impact the application or the interpretation of sovereign debt contracts (A.). The position of domestic courts does not necessarily lead to the conclusion that such public policy would not be able to emerge since some legislative initiatives indicate a recognition – an albeit incomplete one – of such objectives (B.).

Revue de l'Arbitrage, 1986, n° 3, pp. 329-374; FORTEAU Mathias, "L'ordre public 'transnational' ou 'réellement international' – L'ordre public international face à l'enchevêtrement croissant du droit international privé et du droit international public", *Journal du Droit International*, 2011, pp. 3-49.

24 "Public policy" is also defined as the "principles and standards regarded by the legislature or by the courts as being of fundamental concern to the state and the whole of society" (*Black's Law Dictionnary*, 9th ed., 2009, p. 1267). See also, DEUMIER Pascale, REVET Thierry, "Ordre public", in ALLAND Denis, RIALS Stéphane (dir.), *Dictionnaire de la culture juridique*, Paris, PUF, 2003, p. 1120.

A. THE RELUCTANCE OF DOMESTIC COURTS TOWARDS A PUBLIC POLICY FOR SOVEREIGN DEBT CONTRACTS

1. A Sovereign Debt Litigation Interfering With Debt Restructuring Processes

A better understanding of sovereign debt litigation before domestic courts requires a preliminary presentation of the main developments of sovereign borrowing. Until the early 1980s, the majority of private sector lenders were banks[25]. In the case of restructuring proceedings, these institutional investors, due to their relatively small number, were able to cooperate informally among themselves in the "London Club", which has echoed the "Paris Club" in gathering together sovereign creditors[26]. In the 1980s, debt flowed to sovereign borrowers mainly through bond markets[27]. This development has had practical consequences on the management of sovereign insolvencies since the adoption of a restructuring plan involving a debt rescheduling or a partial debt cancellation requires an amendment to sovereign bonds contracts. These decisions, unless otherwise provided, require unanimity and therefore are more likely to be taken by a small number of banks than a plurality of bondholders.

The difficulty in restructuring sovereign bond issues also generates an incentive for some creditors to engage in judicial activism. Indeed, instead of agreeing to a reasonable debt restructuring which usually implies a financial loss, these creditors may prefer to initiate legal proceedings before domestic courts in order to recoup the whole value of their investment. These claims are facilitated by the fact that States usually waive their jurisdictional immunities within the framework of international bond issues[28]. Some of the creditors declining to participate in restructuring procedures (also labeled as "holdouts" or "holdout creditors" in legal and financial jargon)[29] are investment funds (also known as "vulture funds") that have purchased distressed sovereign debt at very low or derisory prices after a default (or because of the dubious solvency of the creditor in the hope of recovering the amount of the nominal value after lengthy and expensive proceedings they can afford)[30]. For instance, such claims have proliferated in the context of the Argen-

25 AUDIT Mathias, "Introduction générale – Dissection du risque souverain", in AUDIT Mathias (dir.), *Insolvabilité des États et dette souveraine*, Paris, LGDJ, 2011, p. 6 *et seq*.

26 For more details, see, RIEFFEL Lex, *Restructuring Sovereign Debt – The Case for Ad Hoc Machinery*, Washington DC, Brookings Institution Press, 2003, p. 56 *et seq*.

27 This development of sovereign borrowing through bond markets in the 1980s is nothing new in the history since bond markets were already highly appreciated at the end of the 19th century. See, WRIGHT Mark J. L., "Sovereign Debt Restructuring: Problems and Prospects", *Harvard Business Law Review*, vol. 2, 2012, p. 165 *et seq*.

28 CHOI, GULATI, POSNER, *supra* note 18, p. 139 and p. 156-157.

29 GOLDMAN Samuel E., "Mavericks in the Market: The Emerging Problem of Hold-Outs in Sovereign Debt Restructuring", *UCLA Journal of International Law and Foreign Affairs*, vol. 5, 2000, p. 159 *et seq*.

30 WAUTELET Patrick, "*Vulture Funds, Creditors and Sovereign Debtors: How to Find a Balance?*", in AUDIT Mathias (dir.), *Insolvabilité des États et dette souveraine*, Paris, LGDJ, 2011, p. 103 *et seq*.;

tinean debt crisis[31]. These holdout strategies seriously interfere with restructuring processes, both from the point of view of the debtor State unwilling to face multiple court proceedings and that of other creditors accepting the restructuring and a financial loss but unwilling to receive a less favorable treatment than the holdouts.

2. The Unsuccessful Public Policy Defense in Sovereign Debt Litigation

In this context, domestic courts have been asked to regulate the potential harmful effects of holdout strategies by identifying public policy objectives impacting the application or the interpretation of sovereign debt contracts. This issue came to the fore in an extremely clear way in the case *NML v. Argentina*, in particular within the framework of the decision of October 26, 2012 of the Court of Appeals for the Second Circuit[32].

In 1994, Argentina completed bond issues pursuant to a Fiscal Agency Agreement which included a *Pari Passu* Clause ensuring the protection of bondholders from subordination and stipulating that "[t]he Securities will constitute […] direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank *pari passu* without any preference among themselves. The payment obligations of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness"[33]. In 2001, Argentina defaulted on its debt by declaring a temporary moratorium on principal and interest payments. In order to restructure this debt, Argentina initiated two exchange offers in 2005 and 2010 with a substantial haircut of about 75% of the face value. After these exchange offers, Argentina had eventually restructured about 91% of its defaulted foreign debt. Since then, it has made all principal and interests payments on its restructured debt but has refused to make payments to the holdouts representing about 9% of the defaulted debt[34]. The reluctant creditors, foremost among them the Cayman Islands-based investment fund NML Capital, filed a claim against Argentina in a New York federal district court. They alleged, inter alia, breach of the *pari passu* clause insofar as the full payments on the restructured debt lowered the rank of holdouts' bonds.

In December 2011, a first partial summary judgment from the US District Court for the Southern District of New York found that Argentina had breached its contractual obligations[35]. This judgment and similar decisions involving other creditors were challenged in the Court of Appeals for the Second Circuit. Argentina

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GIANSETTO Fanny, "Les fonds dits 'vautours' et la dette souveraine – Un nouvel enjeu de la régulation financière", *Cahiers de Droit de l'Entreprise*, November 2012, n° 6, p. 50 *et seq*.

31 HORNBECK J. F., *Argentina's Defaulted Sovereign Debt: Dealing with the 'Holdouts'*, CRS Report for Congress, 6 February 2013, 17 p.

32 *NML Capital, Ltd. et al., v. The Republic of Argentina* (Docket No. 12 105(L)) (2d Circuit, October 26, 2012).

33 The clause is cited in the Court of Appeals' decision (*supra* note 32).

34 HORNBECK, *supra* note 31, p. 3 *et seq*.

35 *NML Capital, Ltd. v. The Republic of Argentina* (08 Civ. 6978 (TPG), 09 Civ. 1707 (TPG), 09 Civ. 1708 (TPG)) (S.D.N.Y., December 7, 2011).

argued that the *pari passu* clause was only a "boilerplate provision" [36] with "[t]he limited purpose […] in the sovereign context as it has been universally understood for over 50 years […] to provide protection from legal subordination or other discriminatory legal ranking by preventing the creation of legal priorities by the sovereign in favor of creditors holding particular classes of debt"[37]. It added that this clause "has […] never been understood by any market participant, to require that payment to one creditor requires payment to all"[38].

Apart from the issue of the textual interpretation of the *pari passu* clause, Argentina also warned the court about the possible large-scale adverse consequences of a ruling requiring Argentina to make full payment to holdouts. It pointed out that there was a "public policy which favors voluntary debt restructurings and opposes the backdoor creation of unbargained-for contractual rights for holdout creditors seeking to "leverage" their positions by disrupting such restructurings"[39]. In this respect, Argentina invoked a public policy exception potentially impacting the application or the interpretation of sovereign debt contracts when they hinder the orderly management of sovereign debt crises.

The federal court remained impervious to Argentina's arguments by confining itself to a literal interpretation of the *pari passu* clause and rejected the public policy exception. It curtly pointed out that "[i]n New York, a bond is a contract […]. Thus, the parties' dispute over the meaning of the Equal Treatment Provision presents a 'simple question of contract interpretation'"[40]. The court also explained its choice not to take into consideration such public policy objectives by stressing that the function of the *pari passu* clause is precisely to ensure an equal treatment of creditors in the absence of centralized bankruptcy proceedings for sovereigns[41]. This position is consistent with a well established case-law of US courts since the mid-1980s[42].

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36 *Brief of the Defendant-Appellant – The Republic of Argentina* (Case No. 12 105(L)) (2d Circuit, March 21, 2012), p. 2.

37 *Ibid*., p. 34.

38 *Ibid*., p. 3.

39 *Ibid*., p. 4-5.

40 *NML Capital, Ltd. et al., v. The Republic of Argentina*, *supra* note 32, p. 16.

41 *Ibid*., p. 19 ("This specific constraint on Argentina as payor makes good sense in the context of sovereign debt: when sovereigns default they do not enter bankruptcy proceedings where the legal rank of debt determines the order in which creditors will be paid. Instead, sovereigns can choose for themselves the order in which creditors will be paid. In this context, the Equal Treatment Provision prevents Argentina as payor from discriminating against the FAA Bonds in favor of other unsubordinated, foreign bonds").

42 Especially since the decision of the same *Court of Appeals for the Second Circuit* in *Allied II*. (*Allied Bank International v. Banco Credito Agricola de Cartago*, 757 F.2d 516 (2d Cir. 1985)). See, GATHII James Thuo, "The Sanctity of Sovereign Loan Contracts and its Origins in Enforcement Litigation", *George Washington International Law Review*, vol. 38, 2006, p. 254 (underlining that "as the sanctity of sovereign loan contracts became the reigning paradigm in sovereign debt litigation in the mid-1980s, the defenses to default and balancing considerations such as comity that once were traditionally available to sovereign debtors simultaneously withered away in subsequent litigation"). See also, ASIEDU-AKROFI Harvey, "Banks, Bonds and the American Bench: Exercising Discretion to Discourage Rogue Sovereign Bond Litigation Claims", *Cambridge Student Law Review*, 2011, pp. 42-61.

However, the Government of the United States has taken a clear position in favor of Argentina. In April 2012, the Department of the Treasury and the Department of State jointly submitted a brief advocating the recognition of public policy objectives and enjoining the court not to give full effect to the *pari passu* clause since the dispute involved "issues of vital public policy and legal importance to the United States that extend beyond the particular facts of this case"[43]. Following the decision of October 2012, Argentina requested a rehearing of the case, which was eventually denied in February 2013[44]. Within the framework of this procedure, the Department of the Treasury and the Department of State, once more, filed an *amicus* brief in which they were even more explicit about these public policy objectives[45]. They first argued that a strict interpretation of the *pari passu* clause could adversely impact the competitiveness of US financial markets. By stressing that "the decision could harm U.S. interests in promoting issuers' use of New York law and preserving New York as a global financial jurisdiction"[46] and that "[t]he decision could encourage issuers to issue debt in non-U.S. currencies in order to avoid the U.S. payments system, causing a detrimental effect on the systemic role of the U.S. dollar"[47], the US Government intended to protect national interests and therefore promoted a kind of "domestic public policy" (although we may have doubts that the solution advocated is likely to attract investors and promote the competitiveness of US financial markets). The second set or arguments took a different approach by focusing more on an international perspective than a purely domestic one. The brief explains that a strict interpretation of the *pari passu* clause gives an incentive for creditors not to participate in sovereign debt restructurings and therefore encourages holdout strategies:

> The effect [of the panel's reasoning] could extend well beyond Argentina […]. [V]oluntary sovereign debt restructuring will become far more difficult if holdout creditors can use novel interpretations of boilerplate bond provisions to interfere with the performance of a restructuring plan accepted by most creditors, and to greatly tilt incentives away from voluntary debt exchanges and negotiated restructuring in the first place. A sovereign's potential resistance to paying nonexchanged debt is a critical tool in its efforts to negotiate broad creditor support for restructuring. This leverage will be lost if creditors believe that a holdout strategy will eventually result in substantial or full payment. If enough creditors adopt

43 *Brief for the United States of America as Amicus Curiae in Support of Reversal* (Case No. 12 105(L)) (2d Circuit, April 4, 2012).
44 *NML Capital, Ltd. et al., v. The Republic of Argentina* (Case No. 12 105(L)) (2d Circuit, February 28, 2013).
45 *Brief for the United States of America as Amicus Curiae in Support of the Republic of Argentina's Petition for Panel Rehearing and Rehearing en Banc* (Case No. 12 105 cv(L)) (2d Circuit, December 28, 2012).
46 *Ibid*., p. 5.
47 *Ibid*.

> this strategy, foreign sovereign debt restructuring will become impossible[48].

Through this argument, the US Government called for the recognition of a genuine "international public policy for Sovereign Debt Contracts"[49]. It was not eventually taken into account by the federal court. However, it must be said in its defense that it would be extremely difficult for a US court to disregard the provisions of sovereign debt contracts on the basis of new public policy objectives, traces of which are found solely in Argentina's submissions and *amicus* briefs. It is within this framework that some legislative initiatives aimed at limiting enforcement actions brought by vulture funds are of special interest in assessing the possible recognition of such objectives.

B. AN INCOMPLETE RECOGNITION OF THE PUBLIC POLICY FOR SOVEREIGN DEBT CONTRACTS IN DOMESTIC LEGISLATIONS

1. The Limited Scope of Domestic Legislative Initiatives

The difficulty of barring holdout strategies has made sovereign debt restructurings (which may involve private as well as public creditors) more complex and have exposed sovereign debtors to the risk of facing several enforcement actions before domestic courts. In this context, some States whose courts are likely to have jurisdiction in sovereign debt disputes have envisaged the adoption of draconian legislation designed to block enforcement procedures brought by private creditors[50]. However, a few of these legislative initiatives were eventually enacted.

The first attempt came from France through a bill "aimed at combating the action of vulture funds". It was first introduced in 2006[51], then withdrawn and subsequently reintroduced in 2007 in identical terms[52]. Although this proposal has not been adopted, it is particularly informative as to its objective and the legal mechanisms that were devised. The explanatory memorandum to the proposal pointed out that holdout strategies adversely impact debt reduction and rescheduling agreements negotiated under the auspices of the Paris Club and London Club insofar as

48 *Ibid*., p. 3-4.

49 Arguments of the same nature have been developed in the *amicus brief* filed by the French Republic in July 2013 in support of Argentina's application before the US Supreme Court. This brief points out that "[t]he decision of the Court of Appeals threatens wider public interests" and that "the Court of Appeals should have addressed the public interest implications of its decision; yet the court did not adequately do so, resulting in a ruling that may exacerbate sovereign debt crises and in turn threaten international financial stability" (*Brief for the Republic of France as Amicus Curiae in Support of The Republic of Argentina's Petition for a Writ of Certiorari* (No. 12-1494) (July 26, 2013).

50 For an overview, see, WAUTELET, *supra* note 30, p. 119 *et seq*.

51 ASSEMBLÉE NATIONALE, XIIème législature, *Proposition de loi de M. Marc Le Fur et de plusieurs de ses collègues visant à lutter contre l'action des fonds financiers dits «fonds vautours»*, No. 3214, 28 June 2006.

52 ASSEMBLÉE NATIONALE, XIIIème législature, *Proposition de loi de M. Marc Le Fur visant à lutter contre l'action des fonds financiers dits «fonds vautours»*, No. 131, 2 August 2007.

debt write-offs *de facto* benefit recalcitrant creditors[53]. The objective of the proposal was therefore to protect the interests of both debtor States and its public creditors, in particular France because debt reductions involve State expenditure[54]. In this context, the bill suggested that, in the case of an enforcement action aiming at recovering a sovereign debt for which a reduction or rescheduling has been granted by France or one of the international institutions to which it belongs, the court may grant the application but only to the extent it considers reasonable by taking into account the efforts made by other public and private creditors as well as the financial capacity of the sovereign debtor[55]. The proposal also included a provision barring the recognition and enforcement of foreign judgments in cases where the debt arises from speculation[56]. In substance, this bill, if ever enacted, would have established a "public policy for Sovereign Debt Contracts" in France, but it would have been limited to States directly or indirectly receiving financial aid by France.

A similar yet unsuccessful proposal was introduced in 2008[57] (then reintroduced in 2009[58]) in the American Congress, strangely entitled "Stop Very Unscrupulous Loan Transfers from Underprivileged countries to Rich, Exploitive Funds Act" (or "Stop VULTURE Funds Act"). The bill was based on a notion of "Sovereign Debt Profiteering" defined as "any act by a vulture creditor seeking, directly or indirectly, the payment of part or all of defaulted sovereign debt of a qualified poor country, in an amount that exceeds the total amount paid by the vulture creditor to acquire the interest of the vulture creditor in the defaulted sovereign debt […], plus 6 percent simple interest per year […]"[59]. Like the French proposal, the purpose of the planned reform was to block any enforcement action characterized, directly or indirectly, as "Sovereign Debt Profiteering"[60]. It even had criminal law aspects since "Sovereign Debt Profiteering" constitutes an offense punishable with a fine of an amount equal to the creditor's claim[61]. The scope of application of the proposed regulation was limited to the sovereign debt of a "Qualified Poor Country", recognized as such by way of inclusion in a list maintained by the Secretary of the Treasury[62]. Like the French proposal, the aim was to prevent the annihilation of the financial efforts made by international financial institutions and creditor States within the framework of sovereign debt reduction and rescheduling schemes, in particular those conducted under the auspices of the Heavily Indebted Poor Coun-

53 *Ibid*.
54 *Ibid* (the proposal pointed out that it was a "*mesure de morale et de cohérence dans l'aide aux pays amis, notamment en Afrique, tant il serait absurde que l'Exécutif efface d'une main nos créances pour que le pouvoir judiciaire accorde de l'autre les sommes rendues disponibles aux usuriers*").
55 *Ibid*.
56 *Ibid*.
57 H.R. 6796 (110th) (August 1, 2008), available at <http://www.govtrack.us>.
58 H.R. 2932 (111th) (June 18, 2009), available at <http://www.govtrack.us>.
59 *Stop Vulture Funds Act* (*supra* note 58), Section 3.4.
60 *Stop Vulture Funds Act* (*supra* note 58), Section 5 ("Prohibition on Use of Courts of the United States to Further Sovereign Debt Profiteering").
61*Stop Vulture Funds Act* (*supra* note 58), Section 4 ("Prohibitions on Sovereign Debt Profiteering – Penalties").
62 *Stop Vulture Funds Act* (*supra* note 58), Section 6 ("Duties of the Department of the Treasury").

tries (HIPC) initiative launched in 1996 by the IMF and the World Bank[63]. Besides, the explanatory memorandum to the proposal pointed out that:

> [at] the same time that the international community has been extending debt relief to the poor countries of the world, a new form of business has emerged for the purpose of speculating in and profiteering from defaulted sovereign debt at the expense of both the impoverished citizens of the poor nations and the taxpayers of the world who have participated in international debt relief[64].

While the initiatives launched in France and the US have stalled at the proposal stage, the British project was eventually enacted. A first proposal entitled "Developing Country Debt (Restriction of Recovery) Bill" was introduced in 2009[65] in the wake of the *Donegal v. Zambia* case, which received extensive publicity[66]. In this case, a British court ordered Zambia to pay the investment fund Donegal a sum representing five times the amount the fund had initially paid for the acquisition of the debt, which was originally owed by Zambia to Romania[67]. Donegal's initial claim (fifteen times the amount paid) was even superior to the debt relief Zambia was due to receive following an agreement concluded in 2005 at the G8 meeting in Gleneagles[68]. The 2009 project was dropped but reintroduced in 2010 through the "Debt Relief (Developing Countries) Act"[69], originally enacted for a period of one year due to the absence of an impact assessment study[70]. It is only in 2011 that it had been given permanent effect[71]. The objective of this legislation is to place a cap on the amount that creditors may recover in British courts. However, the scope of the statute is limited to a category of "Qualifying Debt" for which about forty countries are eligible, qualifying for the World Bank and IMF HIPC initiative[72].

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63 The explanatory memorandum to the proposal (Section 2.5) pointed out that "[a] number of countries, including the United States, have canceled 100 percent of the bilateral loans made by such countries to countries that are eligible for debt relief under the Enhanced HIPC Initiative, and other major donor nations have canceled a large percentage of such loans".

64 *Stop Vulture Funds Act* (*supra* note 58), Section 2.6.

65 *Developing Country Debt (Restriction of Revovery) Bill*, House of Commons, 6 May 2009, available at <www.publications.parliament.uk>.

66 On this case, see, LARYEA Thomas, "*Donegal v. Zambia* and the Persistent Debt Problems of Low-Income Countries", *Law & Contemporary Problems*, vol. 73, 2010, pp. 193-200.

67 *Donegal International Ltd v. Zambia* [2007] EWHC 197 (Comm), [2007] 1 Lloyd's Rep. 397.

68 "'Vulture' feeds on Zambia", *The Guardian*, 15 February 2007.

69 *Debt Relief (Developing Countries) Act 2010*, 8 April 2011.

70 *Debt Relief (Developing Countries) Act 2010*, 8 April 2011, Section 9 ("Duration of Act").

71 *Debt Relief (Developing Countries) Act 2010 (Permanent Effect) Order 2011*, No. 1336, 25 May 2011.

72 *Debt Relief (Developing Countries) Act 2010*, 8 April 2011, Section 1 ("Meaning of 'Qualifying Debt' etc.").

2. A Limited Scope Adversely Impacting the Recognition of an International Public Policy

The limited scope of British legislation would have made it applicable to Zambia in the *Donegal* case since the latter country benefited from the HIPC initiative[73]. However, it would have excluded Argentina, which was not eligible for this IMF/World Bank program[74]. The ambition of the reform was to establish a jurisdictional shield protecting States receiving financial assistance from international institutions involving a direct or indirect contribution from the United Kingdom. Apart from the protection of the UK's own interests, using the HIPC initiative as a reference can also be seen as a desire to ensure the proportionality and the objectivity of a piece of legislation imposing severe restrictions on contractual and property rights. Indeed, the list of countries eligible for the HIPC initiative is determined according to criteria multilaterally established by Bretton Woods institutions and these countries must *inter alia* face "an unsustainable debt burden that cannot be addressed through traditional debt relief mechanisms"[75]. This degree of objectivity was not necessarily reached in the French proposal since it would have been applicable to any sovereign debtor benefiting from a debt reduction or rescheduling granted by France. This does not mean in all cases that the debtor faces an unsustainable debt burden not addressable through traditional debt relief mechanisms.

This brief overview of domestic legislative initiatives indicates that a "public policy for Sovereign Debt Contracts" is conceivable only if such initiatives would be widely implemented in national laws[76]. However, even in this case, some uncertainties would remain about the precise content of this public policy, in particular whether it includes all States or only those eligible for the HIPC initiative. At present, it could be argued that the common denominator of these national experiences is the goal to protect the financial interests of creditor States and not to establish a global mechanism targeting all creditors implementing a holdout strategy. It would therefore be inappropriate to perceive this nascent "public policy" as a genuinely international one.

This assessment would change if international institutions were to develop a consistent doctrine on this issue. Debates within the UN[77] and the Council

73 PARIS CLUB, *Paris Club Reduces Zambia's Debt Under the Enhanced HIPC Initiative*, 11 May 2005, available at <www.clubdeparis.org>.

74 The list of countries qualifying for the World Bank and IMF Highly Indebted Poor Countries (HIPC) Initiative is available at <www.imf.org/external/np/exr/facts/hipc.htm>.

75 IMF, *Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative*, September 2013, available at <www.imf.org/external/np/exr/facts/pdf/hipc.pdf>. See also, IMF, *Selected Decisions and Selected Documents of the International Monetary Fund*, Washington D.C., IMF, 2009, p. 217 ("Directors agreed that the objective of the enhanced HIPC Initiative is to achieve a lasting exit from unsustainable debt […]" (*The Acting Chair's Summing Up – HIPC Initiative […]*, Executive Board Meeting 02/40, 9 April 2002)).

76 We can also mention the 2008 Belgium legislation (see, WAUTELET, *supra* note 30, p. 124 *et seq*.). It is, however, of a more limited practical relevance since Belgium is not a key forum for vulture funds (see, GIANSETTO, *supra* note 30, p. 56).

77 See, *inter alia*, the position of an expert appointed by the UN Human Rights Council: "Stop 'vulture

of Europe[78] show, however, that while concerns have been raised, no conclusive decisions or resolutions have been passed. The only declaration likely to produce legal effects was adopted by Paris Club creditors which declared that they were "committed to avoid selling their claims on HIPC countries to other creditors who do not intend to provide debt relief under the HIPC initiative"[79]. This commitment has therefore a very narrow scope since its objective is to prevent the acquisition of distressed sovereign debt for speculative purposes and not to block enforcement procedures initiated by litigating creditors before domestic courts.

Finally, it seems too ambitious to infer from both domestic and international initiatives the emergence, in the short to medium term, of a genuine international public policy applicable to sovereign debt contracts. The possibility of such a public policy is not to be precluded but it would involve challenging the preconception that policy objectives are solely externally defined or identified by either the legislative or the judicial branch. Indeed, the evolution of sovereign borrowing practices shows that the imperatives of an orderly management of sovereign insolvencies have been included in debt contracts.

II. THE HYPOTHESIS OF AN INTEGRATED "INTERNATIONAL PUBLIC POLICY FOR SOVEREIGN DEBT CONTRACTS"

It is of course a truism to recall the non-existence of centralized insolvency procedures for sovereigns, although some attempts had been made such as the proposal in 1939 for the establishment of an International Loans Tribunal[80] or, more recently, the initiative launched under the auspices of the IMF to institute a Sovereign Debt Restructuring Mechanism (SDRM)[81]. The absence of insolven-

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funds' from paralyzing debt-relief efforts, says UN independent expert", 13 December 2012, available at <www.un.org>. See also, UN HUMAN RIGHTS COUNCIL, *Report of the Independent Expert on the Effects of Foreign Debt and Other Related International Financial Obligations of States on the Full Enjoyment of all Human Rights, Particularly Economic, Social and Cultural Rights, Cephas Lumina*, A/HRC/14/21, 29 April 2010.

78 PARLIAMENTARY ASSEMBLY OF THE COUNCIL OF EUROPE, *Protecting Financial Aid Granted by Council of Europe Member States to Poor Countries Against Financial Funds Known as 'Vulture Funds'*, Doc. 11862, 21 April 2009.

79 PARIS CLUB, *Press Release of the Paris Club on the Threats Posed by Some Litigating Creditors to Heavily Indebted Poor Countries*, 22 May 2007, available at <www.clubdeparis.org>.

80 WAIBEL Michael, *Sovereign Defaults Before International Courts and Tribunals*, Cambridge/New York, Cambridge University Press, 2011, p. 324 *et seq*.

81 KRUEGER Anne O., *A New Approach to Sovereign Debt Restructuring*, Washington DC, International Monetary Fund, 2002, 40 p. The architect of the SDRM, the economist and former First Deputy Managing Director of the IMF, Anne O. Krueger, intervened in the *NML v. Argentina* litigation through the submission of an *amicus curiae* brief in which she pointed out:

> [i]f sovereigns were required […] to repay holdout creditors […], there would be several negative effects. These would include: (l) the increased reluctance of creditors to share in any restructuring and hence an increase in the likelihood and number of holdouts; (2) higher interest costs for all sovereign borrowers; (3) a reduction in capital inflows even for countries with sound macroeconomic policies; (4) increased delays

cy procedures has favored the emergence of informal restructuring mechanisms based on the voluntary participation of various stakeholders, among them the "Paris Club" and the "London Club"[82].

The development of sovereign bond markets has led to an increase in private creditors, particularly bondholders that were not represented in existing institutions. This fragmentation of creditors, with sometimes diverging interests, has reduced the incentives for cooperative strategies among private creditors and between private creditors and other stakeholders (sovereign debtors, public creditors, etc.). This lack of organization has fostered the development of holdout strategies likely to impact existing restructuring mechanisms. As a result, a demand has developed for a greater cohesion between bondholders. Among the different mechanisms that have been considered, the development of "Collective Action Clauses" (CACs) in sovereign debt contracts deserve special attention (A.). In the wake of the euro area sovereign debt crisis, it is also necessary to examine the mandatory inclusion of CACs in bond issues under the new European Stability Mechanism (ESM) (B.).

A. AN INCOMPLETE RECOGNITION OF A DE FACTO "INTERNATIONAL PUBLIC POLICY FOR SOVEREIGN DEBT CONTRACTS" THROUGH COLLECTIVE ACTION CLAUSES (CACS)

1. The regulatory function of CACs

There are different types of CACs in bond issues[83]: clauses establishing a mechanism for the collective representation of bondholders ("collective representation clauses"), clauses empowering a qualified majority of bondholders to modify the terms of a bond contract ("majority action clauses" or "qualified majority voting clauses"), clauses requiring that any litigating creditor has to share any amounts recovered with other bondholders ("sharing clauses"), or clauses preventing bondholders from demanding early repayment in the event of a default unless a certain percentage of bondholder (usually 25%) accepts this initiative ("non-acceleration clauses")[84]. Among these various types of CACs, the second category ("majority action clauses") is particularly useful in the context of a sovereign debt restructuring process. Indeed, they allow a qualified majority of bondholders (usually 75%) to modify the terms of payment of a bond contract (principal, interest, maturity,

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by sovereigns before accepting the need for restructuring […]; and (5) issues for the International Monetary Fund in supporting countries where policy reform could lead to a return to debt sustainability and voluntary debt-servicing if debt were restructured" (*Brief for Amicus Curiae Professor Anne Krueger in Support of the Republic of Argentina and Reversal* (Case No. 12 105 cv(L)) (2d Circuit, January 4, 2013)).

82 See *supra* I.-A.-1.

83 For an in-depth study, see, CHOI, GULATI, POSNER, *supra* note 18, p. 140 *et seq*.

84 OLIVARES-CAMINAL Rodrigo *et al.*, *Debt Restructuring*, Oxford/New York, New York University Press, 2011, p. 434; DIXON Liz, WALL David, "Collective Action Problems and Collective Action Clauses", *Financial Stability Review*, June 2000, p. 143.

etc.)[85] against the will of a minority, thereby neutralizing holdout strategies.

While CACs have improved restructuring procedures, this mechanism is not without deficiencies. Litigating creditors unwilling to participate in negotiations might purchase new bonds in order to constitute a blocking minority preventing an amendment to the bond contract[86]. Moreover, absent an "aggregation clause" ensuring the consolidation of collective action clauses, CACs only operate bond-by-bond which implies that the debtor must separately convince every class of bondholders[87]. This is all the more complex when the sovereign debt stock is comprised of bonds issued in different markets and currencies. This was the case in Argentina, which issued more than 150 types of bonds across eight jurisdictions and in seven currencies[88], rendering unrealistic the conclusion of a comprehensive agreement among all creditors. Although CACs usually specify that bonds held by the issuer or entities under its control are excluded from voting[89], bondholders may also fear abuses related to creditors remotely controlled by the State influencing the restructuring by agreeing to substantial haircuts[90]. These risks must not be disregarded but are more than offset by the predictability and stability provided by CACs included in sovereign debt contracts. Besides, studies show that CACs have not raised the cost of borrowing for sovereign States[91].

Therefore, CACs can contribute to the improved regulation of sovereign insolvencies as long as this mechanism is applicable to a significant proportion of sovereign bonds. The challenge, therefore, is to ensure the systematic inclusion of CACs in sovereign borrowing practices, since it is not possible, at least theoretically, to retroactively insert them in sovereign bond contracts[92]. It is within this framework that international initiatives aimed at the promotion of CACs deserve to be mentioned.

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85 OLIVARES-CAMINAL *et al.*, *supra* note 84, p. 438; DIXON, WALL, *supra* note 84, p. 144.

86 BUCHHEIT Lee. C., GULATI Mitu, "Sovereign Bonds and the Collective Will", *Emory Law Journal*, vol. 51, 2002, p. 1344.

87 *Id.*

88 SCHIER Holger, *Towards a Reorganisation System for Sovereign Debt – An International Law Perspective*, Leiden/Boston, Martinus Nijhoff, 2007, p. 30.

89 HÄSELER Sönke, "Collective Action Clauses in Sovereign Bonds", in KOLB Robert W. (ed.), *Sovereign Debt: From Safety to Default*, Hoboken, John Wiley & Sons, 2011, p. 238.

90 DIXON, WALL, *supra* note 84, p. 144-145.

91 BRADLEY Michael, COX James D., GULATI Mitu, "The Market Reaction to Legal Shocks and Their Antidotes: Lessons from the Sovereign Debt Market", *Journal of Legal Studies*, vol. 39, 2010, p. 301; HÄSELER, *supra* note 89, p. 240. See, however, *contra*, EICHENGREEN Barry, MODY Ashoka, "Do Collective Action Clauses Raise Borrowing Costs?", *The Economic Journal*, n° 114, 2004, p. 247 *et seq*. (concluding (p. 262) that: "[w]e conjecture that more credit-worthy borrowers benefit from being able to avail themselves of an orderly restructuring process, since investors find the availability of this orderly process attractive, while for less credit-worthy borrowers the advantages of provisions facilitating an orderly restructuring are offset by the moral hazard and additional default risk associated with the presence of renegotiation-friendly loan provisions").

92 The Greek experience being an exception (see *infra* II.-B.-1).

2. The International Promotion of CACs

Until recently, there has been no established practice of including CACs in bonds issued under New York Law, unlike the London financial center where CACs have been common market practice in corporate bonds since the end of the nineteenth century[93]. The absence of this practice in the US mainly results from the regulations that apply to corporations. Indeed, the 1939 Trust Indenture Act[94] prohibited the reduction of payments of the principal and interest without the consent of every affected bondholder[95]. While the Trust Indenture Act was not applicable to sovereign bonds, it generated a standardization of contractual practices across the whole bond market and consequently amendment clauses included in sovereign bonds issued in the United States followed the approach applicable to corporate bonds. This practice persisted until the end of the nineties, generating an asymmetry between the two major financial centers, since a particular amendment of bond terms required a qualified majority vote in London and a unanimous one in New York[96].

Only since 2003 has the practice of CACs started to become widespread in New York, slightly less than ten years after the first recommendations that were made in the wake of the 1994 Mexican peso crisis[97]. At the Halifax Summit held in June 1995, the G7 gave the G10 a mandate to explore possible procedures for the orderly resolution of sovereign debt crises[98]. A working group established under the auspices of the G10 published its report in May 1996 (the "Rey Report")[99] which recommended to this end the systematic inclusion of CACs in sovereign bond issues insofar as such clauses "promote cohesion among creditors and reduce the incentive for, or ability of, a small number of dissident creditors to disrupt, delay or prevent arrangements supporting a credible adjustment program that are acceptable to the vast majority of the interested parties"[100]. Apart from "collective representation clauses" and "sharing clauses"[101], this report also pointed out the utility of "qualified majority voting clauses" that "could be expected to facilitate the workout process in the event of a sovereign liquidity crisis, since they limit

93 OLIVARES-CAMINAL *et al.*, *supra* note 84, p. 435; BUCHHEIT, GULATI, *supra* note 86, p. 1324-1325.
94 BUCHHEIT, GULATI, *supra* note 86, p. 1326-1330.
95 15 USC § 77ppp(b) (pointing out that "[…] the right of any holder of any indenture security to receive payment of the principal of and interest […] shall not be impaired or affected without the consent of such holder")
96 For more details, see, BUCHHEIT, GULATI, *supra* note 86, p. 1329.
97 On this episode, see, RIEFFEL, *supra* note 26, p. 188 *et seq*.
98 G7, Halifax Summit Communiqué, 16 June 1995, § 20 ("recognizing the complex legal and other issues posed in debt crisis situations by the wide variety of sources of international finance involved, we would encourage further review by G-10 Ministers and Governors of other procedures that might also usefully be considered for their orderly resolution").
99 The working group was headed by Jean-Jacques Rey of the National Bank of Belgium
100 G10, *The Resolution of Sovereign Liquidity Crises – A Report to the Ministers and Governors Prepared Under the Auspices of the Deputies*, May 1996, § 53, available at <www.bis.org>.
101 *Id.*, § 55-56 and 60-61.

the scope for a small minority of creditors to stall or block the process"[102]. It also briefly explained – implicitly mentioning the United States – that the asymmetry between London and other financial centers with respect to these clauses was due to a "lack of familiarity with such clauses in their national context"[103]. Being aware that a mandatory inclusion of CACs through domestic legislation or an international treaty was not conceivable, the Rey Report advocated the involvement of the private sector in order to promote their adoption[104].

The wishes expressed by the G10, reiterated in greater detail in 2002[105], did not have a direct impact on the US bond market but it constituted the starting point for several initiatives to promote the inclusion of CACs[106]. The US Treasury, and in particular one of its officials, John B. Taylor, had been very active from the early 2000s in attempting to convince market participants in the US[107]. The IMF also recommended such clauses[108] but refused to subject its financial assistance to the insertion of CACs by countries in their sovereign bond issues[109]. The IMF's Sovereign Debt Restructuring Mechanism (SDRM) project, led by Anne Krueger[110], also had a decisive impact. Indeed, through the SDRM, it was intended to establish a supranational regime to address sovereign insolvencies and, as this option was perceived as too radical for both borrowers and private creditors, CACs appeared "as the lesser of two evils"[111]. In this respect, it is indicative that the SDRM was abandoned in the spring of 2003 at the same time CACs were beginning to become common practice in New York, particularly after Mexico's decision to include CACs in its sovereign bonds issued under New York law in February 2003[112].

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102 *Id.*, § 57.
103 *Id.*, § 59.
104 *Id.*, § 62-65.
105 G10, *Report of the G-10 Working Group on Contractual Clauses*, 26 September 2002, available at <www.bis.org>.
106 See also the following study which had a profound influence over this debate: EICHENGREEN Barry, PORTES Richard, *Crisis? What Crisis? Orderly Workouts for Sovereign Debtors*, London, Centre for Economic Policy Research, 1995.
107 TAYLOR John B., *Sovereign Debt Restructuring: A US Perspective*, Speech at the Conference "Sovereign Debt Workouts: Hopes and Hazards", Institute for International Economics, 2 April 2002. See also, SCHIER, *supra* note 88, p. 26.
108 IMF, *Collective Action Clauses in Sovereign Bond Contracts – Encouraging Greater Use*, 6 June 2002, available at <www.imf.org>; IMF, *The Design and Effectiveness of Collective Action Clauses*, 6 June 2002, available at <www.imf.org>.
109 IMF, *IMF Board Discusses Collective Action Clauses in Sovereign Bond Contracts*, PIN No. 02/77, 26 July 2002 (underlining that "[d]irectors also did not support amending the Fund's Articles to require that members of the Fund use collective action clauses" but that "[t]here was general agreement that any efforts to encourage the use of clauses would be most effective if supported by intensified efforts outside the Fund").
110 See *supra* note 81.
111 GELPERN Anna, GULATI Mitu, "Public Symbol in Private Contract: A Case Study", *Washington University Law Review*, vol. 84, 2006, p. 1642-1643 and 1649 *et seq*.
112 SCHIER, *supra* note 88, p. 34; OLIVARES-CAMINAL *et al.*, *supra* note 84, p. 438; GELPERN, GULATI, *supra* note 111, p. 1641; CHOI, GULATI, POSNER, *supra* note 18, p. 162.

The now-widespread use of CACs in all major financial centers for foreign sovereign bond issues[113] thus attests to the development of an integrated *de facto* "public policy for sovereign debt contracts". The euro area debt crisis and the new treaty establishing a European Stability Mechanism have paved the way for how the recognition of such public policy could evolve towards a *de jure* one.

B. CACS AS AN INSTRUMENT OF AN INTEGRATED *DE JURE* "PUBLIC POLICY FOR SOVEREIGN DEBT CONTRACTS" IN THE EURO AREA

1. The Retroactive Insertion of CACs in the Context of the Greek Debt Restructuring

The consolidation of CACs in market practices should have led to a decrease in the proportion of the stock of sovereign debt without collective action mechanisms, thereby minimizing the risks of holdout strategies. This trend holds true for the sovereign debt issued by emerging and developing countries and, besides, the Argentina's debt litigation in New York courts involved bonds issued before 2003 without CACs[114]. The difficulty in restructuring the Greek debt should thus come as a surprise.

A brief study of this crisis shows, however, that holdout strategies have not been anticipated in all Greek bonds[115]. While the debate on CACs focused on the US market, less attention was given to the contractual terms of EU countries' sovereign debt because of the apparent resilience of the euro area. Besides, EU institutions and Member States have not shown considerable interest in this issue. The European Central Bank lauded the development of CACs but seemed to imply that they were only useful for emerging countries[116]. Likewise, in 2002, EU member states committed themselves to introducing CACs in their international sovereign bond issues[117] but not in their domestic ones. These developments were not motivated by a global strategy to prevent possible sovereign debt crises but re-

113 It is necessary to point out that differences remain in the drafting of such clauses. See, DRAGE John, HOVAGUIMIAN Catherine, *Collective Action Clauses (CACs): An Analysis of Provisions Included in Recent Sovereign Bond Issues*, Bank of England, 2 November 2004, 27 p., available at <www.bankofengland.co.uk>.

114 See *supra* I.A.2.

115 For a general overview of the Greek debt crisis, see, MITSOPOULOS Michael, PELAGIDIS Theodore, *Understanding the Crisis in Greece – From Boom to Bust*, Basingstoke, Palgrave Macmillan, 2011.

116 EUROPEAN CENTRAL BANK, "Crisis Resolution in Emerging Market Economies – Challenges for the International Community", *ECB Monthly Bulletin*, November 2003, p. 67 *et seq*.

117 EUROPEAN CENTRAL BANK, *Rapport Annuel 2003*, p. 135. This commitment was made at an informal Ecofin council meeting in Copenhagen and was publicly reiterated at an Ecofin Meeting in 2003: *2537th Council meeting – Economic and Financial Affairs*, Brussels, 4 November 2003, C/03/306, 13689/03 ("Ministers reiterated their commitment to include Collective Action Clauses in all their international sovereign bond issues and stated that they would expect new Member States to follow up on this commitment").

flected more "an effort to lead by example"[118] and to demonstrate that CACs do not raise the cost of borrowing[119]. The EU approach, solely focusing on international sovereign bond issues, has generated a blind spot insofar as euro-denominated bonds issued on domestic markets (for instance French bonds issued in euros in the French domestic market) were not covered by the commitment to include CACs.

The difficulties encountered within the framework of the Greek debt restructuring actually stem from the asymmetry in contract policies between domestic and international sovereign bond issues. Indeed, approximately 90% of Greek bonds issued between 2003 and 2010 were issued on the Greek market, without CACs and governed by Greek law, the rest being issued in London in euros or on other foreign markets in other currencies (US Dollars, Swiss Francs, etc.), usually with CACs[120]. Given the structure of Greek debt and the absence of a collective action mechanism for the vast majority of Greek bonds, the unavoidable restructuring would have obviously faced a high risk of failure since at least a fringe of recalcitrant bondholders would have refused to agree to a voluntary haircut on their loans[121]. Greece opted for an original strategy in order to defuse this "time-bomb" by adopting in February 2012 a legislation (also labeled as the "Mopping-Up Law")[122] authorizing the retroactive inclusion of CACs in Greek bonds issued under Greek law. This permitted the acceptance of an offer through a qualified majority vote to exchange Greek-law bonds for new bonds issued under English Law[123].

The retroactive modification of the terms of payment has a confiscatory effect for bondholders not accepting the exchange. It was obvious and probably expected by Greek authorities that some creditors would challenge this measure before the European Court of Rights (ECtHR) or an investment arbitration tribunal[124]. A Slovakian bank holding Greek bonds and one of its shareholders based in Cyprus filed an arbitration claim against Greece, arguing that the exchange follow-

118 EUROPEAN CENTRAL BANK, *Rapport Annuel 2003*, p. 135 ("In the course of 2003 there was significant progress towards a more widespread inclusion of CACs in sovereign bonds issued under foreign jurisdictions. In an effort to lead by example, the EU Member States committed themselves to including such CACs in their relevant issues").

119 DEUTSCHE BUNDESBANK, *Annual Report 2002*, p. 103.

120 DAS Udaibir S., PAPAIOANNOU Michael G., TREBESCH Christoph, *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts*, IMF Working Paper, WP/12/203, August 2012, p. 42-44; BUCHHEIT Lee C., GULATI Mitu, "Restructuring a Nation's Debt", *International Financial Law Review*, June 2010, p. 46.

121 ZETTELMEYER, TREBESCH, GULATI, *supra* note 2, p. 26.

122 BUCHHEIT, GULATI, *supra* note 121, p. 49.

123 *Greek Bondholder Law n° 4050/2012*, 23 February 2012. See also, HELLENIC REPUBLIC – MINISTRY OF FINANCE, Press Release, 24 February 2012; ZETTELMEYER, TREBESCH, GULATI, *supra* note 2, p. 25; BANK FOR INTERATIONAL SETTLEMENTS, "Governing Law and the Greek Debt Restructuring", *BIS Quarterly Review*, December 2012, p. 67.

124 BOUDREAU Melissa A., "Restructuring Sovereign Debt Under Local Law: Are Retrofit Collective Action Clauses Expropriatory?", *Harvard Business Law Review Online*, vol. 2, 2012, p. 164 *et seq*. See also, GLINAVOS Ioannis, "Investors vs. Greece – The Greek 'Haircut' and Investor Arbitration under BIT's", available at <http://papers.ssrn.com> (to be published in: *Redefining the Market-State Relationship – Responses to the Financial Crisis and the Future of Regulation*, Routledge).

ing the "Mopping-Up Law" decreased the value of their investments and constituted a breach of Greek-Slovak and Greek-Cypriot bilateral investment treaties[125]. Some Greek and Italian bondholders also lodged an application against Greece before the ECtHR[126] for violation of the right to property under Article 1 of Protocol No. 1 of the European Convention on Human Rights (ECHR). They also claimed a violation of the right to non-discrimination under ECHR Article 14, particularly because the exchange had been carried out in a discriminatory manner, by applying different conditions according to the nationality of the bondholders or the size of their investment[127].

While the outcome of these cases is uncertain and the issue of compatibility with ECHR Article 14 seems particularly serious, it is still conceivable that the ECtHR could pay attention to the arguments that could possibly be raised by Greece. Firstly, the Greek "Mopping-Up Law" was not in itself confiscatory or discriminatory but only permitted the exchange adopted by a qualified majority of bondholders, the latter decision not being attributable to Greece[128]. Secondly, the dire economic context must be taken into consideration according to the ECtHR case law. In *Dennis Grainger et al. v. United Kingdom*[129], shareholders in Northern Rock complained that the lack of compensation following the nationalization of the bank by British authorities in 2008 constituted a breach of ECHR Article 1 of Protocol No. 1. The Court dismissed the case as manifestly ill-founded and inadmissible because it recognized that "the Government should be afforded a wide margin of appreciation in this case, since the impugned action arose in the context of macro-economic policy"[130]. It also pointed out that "given the exceptional circumstances prevailing in the financial sector, both domestically and internationally, at the relevant time, a wide margin of appreciation is appropriate"[131] and concluded that in this context "the Court must respect the decisions of the national authorities

125 *Poštová banka, a.s. and Istrokapital SE v. Hellenic Republic*, ICSID Case No. ARB/13/8. See, "Slovak Bank Files Suit Against Greece Over Forced Bond Swap", *Czech News Agency*, 7 May 2013.

126 A website (<http://greekbond-legalactions.eu>) developed by the lawyers who filed this complaint mentions the ECtHR Application Number No. 26055/12.

127 *Ibid.* (arguing a violation of ECHR Article 14:

> because the swap of Greek Government bonds resulting into the deprivation of property complained of has been carried out in a discriminatory manner, namely applying different conditions based on the nationality of the bondholders or treating similarly situations which were significantly different"). This was true in the case of the investment fund Dart Management which purchased English-Law distressed Greek bonds at prices estimated to be between 60% to 70% of the face value. It eventually received full payment by the Greek government whereas other bondholders took a 75% loss within the framework of the restructuring ("Bet on Greek Bonds Paid Off for 'Vulture Fund'", *New York Times*, 15 May 2012).

128 See, WAUTELET Patrick, "The Greek Debt Restructuring and Property Rights A Greek Tragedy for Investors?", in *Mélanges Marc Bossuyt*, Intersentia (forthcoming 2014).

129 ECtHR, 20 July 2012, Application No. 34940/10, *Dennis Grainger and others against the United Kingdom*.

130 *Ibid*, § 39.

131 *Ibid.*

unless it finds them to be 'manifestly without reasonable foundation'"[132].

In the Greek case, the ECtHR could adopt a similar approach, thereby validating the retroactive inclusion of CACs in Greek-law bonds. In substance, such a solution would be a recognition of a d*e jure* "public policy for sovereign debt contracts" aimed at an orderly resolution of sovereign debt crises.

2. The inclusion of CACs in the new European Stability Mechanism

Assuming that the Strasbourg court concludes that Greek measures were compatible with the ECHR, it should not be inferred that they could be repeated in the future for another debt crisis in the euro area. Such stopgap initiatives generate legal risks but also send negative signals to the markets and adversely affect the credibility of both the euro and EU institutions. In this respect, it is noteworthy to mention that in the Greek restructuring, swapping Greek-law bonds for new English-law bonds made sure that "bondholders who had just experienced the power of the local legislature to change contract provisions retroactively […] would find some comfort in the fact that in the event of a new restructuring English law bonds would preclude a change of their contractual rights through the channel of legislative fiat"[133].

In order to improve the predictability and guarantee the legal certainty of any future possible debt restructuring at the European level, a more perennial and robust framework for the management of financial crises has been established through the Treaty Establishing the European Stability Mechanism (ESM), which was adopted in February 2012 and replaced the temporary European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM). The European Council in March 2011 – before the adoption of the ESM Treaty – stressed that its objective was to ensure the inclusion of CACs "consistent with those commonly used in the US and the UK markets since the G10 report on CACs" [134]. According to the Council, it "implies the use of identical and standardised clauses for all euro area Member States, harmonised in the terms and conditions of securities issued by the Members States. Their basis will be consistent with the CACs that are common in New York and English law" [135].

The ESM Treaty[136] makes the inclusion of CACs in the euro area compulsory to prevent the complications encountered in the Greek case where no collective mechanism was available for bonds issued on the domestic market. In this

132 *Ibid.*

133 ZETTELMEYER, TREBESCH, GULATI, *supra* note 2, p. 25 ("Greek law bondholders who had just experienced the power of the local legislature to change contract provisions retroactively […] would find some comfort in the fact that in the event of a new restructuring English law bonds would preclude a change of their contractual rights through the channel of legislative fiat"). See also, CHOI, GULATI, POSNER, *supra* note 18, p. 139-140.

134 EUROPEAN COUNCIL, *Conclusions*, EUCO 10/1/11 REV 1, Annex II (Term Sheet on the ESM), 24-25 March 2011, available at <www.consilium.europa.eu>.

135 *Ibid.*

136 For more details, see, ALLEMAND, MARTUCCI, *supra* note 13, p. 407 *et seq*.

respect, the new treaty provides that "[c]ollective action clauses shall be included, as of 1 January 2013, in all new euro area government securities, with maturity above one year, in a way which ensures that their legal impact is identical"[137]. This requirement constitutes an important change for some euro area countries considered to be more robust (including France, Germany, Luxembourg and The Netherlands) since their model contracts for domestic issues did not include CACs[138] and were only limited to key financial terms (interest rate, amount, maturity)[139]. This new treaty obligation thus places a limitation on the freedom of contract and is non-derogable, thereby giving substance to a "public policy for sovereign debt contracts" for the member states of the euro area.

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The decision to make CACs mandatory through the ESM Treaty has been made within the specific context of a euro area seeking a more advanced economic, monetary and financial form of governance. While it is unlikely that a similar obligation could be reproduced in a broader multilateral setting, the "legalization" of CACs has already started through their progressive inclusion in sovereign debt contracts and their recognition by States and international institutions. This process, joining the practice and the *opinio juris*, reflects the crystallization of a rule of international customary law as well as the recognition of an international "public policy for sovereign debt contracts". It could potentially lead domestic and international tribunals to take into consideration the overriding objective of an orderly resolution of sovereign debt crises in order to effectively address the problem of holdouts in the absence of collective action mechanism. Undoubtedly, the argument should be raised within the framework of the litigation arising out of the unprecedented Greek debt restructuring.

137 MES Treaty, Article 12.3.
138 CHOI, GULATI, POSNER, *supra* note 18, p. 153.
139 *Ibid*., p. 133.