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The Sovereign Debt Dilemma

> When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonourable to the debtor, and least hurtful to the creditor.[1]
>
> —Adam Smith

INTRODUCTION

Over the past two decades, the securitization of sovereign lending and the emergence of the secondary debt market have transformed the contours of the global financial system.[2] Although public debt remains one of the most effective tools to implement domestic economic policy,[3] fundamental changes in the design and structure of sovereign financing have stymied the efficient restructuring of state obligations.[4] In particular, the late-1980s shift from syndicated bank lending[5] to securitized bond financing[6] has resulted in a vast

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[1] 2 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 468 (Edwin Cannan ed., The Univ. of Chi. Press 1976) (1776).

[2] Michael Wolfgang Waibel, Sovereign Debt Restructuring 6 (Winter 2003) (unpublished manuscript, *available at* http://forschungsnewsletter.univie.ac.at/fileadmin/user_upload/int_beziehungen/Internetpubl/waibel.pdf.).

[3] For example, public debt can fund human capital development and physical infrastructure projects, mitigate the effects of temporary economic downturns, and redistribute "resources from future generations to the current one." EDUARDO BORENSZTEIN ET AL., AMERICAN DEVELOPMENT BANK, LIVING WITH DEBT: HOW TO LIMIT THE RISKS OF SOVEREIGN FINANCE 3-4 (2006).

[4] A. Mechele Dickerson, *A Politically Viable Approach to Sovereign Debt Restructuring*, 53 EMORY L.J. 997, 1012 (2004).

[5] Under the syndicated lending practices of the 1970s, relatively small groups of commercial banks would extend credit to a sovereign "on identical terms . . . pursuant to a single loan agreement." Lee C. Buchheit & Ralph Reisner, *The Effect of the Sovereign Debt Restructuring Process on Inter-Creditor Relationships*, 1988 U. ILL. L. REV. 493, 500 (1988). From the perspective of the debtor, syndicated lending facilitates the acquisition of funds, which would otherwise be unattainable from an individual financing source. Likewise, for both lenders and borrowers, syndicate loans promote efficiency by aggregating initial negotiations and subsequent loan administration into a single, collaborative endeavor. *Id.*

[6] In response to the fallout from the Latin American debt crisis of the early-1980s, United States Treasury Secretary Nicholas Brady sought "to 'securitize' sovereign loans by converting loan obligations into bonds." Philip J. Power, *Sovereign Debt: The Rise of the Secondary Market and Its Implications for Future Restructurings*,

diversification of sovereign creditors and a substantial increase in the collective action problems among them.[7] This change, combined with the lack of reliable enforcement regimes and restructuring institutions, has led to a global sovereign debt dilemma.[8]

In conjunction with the return of securitized bond financing,[9] the global debt crisis of the 1980s also spurred the emergence of a secondary market in sovereign debt.[10] To policy makers and sovereign debtors alike, this new market presented a host of challenges that were not present under previous financing schemes.[11] Accordingly, when subsequent financial crises necessitated the renegotiation of sovereign obligations, the syndicate loan restructuring model[12] no longer functioned in

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64 FORDHAM L. REV. 2701, 2720 (1996). Under the so-called "Brady Plan," syndicate bank loans were pooled together and exchanged for debt-securities guaranteed by United States Treasury Bills. Jessica W. Miller, Comment, *Solving the Latin American Sovereign Debt Crisis*, 22 U. PA. J. INT'L ECON. L. 677, 685-86 (2001). After repackaging, the securities were sold in the public markets and the sale proceeds used to satisfy outstanding sovereign loan obligations. Power, *supra*, at 2720. As a result of securitization, individual bondholders replaced commercial bank syndicates. *Id.* at 2719. Although sovereign lending has evolved to include other types of bond instruments, the securitization of debt remains the principle means of sovereign financing today. Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253, 261 (2003).

[7] William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1, 20-22 (2004).

[8] Dickerson, *supra* note 4, at 1012-13.

[9] Following the independence movement of the early nineteenth century, newly sovereign nations in Latin America began to procure external financing through government bond issues in European capital markets. BORENSZTEIN ET AL., *supra* note 3, at 63. After enjoying almost a century of heavy capital inflows, World War I brought most sovereign financing to a halt. *Id.* at 63, 75-76. With the onset of World War II and the resulting European capital controls, the United States replaced Britain as the center of global capital. *Id.* at 76. By the time the credit markets thawed in the 1970s, New York had emerged as the dominant capital market and syndicated lending had replaced bond financing as the primary mode of sovereign borrowing. *Id.* at 74, 79.

[10] *See infra* Part II.

[11] *See infra* Part II.B.

[12] Between 1982 and 1983, over fifteen countries declared that they would fall into arrears or suspend payments on approximately $90 billion in foreign syndicate loans. Power, *supra* note 6, at 2708 n.27. Due to the relatively small number of lenders and the interconnected nature of the affected notes, principles of "shared sacrifice" dominated the syndicate loan restructuring atmosphere. *Id.* at 2710. Accordingly, bank advisory committees were formed to promote "equity among banks, . . . and . . . [make] it harder for individual banks to hold out for special treatment." Charles Lipson, *Bankers' Dilemmas: Private Cooperation in Rescheduling in Sovereign Debts*, WORLD POLITICS, Vol. 38, No. 1 200, 212 (Oct. 1985). In accordance with these equity principles, lenders were asked to extend gap financing to sovereign debtors equal to their pro rata share of credit exposure. Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L. J. 1043, 1058 (2004). As a temporary stopgap measure, bridge financing permitted a

the fluid and dynamic secondary market.[13] Initially, the international debate centered on whether public institutions or private actors should lead the call to restructuring reform.[14] However, with the death of the Sovereign Debt Restructuring Mechanism,[15] independent, contractual remedies continue to govern sovereign debt restructuring and will do so for at least the foreseeable future.[16]

In 2002, soon after Argentina declared a $132 billion public debt default,[17] significant contractual reforms began to permeate throughout the sovereign financing market.[18] At first, Mexico took center stage when it announced the first large-scale sovereign bond issuance in New York to incorporate collective action clauses (the "CACs").[19] By providing for the supermajority modification of certain repayment matters, CACs sought to curb the inefficiencies posed by the unanimous

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debtor to make interest payments while creditors worked to reschedule the principal due on the loan. Power, *supra* note 6, at 2709-10. Likewise, due to the discretionary enforcement nature of the International Lending Supervision Act of 1983, which required lenders to accumulate additional reserves, federal banking regulators were not above making "'friendly' calls" to incentivize uncooperative lenders to participate in the restructuring process. *Id.* at 2713. In addition, cross-default clauses in the syndicate loan agreements discouraged maverick litigation by requiring all legal proceeds to be shared pro rata with fellow lenders. Anne Krueger, First Deputy Managing Director, International Monetary Fund, Speech at the Economics Society Dinner, The Evolution of Emerging Market Capital Flows: Why We Need to Look Again at Sovereign Debt Restructuring (Jan. 21, 2002), *available at* http://imf.org/external/np/speeches/2002/012102.htm.

[13] *See infra* Part II.B.

[14] *See generally* LUCIO SIMPSON, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, G-24 DISCUSSION PAPER SERIES, THE ROLE OF THE IMF IN DEBT RESTRUCTURINGS: LENDING INTO ARREARS, MORAL HAZARD, AND SUSTAINABILITY CONCERNS, 1-9 (2006).

[15] Under the auspices of the International Monetary Fund, the SDRM was based on Chapter 11 of the United States Bankruptcy Code and sought to ensure the "orderly . . . and rapid restructuring of . . . debt, while protecting asset values and creditors' rights." Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299, 337-40 (2005); ANNE O. KRUEGER, INT'L MONETARY FUND, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING 4, 21 (2002).

[16] *See infra* Part I.A.

[17] Clifford Krauss, *Argentine Leader Declares Default on Billions in Debt*, N.Y. TIMES, Dec. 24, 2001, at A1.

[18] *See infra* Part III.

[19] United Mexican States, Prospectus, at 7 (Dec. 4, 2002). Prior to Mexico's 2003 issuance, unanimous action clauses (the "UACs") governed the vast majority of sovereign bonds issued pursuant to New York law. Under a UAC, the modification of reserved matters cannot be effectuated without unanimous bondholder consent. As a result, small factions of holdout creditors can derail the restructuring process. Sergio J. Galvis & Angel L. Saad, *Collective Action Clauses: Recent Progress and Challenges Ahead*, 35 GEO. J. INT'L L. 713, 714-15 (2004). Because CACs impair the ability of a holdout creditor to derail debt rescheduling, they are generally regarded as a more efficient means to facilitate sovereign debt restructuring.

action clauses, which had previously dominated the market.[20] Several months later, Uruguay followed with a similar debt issuance that incorporated CACs along with aggregation principles and a pseudo-trustee structure.[21] In the event of a debt restructuring, aggregation enables a supermajority of bondholders to cram down the modification of certain reserved matters across multiple series of bonds.[22] Likewise, the weak trustee structure underlying the notes provided bondholders with a centralized figure that could both initiate collective legal actions as well as distribute any resulting legal award.[23]

Although these contractual reforms pushed sovereign financing forward, none provided a comprehensive solution to the creditor holdouts that pose the sovereign debt dilemma.[24] Under collective action theory, rational, self-interested individuals will choose personal gain over the pursuit of collective objectives.[25] As a result, some form of coercion is required to obtain the optimal aggregate outcome.[26] In the case of a sovereign debt default, the potential recoveries from holdout-litigation motivate creditors to abstain from the voluntary restructuring process.[27] Without an indenture trustee to strip bondholders of their right to pursue individual legal remedies,[28] the Mexican and the Uruguayan reforms have failed to fully embrace effective contractual coercion.[29] Given this inability to efficiently coerce creditor cooperation, the holdout problem will persist, and the sovereign debt dilemma will remain.

Part I of this Note begins with a brief examination of the primary differences between lending in the public and

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[20] Fisch & Gentile, *supra* note 12, at 1093.

[21] República Oriental del Uruguay, Trust Indenture Filed April 10, 2004, 13-15, 35-36 [hereinafter República Oriental, Indenture]; *see also* Galvis & Saad, *supra* note 19, at 717.

[22] Galvis & Saad, *supra* note 19, at 722.

[23] República Oriental, Indenture, *supra* note 21, at 14; Galvis & Saad, *supra* note 19, at 723-24.

[24] *See infra* Part IV.

[25] Indeed, "even if all of the individuals in a large group are rational and self-interested, and would gain if, as a group, they acted to achieve their common interest or objective, they will still not voluntarily act to achieve that common or group interest." MANCUR OLSON, JR, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 2 (1965).

[26] *Id.*

[27] Wheeler & Attaran, *supra* note 6, at 259-60.

[28] Fisch & Gentile, *supra* note 12, at 1105; *see also* Galvis & Saad, *supra* note 19, at 723.

[29] *See infra* Part IV.

private spheres, as well as a cursory review of the current state of sovereign debt. Part II explores the collective action challenges that resulted from the rise of the secondary debt market and the inability of public institutions to effectively resolve this problem. Part III contends that the Mexican and the Uruguayan models fail to adequately combat the complexities of the holdout problem. To better address this issue, as well as provide for greater efficiency in debt restructuring, Part IV advocates for the inclusion of an indenture trustee clause in subsequent sovereign financing contracts.

I. BACKGROUND OF THE SOVEREIGN DEBT CRISIS

A. *Differences Between Sovereign and Private Lending*

To fully appreciate the role of holdout creditors and the resulting sovereign debt dilemma, it is first necessary to understand the fundamental differences between public and private borrowing.[30] In the context of private lending, creditors have recourse to legal regimes that will enforce the payment obligations of debtors.[31] Similarly, bankruptcy institutions protect distressed borrowers from financial dismemberment[32] and ensure "equal treatment" among similarly situated creditors.[33] As a result, private financing schemes provide both

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[30] Bratton & Gulati, *supra* note 7, at 10-12.

[31] *Id.* at 11. In the sphere of private lending, the maxim *pacta sunt servanda* continues to apply. Henry T. C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1389-90 (2007). Accordingly, if a debtor fails to comport with his or her promise to pay, courts will enforce this obligation in accordance with debtor-creditor and contract law. *Id.*; *see, e.g.*, Gerdes v. Kennamer, 155 S.W.3d. 541, 546 (Tex. App. 2004) (holding that a court may order a judgment debtor to turnover property "subject to the debtor's control" even though the property is located outside of the United States) (quoting TEX. CIV. PRAC. & REM. CODE ANN. § 31.002(b)(1) (Vernon 1997)).

[32] For example, the automatic stay provision of the United States Bankruptcy Code "provides the debtor with relief from the pressure and harassment of creditors seeking to collect on their claims" as well as "breathing space . . . to focus on its rehabilitation or reorganization." 3 COLLIER ON BANKRUPTCY § 362.03 (2005); 11 U.S.C.A. § 362 (2006).

[33] Rory Macmillan, *Towards a Sovereign Debt Work-Out System*, 16 NW. J. INT'L L. & BUS. 57, 74 (1995). The equitable distribution of assets among similarly situated creditors is a core principle of the United States Bankruptcy Code. 5 COLLIER ON BANKRUPTCY § 541.01 (2007). Accordingly, U.S. bankruptcy courts "should aim to treat similarly situated creditors similarly." Till v. SCS Credit Corp., 541 U.S. 465, 477 (2004).

debtors and creditors with access to legal authorities that will enforce the reasonable expectations of the lending agreement.[34]

In the world of sovereign financing, however, things are different,[35] since creditors lack recourse to reliable enforcement institutions when the borrower fails to pay.[36] In the United States, prior to the passage of the Foreign Sovereign Immunities Act (the "FSIA"), sovereign debtors enjoyed an unqualified immunity in both state and federal courts.[37] With a judiciary that recognized absolute sovereign immunity, lenders relied solely on the President to compel payment from recalcitrant sovereign debtors.[38] Today, though the United States Supreme Court has held that debt obligations are a "commercial activity" no longer subject to sovereign immunity,[39]

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[34] Mitu Gulati & George Triantis, *Contracts Without Law: Sovereign Versus Corporate Debt*, 75 U. CIN. L. REV. 977, 986 (2007). "The assurance of protection from the consequences of debtor default is a fundamental necessity in the commercial world, whose order depends upon the predictability of the debtor-creditor relationship and the realization of reasonable expectations." E. Hunter Taylor, Jr., *Recent Developments in Commercial Law*, 11 RUTGERS-CAM. L.J. 527, 657 (1980).

[35] Bratton & Gulati, *supra* note 7, at 11.

[36] *Id.* In addition to the lack of enforcement mechanisms, secured lending is usually not an option when contracting with a sovereign. Patrick Bolton & David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?*, 53 EMORY L. J. 763, 793 (2004).

[37] Bradford R. Clark, *Domesticating Sole Executive Agreements*, 93 VA. L. REV. 1573, 1618 (2007). When the United States Supreme Court first examined sovereign immunity in *The Schooner Exchange v. McFaddon*, the Court found "that the sovereign power of the nation is alone competent to avenge wrongs committed by a sovereign, that the questions to which such wrongs give birth are rather questions of policy than of law, [and] that they are for diplomatic, rather than legal discussion." The Schooner Exchange v. McFaddon, 11 U.S. (7 Cranch) 116, 146 (1812).

[38] Clark, *supra* note 37, at 1618.

> [E]arly Presidents embraced the role of chief negotiator by espousing and settling claims of U.S. citizens against foreign nations barred by foreign sovereign immunity. Presidents would decide, in their discretion, whether and how to espouse such claims. Even if the President agreed to espouse a claim, he retained wide-ranging discretion in disposing of it. He could "compromise it, seek to enforce it, or waive it entirely." . . . In the end, whatever compensation the President secured for the claimant was almost certainly greater than any amount the claimant could recover on his or her own, since foreign sovereign immunity foreclosed access to U.S. courts.

Id. at 1627-29. Outside the United States, one of the most infamous attempts at sovereign debt collection occurred in 1902, when the British and German navies fired on the Venezuelan coast and threatened to invade unless the debts of their subjects were paid in full. Likewise, it was not until 1907 that Luis Drago, the Argentine politician, first espoused the doctrine that sovereign debt cannot justify an armed conflict or occupation of a debtor state. *See* Lee C. Buchheit, *The Role of the Official Sector in Sovereign Debt Workouts*, 6 CHI. J INT'L L. 333, 336-37 (2005).

[39] Republic of Argentina v. Weltover, Inc., 504 U.S. 607, 620 (1992).

lenders continue to face daunting debt collection challenges.[40] For example, because FSIA does not permit a creditor to seize sovereign assets located outside of the U.S. border,[41] sovereign debtors have transferred assets out of the United States on the eve of declaring default.[42] Once these monies have exited the country, the lender often remains without an effective means to collect on the sovereign debt.[43]

When compared to commercial borrowing, sovereign lending also carries a heightened expectation of breach.[44] While economic or political factors may give rise to a sovereign's default, the absence of realistic enforcement procedures provides an incentive for nation-states to ignore debt obligations even when they are able to pay.[45] Rather than face the political, economic, or social consequences of conservative fiscal policies, sovereigns may choose instead to default opportunistically.[46] As a result, a common assumption underlying the sovereign financing process is that the borrower will inevitably fail to pay.[47] Consequently, a primary challenge for sovereign lenders is to devise a contractual mechanism that will realize the reasonable expectations of the lender-borrower relationship when the debtor inevitably defaults.[48]

In addition to the lack of effective enforcement mechanisms, there is similarly no global institution to address

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[40] Bratton & Gulati, *supra* note 7, at 11. For instance, two problems that continue to plague sovereign debt satisfaction are: (1) the difficulty in identifying sovereign property that is subject to execution, and (2) the inability to liquidate a sovereign debtor. *Id.*

[41] Jonathan C. Lippert, *Vulture Funds: The Reason Why Congolese Debt May Force a Revision of the Foreign Sovereign Immunities Act*, 21 N.Y. INT'L L. REV. 1, 14-15 (2008). Indeed, the scope of FSIA extends only to "property in the United States." 28 U.S.C. § 1601(a) (2008).

[42] In fear of creditor enforcement actions, Argentina removed assets from the United States and deposited them in the Bank for International Settlements before declaring a default in 2001. Bratton & Gulati, *supra* note 7, at 35.

[43] In the majority of cases, the sovereign's courts cannot seize the sovereign's assets. Hal S. Scott, *A Bankruptcy Procedure for Sovereign Debtors?*, 37 INT'L LAW 103, 116-17 (2003).

[44] Robert B. Ahdieh, *Between Mandate and Market: Contract Transition in the Shadow of the International Order*, 53 EMORY L.J. 692, 694 (2004). In addition, the transaction costs of dealing in sovereign debt are higher than the costs of similar corporate transactions. Gulati & Triantis, *supra* note 34, at 986.

[45] Fisch & Gentile, *supra* note 12, at 1048-49.

[46] *Id.* Professors Fisch and Gentile argue that holdout litigation serves an important role in frustrating the desirability of an opportunistic default. *Id.* at 1047. Although this may well be the case, it remains to be seen whether such benefits are outweighed by the restructuring disruptions that such creditors pose.

[47] *Id.* at 1044.

[48] *Id.* at 1090.

the problem of sovereign debt restructuring.[49] Whereas legal tribunals can allocate the financial rights of debtors and creditors in bankruptcy, sovereigns are not subject to domestic insolvency proceedings.[50] Although both academics and multinational institutions have put forth proposals for the creation of a global sovereign insolvency regime,[51] these efforts have failed to garner sufficient support for their implementation.[52] Most recently, Anne Krueger of the International Monetary Fund (the "IMF") called for the formation of a Sovereign Debt Restructuring Mechanism (the "SDRM").[53] However, due to pushback from both debtor and creditor states, the SDRM was placed indefinitely on hold.[54] With the rise of contractual approaches to sovereign debt restructuring, the current prospects for a global sovereign insolvency regime appear to be nil.[55] As a result, lenders and borrowers are left to develop their own contractual devices to effectuate the efficient restructuring of sovereign obligations.

B. *History of Modern Sovereign Financing*

The roots of the holdout problem in sovereign debt restructuring can be traced to the years spanning the early 1970s to the early 1980s, when lending to sovereign debtors experienced exponential growth.[56] During this period, syndicate loans[57] from commercial banks in the United States and

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[49] Galvis & Saad, *supra* note 19, at 714. Although creditors and debtors can currently enter into informal agreements under the supervision of the IMF through Paris Club (sovereign creditors and sovereign debtors) and London Club (sovereign debtors and private creditors) negotiations, this system is noncompulsory and has been criticized for its inefficiency. Dickerson, *supra* note 4, at 1008-12.

[50] *See generally*, Caroline Atkinson, *Forget Sovereign Bankruptcy Plans* (2002), *available at* http://www.cfr.org/publication.html?id=4584.

[51] KRUEGER, *supra* note 15, at 4.

[52] Dickerson, *supra* note 4, at 998.

[53] KRUEGER, *supra* note 15, at 21.

[54] Adam Brenneman, Comment, *Gone Broke: Sovereign Debt, Personal Bankruptcy, and a Comprehensive Contractual Solution*, 154 U. PA. L. REV. 649, 679 (2006).

[55] *Id.*

[56] For example, in the ten year period between 1973 and 1983, foreign debt in Latin America increased by more than 700%. Miller, *supra* note 6, at 680 (quoting Roy MacMillan, *The Next Sovereign Debt Crisis*, 31 STAN. J. INT'L L. 395, 311 n.31 (1995) (citing PEDRO-PABLO KUCZYNSKI, LATIN AMERICAN DEBT 14 (1988))).

[57] "A syndicated loan is one that is provided by a group of lenders and is structured, arranged, and administered by one or several commercial or investment banks known as arrangers." STANDARD & POOR'S, A GUIDE TO THE LOAN MARKET 7 (2009), *available at* https://www.lcdcomps.com/d/pdf/LoanMarketguide.pdf.

Western Europe functioned as the dominant source of financing for sovereigns in the developing world.[58] After the 1979 energy crisis,[59] however, the Federal Reserve Board (the "Fed") increased interest rates to combat growing domestic inflation, and as a result capital flew from developing countries back into the United States.[60] In response to the Fed's higher discount rate, lenders in the United States hiked prime rates on outstanding sovereign loans.[61] To the sovereigns, this had the detrimental effect of increasing both the nominal value of interest payments as well as the real rate of interest on their debt.[62] Consequently, on August 22, 1982, Mexico became the first nation of the 1980s financial crisis to announce that it would be unable to service its outstanding loan obligations.[63] Less than one year later, fifteen additional countries declared

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[58] Fisch & Gentile, *supra* note 12, at 1054; *see also* Power, *supra* note 6, at 2707. During this period, U.S. financial institutions were awash in deposits from oil-exporting nations, Fisch & Gentile, *supra* note 12, at 1054, while an economic downturn and rising inflation at home reduced the domestic demand for credit. Power, *supra* note 6, at 2707. Given the surplus of petrodollar deposits and the rising price of raw material exports from developing nations, commercial banks viewed sovereigns as a justifiable credit risk. *Id.* Indeed, lenders believed "sovereign borrowers were immune from bankruptcy risk and would not suspend debt servicing." Alberto Gonzalo Santos, *Beyond Baker and Brady: Deeper Debt Reduction for Latin American Sovereign Debtors*, 66 N.Y.U. L. REV. 66, 74 (1991). As a result, financial institutions would routinely ignore sound lending practices such as profitability analysis and investment requirements. *Id.* at 73-74. To sovereign debtors, rising inflation in the United States counteracted high interest rates, *id.* at 72, and also rendered the real rate of interest negative for a few years, increasing the desirability of borrowing in U.S. dollars. *Id.* at 72 n.41. Encouraged by the liberal lending practices of U.S. banks combined with highly favorable financing costs, many countries pursued unsustainable development through excessive foreign borrowing at the expense of conservative fiscal policies. *Id.* at 74-75.

[59] The overthrow of the Shah of Iran resulted in an energy crisis that doubled the price of oil within a year. Jon H. Sylvester, *Impracticability, Mutual Mistake, and Related Contractual Bases for Equitably Adjusting the External Debt of Sub-Saharan Africa*, 13 NW. J. INT'L L. & BUS. 258, 264 (1992). Although some debtor nations are petroleum producers (e.g., Venezuela), the vast majority are not. *Id.* at 264 n.30. Accordingly, to compensate for the increased cost of petroleum products, sovereign debtors borrowed more heavily from commercial banks. Power, *supra* note 6, at 2707-08. At the same time, however, global recession precipitated a reduction in gross returns on the commodity exports that nations used to service their debt. *Id.* at 2708.

[60] Santos, *supra* note 58, at 74-75.

[61] Edward Cowan, *Bank Lending Rate Set at Record 14% by Federal Reserve*, N.Y. TIMES, May 5, 1981, at A1.

[62] Power, *supra* note 6, at 2708.

[63] Lee C. Buchheit, *A Quarter of a Century of Sovereign Debt Management: An Overview*, 35 GEO. J. INT'L L. 637, 637 (2004). Although earlier in 1982 Argentina suspended payment on $37 billion in foreign debt after its defeat in the Falkland Islands War, "it was the Mexican default that shook the financial world." RICHARD JOLLY ET AL., UN CONTRIBUTIONS TO DEVELOPMENT THINKING AND PRACTICE 142 (2004).

that they too would fall into arrears or suspend payments on approximately $90 billion in foreign debt.[64]

At the time of the crisis, many commercial banks had extended loans to sovereign debtors in amounts that greatly exceeded their capacity to lend.[65] To avoid having to declare significant balance sheet losses, commercial banks jointly extended bridge loans to sovereign debtors, which permitted them to make interest payments while creditors worked to reschedule the principal due on the loans.[66] Although creditors with larger exposure to the debt crisis were more willing to provide funds to engage in gap financing measures,[67] peer and regulatory pressures ensured cooperation even among the smallest and most recalcitrant lenders.[68] In addition to austerity programs,[69] the IMF also instituted policies conditioning new loans on the ability of a nation to obtain

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[64] Power, *supra* note 6, at 2709 n.28; *see also* Steven M. Cohen, Note, *Give Me Equity or Give Me Debt: Avoiding a Latin American Debt Revolution*, 10 U. PA. J. INT'L BUS. L. 89, 97 (1988).

[65] Fisch & Gentile, *supra* note 12, at 1057. For example, in the United States, nine of the nation's largest financial institutions had loaned more than 250% of their aggregate capital to sovereign nations. *Id.* Under United States banking regulations, lenders had to declare a loan as non-performing if interest on the note was over 90-days past due. *Id.* If the sovereign debtors defaulted on their loans, lenders would have almost certainly faced bankruptcy. *Id.*

[66] Power, *supra* note 6, at 2709-10. Under this approach, if banks were continuing to receive interest payments in a timely fashion, they could continue to carry the sovereign notes as assets on their balance sheets and avoid bankruptcy. *Id.* at 2710; Fisch & Gentile, *supra* note 12, at 1057.

[67] Creditors with heavy exposure to the crisis were more willing to provide gap financing for two principal reasons. First, like other creditors, bridge loans would ensure that they could maintain sovereign loans as an asset on their balance sheets. Since these creditors were more heavily exposed to the crises in the region, their prospects for bankruptcy were more acute than those of minor participants. Similarly, these large lenders wanted to maintain good working relationships with the sovereigns. In many cases, the banks looked forward to developing new relationships with local businesses and opening up retail banks in the sovereign nations. *See* Fisch & Gentile, *supra* note 12, at 1058-60.

[68] Free-riding creditors were a potential problem if larger banks provided the entire financing necessary to avoid default. *Id.* at 1060. Under this scenario, sovereign debtors would have sufficient funds to make interest payments on all their outstanding notes. Consequently, less-exposed creditors would receive the benefit of timely interest payments without having to incur the costs and additional exposure required by providing gap financing. To secure full compliance, members of bank advisory committees were assigned to oversee smaller banks within their geographical region. *Id.* at 1060-61. Because smaller banks sought to grow and develop their working relationships with other financial institutions, larger lenders would threaten international and domestic market isolation if the smaller banks failed to participate in the restructuring of sovereign debt. *Id.* at 1061.

[69] Such "programs usually involve[d] cutting public spending, devaluing the national currency to stimulate exports and reducing imports." Burton Bollag, *U.N. Critical of I.M.F. Austerity Plan*, N.Y. TIMES, Sept. 6, 1989, at D7.

additional financing from all of its current lenders.[70] Because of these collective pressures, between 1982 and 1984 commercial banks successfully restructured over forty loan agreements with more than thirty different countries.[71] While the comparatively homogenous views of syndicate bank lenders reduced creditor coordination problems and facilitated the efficient rescheduling of sovereign debt, the subsequent rise of bond financing in the mid-1980s presented new collective action challenges that threatened to hinder the successful restructuring of sovereign obligations.[72]

II. THE EMERGENCE OF A SECONDARY MARKET IN SOVEREIGN DEBT

A. Beginnings of a Secondary Market: Inter-Bank Swaps and Brady Bonds

Although the extension of bridge loans by bank advisory committees and multilateral institutions[73] helped to temporarily stave off losses from debtor nations,[74] several years of cyclical restructuring fatigued creditors, and as a result many institutions opted out of the process.[75] As the crisis continued to worsen, a secondary market in sovereign debt began to emerge.[76] Initially, this market consisted entirely of inter-bank swaps,[77] but as the sovereign debt crisis

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[70] Fisch & Gentile, *supra* note 12, at 1061.

[71] *Id.* at 1063.

[72] Bratton & Gulati, *supra* note 7, at 20-21.

[73] In 1985, at the World Bank Meeting in Seoul, South Korea, United States Secretary of the Treasury James A. Baker III proposed a plan whereby multinational institutions such as the IMF and World Bank would extend an additional $9 billion in loans to debtor states. Under the terms of the plan, borrowing nations would adopt austerity measures in exchange for the funds. To some observers, the differences between the Baker Plan and the private restructuring organized by bank advisory committees were minimal. Santos, *supra* note 58, at 76-77.

[74] *Id*.

[75] Development Committee, Joint Ministerial Committee of the Boards of Governors of the World Bank and the International Monetary Fund, A Strategy for Restoration of Growth in Middle-Income Countries That Face Debt-Servicing Difficulties 12-13 (1986), *available at* http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2001/02/15/000178830_98101901582392/Rendered/PDF/multi_page.pdf.

[76] Sylvester, *supra* note 59, at 272.

[77] Power, *supra* note 6, at 2715.

deteriorated, banks began to trade their foreign loan assets for cash.[78]

After several years of accumulating cash from sovereign loan exchanges, many banks had attained a level of loan-loss reserves that could sustain substantial write-off losses from sovereign notes.[79] Soon thereafter, it became clear to lenders that the principal on sovereign loans would not be repaid at "any time in the foreseeable future."[80] To reduce the debt burden on commercial banks, United States Treasury Secretary Nicholas Brady announced a plan to "'securitize' sovereign debts by converting loan obligations into bonds."[81] Under the Brady Plan, syndicated bank loans were pooled together and exchanged for Brady Bonds guaranteed by United States Treasury Bills.[82] After repackaging, the bonds were sold in the public markets and the proceeds used to satisfy the sovereign's outstanding debt.[83] Importantly, this securitization

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[78] Even though it was highly unlikely that the sovereign debts would be ever be fully repaid, the secondary market became quite popular with some investors. *Id.* at 2716. At first, this market was principally composed of large corporate investors seeking debt-for-equity swaps.

> In a debt-for-equity swap, an investor approaches a large debtor nation and expresses an interest in investing in an industry or specific business. The investor proposes to buy outstanding debt from a specific creditor or on the open market for a fraction of the face amount of the outstanding loan. The investor then sells the outstanding loan to the debtor nation for the face amount or for a discounted amount of local currency . . . . The investor then uses the sale proceeds to buy an equity stake in the local business, and makes further capital investment.

Sylvester, *supra* note 59, at 272. But as lenders increasingly tried to exit from the unraveling sovereign debt market, they rapidly reduced the price of their sovereign loan assets. Rory Macmillan, *supra* note 56, at 328. Given the availability of fire sale prices, investors with no interest in equity swaps began to purchase the heavily discounted notes. Power, *supra* note 6, at 2718. Even if the debtor only paid back a fraction of the loan's face value, an investor could realize a potentially large profit. Macmillan, *supra* note 33, at 328. Similarly, because interest continued to accrue on the face value of the notes, interest payments alone could yield "an above-market rate of return." Power, *supra* note 6, at 2719.

[79] Power, *supra* note 6, at 2719.

[80] Miller, *supra* note 6 at 685. By 1989, "the pretense of keeping . . . [the] loans on the books at face value could not longer be maintained." Macmillan, *supra* note 56, at 313.

[81] Power, *supra* note 6, at 2720. Under the so-called "Brady Plan," commercial banks agreed to partially forgive sovereign debt obligations "in exchange for both a commitment on the part of the debtors to adopt specified reforms designed to achieve sustainable growth . . . and greater assurances of the collectability of the debt." Fisch & Gentile, *supra* note 12, at 1067.

[82] Miller, *supra* note 6 at 685.

[83] Power, *supra* note 6, at 2720. The securitization of sovereign lending was quite popular with the market. Accordingly, within five years of initiating the Brady Plan, "'more than half of the affected debt stock had been traded in the hands of non-

process replaced debts owed to commercial banks with obligations to a group of individual bondholders.[84] As a result of the Brady Plan, sovereign financing "shifted" from the banking business to the securities markets[85] and, although the techniques have changed,[86] the securitization of debt remains the principle means of sovereign lending today.[87]

B. The Emergence of the Holdout Problem

Unlike the homogenized bank syndicates of the 1970s and 1980s, post-Brady bondholders are diverse.[88] Whereas "[b]ank lenders are repeat players, constrained to cooperate with one another,"[89] groups of bondholders constantly change as the securities are bought and sold in the market.[90] Similarly, the vast majority of sovereign bondholders lack any relationship with the debtor, because they became creditors through secondary trading.[91] In the absence of a rapport with either the sovereigns or with each other, bondholders do not feel the same pressures to "compromise their . . . claims" or share sacrifice.[92] Instead of investing with a common purpose, the liquid secondary market aggregates investors[93] with vastly divergent short-term and long-term goals.[94] Given the relative anonymity among them,[95] there is little collective pressure to cooperate.[96] Consequently, sovereign bondholders pose a collective action problem whereby holdout creditors can derail a

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bank investors.'" Wheeler & Attaran, *supra* note 6, at 261 (quoting Lee C. Buchheit, *Sovereign Debtors and Their Bondholders*, *in* UNITAR TRAINING PROGRAMMES ON FOREIGN ECONOMIC RELATIONS: SOVEREIGN DEBTORS AND THEIR BONDHOLDERS 7).

[84] Power, *supra* note 6, at 2719. For the syndicated bank lenders, securitization enabled them to escape from the sovereign debt market. Fisch & Gentile, *supra* note 12, at 1067.

[85] Wheeler & Attaran, *supra* note 6, at 261.

[86] In the past ten years, sovereign lending has moved from Brady Bonds to other types of bond instruments. *See* Miller, *supra* note 6, at 687.

[87] Wheeler & Attaran, *supra* note 6, at 261.

[88] *Id.*

[89] Bratton & Gulati, *supra* note 7, at 20.

[90] Fisch & Gentile, *supra* note 12, at 1071.

[91] Wheeler & Attaran, *supra* note 6, at 261.

[92] Dickerson, *supra* note 4, at 1013.

[93] Fisch & Gentile, *supra* note 12, at 1071.

[94] *Id.*

[95] Ahdieh, *supra* note 44, at 704.

[96] Wheeler & Attaran, *supra* note 6, at 261.

potentially successful restructuring.[97] It is this tyranny of the minority that poses the sovereign debt dilemma.

1. The Unanimous Action Requirement and the Vulture Fund Holdouts

Currently, the United States dominates the market for sovereign bond issuances, and New York law governs the majority of U.S.-issued sovereign bonds.[98] Until Mexico's sovereign bond issuance in 2003, the vast majority of these bonds incorporated unanimous action clauses (the "UACs").[99] Under a UAC, any alteration to a bond's repayment terms cannot be effectuated without the unanimous consent of all bondholders.[100] As a result, small factions of minority creditors can derail a widely approved restructuring by withholding their support.[101]

Along with the disruptive power of minority bondholders, the creation of a secondary market in sovereign debt also brought about the rise of "[f]unds specializing in distressed assets."[102] Generally, these "vulture funds" purchase deeply discounted sovereign debt on the secondary market[103] and later attempt to collect on their claim in full.[104] Although

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[97] Dickerson, *supra* note 4, at 1013.

[98] Wheeler & Attaran, *supra* note 6, at 259. Historically, most sovereign financing activity took place in European capital markets. However, with the onset of World War I in 1914 and the subsequent global depression, sovereign lending shifted west. As the dominant capital market in the United States, New York emerged as the new leader in sovereign finance. By the time the credit markets thawed in the 1970s, New York had already established itself as the center of the sovereign financing establishment, a position it maintains to this day. BORENSZTEIN ET AL., *supra* note 3, at 74-76.

[99] Dickerson, *supra* note 4, at 1013-14. In part, the use of UACs in sovereign bonds can be traced to the United States' implementation of the Trust Indenture Act of 1939. Pursuant to the Act, corporate bonds issued in the United States were required to incorporate UACs. Although the Act did not apply to sovereign bonds, commentators have noted that the inclusion of UACs in sovereign financing contracts may simply be the result of "drafting momentum." Buchheit & Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1329-30 (2002).

[100] Dickerson, *supra* note 4, at 1013-14.

[101] Brenneman, *supra* note 54, at 680.

[102] Wheeler & Attaran, *supra* note 6, at 254.

[103] *Id.* As a business model, the vulture fund structure can reap significant rewards. In one case, Elliott Associates, a New York-based fund, earned over 494% on a single investment in Peruvian debt. *See id.* at 258.

[104] *Id.* at 262. While champerty laws prevent a third party from purchasing a secondary debt with the sole intention of immediately litigating the claim to obtain full recovery, sovereigns have resoundingly failed in their attempt to combat vulture funds through champerty statutes. *See* James Thuo Gathii, *The Sanctity of Sovereign Loan Contracts and Its Origins in Enforcement Litigation*, 38 GEO. WASH. INT'L L. REV. 251,

there is usually no reasonable expectation that the debt will be fully repaid,[105] vulture funds "refuse to participate" in the restructuring process[106] because they are immune to the "peer or regulatory" pressures that permeate syndicated bank lending.[107] As a result, these funds circumvent traditional sovereign debt collection procedures and utilize litigation to obtain the full face value of their claims.[108]

For a bond issued with UACs, the vulture fund litigation strategy poses substantial problems for the restructuring process.[109] Since an amendment to repayment terms cannot take effect without all outstanding bondholders agreeing to the alteration, the sovereign debtor has incentives to make side payments to any recalcitrant creditors.[110] In doing so, the sovereign debtor inadvertently encourages future holdouts.[111] Not only does a holdout receive the benefit of a side payment, it may also continue to pursue legal remedies to recover on the full face value of its claim.[112] If such litigation proves successful, it depletes the total funds available to satisfy the claims of other similarly-situated creditors.[113] Thus, instead of promoting an orderly distribution of assets, the ability of a vulture fund to derail the restructuring process encourages the financial butchering of a sovereign's foreign exchange reserves.[114] "[A] single default" can activate cross-default clauses in other debt instruments and quickly flood the sovereign in an unexpected "avalanche of redeemed debt."[115] Even if litigation proves to be unsuccessful, the unanimity requirements of a UAC provision allow a single holdout to

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311-12 (2006); *see also* Elliott Assocs. v. Banco de la Nacion, 194 F.3d 363, 381 (2d Cir. 1999) (holding that the New York champerty statute "is not violated when . . . the accused party's 'primary goal' is . . . [the] satisfaction of a valid debt and its intent is only to sue absent full performance.").

[105] *See generally* Fisch & Gentile, *supra* note 12, at 1044.

[106] Wheeler & Attaran, *supra* note 6, at 254, 263.

[107] *Id.* at 262.

[108] Fisch & Gentile, *supra* note 12, at 1045. The litigation by some vulture funds has become increasingly aggressive. In the case of the Republic of Congo, vulture funds have attempted to collect on claims by attaching assets held by United States corporations doing business with the nation. *See generally*, Lippert, *supra* note 41.

[109] *See* Dickerson, *supra* note 4, at 1013-15; Fisch & Gentile, *supra* note 12, 1045-46; Wheeler & Attaran, *supra* note 6, at 262-63.

[110] Wheeler & Attaran, *supra* note 6, at 259-60.

[111] *Id.*

[112] *Id.*

[113] *Id.*

[114] *Id.* at 260-61

[115] *Id.* at 260.

bring the entire restructuring process to a halt during the pendency of the suit.[116] Although these holdouts may provide valuable benefits to the sovereign financing process,[117] they can also thwart a potentially successful restructuring[118] and impose heavy burdens on the citizenry of the debtor nation.[119] Consequently, holdout bondholders can obstruct the efficient restructuring of sovereign obligations and therefore create the sovereign debt dilemma.[120]

2. Inability of Public Institutions to Solve the Sovereign Debt Crisis

In 2002, to combat the efficiency costs of the holdout problem, Anne Krueger of the International Monetary Fund called for the creation of a Sovereign Debt Restructuring Mechanism (the "SDRM") under the auspices of the IMF.[121] Based on Chapter 11 of the United States Bankruptcy Code,[122] the SDRM sought to ensure the "orderly . . . and rapid restructuring of . . . debt while protecting asset values and creditors' rights."[123] However, the plan ran into problems as soon as it was announced. On the one hand, debtor-states criticized the SDRM for its infringement on national sovereignty and its potential to increase the cost of credit.[124] On the other hand, lenders argued that a uniform means to restructure sovereign debt would reduce the number of potential investors.[125] Most importantly, however, the United States disapproved of any global regime to effect sovereign debt

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[116] Dickerson, *supra* note 4, at 1013-14.

[117] According to Professors Fisch and Gentile, "[h]oldout creditors . . . serve as a check on opportunistic defaults and onerous restructuring terms." Moreover, the enforcement of debt obligations by the judiciary "enhances the operation of the sovereign debt market by lowering the cost of financing to sovereign debtors and increasing the value of the obligation to creditors." Fisch & Gentile, *supra* note 12, at 1112.

[118] Wheeler & Attaran, *supra* note 6, at 254.

[119] *Id.*

[120] *Id.* at 262 (quoting, G. Mitu Gulati & Kenneth N. Klee, *Sovereign Piracy*, 56 BUS. LAW 635, 637-38 (2001)).

[121] KRUEGER, *supra* note 15, at 1, 21.

[122] *Id.* at 1, 4.

[123] *Id.* at 1, 4. The SDRM was modeled closely on Chapter 11 bankruptcy proceedings in the United States. *See id.* at 21.

[124] Brenneman, *supra* note 54, at 677-78.

[125] Arturo C. Porzecanski, *A Critique of Sovereign Bankruptcy Initiatives: The IMF and G7 Should Curb Financial Assistance to Countries in Trouble*, BUS. ECON., Jan. 2003, at 39, 44.

restructuring.[126] Accordingly, in April 2003, United States Treasury Secretary John W. Snow stated that it was "neither necessary nor feasible to continue working on the SDRM."[127] Given the resistance of the United States and the investment community to any "statutory bankruptcy-like process,"[128] the SDRM proposal was placed on hold.[129] Today, any prospect for the establishment of a formal nation-state restructuring regime appears to be dead.[130]

In the debate leading up to the demise of the SDRM, Treasury Secretary John W. Snow noted that "a contractual approach . . . would help promote a more orderly restructuring process . . . [because] [t]he source of . . . [the] problem . . . lies in the relationships and agreements . . . [between] debtors and their creditors."[131] Given the prevalence of UACs prior to 2003 and the resulting holdout problem, the IMF,[132] the United States,[133] and the Group of 10 (the "G-10"),[134] advocated for a full transition from unanimous action clauses to collective action clauses in sovereign financing contracts. Through the use of CACs, it was believed that the collective action problem could be mitigated, since a supermajority vote could bind a minority of holdout creditors.[135]

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[126] John W. Snow, U.S. Sec'y of Treas., Statement at the Meeting of the International Monetary and Financial Committee (Apr. 12, 2003), *available at* http://www.imf.org/external/spring/2003/imfc/state/eng/usa.htm.

[127] *Id.*

[128] Galvis & Saad, *supra* note 19, at 715. Since adoption of the SDRM would require an amendment to the IMF charter, the proposal would have required the affirmative vote of U.S. representatives to the IMF. *See* Dickerson, *supra* note 4, at 1017.

[129] Ahdieh, *supra* note 44, at 708.

[130] Brenneman, *supra* note 54, at 679.

[131] Snow, *supra* note 126.

[132] International Monetary and Financial Committee, International Monetary Fund, Communiqué, Dubai (Sept. 21, 2003) *available at* http://www.imf.org/external/np/cm/2003/092103a.htm.

[133] Ahdieh, *supra* note 44, at 708.

[134] WORKING GROUP ON CONTRACTUAL CLAUSES, GROUP OF TEN, REPORT OF THE G-10 WORKING GROUP ON CONTRACTUAL CLAUSES 3-6 (2002) [hereinafter WORKING GROUP ON CONTRACTUAL CLAUSES], *available at* http://www.bis.org/publ/gten08.pdf. The "Group of 10" "refers to the group of countries that have agreed to participate in the [IMF's] General Arrangements to Borrow, a supplementary borrowing arrangement that can be invoked if the IMF's resources are estimated to be below member's [sic] needs." INTERNATIONAL MONETARY FUND, FACT SHEET, A GUIDE TO COMMITTEES, GROUPS, AND CLUBS, 4 (2009), *available at* http://www.imf.org/external/np/exr/facts/pdf/groups.pdf. The members of the G-10 are: Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, the United Kingdom, and the United States. *Id.*

[135] BARRY EICHENGREEN ET AL., INTERNATIONAL MONETARY FUND, CRISIS RESOLUTION: NEXT STEPS, 12-15 (2003).

III. THE MEXICAN AND URUGUAYAN MODELS

A. *The Mexican Model: Rise of the Collective Action Clause*[136]

In February 2003, Mexico became the first major issuer to incorporate collective action clauses (the "CACs") into sovereign bonds governed by New York law.[137] Although other large capital markets had included CACs in sovereign bonds for quite some time, the New York markets had been hesitant to incorporate them.[138] Unlike unanimous action clauses, CACs enable a sovereign to amend certain reserved matters[139] on an outstanding bond by mere supermajority vote.[140] Both academics and multinational

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[136] Although other nations had previously incorporated collective action clauses into their sovereign bond indentures, Mexico's debt offering in 2003 was by far the largest and most visible. *See generally* Mark Gugiatti & Anthony Richards, *The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers* 6 (2004) (unpublished manuscript, *available at* http://www.law.georgetown.edu/international/documents/gugiatti.pdf).

[137] Galvis & Saad, *supra* note 19, at 715; *see also* United Mexican States, Prospectus, at 7 (Dec. 4, 2002).

[138] These markets include London, Brussels, Luxemburg, and Tokyo. Hagan, *supra* note 15 at 317-18; *see also* Elmar B. Koch, Essay, *Collective Action Clauses: The Way Forward*, 35 GEO. J. INT'L L. 665, 667 (2004). In various forms, collective action clauses have been the norm under English law since the late 19th Century. Andrew G. Haldane et al. *Optimal Collective Action Clause Thresholds* 9 (2004) (unpublished manuscript, *available at* http://www.bankofengland.co.uk/publications/workingpapers/wp249.pdf). However, in the United States, the Trustee Indenture Act of 1939 prohibits the use of CACs in corporate bonds. Trust Indenture Act of 1939 § 316(b), 15 U.S.C. § 77ppp (2004); *see also* Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 250 (1987). Due in large part to market practice, the prohibition on CACs in the corporate context migrated to sovereign bonds. Bratton & Gulati, *supra* note 7, 55. In 2002, the G-10 Working Group on Contractual Clauses issued a report calling for the inclusion of CACs in future sovereign bond agreements. WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 134, at 3-4. In particular, the Working Group noted that the inclusion of CACs would diverge from market practice in both New York and Germany. *Id.*

[139] In Mexico's 2003 issuance, reserved matters included: "payment dates, payment amounts, interest rates, . . . payment currency . . . governing law, specified events of default, *pari passu* ranking, and submission to the jurisdiction of New York courts." Galvis & Saad, *supra* note 19, at 715-16.

[140] *Id.* at 715. Within the realm of collective clauses, there is much diversity. Although the general approval threshold was set by Mexico at 75%, some counties, such as Brazil, have required up to 85% approval. Likewise, though the majority of collective action clauses measure the voting base as the percentage of all outstanding bondholders, other nations have provided that the voting base will only consist of those holders who are present at a bondholder meeting. Similarly, other issues arise when the issuing nation or a state-owned entity is a holder of its own bonds. To combat the potential of undue influence in the approval process, most indentures have incorporated disenfranchisement clauses that prevent the state or entity from voting

institutions alike view CACs as "the most critical component" of curbing disruptive holdout litigation.[141] Since a supermajority of bondholders can impose new repayment terms on recalcitrant holdout creditors,[142] CACs are an effective restraint on the "tyranny of the minority" problem.[143] To address the new risk of the majority abusing its bargaining power at the expense of minority bondholders,[144] heightened approval thresholds may be utilized.[145] Not surprisingly, CACs have been widely regarded as a necessary but potentially insufficient means to achieve the efficient restructuring of sovereign debt.[146]

Pursuant to Mexico's 2003 bond issuance, three-fourths of bondholders can ratify an amendment to certain reserved matters, such as repayment terms.[147] To curb investor concerns that the English quorum approach[148] would interfere with majority bondholder rights, the Mexican issuance provided for an approval threshold based on the total principal remaining on all outstanding bonds.[149] In addition to CACs, Mexico also incorporated a disenfranchisement clause.[150] As one of the

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on matters that require majority approval. *Id.* at 719-22; *see also* WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 131, at 1-6; Brenneman, *supra* note 54, at 681.

[141] WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 134, at 3.

[142] Brenneman, *supra* note 54, at 681; *see also supra* Part II.

[143] Buchheit & Gulati, *supra* note 99, at 1325 (quoting FRANCIS B. PALMER, COMPANY PRECEDENTS 271 (2d ed. 1881)).

[144] Fisch & Gentile, *supra* note 12, at 1094-95.

[145] The approval threshold represents the percentage of bondholders that must accept an amendment to the bond's repayment terms. WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 134, at 4. In its contractual reform recommendations, the G-10 Working Group suggested that a 75% threshold would provide optimal benefits. *Id.* On the one hand, a higher threshold would increase the probability of holdout litigation. *Id.* On the other hand, too low a threshold may enable majority abuse of minority bondholders. Fisch & Gentile, *supra* note 12, at 1094-95. Initially, investors in the United States were hesitant to accept this change out of a concern that the threshold represented the percentage of holders actually present at a bondholders' meeting. WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 4. To address this concern, the G-10 recommended that the threshold percentage be based on the total principal remaining on all outstanding bonds. *Id.*

[146] *See generally*, WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 3-7 (noting several recommendations to thwart holdouts in sovereign debt restructuring).

[147] United Mexican States, Prospectus, at 7 (Dec. 4, 2002); Galvis & Saad, *supra* note 19, at 715.

[148] WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 4. Under the English quorum approach, the approval threshold is based on the percentage of bonds that are represented at the bondholders' meeting, *not* the total number of bonds outstanding. Galvis & Saad, *supra* note 19, at 719.

[149] United Mexican States, Prospectus, at 7 (Dec. 4, 2002).

[150] Galvis & Saad, *supra* note 19, at 715.

recommendations made by the G-10,[151] disenfranchisement clauses ensure that "[b]onds owned or controlled directly or indirectly, by the Issuer or by any public sector instrumentality of the Issuer . . . be disregarded and deemed not to be [o]utstanding."[152] To curb concerns over potential vote manipulation by the sovereign debtor,[153] such provisions limit the ability of a sovereign to distort the outcome of a proposed debt restructuring by having bondholders vote against their interests and in favor of the sovereign's dictates.[154] Although Mexico limited the scope of its disenfranchisement clause,[155] the 2003 issuance did prohibit bonds "owned directly or indirectly by the [Mexican] federal government" from being counted in any subsequent vote.[156] Within a year of Mexico's drastic contractual reforms, both CACs and disenfranchisement clauses became standard market practice in New York.[157]

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[151] In 2002, the G-10 formed a Working Group on Contractual Clauses "to consider how sovereign debt contracts could be modified in order to make the resolution of debt crises more orderly." WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 1. To that end, in September of 2002, the Working Group issued a Report with recommendations of contractual provisions to include in future sovereign financing agreements. *Id.* For the Working Group, the objectives to be achieved were:

> (i) to foster early dialogue, coordination, and communication among creditors and a sovereign caught up in a sovereign debt problem;
>
> (ii) to ensure that there are effective means for creditors and debtors to re-contract, without a minority of debt-holders obstructing the process; and
>
> (iii) to ensure that disruptive legal action by individual creditors does not hamper a workout that is underway, while protecting the interest of the creditor group.

Id.

[152] *Id.* at 7.

[153] Galvis & Saad, *supra* note 19, at 720.

[154] WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 4.

[155] The wording of the Mexican disenfranchisement clause is somewhat narrower than that suggested by the G-10. Galvis & Saad, *supra* note 19, at 720. Under the G-10's wording, bonds "owned or controlled" by the sovereign would be prohibited. WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 17. Because Mexico limited its provision to bonds "owned" by the federal government, this might be viewed as more favorable to the sovereign debtor. Galvis & Saad, *supra* note 19, at 720. Although most other sovereigns have followed Mexico's lead, Uruguay adopted the G-10's recommendation word-for-word. *Id.*

[156] *Id.*

[157] INTERNATIONAL MONETARY FUND, PROGRESS REPORT TO THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE ON CRISIS RESOLUTION 5 (Apr. 20, 2004), *available at* http://www.imf.org/external/np/pdr/cr/2004/eng/042004.pdf. In less than a year after Mexico made its initial offering using CACs, over 11 countries, including Chile, Indonesia, Israel, Italy, Peru, Poland, Turkey and Venezuela, incorporated CACs into their bonds governed by New York law. *Id.* at 3; *see also* Koch, *supra* note 138, at 673. Indeed, although "there were no sovereign bonds with CACs on

However, while the Mexican reforms were necessary, they were insufficient to achieve effective creditor cooperation in the absence of other coercive legal remedies.[158]

B. The Uruguayan Model

In March 2003, Uruguay became the second country to issue sovereign bonds incorporating CACs.[159] Like the Mexican model, Uruguay provided for both a 75% approval threshold on reserved matters[160] as well as an issuer disenfranchisement provision.[161] In addition to the incorporation of reforms adopted from the Mexican model,[162] the Uruguayan issuance also included aggregation principles[163] and a weak-trustee structure.[164] When compared to the Mexican reforms, the Uruguayan additions appear to provide a superior means to tackle several of the unresolved collective action problems.[165] However, though the Uruguayan issuance appears to better constrain the power of holdout creditors, it too fails to fully address the collective action crisis of sovereign debt restructuring.[166]

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the New York market in 2002, in 2003 nearly 50% . . . of all new sovereign bonds under New York law included CACs." *Id.*

[158] Robert B. Gray, Chairman, Int'l. Primary Mkt. Ass'n., Remarks at UNCTAD Fourth Inter-Regional Debt Management Conference (Nov. 11, 2003), *available at* http://www.efmagroup.net/getdoc/7514dd4b-4c34-4bc0-a266-f77648b5638a/111103-RBG-UNCTAD-Speech-PDF.aspx.

[159] República Oriental, Indenture, *supra* note 21, at 13-15; *see also* Galvis &. Saad, *supra* note 19, at 717.

[160] República Oriental, Indenture, *supra* note 21, at 36. Under the Uruguayan issuance, reserved matters are very similar to those included under the Mexican model. *See supra* note 139 and accompanying text. In Uruguay's 2003 issue, reserved matters include: payment dates, principal amounts, interest rates, currency, percentage of votes required for taking any action, *pari passu* rankings, governing law, and submission to New York courts' jurisdiction. República Oriental, Indenture, *supra* note 21, at 38.

[161] Unlike the Mexican issuance, the Uruguayan disenfranchisement clause mirrored the G-10 recommendations exactly. Galvis & Saad, *supra* note 19, at 720; *see also* República Oriental, Indenture, *supra* note 21, at 25.

[162] Galvis & Saad, *supra* note 19, at 717.

[163] República Oriental, Indenture, *supra* note 21, at 36; *see also* Galvis & Saad, *supra* note 19, at 722-23.

[164] República Oriental, Indenture, *supra* note 21, at 15; *see also* Galvis & Saad, *supra* note 19, at 724.

[165] *See infra* Part III.B.1-2.

[166] *See infra* Part IV.

1. Aggregation

Under the Mexican model, voting provisions and approval thresholds apply individually to each bond series, and as a result, hinder the efficient restructuring of sovereign debt.[167] In the absence of aggregation, an issuer must seek approval of a restructuring plan from the requisite percentage of holders in each individual bond series.[168] Consequently, collective action problems arise both among bondholders within the same class, as well as among the various series of bonds.[169] As the number of series increases, or when different modification provisions govern several different series of bonds, this process becomes progressively complex.[170] Similarly, the repeated renegotiation of identical terms across multiple bond series can prove to be incredibly inefficient to the sovereign debt restructuring process.[171] Without aggregation, a group of rogue bondholders within a single series can hold up a potentially successful restructuring.[172] In an effort to ameliorate these holdout creditors and move the restructuring process forward, a sovereign may "purchase" the consent of dissenting creditors through side payments, and inadvertently create a run on the sovereign debtor's assets.[173] Moreover, even

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[167] *See* Galvis & Saad, *supra* note 19, at 722-23. A single bond issuance may incorporate multiple series of bonds. For example, after the debt crisis of 2001, Argentina had to restructure 152 different bonds, issued in 14 different countries, denominated in seven different currencies, and subject to eight different governing laws. Dr. Guillermo Nielsen, Argentine Republic Sec'y of Finance, Speech at Dubai on Argentina's Restructuring Guidelines (Sept. 22, 2003), *available at* http://www.argentinedebtinfo.gov.ar/documentos/discurso_gn_dubai_con_diap_english.pdf.

[168] WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 3.

[169] Galvis & Saad, *supra* note 19, at 722.

[170] David A. Skeel, Jr., Review Essay, *Can Majority Voting Provisions Do It All?*, 52 EMORY L. J. 417, 422-23 (2003). For example, an issuer could experience significant problems if one series of bonds is governed by CACs and another series has incorporated UACs.

[171] Barry Eichengreen & Ashoka Mody, *Is Aggregation a Problem for Sovereign Debt Restructuring?* 1 (Jan. 2003) (unpublished manuscript, *available at*, http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=801485); *see also* INTERNATIONAL MONETARY FUND, LEGAL DEPARTMENT, THE RESTRUCTURING OF SOVEREIGN DEBT—ASSESSING THE BENEFITS, RISKS, AND FEASIBILITY OF AGGREGATING CLAIMS 8 (2003) (available at http://www.imf.org/external/np/pdr/sdrm/2003/090303.pdf).

[172] Fisch & Gentile, *supra* note 12, at 1094. The success of such a holdout strategy will ultimately depend on whether the bonds incorporate UACs or CACs. LEGAL DEPARTMENT, INTERNATIONAL MONETARY FUND, THE RESTRUCTURING OF SOVEREIGN DEBT—ASSESSING THE BENEFITS, RISKS, AND FEASIBILITY OF AGGREGATING CLAIMS 8 (2003).

[173] Eichengreen & Mody, *supra* note 171, at 3. Under the United States Bankruptcy Code, private debtors and creditors can avoid this outcome because of the effect of the automatic stay (which halts attempts by creditors to collect on their debt

assuming that a change in repayment terms could be effectuated across multiple series of bonds, the size of a single holdout's stake may be large enough to make the entire restructuring meaningless.[174]

To address these efficiency issues and conform to the contractual recommendations of the G-10,[175] Uruguay became the first sovereign to incorporate aggregation principles that provide for the cram down modification of reserved matters across multiple series of bonds.[176] Under this provision, an amendment to repayment terms can be imposed against multiple bond series.[177] Specifically, cram down can occur if the proponents of the modification obtain the support of "[h]olders of not less than 85% in aggregate principal amount of the Outstanding Debt Securities of all Series affected by that Modification (taken in aggregate) . . . and [h]olders of not less than 66-2/3% in aggregate principal amount of the Outstanding Debt Securities of that Series (taken individually)."[178] When combined with Uruguay's 75% approval threshold CAC,[179] aggregation allows the issuer to impose repayment term amendments on a one-third-minority holdout.[180]

Most importantly, the incorporation of an aggregation clause encourages the type of collaboration and shared sacrifice that was commonplace during the era of syndicated bank lending.[181] Because of cram down, aggregation permits the

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during the pendency of the case) and avoidable preference provisions (which void transactions that were made on the eve of filing the bankruptcy petition). 11 U.S.C. §§ 362, 547 (2005).

[174] For example, if the holdout was the cause of the sovereign's financial crisis.

[175] Although the G-10 Working Group did "not [focus] on the technicalities of [aggregation provisions] in any detail," their 2002 report did note that such clauses have "a great deal of potential" and "[merit] further exploration." WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 138, at 6.

[176] Alinna Arora & Rodrigo Olivares Caminal, *Rethinking the Sovereign Debt Restructuring Approach*, 9 L. & BUS. REV. AM. 629, 663-64 (2003).

[177] Galvis & Saad, *supra* note 19, at 722.; *see also* WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 6-7.

[178] República Oriental, Indenture, *supra* note 21, at, 36; *see also* Galvis & Saad, *supra* note 19, at 722.

[179] Galvis & Saad, *supra* note 19, at 723.

[180] By providing for aggregation, the Uruguayan model "effectively reduces" the approval threshold "from 75% to two-thirds." Galvis & Saad, *supra* note 19, at 723. For example, under CAC with a 75% approval threshold, a minority faction of one-third of outstanding bondholders in a single series can block any amendment to reserved matters for that series. With aggregation, however such holdouts have less power. If the proponents of a reserved matter modification can obtain the approval of 85% of the aggregate principle of all outstanding series, the amendment can be crammed down on a single series with no more than one-third holdouts.

[181] *See supra* Part I.B.

issuer to focus on areas of collective agreement across multiple bond series.[182] Similarly, the threat of cram down encourages the holders of different bonds to work together to arrive at a settlement that is jointly advantageous.[183] With the presence of a highly liquid secondary market, moreover, recalcitrant bondholders remain free to avoid what they may deem as inequitable concessions by selling their bonds in the open market.[184] As a result, the Uruguay model promotes and fosters collaboration among creditors while providing an avenue for those who wish to opt out of the process.[185]

2. Fiscal Agency and Trust Structures

While collective action clauses make the restructuring of sovereign debt somewhat easier, they only solve a portion of the holdout problem.[186] Under both UACs and CACs, sovereign bonds issued pursuant to New York law generally incorporate a fiscal agency structure.[187] Under this approach, each bondholder retains an individual right to seek legal remedies against the sovereign debtor in the event of default.[188] Although direct legal actions were at one time quite rare,[189] litigation to collect against sovereign debtors is increasing.[190] In the absence of "sharing clauses,"[191] litigating creditors under both the Mexican and the Uruguayan models do not have to divide legal awards

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[182] Galvis & Saad, *supra* note 19, at 722.

[183] Fisch & Gentile, *supra* note 12, at 1090-95.

[184] *Id.*

[185] *Id.*

[186] Fisch & Gentile, *supra* note 12, at 1093-95; *see also* Skeel, *supra* note 170, at 423-24.

[187] Galvis & Saad, *supra* note 19, at 723; *see also* WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 138, at 6. Although sovereign bonds issued in England have incorporated trust deeds for quite some time, sovereign bonds in the United States typically utilize a fiscal agent. WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 6; Fisch & Gentile, *supra* note 12, at 1102.

[188] INTERNATIONAL MONETARY FUND, PROGRESS REPORT TO THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE ON CRISIS RESOLUTION 10 n.16 (Apr. 20, 2004) [hereinafter IMF, PROGRESS REPORT], *available at* http://www.imf.org/external/np/pdr/cr/2004/eng/042004.pdf.

[189] Bratton & Gulati, *supra* note 7, at 34.

[190] IMF, PROGRESS REPORT, *supra* note 188, at 13.

[191] For example, in the event that a court awards a litigating bondholder a "disproportionate" judgment, a sharing clause may require that bondholder to turn over any overpayment to the fiscal agent for a pro rata distribution to other bondholders. Although such clauses were common during the era of syndicated bank lending, they are rarely found in sovereign bond financing. Lee C. Buchheit, *Changing Bond Documentation: The Sharing Clause*, 17 INT'L FIN. L. REV. 17, 17-18 (1998).

pro rata with fellow bondholders.[192] Because sovereign debt restructuring qualifies as a "zero sum game,"[193] litigation becomes "infectious"[194] as creditors race to seize a defaulting sovereign's assets.[195] Accordingly, though the introduction of CACs and aggregation principles begin to address the holdout problem, civil suits by dissenting bondholders continue to reduce both the net pool of assets available to other creditors as well as the potential for a successful restructuring of the sovereign's outstanding debt.[196]

Under the Mexican model, the fiscal agent is a relatively weak entity that controls merely the distribution of payments and simple forms of interaction between the issuer and the bondholders.[197] As an agent of the sovereign debtor, the fiscal agent does not represent the interests of the bondholder class.[198] Pursuant to most Fiscal Agency Agreements,[199] the fiscal agent "acts solely . . . for the issuer and does not have any fiduciary relationship to the bondholders."[200] As a result, the fiscal agent has very limited bondholder duties.[201] In most cases, these obligations are confined to: giving notice of specified events, assembling a bondholder meeting if petitioned by the requisite percentage of bondholders, and appointing a chairperson at the bondholder meeting.[202] Given that the fiscal agent has no power to file suit against the sovereign debtor,[203] and that the creditors retain an individual right to litigate on their claims,[204] the fiscal agency structure is ineffective in preventing disruptive litigation on the part of holdout creditors.[205]

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[192] Brenneman, *supra* note 54, at 680.

[193] Buchheit, *supra* note 191, at 18. In other words, the sovereign's assets that are available to satisfy bondholder debt are limited. Therefore, as one creditor collects on its claim, another creditor is left with fewer assets to satisfy its claim.

[194] *Id.*

[195] *Id.*

[196] Fisch & Gentile, *supra* note 12, at 1093-95 .

[197] Macmillan, *supra* note 33, at 65-66.

[198] Fisch & Gentile, *supra* note 12, at 1102 .

[199] The Fiscal Agency Agreement is the controlling document that governs the sovereign debtor and fiscal agent relationship. Macmillan, *supra* note 56, at 341.

[200] *Id.* at 341-42.

[201] *Id.* at 341.

[202] *Id.*

[203] *See also* Working Group on Contractual Clauses, Group of Ten, Report of the G-10 Working Group on Contractual Clauses (2002), *available at* http://www.bis.org/publ/gten08.pdf.

[204] Fisch & Gentile, *supra* note 12, at 1102.

[205] *Id.* at 1103.

To avoid some of the collective action and efficiency problems inherent in multiple civil suits,[206] the Uruguayan model incorporates a weakened trustee structure instead of the fiscal agency model.[207] Although the trustee structure does not preclude individual bondholders from filing suit to recover outstanding amounts payable,[208] the trustee does have the power to initiate legal action on behalf of the bondholder class.[209] Accordingly, in the event of a default, the trustee is an "identifiable leader" to coordinate collective bondholder action.[210] Similarly, when engaged in litigation, the trustee acts for the benefit of the entire bondholder class and distributes any resulting award pro rata.[211] In accordance with G-10 recommendations,[212] the trustee is also responsible for gathering and distributing financial information concerning the sovereign debtor in the event of a debt restructuring.[213] Yet, while the Uruguayan trustee structure plays a more prominent role in addressing the holdout problem, the model fails to

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[206] *See supra* Part II.B.

[207] República Oriental, Indenture, *supra* note 21, at 17;, *see also* Part IV. Uruguay was the first nation to utilize an Indenture Trustee in a New York sovereign financing agreement. Galvis &. Saad, *supra* note 19, at 724. In addition, by incorporating a weak trustee structure, the success of Uruguay's issuance also demonstrated a market willingness to move away from the traditional fiscal agency model.

[208] In particular, if the Republic fails to make payments when due, individual bondholders can sue to recover. República Oriental, Indenture, *supra* note 21, at 15; *see also* Arora & Caminal, *supra* note 176, at 663; Galvis &. Saad, *supra* note 19, at 724.

[209] The trustee can initiate such action on the request of 25% of outstanding bondholders. República Oriental, Indenture, *supra* note 21, at 15. Pursuant to the indenture, "the Trustee, in its own name . . . shall be entitled and empowered to institute any action or proceedings at law or in equity for the collection of . . sums . . . due and unpaid." *Id.* at 13. Some academics suggest that the primary benefits of a trustee could be achieved without shifting from the fiscal agent structure. By "concentrat[ing] 'the right to sue' in a single representative of bondholders" the same benefits could be obtained. Galvis & Saad, *supra* note 19, at 723-25.

[210] Macmillan, *supra* note 56, at 341.

[211] Galvis & Saad, *supra* note 19, at 722-24.

[212] WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 3.

[213] Such information includes:

> (i) a description of the economic or financial circumstances that . . . explain the request for the proposed Modification;
>
> (ii) if the Republic . . . [has] entered into a standby, extended funds, or similar program with the International Monetary Fund . . . ; and
>
> (iii) a description of the Republic's proposed treatment of its other major creditor groups . . . .

República Oriental, Indenture, *supra* note 21, at 37; *see also*, Galvis & Saad, *supra* note 19, at 722; Anna Gelpern, *How Collective Action is Changing Sovereign Debt*, 22 INT'L FINANCIAL L. REV., 19 (2003).

prevent rogue litigation,[214] and as a result, collective action problems remain.

IV. THE SUPER TRUSTEE SOLUTION

In 2002, when the G-10 reported on contractual solutions to the sovereign debt crisis, it recommended both the inclusion of CACs[215] and the incorporation of a "super" trustee structure.[216] Under the "super" trustee model, bondholders generally do not have the right to bring legal actions in their individual capacity.[217] Rather, the authority to file suit against the sovereign debtor usually lies solely with an indenture trustee.[218] As a result, litigation can only be brought on the trustee's own initiative or upon the direction of a specified percentage of outstanding bondholders.[219] Similar to the Uruguay model, if any resulting legal action proves successful, the trustee, as representative of the entire bondholder class, must share any award pro rata.[220]

For the better part of the last century, the Trust Indenture Act of 1939 (the "Act") has mandated a trust indenture structure for public corporate bonds.[221] Under the Act, the trustee is an agent of the bondholders and owes to them a duty of good faith.[222] Although the trustee's duties are limited outside of the default scenario,[223] the trustee does ensure compliance with the terms of the indenture even when the debtor is paying as required.[224] If a debtor defaults,

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[214] Galvis & Saad, *supra* note 19, at 723-24. Although the Uruguayan Trustee curbs holdout litigation on accelerated amounts (those payments not yet due), it fails to effectively control individual legal actions for past amounts due. *Id.* at 724 n.23.

[215] WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 3.

[216] Other recommendations included: revised provisions for calling bondholder meetings; majority enforcement of acceleration clauses; provisions requiring appropriate information to be disseminated to bondholders; and disenfranchisement provisions from the issuer of the bonds. *See id.* at 2-7.

[217] IMF, PROGRESS REPORT, *supra* note 157, at 10 n.16.

[218] WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 6-7.

[219] IMF, PROGRESS REPORT, *supra* note 157, at 10 n.16.

[220] WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 6-7.

[221] Yakov Amihud, Kenneth Garbade, & Marcel Kahan, *A New Governance Structure For Corporate Bonds*, 51 STAN. L. REV. 447, 485 (1999). In addition, the Trust Indenture Act of 1939 explicitly exempts governments, both domestic and foreign, from its requirements. 15 U.S.C.A. § 77ddd(a)(6) (1998); *see also* Macmillan, *supra* note 56, at 339-41.

[222] Macmillan, *supra* note 586, at 339-41.

[223] Fisch & Gentile, *supra* note 12, at 1105.

[224] Macmillan, *supra* note 586, at 339-40.

however, the trustee's duties become much more complex.[225] In accordance with the Act, the debtor's default triggers the trustee's fiduciary duties to the bondholder class.[226] In addition, the trustee is the only entity that is able to accelerate principal amounts due on outstanding bonds.[227] Unlike a fiscal agent, the trustee acts as a fiduciary for bondholders, and thus only the trustee may file suit against the debtor.[228] Unless the trustee fails to comport with its fiduciary obligations, bondholders are limited in the types of lawsuits they can bring.[229] Consequently, the Act both limits the ability of holdouts to pursue obstructive litigation tactics and provides bondholders with a centralized fiduciary to enforce the payment obligations of recalcitrant corporate debtors.[230]

Although the Uruguayan model provides for an indenture trustee with some control over the sovereign debt restructuring process, it fails to solve the holdout dilemma, because rogue creditors can continue to file adversary actions.[231] By incorporating CACs and aggregation principles but failing to preclude suits by individual bondholders,[232] the model fails to live up to its full potential.[233] Under a "super" trustee approach akin to that required by the Trust Indenture Act, the holdout problem could be greatly curbed.[234] Whereas CACs and aggregation clauses in the Uruguay model prevent holdout creditors from halting the restructuring process itself, the problem of a race to the sovereign debtor's assets remains.[235] By entrusting an individual or entity with exclusive power to file suit for default, the "super" trustee structure prevents vulture funds and rogue creditors from disrupting the restructuring process with threats of costly and cumbersome litigation.[236] Similarly, the pool of assets to be distributed among equally

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[225] *Id.* at 339-41.

[226] *Id.*

[227] Fisch & Gentile, *supra* note 12, at 1104.

[228] *Id.* at 1105. Although the Act provides that public, corporate bondholders have an absolute right to sue for past amounts due (as opposed to accelerated amounts), this provision could be removed from sovereign bond trustee indentures. *See* Galvis & Saad, *supra* note 19, at 724 n.23.

[229] Fisch & Gentile, *supra* note 12, at 1105.

[230] *Id.*

[231] *See* Galvis & Saad, *supra* note 19 , at 723.

[232] *See id.* at 723-25.

[233] *See* Fisch & Gentile, *supra* note 12, at 1094.

[234] *See id.*

[235] *See id.*

[236] *See* WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 6-7.

situated bondholders is not raided, but distributed pro rata.[237] In addition, the case law and legal theories that have been applied to the trustee structure in the corporate context for almost three-fourths of a century could easily be transplanted to sovereign debt.[238] Furthermore, fiduciary duties should curb fears that a trustee will not be aggressive in defending bondholders' interests.[239] Accordingly, the application of a "super" trustee structure should be the next step in solving the holdout crisis at the core of the sovereign debt dilemma.[240]

CONCLUSION

Although sovereign financing has undergone significant contractual reforms over the past decade,[241] these efforts have generally failed to adequately address the inefficiencies created by holdout strategies. In the absence of a global sovereign debt restructuring regime, both creditors and debtors will need to continue to rely on contractual methods to effectuate sovereign debt restructuring.[242] Notwithstanding the laudable improvements made by Mexico and Uruguay,[243] additional refinements are necessary. In particular, the sovereign financing market should move towards the incorporation of a super trustee indenture. With a trustee to coerce creditor cooperation and ensure equitable treatment among bondholders, the super trustee fills in the gaps left by the early reforms. Therefore, the super trustee is necessary to curb the holdout problem and finally extinguish the sovereign debt dilemma.

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[237] *See id.*

[238] *See* Macmillan, *supra* note 33, at 65.

[239] Fisch & Gentile, *supra* note 12, at 1107.

[240] *See* WORKING GROUP ON CONTRACTUAL CLAUSES, *supra* note 1384, at 6-7.

[241] *See supra* Part III.

[242] *See supra* Part II.B.2.

[243] *See supra* Part III.

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