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## Defaulting the Purpose: The Future of Foreign Sovereign Debt Restructuring in the Wake of Argentina's Debt Crisis

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# Defaulting the Purpose

## THE FUTURE OF FOREIGN SOVEREIGN DEBT RESTRUCTURING IN THE WAKE OF ARGENTINA'S DEBT CRISIS

“They don’t call it sovereign debt for nothing.”<sup>1</sup>

### INTRODUCTION

The Second Circuit’s ruling in *NML Capital, Ltd. v. Republic of Argentina*, a case in which wealthy creditors sued Argentina under New York law for the repayment of defaulted debt bonds, sought to prevent Argentina from paying back creditors that accepted restructured bonds unless Argentina also paid back holdout bondholders equally.<sup>2</sup> This decision was the subject of much criticism and scholarly debate because it was one of the first instances of a court granting specific performance based on a *pari passu*, or equal footing, clause.<sup>3</sup> While the court hoped that the creative relief would pressure Argentina to pay back both restructured and holdout bondholders alike, it now seems that the decision was counterproductive.

Argentina successfully skirted the court’s injunctions and escaped paying back the holdout bondholders by defaulting on its debt and relinquishing all responsibility for repayment, but at the cost of plunging the country into another economic crisis.<sup>4</sup> Argentina has made it abundantly clear that it will stop at nothing in order to continue repayments to those bondholders that cooperated with Argentina’s debt restructuring, despite U.S.

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<sup>1</sup> Dan Rosenheck, *Argentina’s Rational Default*, NEW YORKER (Aug. 7, 2014), <http://www.newyorker.com/business/currency/argentinas-rational-default> [http://perma.cc/3GLT-DXF5].

<sup>2</sup> See *NML Capital, Ltd. v. Republic of Argentina*, 699 F.3d 246, 250 (2d Cir. 2012).

<sup>3</sup> See, e.g., Jack Jrada, *Closing the Book on Argentina’s Sovereign Debt Default: The Second Circuit’s Decision and its Ramifications for Sovereign Debt Restructuring in the Eurozone*, 32 REV. BANKING & FIN. L. 222, 232 (2013); Brett Neve, *NML Capital, Ltd. v. Republic of Argentina: An Alternative to the Inadequate Remedies under the Foreign Sovereign Immunities Act*, 39 N.C. J. INT’L L. & COM. REG. 631, 657-60 (2014).

<sup>4</sup> Jon Hartley, *Argentina’s Default: Lessons Learned, What Happens Next*, FORBES (Aug. 4, 2014), <http://www.forbes.com/sites/jonhartley/2014/08/04/argentinas-default-lessons-learned-and-what-happens-next/> [http://perma.cc/75BH-VWNF].

injunctions ordering the country to refrain from doing so.<sup>5</sup> Argentina has defied court orders, enacted legislation to avoid New York intermediary banks, and continued to deposit funds for restructured bondholders.<sup>6</sup> As a result, Argentina has established a model for other nations seeking to avoid their international creditors by making debt restructuring impossible.<sup>7</sup>

Governments borrow substantial capital by issuing debt in the form of sovereign bonds.<sup>8</sup> A debt restructuring allows a distressed debtor to minimize costs and restore economic growth by changing the terms of the bonds.<sup>9</sup> The terms that are changed in a restructuring vary, but the two most commonly used are debt rescheduling, which involves lengthening the maturity date of the old debt, and debt reduction, which involves reducing the face value of the original debt.<sup>10</sup> Restructuring agreements are crucial in facilitating recovery when a nation can no longer afford to pay the full amount of its debt.<sup>11</sup> When certain bondholders “hold out,” or refrain from accepting the terms of the restructured debt, not only is the restructuring process frustrated, but it becomes nearly impossible for the sovereign to settle its debt.<sup>12</sup> In some cases, the sovereign will be forced to default on its debt in order to maintain domestic stability.<sup>13</sup> As Argentina’s default shows, however, under the current international system, a sovereign can also choose to default for strategic reasons.<sup>14</sup>

Argentina defaulted on its foreign debt on July 31, 2014, marking its second default since 2001.<sup>15</sup> The defaulted bonds had been the issue of litigation for over a decade, and this most

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<sup>5</sup> Ken Parks & Taos Turner, *Argentina Moves to Pay Exchange Bondholders in Argentina*, WALL ST. J. (July 11, 2014, 10:08 PM), <http://blogs.wsj.com/frontiers/2014/08/20/argentina-moves-to-pay-exchange-bondholders-in-argentina/tab/print/> [<http://perma.cc/6XAP-X3RD>].

<sup>6</sup> Nicole Hong, *Bondholders Not Optimistic About Argentina’s New Scheme*, WALL ST. J. (Aug. 20, 2014, 12:21 PM), <http://blogs.wsj.com/moneybeat/2014/08/20/bondholders-not-optimistic-about-argentinas-new-scheme/> [<http://perma.cc/PG7H-JVXT>].

<sup>7</sup> Laura Alfaro, *To Pay or Not to Pay: Argentina and the International Debt Market*, HARV. BUS. SCH. WORKING KNOWLEDGE (Apr. 25, 2014), <http://hbswk.hbs.edu/item/to-pay-or-not-to-pay-argentina-and-the-international-debt-market> [<http://perma.cc/BGB8-BJKU>].

<sup>8</sup> Robert Auray, *In Bonds We Trustee: A New Contractual Mechanism to Improve Sovereign Bond Restructurings*, 82 FORDHAM L. REV. 899, 903 (2013).

<sup>9</sup> JOSE M. GARRIDO, OUT-OF-COURT DEBT RESTRUCTURING 1 (2012).

<sup>10</sup> Auray, *supra* note 8, at 903-04.

<sup>11</sup> GARRIDO, *supra* note 9, at 1.

<sup>12</sup> Jrada, *supra* note 3, at 223-25.

<sup>13</sup> *Id.*; Nicola Gennaioli, Alberto Martin & Stefano Rossi, *Sovereign Default, Domestic Banks and Financial Institutions* 12-13 (CEPR Discussion Paper No. DP7955 2010), <http://ssrn.com/abstract=1658282> [<http://perma.cc/HN3Y-G5VR>].

<sup>14</sup> See Rosenheck, *supra* note 1 (predicting that Argentina’s 2014 default was based on strategy, and not financial instability, since Argentina had access to steady cash flow and a timely interest repayment schedule at the time of default).

<sup>15</sup> Hartley, *supra* note 4.

recent default brings about new issues in international debt restructuring and problems with holdout litigation.<sup>16</sup> Since the 2001 default, Argentina has been unable to secure the investors and lenders needed to get the economy back on its feet.<sup>17</sup> Argentina has instead relied on government interference in the private sector, manipulation of inflation reporting, and the printing of central bank money to maintain reserves.<sup>18</sup> The litigation surrounding its first default has prevented Argentina from re-entering the international debt market for the past 13 years, forcing it to sell local-law bonds—issued domestically under Argentine law—and incur an additional \$20 billion in debt.<sup>19</sup> Price freezes and volatile exchange rates have made it increasingly difficult for private Argentine companies to cover their operating costs, putting many out of business.<sup>20</sup> Meanwhile, the Argentine peso has continued to fall in the informal (black) market, making its devaluation a likely possibility.<sup>21</sup> Argentina’s default and ensuing economic policies have cost Argentina’s lenders an estimated \$74 billion, imposed more than \$24 billion in revenue costs on taxpayers worldwide, and reduced the value of direct investments in Argentina by another \$39 billion.<sup>22</sup>

Additionally, the *NML Capital* decision has reinforced the rights of holdout creditors to frustrate restructuring efforts worldwide, which creates an unsustainable framework for foreign sovereign debt management. Foreign debt litigation has in effect become “a chess match: a move by a vulture is blocked or countered, and a new move or theory comes into vogue as

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<sup>16</sup> Neve, *supra* note 3, at 631-32.

<sup>17</sup> *Id.*

<sup>18</sup> *Announcement: Moody's: Limited Market Access and Low Growth Will Pressure Argentina's Next Administration to Adjust Policies*, MOODY'S (Aug. 11, 2015), [https://www.moody.com/research/Moodys-Limited-market-access-and-low-growth-will-pressure-Argentinas-PR\\_332306](https://www.moody.com/research/Moodys-Limited-market-access-and-low-growth-will-pressure-Argentinas-PR_332306) [<http://perma.cc/2C66-J378>].

<sup>19</sup> Katia Porzecanski & Camila Russo, *Argentina's Griesa-Proof Bondholders Unfazed by Sale Halt*, BLOOMBERG BUS. (Mar. 5, 2015, 12:22 PM), <http://www.bloomberg.com/news/articles/2015-03-05/griesa-proof-bondholders-unfazed-by-sale-halt-argentina-credit> [<http://perma.cc/NS4X-YWJY>].

<sup>20</sup> MOODY'S, *supra* note 18.

<sup>21</sup> Pan Kwan Yuk & Benedict Mander, *US Cleaning Company Clorox Warns of Argentine Devaluation*, FIN. TIMES (Aug. 3, 2015, 8:28 PM), <http://www.ft.com/intl/cms/s/0/3c2d3814-3a10-11e5-bbd1-b37bc06f590c.html#axzz3tx1rOHH5> [<http://perma.cc/9KAN-MXDS>].

<sup>22</sup> ROBERT J. SHAPIRO & NAM D. PHAM, DISCREDITED—THE IMPACT OF ARGENTINA'S SOVEREIGN DEBT DEFAULT AND DEBT RESTRUCTURING ON U.S. TAXPAYERS AND INVESTORS 24 (Oct. 2006), [http://www.sonecon.com/docs/studies/argentina\\_1006.pdf](http://www.sonecon.com/docs/studies/argentina_1006.pdf) [<http://perma.cc/56JR-AHSJ>].

another avenue to try to increase the chances of recovery.”<sup>23</sup> Incentivizing creditors to hold out will cause restructuring to become more complicated and time consuming, which will in turn prolong economic hardship.<sup>24</sup> Continued debt crises result not only in economic harm, but also in social and humanitarian disaster, such as severe cuts to social services and increased rates of unemployment, homelessness, and crime.<sup>25</sup> Thus, this is a particularly important time to consider novel solutions to restructuring given the catastrophic consequences brought on by Argentina’s recent default and the litigation it provoked.

An exploration of the implications of the *NML Capital* decision and Argentina’s resulting default is essential in considering a sustainable global framework for future disputes between sovereign creditors and sovereign debtors. Part I of this note describes the issues for sovereign debt restructuring caused by holdout litigation. Part II explains the three main scholarly proposals for ameliorating holdout litigation in foreign debt restructuring and ultimately concludes that all three are inadequate in isolation. Part III proposes an international restructuring court to enforce an international restructuring code as a solution to the problem of unsuccessful sovereign debt restructuring. This international restructuring regime would combine elements of the three previous proposals in a new way and would be best equipped to solve the seemingly unsolvable problem of restructuring sovereign debt after the recent Argentine saga. Ultimately, this hybrid solution would prevent holdout litigation on existing debt while also establishing an efficient and functional framework for restructuring future debt and protecting other sovereign nations from the pitfalls of the Argentine approach.

## I. THE ARGENTINE DEBT SAGA

Argentina’s current debt problems began in the early 1990s, around the time the country started to issue sovereign bonds under a Fiscal Agency Agreement (FAA).<sup>26</sup> In 1991, the

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<sup>23</sup> Jonathan I. Blackman & Rahul Mukhi, *The Evolution of Modern Sovereign Debt Litigation: Vultures, Alter Egos, and Other Legal Fauna*, 73 L. & CONTEMP. PROBS. 47, 61 (2010).

<sup>24</sup> TIAGO STICHELMANS, EURODAD, WHY A UNITED NATIONS SOVEREIGN DEBT RESTRUCTURING FRAMEWORK IS KEY TO IMPLEMENTING THE POST-2015 SUSTAINABLE DEVELOPMENT AGENDA 9 (2015), <http://www.eurodad.org/files/pdf/557aad402bec.pdf> [<http://perma.cc/JNY3-HUNF>].

<sup>25</sup> *Id.* at 7-8.

<sup>26</sup> Arturo C. Porzecanski, *The Origins of Argentina’s Litigation and Arbitration Saga, 2002-2014*, at 15 (Am. U. Sch. of Int’l Service, Working Paper No.

Argentine peso was pegged to the U.S. dollar, meaning that the exchange rate was the same for both pesos and dollars, as part of a plan to attract foreign investment and end high rates of inflation.<sup>27</sup> Despite this effort, Argentina's national debt continued to grow as the value of exports decreased, and Argentine debt was downgraded twice by 2001.<sup>28</sup> During the recession leading up to 2001, Argentina's Gross Domestic Product (GDP) continued to decrease while the debt burden continued to increase, and hyperinflation rose to new highs.<sup>29</sup> This caused innumerable withdrawals of money from the market, triggering a Presidential Decree that limited further withdrawals in order to prevent a bank run.<sup>30</sup> Riots erupted against the regime responsible for the decree, causing political chaos that involved the transition of five interim presidents in just two weeks.<sup>31</sup> Subsequently, the Argentine peso plunged in value, causing Argentina to sever previous debt negotiations with the International Monetary Fund (IMF).<sup>32</sup> This forced Argentina to default on its international debt obligations in 2001.<sup>33</sup>

#### A. *The Beginning of the Endless Debt Battle*

As a result of the default and ensuing economic crisis, the new Argentine President declared a "temporary moratorium" that prevented payments to all bondholders.<sup>34</sup> In an effort to recuperate from the default and successfully reengage in the international market, Argentina began to negotiate restructuring terms with bondholders in 2005.<sup>35</sup> Seventy-six percent of the original bonds were exchanged in the 2005 restructuring, which gave bondholders the option to exchange their original bonds for new restructured

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2015-6, 2015), <http://www.researchgate.net/publication/276267255> [<http://perma.cc/F5SY-K2SL>]; Jrada, *supra* note 3, at 222.

<sup>27</sup> Samuel Maynard & Alexandria Todd, Note, *Chaos, Pure and Simple: Examining the Complexities of the 2001 Economic Crisis in Argentina*, 15 J. INT'L REL. 150, 152 (2013); Matt O'Brien, *Everything You Need to Know About Argentina's Weird Default*, WASH. POST (Aug. 3, 2014), <http://www.washingtonpost.com/news/wonkblog/wp/2014/08/03/everything-you-need-to-know-about-argentinas-weird-default/> [<http://perma.cc/4CBY-RMQ3>].

<sup>28</sup> Rodrigo Olivares-Caminal, *Expedited Debt Restructuring Under Argentine Law: Acuerdo Preventivo Extrajudicial (APE)*, in EXPEDITED DEBT RESTRUCTURING: AN INTERNATIONAL COMPARATIVE ANALYSIS 19, 22 (Rodrigo Olivares-Caminal ed., 2007); O'Brien, *supra* note 27.

<sup>29</sup> Maynard & Todd, *supra* note 27, at 154; SHAPIRO & PHAM, *supra* note 22, at 8.

<sup>30</sup> Olivares-Caminal, *supra* note 28, at 22; O'Brien, *supra* note 27.

<sup>31</sup> Maynard & Todd, *supra* note 27, at 154; SHAPIRO & PHAM, *supra* note 22, at 8.

<sup>32</sup> *Id.* at 154.

<sup>33</sup> See *NML Capital, Ltd. v. Republic of Argentina*, 699 F.3d 246, 251 (2d Cir. 2012); Neve, *supra* note 3, at 631.

<sup>34</sup> See *NML Capital*, 699 F.3d at 251; Neve, *supra* note 3, at 634.

<sup>35</sup> See *NML Capital*, 699 F.3d at 252; Neve, *supra* note 3, at 634.

bonds worth about 29 cents to every dollar owed on the original bonds.<sup>36</sup> Argentina also passed the Lock Law in 2005, making it illegal for the Argentine government to repay or settle with any bondholder who did not agree to the restructurings.<sup>37</sup>

The second restructuring in 2010 brought participating bonds up to roughly 91% of Argentina's total debt.<sup>38</sup> The creditors that refused to accept restructured bonds—labeled holdouts or vulture funds—were left free to seek enforcement for full repayment on their original bonds. Argentina made it clear, however, that it had no intention of repaying these holdout creditors.<sup>39</sup> While Argentina continued to make all payments due on the restructured bonds, it refused to pay the holdouts anything at all.<sup>40</sup>

The conflict between these holdout vulture funds and Argentina has since prompted more than a decade of litigation.<sup>41</sup> This subset of bondholders are labeled “vulture funds” because they (usually wealthy American investors) strategically buy sovereign debt at extreme discounts when the country is distressed and close to default in order to sue the sovereign later for the full value of the original bond.<sup>42</sup> Five vulture funds—the “Gang of Five”—began to seek full repayment on the defaulted Argentine bonds: NML Capital (the subsidiary of Paul Signer's Elliot Management), Aurelius Capital, Blue Angel Capital, Oliphant, and a small group of retail investors.<sup>43</sup> NML Capital has also pursued a variety of other avenues to force Argentina into full repayment, including chasing the country's assets around the world. In 2012, NML Capital even won a favorable verdict in Ghana that allowed the country to seize and detain an Argentine navy ship.<sup>44</sup> Tensions continued to escalate as the “Gang of Five”<sup>45</sup>

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<sup>36</sup> Neve, *supra* note 3, at 634-35; SHAPIRO & PHAM, *supra* note 22, at 14.

<sup>37</sup> Neve, *supra* note 3, at 634-35.

<sup>38</sup> Porzecanski, *supra* note 26, at 17; Neve, *supra* note 3, at 635.

<sup>39</sup> Hilary Burke, *What Argentina's Fight with Holdout Creditors Is All About*, REUTERS (Feb. 22, 2013, 4:33 AM), <http://www.reuters.com/article/2013/02/22/uk-argentina-debt-idUSSLNE91L00B20130222> [<http://perma.cc/4NQ6-JSGJ>].

<sup>40</sup> See *NML Capital*, 699 F.3d at 252-53; Neve, *supra* note 3, at 635.

<sup>41</sup> See, e.g., *Republic of Argentina v. NML Capital*, 134 S. Ct. 2250 (2014); *NML Capital*, 699 F.3d at 246; *Lightwater Corp. v. Republic of Argentina*, No. 02 Civ. 3804, 2003 WL 1878420 (S.D.N.Y. Apr. 14, 2003).

<sup>42</sup> Jrada, *supra* note 3, at 227.

<sup>43</sup> Sheelah Kolhatkar, *A New Twist in the Argentine Debt Saga*, BLOOMBERG BUS. (Oct. 29, 2014), <http://www.businessweek.com/articles/2014-10-28/a-surprise-appearance-in-the-argentine-debt-drama> [<http://perma.cc/H5T8-8UQ9>]. See generally *NML Capital*, 699 F.3d at 246 (affirming permanent injunctions preventing Argentina from continuing payments to restructured bondholders unless it made ratable payments to holdouts).

<sup>44</sup> Jamila Trindle, *Argentine Default Bad Test Case for Sovereign Debt Negotiations*, FOREIGN POLY (Aug. 25, 2014), <http://www.foreignpolicy.com/articles/2014/08/>

brought suit in the Southern District of New York, requesting injunctive relief for an alleged breach of contract.<sup>46</sup>

Argentina consented to jurisdiction in New York City by an express provision in the FAA bonds stating that the bonds are governed by the laws of New York and are subject to any state or federal court in New York City.<sup>47</sup> The FAA terms and conditions included in the bonds contained a *pari passu* clause, which guarantees bondholders that all claims would be ranked equally with all “other present and future . . . [e]xternal [i]ndebtedness.”<sup>48</sup> Although this clause has been traditionally inserted into bond contracts as a boilerplate provision, the plaintiffs argued that the *pari passu* clause prevented Argentina from making scheduled payments to restructured bondholders without also making payments to the holdouts.<sup>49</sup> The main thrust of the plaintiffs’ argument was that Argentina violated this provision in the FAA bonds when it made payments to the restructured bondholders while refusing to pay the obligations under the original holdout bonds. The plaintiffs also argued that Argentina further violated this provision when it enacted the Lock Law, which outlawed payment or negotiation with bondholders that refused to restructure.<sup>50</sup>

Despite Argentina’s urgings that the broad scope of the injunctions sought by the Gang of Five would infringe upon its sovereign immunity under the Foreign Sovereign Immunities Act (FSIA) by effectively preventing it from using its own assets outside of the United States, Judge Thomas Griesa granted an unusually broad equitable remedy by ordering Argentina to pay holdout bondholders any time it pays restructured bondholders.<sup>51</sup> NML Capital won suit in the district court against Argentina on the defaulted FAA bonds, and Argentina subsequently appealed to the United States Court of Appeals for the Second Circuit.<sup>52</sup>

On appeal, Argentina argued, among other things, that it had not violated the *pari passu* clause because it had not legally subordinated the FAA bondholders to the exchange bondholders, which it argued was required by the clause in order for the

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25/argentina\_default\_bond\_vulture\_hedge\_fund\_sovereign\_debt\_grenada [http://perma.cc/Z7QF-BTPF].

<sup>45</sup> Kolhatkar, *supra* note 43.

<sup>46</sup> NML Capital, Ltd. v. Republic of Argentina, No. 08 Civ. 2541 (TPG), 2009 U.S. Dist. Lexis 19046 (S.D.N.Y. Mar. 4, 2009).

<sup>47</sup> *Id.* at \*2-3.

<sup>48</sup> Jrada, *supra* note 3, at 223 (quoting *NML Capital*, 699 F.3d at 251).

<sup>49</sup> *Id.*

<sup>50</sup> Neve, *supra* note 3, at 637.

<sup>51</sup> *NML Capital*, 2009 U.S. Dist. Lexis 19046, at \*6; Neve, *supra* note 3, at 637.

<sup>52</sup> *NML Capital, Ltd. v. Republic of Argentina*, 699 F.3d 246, 250 (2d Cir. 2012).

provision to be legally enforceable.<sup>53</sup> The court stated that it was “unpersuaded” by Argentina’s interpretation of the *pari passu* clause as a “well settled” protection against the legal ranking of bonds.<sup>54</sup> Additionally, the court did not give merit to Argentina’s contention that the injunctions violated its immunity under the FSIA because, the court said, the injunctions did not constitute formal attachment, arrest, or execution, as is required for FSIA immunity.<sup>55</sup> The court similarly set aside arguments that any injunction would cause extreme hardship to the exchange bondholders and lead to another economic crisis in Argentina.<sup>56</sup>

Ultimately, the Second Circuit upheld the imposition of the injunctions but remanded for clarification of the broad scope of the injunctions.<sup>57</sup> On remand, the district court amended the injunctions and clarified that although Argentina was the only party previously bound by the injunctions, the injunctions now also prevented third parties from assisting Argentina in evading the injunctions under Federal Rule of Civil Procedure 65(d), which defines the scope of every injunction.<sup>58</sup>

Argentina again appealed the district court’s decision and was joined by nonparty appellants and intervenors.<sup>59</sup> These other groups included exchange bondholders and the Bank of New York Mellon (BNY Mellon).<sup>60</sup> As the indenture trustee to the exchange bondholders,<sup>61</sup> BNY Mellon was the appointed agent responsible for acting on behalf of all of the bondholders.<sup>62</sup> After the close of oral argument, the court allowed Argentina to recommend a new payment schedule for the bonds.<sup>63</sup> But instead of recommending a new schedule, Argentina first refused to settle or make payments to the holdout litigators and then proposed a new and separate

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<sup>53</sup> *Id.* at 256-57.

<sup>54</sup> *Id.* at 258.

<sup>55</sup> *Id.* at 262.

<sup>56</sup> *Id.* at 263.

<sup>57</sup> *Id.* at 258-65.

<sup>58</sup> See generally *NML Capital, Ltd. v. Republic of Argentina*, No. 08 Civ. 6978 (TPG), 2012 U.S. Dist. LEXIS 168292 (S.D.N.Y. Nov. 21, 2012) (ordering third parties to refrain from making interest payments to exchange bondholders unless Argentina certifies that it is making equal payments to all bondholders). See also FED. R. CIV. P. 65(d). Specifically, under Rule 65(d)(2), injunctions bind all persons who are “in active concert or participation with” either “the parties” or “the parties’ officers, agents, servants, employees, and attorneys.” *Id.*

<sup>59</sup> *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230, 237-39 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 2819 (2014).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> Steven L. Schwarcz & Gregory M. Sergi, *Bond Defaults and the Dilemma of the Indenture Trustee*, 59 ALA. L. REV. 1037, 1038 (2008).

<sup>63</sup> *NML Capital*, 727 F.3d at 238.

issuance of substitute bonds and stated that it “would not voluntarily obey” the district court’s decisions.<sup>64</sup>

The court affirmed the injunctions but granted a stay on their enforcement until after the resolution of a timely appeal to the Supreme Court.<sup>65</sup> The Supreme Court denied certiorari,<sup>66</sup> but the legal battle did not stop there. To the contrary, the final judicial decision against Argentina marked only the start of the country’s problems with its debt negotiation and the serious implications for the future of foreign debt restructuring.

### B. *The Battle Between Vultures and Bargainers*

The *NML Capital* decision has been the source of much criticism, and many predict that it will have a crippling effect on future foreign sovereign debt restructuring.<sup>67</sup> The first criticism of the decision argues that the district court used an extremely expansive interpretation of the *pari passu* clause, which was only inserted by Argentina as a final attempt to encourage creditor participation in the face of economic crisis.<sup>68</sup> Argentina argued that, in the context of sovereign debt litigation, the *pari passu* clause had been widely accepted as a limitation on the legal subordination of debt only.<sup>69</sup> Thus, the court’s interpretation of Argentina’s conduct as a breach of the *pari passu* clause left the door open for an increase in litigation for alleged breaches of these clauses.

The second main criticism of *NML Capital* is that the injunctions issued by the district court are unjust and unenforceable.<sup>70</sup> The very idea of mandating a sovereign nation to comply with another sovereign’s court impinges on the freedom of the enjoined sovereign.<sup>71</sup> Therefore, an enjoined nation will often be outraged at an injunction of this type, causing it to defy the enjoining court and ultimately preventing any significant compliance.<sup>72</sup> More importantly, courts are incapable of imposing

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<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> Exch. Bondholder Grp. v. NML Capital, Ltd., 134 S. Ct. 2819 (2014) (mem.).

<sup>67</sup> John A. E. Pottow, *Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign-Debt Restructurings*, 49 TEX. INT’L L.J. 221, 230-32 (2014).

<sup>68</sup> Rodrigo Olivares-Caminal, *To Rank Pari Passu or Not to Rank Pari Passu: That is the Question in Sovereign Bonds after the Latest Episode of the Argentine Saga*, 15 L. & BUS. REV. AM. 745, 766 (2009).

<sup>69</sup> *Id.* at 768-69.

<sup>70</sup> W. Mark C. Weidemaier, *Sovereign Debt after NML v. Argentina* 2, 12 (UNC Legal Studies Research, Paper No. 2199655, 2013), <http://ssrn.com/abstract=2199655> [<http://perma.cc/B3DP-S6BB>]; W. Mark C. Weidemaier & Anna Gelpern, *Injunctions in Sovereign Debt Litigation*, 31 YALE J. ON REG. 189, 190 (2014).

<sup>71</sup> Weidemaier & Gelpern, *supra* note 70, at 190.

<sup>72</sup> *Id.* at 200.

effective contempt sanctions, attaching or seizing property of the sovereign, or forcing the sovereign to pay certain creditors.<sup>73</sup> This is primarily because most sovereign assets are immune from attachment and execution under the FSIA.<sup>74</sup> The consequences of the *NML Capital* decision are a perfect example of the ineffectiveness of granting injunctions in cases involving foreign debt restructurings.

After the Supreme Court declined to hear *NML Capital*, the district court appointed a mediator to oversee negotiations between the parties. But Argentina continuously refused to cooperate with both direct and indirect attempts at negotiation.<sup>75</sup> Argentina recognized that the injunctions could not be enforced in any direct way because of its immunity to foreign seizure of assets and began to plot a way to get around the rulings.<sup>76</sup> Argentina's first move was to deposit \$539 million with trustee bank BNY Mellon in order to pay exchanged bondholders by July 31, 2014.<sup>77</sup>

In doing so, Argentina relied on a provision included in most of their bonds stating that the obligation to make a payment is fulfilled once the money is delivered to the trustee.<sup>78</sup> This put BNY Mellon in the hot seat, facing possible sanctions from the district court if it aided Argentina in paying exchanged bondholders without also paying holdouts equally.<sup>79</sup> On the flip side, Argentina also threatened to sue BNY Mellon for breaching its relationship as trustee to the exchange bondholders by withholding payment.<sup>80</sup> Faced with a lose-lose situation, BNY

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<sup>73</sup> *Id.* at 190.

<sup>74</sup> See Foreign Sovereign Immunities Act of 1967, 28 U.S.C. § 1604 (2006).

<sup>75</sup> Taos Turner, *Hedge Fund Says Argentina Not Working to Negotiate Deal in Dispute*, WALL ST. J. (July 11, 2014, 10:08 PM), <http://online.wsj.com/articles/representatives-from-argentina-hedge-funds-meet-with-court-appointed-mediator-1405119797> [<http://perma.cc/C3N5-DA33>] [hereinafter Turner, *Hedge Fund*].

<sup>76</sup> Hong, *supra* note 6.

<sup>77</sup> Daniel Bases, *BNY Mellon to U.S. Judge: What Should We Do with Argentina's Money?*, REUTERS (July 2, 2014), [http://articles.chicagotribune.com/2014-07-02/business/sns-rt-us-argentina-debt-bnymellon-20140702\\_1\\_bny-mellon-u-s-judge-thomas-griesa-aurelius-capital-management](http://articles.chicagotribune.com/2014-07-02/business/sns-rt-us-argentina-debt-bnymellon-20140702_1_bny-mellon-u-s-judge-thomas-griesa-aurelius-capital-management) [<http://perma.cc/F45P-SXFU>].

<sup>78</sup> Sheelah Kolhatkar, *Argentina's Secret Plan to Escape Default*, BLOOMBERG BUS. (Aug. 4, 2014), <http://www.businessweek.com/articles/2014-08-04/argentinas-plan-to-escape-default-is-hidden-in-the-fine-print> [<http://perma.cc/5HBB-TU24>].

<sup>79</sup> Alexandra Stevenson, *Hedge Fund Sues to Get Argentine Bond Payment in London*, N.Y. TIMES (Aug. 25, 2014, 7:37 PM), [http://dealbook.nytimes.com/2014/08/25/hedge-funds-sue-to-get-argentine-bond-payment-in-london/?\\_r=0](http://dealbook.nytimes.com/2014/08/25/hedge-funds-sue-to-get-argentine-bond-payment-in-london/?_r=0) [<http://perma.cc/N54P-2V6H>].

<sup>80</sup> Maximiliano Rizzi, *Judge Orders New York Bank to Hold on to Argentine Bonds*, REUTERS (Aug. 6, 2014, 8:58 PM), <http://www.reuters.com/article/2014/08/07/us-argentina-debt-idUSKBN0G702420140807#GuKuB2lHr7kUZTek.97> [<http://perma.cc/TCF5-HBH7>].

Mellon did not disperse the payments to the exchange creditors by the July 31, 2014, due date.<sup>81</sup>

Meanwhile, Judge Griesa had placed a separate July 30, 2014, deadline on a settlement between the holdouts and Argentina.<sup>82</sup> A settlement was never reached because Argentina refused to cooperate with the demands of the vulture funds—primarily because it feared that its economy would collapse if other vulture funds brought suit for the full value of the original bonds.<sup>83</sup> The failure to negotiate with the holdouts, combined with the failure to pay the scheduled exchange payment, plunged Argentina into a default on July 31, 2014.<sup>84</sup> This marked the second default in the country's history in just 13 years, causing nearly \$1 billion in credit-default swaps and complicating the holdout litigation even further.<sup>85</sup> By defaulting, Argentina expressed a clear decision to the district court and the holdout funds: it would do whatever it takes to avoid paying the vulture funds.

While Argentina's default prevented the country from paying the holdouts, it did so at the cost of causing Argentina to fall behind on exchange bondholder payments for the first time since the restructuring negotiations.<sup>86</sup> In New York, Citibank, the consumer division of Citigroup, appealed the injunction that prevented it from processing a payment on bonds governed by Argentine law due on September 30, 2014, arguing that it was not bound by the injunctions aimed at New York law governed bonds.<sup>87</sup> "The exchange bonds governed by Argentine law are denominated in [both] U.S. dollars and in Argentine pesos," but only the dollar-denominated bonds were at issue in the Citibank case.<sup>88</sup>

Citibank feared that it would be subject to criminal sanctions from Argentina for missing the scheduled interest payment to exchange bondholders governed by local law.<sup>89</sup> The Second Circuit dismissed Citibank's appeal for lack of

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<sup>81</sup> Kate Kelly, *Bank of NY Mellon Informs Exchange Holders of Argentina's Default*, CNBC (July 31, 2014, 8:33 AM), <http://www.cnbc.com/2014/07/31/bank-of-ny-mellon-informs-exchange-holders-of-argentinas-default.html> [<http://perma.cc/3EYP-RRPC>].

<sup>82</sup> Hartley, *supra* note 4.

<sup>83</sup> Turner, *Hedge Fund*, *supra* note 75.

<sup>84</sup> Hartley, *supra* note 4.

<sup>85</sup> Kolhatkar, *supra* note 78.

<sup>86</sup> Taos Turner, *Argentina Deposits \$161 Million Bond Payment Locally*, WALL ST. J. (Sept. 30, 2014, 12:30 PM), <http://www.wsj.com/articles/argentina-deposits-161-million-bond-payment-locally-1412094626> [<http://perma.cc/AZN6-X974>] [hereinafter Turner, *Argentina Deposits*].

<sup>87</sup> Jeff Sistrunk, *2nd Circ. Tosses Citibank Appeal of Argentina Bond Ruling*, LAW360 (Sept. 19, 2014, 3:48 PM), <http://www.law360.com/articles/579292/2nd-circ-tosses-citibank-appeal-of-argentina-bond-ruling> [<http://perma.cc/6CWX-9JFE>].

<sup>88</sup> *NML Capital, Ltd. v. Republic of Argentina*, No. 08 Civ. 06978 (TPG), 2015 U.S. Dist. Lexis 30625, at \*34 (S.D.N.Y. Mar. 12, 2015).

<sup>89</sup> Sistrunk, *supra* note 87.

jurisdiction,<sup>90</sup> and Citibank responded by requesting a hold on the injunction.<sup>91</sup> Surprisingly, Judge Griesa said Citibank could process its regularly scheduled interest payment in order to allow enough time for lawyers on both sides to present evidence on whether future payments to exchange bondholders under local law should be prevented.<sup>92</sup>

Despite the initially favorable ruling for Citibank, as of December 2015, the case continues to be a bitter legal feud between Argentina and the vulture funds.<sup>93</sup> Judge Griesa refused to allow a group of creditors to tap into the funds held by BNY Mellon because the funds were located outside of the country, but the potential for asset seizure was enough to provoke Argentina into action.<sup>94</sup> In an attempt to skirt these decisions, Argentina set up a new plan. It first passed legislation permitting it to pay restructured bondholders in Argentina rather than in New York.<sup>95</sup> It then removed BNY Mellon as its indentured trustee and replaced it with a local Argentine trustee, Nación Fideicomisos S.A.<sup>96</sup> Argentina subsequently made a \$161 million deposit in interest payments to the local trustee for issuance to the restructured bondholders.<sup>97</sup> This act of defiance directly violated the injunction against Argentina that prevented it from making payments to restructured bondholders without also making ratable payments to holdouts. Quite predictably, this scheme to continue local interest payments resulted in yet another unfavorable ruling for Argentina.

### C. *The Growth of the Battlefield and the Current Situation*

As a result of Argentina's scheme to remove BNY Mellon as trustee and pay restructured bondholders under local law,

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<sup>90</sup> *Id.*

<sup>91</sup> Nate Raymond, *Citigroup to Seek Pause of Order Blocking Argentine Bond Payment*, REUTERS (Sept. 22, 2014, 11:37 AM), <http://www.reuters.com/article/2014/09/22/argentina-debt-citigroup-idUSL2N0RN0UH20140922> [<http://perma.cc/ZC55-U44P>].

<sup>92</sup> Matt Day, *U.S. Judge: Citibank May Make Interest Payment on Argentine Bonds*, WALL ST. J. (Sept. 26, 2014, 6:32 PM), <http://online.wsj.com/articles/u-s-judge-citibank-may-make-interest-payment-on-argentine-bonds-1411770775> [<http://perma.cc/HM7X-33PC>].

<sup>93</sup> Rizzi, *supra* note 80.

<sup>94</sup> Kurt Orzeck, *BNY Doesn't Have to Turn Over \$539M to Argentina Creditors*, LAW360 (Oct. 27, 2014, 9:02 PM), <http://www.law360.com/articles/590925/bny-doesn-t-have-to-turn-over-539m-to-argentina-creditors> [<http://perma.cc/P3BS-MTDC>].

<sup>95</sup> Turner, *Argentina Deposits*, *supra* note 86.

<sup>96</sup> Jorge Otaola, *Argentina Defies U.S. Court Order by Depositing Debt Payment*, REUTERS (Sept. 30, 2014, 8:15 PM), <http://www.reuters.com/article/2014/10/01/us-argentina-debt-idUSKCN0HP1O820141001> [<http://perma.cc/EMZ8-6AWY>]; Turner, *Argentina Deposits*, *supra* note 86.

<sup>97</sup> Jorge Otaola, *supra* note 96; Turner, *Argentina Deposits*, *supra* note 86.

Judge Griesa found Argentina in contempt of court.<sup>98</sup> In addition, Judge Griesa ordered the country to stop its attempts at skirting his rulings and to reinstate BNY Mellon as its indentured trustee.<sup>99</sup> Argentina appealed the contempt decision to the Second Circuit.<sup>100</sup>

Meanwhile, Judge Griesa held a March 3, 2015, hearing on the issue of whether Citibank could continue to process interest payments on exchange bonds governed by Argentine law.<sup>101</sup> On March 12, 2015, Judge Griesa ruled that Citibank could not continue to make payments due on the U.S. dollar-denominated bonds despite the fact that the bonds are governed by Argentine law.<sup>102</sup> Argentina subsequently threatened to revoke Citibank's operating license if it failed to process payments to exchange bondholders.<sup>103</sup> In response, Citibank announced its intention to quit the local custody business in Argentina.<sup>104</sup> Then, on April 7, 2015, the Second Circuit dismissed the appeal of the contempt ruling on the grounds that it was not the result of a final judgment.<sup>105</sup> Although the holdouts urged Judge Griesa to fine Argentina \$50,000 a day until it complied with his orders, no such fine has been imposed.<sup>106</sup>

In an attempt to ease tensions created by his prior Citibank ruling, Judge Griesa allowed Citibank to process interest payments on the Argentine bonds due on March 31,

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<sup>98</sup> Turner, *Argentina Deposits*, *supra* note 86.

<sup>99</sup> Jones Day Business Restructuring & Reorganizing Practice, *Worldwide: Sovereign Debt Update—November-December 2014*, MONDAQ (Dec. 15, 2014), <http://www.mondaq.com/unitedstates/x/359598/Human+Rights/Sovereign+Debt+Update> [<http://perma.cc/U5UV-5D93>].

<sup>100</sup> Bob Van Voris & Phil Milford, *Argentina Appeals New York Bond Judge's Contempt Finding*, BLOOMBERG BUS. (Nov. 4, 2014, 7:31 AM), <http://www.bloomberg.com/news/2014-11-04/argentina-appeals-new-york-bond-judge-s-contempt-finding-1.html> [<http://perma.cc/NN9M-BG4E>].

<sup>101</sup> Nate Raymond & Chris Reese, *U.S. Judge Sets March Hearing Over Citi Processing of Argentine Bond Payments*, REUTERS (Jan. 6, 2015, 5:19 PM), <http://www.reuters.com/article/2015/01/06/us-argentina-debt-citigroup-idUSKBN0KF24020150106> [<http://perma.cc/4T3F-28R9>].

<sup>102</sup> *NML Capital, Ltd. v. Republic of Argentina*, No. 08 Civ. 06978 (TPG), 2015 U.S. Dist. Lexis 30625 (S.D.N.Y. Mar. 12, 2015).

<sup>103</sup> *Citibank Gets Stern Warning from Argentina that it Could Lose Banking License*, FOX NEWS LATINO (Mar. 14, 2015), <http://latino.foxnews.com/latino/money/2015/03/14/citibank-gets-stern-warning-from-argentina-that-it-could-lose-banking-license/> [<http://perma.cc/YL2N-2GPK>].

<sup>104</sup> Richard Lough, *Argentina Sues Citibank Over Deal with Holdout Creditors*, REUTERS (Apr. 8, 2015, 7:39 PM), <http://www.reuters.com/article/2015/04/08/us-argentina-debt-idUSKBN0MZ1RP20150408> [<http://perma.cc/9LGB-8WZZ>].

<sup>105</sup> Y. Peter Kang, *2nd Circ. Nixes Argentina's Contempt Appeal in Bond Row*, LAW360 (Apr. 7, 2015, 6:27 PM), <http://www.law360.com/articles/640474/2nd-circ-nixes-argentina-s-contempt-appeal-in-bond-row> [<http://perma.cc/HS45-AM6X>].

<sup>106</sup> Van Voris & Milford, *supra* note 100.

2015, and June 30, 2015.<sup>107</sup> But Judge Griesa conditioned the authorization of these payments on a stipulation between Argentina's holdout bondholders and Citibank that forbid Citibank from appealing the *NML Capital* decision.<sup>108</sup> After Citibank accepted this deal and distributed the March 31 payment, Argentina brought suit against Citibank for striking an allegedly illegal deal with the court.<sup>109</sup> As part of this rebellion against Citibank, an Argentine court upheld an injunction ordering Citibank not to comply with the agreement to cooperate with the holdouts and suspended the application of the agreement.<sup>110</sup> Citibank has since been suspended from capital market operations in Argentina.<sup>111</sup>

This infectious legal battle also provoked creditors outside of the United States to bring suit for repayment. In Germany, two German investors have already succeeded in obtaining favorable rulings against Argentina for full repayment of their original bonds.<sup>112</sup> In London, four U.K. creditors joined suit against BNY Mellon, alleging that it put its own interests in obeying the court before its fiduciary duty as trustee to the exchange bondholders.<sup>113</sup> The lawyer representing these creditors argued that they were merely "innocent third parties" to the conflict between Argentina and the holdout creditors.<sup>114</sup> The U.K. court initially delayed deciding the case in the hopes that the pending U.S. disputes would be resolved.<sup>115</sup> Foreseeing that a wait-and-see approach

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<sup>107</sup> Anthony Esposito & David Goodman, *U.S. Court Authorizes Citigroup to Process Argentine Bond Payments*, REUTERS (Mar. 22, 2015), <http://www.reuters.com/article/2015/03/22/argentina-debt-citigroup-idUSL2N0W00C420150322> [<http://perma.cc/5N-VY-KXKE>].

<sup>108</sup> Lough, *supra* note 104.

<sup>109</sup> *Id.*

<sup>110</sup> Jerin Mathew, *Argentine Court Suspends US Judge-Backed Agreement Between Citibank and Vulture Funds*, INT'L BUS. TIMES (May 19, 2015), <http://www.ibtimes.co.uk/argentine-court-suspends-us-judge-backed-agreement-between-citibank-vulture-funds-1501926> [<http://perma.cc/94YN-YUXG>].

<sup>111</sup> Lough, *supra* note 104.

<sup>112</sup> Pablo Kummetz, *German Court to Rule on Argentina Bond Repayment Terms*, DW (Jan. 16, 2015), <http://www.dw.de/german-court-to-rule-on-argentina-bond-repayment-terms/a-18196207> [<http://perma.cc/X4YL-QUHH>].

<sup>113</sup> Richard Lough & Walter Bianchi, *Argentina's Fernandez to Meet Billionaire Investor Soros in New York*, REUTERS (Sept. 22, 2014, 10:38 AM), <http://www.reuters.com/article/2014/09/22/us-argentina-debt-soros-idUSKCN0HH1ZI20140922> [<http://perma.cc/GXL2-F2RF>].

<sup>114</sup> Mani, *George Soros and Kyle Bass Battle It Out with Paul Singer in London Court*, VALUEWALK (Nov. 4, 2014, 12:25 PM), <http://www.valuwalk.com/2014/11/george-soros-kyle-bass-argentina/> [<http://perma.cc/Z4S5-FXCB>].

<sup>115</sup> *U.K. Judge Delays Ruling on Order Sought by Argentina Creditors*, BLOOMBERG BUS. (Nov. 6, 2014, 7:08 AM), <http://www.bloomberg.com/news/articles/2014-11-06/u-k-judge-delays-ruling-on-order-sought-by-argentina-creditors> [<http://perma.cc/36-QZ-3JWR>].

could end up being an indefinite stay, the U.K. court held on February 13, 2015, that U.K. law, and not U.S. judicial rulings, governs Argentine bonds issued under U.K. law.<sup>116</sup> The U.K. court refrained from making a decision with respect to BNY Mellon's obligations, however, due to the fact that BNY Mellon was still severely limited by the U.S. injunction.<sup>117</sup>

Although NML Capital has continued to pursue debt repayment in full force, the issue remains unresolved. NML Capital previously filed a motion to compel subpoenas requiring Argentina to disclose information about its assets that were capable of being seized in order to satisfy Judge Griesa's judgment.<sup>118</sup> The Second Circuit upheld Judge Griesa's ruling, ordering Argentina and 29 banks to provide information about Argentina's assets.<sup>119</sup> Argentina subsequently refused to provide documents and information about its U.S. assets.<sup>120</sup> On August 12, 2015, Judge Griesa sanctioned Argentina for failing to produce such documents and declared that any Argentine property located within the United States, unless for diplomatic or military use, was deemed "commercial."<sup>121</sup> Such a declaration makes it easier for creditors to go after Argentina's assets under the FSIA,<sup>122</sup> but despite this ruling, none of Argentina's assets have yet to be seized. It is fairly unlikely that Argentina will suddenly decide to cooperate with the vultures by disclosing information about its assets.<sup>123</sup> Such cooperation is even more unlikely since the Second

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<sup>116</sup> *Knighthood Master Fund LP v. The Bank of New York Mellon* [2015] EWHC270 (Ch); Joseph E. Stiglitz & Martin Guzman, *A Fair Hearing for Sovereign Debt*, PROJECT SYNDICATE (Mar. 5, 2015), <http://www.project-syndicate.org/commentary/argentina-repay-vulture-fund-by-joseph-e--stiglitz-and-martin-guzman-2015-03> [<http://perma.cc/TEP4-G7YR>].

<sup>117</sup> *Knighthood Master Fund*, EWHC270, at 11.

<sup>118</sup> Erik Larson & Chris Dolmetsch, *Argentina Fails to Block Subpoenas Over Assets in Bond Case*, BLOOMBERG BUS. (Dec. 23, 2014, 3:43 PM), <http://www.bloomberg.com/news/2014-12-23/argentina-loses-appeal-to-quash-subpoenas-over-its-assets.html> [<http://perma.cc/747M-KHP9>].

<sup>119</sup> *U.S. Appeals Court Rules Against Argentina in Debt Case*, LATIN AM. HERALD TRIB., <http://www.laht.com/article.asp?ArticleId=2366765&CategoryId=14093> [<http://perma.cc/E9BG-8CMD>] (last visited Dec. 8, 2015).

<sup>120</sup> Nate Raymond, *UPDATE 1—U.S. Judge Sanctions Argentina in Debt Default Litigation*, REUTERS (Aug. 12, 2015, 6:32 PM), <http://www.reuters.com/article/2015/08/12/argentina-debt-idUSL1N10N2ZC20150812> [<http://perma.cc/SBZ4-JEWW>].

<sup>121</sup> Bob Van Voris, *Argentina Sanctioned for Failing to Turn Over Asset Evidence*, BLOOMBERG BUS. (Aug. 12, 2015, 4:06 PM), <http://www.bloomberg.com/news/articles/2015-08-12/hml-seeks-to-penalize-argentina-for-withholding-asset-evidence> [<http://perma.cc/53YF-VWLQ>].

<sup>122</sup> Raymond, *supra* note 120.

<sup>123</sup> Jonathan Gilbert, *Debt Dispute Between Hedge Funds and Argentina at Impasse*, N.Y. TIMES (Jan. 5, 2015, 4:57 PM), [http://dealbook.nytimes.com/2015/01/05/debt-dispute-between-argentina-and-hedge-funds-at-impasse/?\\_r=0](http://dealbook.nytimes.com/2015/01/05/debt-dispute-between-argentina-and-hedge-funds-at-impasse/?_r=0) [<http://perma.cc/TNJ7-6VHA>].

Circuit recently ruled that bondholders couldn't seize Argentina's central bank assets as payment for the bonds.<sup>124</sup>

In the wake of this dispute between Argentina and the holdouts, the feared consequence—that Judge Griesa's decision has encouraged other creditors to emulate the success of *NML Capital*—is becoming a reality.<sup>125</sup> In late 2014, yet another party brought suit against Argentina seeking full repayment of its original bonds.<sup>126</sup> Billionaire Kenneth Dart is a vulture investor who, like NML Capital's Paul Singer, has made a living buying defaulted sovereign debt, only to bring suit later in order to enforce repayment on the full value of the bonds.<sup>127</sup> Dart remained quiet throughout the *NML Capital* battle but is now seeking an order for full repayment.<sup>128</sup>

While the additional lawsuit is problematic in and of itself given the lack of success in enforcing the injunctions, Dart's sudden emergence into the Argentine drama brings to light an even more troubling reality: the bonds owned by the five holdouts at the core of the *NML Capital* drama represent only *a quarter* of the Argentine bonds governed by New York law and held by holdout bondholders.<sup>129</sup> These holdout bondholders have since filed 36 separate lawsuits against Argentina seeking full repayment of the bonds in order to profit from Judge Griesa's order.<sup>130</sup> These new holdouts—termed “me too” plaintiffs—seek an additional \$5.4 billion from Argentina before the country is permitted to make any payments on restructured debt.<sup>131</sup> On June 5, 2015, Judge Griesa granted partial summary judgment to a group of 526 “me too” plaintiffs.<sup>132</sup> Argentina appealed the decision, and the Second

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<sup>124</sup> Erik Larson & Daniel Cancel, *Argentine Bank Assets Can't Be Seized by Bondholders*, BLOOMBERG BUS. (Aug. 31, 2015, 10:21 AM), <http://www.bloomberg.com/news/articles/2015-08-31/argentina-central-bank-assets-can-t-be-seized-by-bondholders> [<http://perma.cc/64WR-LP6U>].

<sup>125</sup> Jrada, *supra* note 3, at 231.

<sup>126</sup> Sophia Pearson & Bob Van Voris, *Argentina Bond Fight Judge Griesa Gets New Ken Dart Suit*, BLOOMBERG BUS. (Oct. 24, 2014, 2:08 PM), <http://www.bloomberg.com/news/articles/2014-10-24/argentina-bond-fight-judge-griesa-gets-new-ken-dart-suit> [<http://perma.cc/X3XP-3NKK>]; Kolhatkar, *supra* note 43.

<sup>127</sup> Kolhatkar, *supra* note 43.

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> *Sovereign Debt Update*, JONES DAY COMMENT. (July/Aug. 2015), <http://www.jonesday.com/sovereign-debt-update-07-31-2015/#> [<http://perma.cc/9ZE6-3M6Z>].

<sup>131</sup> *Id.*

<sup>132</sup> *NML Capital v. Republic of Argentina*, No. 14 Civ. 8601 (TPG), 2015 U.S. Dist. LEXIS 73521 (S.D.N.Y. June 5, 2015).

Circuit has since reversed many of Judge Griesa's additional class certifications for these plaintiffs.<sup>133</sup>

As the saga continues between Argentina and the holdouts, restructured bondholders and BNY Mellon, and the intermediaries and the district court itself, some troublesome issues have become apparent. Despite the creative attempt by the court to force Argentina to pay back restructured bondholders or face a default, Argentina has repeatedly refused to cooperate. Given the very nature of an injunction against a sovereign nation, it would not be surprising if Argentina simply never paid back these holdout bondholders at all. Moreover, Argentina will undoubtedly stop at nothing in order to continue repaying those creditors who cooperated with them in the debt restructuring and who are protected under the Lock Law aimed at pressuring such cooperation. These factors, taken together, will likely ensure that Argentina will never make payments to the holdout bondholders.

Judge Griesa's only remaining course of action is to impose additional sanctions on Argentina for its defiance. But these too will likely be ignored, considering that Argentina still has not paid a \$29 million sanction for violating a court order imposed by the United States in 2000.<sup>134</sup> While the U.S. district court can continue to rule against Argentina, the nation will appeal, it will defy, and it will not negotiate. Not only is this course of action problematic for settling Argentina's own debt disputes, but it is also establishing a scheme for other nations to permanently skirt the repayment of their creditors.

The vulture funds have also made it abundantly clear that they "will 'continue to enthusiastically pursue vigorous enforcement of . . . [their] contractual rights, including following the trail of Argentine assets wherever it leads.'"<sup>135</sup> Despite the fact that Argentina is attempting to pay back its debt (or at least its restructured debt), emerge from the default, and once again become a player in the international economy, the vulture funds will stop at nothing to collect their profit on bonds they knew were doomed from the start. The vulture funds take advantage of foreign states when they are at their weakest by employing investment strategies that are only possible because these distressed foreign states lack bankruptcy protection.<sup>136</sup> Now that

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<sup>133</sup> Nate Raymond, *Argentina Urges U.S. Appeals Court to Toss Debt Class-Action Ruling*, REUTERS (Aug. 21, 2015, 1:32 PM), <http://www.reuters.com/article/2015/08/21/argentina-debt-court-idUSL1N10W1IX20150821> [<http://perma.cc/78S5-6494>].

<sup>134</sup> Van Voris & Milford, *supra* note 100.

<sup>135</sup> Mani, *supra* note 114.

<sup>136</sup> Blackman & Mukhi, *supra* note 23, at 49-50.

these vulture funds have the courts on their side, it is difficult to see a light at the end of the foreign debt restructuring tunnel. The district court's decision has created a prisoner's dilemma, wherein both sides have strong incentives to avoid cooperation. This in turn encourages creditors to hold out from restructuring agreements in order to sue in full.<sup>137</sup>

*D. Argentina, Puerto Rico, and Greece—Oh My*

Despite the fact that vulture funds like NML Capital have yet to collect on Argentina's debt, this has not stopped many of those same vulture funds from lining up to collect on other major recent defaults in Puerto Rico and Greece.<sup>138</sup> Greece became "the first developed nation to default on an IMF loan" when it failed to make a scheduled loan payment due on June 30, 2015.<sup>139</sup> Although the Greek bonds included Collective Action Clauses (CACs)—contractual clauses that make restructuring easier by allowing a certain majority of bondholders to agree on restructuring terms that bind all other bondholders—the potential for holdout litigation still exists under any one of the 40 bilateral investment treaties Greece has signed with other countries.<sup>140</sup> The Greek financial crisis has led to major consequences; its GDP fell by 29% between 2008 and 2014, and its unemployment rate increased to 26.2% in 2014.<sup>141</sup> Greece has also seen an increase in homelessness, depression, and suicides<sup>142</sup>—not to mention that its health system is on the brink of collapse and access to health services has become increasingly limited.<sup>143</sup> If vulture funds are able to prolong Greece's economic recovery, humanitarian disaster could very well ensue.<sup>144</sup>

Puerto Rico also defaulted on its debt on August 3, 2015, and a proposal has already been introduced to issue new bonds

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<sup>137</sup> Jrada, *supra* note 3, at 223-32.

<sup>138</sup> *Hedge Fund Vultures in Puerto Rico*, HEDGECLIPPERS (July 10, 2015), [http://hedgeclippers.org/hedgepapers-no-17-hedge-fund-billionaires-in-puerto-rico/#\\_ftn4](http://hedgeclippers.org/hedgepapers-no-17-hedge-fund-billionaires-in-puerto-rico/#_ftn4) [<http://perma.cc/X454-6UKP>].

<sup>139</sup> John Geddie & Marius Zaharia, *Greek Debt Better Shielded from Vultures than Argentina's*, REUTERS (July 3, 2015, 8:09 AM), <http://www.reuters.com/article/2015/07/03/euro-zone-greece-vultures-idUSL8N0ZI23B20150703> [<http://perma.cc/LEW5-CBKC>]; Don Lee, *Greek Debt Crisis: Athens not Alone on Sovereign Default*, SYDNEY MORNING HERALD (July 8, 2015, 5:43 PM), <http://www.smh.com.au/world/greek-debt-crisis-athens-not-alone-on-sovereign-default-20150708-gi7ned.html> [<http://perma.cc/T8VS-84M6>].

<sup>140</sup> Geddie & Zaharia, *supra* note 139.

<sup>141</sup> STICHELMANS, *supra* note 24, at 3; Press Release, Hellenic Statistical Authority, Labour Force Survey (Nov. 12, 2015), <http://www.statistics.gr/documents/20181/c09e1e55-a397-4859-a11e-3607517bcd04> [<http://perma.cc/P2DZ-FSUV>].

<sup>142</sup> STICHELMANS, *supra* note 24, at 7.

<sup>143</sup> *Id.*

<sup>144</sup> *Id.* at 9.

with more favorable terms to bondholders.<sup>145</sup> It is probable, however, that the major U.S. firms and banks will hold out against Puerto Rico in the federal courts.<sup>146</sup> Based on the precedent set by *NML Capital*, these holdouts will likely win these cases.<sup>147</sup> Creditors will be discouraged from participating in future debt restructuring initiatives if vulture funds continue to win cases against sovereign debtors.<sup>148</sup> Time is of the essence, however, as Puerto Rico has already experienced skyrocketing energy costs, devastation to its infrastructure, and a middle class that is abandoning ship in the hopes of finding a more stable economy.<sup>149</sup> The long-term consequences of Puerto Rico's default are innumerable.

These recent defaults have brought the many failures of the Argentine restructuring back into the spotlight, making debt restructuring a less appealing remedy for an economically struggling sovereign. As the Argentine debt saga continues to unfold, it appears increasingly clear that a drastic change in sovereign foreign debt restructuring must be made in order to prevent similar situations from occurring in the future. In the wake of Argentina's default, the United Nations Human Rights Council passed a resolution advocating for an international legal framework designed to regulate the restructuring of sovereign debt in a way that protects sovereigns from vulture fund litigation.<sup>150</sup> In support of the resolution, the United Nations Conference on Trade and Development created the Ad Hoc Committee on Sovereign Debt Restructuring.<sup>151</sup> In late July 2015, the Committee unanimously adopted nine new principles aimed at increasing good faith negotiations, transparency, impartiality, equitable treatment, sovereign immunity, legitimacy, and sustainability in the global

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<sup>145</sup> Carlos Marichal, *After the Default: A Neoliberal Debt Solution for Puerto Rico*, NACLA (Aug. 18, 2015), <https://nacla.org/news/2015/08/18/after-default-neoliberal-debt-solution-puerto-rico> [<http://perma.cc/K755-GYGL>].

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> Stichelmans, *supra* note 24, at 9.

<sup>149</sup> Laura Barron-Lopez & Adriana Usero, *The Curious Case of Puerto Rico, and Why Default Poses a Risk to the U.S.*, HUFFINGTON POST (June 30, 2015), [http://www.huffingtonpost.com/2015/06/30/puerto-rico-default-us\\_n\\_7692006.html](http://www.huffingtonpost.com/2015/06/30/puerto-rico-default-us_n_7692006.html) [<http://perma.cc/3NY7-W6S8>].

<sup>150</sup> Sapa, *Argentina Scores Diplomatic Point in Debt Row*, NEW AGE (Sept. 26, 2014, 3:25 PM), [http://www.morningstar.co.uk/uk/news/AN\\_1411737802277658000/argentina-scores-diplomatic-point-in-debt-row.aspx](http://www.morningstar.co.uk/uk/news/AN_1411737802277658000/argentina-scores-diplomatic-point-in-debt-row.aspx) [<http://perma.cc/SL6M-GPU4>].

<sup>151</sup> *Ad Hoc Committee on Sovereign Debt Restructuring Processes*, J. United Nations, No. 2015/6 (Jan. 10, 2015), <http://www.un.org/esa/ffd/wp-content/uploads/2015/01/ie-debt-UN-journal-2015-6.pdf> [<http://perma.cc/HMF3-NFMP>].

marketplace.<sup>152</sup> This is certainly a step in the right direction towards implementing a new restructuring mechanism, but more than general principles are needed to bring about significant changes in the international debt arena.

There are roughly \$900 billion worth of outstanding international sovereign bonds—none of which would be subject to the new principles endorsed by the United Nations.<sup>153</sup> Meanwhile, the Argentine holdouts are setting an example for creditors on how to prevent further effective restructuring. Previous proposed solutions to debt restructuring have highlighted the need for change, but each is riddled with its own issues. The inherent problems of the three main proposals, however, shed light on a potential solution that is better equipped to facilitate successful restructuring with both new and existing sovereign bonds.

## II. THE THREE MAIN PROPOSALS AND THEIR DEFICIENCIES

In recent decades, three main scholarly proposals for alleviating holdout litigation and reforming foreign debt restructuring practices have emerged. Unfortunately, no one of these proposals is perfect, as each one contains inherent inadequacies that prove fatal to resolving the problem of holdout litigation and foreign debt restructuring. By examining the benefits present in each of the three proposals, however, a potential solution to foreign debt restructuring emerges.

### A. *Judicial Reform: An International Certification Board*

One solution for facilitating successful debt restructurings, proposed by University of Michigan Law School Professor John E. Pottow, is the establishment of an international certification board.<sup>154</sup> The purpose of such a board would be to create a neutral global forum in which to address issues in the international monetary and financial system.<sup>155</sup> As far as restructuring goes,

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<sup>152</sup> *United Nations Lays Down Clear Principles in Tackling Sovereign Debt*, UNITED NATIONS CONF. ON TRADE AND DEV. (July 29, 2015), <http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1047> [<http://perma.cc/5GAD-SR5G>].

<sup>153</sup> IMF, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, at 33 (Oct. 2014), <https://www.imf.org/external/np/pp/eng/2014/090214.pdf> [<http://perma.cc/8HNL-BGQ9>] [hereinafter IMF, *Strengthening the Contractual Framework*].

<sup>154</sup> See, e.g., Pottow, *supra* note 67, at 236; BERTRAND COUILLAULT & PIERRE-FRANÇOIS WEBER, *BANQUE DE FRANCE, TOWARDS A VOLUNTARY CODE OF GOOD CONDUCT FOR SOVEREIGN DEBT RESTRUCTURING* (2003).

<sup>155</sup> Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System 90-91

the board would essentially be required to approve a sovereign's restructuring plan prior to the proposal of such plan to bondholders.<sup>156</sup> The board would look to international law customs to determine whether the plan ensures procedural fairness and protects bondholder interests.<sup>157</sup>

In theory, an international certification board would help combat holdout problems by providing formal approval of restructuring proposals.<sup>158</sup> But in application, the board's decision would still be nonbinding. "[T]he chief role the Board could play is that its *nonbonding* declarations of restructuring proposals . . . with generally fair treatment of creditors could then be relied . . . [on] by nonexpert, generalist judges who might be called upon to exercise judicial discretion."<sup>159</sup> Thus, the board would have no authority to force compliance, punish noncompliance, or resolve disputes over bond proprieties—the very issues Argentina experiences.<sup>160</sup> Moreover, the board would have no power to condition plan approval on a sovereign's passage of austerity measures to improve economic policies.<sup>161</sup> An international certification board would effectively do nothing to help correct the underlying problems in a sovereign's economic structure.

Further, the board's disciplinary influence would be limited to inflicting reputational damage, rendering it essentially "toothless."<sup>162</sup> Vulture funds do not respond to reputational pressures.<sup>163</sup> They seek the highest immediate return on investment, regardless of the effects on their relationships with debtors or other investors.<sup>164</sup> As the vulture funds in the Argentine litigation have demonstrated, the criticisms and pressures of international financial institutions

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(Sept. 21, 2009), [http://www.un.org/ga/econcrisissummit/docs/FinalReport\\_CoE.pdf](http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf) [<http://perma.cc/TRU8-Y495>].

<sup>156</sup> Pottow, *supra* note 67, at 236.

<sup>157</sup> *Id.*

<sup>158</sup> See generally Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408, 6408 (Jan. 30, 2013) (to be codified at 12 C.F.R. 1026) (discussing the loan approval process for the Organization of Management and Budget under the Truth in Lending Act); Pottow, *supra* note 67, at 222.

<sup>159</sup> Pottow, *supra* note 67, at 237 (emphasis added).

<sup>160</sup> *Id.* at 236; see also Patrick Bolton & David A. Skeel, Jr., Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured? 812 (Apr. 2, 2003), [https://www0.gsb.columbia.edu/faculty/pbolton/PDFS/Inside\\_Black\\_Box.pdf](https://www0.gsb.columbia.edu/faculty/pbolton/PDFS/Inside_Black_Box.pdf) [<http://perma.cc/ZU99-7XRC>] (unpublished manuscript) (questioning whether an international restructuring court would have sufficient authority to bind sovereign debtors to a debt restructuring process).

<sup>161</sup> See generally Pottow, *supra* note 67, at 236 (describing the various limitations on an international restructuring board's power).

<sup>162</sup> *Id.* at 236, 242; Bolton & Skeel, *supra* note 160, at 812.

<sup>163</sup> Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1090 (2004).

<sup>164</sup> *Id.*

do not sway holdouts.<sup>165</sup> This would leave the board effectively incapable of exerting any influence over these vulture funds.

More importantly, one of the biggest current problems in sovereign debt default, highlighted by the situation in Argentina, is that a sovereign can simply refuse to pay its debts.<sup>166</sup> An international certification board could not force a stubborn sovereign to repay its “board approved” debt.<sup>167</sup> And absent some legally binding standards to enforce and punish, an international certification board could also do nothing to subside the contentious holdout litigators or their equally contentious sovereign opponents, which is currently the largest issue facing foreign sovereign debt.

### *B. Statutory Reform: The “Sovereign Debt Restructuring Mechanism”*

In 2001, the IMF proposed a statutory framework for addressing the weaknesses in sovereign debt restructuring: the Sovereign Debt Restructuring Mechanism (SDRM).<sup>168</sup> The SDRM proposes a framework for a majority of creditors to bind all bondholders regarding critical decisions on the restructuring terms of their bond contracts.<sup>169</sup> The SDRM has three main features.<sup>170</sup> First, it proposes the aggregation of all claims related to the same sovereign debt despite different instruments and issuances.<sup>171</sup> Second, SDRM provisions would apply to all existing claims at the time of the restructuring proposal.<sup>172</sup> Third, SDRM features would bind all judgment creditors and would not be limited to contractual claims.<sup>173</sup>

The SDRM is riddled with substantial limitations that minimize its possible impact on restructuring issues. The SDRM’s legal framework aims to make the restructuring process more efficient and predictable by imposing sanctions on

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<sup>165</sup> *Id.*

<sup>166</sup> Pottow, *supra* note 67, at 238; Jrada, *supra* note 3, at 230.

<sup>167</sup> Pottow, *supra* note 67, at 236.

<sup>168</sup> See Anne Krueger, First Deputy Managing Dir., IMF, International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring, Address at the National Economists’ Club Annual Members’ Dinner (Nov. 26, 2001), <https://www.imf.org/external/np/speeches/2001/112601.htm> [<http://perma.cc/UNS4-P6LH>]; IMF, *Proposed Features of a Sovereign Debt Restructuring Mechanism* (Feb. 2003), <https://www.imf.org/external/np/pdr/sdrm/2003/021203.pdf> [<http://perma.cc/M77N-ZFZ4>] [hereinafter Proposed Features].

<sup>169</sup> See Proposed Features, *supra* note 168; Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT’L L. 299, 336 (2005).

<sup>170</sup> Hagan, *supra* note 169, at 336.

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

all violators of the statute.<sup>174</sup> After its proposal, however, the SDRM received much criticism, and in particular, the United States strongly disapproved of it in favor of a more market-based solution, such as contractual reform.<sup>175</sup> The SDRM also creates issues of fairness in intercreditor negotiations.<sup>176</sup> It does not provide for formal negotiation procedures for majority and minority creditors, which raises questions of accountability when, for instance, a bank is representing a minority of bondholders.<sup>177</sup> This is because a bank tasked with representing the interests of all bondholders equally would have to balance pressure from majority shareholders with the interests of minority shareholders.<sup>178</sup>

The IMF originally predicted that the SDRM would reduce the costs associated with restructuring by decreasing undue delays to the restructuring process, but the opposite is more likely.<sup>179</sup> The IMF argued that it would be better equipped to resist pressures to provide financial packages to sovereigns with unstable debt, knowing that a reliable statutory mechanism for restructuring existed.<sup>180</sup> In turn, sovereigns aware of the IMF's decreased financing susceptibility would be more willing to start restructuring negotiations earlier, which would encourage restructuring prior to default.<sup>181</sup> Conversely, uncertainties about the implementation and operation of the SDRM would likely lower the price of outstanding sovereign debt, which would deter the SDRM's enactment.<sup>182</sup> Costs would also remain high for the sovereign, especially when banks hold a majority of its debt.<sup>183</sup> This would effectively prevent sovereigns from initiating restructuring agreements before it was absolutely necessary.

The largest limitation on the IMF's argument for the SDRM is that, ultimately, its effectiveness would depend entirely on the sovereign's policies.<sup>184</sup> The SDRM does nothing to remedy

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<sup>174</sup> Commentators have recognized that a more organized and financially efficient restructuring framework could ease the financial burden on the IMF. *See, e.g.*, GROUP OF 30, KEY ISSUES IN SOVEREIGN DEBT RESTRUCTURING (2002); Kenneth Rogoff, Emerging Market Debt. What Is the Problem?, Speech at the IMF Sovereign Debt Restructuring Conference (Jan. 22, 2003), <http://www.imf.org/external/np/speeches/2003/012203a.htm> [<http://perma.cc/G6V6-UX5C>].

<sup>175</sup> Auray, *supra* note 8, at 917.

<sup>176</sup> Fisch & Gentile, *supra* note 163, at 1096.

<sup>177</sup> *Id.* at 1096-97.

<sup>178</sup> *Id.*

<sup>179</sup> Hagan, *supra* note 169, at 338.

<sup>180</sup> *Id.*

<sup>181</sup> *Id.* at 339.

<sup>182</sup> Fisch & Gentile, *supra* note 163, at 1097.

<sup>183</sup> Hagan, *supra* note 169, at 340; BRAD SETSER, IPD TASK FORCE ON SOVEREIGN DEBT, THE POLITICAL ECONOMY OF THE SDRM 5 (2008).

<sup>184</sup> Hagan, *supra* note 169, at 340; SETSER, *supra* note 183, at 10-11.

the underlying issues in the sovereign's economic policies, which are the very policies that contributed to the sovereign's distressed debt burden in the first place.<sup>185</sup> Thus, "[n]o matter how effective the collective action mechanism, creditors would not be willing to agree to a restructuring unless and until the sovereign had formulated . . . [a] framework that would provide adequate assurance that the country would be able to repay the restructured claims."<sup>186</sup> Instead, the SDRM may actually make it more difficult for sovereigns to pay back debts and start fresh.<sup>187</sup>

### C. *Contractual Reform: Collective Action Clauses*

The contractual mechanism is currently the most commonly used device for combating restructuring issues.<sup>188</sup> The contractual proposal advocates for a free-market approach that provides more complete debt restructuring contracts by inserting Collective Action Clauses (CACs) in bond agreements.<sup>189</sup> Bonds under English law have included CACs for over 100 years, but CACs were not added to New York bonds until 2003.<sup>190</sup>

There are two basic types of CACs.<sup>191</sup> The first is the majority restructuring provision, which is a clause that allows for a certain majority of bondholders to bind all other bondholders to the terms of a restructuring negotiation by a majority vote.<sup>192</sup> The second is the majority enforcement provision, which enables a certain majority of bondholders to vote on a separate restructuring agreement that governs the voting majority without disrupting the restructuring process for the minority bondholders.<sup>193</sup> In the foreign debt context, CACs are generally used to allow a supermajority (commonly 75%) of bondholders to require all bondholders of the same bonds to comply with the terms of the agreed-upon restructuring agreement.<sup>194</sup>

At first glance, CACs appear to be a perfect solution to the holdout problem, but they do not do enough to solve current and

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<sup>185</sup> Hagan, *supra* note 169, at 340; SETSER, *supra* note 183, at 11.

<sup>186</sup> Hagan, *supra* note 169, at 340.

<sup>187</sup> SETSER, *supra* note 183, at 5-6.

<sup>188</sup> Auray, *supra* note 8, at 918.

<sup>189</sup> Stephan Airapetian, Note, *Managing Sovereign Debt: A More Long-Term Debt-Restructuring Solution*, 22 S. CAL. INTERDISC. L.J. 385, 394 (2013).

<sup>190</sup> Auray, *supra* note 8, at 918.

<sup>191</sup> *Id.*

<sup>192</sup> Hagan, *supra* note 169, at 317.

<sup>193</sup> Auray, *supra* note 8, at 918-19.

<sup>194</sup> See IMF, *The Design and Effectiveness of Collective Action Clauses*, at 5 (June 6, 2002), <http://www.imf.org/external/np/psi/2002/eng/060602.pdf> [<http://perma.cc/TVX5-N66V>]; Hagan, *supra* note 169, at 317.

future restructuring issues.<sup>195</sup> These contractual provisions are designed to prevent the possibility of holdout litigation by binding all bondholders to the restructuring agreement.<sup>196</sup> But CACs only bind bondholders within the same issuance, which leaves open the possibility that holdouts could obtain a supermajority in any particular issuance and block the intended operation of the CAC.<sup>197</sup> Recent proposals for contractual changes aim to solve these discrepancies by including aggregation clauses that would allow all majority decisions to bind holders of the same bond across multiple issuances.<sup>198</sup>

These aggregation provisions are also flawed, because if disputes about the agreed-upon voting provisions arise between bondholders, they would likely be hailed into different courts that could use different interpretations of the clauses.<sup>199</sup> Further, if just one issuance of a particular country's bonds omitted the aggregation clause, that particular issuance could give rise to holdout litigation, which would frustrate the entire restructuring process. These flaws prevent CACs from effectively safeguarding against the holdout problem, as is the case in Greece, where the use of CACs did not prevent holdout litigation.<sup>200</sup>

Even more problematic is the fact that CACs are merely contractual terms. CACs are designed to safeguard against the possibility that a sovereign will pressure bondholders to agree to certain conditions that benefit the sovereign.<sup>201</sup> By giving bondholders control over the restructuring process, CACs are supposed to ensure that sovereigns will not restructure only to never actually pay back the debt.<sup>202</sup> But CACs are not binding, and debtors are not bound to include such language in their contracts.<sup>203</sup> For instance, some sovereign creditors embrace the

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<sup>195</sup> See, e.g., Pottow, *supra* note 67, at 224.

<sup>196</sup> Auray, *supra* note 8, at 918.

<sup>197</sup> Hagan, *supra* note 169, at 320-21; see also Bolton & Skeel, *supra* note 160 (describing how the requirement of a supermajority could actually result in less protection for bondholders).

<sup>198</sup> See INT'L CAPITAL MKT. ASS'N, STANDARD AGGREGATED COLLECTIVE ACTION CLAUSES ("CACs") FOR THE TERMS AND CONDITIONS OF SOVEREIGN NOTES 5 (Aug. 2014), <http://www.icmagroup.org/assets/documents/Resources/ICMA-Standard-CACs-August-2014.pdf> [<http://perma.cc/H9CA-2VKU>]; IMF, *Strengthening the Contractual Framework*, *supra* note 153.

<sup>199</sup> Hagan, *supra* note 169, at 320; Patrick Bolton, *Toward a Statutory Approach to Sovereign Debt Restructuring: Lessons from Corporate Bankruptcy Practice Around the World* (IMF Working Paper, No. 03/13, 2003), <http://www.imf.org/external/pubs/ft/wp/2003/wp0313.pdf> [<http://perma.cc/8Vfy-U5DN>].

<sup>200</sup> See IMF, *Sovereign Debt Restructuring—Recent Developments and Implications for the Funds Legal and Policy Framework*, at 28 (Apr. 2013), <https://www.imf.org/external/np/pp/eng/2013/042613.pdf> [<http://perma.cc/L8SY-9Y5X>].

<sup>201</sup> Auray, *supra* note 8, at 919.

<sup>202</sup> *Id.*

<sup>203</sup> See Fisch & Gentile, *supra* note 163, at 1110.

possibility of holdout litigation in the restructuring process because they believe it can help thwart strategic and unnecessary defaults and restructuring agreements.<sup>204</sup> These creditors could simply opt not to include such provisions in their contracts, which would cause inconsistencies in the application of this contractual solution.<sup>205</sup>

Even if sovereign debtors choose to adopt the modified terms as proposed by the IMF and other institutions, the modification will likely be a lengthy process.<sup>206</sup> Disagreements on what particular provisions should be included could delay modification.<sup>207</sup> The costs associated with drafting and marketing the new terms for the sovereign bonds may also deter the adoption of new CACs.<sup>208</sup> Unlike a statutory mechanism, the implementation of which would only create legal costs associated with the drafting of one uniform code, CACs would need to be inserted into every single bond contract. The incremental nature of contract reform inherently fails to provide an efficient and comprehensive solution to the volatile debt market.<sup>209</sup>

Most importantly, CACs cannot be applied retroactively, so pre-CAC issuances, like the ones Argentina issued throughout the 1990s and early 2000s, would still pose a serious threat of holdout litigation.<sup>210</sup> Despite these flaws, proponents of the free-market approach still assert that contractual mechanisms are the best solution for sovereign restructuring problems.<sup>211</sup> For example, the Second Circuit noted that “[c]ollective action clauses have been included in 99% of the aggregate value of New York-law bonds issued since January 2005.”<sup>212</sup>

But as the Argentine saga has shown, this is clearly not the case. Not only have CACs proved inefficient at preventing holdout litigation when the bonds at issue actually included the contractual provisions,<sup>213</sup> other holdouts have now followed suit and pursued litigation against sovereign creditors.<sup>214</sup> Without a

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<sup>204</sup> See, e.g., *id.*

<sup>205</sup> *Id.*

<sup>206</sup> *Id.*

<sup>207</sup> *Id.*

<sup>208</sup> See *id.*; Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347, 359-62 (1996).

<sup>209</sup> Fisch & Gentile, *supra* note 163, at 1110-11.

<sup>210</sup> Pottow, *supra* note 67, at 224-25.

<sup>211</sup> Auray, *supra* note 8, at 935-36.

<sup>212</sup> COMM. ON FOREIGN & COM. L., N.Y.C. BAR, GOVERNING LAW IN SOVEREIGN DEBT—LESSONS FROM THE GREEK DISPUTE OF 2012, at 14 (2013), <http://www2.nycbar.org/pdf/report/uploads/20072390-GoverningLawinSovereignDebt.pdf> [<http://perma.cc/YX5N-P3LN>].

<sup>213</sup> *Id.* at 10-11.

<sup>214</sup> Trindle, *supra* note 44.

binding international resolution to replace the current contractual mechanisms, CACs will continue to be ineffective at preventing future holdout litigation *a la* the Argentine debt crisis.<sup>215</sup>

### III. AN INTERNATIONAL RESTRUCTURING REGIME

While there are many positive elements present in the three main proposals, the flaws in each prove fatal to solving the issues inherent in sovereign debt restructuring. By taking the positive elements of each of the existing proposals and also including provisions from the U.S. Bankruptcy Code, a new, fourth proposal could provide the solution to the growing issues in sovereign debt restructuring. Although this solution contains its own shortcomings, the many advantages of this hybrid proposal outweigh any weaknesses, and it ultimately provides the best mechanism for preventing sovereigns from behaving like Argentina and skirting their debt obligations.

#### A. *An International Restructuring Code and Court*

A statutory solution presents an ideal model for binding sovereigns and bondholders to an efficient and successful restructuring negotiation. The following are some suggested provisions that could be incorporated into a larger international debt statute—or left alone as a narrow restructuring code. At its core, the international restructuring code would be a statutory version of a majority restructuring clause that would allow a 75% majority vote of bondholders to bind all other bondholders of the same bonds to the terms of the agreed-upon restructuring contract.<sup>216</sup> This section would be based on the CACs and the SDRM majority restructuring provisions.<sup>217</sup> The code would mirror the SDRM by incorporating aggregation clauses that would combine all claims related to the same sovereign debt, despite different instruments and issuances.<sup>218</sup> The code would also be applied to all existing claims at the time of the restructuring proposal, which would help combat issues associated with existing sovereign debt.<sup>219</sup>

Unlike CACs and the SDRM, however, if a supermajority does not reach an agreement for a restructuring plan, but a minority of bondholders do agree on a restructuring

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<sup>215</sup> Auray, *supra* note 8, at 935-36.

<sup>216</sup> See INT'L CAPITAL MKT. ASS'N, *supra* note 198.

<sup>217</sup> See *id.*; Proposed Features, *supra* note 168.

<sup>218</sup> Hagan, *supra* note 169, at 336.

<sup>219</sup> *Id.*

plan, then those minority bondholders may still agree to that plan. If this occurs, holdout creditors would not be permitted to bring collection actions for the value of their outstanding bonds until after restructured creditors are paid under a certified repayment plan.<sup>220</sup> This provision would be modeled loosely on Chapter 5 of the U.S. Bankruptcy Code, which forbids a creditor who has won a portion of his claim in a foreign proceeding from receiving any payment until after domestic creditors are paid equally.<sup>221</sup>

The greatest difference between all three previous proposals and the international restructuring regime is that this proposed provision would have a filtering mechanism to determine the need for restructuring before approving any restructuring plan.<sup>222</sup> The filtering provision would ensure that the sovereign attempting to restructure had a legitimate need to restructure before considering a restructuring plan. This “gatekeeper” provision could be modeled on Chapter 9 of the U.S. Bankruptcy Code, which requires a good faith need to restructure.<sup>223</sup> The United Nations acknowledged the importance of not only good faith engagement between creditors and debtors, but also transparency, fairness, and equal treatment as best practices in debt restructuring agreements.<sup>224</sup>

These features are similar to Chapters 9 and 11 of the U.S. Bankruptcy Code, making U.S. law a preferable starting point for designing an international code.<sup>225</sup> Moreover, U.S. bankruptcy law is largely governed by statute, whereas the United Kingdom tends to rely more on contractual mechanisms, other European countries rely heavily on court involvement, and many Asian and Latin American countries utilize U.S. law as a model for their own bankruptcy laws.<sup>226</sup> Although the good faith requirement would be an easy standard to meet,<sup>227</sup> it would at least prevent a sovereign’s blatant attempts to prolong repayment despite having adequate funds. It would also protect bondholders by preventing sovereigns from frivolously restructuring to avoid repayment.

The approval of the proposed restructuring plan would also be conditioned on the debtor government passing austerity measures aimed at solving the original problems that caused the

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<sup>220</sup> See Pottow, *supra* note 67, at 238 (suggesting that a judge could take an innovative tool from bankruptcy law to adopt a reverse injunction against holdouts).

<sup>221</sup> See 11 U.S.C. § 508 (2012).

<sup>222</sup> Hagan, *supra* note 169, at 342.

<sup>223</sup> See 11 U.S.C. § 921(c).

<sup>224</sup> UNITED NATIONS CONF. ON TRADE AND DEV., *supra* note 152.

<sup>225</sup> See 11 U.S.C. §§ 921(c), 1126.

<sup>226</sup> Bolton, *supra* note 199, at 13-17.

<sup>227</sup> Pottow, *supra* note 67, at 241.

country to default (or come close to default) in the first place. This condition would allow the creditors to maintain control over the restructuring process, which would prevent the debtor from enacting unfavorable terms. This “take it or leave it” approach would pressure debtors to assent and would prevent sovereigns from entering into restructuring contracts that they have no intention of paying back.<sup>228</sup>

A possible enforcement agency could be an international debtors commission similar to the international boards proposed by Professor Pottow.<sup>229</sup> This commission would not be powerless, however, because it would have the authority to approve austerity measures and restructuring plans, enforce the international restructuring code, and punish violators. The court would have limited jurisdiction and specialized knowledge, much like the courts in the U.S. bankruptcy system. As a result, this would increase the efficiency and success of sovereign debt restructuring packages because neutral experts would scrupulously consider the particular terms of each agreement. Additionally, austerity measures would be imposed on a case-by-case basis so as to tailor the agreements to the exact needs of the sovereign state and the interested creditors.

Allowing an international bankruptcy court to determine and enforce austerity measures in restructuring agreements is also a better alternative to having an institution like the IMF handle both predefault bailout packages and postdefault restructuring agreements. While the IMF imposes austerity measures as a condition of the use of bailout packages before a country defaults, the IMF framework is not always perfect.<sup>230</sup> In fact, many blame the IMF for Argentina’s 2001 default because the bailout packages lent too much money based on predicted GDP growth that never occurred and unsustainable neoliberal reforms that were never enforced.<sup>231</sup> Overall, an international restructuring court that handles postdefault restructuring would provide for an efficient debt repayment process. By allowing the sovereign to negotiate with its own bondholders, the international restructuring court would allow it to reform and reemerge from debt back into the international market. Thus, this proposed court would create a balance between autonomy and oversight by allowing the sovereign to negotiate with its own bondholders

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<sup>228</sup> Airapetian, *supra* note 189, at 416-17.

<sup>229</sup> See, e.g., Pottow, *supra* note 67, at 238-39.

<sup>230</sup> Airapetian, *supra* note 189, at 415.

<sup>231</sup> Maynard & Todd, *supra* note 27, at 154-55.

while also maintaining the ability to prevent a sovereign from going off the rails as Argentina did.

### *B. Advantages of a Hybrid Solution*

Sovereign nations may be reluctant to embrace an international court that facilitates sovereign debt restructurings, but it is likely that the neutral forum such a court would provide would create an incentive for countries to litigate there. For current bondholders, doing so would require the sovereign to enact legislation subjecting their existing bonds to the court's jurisdiction rather than New York or English law. Unlike Argentina's attempt at circumventing the U.S. district court's injunctions, these enactments would be perfectly legal since they would not equate to defiance of court orders. Once agreed to, the international arena could avoid the jurisdiction and venue issues that are currently so common in international debt litigation.

Most importantly, the court would increase the legitimacy of restructuring agreements by using legal sanctions and official oversight that are lacking in contractual processes.<sup>232</sup> While immunity doctrines like the FSIA place states and their assets outside the scope of judicial review unless the state waives or falls under an exception to immunity,<sup>233</sup> the proposed code and court would not be subject to the provisions of the FSIA because it would not be bound by U.S. law. This would leave the court free to create its own, possibly less restrictive immunity policy that could be adjusted on a case-by-case basis. Although designing and implementing such a code and corresponding court could be a lengthy process, the creation of a statutory regime with the ability to effectively regulate sovereign debt restructuring will be well worth it in the long run.

Once organized, an international debt restructuring regime creates a negotiation structure for modifying bond contracts in an orderly, legitimate process that prevents the prolongation of sovereign debt issues.<sup>234</sup> The legal framework established by the international restructuring regime, like the proposed SDRM, would make the restructuring process more efficient and predictable by imposing sanctions on all violators of the statute.<sup>235</sup> In the end, this process would reduce the inconsistencies of ad hoc decisions made by debt-distressed

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<sup>232</sup> Anna Gelpern, *Bankruptcy Backwards: The Problem of Quasi-Sovereign Debt*, 121 YALE L.J. 888, 936 (2012).

<sup>233</sup> See Foreign Sovereign Immunities Act of 1967, 28 U.S.C. § 1605 (2006).

<sup>234</sup> Gelpern, *supra* note 232, at 935.

<sup>235</sup> *Id.* at 936.

sovereigns.<sup>236</sup> It would similarly reduce the problems of unplanned restructuring reform, which provides for toothless remedies incapable of binding sovereigns and bondholders into an equal and successful restructuring agreement. Moreover, this regime encourages restructurings to take place prior to defaults, thereby protecting valuable assets and limiting the economic and social damage that results from a default. In this respect, Chapter 11 of the U.S. Bankruptcy Code is a strong model, since it provides for insolvency proceedings in which debtors and creditors can negotiate.<sup>237</sup> Ultimately, the proposed international court and code would facilitate successful restructuring and prevent future sovereign debt issues by helping to correct the underlying economic issues in the particular sovereign's economic regime.

## CONCLUSION

Argentina's second default and the ensuing litigation have brought to light serious issues in the current sovereign debt restructuring process, such as prolonged debt litigation, hostile negotiations between creditors and debtors, and unsuccessful restructuring arrangements. An international restructuring court that enforces an international restructuring code is a viable solution to these ever-increasing problems in restructuring litigation. While there is a plethora of scholarly proposals that range from statutory to contractual, none have suggested an effective solution to the problems of foreign debt restructuring.<sup>238</sup> Most scholars have considered individual proposals in isolation from, and in opposition to, the other proposed solutions to the restructuring problem.<sup>239</sup>

A combination of all three proposals' benefits produces a new and preferable "super-proposal." This proposal avoids many of the issues associated with CACs, the SDRM, and an international certification board. It would also prevent unnecessary restructuring by implementing a filtering provision that would require a showing of a good faith need to restructure. Most importantly, this solution would attempt to put a sovereign debtor on a path to economic stability by conditioning restructuring on the passing of certain austerity measures determined on a case-by-case

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<sup>236</sup> *Id.* at 937.

<sup>237</sup> Hagan, *supra* note 169, at 339.

<sup>238</sup> See generally Udaibir S. Das et al., *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts* (IMF, Working Paper No. 12/203, 2012) (outlining comprehensive analysis of all major sovereign debt issues and proposals throughout a 60-year period).

<sup>239</sup> *Id.*

basis by the specialized court. This in turn would reduce the heavy debt burden placed on many economically distressed nations in the long term.

Although additional action is currently being taken by the IMF to reform bond contracts in order to prevent collective action problems,<sup>240</sup> this alone is not enough to put a dent in the issues resulting from a sovereign default on international debt. Major reform must be undertaken to prevent future holdout litigation on existing bonds and ensure that new bonds are also protected from the possibility of indefinite holdouts. While “the international realm has long countenanced degrees of hardness in legal reforms,” the increasing litigation, hostility, and inefficiency of the Argentine debt restructuring process have illuminated the fact that times are changing.<sup>241</sup>

International institutions themselves are now calling for drastic reform in order to combat holdout issues and prevent the possibility of catastrophic consequences in the international market.<sup>242</sup> If a legally enforceable remedy binding all international debtors to comply with an efficient restructuring plan is not instituted soon, sovereign debt will remain just that: sovereign.

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<sup>240</sup> See generally IMF, *Strengthening the Contractual Framework*, *supra* note 153 (identifying ways in which contractual reform may resolve issues in sovereign debt restructuring).

<sup>241</sup> Pottow, *supra* note 67, at 238.

<sup>242</sup> CLIFFORD CHANCE, ICMA CONSULTS ON SOVEREIGN BONDS (2014), <http://www.emta.org/WorkArea/DownloadAsset.aspx?id=8516> [<http://perma.cc/6BSJ-YV24>]; IMF, *Strengthening the Contractual Framework*, *supra* note 153; *UN Human Rights Council Backs Argentina on US Debt Row*, BBC NEWS (Sept. 26, 2014), <http://www.bbc.com/news/world-latin-america-29387872> [<http://perma.cc/5Q58-6RQK>].

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