

Feel-Good Formalism

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This essay highlights a phenomenon that has no place in the conventional theory of sophisticated business contracts: the term that makes no sense as an enforceable promise, one that defies functional explanation, one that drafters blush to rationalize in retrospect or chalk up to honest mistake. The subset of contract drafters who stop and think about the term before the contract is signed know that it has little enforcement or other instrumental value. Even if a court were to enforce such a term, its interpretation would be extremely hard to predict at signing. Nevertheless, such clauses get included in contracts between sophisticated parties. Why? The authors speculate that some terms are in business contracts because the process of formalizing certain feelings about the parties' relationship in an official and routine manner characteristic of business contracting provides value to the parties. They suggest that such value is, at least in part, the satisfaction of expressing their feelings publicly and formally. The authors introduce the concept of "feel-good formalism" to describe the impulse to express feelings in contract terms, with limited or no regard for the terms' instrumental utility.

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*Etymologically this is not entirely a nonsense word: super-
“above,” cali- “beauty,” fragilistic- “delicate”, expiali- “to atone,”
and docious- “educable”, the sum of which equals “atoning for
extreme and delicate beauty [while being] highly educable.”*
-Richard Lederer, *Crazy English* (1989)

I. Introduction: Supercalifragilisticexpialidocious

This essay highlights a phenomenon that has no place in the conventional theory of sophisticated business contracts: the term that makes no sense as an enforceable promise, one that defies functional explanation, one that drafters blush to rationalize in retrospect or chalk up to honest mistake. In the typology of suboptimal contracting, this nonsense term is adjacent to but distinct from the wildly ambiguous term, which might reflect incomplete information, a deliberate agreement to disagree,¹ or a commitment to stay out of court.² The nonsense term is inserted intentionally, and thus different from a true oversight. It may be brand new and nonsensical from the start; or it may have lost meaning over time, yet is deliberately retained in the contract.³ It may occasionally look

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¹See e.g. Charles J. Goetz & Robert E. Scott, “Principles of Relational Contracts” (1981) 67 Va. L. Rev. 1089 at 1091.

² Claire A. Hill, “Bargaining in the Shadow of the Lawsuit: Norms Theory of Incomplete Contracts” (2009) 34 Del. J. Corp. L. 191.

³On “sticky boilerplate” terms that are retained despite being suboptimal (though not necessarily nonsense), see Marcel Kahan & Michael Klausner, “Standardization and Innovation in Corporate Contracting (or “The Economics of Boilerplate”)” (1997) 83 Va. L. Rev. 71; Charles J. Goetz & Robert E. Scott, “The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms” (1985) 73 Cal. L. Rev. 261 [Goetz & Scott]. See Mitu Gulati & Robert E. Scott, *Three and a Half Minutes* (2009) [unpublished, archived with authors] for a full literature survey and catalogue of theoretical explanations of boilerplate stickiness.

like an illusory promise (“I will if I want to”), traditionally unenforceable in contract law, yet it is purposefully bargained for by the other side. It is unlike a recital, which may describe the parties’ motives for entering into the contract but is not generally intended for direct, functional implementation.⁴ The nonsense term purports to tell the parties what to do, but simply does not work, and makes this defect transparent to anyone who pauses to read it twice, to say nothing of the sophisticated business people whom it purports to bind.

We speculate that some nonsense terms are in business contracts at least in part because – like “supercalifragilisticexpialidocious” in Disney’s film version of *Mary Poppins* – they make the parties feel good for saying the words. To be sure, such terms usually make more linguistic sense than the “eighteen consonants and sixteen vowels” in the ditty, yet a drafter who stops to think about the term before the contract is signed knows full well that no party would sue on it, no court would enforce it, and it would make little if any difference in the normative constitution of the parties’ relationship – it would give the breacher no added pause before breaching.⁵ Yet one side insists on the term because it expresses something, something it wishes to say publicly and formally about the relationship it is about to enter. We call this phenomenon “feel-good formalism” to denote an anti-instrumental, aesthetic and sentimental attraction to legal form, in which the primary aim is to make the speaker feel better for deploying the form. Our adoption of the term “formalism” is admittedly unorthodox; we use it to link our examples both to the literature on the production of contract documents, and to the debate about judicial interpretation and drafting incentives.⁶

⁴Recitals may stop short of being performative utterances. See Claire A. Hill, “A Comment on Language and Norms in Complex Business Contracting” (2001) 77 *Chicago-Kent L. Rev.* 29 [*Language and Norms*].

⁵ This essay is limited to terms that have neither legal nor normative “bite”. Some terms that have no legal force have strong normative pull and are bargained for this reason; they are beyond the scope of this essay.

⁶ We rely in part on Annelise Riles’s exploration of the formalist aesthetic. Annelise Riles, “The Transnational Appeal of Formalism: The Case of Japan’s Netting Law” (2000) *Stanford/Yale Junior Faculty Forum*, Research Paper No. 00-03, online: [Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=162588>](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=162588). The term formalism is used differently throughout the law literature; in recent contracts scholarship, it has come to describe a subset of reactions to 20th-century legal realism, which favor judicial interpretation strategies that hew close to the plain meaning of express contract terms and rely less on the social context. See Richard H. Pildes, *Forms of Formalism*, 66 *U. CHI. L. REV.* 607 (1999) (describing the wide range of meanings ascribed to the term “formalism” by law scholars, published in a symposium exploring the range). We are mindful of the risks inherent in using

We illustrate what might be feel-good formalism with examples from emerging market sovereign debt contracts; however, we suspect that the phenomenon occurs throughout business contracting. Moreover, if it turns out that the feel-good motive drives the production and use of nonsense terms, it is likely present, albeit less prominent, in the parts of the contract that make more functional sense.

We begin by describing what we believe to be one of the purest examples of a feel-good term, the promise never to seek restructuring of a debt instrument, which became standard in the Brady Bonds issued by poor and middle-income governments beginning in 1990. These bonds were the last and most successful policy response to the debt crisis that gripped middle-income and poor countries in Latin America and elsewhere for most of the 1980s. They also marked a shift from commercial bank loans to capital markets finance for governments in developing countries, and the start of what became the multi-trillion dollar emerging markets bond market.⁷ Bond contracts in this relatively young market are the subject of our remaining examples.

After exploring the peculiarities of Brady Bond anti-restructuring terms, we move to the feel-good aspect of the *pari passu* clause, an old and sticky term which became a rallying cry for equal treatment among the creditors of defaulting sovereigns in the late 1990s. We revisit the controversy surrounding the term using our expressive lens. Finally, we recount recent changes in sovereign debt documentation that made it virtually impossible to alter the contractual choice of litigation forum, even as they made it much easier to

a term that has been debated at length and in depth, and has become quite loaded. See e.g., Lawrence B. Solum, *Legal Theory Blog: Choi & Gulati on Contracts*, Dec. 30, 2005 at http://lsolum.typepad.com/legaltheory/2005/12/choi_gulati_on_.html (addressing the use of the term “formalism” in an earlier paper co-authored by one of us). We see an offsetting benefit in linking to the formalism conversation: we explore new motives behind the parties’ attachment to particular nonsense terms. To the extent such attachment helps support the broader bargain, a “formalist” court faces the challenge of enforcing terms that are difficult or impossible to operationalize.

⁷ EMTA, *History and Development*, at <http://www.emta.org/template.aspx?id=34> (last visited Nov. 2, 2009). See also *infra* note 11. The volume of debt outstanding has recently hovered around \$500 billion. See J.P. Morgan, *Tradeable Index Strategies: Emerging Markets*, at <http://www.jpmorgan.com/pages/jpmorgan/investbk/solutions/research/EMBI> (listing the market capitalization of the leading index at \$486.90 billion as of October 30, 2009).

reduce the principal and interest on the underlying debt. Lawyers involved in this innovation justified the apparent disconnect primarily in expressive terms.

II. Don't Even Ask

By 1989, the bankers were tired. Tired of not getting paid, tired of weekend calls from government officials, tired of hearing echoes of their own footsteps in the stone corridors of the New York Fed, and more than anything, tired of seeing one another's long faces around the endless parade of conference room tables in London, Paris, New York, Manila and Buenos Aires.

A cascade of sovereign debt crises, beginning with Mexico's payment suspension in August 1982, prompted concerted international efforts to preempt outright default using serial payment reschedulings, "quasi-voluntary"⁸ injections of new money by old creditors to service old debts, and all manner of accounting gimmicks to help forestall the recognition of pervasive debt distress on the queasy balance sheets of the world's leading financial institutions. For all the headaches it caused the banks, what came to be known as the Third World Debt Crisis of the 1980s had dire effects on the borrowers: a "lost decade" of economic decline and human suffering, an ever-growing debt burden, and a succession of painful economic reform programs under the auspices of the World Bank and International Monetary Fund.

After seven years of quietly assuring commercial banks that they would suffer no losses on their developing country exposure, the U.S. Administration shifted tactics. Nicholas F. Brady, the new Treasury Secretary, gave a speech in March 1989 in which he stressed the centrality of "both debt and debt service reduction" — words that had been taboo — for achieving a durable end to the crisis.⁹ The speech was not only a turning point in the

⁸On this and other "idiotic" euphemisms in sovereign debt restructuring during the 1980s, see Lee C. Buchheit, "You'll Never Eat Lunch in this Conference Room Again" (1992)11:2 Int'l Fin. L. Rev. 11.

⁹Nicholas F. Brady, "Dealing with the International Debt Crisis" Remarks before a Conference on Third World Debt Sponsored by the Brookings Institution and the Bretton Woods Committee (Mar. 10, 1989), U.S., 89 Department of State Bulletin (No. 2146)(Washington, D.C.: United State Government Printing Office, May 1989).

crisis, but also in the development of the international financial markets and the underlying legal infrastructure.

The Brady Bonds were tradable instruments that banks received from their debtors (the developing country governments) in exchange for writing down their loans.¹⁰ Mexico issued the first batch in 1990. The Brady Bonds catalyzed the revival of international sovereign bond markets, which had been largely dormant since the defaults of the Great Depression. The Bradies' documentation was principally a combination of old loan, corporate bond, and original contract drafting, but it also reflected the drafting conventions in a thin smattering of sovereign bonds issued over the decades of market dormancy. Brady Bond contracts in turn became the template for emerging market sovereign bonds, a market with an annual trading volume over \$6.5 trillion in the mid 2000s.¹¹

Lawyers who participated in the Brady restructurings offered a critical insight into the underlying contract drafting. At heart, the new bonds were not “market instruments but rather crisis instruments created specifically by the creditor banks as a prerequisite for agreeing to significant debt and debt service reduction.”¹²

By 1989, the bankers were tired – but they were also angry with Brady and his principal deputy, Treasury Under Secretary David Mulford, for making them take losses when they had been promised for years that they would not have to. Commercial bank creditors that agreed to accept the Brady Bonds demanded an ironclad promise that they would never again be dragged to the same conference rooms over the same countries. The result was a set of exceptionally strict anti-modification provisions, requiring the consent of every single bondholder to amend the payment terms of any bond. Also included was, in the

¹⁰ For a concise summary of the Brady Plan from the financial industry perspective, see *The Brady Plan*, online: Emerging Markets Traders Association <<http://www.emta.org/template.aspx?id=35>>.

¹¹ *Significant Market Events and EMTA Accomplishments*, online: Emerging Markets Traders Association <<http://www.emta.org/template.aspx?id=70>>.

¹² See e.g., James Hurlock & Troy Alexander, “The Fire Next Time: The Dangers in the Next Debt Crisis” (1996) 15:3 Int'l Fin. L. Rev. 14.

words of one borrower representative, “the most fatuous thing ever to have been put into an agreement”:¹³

[The sovereign] will not, directly or indirectly, seek any restructuring or rescheduling of the Bonds or any provisions thereof, nor will it, directly or indirectly, seek or request any loans, advances, extensions of credit or other financial accommodation from any holders of the Bonds or any affiliate thereof based upon such holdings.¹⁴

Such a formal promise never to seek a debt restructuring was new in the Brady Bonds. It also made little practical sense. Suppose a sovereign borrower bound by the clause ran out of funds, or decided to stop paying, and sought to renegotiate. The creditor might refuse, which would give the debtor the choice between continued performance and payment default. Under the “don’t even ask” clause excerpted here, the creditor would also have the right to sue in the absence of payment default.¹⁵ Yet no one involved in negotiating the Brady contracts has suggested that the risk of such a lawsuit could deter a debtor contemplating default from merely requesting relief. If it existed, such a threat appears to have had no impact on Ecuador’s 1999 decision to proceed with the first default and restructuring of the Brady Bonds that were issued just four years earlier.¹⁶

¹³ Interview of Lee C. Buchheit (9 July 2009).

¹⁴ This provision is excerpted from *The 1992 Philippine Bond Fiscal Agency Agreement*, Republic of the Philippines, Morgan Guaranty Trust Company of New York, and Banque Paribus Luxembourg, 1 December 1992, 1 at 24. Substantially the same language appears in all other Brady Bond contracts of which we are aware based on our own examination of such contracts and conversations with lawyers involved in the drafting of Brady Bond documentation.

The excerpted provision is distinct from the classic anti-modification term, which has come to be disfavoured in U.S. contract doctrine. See e.g., *Beatty v. Guggenheim Exploration*, 122 N.E. 378 (N.Y. 1919) (“Those who make a contract, may unmake it. The clause which forbids a change, may be changed like any other.”) Unlike the Brady term, which only binds the sovereign, the provision invalidated by Justice Cardozo in *Beatty* – a general prohibition of oral modification and waiver – purported to bind both parties. See e.g., Christine Jolls, “Contracts as Bilateral Commitments: A New Perspective on Contract Modification” (1997) 26 J. Legal Stud. 203. Explicit formal restrictions on modification are also distinct from structural and functional barriers that may make modification difficult or practically impossible. The unanimity requirement for amending payment terms, present in all Brady Bonds, may be characterized as a combination of formal and functional barrier: unanimous consent is so difficult to attain that its requirement is tantamount to a formal prohibition on amendment. For a typology of anti-modification devices, see Anna Gelpern & Adam J. Levitin, “Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities” S. Cal. L. Rev. [forthcoming in 2009].

¹⁵ The creditor might also sue based upon the excerpted clause to enjoin a restructuring agreed upon by other bondholders — except that there could be no such restructuring as a practical matter where the contract requires unanimous consent by every bondholder.

¹⁶ See Lee C. Buchheit, “How Ecuador Escaped the Brady Bond Trap” (2000) 19:12 Int’l. Fin. L. Rev. 17. The “don’t even ask” provision was sufficiently bothersome for Ecuador to ask creditors participating in its Brady Bond exchange to vote to delete it from the old bonds. It seems ironic in retrospect that, unlike the

Why, then, did the creditors insist on, and borrowers accept, such nonsense in their contracts? The borrowers' answer seems simple: it would cost them nothing "because it was so fatuous."¹⁷ Unlike other provisions in business contracts that are not normally intended to be enforced as written,¹⁸ a "don't even ask" clause would not shame a would-be defaulter into paying, or deter a casual inquiry into restructuring terms (assuming such inquiries are ever made).¹⁹ The clause offers no road map, jogs no memory, administers no truth serum to debtor government functionaries.²⁰ For the serially defaulting sovereign,²¹ it seems costless and strongly resembles a textbook illusory promise ("I will not seek to restructure until I do").

The creditors' motives are harder to discern, and potentially more interesting. Some have suggested that the new term was an attempt at retribution, and a shot across the bow aimed less at the borrowers, than at the international official sector – rich country governments and international financial institutions – seen as betraying earlier promises not to force bankers into debt relief.²² Yet neither the term nor anything else in the contract purported to bind official actors. Although the officialdom of the day most likely felt a reputational stake in the outcome, the contract between the debtor and its creditors was an odd place to express it.

payment terms, the solemn promise never to seek restructuring could be amended by a simple majority of the bondholders.

¹⁷ *Supra* note 12.

¹⁸ Hill details at least a dozen in *Language and Norms*, *supra* note 4.

¹⁹ We suspect that the normative pull of such a clause may be weaker for a sovereign than for a private debtor because it is likely to represent a moral or political commitment of a different government. And to the extent the clause purports to sanction a restructuring request, rather than payment default, its political legitimacy may be difficult to maintain in economic distress even where a government would prefer to pay.

²⁰ *Language and Norms*, *supra* note 4.

²¹ See Carmen M. Reinhart, Kenneth S. Rogoff & Miguel A. Savastano, *Debt Intolerance*, 2003 BROOKINGS PAPERS ON ECON. ACTIVITY 1 (2003).

²² *Cf.* George Triantis & Mitu Gulati, "Contracts Without Law: Sovereign Versus Corporate Debt" (2007) 75 U. Cin. L. Rev. 977 (suggesting that some of the contract terms in sovereign contracts might serve a creditor-multilateral communication function). See Jeremy Bulow & Kenneth Rogoff, "Multilateral Negotiations for Rescheduling Developing Country Debt: A Bargaining-Theoretic Framework" (1988) 35 IMF Staff Papers 644 (discussing sovereign debt restructuring as a multilateral process including debtors, creditors, and the official sector). This is distinct from the view of the contract as the parties' communication of the substantive terms of their relationship to the state *qua* courts for subsequent enforcement, described in *Goetz & Scott*, *supra* note 3 at 262. Here the recipient of the message is some combination of the Executive, multilateral institutions, and independent agencies such as central banks.

In retrospect, government officials privy to the Brady negotiations sound sheepish about the clause. In the words of one senior official at the U.S. Federal Reserve at the time, “You bloody lawyers while I was asleep let the Bradies go forward with ‘cross our heart and hope to die...’ ”²³ They suggest that the clause served as symbolic reinforcement of the Bradies’ status as exit instruments for long-suffering banks, and may have reaffirmed what was then believed to be a practical reality – that bonds held by a multitude of atomistic creditors dispersed worldwide could not be restructured, at least not without causing a global financial cataclysm.

For our purposes, the crucial point is that in over a decade of working in the sovereign debt community, we have found no one willing to attribute functional significance to the promise not to seek a restructuring.²⁴ On paper, it was a negative covenant, one of the most important structural elements of a business contract.²⁵ In practice, it was a symbol, a marker, a *cri de coeur*, a plaintive never-again that made it crystal-clear to everyone how the banks felt about the events leading up to the contract. It was the antithesis of stale boilerplate, a new provision that was most important in the very context where it was introduced – as a matter of expression – perhaps more so because it could have little, no, or highly uncertain practical effect on the behavior of the parties going forward.

III. *Liberté, égalité, fraternité*

In the 1988 film *A Fish Called Wanda*, the lead character makes her lovers jabber in foreign languages during intimate encounters. Latin phrases occasionally play a similar role in business contracts.²⁶ In the case we discuss below, the Latin term *pari passu*, whose meaning in sovereign debt contracts remains obscure and actively contested after a

²³Interview of former Federal Reserve Board official (7 October 2005) on the condition of anonymity.

²⁴Our observation is not based on statistical surveys of the sort that might be used to test the intuition advanced here; an in-depth empirical study is beyond the scope of this essay.

²⁵*Language and Norms*, *supra* note 4.

²⁶More often, they merely blunt the drafter’s already weak inclination to innovate, perhaps because foreign-language boilerplate has even greater potential than plain English to hide the wisdom of generations that came before. See *Gulati & Scott*, *supra* note 3.

decade of litigation and academic debate, became a rallying cry and a focal point for creditor organization.

A typical *pari passu* clause reads as follows: “All the obligations and liabilities of the Borrower hereunder rank, and will rank, either *pari passu* in rank of payment with or senior to all other unsubordinated Indebtedness of the Borrower.”²⁷ The Latin phrase means “equally” or “in equal step.” Such a clause has appeared in sovereign debt instruments since at least the late nineteenth century. It is one of the few terms that has been continuously included in sovereign debt contracts since before World War II. It was common in the handful of sovereign bonds issued in the 1960s and 1970s, continued in the commercial bank loans that ran into trouble in the 1980s, and remained common in the sovereign bonds of the 1990s and beyond. Yet, it is not clear that the clause ever made any sense from an enforcement perspective. Commentators have long highlighted the limited (or non-) utility of the clause in the sovereign setting.²⁸ In domestic corporate bankruptcy, the notion of being in equal step has meaning because proceeds from liquidation are distributed among creditors in the order established in advance by statute and contract.²⁹ Senior creditors go first, subordinated creditors take what is left, and all those in equal step recover ratably from the liquidation proceeds. But sovereigns cannot be liquidated. If there is no liquidation event where the assets of the sovereign are counted up and paid out, it is unclear when, if ever, the clause might be deployed. Yet, for over a century, the clause has remained a staple of these sovereign contracts, even as other clauses have come and gone.

²⁷ Lee C. Buchheit, *How to Negotiate Eurocurrency Loan Agreements* (London: International Financial Review, 1995) at 76-79.

²⁸ See Qamar S. Siddiqi, “Some Critical Issues in Negotiations and Legal Drafting” in Lars Kalderén & Qamar S. Siddiqi, eds., *Sovereign Borrowers: Guidelines on Legal Negotiations with Commercial Lenders* (Uppsala: Dag Hammarskjöld Foundation, 1984) 45 at 57 (“[the *pari passu* clause] is likely to have little practical significance in the case of a sovereign borrower, where there may not be an occasion for a forced distribution of the assets to unsecured claimants following the bankruptcy, insolvency or liquidation of the borrower”).

²⁹ Jon Yard Arnason & Ian M. Fletcher, *Practitioner’s Guide to Cross-Border Insolvencies*, looseleaf (Dobbs Ferry, NY : Oceana Publications, 2000) ENG-3 (“The principle of *pari passu* distribution applies only in liquidation”).

A *pari passu* clause without more is a promise by the debtor not to subordinate the creditor to others that would, as a result, come ahead of it in an asset distribution. For most of its history in sovereign debt instruments, the clause has been interpreted as going to the status or ranking of the debt, but not to the manner in which it will be serviced. A stock example of a *pari passu* violation in the sovereign debt writing of the 1980s involved advance preferential earmarking of government revenues or foreign exchange.³⁰ The prevailing view of sovereign debt practitioners and writers appeared to be that the universe of such violations was extremely narrow, since earmarking and formal subordination are virtually unheard of in modern sovereign practice. It was also commonly thought that a creditor facing discrimination in payment would seek redress under provisions that go specifically to payment, not to ranking.³¹ Our interviews for related projects suggest that a widely held view among sovereign debt cognoscenti in the mid-1990s was that no one knew quite what the clause meant.³²

The consensus, such as it was, came under attack in the fall of 1999, when Ecuador announced it would default on its Brady Bonds. It made the mistake of trying to go about default in what must have seemed to Ecuador and its advisors a clever and nuanced way: it proposed to service uncollateralized Brady Bonds, draw down the collateral on the bonds secured by zero-coupon U.S. Treasury Bonds, and exempt Eurobonds from restructuring altogether in a last-ditch effort to preserve a prayer of accessing the capital

³⁰ See e.g., Philip Wood, *Law and Practice of International Finance* (London: Sweet & Maxwell Ltd., 1980) at 156; William Tudor John, “Sovereign Risk and Immunity under English Law and Practice” in Robert S. Rendell ed. *International Financial Law: Lending, capital transfers and institutions*, vol. 1, 2d ed. (London: Euromoney Publications, 1983) 79 at 96. See also Brian W. Semkow, “Syndicating and Rescheduling International Financial Transactions: A Survey of the Legal Issues Encountered by Commercial Banks” (1984) 18 *Int’l Law*. 869 at 899 [Semkow]. Semkow makes a subtle but crucial move: he suggests that “discrimination against lending banks in the payment” of general revenues or foreign currency, rather than their advance earmarking, would be a *pari passu* violation in a sovereign loan contracts.

³¹ For a survey of literature and arguments on the meaning of the *pari passu* clause, see Lee C. Buchheit & Jeremiah S. Pam, “The *Pari Passu* Clause in Sovereign Debt Instruments,” (2004) 53 *Emory L.J.* 869; G. Mitu Gulati & Kenneth N. Klee, “Sovereign Piracy” (2001) 56 *Bus. Law*. 635 [Gulati & Klee].

³² See e.g. Lee. C. Buchheit, “The *pari passu* clause *sub specie aeternitatis*” (1991) 10:12 *Int’l. Fin. L. Rev.* 11 (“The fact that no one seems quite sure what the clause really means, at least in a loan to a sovereign borrower, has not stunted its popularity among drafters of loan agreements and debt restructuring agreements”); Philip R. Wood, *Project Finance, Subordinated Debt and State Loans* (London: Sweet & Maxwell Press, 1995) at 165 (“In the state context, the meaning of the clause is uncertain because there is no hierarchy of payment which is legally enforced under a bankruptcy regime”).

markets.³³ Although giving creditors access to interest collateral was specifically contemplated in the underlying bond contracts, the bondholders' response was irate. Led by hedge fund manager Marc Hélié, they took the unprecedented step of accelerating the collateralized bond — a move that had been considered way beyond their organizing capacity — ostensibly to force Ecuador into “*pari passu* treatment” of its creditors.³⁴ Investors succeeded in forcing all private bonded debt into the restructuring, and Hélié briefly acquired folk hero status as “The Man Who Broke Ecuador”. However, in the ensuing negotiations, he and his allies failed to secure a ratable payment profile among all of Ecuador’s official and private creditors.³⁵

For the purposes of this discussion, the key point is that, no matter what meaning *pari passu* may have had when first included in a sovereign debt instrument or what meaning it may have acquired after a wave of high-profile court battles starting in 2000, by late 1999, only one writer had suggested, and only in passing, that it conferred the right to ratable payment.³⁶ This view ran counter to that of the leading writers and practitioners in the field. Yet even though the Latin term probably did not mean what the Hélié and colleagues were demanding, it captured investor imaginations, and channeled righteous anger like no other legal or moral theory to condemn Ecuador’s wrongdoing.³⁷ Ecuador’s *pari passu* moment got almost completely drowned out the following year, after a Belgian court upheld the ratable payment interpretation of the *pari passu* clause in a lawsuit against Peru.³⁸ That lawsuit jolted the sovereign debt establishment, and became the subject of innumerable articles in the scholarly and trade press, most of which

³³ Felix Salmon, “The Buy Side Starts to Bite Back”, *Euromoney*, (April 2001) 46[Salmon].

³⁴ “Living with the Dollar: Dollarization has put Ecuador's economy back on track after a disastrous rollercoaster ride that ended in default. Confidence is back, but the new currency poses new challenges. (Ecuador dollarization)” *Latin Finance* (March 2002) SS11 [*Living with the Dollar*]. ; see also Salmon, *supra* note 31; Soma Biwas, “Carrion at Ecuador's Gate” *Latin Trade* 8:3 (March 2000) 26.

³⁵ Salmon, *supra* note 32; *Living with the Dollar*, *supra* note 32.

³⁶ Semkow, *supra* note 28.

³⁷ Ironically, the term whereby Ecuador undertook never to seek a Brady Bond restructuring, discussed in the previous section, played a minor role in the debates surrounding its default.

³⁸ Elliott Assocs., L.P., General Docket No. 2000/QR/92 (Court of Appeals of Brussels, 8th Chamber, Sept. 26, 2000); see also Elliott Assocs., L.P. v. Banco de la Nacion, 2000 U.S. Dist. LEXIS 368 (S.D.N.Y. Jan. 18, 2000) (executed Aug. 31, 2000) and Declaration of Professor Andreas F. Lowenfeld Dated August 31, 2000, at 11-12 (footnote omitted), *Elliott Assocs.*, 2000 WL 1449862 (96 Civ. 7916 (RWS), 96 Civ. 7917 (RWS) (advocating the ratable payment interpretation).

were harshly critical of the court.³⁹ Belgian legislation ultimately foreclosed the possibility of similar suits. However, copycat arguments proliferated in the United States and the United Kingdom, and at least in the United States, they have yet to be authoritatively resolved.⁴⁰ Four years after Ecuador's default, a cartoon that accompanied an article about *pari passu* in a U.K. trade journal featured the Oracle of Delphi opining on the meaning of the clause: "Damned if I know!!!"⁴¹

Nevertheless, beginning in 2003, *pari passu* was routinely elevated to the category of "Reserve Matters" in sovereign debt contracts in New York and London, which meant that amending the Latin would require the highest possible creditor voting threshold available under the contract.⁴² This newfound salience of the term was undoubtedly due at least in part to its surprising success in the courts. But after the profound interpretive shock of the *Elliott* decision in Belgium, observers also expected the parties to clarify the meaning of the term: merely making an admittedly inartful, litigation-prone clause harder to amend seemed counterintuitive.⁴³

The nearly forgotten rebellion of Ecuador's bondholders in the fall of 1999 might suggest part of an explanation: whatever it might have meant as a legal matter, *pari passu* had

³⁹ See e.g. Gulati & Klee, *supra* note 29; see also *EMTA Position Regarding the Quest for More Orderly Sovereign Work-Outs* (17 October 2002), online: Emerging Markets Traders Association <<http://www.emta.org/ndevelop/keymsg1.pdf>>.

⁴⁰ For a summary of follow up litigation, see Lee C. Buchheit & Jeremiah Pam, "The Hunt for *Pari Passu*" (2004) 23:2 Int'l. Fin. L. Rev. 20 [Buchheit & Pam]. Bill Bratton uses principles of contract interpretation to argue persuasively that the clause is radically ambiguous. William W. Bratton, "*Pari Passu* and a Distressed Sovereign's Rational Choices" (2004) 53 Emory L.J. 823.

⁴¹ *Ibid.*

⁴² The broader phenomenon of elevating some terms to the status of "Reserve Matters" is discussed in more detail in the next section. It was motivated in large part by Ecuador's use of exit consents in its 2000 debt exchange to strip out of its Bradies a group of non-financial terms that went to the liquidity and enforcement of the bonds. The same technique was used to delete the "don't even ask" provision discussed in the preceding section. See *supra* note 14. For more on the use of exit consents in sovereign debt instruments, see Lee C. Buchheit & G. Mitu Gulati, "Exit Consents in Sovereign Bond Exchanges" (2000) 48 UCLA L. Rev. 59.

⁴³ Gulati & Scott, *Supra* note 3. More recent empirical work supports the view that the new interpretation and contractual elevation of *pari passu* did not boost market perceptions of sovereign debt enforcement to any significant degree. See Laura Alfaro, Noel Maurer & Faisal Ahmed, *Empire and Lawsuits: U.S. Enforcement of Sovereign Debt in Latin America* (Jul. 2009), forthcoming, Law & Contemporary Problems.

acquired unusual rhetorical pull as a symbol of equality and bondholder brotherhood in the face of sovereign venality.⁴⁴ This expressive value was quite apart from the term's capacity to make the debtor do the right thing, or make a court tell the debtor to do the right thing. *Pari passu* was more than a novel legal argument; it was a slogan and an incantation. To some, amending it might have seemed akin to amending the words written on a banner that had flown over the barricades.

IV. Sacred Rights and Profane Payments

Our last example is a set of clauses that look perfectly functional at first blush—so functional, in fact, that a major trade association proposed them as part of its sovereign bond documentation template. The peculiarity of these clauses, which struck us and some of the practitioners with whom we have discussed it, is their radical reversal of the priorities embedded in standard-form sovereign bond contracts only a few years earlier. Part of this whiplash effect may be attributable to the expressive motive, or feel-good formalism.

As noted, emerging-markets sovereign bonds issued in New York between 1990 and 2003 required the consent of each bondholder to amend payment terms. The theories on the origins and persistence of this unanimity requirement are numerous and still hotly debated across academic disciplines.⁴⁵ Part of the impetus behind it in the early 1990s may have been a desire to make the Brady Bonds and their successors “senior” instruments, immune from restructuring.⁴⁶ New York law instruments with unanimity

⁴⁴ Hill suggests that contract terms may have a community-constituting function. Hill, *Language and Norms*, *supra* note 4.

⁴⁵ For legal perspectives, see Lee C. Buchheit & G. Mitu Gulati, “Sovereign Bonds and the Collective Will” (2002) 51 Emory L.J. 1317; William W. Bratton & G. Mitu Gulati, “Sovereign Debt Reform and the Best Interest of Creditors” (2004) 57 Vand. L. Rev. 1. For debates among economists, see e.g. Anthony Richards & Mark Gugiatti, “Do Collective Action Clauses Influence Bond Yields? New Evidence from Emerging Markets” (2003) 6:3 International Finance 415; Mark Gugiatti & Anthony Richards, “The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers” (2004) 35 Geo. J. Int’l L. 815; Barry Eichengreen, “Restructuring Sovereign Debt” (2003) 17:4 Journal of Economic Perspectives 75; Barry Eichengreen & Ashoka Mody, “Would Collective Action Clauses Raise Borrowing Costs?” (January 2000), online: National Bureau of Economic Research < <http://www.nber.org/papers/w7458.pdf>>

⁴⁶ Hurlock & Alexander, *supra* note 11.

provisions dominated emerging markets debt issuance in the 1990s and early 2000s.⁴⁷ The rest comprised mainly English-law bonds, which could be amended with the consent of a bondholder majority.⁴⁸

By the mid-1990s, the official sector had come to see the amendment restrictions as a threat to financial stability. Like some creditors, officials bought into the view that a unanimity requirement could effectively block debt renegotiation. Conventional policy wisdom in 1995—1996 held that more sovereign debt distress was inevitable: that bonds had quickly become too big to exempt in any meaningful restructuring; and that any contract term that could block bond restructuring would lead to negotiating stalemate, protracted court battles and economic decline, worse than anything seen in the 1980s.⁴⁹

We have detailed elsewhere the complex combination of public and private effort that led to the shift away from unanimity to qualified majority amendment in New York sovereign bond practice beginning in 2003.⁵⁰ Here we highlight a curious development in London after the New York shift. Since 2003, most English-law sovereign bonds have retained, but tightened, the majority amendment formula for the payment terms. Many New York and London contracts also elevated certain non-payment terms, such as *pari passu*, to Reserve Matter status on par with the payment terms. But several English-law contracts went farther: they revived the unanimity requirement and applied it to litigation-related terms, such as choice of law, choice of forum, submission to jurisdiction, waiver

⁴⁷ See e.g., *Global Financial Stability Report: Market Developments and Issues* online: International Monetary Fund <<http://www.imf.org/external/pubs/ft/gfsr/2002/04/pdf/chp3.pdf>> at 44 (citing New York law bonds comprising at least 80% of the market).

⁴⁸ The precise threshold varied, as did the way in which the amendment vote would be taken. See Anna Gelpern & Mitu Gulati, “Innovation after the Revolution: Foreign Sovereign Bond Contracts Since 2003” (2009) 4 *Capital Markets Law Journal* 85 at 91-93.

⁴⁹ See e.g., Group of Ten, *The Resolution of Sovereign Liquidity Crises: A Report to the Ministers and Governors Prepared under the Auspices of the Deputies* (1996) online: <<http://www.bis.org/publ/gten03.pdf>>; Barry Eichengreen, et al., *Crisis? What Crisis? Orderly Workouts for Sovereign Debtors* (London: Centre for Economic Policy Research, 1995) (a volume commissioned by the Bank of England as part of its work on the Rey Report).

⁵⁰ We have detailed elsewhere the complex combination of public and private effort that led to the shift in Anna Gelpern & Mitu Gulati, “Public Symbol in Private Contract: A Case Study” (2006) 84 *Wash. U.L.Q.* 1627.

of sovereign immunity, and the appointment of an agent for the service of process.⁵¹ Thus if three-quarters of all bondholders in a recent issue by the Republic of Georgia agreed to forgive their debts entirely, they could do so and bind the quarter that wanted to be paid. However, if the same creditors agreed to let the Republic be sued in New York rather than London, they would likely run afoul of the unanimity requirement for litigation-related terms. This special protection of judicial enforcement is also enshrined in the model clauses promulgated by the leading financial industry association in London, which served as a template for the few sovereign bonds that have adopted unanimity for non-financial terms.⁵²

Practitioners have told us that raising the amendment threshold for litigation terms to 100% was meant “to protect minority rights ... [so that the] process for a suit is preserved if the minority believed there had been an anomaly in how the majority went about exercising collective action.”⁵³ Creditors gave up the heretofore sacrosanct right to be paid in exchange for an immutable right to sue the sovereign—on a contract whose economic terms could be eviscerated by a supermajority vote of their colleagues. One cynical law firm partner who counsels sovereign debtors observed:

If seventy-five percent of the holders can vote to reduce the payment amount, who cares whether unanimity is required to alter the right to sue. The seventy-five percent could reduce the payment obligation to zero. What use would the right to sue be then? This makes no sense.⁵⁴

This flip from privileging payment terms to privileging litigation terms could have any number of functional and historical explanations. Maybe it made sense for creditors to reassess the value of an ironclad payment promise in a world of limited sovereign resources, no statutory bankruptcy regime to enforce payment priorities, and increasingly

⁵¹ See e.g., Republic of Georgia, Prospectus, \$750,000,000 7.5% Notes Due 2013 (Apr. 11, 2008) at 79 (Lithuania, Serbia and Seychelles have similar provisions).

⁵² *International Primary Market Association Standard Collective Action Clauses (CACs) for the Terms and Conditions of Sovereign Notes* (October 28, 2004) online: International Capital Market Association <<http://www.icmagroup.org/ICMAGroup/files/3c/3cc80d90-da99-4562-8ef2-f604a8e5963e.PDF>> [*New CACs*].

⁵³ Telephone interview of creditor counsel (6 August 2008) on the condition of anonymity. It is not clear to what extent freezing the sovereign’s submission to jurisdiction might facilitate inter-creditor enforcement. Cf. Bratton & Gulati, *supra* note 43 (discussing inter-creditor duties under sovereign bond contracts).

⁵⁴ Telephone interview of debtor counsel (11 August 2009) on the condition of anonymity.

frequent debt exchanges that circumvented unanimity to achieve deep debt relief.⁵⁵ Yet the elevation of judicial enforcement terms made less sense. Despite a handful of high-profile settlements and a spike in lawsuits on sovereign bonds (mostly arising out of Argentina's \$100 billion default in late 2002), litigation-related recoveries from sovereigns remained minuscule, while the lawsuits' deterrent effect was undetectable. Litigation was not much more effective at getting governments to perform in 2008 than it had been in 1998. But it is the conjunction of the two trends that is hardest to understand: the right to sue is protected when the substantive cause of action is most likely to be taken away. Litigation is hard enough where there is a debt to sue on; it is hard to imagine where the debt has been amended away.⁵⁶

Other parts of the model clauses proposed by the U.K. industry group may help solve the riddle of unanimity's revival. Apart from judicial enforcement terms, the model recommended requiring unanimous bondholder consent to amend any terms in a debt exchange in ways that discriminate against the old debt holders.⁵⁷ Such a provision would make it impossible for a sovereign to use exit consents to render old bonds illiquid and unenforceable as part of a debt exchange, much as Ecuador had done in 2000. The unanimity barrier to the use of exit consents, along with the use of unanimity to freeze creditors' right to sue the sovereign, both reacted to Ecuador's Brady Bond restructuring. However, the exit consent technique is less important—some say practically irrelevant—now that bonds issued under New York law have adopted majority-modification provisions. As a result, we suspect that the motive for elevating litigation terms in this context was, in significant part, expressive and symbolic. Creditors sought to protect the right to sue the sovereign above the economic terms, even where lawsuits “have not

⁵⁵ Argentina's 2005 exchange was among the most aggressive; it left creditors with less than 40 cents on the dollar. See Arturo C. Porzecanski, “From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default” (2005) 6 *Chicago J. Int'l L.* 311 (this account generally tracks the creditor perspective); see also Federico Sturzenegger & Jeromin Zettelmeyer *Debt Defaults and Lessons from a Decade of Crises* (Cambridge: Massachusetts Institute of Technology Press, 2006) (summarizing half a dozen debt restructuring operations).

⁵⁶One law firm partner representing creditors suggested that the right to sue under such circumstances would give dissenting creditors a valuable right to challenge the process by which the payment terms were amended. Interview with creditor counsel, *supra* note 51. We find this to be a plausible but limited explanation; other lawyers we have interviewed were even more skeptical.

⁵⁷*New CACs*, *supra* note 50.

yielded one cent on the dollar”⁵⁸ or discernibly deterred default, to reaffirm the salience of “creditor rights”, and register continued opposition to obnoxious restructuring tactics.

V. Conclusions

We have speculated that parties may sometimes include terms in complex business contracts because they feel better for *saying* it, even where they know full well that the term will *do* little or nothing to advance their cause. This intuition is not part of the conventional accounts of contracting, although it is consistent with the recent trend to see contracts as more than instrumental devices that do what they say,⁵⁹ as well as with established theories of contracts as vehicles for parties to tell the world about their relationship.⁶⁰ If future research bears out our suspicions, it would also cast a different light on the canons of contract interpretation, which demand that judges either give functional meaning to a contract clause, or refuse to enforce it as unsupported by a bargain. We suspect that there are times when parties do not intend for judges to enforce their contract term as written, even where its structural position – for example, as a covenant rather than a recital – might suggest that it was supposed to “do something” rather than just “say something”. Yet such a term is far from illusory; on the contrary, it may be the product of hard bargaining, knowingly exchanged for the other side’s substantial promises.

There are many kinds of non-functional clauses and many motives for their inclusion. We limit our speculation to one—we call it feel-good formalism—where a party derives value from putting words in its contract to get something off its chest, to say it “out loud” in the formal contractual setting, without regard for the term’s technical efficacy.

⁵⁸ *H.W. Urban, GMBH et al. v. Republic of Argentina*, Hearing Transcript before Hon. Thomas B. Griesa, District Judge, Nov. 16, 2004, at 18.

⁵⁹ See e.g. Mark C. Suchman, “The Contract as Social Artifact” (2003) 370:1 *Law & Soc’y Rev.* 91; see also Hill, “Language and Norms”, *supra* note 4.

⁶⁰ This is part of “channeling” in Lon Fuller’s typology of contract functions. Lon L. Fuller, “Consideration and Form” (1941) 41 *Colum. L. Rev.* 799 at 801-03[Fuller].

The three anecdotes in our essay, all of which come from the emerging markets sovereign debt setting, suggest different ways in which feel-good formalism may be present in contracting. These range from purely feel-good terms – we suspect these are rare – to suboptimal terms that may persist in part because the parties find them emotionally potent, to contract innovation practices that may represent an emotional reaction to an earlier event in, or even outside, the contracting relationship. In most cases, such terms and practices will also have functional dimensions, and may have other nonfunctional ones – as symbols or signals directed at the outside world.⁶¹ Our argument, then, is narrow: it goes to one motive among many for including a term in a complex business contract.

The pure feel-good motive is not prominent in the contracts literature, although it is implicated in practices that have periodically received considerable scholarly attention. This essay flags it in a particular setting, where enforcement is limited by sovereign immunity and the lack of an international infrastructure for sovereign debt restructuring. In this setting, precisely because of the enforcement difficulties, it may be relatively easy to identify nonsense terms.⁶² Future research might ask whether the phenomenon is idiosyncratic to the sovereign debt world.

The relationship between a sovereign debtor and its creditors is distinct from private debtor-creditor relationships that drive the contracts literature, not least because the borrowing state still enjoys considerable protections under the law of sovereign immunity. However, the lawyers and contracting routines are the same in sovereign and large corporate settings. Lawyers go about negotiating and analyzing contracts in sovereign deals much as they do in other deals; this overlap is evident in the similarities of contract structure and language. If they find it useful to insert nonsense terms in sovereign contracts, we suspect these same rationales carry over to other settings.

⁶¹ See Fuller, *supra* note 58; see e.g. Philippe Aghion & Patrick Bolton, “Contracts as a Barrier to Entry” (1987) 77 *The American Economic Review* 388.

⁶² Sovereign debt contracts from the pre-World War II era likely have a much larger set of feel-good terms, given that enforcement was even less likely. *Cf.* Mark Weidemaier, “Haggling Over... What Exactly?” online: The Faculty Lounge <<http://www.thefacultyounge.org/2009/08/haggling-over-what-exactly.html>>.