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ABSTRACT

Sovereign debt restructurings may experience marginal changes as a result of recent modifications in contractual terms being incorporated into new bond issues, but for the most part they will likely resemble what has generally worked so well in recent decades to the satis- faction of most governments and private creditors. The statutory reforms that have been proposed to date are highly unlikely to gain traction for a variety of reasons, including the prospect that they would have been stymied when confronted with a rogue sovereign debtor such as Argentina.

KEYWORDS: Argentina, default, debt, sovereign, restructuring, statutory; contractual; collective action; pari passu; finance
JEL CODES: E6, F3, F34, F51, F65, H63, K4, N26, Q15

INTRODUCTION

During the late 1990s and early 2000s, a number of academic economists, legal scholars, and policy gurus focused their attention upon the alleged inefficiencies in international financial markets that supposedly had contributed to systemic financial crises in Southeast Asia, Russia, Brazil—and especially in Argentina, the locus of the world's largest default up to that point in time.

The scribblers argued that globalization had spawned increasingly diverse, diffuse, and unmanageable creditor and debtor communities that posed coordination and collective-action problems. No longer could a relatively small syndicate of commercial banks gather quickly in New York or London, spurred into action by urgent telephone calls from their supervisory authorities, to deal with whatever financial emergency had erupted in some distant corner of the world. As a result, governments that lost the confidence of their bank depositors, bondholders, or bank creditors, or fell victim to regional 'contagion' effects, were claimed to be unable to work out constructive solutions prior to a major currency, banking, or debt crisis.

After a crisis erupted, it was alleged, financial stability could only be restored through the extension of massive loan packages from the G-7 governments acting through the International Monetary Fund (IMF). Moreover, these financial rescues reportedly were generating moral hazard and other adverse systemic risks—particularly in situations where nations' debt sustainability was questionable. And when sovereign liabilities needed to be restructured or written down, the story went, the absence of an orderly sovereign bankruptcy mechanism meant that workouts were delayed, and their effectiveness was undermined, by 'free riders' and 'rogue' (holdout) creditors.

This focus on the alleged shortcomings of financial globalization, and the seeming repetition of currency, banking and/or sovereign debt crises, spawned various concrete proposals to reform the international financial architecture (Porzecanski 2005). The 'statutory approach' argued for the creation of a supranational bankruptcy authority that would adjudicate financial claims on troubled sovereigns in an expeditious manner, overriding contracts written in national jurisdictions. The 'contractual approach', on the other hand, called for the modification of boilerplate bond clauses—especially under New York law—in ways that would facilitate communication among creditors and with the sovereign debtor, restrain disruptive litigation, and enable restructuring decisions by a qualified majority of creditors rather than by unanimous consent.

Initially, several academics urged, and the G-7 governments favoured, consideration of both approaches. However, this was generally resisted by both the financial industry and the largest sovereign issuers in the emerging markets. In the end, the government of Mexico and its bankers decided to issue a bond, in early 2003, subject to New York law but incorporating innovative 'collective action clauses' (CACs), in exchange for the U.S. Treasury embracing the contractual approach to reforms (Taylor 2007: 111–32). The transaction was successful because investors did not demand a premium for the contractual innovation, and ever since then, most sovereign bond issues under U.S. law have incorporated the said clauses at no obvious additional cost (Bradley et al. 2010: 297, 320).

The impetus to continue to reform the rules and practices of international finance subsided for about a decade, until the Greek financial crisis erupted in 2010–12 and led to a massive official rescue underwritten by the European Union (EU) and the IMF—only to result in a record- breaking default more than twice the size of Argentina's a decade earlier. But it was not until long-simmering litigation against Argentina began to yield victories for holdout creditors in 2012–14 that the G-20 countries mobilized to introduce a further contractual reform.

The crisis in Greece engendered regrets in official and academic circles because the passage of time revealed that IMF and EU emergency lending had been utilized in part to finance the exit of private creditors in the two years ahead of the restructuring of government debt in March 2012 (IMF 2014: 12). Moreover, while the eventual restructuring of obligations in the hands of local and foreign private investors achieved a very high creditor participation rate of 97 percent, despite being pre-emptive and involving massive debt forgiveness, the IMF and mostly European policymakers and academics bemoaned the fact that it was not 100 percent comprehensive. The leakage of 3 percent was accounted by the fact that the owners of 19 of the 36 Greek government bonds subject to English law had not participated in the debt relief operation, because blocking majorities of holdout creditors had exercised their rights under those bonds' CACs to prevent any changes to their payment terms (IMF 2013: 28).

The saga of litigation against Argentina on the part of holdout creditors who refused to exchange their original bonds for new ones worth a fraction—bondholders who accounted for 7 percent of the government's bonded debt in default as of 2002—became a source of concern to the IMF and a variety of governments and academics once the holdouts finally scored important judicial victories. These included a June 2014 U.S. Supreme Court decision not to hear Argentina's appeal of lower federal court rulings which (a) had found Argentina in breach of a clause in its defaulted bonds—the so-called pari passu clause—pledging to treat all bondholders equally, and (b) had prohibited Argentina from making payments to creditors who had accepted new bonds unless it paid also holdout creditors what they were owed. The governments of Brazil, France, Mexico and the United States filed legal briefs before the U.S. Supreme Court, stating that these rulings would have a negative impact on the orderly and timely conduct of sovereign debt restructurings by encouraging more bondholders to resist going along with future sovereign debt restructuring. Several law firms, academics, policy groups, and international bodies like- wise expressed their opposition to the verdicts (IMF 2014: 7–13).

THE CASE FOR STATUTORY AND CONTRACTUAL REFORMS

The most outspoken critic of the existing international financial architecture has been Joseph Stiglitz, the hetero- dox economist who in numerous books, articles, opinion pieces and speeches has called for a comprehensive inter- national bankruptcy procedure to ensure the proper resolution of sovereign debt crises (Guzman and Stiglitz 2016a).[1] Stiglitz has gone beyond the confines of academia to flog his ideas, serving as an advisor to, and public advocate and expert witness for, then Presidents Néstor and Cristina Kirchner of Argentina in their quest to impose the punishing 2005 debt restructuring on holdouts who had court-validated rights to refuse any such cramdown (Johnson 2014). However, Stiglitz has been surprisingly short on concrete reform proposals, putting forth that 'there should be a global agreement that no country can surrender its sovereign immunity (even voluntarily)' to creditors, combined with the establishment of 'an oversight commission [made up of government representatives] with the mission of mediating and supervising the [debt] restructuring pro- cess' of sovereigns (Guzman and Stiglitz 2016a: 22).[2]

José Ocampo, Stiglitz's colleague at Columbia University, has been inspired by the dispute-settlement process at the World Trade Organization (WTO), which follows three consecutive stages with clear deadlines: one of voluntary negotiations, a second of mediation, and a final of arbitration, if the former two fail. He has been advocating for a similar mechanism to be established for sovereign debt restructurings, possibly to be hosted by the IMF but independent of it, to ensure a process that would be efficient, impartial and speedy with a result that is binding on all parties involved (Ocampo 2016).

Jürgen Kaiser, of Jubilee Germany, has been advocating for a state insolvency process through international arbitration, an updated version of proposals which first circulated in the 1990s, because in his view both the sovereign debtor as well as good-faith creditors have the most to win through an impartially facilitated compromise.[3] He does not call for a new international organization, nor a

[1] 'The current non-system does not achieve the described objectives of restructuring. Instead, it creates a host of inequities as well as inefficiencies. It overpenalizes debtors in distress, causing delays in the recognition of the problems. It leads to the 'too little, too late' syndrome. In some cases, there is too much lending—and too much suffering later on; in other cases, there may be too little lending. Moreover, the legal frameworks permit a situation in which a few specialized agents (the vulture funds) can block the finalization of a restructuring, imposing large costs on the debtor and on other creditors' (Guzman and Stiglitz 2016a: 10).

[2] 'The commission would not rule over different alternatives. Instead, the sovereign would finalize the process with a final proposal and the commission would produce statements about the reasonability of the process and the final proposal. This approach would serve to legitimate the restructuring or, alternatively, to legitimate positions that speak of illegitimate restructurings.' (Guzman and Stiglitz 2016a: 22).

[3] In the mid-1990s, Barry Eichengreen and Richard Portes had called for the establishment of an independent agency that 'could provide mediation and conciliation services in negotiations between the debtor and creditors and, if desired by the parties themselves, binding arbitration' (Eichengreen and Portes 1995: 43), but the earliest proposal for an ad-hoc debt arbitration process was put forth by the Austrian economist Kunibert Raffer in the late 1980s (Raffer 1990). With some of its features further developed, this concept was later on adopted by NGOs campaigning for debt relief as part of the Jubilee 2000 Campaign, and is nowadays referred to as the Fair and Transparent Arbitration Process (Fritz and Hersel 2002).

costly bureaucracy, but rather for a liaison office to arrange for ad hoc mediation, conciliation and arbitration services, with panels nominated freely by the parties based on a mutual agreement, whenever sovereigns are looking for a comprehensive solution to their looming or acute sovereign debt problems (Kaiser 2016).

As of early 2017, none of these statutory reforms or any others had gained traction, whereas certain draft contractual reforms had earned strong support in G-20 official circles, were adopted by law in Europe, and have been incorporated by a number of sovereign debtors and accepted by bond-holders elsewhere. The first reform involves the introduction of so-called 'super-CACs' containing aggregation provisions. Their purpose is to limit the ability of holdout creditors to impede restructurings acceptable to a supermajority of creditors, because whereas voting under existing CACs is to be carried out by holders of one bond series at a time, the new clauses contemplate aggregated, simultaneous voting across all debt instruments subject to a restructuring with binding effect on all bond series.

In the wake of growing concern that the Greek restructuring of March 2012 would encourage more holdouts in the future, the European Council decided, and the treaty establishing the European Stability Mechanism enshrined, that as of the start of 2013 a new aggregation clause would be mandatorily included in all new euro-area government securities with a maturity greater than one year.[4] In August 2014, following an extensive consultative process with financial intermediaries, the International Capital Market Association (ICMA) published suggested wording for aggregation CACs to be utilized by sovereign issuers around the world, and these clauses have since come into use with Mexico once again taking the lead (Makoff and Kahn 2015; Gelpern et al. 2016).[5] During the period from 1 October 2014 to 31 October 2016, there were 228 international sovereign bond placements, for a total nominal principal amount of approximately US$ 262 billion (excluding Eurozone issues). And, out of these, 154 bonds, issued by 49 different sovereigns representing about 74 percent of the nominal principal amount of total issuance, included the super-CACs (IMF 2016: 3).

The second reform involved the introduction of a model pari passu clause, responding to concerns about the implications of the Argentina litigation for future bonds, as voiced by the IMF and G-20 governments (IMF 2016: 2–3). The proposed language was likewise first published by ICMA in August 2014, intending to mitigate the risk that other courts would read into the clause the interpretation given by the U.S. courts in the case of Argentina's clause. It explicitly states that while

[4] Bonds issued by euro-area sovereigns are required to include a CAC that allows for either a series-by-series or a two-limb aggregated voting procedure. The latter enables differential treatment among creditors. For additional background and details, see Hofmann (2014).

[5] In order to accommodate stylistic differences between legal markets, ICMA published in May 2015 two different versions of the model clauses, one for English-law bonds and another for New York-law bonds, see www.icmagroup.org/assets/documents/ Resources/ICMA-Standard-CACs-Pari-Passu-and-Creditor-Engagement-Provisions—May-2015.pdf, accessed 23 March 2017.

a debt will rank pari passu with all other unsecured debt of the issuer, there is no implied requirement that the issuer must pay its debts at the same time (technically, on an equal or ratable basis).[6] The model pari passu clause has been adopted in tandem with the super-CACs by most sovereigns issuing new debt between 1 October 2014 and 31 October 2016 (IMF 2016: 5).

THE CASE AGAINST STATUTORY REFORMS

It would appear that those who have been advocating for statutory reforms of the international financial architecture are not persuaded that the latest round of contractual reforms is sufficient to remedy whatever deficiencies they perceive. Stiglitz, for instance, recently wrote about Argentina's settlement with its holdout creditors:

> This resolution will carry a high price for the inter- national financial system, encouraging other funds to hold out and making debt restructuring virtually impossible (Guzman and Stiglitz 2016b)

His colleague Ocampo, for his part, had previously written:

> The most important effect of the U.S. rulings, how- ever, is that they discourage any future voluntary debt renegotiation, for obvious reasons: if investors know they have a chance to claim full payment through the courts, why would they take part in any restructuring? (Ocampo 2014)

It is not hard to disagree with these pessimistic assessments for several reasons. First, the record shows that most sovereign debt restructurings have been handled expeditiously despite the absence of a world sovereign bankruptcy regime. Neither the threat nor the act of litigation, nor isolated instances of 'rogue creditor' behaviour, have thwarted the debt restructurings that have needed to be accomplished.

According to a Moody's analysis of 34 sovereign bond restructurings from 2008 through early 2013, the evidence shows that negotiations between sovereigns and their private creditors have proceeded fairly quickly, such that on average debt restructurings were completed within seven months after the start of negotiations.[7] In only two cases have holdout creditors represented more than ten percent of the value of outstanding bonds, and in just one of those instances—that of Argentina—did the holdouts engage in persistent litigation (Duggar 2013). This is the case because most

[6] ICMA (2014); see also the prior note and citation for the May 2015 version of the provision as tailored for sovereign bonds governed by New York law.
[7] This average would be considerably shorter if the sample were to exclude the longest delays, which had to do with unique restructuring strategies and the parallel restructuring of official sector and commercial loan debt simultaneously with the restructuring of the bond instruments (Duggar 2013).

sovereigns have made reasonable debt relief demands from their creditors and have pursued good-faith negotiations—whereas Argentina did neither. In fact, the unilateral, coercive and aggressive mode with which the authorities in that country went about managing, defaulting and restructuring their debt obligations stands out in a comprehensive academic study of the nature of past sovereign debt disputes:

> The well-known case of Argentina from 2001 to 2005 displays an exceptional degree of coerciveness, as the government officially declares a default, sticks to the proclaimed moratorium by stopping all payments to its bondholders for four years, freezes foreign assets, and rejects any meaningful negotiations (Enderlein et al. 2012: 261).

Second, by now most international sovereign bonds include the first-generation CACs binding investors in any one debt instrument to the decisions of a supermajority, and as mentioned above, the bulk of new bonds issued since late 2014 include the super-CACs. Indeed, whereas at the end of 2002 a mere one-third of international sovereign bonds featured CACs, by late 2016 that proportion had risen to almost 80 percent (IMF 2016: 7). While the first- generation CACs do not eliminate the holdout problem witnessed during the Greek debt restructuring of 2012, which was a minor one involving creditors obtaining blocking position in particular bond series, they would have minimized Argentina's significant holdout problem if they had figured in that country's obligations. However, because Argentina's default in late 2001 involved mostly bonds issued during the 1990s, very few of them included CACs and the bulk required the unanimous consent of their owners for any amendments to their payment terms—the feature which attracted, and then empowered, holdouts (Duggar 2014).

Third, sovereigns are free to repurchase whichever bonds they regard as potentially problematic—for instance because they do not feature first- or second-generation CACs—while issuing new ones with whatever promissory language they are prepared to honour. The fact that no sovereign issuer is known to have engaged in such a liability-management operation to accelerate the incorporation of the enhanced contractual provisions (IMF 2016: 7) suggests that most sovereigns do not contemplate ever managing, defaulting on, and restructuring their debt obligations in the same unilateral, coercive, aggressive and ultimately self-defeating manner as Argentina did.

Fourth, pari passu language is usually not as holdout- friendly as was the one in Argentina's indentures from the 1990s at the heart of the country's default. Pari passu clauses are a standard feature of sovereign bond contracts, but there are three major formulations, the most common of which appears in the majority of sovereign bonds issued over the past two decades, and in almost all bonds issued earlier—and it is not suitable for Argentina-style litigation (Duggar 2014: 2).[8]

[8] The pari passu clause in the old Argentine bonds reads as follows: '[t]he Securities will constitute… direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all time rank pari passu without any preference among themselves. The payment obligations of the Republic under the Securities shall at all times rank at

Moreover, there already is one case where a holdout creditor tried but failed to use the ruling in the Argentina case as a suitable precedent. The Export–Import Bank of the Republic of China (Taiwan) chose not to participate in the restructuring of Grenada's debt in 2005, and in March 2013 the bank filed a lawsuit against Grenada based on the pari passu violation argument used against Argentina. However, in August 2013, the federal district court in New York ruled that the Argentina decision was limited to Argentina's unique set of circumstances and did not apply to Grenada's (Alfaro 2015: 70–71).

Fifth, the threat of holdout creditors actually has been a force mainly for good in the international financial land- scape. Sovereign distressed-debt investors have been characterized as disruptive to the restructuring process and unfair to the creditors that participate in restructurings. However, just like distressed-debt investors can expedite business reorganizations and protect going-concern enterprise values in the private sector (Goldschmid 2005), 'vulture investors' can and often do play a salutary role in the sovereign debt context by advancing creditor rights (Fisch and Gentile 2004: 1097–1101).

Unlike many risk- and confrontation-averse institutional and retail investors, opportunistic investors are more likely to challenge aggressive sovereigns and motivate them to make a better offer than they would otherwise make to the meeker creditors. In the case of Argentina, tens of thousands of elderly retail investors benefited from the litigation spearheaded by the distressed-debt investors (Mander 2016)—and hundreds of thousands more would have benefited if the wheels of justice had only turned faster. Holdout litigation can also serve as a potential check on opportunistic defaults by sovereign debtors, and it was sorely missing in the blatant case of Ecuador in 2008–09 (Porzecanski 2010). It boggles the mind that so much of the academic and policymaking literature has ignored the realistic possibility that rogue sovereign debtors like Argentina, rather than holdout private creditors, are the ones that pose the greater threat to the integrity and efficiency of the international financial architecture (Porzecanski 2005: 331).

Sixth, Argentina's behaviour during 2002–2015 demonstrates why none of the proposed statutory reforms would work in the case of a similarly recalcitrant, dishonourable sovereign debtor. If governments around the globe were to agree not to surrender their sovereign immunity voluntarily when accessing the leading financial markets, as Stiglitz has proposed, then uncreditworthy sovereigns like Argentina would never be able to raise funding outside their own borders. Argentina sold the then largest-ever amount of bonds placed abroad by any emerging-market economy after

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least equally with all its other present and future unsecured and unsubordinated External Indebtedness…' (Duggar 2014: 2). The U.S. federal courts interpreted it as requiring equal ranking of payment obligations under the relevant debts, and they prevented Argentina from making payments to the restructured bondholders without first making a 'ratable payment' to the holdout creditors (IMF 2014: 37–44).

making up with its creditors (Platt and Moore 2016)— but only after surrendering its sovereign immunity irrevocably, as it had always done prior to the 2001 default.

And if there were to be an oversight commission made up of government representatives with the mission of mediating and supervising the debt restructuring process of sovereigns, then Argentina would not have accomplished a restructuring when it wanted it, because in 2002 the country was barely on speaking terms with the official international community. In fact, Argentina at the time also defaulted to its official bilateral creditors (namely, the world's export-credit and foreign-aid agencies)—and it remained in default to them for over a dozen years (Mander 2014). It is hard to conceive that the country would have turned to a group of foreign government officials for mediation and supervision in the early 2000s, when it was in such a confrontational mood.

In terms of a dispute-settlement process for sovereign debtors akin to that for trade disputes at the WTO, that would not have worked well, either. During the past two decades, Argentina has been the target of more trade complaints triggering dispute-settlement procedures than any country in Latin America—more than any other developing country except for China and India, in fact (WTO 2015). In recent years, Argentina went through a heated WTO dispute-settlement process because of the stringent import restrictions that it imposed after 2010. The country was found guilty of breaking the WTO rules in 2014 and again (after an appeal) in 2015. It subsequently pledged to remove the restrictions by end-2015, but as of mid-2016, even the new government in Buenos Aires had yet to abolish all the import controls that it was supposed to remove (Baker and McKenzie 2015; WTO 2016). This track record does not inspire confidence that any WTO- like, debt-resolution mechanism would have met Argentina's approval in the early 2000s unless it had validated the country's aggressive debt-relief objectives.

As concerns the applicability of a state insolvency process through international arbitration, the fact is that since 2001 Argentina has likewise been the target of numerous claims filed with tribunals under the International Centre for Settlement of Investment Disputes (ICSID), the United Nations Commission on International Trade Law (UNCITRAL), and the International Chamber of Commerce (ICC)—the most ever against a country party to those conventions. Argentina dragged all the cases out for as many years as possible through endless challenges and appeals, and whenever it lost arbitrations definitively, it either did not pay the resulting awards or it paid them in part after long delays (Cancel 2013; Porzecanski 2016). In this regard, Argentina's rogue behaviour in connection with arbitration proceedings was consistent with its refusal to obey and pay foreign court judgments, and it is highly suggestive of the lack of efficacy that an arbitral vehicle for state insolvency matters would have had in Argentina's case.

Finally, advocacy for statutory reforms is pointless because there has not been a willingness on the part of most governments and most private creditors to depart from the current financial architecture. Governments are evidently unwilling to cede their sovereignty when it comes to such important matters as their creditworthiness and capacity to respond quickly to any economic or financial emergency they may confront. And bond investors and commercial lenders are likewise unwilling to cede their creditor rights to a mediation, conciliation, or arbitration process without the inclination and enforcement powers to confront way- ward governments—especially now that the U.S. judiciary proved able to checkmate an insubordinate sovereign such as Argentina.

In sum, sovereign debt restructurings may experience marginal changes as a result of recent modifications in contractual terms being incorporated into new bond issues, but for the most part they will likely resemble what has generally worked so well in recent decades to the satis- faction of most governments and most private creditors. The statutory reforms that have been proposed to date are highly unlikely to gain traction for a variety of reasons, including the prospect that they would have been stymied if they had been in place and were confronted with a rogue sovereign debtor such as Argentina.

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