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8-1-2013

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#### Working Paper Citation

Pottow, John A. E., "Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign Debt Restructurings" (2013). *Law & Economics Working Papers*. 81.

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**Mitigating the Problem of Vulture Holdout:  
International Certification Boards for Sovereign Debt Restructurings**

*John A. E. Pottow, University of Michigan Law School, August 2013.*

The Great Recession has brought greater sovereign debt defaults, which in turn has brought a surfeit of academic explorations and policy discussions of sovereign debt restructuring. The purpose of this article is to offer yet one more idea for the hopper of what to do with the seemingly intractable problem of restructuring sovereign bond debt.<sup>1</sup> The field does not lack for statutory and contractual proposals, from SDRM to CACs, but it is not yet sufficiently saturated that another proposal cannot join the mix.<sup>2</sup> The proposal is for the establishment of international certification boards that can give a stamp of approval to workout proposals for bond debt that is (at least in part) privately held. The reason for the boards is to combat the problem of holdouts in an age of vulture funds and other new-age sovereign debt investors. The boards are deliberately non-judicial and will have no hard law power by design. Nonetheless, it is suggested that these boards will have an incremental effect in coalescing agreement around sovereign debt restructuring proposals.

To make the case of the boards requires some foundational legwork. First, this article discusses the persistence of the holdout problem in sovereign debt restructurings. Second, it discusses the specific conduct of vulture funds and other investment actors who are likely to

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<sup>1</sup> For a comprehensive review of sovereign debt restructurings, see Udaibir S. Das, Michael G. Papaioannou, & Chrisoph Trebesch, *Sovereign Debt Restructurings 1950-2010: Concepts, Literature Survey, and Stylized Facts* (Int'l Monetary Fund, Working Paper No. 12/203, 2012).

<sup>2</sup> Those who abhor acronyms should know that SDRM stands for the Sovereign Debt Restructuring Mechanism first put forth by the IMF/World Bank that withered on the vine back in the early 2000s, and CAC stands for Collective Action Clause, a provision now commonplace in sovereign debt issuances that permit supermajoritarian thresholds to adjust repayment terms (i.e., consent to principal reductions). INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK, 12-14 (2013).

accentuate and indeed crystallize the holdout problem, arguing not just a problem of holdouts qua holdouts, but of pernicious knock-on effects to the international legal order generally and to the law of sovereign debt particularly. The foundation thus laid, consideration proceeds to certification boards and how they might play a role in combatting these problems.

### **I. Holdout: Still a Problem with Sovereign Debt Restructurings.**

The initial proposition that animates this proposal is a firm conviction that of all the challenges to sovereign debt default that have been well documented by others (moral hazard, taxpayer burden, odiousness, etc.), the principal one—at least for those coming from the world of bankruptcy—is that of holdout. One of the key attributes of a bankruptcy system is the ability to bind all stakeholders to an *in rem* resolution of restructured obligations,<sup>3</sup> and more specifically the ability to bind holdouts to blunt their potentially destructive impulses.<sup>4</sup>

Indeed, in the high-profile dispute between NML and Argentina in the Second Circuit, the court has repeatedly bemoaned the lack of a bankruptcy system to turn to as a way out of the mess.<sup>5</sup> As Judge Griesa pointedly complained, “Unlike bankruptcy courts, which have significant

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<sup>3</sup> See *Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440, 447 (2004) (A bankruptcy court’s *in rem* jurisdiction permits it to ‘determin[e] all claims that anyone, whether named in the action or not, has to property or thing in question. The proceeding is ‘one against the world.’”); *Shawhan v. Wherritt*, 48 U.S. 627 (1849) (“No creditor can, by instituting proceedings in a state court after the commission of an act of bankruptcy by his debtor, obtain a valid lien upon property conveyed by such fraudulent deed, if he has notice of the commission of an act of bankruptcy by the debtor. It passes to the assignee of the bankrupt for the benefit of all creditors.”). See also 28 U.S.C. §1334(e) (“The district court in which a case under Title 11 is commenced or pending shall have exclusive jurisdiction [] of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate . . .”).

<sup>4</sup> Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 *Cornell L. Rev.* 439, 467 (1992) (“[W]ithout bankruptcy, negotiation and holdout problems could impose even greater costs on a debtor than does negotiation within bankruptcy, which prevents destructive individual creditor action.”). See 11 U.S.C. s. 1129(a)(9) (deploying super-majoritarian voting rules to bind dissidents); cf. *id.* At 1129(b) (providing alternative dissident-binding procedure).

<sup>5</sup> One pair of commentators suggests that the court was trying mediate a debt swap between the holdouts and the institutional investors in this case to fill the gap left by the lack of an SDRM, thus serving two of that proposal’s functions (aggregation and transition). See Marcus H. Miller and Dania Thomas, *Sovereign Debt Restructuring: The Judge, Vultures, and Creditor Rights*, 30 *The World Economy* 1491 (2007).

power to reallocate debtors' assets to satisfy creditor claims, the court in this case is limited to enforcing the terms of the specific contracts before it.”<sup>6</sup> Accordingly, the holdout problem not just real but a serious challenge in need of continued attention by policymakers.

This concern over holdouts is fully mindful of the limited incidence of public debt “proceedings,” under even the most capacious definition of that term. There have only been 180 sovereign debt restructurings from 1970 to 2010,<sup>7</sup> and most of them have not reached Argentine levels of acrimony.<sup>8</sup> So, too, are some defaults “too small fish to fry” for putative holdouts.<sup>9</sup> All that being said, the fact that we see the holdout problem in Argentina, where approximately 93%—surely a super-majority by whatever metric one uses—consented to the bond exchanges, means that the holdout problem is alive and thriving.<sup>10</sup>

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<sup>6</sup> NML Capital, Ltd. v. The Republic of Arg., No. 05 Civ. 2434 (TPG); 06 Civ. 6466 (TPG); 7 Civ. 2690 (TPG); 05 Civ. 3328 (TPG); 05 Civ. 4239 (TPG); 05 Civ. 10201 (TPG); 07 Civ. 2349 (TPG); 06 Civ. 5887 (TPG); 07 Civ. 1797 (TPG), 2009 U.S. Dist. LEXIS 21530, at \*13 (S.D.N.Y. March 18, 2009). See also NML Capital, Ltd. v. The Republic of Argentina, 699 F.3d 246, FN 2 (2nd Cir. Oct. 26, 2012) (noting that “in the event of a debt crisis, sovereigns wishing to honor some portion of their defaulted debt must negotiate with individual creditors or groups of creditors to effect restructurings,” which leave “in their wake so-called ‘holdout’ creditors”).

<sup>7</sup>The probability of litigation and the number of cases both vary directly with the size of the proposed haircut, Julian Schumacher, Christoph Trebesch, Henrik Enderlein, Sovereign Defaults in Court: The Rise of Creditor Litigation 1976-2010, (December 16, 2012), Working Paper, available at <http://ssrn.com/abstract=2189997> or <http://dx.doi.org/10.2139/ssrn.2189997>. (“A one standard deviation increase in haircuts (28 percentage points) almost doubles the probability of filing suit, from 7 to 14%. We also find that haircuts are a good predictor for the number of cases.”).

<sup>8</sup> Id. at 3, 11-12 (noting that half of sovereign litigation pertains to the large-haircut restructurings of Argentina and Peru because “countries imposing larger debt write-downs are more likely to be sued for full repayment”).

<sup>9</sup> Andres Schipani, Ecuador: too small of a fish to fry for vulture funds, FT.com (last accessed March 24, 2013 11:35am), available at <http://blogs.ft.com/beyond-brics/2012/11/23/ecuador-too-small-of-a-fish-to-fry-for-vulture-funds/#axzz2DKZs5IDy> (contrasting the \$3.2 billion Ecuadorian default in 2008 with the \$81 billion Argentine default in 2001 and remarking that the Argentine default involved “big players” and “big funds . . . with enough power to afford lengthy and costly legal procedures”).

<sup>10</sup> Agustino Fontevicchia, The Real Story of How a Hedge Fund Detained a Vessel In Ghana and Even Went for Argentina's 'Air Force One', Forbes.com, available at <http://www.forbes.com/sites/afontevicchia/2012/10/05/the-real-story-behind-the-argentine-vessel-in-ghana-and-how-hedge-funds-tried-to-seize-the-presidential-plane/> (last accessed March 27, 2013 at 1:57pm).

Nor ought one be assuaged by the rise of CACs (either payment or non-payment),<sup>11</sup> although to be sure this makes the severity of the holdout problem a closer question. Theoretically, CACs seem at first to be elegant solutions to the holdout problem, and their increased prevalence means either that the market thinks so too or that the market is close enough to thinking so that the signaling herd is stampeding thus.<sup>12</sup> But serious commentators contend that CACs do not fix the holdout problem altogether,<sup>13</sup> and their arguments have force. (Greece presents as stark recent example where CACs did not prevent holdouts.)<sup>14</sup> Indeed, there are at least two ways in which holdout problems *cannot* be solved by CACs. First, as an empirical matter, vulture funds (whom will be scapegoated as quintessential holdouts for expositional ease) may easily be able to marshal blocking positions, especially when a sovereign has issued multiple rounds of debt.<sup>15</sup> Second, as a more structural matter, it could be that the legal community is so ingenious that anytime you think you've fixed something they just outmaneuver you at every turn. Consider, for example, how seemingly unanimous Unanimous Consent Clauses got hobbled by Exit Consents.<sup>16</sup> (Some unanimities are more unanimous than

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<sup>11</sup> Marco Committeri & Francesco Spadafora, *You Never Give Me Your Money? Sovereign Debt Crises, Collective Action Problems, and IMF Lending* 17 (IMF Working Paper WP/13/20 January 2013).

<sup>12</sup> Id. CACs and other market instruments, such as minimum participation thresholds and exit consents, have helped to ensure high rates of participation. INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK 28 & n.24 (2013).

<sup>13</sup> A. Mechele Dickerson, *A Politically Viable Approach to Sovereign Debt Restructuring*, 53 Emory L. J. 997, 1015 (2004) ("Even if all new bonds contained CACs, there would still be a creditor coordination problem because the holders of old, longer maturity bonds could still rely on the UACs in those bonds to thwart the sovereign's debt restructuring negotiations."); David A. Skeel, Jr., *Can Majority Voting Provisions Do It All?*, 52 Emory L.J. 417, 423 (2003) (arguing that CACs are not all that attractive when considering a sovereign's complicated borrowing structure often has multiple classes of bonds and the problem that CACs lack a stay to halt collections while creditors and sovereign negotiate the restructuring); Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 Emory L.J. 1043, 1095 (2004). (noting that CACs as of 2004 failed to eliminate the strategic use of litigation largely because of a lack of "jurisprudence clarifying the rights and responsibilities of creditor groups in restructurings").

<sup>14</sup> IMF Report at 28.

<sup>15</sup> Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 Emory L.J. 1043, 1095 (2004).

<sup>16</sup> Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 Emory L.J. 1043, 1091 (2004) ("As a condition of the exchange offer, creditors accepting the offer are required

others?) Maybe those instances were outrages, or maybe they were just a manifestation of the legal world devising creative workarounds to transactional problems.

The first, empirical point on the inefficacy of CACs is not theoretically problematic. Sure, anyone can hold out, whatever your voting threshold is, but there's nothing that can be done about that. (More specifically, the tougher one wants to make it to acquire a blocking position, the less consensus one must tolerate for the restructuring – because the voting threshold must be lowered – which means there is a zero-sum theoretical fight between consensus and holdout-potential.)<sup>17</sup> The second point creates more concern. It is difficult to escape the nagging feeling that CACs won't do it all, even if they do do a lot.<sup>18</sup> In any event, even if the happy outcome of CACs' fixing much or all of the holdout problem comes to pass, we are still left with the legacy issue of pre-CAC issuances, which represent enough money that holdouts remain a serious problem to the restructuring of sovereign debt.<sup>19</sup> Moreover, it is far from clear this is a mere legacy issue, as some recent empirical scholarship suggests,<sup>20</sup> and the specter of holdouts continues to stalk policymakers in Europe:

it is the undisguised fear of holdouts and the prospect of a messy, Argentine-style debt restructuring in the belly of Europe that has been one of the principal motivations for the official sector's willingness to use its taxpayer money

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[by exit consents] to consent to various modifications to the terms of the original debt that reduce its value . . . The amendments are designed to make the original bonds less valuable, thereby making their retention less attractive to investors.”).

<sup>17</sup> Beyond the scope of this discussion are aggregation clauses, which alleviate some of this problem.

<sup>18</sup> See Declaration of Stephen Choi at 8-10 *NML Capital, Ltd. v. The Republic of Argentina* 2012 U.S. Dist. LEXIS 168292 (Nov. 21, 2012) (No. 08 Civ. 6978 (TPG), 90 Civ. 1707(TPG), 09 Civ. 1708 (TPG) (opining as paid expert on the benefits of CACs).

<sup>19</sup> A. Mechele Dickerson, *A Politically Viable Approach to Sovereign Debt Restructuring*, 53 *Emory L. J.* 997, 1015-16 (2004).

<sup>20</sup> Lee c. Buchheit, G. Mitu Gulati, Ignacio Tirado, *The Problem of Holdout Creditors in Eurozone Sovereign Debt Restructurings*, Working Paper (1/22/2013), available at [http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5485&context=faculty\\_scholarship](http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5485&context=faculty_scholarship)

to repay, in full and on time, all of the private sector creditors of Eurozone countries receiving bailouts (the belated Greek restructuring being the sole exception).<sup>21</sup>

Accordingly, CACs or not, holdout is still a problem in the sovereign debt arena looking for solutions.

## **II. Vulture Funds and the Problem of Costly, Uncoordinated Litigation.**

The second proposition that must be established before turning to the certification boards proposal regards vulture funds in particular: not only do they present a theoretical risk of holdout-ism – as seen with, for example, Peru<sup>22</sup> – but they are excessively tenacious in their litigation strategies, which has systemic costs, both for the international community generally and for the development of a coherent body of sovereign debt law specifically.<sup>23</sup>

Vulture funds are easy scapegoats for free-floating malaise,<sup>24</sup> and policymakers have directed an inordinate amount of hostility in recent years toward hedge funds, perhaps preferring to point the finger at external investors as opposed to government regulators in laying blame to the credit crisis. Indeed, some countries have gone so far as to introduce legislation that would

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<sup>21</sup> *Id.* at 1. Interestingly, this appears to be a change from earlier scholarly understanding (by the same knowledgeable observers): “Second, in stark contrast to the 1990s and 2000s, no policy maker has identified a collective action problem for collective action clauses to solve in European sovereign debt. To be sure, few doubt that there is a debt problem—but no one has described a coordination problem.” See Anna Gelpern and G. Mitu Gulati, “Foreword: Of Lawyers, Leaders, and Returning Riddles in Sovereign Debt,” 73 *Law and Contemp. Probs.* I, ii (2010) available at <http://scholarship.law.duke.edu/lcp/vol73/iss4/1/> (emphasis added).

<sup>22</sup> Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 *Emory L.J.* 1043, 1084-85 (2004).

<sup>24</sup> Funds are easy scapegoats for free-floating malaise. Consider, for example, the U.S. proposal to tax capital gains for hedge fund managers as constructive income, which one might safely characterize as a “novel” development under taxation law. S. 1626.IS, 110<sup>th</sup> Cong. (2007) | H.R. 1935 (2009) (reintroduced).

limit hedge fund recoveries against sovereign debtors,<sup>25</sup> an expressive gesture of ire (or at the very least an unprecedented “un-waiver” of sovereign immunity by another sovereign).<sup>26</sup> But there’s surely something at the root of these grumblings. In the sovereign debt area, vulture funds seem to be at the vanguard of using the private mechanism of litigation and judicial process to collect on defaulted sovereign debt. Consider what happened with the Argentine debt and the *ARA Fragata Libertad*.<sup>27</sup> Ellioit/NML refused to tender its bonds to the exchange offer put forth by Argentina (both pre- and post Lock Law),<sup>28</sup> deciding instead to sue. To realize its judgment, NML was willing to travel the globe in search of Argentine assets.<sup>29</sup> Too wise to

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<sup>25</sup> In 2008 and 2010, Belgium and the United Kingdom, respectively, passed national legislation limiting the potential recovery of holdout hedge funds against debtor nations. See U.N. Human Rights Council, Report of the independent expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social, and cultural rights, 14th Sess., ¶¶ 48-53, U.N. Doc. A/HRC/14/21 (April 29 2010) [hereinafter Human Rights Council Report]. A similar proposal was proposed in the United States by House Representative Rep. Maxine Waters in July 2009. *Id.* at ¶ 49.; See also Elizabeth Broomfield, Survey: Subduing the Vultures: Assessing Government Caps on Recovery in Sovereign Debt Litigation, 2010 Colum. Bus. L. Rev. 473, 502-10 (surveying legislation from Belgium, the United Kingdom, and the United States aimed at limiting recoveries by non-cooperating creditors). Moreover, countries such as Belgium have made concentrated appeals to the World Bank and IMF to restrict creditor litigation in sovereign debt restructurings. Broomfield at 10.

<sup>26</sup> For a general summary of sovereign immunity in sovereign debt defaults, see Schumacher, Julian, Trebesch, Christoph and Enderlein, Henrik, Sovereign Defaults in Court: The Rise of Creditor Litigation 1976-2010, 6-9 (December 16, 2012), available at SSRN: <http://ssrn.com/abstract=2189997> or <http://dx.doi.org/10.2139/ssrn.2189997>.

<sup>27</sup> *ARA Libertad (Argentina v. Ghana)*, Case No. 20, Request for the Prescription of Provisional Measures Under Article 209, Paragraph 5, of the United Nations Convention on the Law of the Sea, ¶¶ 3-18, <http://www.itlos.org>.

<sup>28</sup> *NML Capital, Ltd. v. Republic of Argentina*, 699 F.3d 246, 251-52 (Oct. 26, 2012) (providing a brief summary of Argentina’s restructuring, the passage of the Lock Law, and the hedge funds’ decision not to participate).

<sup>29</sup> Agustino Fontevicchia, The Real Story of How a Hedge Fund Detained a Vessel in Ghana and Even Went for Argentina’s ‘Air Force One’, *Forbes*, Oct. 5, 2012 (last accessed March 29, 2013 at 10:35am), available at <http://www.forbes.com/sites/afontevicchia/2012/10/05/the-real-story-behind-the-argentine-vessel-in-ghana-and-how-hedge-funds-tried-to-seize-the-presidential-plane/> (“Back in 2007, a group of bondholders discovered that the Tango 01, Argentina’s presidential airplane, would be in the U.S. for scheduled maintenance and pilot training” . . . and “moved to get a court to keep the plane grounded after it landed . . .”). See also H.C., Argentina and Its Creditors: A Languid Tango, *The Economist Blog*, (Jan 16, 2013) (last accessed March 28<sup>th</sup>, 2013 at 10:14 am), available at <http://www.economist.com/blogs/americasview/2013/01/argentina-and-its-creditors>. (noting that since the seizure of the *Libertad* in Ghana, the Argentine government has been renting a corporate jet for three months in response to the “aggressive posture of the vulture funds with Argentina”).



leave substantial funds parked in the United States,<sup>30</sup> and able to demur collections actions in its own courts, Argentina made this collection phase of the victorious plaintiffs a difficult one.<sup>31</sup>

Undiscouraged, NML doggedly pursued Argentina for assets abroad, from Belgian diplomatic accounts to a colorful attempt on the presidential helicopter, *Tango 1*.<sup>32</sup> It's not that this aggressive style should offend our wilting-violet sensibilities; on the contrary, lawyers should be happy to create full employment for The Brotherhood. The issue is that, especially given the positive reinforcement the funds received for their holdout conduct with Peru,<sup>33</sup> it is difficult to reject the hypothesis that their relentless strategy is animated more by a complex signaling game of pit-bulldogness, designed to make it clear that they are here and here to stay and so a defaulting sovereign ought just to cough up and pay them off.

Consider in this regard the detention of the *Libertad* in Ghana.<sup>34</sup> The fund successfully arrested the vessel and brought it within the jurisdiction of the Ghanaian court.<sup>35</sup> Although Argentina was ultimately able to prevail on a sovereign immunity defense (slow as she is, the *Libertad* is still a warship that enjoys the traditional immunity accorded such property under international law),<sup>36</sup> it was not a costless defense. And that's precisely the problem – the fund

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<sup>31</sup> Luke Eric Peterson, Argentine Crisis Arbitration Awards Pile Up, but Investors Still Wait for a Payout, LAW.COM (June 25, 2009) (last visited March 29, 2013 at 6:42pm), available at <http://www.law.com/jsp/law/international/LawArticleIntl.jsp?id=1202431736731&thepage=1&slreturn=20130229183938>.

<sup>32</sup> Fontevecchia, *supra* n. 33.

<sup>33</sup> Jill E. Fisch & Caroline M. Gentile, Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring, 53 Emory L.J. 1043, 1045 (2004).

<sup>34</sup> Fontevecchia, *supra* n. 33.

<sup>35</sup> Fontevecchia, *supra* n. 33.

<sup>36</sup> Buque Escuela, Armada Argentina, Ministerio de Defensa Presidencia de la Nacion, available at <http://www.armada.mil.ar/pag.asp?idItem=299> (last accessed March 29, 2013 at 10:20am) (describing the *Libertad*, a frigate in service since 1963, as having a max speed of 13.5 knots.); Compare with the USS Missouri (BB-63), The Ship, Battleship Missouri Memorial Pearl Harbor, Hawaii, available at <http://www.ussmissouri.com/page.aspx?pid=590> (last accessed March 29, 2013 at 10:23am) (describing the USS Missouri, a battleship launched in 1944, as having a max speed of 33 knots); See ARA Libertad (Argentina v.

was willing to travel halfway around the world to arrest a vessel that in a best case scenario would have netted it 1% of its outstanding claim.<sup>37</sup> True, ninety-nine more ships later the fund might have been made whole, but the jarring disconnect between the value of the claim and the legal effort involved in seizing such a remote asset raises the question whether NML was doing it just to posture for its larger holdout game.

As an aside, you may wonder what's wrong with posturing? After all, if the funds are willing to pay for the lawyers to gain what they perceive is a tactical advantage, then that's just more good news for The Brotherhood, isn't it? The analysis may be more complex. When private litigants invoke the international machinery of dispute resolution there are costs well beyond the filing fees. When NML secured the attachment from the Ghanaian court, Argentina had to initiate a proceeding under the United Nations Convention on the Law of the Sea ("UNCLOS"), a treaty finally completed in 1982 to resolve maritime disputes, to resolve its claim of immunity.<sup>38</sup> Although it expressed willingness to arbitrate, Argentina also had to seek

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Ghana), Case No. 20, Order of Dec. 15, 2012, ¶ 98, <http://www.itlos.org> (highlighting the consideration "that actions taken by the Ghanaian authorities that prevent the ARA Libertad, a warship belonging to the Argentine Navy, from discharging its mission and duties affect the immunity enjoyed by this warship under general international law").

<sup>37</sup> Jacob Goldstein, Why A Hedge Fund Seized An Argentine Navy Ship In Ghana, NPR Planet Money, October 22, 2012 (last accessed March 29, 2013 at 10:30am), available at <http://www.npr.org/blogs/money/2012/10/22/163384810/why-a-hedge-fund-seized-an-argentine-navy-ship-in-ghana>. (remarking that the Ghanaian court ordering the *Libertad's* detention would have allowed the ship's release if Argentina posted a \$20 million dollar bond).

<sup>38</sup> Letter from Hector Timerman, Minister of Foreign Affairs and Worship of the Argentine Republic, to Philippe Gautier, Registrar of International Tribunal for the Law of the Sea (Sept. 11, 2012), available at [http://www.itlos.org/fileadmin/itlos/documents/cases/case\\_no.20/C20-Request\\_for\\_official\\_website.pdf](http://www.itlos.org/fileadmin/itlos/documents/cases/case_no.20/C20-Request_for_official_website.pdf); Request for The Prescription of Provisional Measures Under Article 290, Paragraph 5, of the United Nations Convention on the Law of the Sea, (Nov. 14, 2012), available at [http://www.itlos.org/fileadmin/itlos/documents/cases/case\\_no.20/C20-Request\\_for\\_official\\_website.pdf](http://www.itlos.org/fileadmin/itlos/documents/cases/case_no.20/C20-Request_for_official_website.pdf); *The Tribunal*, INTERNATIONAL TRIBUNAL FOR THE LAW OF THE SEA, <https://www.itlos.org/index.php?id=15>.

“provisional measures” to address the injunctive detention of her frigate.<sup>39</sup> This required convening the rarely deployed International Tribunal of the Law of the Sea (“ITLOS”).<sup>40</sup>

The ITLOS has convened only twenty-odd times throughout its lifetime.<sup>41</sup> Looking at the sorts of disputes it tends to hear, one sees such matters as seized fishing vessels due to capacious claims of exclusive economic zones.<sup>42</sup> Nominally, Argentina’s beef was with Ghana,<sup>43</sup> but it is clear to any observer that Argentina had to sue a private investment fund to get its own naval ship back. It is not the obscurity of the tribunal on its own that is problematic; it is the fact that empanelling these tribunals has costs. Yes, some costs can be passed onto the parties,<sup>44</sup> but there are myriad indirect costs that cannot. And when private parties can force the convening of tribunals that were themselves the result of delicate compromises of wary nations forging unsteady alliances in an international treaty, it can cheapen the broader field of international conflict resolution. Skeptical nations (note that the United States has still to ratify the

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<sup>39</sup> Letter from Hector Timerman, Minister of Foreign Affairs and Worship of the Argentine Republic, to Philippe Gautier, Registrar of International Tribunal for the Law of the Sea (Sept. 11, 2012, available at [http://www.itlos.org/fileadmin/itlos/documents/cases/case\\_no.20/C20-Request\\_for\\_official\\_website.pdf](http://www.itlos.org/fileadmin/itlos/documents/cases/case_no.20/C20-Request_for_official_website.pdf); Request for The Prescription of Provisional Measures Under Article 290, Paragraph 5, of the United Nations Convention on the Law of the Sea, (Nov. 14, 2012), available at [http://www.itlos.org/fileadmin/itlos/documents/cases/case\\_no.20/C20-Request\\_for\\_official\\_website.pdf](http://www.itlos.org/fileadmin/itlos/documents/cases/case_no.20/C20-Request_for_official_website.pdf).

<sup>40</sup> *List of Cases*, INTERNATIONAL TRIBUNAL FOR THE LAW OF THE SEA, <https://www.itlos.org/index.php?id=35> (listing only twenty-one cases in the Tribunal’s history).

<sup>41</sup> *Id.*

<sup>42</sup> See, e.g., (the “Monte Confurco” case) (Seychelles v. France), Case No. 6, Judgment of December 18, 2000, ITLOS Rep. 2000, ¶¶ 27-30.

<sup>43</sup> Letter from Hector Timerman, Minister of Foreign Affairs and Worship of the Argentine Republic, to Philippe Gautier, Registrar of International Tribunal for the Law of the Sea (Sept. 11, 2012, available at [http://www.itlos.org/fileadmin/itlos/documents/cases/case\\_no.20/C20-Request\\_for\\_official\\_website.pdf](http://www.itlos.org/fileadmin/itlos/documents/cases/case_no.20/C20-Request_for_official_website.pdf); Request for The Prescription of Provisional Measures Under Article 290, Paragraph 5, of the United Nations Convention on the Law of the Sea, (Nov. 14, 2012), available at [http://www.itlos.org/fileadmin/itlos/documents/cases/case\\_no.20/C20-Request\\_for\\_official\\_website.pdf](http://www.itlos.org/fileadmin/itlos/documents/cases/case_no.20/C20-Request_for_official_website.pdf); *The Tribunal*, INTERNATIONAL TRIBUNAL FOR THE LAW OF THE SEA, <https://www.itlos.org/index.php?id=15>.

<sup>44</sup> The United Nations Convention on the Law of the Sea, Annex VI, ¶ 34, December 10, 1982 (“Unless otherwise decided by the Tribunal, each party shall bear its own costs.”).

UNCLOS)<sup>45</sup> can point to such spectacles to say, “See, if we sign on we could get sued by some crazy hedge fund.” It also forces public confrontation among nation states at the behest of private parties (e.g., Argentina had to sue Ghana, a country with which it was experiencing perfectly cordial relations).<sup>46</sup>

These costs make it difficult to dismiss the convening of the ITLOS as harmless and fully internalized conduct. On the contrary, it shows that vulture funds’ litigious impulses can have real and serious adverse consequences. If that is so, the primary reason for which they initiate such international actions, namely, to gain leverage in their holdout negotiations, must be re-analyzed through the lens of cost-imposition onto other actors.

\* \* \*

Taking these two propositions together—the incentive for vulture fund holdout and the amenability of those funds to initiate litigation to assist their holdout strategy—we should predict a high number of vulture fund lawsuits in sovereign debt restructurings. Whether we actually see that, though, is unclear, because available evidence suggests that much sovereign debt is restructured with minimal acrimony.<sup>47</sup> That said, the trend line is worrisome according to the

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<sup>45</sup> *Chronological Lists of Ratifications of, Accessions and Successions to the Convention and the Related Agreements As of 23 January 2013*, UNITED NATIONS DIVISION FOR OCEAN AFFAIRS AND THE LAW OF THE SEA, (Jan. 23, 2013). [https://www.un.org/Depts/los/reference\\_files/chronological\\_lists\\_of\\_ratifications.htm#The United Nations Convention on the Law of the Sea](https://www.un.org/Depts/los/reference_files/chronological_lists_of_ratifications.htm#The%20United%20Nations%20Convention%20on%20the%20Law%20of%20the%20Sea).

<sup>46</sup> See *Ghana To Ensure Release of Argentine Navy Ship*, Government of Ghana Official Website, Dec. 17, 2012 at 8:05, (last visited March 29, 2012), available at <http://www.ghana.gov.gh/index.php/news/general-news/18548-ghana-to-ensure-release-of-argentine-navy-ship> (noting the government’s statements that “[i]t is pertinent to recall that the arrest of the Argentine vessel arises from a dispute between Argentina and a *private foreign company*” . . . and the “Government of Ghana has always maintained that it does not consider itself to be in dispute with Argentina”) (emphasis added).

<sup>47</sup> MONETARY AND CAPITAL MARKETS DEP’T OF THE INT’L MONETARY FUND, *A SURVEY OF EXPERIENCES WITH EMERGING MARKET SOVEREIGN DEBT RESTRUCTURINGS* 11 (2012) (noting that the number of litigated cases remains low, participation rates remain high, and bond restructurings have generally been faster than restructurings with banks).

recent empirical data.<sup>48</sup> Moreover, even if the absolute litigation rate is low, the relative one is high;<sup>49</sup> that is, even if there's not a lot of litigation out there yet, when there *is* litigation, the vulture funds are frequently present, and their rising prevalence in holding publicly issued sovereign debt predicts a worsening of the problem.

Indeed, it is the still-relative infrequency of litigation that ironically exacerbates the negative influence of vulture funds. The problem is because there is such a thin precedent book, there's no comfort zone of relevant case law for judges to fall back upon when presented with a legal challenge by such a tenacious litigant. Judges are nevertheless asked to make important policy decisions in one-off interventions that occur every few years, a task to which they are poorly suited. The litigiousness of vulture funds exacerbates this problem.<sup>50</sup> As the funds become increasingly emboldened to start lawsuits all around the world, they are dragging the enforcement of sovereign debt into the courtrooms rather than the halls of the IMF.<sup>51</sup> Judges can't hide from these cases, and there is no reason to believe vulture funds will drop their lawsuits without having succeeded in extorting a higher payout.

Doubtless stemming from this lack of experience and familiarity, courts of general jurisdiction— at least in the United States— can botch things up. The widespread criticism of the *NML v. Argentina* proceedings provides a case in point.<sup>52</sup> Indeed, the court at several times was

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<sup>48</sup> Julian Schumacher, Christoph Trebesch, Henrik Enderlein, *Sovereign Defaults in Court: The Rise of Creditor Litigation 1976-2010*, at 3 (December 16, 2012), Working Paper, available at <http://ssrn.com/abstract=2189997> or <http://dx.doi.org/10.2139/ssrn.2189997>. (“Compared to the 1980s, the likelihood that a debt crisis is accompanied by creditor litigation has more than doubled in recent years, to more than 30% in the 2000s.”).

<sup>49</sup> MONETARY AND CAPITAL MARKETS DEP'T OF THE INT'L MONETARY FUND, *A SURVEY OF EXPERIENCES WITH EMERGING MARKET SOVEREIGN DEBT RESTRUCTURINGS* 1, 12 (2012) (noting that “creditor coordination and holdouts have not generally been a problem”).

<sup>50</sup> *Id.* at 12.

<sup>51</sup> *Id.*

<sup>52</sup>; INTERNATIONAL MONETARY FUND, *SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK*, 31 (2013); Mark C. Weidemaier, *Sovereign Debt after NML v. Argentina*, 8 *CAP. MKTS.*

at pains to point out it would be much better if there was an organized collective proceeding, like a bankruptcy, to resolve the dispute,<sup>53</sup> almost as if it resented having to adjudicate a restructuring through the agenda-setting of one creditor. For those jurisdictions without specialized insolvency or business tribunals, confronting sovereign debt problems in the posture of a general civil action for breach of contract is especially awkward.<sup>54</sup>

In the *NML* case, a striking example of the lack of familiarity shown to matters of debt default comes from the Second Circuit and SDNY's treatment of the *pari passu* clause with Argentina.<sup>55</sup> As discussed already above, the most troubling policy outcome with this case is the perverse holdout incentive it creates by paying the holdouts *more* than the cooperators. Brushing aside the concerns of the United States as *Amicus curiae*, the lower court expressed mystification as to why there was a holdout problem at all: any "holding out," it reasoned, was largely a consequence of Argentina's staunch refusal to make payment on its defaulted bonds, not the recalcitrance of the vulture funds.<sup>56</sup> If you just capitulated and paid, implied the court, you wouldn't have a holdout problem anymore(!).

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L. J. 123 (2013). Cf. Romain Zamour, *NML v. Argentina and the Ratable Payment Interpretation of the Pari Passu Clause*, 38 Yale L.J. 55, 55-56 (2013) ("When the Second Circuit affirmed Judge Griesa's orders, many commentators announced the end of sovereign debt restructuring as we know it.") (arguing that this widespread "alarmist interpretation" is unwarranted).

<sup>53</sup> Amended February 23, 2012 Order, at 3-4 *NML Capital Ltd. v. Republic of Argentina* (Nov. 21, 2012) (08 Civ. 6978 TPG) ("The public interest of enforcing contracts and upholding the rule of law will be served by the issuance of this Order, particularly here, where creditors of the Republic have no recourse to bankruptcy regimes to protect their interests and must rely upon courts to enforce contractual promises."), available at <http://www.shearman.com/files/upload/Arg5-Order-112112.pdf>.

<sup>54</sup> Commercial List in Toronto, Ontario Courts, Superior Court of Justice (last visited March 29, 2013 at 11:50), available at [http://www.ontariocourts.ca/scj/en/notices/pd/toronto/commercial\\_list\\_2010.htm](http://www.ontariocourts.ca/scj/en/notices/pd/toronto/commercial_list_2010.htm) ("Established in Toronto in 1991, the Commercial List is comprised of a team of judges who have experience in managing complex commercial litigation.").

<sup>55</sup> See *NML Capital Ltd. v. Republic of Argentina*, 699 F.3d 246, 257-61 (2d Cir. 26, 2012).

<sup>56</sup> *NML Capital Ltd. v. Republic of Argentina*, 699 F.3d 246, 263-65 (2d Cir. 26, 2012) ("Nor will the district's court's judgment have the practical effect of enabling 'a single creditor to thwart the implementation of an internationally supported restructuring plan' . . . as '[i]t is up to the sovereign—not 'any single creditor'—whether it will repudiate that creditor's debt in a manner that violates a *pari passu* clause.")

Bracketing for the moment whether the court was serious in this comment (there is more to this case than meets the eye),<sup>57</sup> let's assume, just for sake of argument, the court really thought there was not a holdout problem afoot. That's astonishing. Saying they'll go away if you just pay them a bit more than all the others *is what a holdout problem is*. Accordingly, if we take the court at its word— that it really doesn't see any holdout problem— then we have a vivid illustration of generalist courts that don't see lots of bankruptcy actions “getting it wrong,” relying upon reasoning most steeped in bankruptcy law would consider absurd.<sup>58</sup>

As such, the real problem of private enforcement of sovereign debt by vulture funds is not just the gratuitous invocation of international judicial apparatuses, but the development of a lurching, disorganized, ad hoc casebook of judicial precedent on sovereign debt, all spun out by busy jurists who have little expertise on the subject matter. That leads to bad legal outcomes, or at the very least naïve legal outcomes.<sup>59</sup> Worse, if the merits of the *NML* case are allowed to stand, the incentive for these holdouts has just increased astronomically, auguring a worsening of the trend.<sup>60</sup> (The fallout in the sovereign debt market has been panic-stricken; even the IMF has

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<sup>57</sup> As the exasperated judges of the Second Circuit complained, Argentina's conduct has hardly instilled confidence in the rule of law and the vindication of commercial expectations. *NML Capital, Ltd. v. Republic of Arg.*, No. 03 Civ. 8845 (TPG), 2011 U.S. Dist. LEXIS 99502, at \*24 (S.D.N.Y. 2011) (“The difficulties involved result solely from the failure of the Republic to honor its legal obligations in a normal, direct manner.”).

<sup>58</sup> I don't want to pick on the *NML* courts too much. Indeed, there is repeated reference to the true problem being the lack of a CAC. See, e.g., *NML Capital Ltd. v. Republic of Argentina*, 699 F.3d 246, 253-65 (5<sup>th</sup> [?] Cir. 2012).

<sup>59</sup> One hastens to jump on the bandwagon criticizing the opinion – I'll leave the United States as *Amicus Curiae* to carry that charge. Brief for the United States of America as *Amicus Curiae* in Support of Reversal at 1-4, *NML Capital, LTD. v. Banco Cent. de la Republica Arg.*, 652 F.3d 172 (2011) (Nos. 10-1487-cv(L), 10-1488-cv(CON), 10-1493-cv (CON), 10-1507-cv(CON), 10-1510-cv(CON), 10-1524-cv(CON), 10-1529-cv(CON), 10-1545-cv(CON), 10-1603-cv(CON), 10-1629-cv(CON)). – but to give an idea of the depth of the academic opposition, consider W. Mark C. Wedemaier, *Sovereign Debt After NML v. Argentina*, Capital Markets L.J. (discussing *pari passu* clause interpretation as jarringly ahistorical and contrary to widespread international interpretation).

<sup>60</sup> Be careful what I wish for: I could get the very field of jurisprudence for which I purportedly long.

fretted that *NML* will “give holdout creditors greater leverage.”<sup>61</sup> This concern doesn’t even get into the problem of potentially conflicting judgments from different tribunals on, e.g., the proper contractual interpretation of a given clause in a bond issuance (although the choice of law and forum clauses help mute that problem somewhat, albeit it at the cost of concentrating it all on New York law, as now interpreted by the Second Circuit). Leaving aside political viability, one benefit from a SDRM framework would at the least be an evolving coherent jurisprudence, something the unfolding status quo inhibits.<sup>62</sup>

Accordingly, sovereign debt restructuring faces a continued and ongoing problem of how to deal with holdouts, even in an age of the CAC. The presence of vulture funds crystallizes this theoretical potential in a way that has not just the direct negative consequence of the holdout qua holdout, but of the indirect problems stemming from a robust litigation appetite that leads to the inappropriate use of a fragile international legal framework and the development of a potentially disruptive ad hoc book of legal precedent in domestic courts. The time is thus ripe for private-fund-directed reform.

### **III. An International Certification Board for Sovereign Debt Restructuring.**

Before turning to the certification board proposal, we must pause to ask whether the forgoing discussion has proved too much. That is, if all these evils with vulture funds are so, then why not return to the ever-beckoning bandwagon and join the policy proposals that seek to

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<sup>61</sup> INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND’S LEGAL AND POLICY FRAMEWORK, 31 (2013). See also Anna Gelpern, *Italy’s Pari Passu Scrubbing*, CREDIT SLIPS (April 17, 2013 12:17 AM) <http://www.creditslips.org/creditslips/>.

<sup>62</sup> David A. Skeel, Can Majority Voting Provisions Do It All?, 52 Emory L.J. 417, 421 (2003) (noting that the potential for “thriving good faith jurisprudence withered on the vine” after majority voting provisions, such as CACs, became obsolete for U.S. corporations following Congress’s codification of a large scale corporate reorganization framework in the 1930s). See also Patrick Bolton and David A. Skeel, Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?, 53 Emory L.J. 763 (2004).



curtail the rights of these funds to sue for private enforcement of sovereign debt upon default?<sup>63</sup> After all, the simplest and most direct solution to a perceived danger of vulture fund litigation would surely be to clamp down on such lawsuits directly. If the market doesn't do so itself (with the promulgation of litigation-vote clauses or vesting litigation powers in indenture trustees), there are plentiful ways this could be done by the state: buffing up immunity doctrines, resurrection of champerty laws, etc.

The problem is overdeterrence. Sometimes these funds do provide a valuable monitoring function, as others before have eloquently demonstrated.<sup>64</sup> Consider for a recent example the healthy role of vulture funds in the recent private-law insolvency case of *Vitro* in Mexico.<sup>65</sup> Although *Vitro* was a private company, it was a big enough player that analysis of the case within a discussion of sovereign debt is not inappropriate. In *Vitro*,<sup>66</sup> the Mexican company proposed a *concurso* plan that sought to cut around half the bondholder debt but allow equity to retain much of its interest.<sup>67</sup> It did so pursuant to a majority vote of creditors, but those creditors included inter-company obligations (allegedly manufactured by the debtor to gerrymander the vote), including the debts of solvent debtor subsidiaries that would have their guarantees to the

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<sup>63</sup> See *supra*, Part II.

<sup>64</sup> See Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 Emory L.J. 1043, 1046 (2004) (“Holdout creditors, by refusing to participate in restructurings of sovereign debt, serve as a check on opportunistic defaults and onerous restructuring terms, . . . may limit collusive behavior among the majority of creditors,” . . . and may “promote the functioning of the international capital markets.”).

<sup>65</sup> I did some paid legal work in the *Vitro* case, so my analysis in the text above should perhaps be tempered by this disclosure. Then again, now that that legal work is informing my scholarship, maybe I should claim any unreimbursed expenses in that consulting from my academic research account at the university! (I hereby dub this type of argument an “ethical double-down.”)

<sup>66</sup> See *In re Vitro S.A.B. de C.V.*, 473 B.R. 117 (Bank N.D. Tex. June 13, 2012), *aff'd*, 701 F.3d 1031 (5th Cir. Nov. 28, 2012),

<sup>67</sup> See *Ad Hoc Grp. of Vitro Noteholders v. Vitro SAB de CV (In re Vitro SAB de CV)*, 701 F.3d 1031, 1036-1040 (5<sup>th</sup> Cir. 2012).

bondholders extinguished.<sup>68</sup> There, it was investment consortia—including vulture funds—that blew the whistle and challenged the Mexican proceedings in U.S. court.<sup>69</sup> (Actually, per the previous observations on vulture fund litigation appetite, they did so everywhere—Mexico, the U.S., both state and federal court<sup>70</sup>—you name it.)

Particularly telling in that case was how the Mexican debtor tried to demonize the funds. For example, it argued that the bondholders shouldn't whine about their treatment under Mexican law because some of them, like vulture funds, bought the debt at a steep discount well after default.<sup>71</sup> Yet the funds were ultimately vindicated, from bankruptcy court up to the Fifth Circuit,<sup>72</sup> true to the predictions of those who say these investment funds can serve an important monitoring function, whether through policing debtor misconduct or exposing behavior that tramples on the rights of minority stakeholders. The funds in *Vitro* protected significant value for retail and other investors. As mentioned, *Vitro* is not a sovereign case (at least not nominally, although there was apparently some dispute about the extent to which Mexican governmental thumbs were on the scales). Still, it serves as a stark illustration of the “good” side of vulture funds: scrappy litigants who won't roll over when told that “that's just the way the law works over here.” This is wholly in addition to the market-facilitating role some say they serve in simply speeding things along by entering and then exiting an investment contingent on

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<sup>68</sup> *Id.* at 1037, 1067.

<sup>69</sup> *Id.* at 1040.

<sup>70</sup> *Id.*

<sup>71</sup> Supplemental Opening Brief of Appellant *Vitro*, S.A.B. de C.V., *In re Vitro*, 701 F.3d 1031 (5th Cir. Sept. 28, 2012) (No. 12-10689), 2012 WL 4839064 at 25 (stating that the appellee creditors are “sophisticated distressed debt investment funds that took a calculated and ultimately unsuccessful risk that they could obtain greater profits by purchasing Old Notes at a discount” and are now “using them to block *Vitro* SAB's restructuring”).

<sup>72</sup> See *In re Vitro*, 701 F.2d at 1069-1070.

confirmation of a plan: if they have an exit strategy, they will keep the pressure on for plan confirmation.<sup>73</sup>

Reconsidering Argentina, we must ask ourselves which narrative applies. On the one hand, a picture has been painted of a voracious litigant willing to take matters all the way to the high seas to hunt down extraterritorial assets of a defaulting sovereign. But on the other hand, Argentina's recalcitrance is well known.<sup>74</sup> In fact, even under the well-respected regime of the International Centre for Settlement of Investment Disputes ("ICSID")<sup>75</sup>— where all sorts of countries who are hardly poster children for the rule of law cough up awards— Argentina has steadfastly refused to pay when losing (on the theory that no-one has come to Argentina and asked to domesticate such an award).<sup>76</sup> The Lock Law and its suspension hardly evince a willingness to negotiate with remaining creditors, and the senior governmental officials' repeated, almost gleeful announcements that they have no intention whatsoever of paying any old debtholders seems verging on anarchic, especially in light of the country's improved economic circumstances and payment ability.<sup>77</sup> Were this a question of odious debt,<sup>78</sup> different

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<sup>73</sup> Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 Emory L.J. 1043, 1047 (2004).

<sup>74</sup> Luke Eric Peterson, *Argentine Crisis Arbitration Awards Pile Up, but Investors Still Wait for a Payout*, LAW.COM (June 25, 2009) (last visited March 29, 2013 at 6:42pm), available at <http://www.law.com/jsp/law/international/LawArticleIntl.jsp?id=1202431736731&thepage=1&slreturn=20130229183938>. (noting that even after a ICSID ordered Argentina to pay \$133.2 million to an ICSID award-holder, Argentina refused saying that award-holders "should bring the award to an Argentine court for recognition and enforcement").

<sup>75</sup> ICSID recently determined, for the first time, that it has jurisdiction to hear sovereign default claims under a Bilateral Investment Treaty. *Abaclat and Others v. The Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissability, ¶ 713 (August 4, 2011). See also See Jessica Beess und Chrostin, Note, *Sovereign Debt Restructuring and Mass Claims Arbitration before the ICSID, The Abaclat Case*, 53 Harv. Int'l L.J. 505 (2012), available at <http://www.harvardilj.org/wp-content/uploads/2010/05/HLI206.pdf> (noting that *Abaclat* is the first case of its kind). It is possible that the use of international arbitration to resolve sovereign debt disputes will increase as a result.

<sup>76</sup> Peterson, *supra* n. 82.

<sup>77</sup> *NML Capital v. Argentina*, 2012 U.S. Dist. LEXIS 168292 at \*8-9 (S.D.N.Y. Nov. 21, 2012) ("From the moment of the October 26, 2012 Court of Appeals' decision, the highest officials in Argentina have declared that Argentina

moral concerns might be engaged,<sup>79</sup> but Argentina seems to take the position that her intransigence is *pour encourager les autres* not to hold out: NML had its chance, got greedy, and so now has to pay the price.<sup>80</sup>

Judge Griesa's exasperation with the Republic is thinly veiled and drips from the pages of the Federal Reporter.<sup>81</sup> This anger harkens back to the prior point of whether he really doesn't think there's a holdout problem in this case. An alternative and equally likely interpretation is that the judge thinks that any holdout problem is trivial in comparison to the flagrant contempt for legal process, including his own orders, shown by Argentina.<sup>82</sup> This view would be consistent with a narrative that frames Argentina less as the victim of voracious ship-scavenging vultures and more as abusive, Vitro-like (vitreous?) juggernauts stampeding over the rights of creditors. The question, then, for a proposal to change the sovereign debt collection system is

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would pay the exchange bond-holders but would not pay one dollar to holders of the original FAA Bonds" . . . and . . . "[t]he Minister of Economy, Lorenzino, declared that despite *any ruling to come out of any jurisdiction*, Argentina would not pay the FAA bondholders." (emphasis added).

<sup>78</sup> See Robert K. Rasmussen, *Sovereign Debt Restructuring, Odious Debt, and the Politics of Debt Relief*, 70 *Law & Contemp. Probs.* 249, 249 (2007) ("The central intuition [behind odious debt] is that the citizens of a country should not have to pay for the debts incurred by a prior "odious" regime when those funds did not benefit these citizens."). See also Lee c. Buchheit, G. Mitu Gulati, and Robert B. Thompson, *The Dilemma of Odious Debts*, 56 *Duke L.J.* 1201, 1218 (2007) (summarizing Alexander Sack's 1927 formulation of odious debt as sovereign lending that is (1) "contracted by a despotic power," (2) "for a purpose that is not in the general interests or needs of the state," and that (3) "the lender knows that the proceeds of the debt will not benefit the nation as a whole").

<sup>79</sup> See Arturo C. Porzecanski, *When Bad Things Happen to Good Sovereign Debt Contracts: The Case of Ecuador*, 73 *Law & Contemp. Probs.* 251, 256 (2010) (describing Ecuador's choice to default on its loans, which likely could have been repaid, when the then populist Ecuadorian government declared the sovereign bonds "immoral and illegitimate").

<sup>80</sup> See Agustino Fontevicchia, *The Real Story of How a Hedge Fund Detained a Vessel In Ghana and Even Went for Argentina's 'Air Force One'*, *Forbes.com*, available at <http://www.forbes.com/sites/afontevicchia/2012/10/05/the-real-story-behind-the-argentine-vessel-in-ghana-and-how-hedge-funds-tried-to-seize-the-presidential-plane/>

<sup>81</sup> See *supra* note 32 and accompanying text.

<sup>82</sup> Argentina's flagrant comments that it would contravene *any* negative outcome it receives in the New York federal courts undoubtedly only poured more gas on Griesa's inflamed concern over Argentina's defiance. Judge Griesa noted: "For the past ten years, Argentina has repeatedly submitted matters to the District Court and the Court of Appeals, and received what was undoubtedly fair treatment, since Argentina prevailed in most matters." *Id.* If Argentina did not back away from these "ill-advised threats," he continued, Argentina's defiance would "not only be illegal but would represent *the worst kind of irresponsibility in dealing with the judiciary.*" *Id.* (emphasis added).

how to decide whether a vulture fund is being “good” or being “bad.” Judge Griesa clearly thought NML was being good (or, perhaps more accurately, better than Argentina),<sup>83</sup> but what are we to make with his seemingly poor familiarity with the concept of a holdout problem?

The conceit of this article is to try to offer a new proposal that captures the good side of fund behavior but curbs its bad side. Great work has been done already in this area offering reform proposals,<sup>84</sup> and so the additional contribution of this article is modest. It is also mindful of the pragmatic and political impediments to some of these theoretically attractive proposals, such as the SDRM. (If it was a good idea in the early 2000s, it’s an even better idea now post (intra?) Great Recession.) The IMF, for example, has previously noted the theoretical attractiveness of the SDRM, stating that it “preserves the economic value of assets and facilitates a return to medium-term viability, and thereby reduces the costs of the restructuring process” and “should also be expected to improve the functioning of the capital markets.”<sup>85</sup> The Fund has recently been forced to concede, however, that the proposal “received considerable support within the Board, but failed to command the majority needed to amend the Fund’s Article of Agreement due to the members’ reluctance to surrender the degree of sovereignty required to establish such a framework.”<sup>86</sup> Accordingly, the time has come for modest innovation to move down the road to SDRM but recognize the reality that that destination is a long way off.

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<sup>83</sup> See *NML Capital Ltd. v. Republic of Argentina*, 699 F.3d 246, 263-64(5th Cir. 26, 2012).

<sup>84</sup> See Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 *Emory L.J.* 1043 (2004); A. Mechele Dickerson, *A Politically Viable Approach to Sovereign Debt Restructuring*, 53 *Emory L. J.* 997 (2004); David A. Skeel, Jr., *Can Majority Voting Provisions Do It All?*, 52 *Emory L.J.* 417 (2003); Hal S. Scott, *A Bankruptcy Procedure for Sovereign Debtors?*, 37 *Int’l Law.* 103 (2003); Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 *Cornell L. Rev.* 956 (2000); Daniel K. Tarullo, *Neither Order Nor Chaos: The Legal Structure of Sovereign Debt Workouts*, 53 *Emory L.J.* 657 (2004); Anna Gelper, *Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt*, 121 *Yale L.J.* 888 (2012).

<sup>85</sup> INTERNATIONAL MONETARY FUND, *PROPOSED FEATURES OF A SOVEREIGN DEBT RESTRUCTURING MECHANISM 2* (2003).

<sup>86</sup> INTERNATIONAL MONETARY FUND, *SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND’S LEGAL AND POLICY FRAMEWORK 12-13* (2013).

The preference for a more modest policy innovation than, for example, a supranational sovereign debt insolvency tribunal is not a coward's slide to second best. It is driven by a sentiment akin to that expressed in Professor Tarullo's article about the virtues of the unspecified and the inchoate in international matters such as sovereign debt restructuring.<sup>87</sup> Sometimes when consensus is difficult to achieve, matters are best elided and left for a later day when resistance may have changed. In this vein, it may actually be not all that bad that we don't yet have an SRDM. Maybe we're just not ready for it yet. If so, then ad hoc incrementalism may be the best recipe.<sup>88</sup>

Accordingly, given that the holdout problem is unlikely to be solved anytime soon by a broadly adopted macro-level policy proposal (except maybe regionally—keep trying, Europe!),<sup>89</sup> a different approach might be to try a much more modest next step: a Board of Certification for sovereign debt restructuring proposals. The idea would be to give such a Board the power to “bless” a sovereign's proposal as generally complying with standards of procedural fairness and minority protection, following kind of an aggregated customary international law of financial default.<sup>90</sup> It would do so in broad terms only and deliberately eschew getting into the details of whether the absolute haircut demanded is too much (or not enough) for the creditors to bear. The

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<sup>87</sup> See Daniel K. Tarullo, *Neither Order Nor Chaos: The Legal Structure of Sovereign Debt Workouts*, 53 *Emory L.J.* 657 (2004). There is some evidence, however, that arbitrators may use precedent more, or at least differently, than is commonly believed, in what has affectionately been called “judging-lite.” Mark C. Weidemaier, *Judging-Lite: How Arbitrators Use and Create Precedent*, 90 *N.C.L. Rev.* 1091, 1092-1094 (2012).

<sup>88</sup> If the reader won't gag at a self-citation, this is a point I have made on cross-border corporate debt restructuring. JOHN A. E. POTTOW, *PROCEDURAL INCREMENTALISM: A MODEL FOR INTERNATIONAL BANKRUPTCY* (2005). (advocating incremental reform efforts of procedural focus as first-stage development of international business laws).

<sup>89</sup> INTERNATIONAL MONETARY FUND, *SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK* 37 (2013) (mentioning the possibility of a European Crisis Resolution Mechanism).

<sup>90</sup> The Certification Board builds on prior proposals suggesting that sovereigns and creditors abide by a code of conduct in their negotiations. See, e.g., BETRAND COUILLANT & PIERRE-FRANCOIS WEBER, *TOWARDS A VOLUNTARY CODE OF GOOD CONDUCT FOR SOVEREIGN DEBT RESTRUCTURING* 154 (2003). However, a Certification Board would go beyond present proposals in that, rather than asking the parties to follow a code of conduct out of their own good consciences, the Certification Board would play a monitoring and enforcing role (albeit only with the powers of reputational constraints and extremely soft law).

Board would thus be remedially toothless. For example, it would have no power to compel compliance or resolve priority disputes. Those matters would have to await whatever judicial processes the parties might choose to engage. To be sure, the Board could perhaps have rosters of arbitrators that parties to a dispute related to the sovereign debt might avail themselves,<sup>91</sup> but the Board would be, by design, nonadjudicatory. The reason for this hobbling-by-design is that international institutions tend to garner support in inverse proportion to the power they wield. In this sense, the Board would occupy a middle ground between a statutory (SDRM) and market-based (CAC) approach, with the atmospherics of the former but the party autonomy of the latter.<sup>92</sup>

Just what could such a Board actually do, then? That is, if by design the Board is to be defanged of any adjudicatory power, will it be able to have any relevance in the rough and tumble state of nature of sovereign debt default? Tentative yes: the Board can have an impact. First, it is worth noting that the Corporation of Foreign Bondholders and the Foreign Bondholders Protective Council carried great weight in recommending settlements with U.K. sovereign bondholders even though they had no authority to commit individual creditors to anything.<sup>93</sup> (They are surely inspirations for the Gitlin and House idea of a “Sovereign Debt Forum” to facilitate inter-creditor communication.)<sup>94</sup> The stamp of approval by a respected

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<sup>91</sup> Christoph G. Paulus, *A Standing Arbitral Tribunal as a Procedural Solution for Sovereign Debt Restructurings*, in *Sovereign Debt and the Financial Crisis: Will this Time be Different?* 317-327 (Carlos A. Primo Braga & Gallina A. Vincelette, eds. 2011), available at [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2010/12/07/000333037\\_20101207001919/Rendered/PDF/582830PUB0ID231n0Debt09780821384831.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2010/12/07/000333037_20101207001919/Rendered/PDF/582830PUB0ID231n0Debt09780821384831.pdf).

<sup>92</sup> The Code of Conduct, similar in spirit, has been called a “comprehensive, non-statutory approach,” which might be as good a label as any. BERTRAND COUILLANT & PIERRE-FRANCOIS WEBER, *TOWARDS A VOLUNTARY CODE OF GOOD CONDUCT FOR SOVEREIGN DEBT RESTRUCTURING* 157 (2003).

<sup>93</sup> Wediemark, *Capital Markets* paper at 8, citing sources at fn 16.

<sup>94</sup> See Richard Gitlin and Brett House, *A Renewed Proposal for a Sovereign Debt Forum* (2013), available at <http://www.sauvescholars.org/uploads/A%20Renewed%20Proposal%20for%20a%20Sovereign%20Debt%20Forum%20-%2027Mar2013.pdf>.

entity can carry great weight in the investment world. Second, the Board can also have an impact even with more litigiously inclined investors. Consider that the chief role the Board could play is that its non-binding declarations of restructuring proposals being compliant (or non-compliant) with generally fair treatment of creditors could then be relied upon by non-expert, generalist judges in later domestic court proceedings who might be called upon to exercise judicial discretion. In systems that accord such judges wide discretion (e.g., perhaps arrest of a foreign vessel is a discretionary form of relief a libellant might seek, not an automatic right), that discretion can then be exercised in the light of knowing whether the sovereign has been playing fair or not and, by implication, whether the private party litigant, which we'll assume is a vulture fund, is a presumptive holdout. Creditors fighting such a "board-certified" restructuring can of course never be deprived of their pre-existing contractual and property rights; that would require some binding legal authority, such as a sovereign bankruptcy code, which is still quite some way off. But they will have to seek whatever legal relief they do want as either participants or non-participants in a board-certified (or uncertified) proceeding, with all the attendant atmospheric baggage that that status might entail.

To offer just one example, the certification proposal is a kindred spirit to the idea of "plain vanilla" financial products to be regulated by the new Consumer Financial Protection Bureau ("CFPB") in the United States.<sup>95</sup> Heterogeneous financial products are still permitted with few outright bans, but some that receive an administrative seal of approval will be protected by more favorable legal treatment. The comparison is not perfect, however, because the lack of

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<sup>95</sup> See About Us, Consumer Financial Protection Bureau, available at <http://www.consumerfinance.gov/the-bureau/> (last visited March 30, 2013 at 2:14pm) (describing the CFPB's mission as making "markets for consumer financial products and services work for Americans—whether they are applying for a mortgage, choosing among credit cards, or using any number of other consumer financial products"); see also Michael B. Mierzewski, Beth S. DeSimone, Jeremy W. Hochberg, and Brian P. Larkin, The Dodd-Frank Act Establishes the Bureau of Consumer Financial Protection As the Primary Regulator Of Consumer Financial Products And Services, 127 *Banking L.J.* 722 (2010) (providing an overview of the CFPB and its role in the regulation of consumer financial products).



a SDRM or other mechanism to provide firm legal consequences (be they carrots or sticks) for certification means that a certification's punch will necessarily be less significant than, for example, being a "qualified residential mortgage" by the CFBP,<sup>96</sup> but it's a start for an international world.<sup>97</sup> In fact, this lack of strong compulsive power might be seen as a cognate to the denuded authority a U.S. bankruptcy judge holds in a chapter 9 bankruptcy proceeding (for municipal and other public debtors).<sup>98</sup> Thus, the fact that certifications cannot "force" any legal outcome just means they are yet another form of soft—very soft—international law (perhaps even soft *non-law*?). But the international realm has long countenanced degrees of hardness in legal reforms,<sup>99</sup> and so international lawyers, one hopes, can readily anticipate certification by a respected board carrying some non-trivial weight. (Moreover, wholly apart from the certification itself is the process: the Board's procedure in reviewing a workout proposal will facilitate the transparent exchange of information and dialogue – hugely important requirements for efficient resolution of sovereign financial distress.)

The tougher question is even if, in the abstract, a certification could exert some softest of soft law effect on commercial actors, what about vulture funds, with their hardnosed litigation appetite? Will the vultures just thumb their beaks at its pronouncements? The quick answer is

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<sup>96</sup> Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 20, 6408 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt 1026) ("The Dodd-Frank Act provides that 'qualified mortgages' are entitled to a presumption that the creditor making the loan satisfied the ability-to- repay requirements," which provide that a mortgage lender must first "consider consumers' ability to repay home loans before extending them credit.").

<sup>97</sup> Cf. Marie Visot, Cyrille Lachèvre, and Anne Cheyvalle, Three Solutions to the Euro Zone Crisis, *Le Figaro.fr* (Brenna M. T. Daldorph, trans.) (Jan. 12, 2011, 5:48 p.m.), <http://plus.lefigaro.fr/note/three-solutions-to-the-euro-crisis-20111201-616031> (quoting one of the authors of the red- and blue-debt Eurozone scheme and summarizing the idea and dividing the public debts of each Eurozone country into two with the blue debt—considered senior and set a maximum of 60% GDP—always reimbursed first and the red debt—considered junior and compromising the debt going beyond 60% GDP—covered by the separate countries).

<sup>98</sup> Chapter 9: Municipality Bankruptcy, United States Courts, <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter9.aspx> (last visited March 30, 2012 at 3:10 pm) (describing a bankruptcy court's limited powers pursuant to Sections 903 and 904).

<sup>99</sup> See generally Michael Reisman, *The Concept and Functions of Soft Law in International Politics*, in *ESSAYS IN HONOUR OF JUDGE TASLIM OLAWALE ELIAS* (Emmanuel G. Bello and Bola A. Ajibola, eds. 1992).

we won't know 'til we try it. But we can have theoretical predictions, and even admitting the need for speculation, there is reason to believe there is a chance for impact. The basis for this optimism is the degree to which the current system substantially requires the exercise of discretionary judicial power.<sup>100</sup> Even if funds are impervious to norms, they do respect power. Already a suspicious class of plaintiffs, vulture funds will surely appreciate their disadvantaged status walking into court as opponents of a "board-certified" sovereign debt restructuring proposal.

Consider, indeed, the injunction as the quintessential equitable request at Anglo-American law. Assume that Judge Griesa had been confronted with injunction requests from NML *after* the hypothetical Board of Certification had approved the Argentine proposal as a legitimate conciliation of debts that 93% of creditors had gone along with it. While he may have come out the exact same way in his ruling, it is also possible that the creditors' then-exposed recalcitrance would make him view Argentina's own intransigence against these creditors in a different light. In fact, taking an innovative tool from U.S. bankruptcy law, an injunction-deciding judge might even adopt a reverse-injunction rule and enjoin holdout creditor collection actions until *after* creditors accepting haircuts are paid under a board-certified proposal.<sup>101</sup> This sort of "channeling injunction" sometimes used in U.S. mass-tort cases would be a way of designing a judicial hotchpot rule of the sort being considered by some reformers.<sup>102</sup> A judge

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<sup>101</sup> See 11 U.S.C. s. 508 (implementing common law hotchpot rule).

<sup>102</sup> See Eric D. Green, James L. Patton, Edwin J. Harron, Future Claimant Trusts and "Channeling Injunctions" To Resolve Mass Tort Environmental Liability In Bankruptcy: The Met-Coil Model, 22 Emory Bankr. Dev. J. 157, 161-62 (2005) (describing how a bankruptcy court can use a channeling injunction to satisfy the competing aims of "(1) providing companies with a comprehensive resolution of their liabilities and (2) protecting the interests of future claimants" by channeling "future claims not subject to discharge away from the debtor (and potentially the debtor's affiliates and insurers) into a trust that resolves the claims for future claimants"). See also *In re Johns-Manville Corp.*, 68 B.R. 618, 626 (Bankr. S.D.N.Y. 1986) (applying a channeling injunction in a situation where the debtor faced a flood of current and future asbestos-related litigation). Actually, the channeling would have the

worried about going out on a limb with such an innovation could always cite the existence of a certification as a comity-based justification for extraordinary judicial cooperation. (On the other side of the restructuring ledger – what would motivate a sovereign to seek board approval? – the worries are slighter. Sovereign debtors will fear market punishment, and there’s always the stick of IMF conditionality that could conceivably be brandished.)<sup>103</sup>

As for who should staff such a Board, presumable starting candidates might be the IMF or even World Bank, although there may be political reasons why they might be undesirable choices.<sup>104</sup> The UN— more specifically, UNCITRAL— might be another possibility. ICSID is another candidate. In contrast to the proposals of others who want to decentralize control onto the several states of the world,<sup>105</sup> this proposal embraces centralization, piggybacking off the reputation of some hoary international body, all the while making clear that the ensuing Board would have no adjudicatory capabilities.<sup>106</sup> (Technocrats are preferable to politicians.)

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effect of subordinating the holdouts claim, which implicates the different kettle of equitable subordination fish, but that’s another topic.

<sup>103</sup> This is what the Code of Conduct supporters recommended. BERTRAND COUILLANT & PIERRE-FRANCOIS WEBER, TOWARDS A VOLUNTARY CODE OF GOOD CONDUCT FOR SOVEREIGN DEBT RESTRUCTURING 160 (2003).

<sup>104</sup> The IMF and the World Bank have both been criticized (and praised) for their alleged pro-Western bias and their support of U.S. Strategic Interests. See, e.g., *Bribing Allies: The IMF and the World Bank Become Part of America’s Anti-Terrorist Arsenal*, *The Economist*, Sept. 29, 2001, available at <http://www.economist.com/node/800160> (noting various political uses of the IMF and the World Bank and the influence held over both organizations by the United States, but concluding that “such political decisions come at a price: they undermine the Fund’s credibility as a purely economic institution”).

<sup>105</sup> See Jay Lawrence Westbrook, A Comment on Universal Proceduralism, 48 *Colum. J. Transnat’l L.* 503, FN. 33, 44 (2010) (stating that dispute resolution should in some respects be decentralized because “local processing of claims addresses legitimate concerns that local creditors, especially consumers and other small creditors, cannot effectively press their claims in a distant forum”); Patrick Bolton and David A. Skeel, Jr., Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured, 53 *Emory L.J.* 763, 809-11 (2004) (proposing that existing corporate bankruptcy courts should serve as the institutional decisionmakers for a new sovereign insolvency framework).

<sup>106</sup> Anne O. Krueger, First Deputy Managing Director, International Monetary Fund at the National Economists’ Club Annual Members’ Dinner (Nov.26, 2001) (transcript available at <http://www.imf.org/external/np/speeches/2001/112601.htm>) (providing the initial SDRM proposal) ; Sean Hagan, Designing a Legal Framework to Restructure Sovereign Debt, 35 *Geo. J. Int’l L.* 299 (2005); Hal S. Scott, A Bankruptcy Procedure for Sovereign Debtors?, 37 *Int’l Law.* 103, 133-35 (2003) (proposing an SDRM-based

The tougher question to address is selecting the criteria by which a proposal would be rated for certification by the Board. One good initiative, from Governor Trichet, is the Code of Conduct for sovereign debt restructuring.<sup>107</sup> The Board could certify whether the proposal complies with the Code of Conduct. In general, the idea is to keep the criteria as procedurally and non-substantively focused as possible (straying far afield from those commentators who suggest fixed haircuts be written into law as a substantive requirement imposed on creditors).<sup>108</sup> Indeed, consider the criteria discussed in the Code of Conduct: matters such as whether the creditors were accorded representation rights, including the formation of a committee; whether the sovereign negotiated with stakeholders in good faith; etc.<sup>109</sup> Borrowing just for sake of argument some ideas from the U.S. Bankruptcy Code, it probably would not make sense to have a “best interest test” analysis,<sup>110</sup> which gauges what the creditors might get in a hypothetical liquidation. But there *can* be analysis of basic procedural safeguards in the reorganization context. This could take a page from the IMF’s playbook, which has upped its insistence on permitting creditor representation with requiring “good-faith effort” to negotiate with creditors (although qualifying that that can arise through informal consultation before a take-it-or-leave-it offering – or a “non-negotiated offer” as the Fund prefers to call it).<sup>111</sup>

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insolvency structure which would be administered by an international commission comprised by individuals chosen from a list of certified experts agreed to in advance).

<sup>107</sup> BETRAND COUILLANT & PIERRE-FRANCOIS WEBER, TOWARDS A VOLUNTARY CODE OF GOOD CONDUCT FOR SOVEREIGN DEBT RESTRUCTURING 154 (2003). But see Barry Herman, *Why the Code of Conduct for Resolving Sovereign Debt Crises Falls Short* (Graduate Program in Int’l Affairs at The New Sch., Working Paper 2008-02, 2008).

<sup>108</sup> DANIEL GROS AND THOMAS MAYER, TOWARDS A EURO(PEAN) MONETARY FUND 4-5 (2010)(criticizing the Code of Conduct approach).

<sup>109</sup> BETRAND COUILLANT & PIERRE-FRANCOIS WEBER, TOWARDS A VOLUNTARY CODE OF GOOD CONDUCT FOR SOVEREIGN DEBT RESTRUCTURING 157-59 (2003).

<sup>110</sup> 11 U.S.C. § 1129 (a)(7) (setting forth the best interest test in chapter 11 proceedings).

<sup>111</sup> INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND’S LEGAL AND POLICY FRAMEWORK 11 (2013).

Additionally, the Certification Board can decide whether there has been equal, non-discriminatory treatment of creditors, although this is an area where sovereign debt departs from purely private corporate debt restructuring. This last point is an area where some caution must be exercised. Sovereign debt workouts often have differential treatment, as seen just recently with the Seychelles and Belize.<sup>112</sup> Indeed, the Code of Conduct suggests public sector debt should be outright disenfranchised if “directly or indirectly owned or controlled by the sovereign issuer and its public sector,” which makes sense given the different stakes involved.<sup>113</sup> This is an area still in some flux, though: The IIF Principles at first suggested that private creditors should not be asked to restructure their debt without buy-in from public bilateral creditors to share the pain – which the IMF in characteristic understatement said “could prove controversial” – but later toned down its Principles in later 2012 (post-Greece, where there was much grumbling that domestic banks, who held half the debt, sold out on the cheap to stay in good with the government on whom they in turn might need support)<sup>114</sup> to insist only upon fair and equal treatment of all claims, meaning that no creditor group should be excluded *ex ante*.<sup>115</sup> The IMF thinks this initial stance is too strong and points out that “[i]n some cases, creditors may accept some differentiation in the treatment of their claims, either to better fit with individual creditor preferences or on the grounds that this would help limit the extent of economic dislocation,

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<sup>112</sup> Sovereign debt restructurings actually accord differential treatment with regularity to different stakeholders. For example, the Seychelles paid domestic and foreign creditors differently because of concerns over failure of the domestic banking sector, and Belize only restructured foreign debt but not domestically held debt. See INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND’S LEGAL AND POLICY FRAMEWORK, 27-28 (2013).

<sup>113</sup> BETRAND COUILLANT & PIERRE-FRANCOIS WEBER, TOWARDS A VOLUNTARY CODE OF GOOD CONDUCT FOR SOVEREIGN DEBT RESTRUCTURING 156 (2003).

<sup>114</sup> INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND’S LEGAL AND POLICY FRAMEWORK, 40-41 (2013).

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maintain market access and preserve financial stability.”<sup>116</sup> The point is not to resolve this hot potato issue right now, it is merely to observe that the Certification Board could assess whether, once the potato has cooled and a consensus standard emerges (and we will get there), compliance has been achieved.<sup>117</sup>

Other areas where the Board might weigh in could be general comportment with the principles of absolute priority (which would arise with quasi-sovereign entities like banks, a question that in turn would depend on the Board’s scope). For secured creditors, too, attention can be paid to the adequate preservation of liens, etc. Even with thorny issues, such as priorities, the Board could possibly decide whether any claim inversion is appropriate, perhaps following local insolvency law. The Board might even get into the sustainability question, delving into insolvency vs. liquidity distress, but that might be getting into matters that are too delicate. The point is for this to be light-touch analysis.<sup>118</sup>

The hardest thing might be questions of valuation and sustainability. That is, the gist of the moral hazard concern in sovereign debt default is whether the sovereign can pay its debts but just doesn’t want to.<sup>119</sup> The Board could weigh in on this, perhaps using an open-ended standard of “financial distress,” as opposed to a harder-line balance sheet analysis, consistent with the

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<sup>116</sup> INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND’S LEGAL AND POLICY FRAMEWORK, 41 (2013).

<sup>117</sup> Similar consideration must be given to whether to treat voluntary from involuntary creditors differently in the restructuring process. Cf. 11 U.S.C. 507 (according priority to some, but not all, involuntary creditors). One wonders whether a nation should be able to discharge the claims of certain involuntary creditors, such as victims of state-sponsored terrorism and other torts. Cf. *Ben-Rafael v. Islamic Republic of Iran*, 540 F. Supp. 2d 39, 43 (D.D.C. 2008) (awarding damages to a group of survivors of the AMIA bombing).

<sup>118</sup> The Board could of course complement myriad other proposals, such as Gros and Mayer’s idea of a Creditor Registry for Eurobonds DANIEL GROS AND THOMAS MAYER, TOWARDS A EURO(PEAN) MONETARY FUND 5 (2010).

<sup>119</sup> Steven L. Scharcz, *“Idiot’s Guide” to Sovereign Debt Restructuring*, 53 Emory L.J. 1189, 1194 (2004).

flexibility-favoring approach of the IMF.<sup>120</sup> This wanders, however, into factually disputed issues from which the Certification Board ought to steer clear. But even so, many defaults are so clearly the consequence of financial distress it is hard to envision serious dispute.<sup>121</sup> Would anyone doubt Argentina was in financial distress back in 2001? Again, a U.S. analogy might provide some instruction, such as to the gatekeeping factors to a chapter 9 municipal reorganization that must be shown to establish a good-faith need to restructure debt.<sup>122</sup> (The hard case is odious debt default; I am candidly uncertain whether I would suggest the Board to assess odiousness, which seems straying perhaps too far from the technocratic to the political.)<sup>123</sup>

One thing that ought to be beyond the Board's purview would be mediating a priority dispute across different bond issuances. Suppose a default trigger would launch a subsequent issuance into priority over a prior issuance. Getting the Board in the middle of deciding the (surely contested) issue of the triggering event might mire it into the powerful side-picking from which this proposal tries to spare it. If the Board gets involved in dispute resolution, it loses its capacity of being an above-the-fray arbiter of generic fairness. Two possible solutions could work around this concern. First, the Board could conceivably get into contingent certification (*i.e.*, if X, then Y is fair, etc.), but that might be logistically too complicated. Alternatively, the Board could recommend (even endorse) specific claims-ranking disputes to be sent to international arbitration. The advantage of arbitration (apart from the generic ADR benefits of

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<sup>120</sup> INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK 9-10 (2013).

<sup>121</sup> Again borrowing from the domestic U.S. chapter 9 bankruptcy example, debtors have consistently prevailed against litigants contending the financial distress eligibility screen to filing has not been met. See, e.g., *In re City of Stockton*, No. 12-32118-C-9, 2013 Bankr. LEXIS 2416, 31-40 (June 12, 2013 Bankr. E.D. Cal. 2013) (finding the eligibility requirement of insolvency had been met under 11 U.S.C. s. 109(c).

<sup>122</sup> 11 U.S.C. §109(c).

<sup>123</sup> Anna Gelpern, *Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt*, 121 *Yale L.J.* 888, 928-30 (2012) (citing Republic of Ecuador, Noteholder Circular, at iii-iv (Apr. 20, 2009), available at <http://blogs.reuters.com/felix-salmon/files/2009/04/noteholder-circular-goe-bond-offer.pdf> (Letter from the Minister of Finance)).

arbitration over litigation in commercial matters)<sup>124</sup> is that it avoids the state-affiliation of a home court or the need to create an international one. True, many bond issuances already contain choice of law and forum clauses,<sup>125</sup> but the carving out of specific disputes for arbitration resolution can de-politicize a potentially fractious scenario. It also avoids the issue of asset-flight concerns for sovereign defendants. What it doesn't solve, of course, is whether the arbitral awards will ever be enforced. Keeping on the present example, Argentina has a good track record of participating in several investor-state arbitrations (winning many) but has a poor record of paying adverse awards.<sup>126</sup> The recent certification of the Italian class action against sovereign debt action under its BIT will be worth watching closely.<sup>127</sup>

If the purpose of this certification board proposal is to provide some “reputational pressure” on sovereign debt stakeholders to come to consensus in the face of, say, a bond exchange offering, then there arises a timing complication. The proposal has a perhaps stylized scenario in which first a haircut is proposed, then creditors quietly cogitate over its terms as a Certification Board offers its imprimatur, and finally the process of voting and tendering begins. In domestic bankruptcy proceedings, such orderliness is not always the case. That point on its own should not present problems, however, as sovereign debt restructuring seems to occur on a

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<sup>124</sup> AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1749 (2011).

<sup>125</sup> Stephen Choi, Mitu Gulati & Eric Posner, *Political Risk and Sovereign Debt Contracts* 8 (John. M. Olin Law & Econ. Working Paper No. 583, Pub. Law and Legal Theory Working Paper No. 370, 2011) available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1962788](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1962788).

<sup>126</sup> Luke Eric Peterson, Argentine Crisis Arbitration Awards Pile Up, but Investors Still Wait for a Payout, LAW.COM (June 25, 2009) (last visited March 29, 2013 at 6:42pm), available at <http://www.law.com/jsp/law/international/LawArticleIntl.jsp?id=1202431736731&thepage=1&slreturn=20130229183938>.

<sup>127</sup> *Abaclat and Others v. The Argentine Republic*, ICSID Case No. ARB/0715, Decision on Jurisdiction and Admissibility (Aug. 4, 2011), available at <http://italaw.com/documents/AbaclatDecisiononJurisdiction.pdf>.



glacial timeline without too many prepacks.<sup>128</sup> The harder point is that even if a proposal is fair in the abstract, at what threshold does one declare that there has been “a holdout”? That determination requires an independent factual input wholly distinct from the underlying terms of the proposal – an assessment of the significance of the number of creditors who have gone along.<sup>129</sup> Suppose a sovereign proposes an eminently fair haircut, offered to its creditors in an above-board, nondiscriminatory manner, but then encounters genuine, good-faith lack of interest from the creditors. If *everyone’s* holding out, that’s not holdout – that’s just unfortunate. Can the Certification Board do anything about this?

It’s not clear. Yes, of course the Board could opine on this or any question. (One can envision an intelligible holdout standard that would not require a fixed voting cut-off, like 75%; it could just be a standard, like “overwhelming majority.”) The issue is how to deal with the timing problem. The Board’s main work will be to certify an exchange proposal as “legitimate.” For example, there was some suggestion that the initial Argentine offering—a “take it or leave it” offer—was too heavy-handed to allow for meaningful negotiation;<sup>130</sup> those are the precise sorts of issues in which the Board should ideally get involved. But that all occurs pre-voting. If we drag the Board back in *ex post* to cast the official condemnation of “holdout” on someone who didn’t go along with the tender, we insert the Board into a far more powerful and contentious position. That development could undercut the very delicate, soft-law influence the

<sup>128</sup> MONETARY AND CAPITAL MARKETS DEP’T OF THE INT’L MONETARY FUND, A SURVEY OF EXPERIENCES WITH EMERGING MARKET SOVEREIGN DEBT RESTRUCTURINGS 1 (2012).

<sup>129</sup> Cf. Mark L. J. Wright, Sovereign Debt Restructuring: Problems and Prospects, 2 Harv. Bus. L. Rev. 154, 179-83 (2012) (explaining the mechanics, current rise, and inherent problem of aggregation clauses in sovereign debt contracts, “which [] allow for the imposition of settlement terms on the minority holders of individual bonds in the context of a multi-bond restructuring arrangement”).

<sup>130</sup> Guachos and gadflies: Creditors’ decade-long battle with Argentina shows just how tangled sovereign defaults can be, The Economist, (Oct. 22, 2011), available at <http://www.economist.com/node/21533453> (describing Argentina’s offer to bondholders of 35 cents on the dollar as a “take-it-or-leave-it offer,” which was viewed as “derisory” by the investment community). Cf. INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND’S LEGAL AND POLICY FRAMEWORK 11 (2013).

Board is designed to have. Accordingly, to let the Board give an official scarlet H to the vulture funds who are holding out is probably a bridge too far. Instead we should just let domestic courts put two and two together by coupling the Board's certification and the creditor votes to draw their own conclusions.

Could this actually work? Hard to say, but there is little downside to trying, other than the opportunity cost of distracting from something more whole-hog like SRDM if there's burgeoning political will to make that happen. (There's not.)<sup>131</sup> Absent opportunity cost concerns, the Board could be a small step in corralling the vulture funds (and other actors) in the sovereign debt world into more rational resolution of sovereign financial distress. How much a role the Board has of course depends upon multiple factors, including a grittily legal-realist assessment of just how judges interpret open law. For example, this article has made the modest argument that surely certification could be a relevant factor of decision in weighing the propriety of equitable relief. A more radical suggestion—which of course is merely raised academically—would be to speculate that certification might affect more substantive legal determinations. We may leave as a thought experiment whether, in the presence of such a certification, Judge Griesa might have been inclined to take the narrower interpretation of the *para passu* clause advocated by many.<sup>132</sup> But that speculation is perhaps best left for another day.

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<sup>131</sup> INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK 12-13 (2013) (noting lengthy negotiations and delays).

<sup>132</sup> To be clear, I am not in any way saying Argentina's proposal would be certified. In fact, "no constructive dialogue was observed and the authorities presented a non-negotiated offer . . . more than three years after default." INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING: RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK 36 (2013). This scarcely smacks of procedurally fair engagement and negotiation.