

# An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law

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I. INTRODUCTION: LOOKING BEYOND STATUTORY AND CONTRACTUAL APPROACHES .....	13
II. PRINCIPLES IN INTERNATIONAL LAW .....	15
III. THE EMERGENCE OF SOVEREIGN DEBT SUSTAINABILITY AS PRINCIPLE OF PUBLIC INTERNATIONAL LAW.....	17
A. Before the End of WWI: The Prevalence of the Private Law Paradigm .....	17
B. Before the End of Bretton Woods: A Public Law Regime in the Making.....	18
C. After Bretton Woods: The Emergence of Sovereign Debt Sustainability .....	21
IV. HOLDOUT LITIGATION: A LITMUS TEST FOR DEBT SUSTAINABILITY .....	27
A. Holdout Litigation as a Legal Challenge to Debt Sustainability .....	28
B. Holdout Litigation as a Factual Challenge to Debt Sustainability.....	30
C. Recent Affirmations of Debt Sustainability .....	31
V. SAFEGUARDING DEBT SUSTAINABILITY: AN INCREMENTAL APPROACH TO SOVEREIGN DEBT RESTRUCTURING .....	34
A. Contractual and Other Bilateral Approaches.....	34
B. The Difficulty with a Treaty Option.....	37
C. An Incremental Approach Based on Legal Principles.....	38
VI. CONCLUSION: CHALLENGES AHEAD.....	42

## I. INTRODUCTION: LOOKING BEYOND STATUTORY AND CONTRACTUAL APPROACHES

Current sovereign debt restructuring practice does not always provide timely and effective solutions for troubled states. Restructuring is tedious and causes economic hardship; this makes it unattractive for leaders of debtor states with increasingly unsustainable debt burdens to enter the process in time.<sup>1</sup> Once states decide to restructure, overly optimistic growth expectations

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1. From the rich literature: Lee C. Buchheit, et al., *Revisiting Sovereign Bankruptcy*

might lead to inadequate restructuring terms.<sup>2</sup> Once the debtor state makes an exchange offer to its bondholders, holdout strategies might lead to further delays.<sup>3</sup>

To improve this economically and politically unsatisfactory situation, two types of solutions dominate the discussion: contractual proposals (such as improved aggregated Collective Actions Clauses – CACs)<sup>4</sup> and statutory proposals (e.g., a treaty establishing an international bankruptcy court).<sup>5</sup> The relative practical advantages and disadvantages of each set of proposals are the subject of a rich debate. What is less often discussed is whether they satisfy the normative demands towards sovereign debt restructuring that emanate from the international legal order and its practices. The goal of this Article is therefore to reconstruct the normative implications of current sovereign debt restructuring practice and measure contractual and statutory proposals in their light.

The normative implications of current sovereign debt restructuring practice find expression in principles of international law (reflecting the main structures of the international legal order), to be distinguished from general principles of law (reflecting overlapping consensus among domestic legal orders). We explain this difference in Section II.

In Section III we argue that changes in sovereign debt restructuring practices over the last decades reflect an increasing recognition of sovereign debt sustainability as a principle of public international law. This principle expresses the now widely shared conviction that states need healthy financial conditions for economic development, as well as the provision of welfare. It therefore also implies concern for the protection of human rights in sovereign debt crises, including of internationally guaranteed economic, social and cultural rights. We track down the emergence of this principle in the practice of sovereign debt restructuring. While a private law paradigm prevailed up to the end of the First World War that left the resolution of sovereign debt crises to unregulated, *ad-hoc* negotiations between debtor states and their creditors, first traces of the recognition of sovereign debt sustainability as a public interest can be found in the aftermath of the First World War. They coincided

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(Brookings Committee on International Economic Policy and Reform, 2013), available at [http://www.brookings.edu/~media/research/files/reports/2013/10/sovereign-bankruptcy/ciepr\\_2013\\_revisitingsovereignbankruptcyreport.pdf](http://www.brookings.edu/~media/research/files/reports/2013/10/sovereign-bankruptcy/ciepr_2013_revisitingsovereignbankruptcyreport.pdf); Christoph Trebesch, *Delays in Sovereign Debt Restructurings* (working paper, 2010), available at <https://sites.google.com/site/christophTrebesch/research/Trebesch-RestructuringDelays.pdf?attredirects=0>.

2. Olivier Blanchard & Daniel Leigh, *Growth Forecast Errors and Fiscal Multipliers* (IMF Working Paper WP/13/1, 2013).

3. Julian Schumacher, et al., *Sovereign Defaults in Court* (SSRN working paper, 2014), available at <http://ssrn.com/abstract=2189997>.

4. E.g. International Capital Markets Association, *Standard Aggregated Collective Action Clauses (“CACs”) for the Terms and Conditions of Sovereign Notes* (2014), available at <http://www.icmagroup.org/resources/Sovereign-Debt-Information>.

5. E.g. ANNE O. KRUEGER, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING (2002); José A. Ocampo, *A Brief History of Sovereign Debt Resolution and a Proposal for a Multilateral Instrument*, in TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 189 (Martin Guzman, José Antonio Ocampo & Joseph Stiglitz eds., 2016); comprehensive overview in Kenneth Rogoff & Jeromin Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976–2001*, 49 IMF STAFF PAPERS 470 (2002).

with institutional arrangements that were vertical rather than horizontal, reflecting an emerging public law regime. This regime was consolidated after the demise of the Bretton Woods system in the early 1970s and the ensuing debt crises that have afflicted the developing world since then. In the course of this development, sovereign debt sustainability gained recognition as the objective of international debt restructuring efforts. Thus, sovereign debt restructurings are not an issue of concern only for the debtor state and its creditors, but for the entire international community.

Subsequently, Section IV explores the challenge to sovereign debt sustainability constituted by the rise in holdout litigation, a development that has serious legal and factual consequences for debt sustainability. Nevertheless, in reaction to this development, a wide array of stakeholders has strongly rejected holdout litigation and taken measures to prevent it, thereby confirming the principle of sovereign debt sustainability.

Section V assesses current proposals by this standard. As valuable as contractual proposals are from a practical standpoint, taking them as the sole response to debt crises appears normatively unsatisfactory. Sovereign debt sustainability as a global concern implies that sovereign debt restructurings cannot depend on the mercy of the creditors alone. By contrast, statutory proposals would satisfy this requirement. But for the time being, they seem to be politically unavailable. We therefore propose a third avenue: an incremental approach. It complements current practice, including contractual approaches, with a set of legal principles, both principles of international law and general principles of law, with the principle of sovereign debt sustainability as the normative center. They should help remedy the shortcomings of current practice. Section IV concludes.

## II. PRINCIPLES IN INTERNATIONAL LAW

We understand principles in international law to be abstract, general norms, which express an important structural element of the present international legal order. Broadly speaking, principles in international law can take two forms. First, there are general principles of law, which are original sources of international law derived from domestic law.<sup>6</sup> Although general principles of law play an important role for the incremental build-up of a sovereign debt restructuring mechanism, this Article concentrates instead on the second, less widely known form of principles: principles *of* public international law.<sup>7</sup> Unlike general principles of law, principles of international law do not have a basis in domestic law. Rather, they reflect the main structures of the international legal order.<sup>8</sup> At first sight, the international legal

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6. Cf. Art. 38(1)(c), Statute of the International Court of Justice.

7. For a focus on general principles, see Matthias Goldmann, *Putting your Faith in Good Faith: A Principled Strategy against Holdouts in Sovereign Debt Workouts*, 41 YALE J. INT'L L. ONLINE (2016), in this special issue.

8. WOLFGANG G. FRIEDMANN, *THE CHANGING STRUCTURE OF INTERNATIONAL LAW* 196 et seq. (1964); RÜDIGER WOLFRUM, *General International Law (Principles, Rules, and Standards)*, in MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW ¶ et seq. (Rüdiger Wolfrum ed., 2010); Matthias Goldmann, *Principles in International Law as Rational Reconstructions. A Taxonomy* (working paper, 2013), available at <http://ssrn.com/abstract=2442027>.

order is a chaotic, amorphous arrangement consisting of myriad rules and practices with different normative status, ranging from treaty law to soft law, which often appear incomplete and contradictory.<sup>9</sup> Like in any legal order,<sup>10</sup> principles give structure to this amorphous arrangement, ensuring consistency and providing orientation to those applying the law. It is the foremost task of legal practice and scholarship to make sense of this chaos and create a fairly consistent order by identifying and, where possible, codifying principles.<sup>11</sup>

Of course, the existence of principles of public international law presupposes that one understands international law as an order, albeit a fragmented one that does not emanate from one centralized power, rather than as inherently chaotic and incomplete. Today, one cannot presume that public international law is not an order.<sup>12</sup> Its development since the Second World War has given rise to the presumption that the rules of international law do not contradict each other<sup>13</sup> and form a legal order that is by and large coherent.<sup>14</sup> Principles are the backbone of that order. They ensure consistency in the application of specific international legal rules and serve the interpretation and further development of the law.<sup>15</sup> Moreover, as any seasoned lawyer can attest, even legal orders that emanate from one central power are often no less chaotic and fragmented than international law as they result from political compromises made by different people at different times.<sup>16</sup>

The formation of principles of public international law thus requires a constructive, interpretative effort. They emerge as abstractions from the rules and practice of international law. One may establish a principle by showing that practice follows a fairly consistent normative pattern in a certain field of international law, which is consistent with other rules and principles of international law. This implies that practice will hardly ever follow a principle to the fullest extent. Rather, establishing a principle implies almost by definition that there are certain specific rules that deviate from the principle, as long as the principle prevails. Principles might also reflect a trend or a

9. *Id.*

10. Seminal: RONALD DWORKIN, *TAKING RIGHTS SERIOUSLY* 22 (1977); JÜRGEN HABERMAS, *BETWEEN FACTS AND NORMS* ch. 5.1.3 and 5.2.1 (Repr. ed. 2008).

11. This has been called “doctrinal constructivism.” See Armin von Bogdandy, *The Past and Promise of Doctrinal Constructivism: A Strategy for Responding to the Challenges Facing Constitutional Scholarship in Europe*, 7 *INT’L J. CONST. L.* 364 (2009).

12. Cf. by contrast, the Case of the S.S. “Lotus” (France v. Turkey), 1927 P.C.I.J. (ser. A/B) No. 9, at 16-7 (Sept. 7), which puts “principles of international law” on a par with contractual or customary obligations.

13. Right of Passage over Indian Territory (Portugal v. India), 1957 I.C.J. 142 (Nov. 26).

14. A first-rate example for this approach is the understanding of jurisdiction in Prosecutor v. Tadic, Case No. IT-94-1-I, Decision on Defence Motion for Interlocutory Appeal on Jurisdiction (Int’l Crim. Trib. For the Former Yugoslavia Oct. 2, 1995).

15. Koskenniemi calls them “descriptive principles”. See Martti Koskenniemi, *General Principles: Reflexions on Constructivist thinking in International Law*, in *SOURCES OF INTERNATIONAL LAW* 365-6 (Martti Koskenniemi ed. 2000). Herdegen prefers calling them “values”, see Matthias Herdegen, *Interpretation in International Law*, in *MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW* ¶ 64 (Rüdiger Wolfrum ed. 2010). See also Samantha Besson, *General Principles in International Law – Whose Principles?*, in *PRINCIPLES IN EUROPEAN LAW* 48-51 (Samantha Besson & Pascal Pichonnaz eds., 2011).

16. Cf. *supra* note 10 — both Dworkin and Habermas developed their theories with respect to domestic law.

tendency in practice that is not yet fully prevailing. In that case, one might speak of an emerging principle.<sup>17</sup>

### III. THE EMERGENCE OF SOVEREIGN DEBT SUSTAINABILITY AS PRINCIPLE OF PUBLIC INTERNATIONAL LAW

This Section tracks the emergence of debt sustainability as a principle in international law. While international legal practice had long turned a blind eye to issues of debt sustainability, the period from the end of the First World War to the end of the Bretton Woods system marks signs of a paradigm change. But it was only after the end of the Cold War that sovereign debt sustainability came to be broadly recognized in the practice of international law. As will be explained in the following, the concept of sovereign debt sustainability implicates a concern for economic development as well as for human rights.

#### *A. Before the End of WWI: The Prevalence of the Private Law Paradigm*

Since the formation of statehood in Europe during early modernity, states have assumed domestic and external debt<sup>18</sup> in order to finance their activities. Before 1800, this led to occasional and sometimes even serial sovereign defaults.<sup>19</sup> But it was only in the 19th century that the volume of sovereign debt and the number of defaults skyrocketed.<sup>20</sup> This period marked the beginning of the development of international sovereign bond markets.<sup>21</sup> Newly independent states — particularly those in Latin America and later Japan, Central European, and North African states — took out loans from banks located in the United States, Great Britain, and a few other Western European countries like Switzerland.<sup>22</sup> This fueled several cycles of credit expansion and sovereign default in various countries. Sometimes this resulted from unstable political development and wars of independence, and sometimes in reaction to economic development that turned out to be slower than the providers of highly mobile capital had wished.<sup>23</sup>

Throughout that period, the international legal order was dominated by

17. On the formation and taxonomy of principles, see Matthias Goldmann, *On the Comparative Foundations of Principles in International Law: The Move Towards Rules and Transparency in Fiscal Policy as Examples*, in SOVEREIGN FINANCING AND INTERNATIONAL LAW 113 (Carlos Esposito et al. eds., 2013).

18. The terms domestic and external debt refer to the legal regime governing the debt instrument. See Ugo Panizza, *Domestic and External Debt in Developing Countries* (UNCTAD Working Paper, 2008).

19. CARMEN M. REINHART & KENNETH S. ROGOFF, THIS TIME IS DIFFERENT. EIGHT CENTURIES OF FINANCIAL FOLLY 87 (2009).

20. *Id.*, at 90.

21. Barry Eichengreen & Richard Portes, *Debt and default in the 1930s: Causes and consequences* 30 EUROPEAN ECONOMIC REVIEW 599, 601-2 (1986); HORST FELDMANN, INTERNATIONALE UMSCHULDUNGEN IM 19. UND 20. JAHRHUNDERT. EINE ANALYSE IHRER URSACHEN, TECHNIKEN UND GRUNDPRINZIPIEN 20 et seq. (1991).

22. *Id.*

23. The Baring crisis of 1890 provides a textbook example of such crises. See Kris James Mitchener & Marc D. Weidenmier, *The Baring Crisis and the Great Latin American Meltdown of the 1890s*, 68 JOURNAL OF ECONOMIC HISTORY 462 (2008).

the idea of sovereign equality.<sup>24</sup> Hence, debt restructurings were a matter to be dealt between the debtor and the creditor only.<sup>25</sup> This is what we call the private law paradigm. It rests on the idea of a relative equality of arms. On the one hand, states could repudiate their debt and remain protected against foreign law enforcement authorities by their sovereign immunities. On the other hand, creditors could capitalize on the desire of debtor states to regain access to credit markets. Even if the debt had been issued in the debtor state's currency, currency devaluation was not an option since debt instruments frequently included gold clauses, obliging the debtor state to make payments in gold or the equivalent thereof.<sup>26</sup> This delicate balance was often threatened in the one or the other way, triggering government action to reinstate it. On the one hand, creditors for a long time lacked organizations for their effective coordination.<sup>27</sup> This led to the formation of the British Corporation of Foreign Bondholders and later the Foreign Bondholders Protective Council.<sup>28</sup> Even though the American and British governments had midwived these entities, they did so only to establish an equality of arms, not to actively enforce claims of their nationals.<sup>29</sup> On the other hand, in a few cases, governments of creditors exercised "gunboat diplomacy" in order to corroborate the claims of their nationals.<sup>30</sup> This gave rise to the Drago-Porter Convention of 1907, which established the universal principle that states may not use force in order to collect claims arising from sovereign debt of the attacked state held by their nationals.<sup>31</sup> As these developments demonstrate, crisis resolution was not always swift and smooth. But reform proposals aimed to reinstate an equality of arms between the parties, in accordance with the private law paradigm.<sup>32</sup> Debt restructurings were hardly seen as problems requiring the intervention of international institutions representing some form of common global interest.

### *B. Before the End of Bretton Woods: A Public Law Regime in the Making*

The situation changed slightly after the First World War. Sovereign debt issues acquired a new dynamic, as Europe's war-ridden economies, as well as China and other states, required funds for reconstruction and development,

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24. S.S. Lotus case (France v. Turkey), 1927 PCIJ (Ser. A) No. 10.

25. Feldmann, *supra* note 21, 200 et seq., 368 et seq.

26. Feldmann, *supra* note 21, 20 et seq.

27. Eichengreen & Portes, *supra* note 22, 621-22.

28. Feldmann, *supra* note 21, 261 et seq.; Michael R. Adamson, *The Failure of the Foreign Bondholders Protective Council Experiment, 1934-1940*, 76 BUSINESS HISTORY REVIEW 479 (2002).

29. Eichengreen & Portes, *supra* note 22, 619; Feldmann, *supra* note 21, 30-1, 100-1.

30. A prominent example is the blockade of Venezuelan ports in 1902 by Great Britain, Germany and Italy. British occupation of Egypt in 1882 had the objective to control the Suez channel. See Wolfgang Benedek, *Drago-Porter Convention*, in MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW (Rüdiger Wolfrum ed. 2007).

31. Convention Respecting the Limitation of the Employment of Force for the Recovery of Contract Debts, 18 October 1907, 36 Stat. 2241.

32. This includes Meili's remarkable proposal for an international bankruptcy court, see FRIEDRICH MEILI, DER STAATSBANKEROTT UND DIE MODERNE RECHTSWISSENSCHAFT: VORTRAG GEHALTEN IN DER INTERNATIONALEN VEREINIGUNG FÜR VERGLEICHENDE RECHTSWISSENSCHAFT UND VOLKSWIRTSCHAFTSLEHRE ZU BERLIN (1895).

which they mainly found in the United States.<sup>33</sup> The activities of the League of Nations in relation to sovereign debt issues constituted a decisive step forward and a sign of a changing perception of sovereign debt issues in international legal practice. The League made the prevention and resolution of debt crises an issue of international concern for the first time. It carefully scrutinized the development of contractual provisions used for sovereign bonds, such as gold clauses and the relevant case law.<sup>34</sup> The League did not have funds to provide financial support to troubled debtor states.<sup>35</sup> However, it advised member states on economic reform and monitored the implementation of its recommendations.<sup>36</sup> This generated trust in those states' economic viability and helped them regain access to capital markets.<sup>37</sup> During the interwar period, bond settlements in Latin American countries led to substantial debt forgiveness in the longer run, ranging from fifteen to forty-eight percent.<sup>38</sup> International agreements like the Young Plan for the restructuring of German post-war debt concerned reparations, not sovereign debt, but they also improved the situation of debtor states.<sup>39</sup> In addition, inflation reduced their debt issued in domestic currency.<sup>40</sup> Nevertheless, inflation also gave rise to the first interventions of international tribunals in debt matters. The Permanent Court of International Justice (PCIJ) helped French creditors to enforce contractual rights to be repaid in gold against Brazil and Serbia.<sup>41</sup> In the *Serbian Loans* case, the court rejected Serbia's invocation of *force majeure* because of economic deteriorations after the First World War.<sup>42</sup> One might therefore conclude that the pre-war equilibrium was re-established under different terms. While the League of Nations and certain generous restructuring agreements improved the lot of the debtor states, elevating debt sustainability to the level of a global concern for the first time, creditors' trust in the validity of contracts was re-established by the court.

This new equilibrium underwent a stress test during the massive debt market troubles of the 1930s. The Great Depression saw many debtor states default on their external debt, especially in Latin America and the eastern

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33. Barry Eichengreen, *The US Capital Market and Foreign Lending, 1920-1955*, in *DEVELOPING COUNTRY DEBT AND THE WORLD ECONOMY* 239-40 (Jeffrey D. Sachs ed. 1989); Eichengreen & Portes, *supra* note 22, 605-6.

34. See *Report of the Committee for the Study of International Loan Contracts*, League of Nations Doc. C.145.M.93.1939. II. A. (1939).

35. Juan H. Flores & Yann Decorzant, *Public borrowing in harsh times: The League of Nations Loans revisited* (University of Geneva Working Paper Series No. 12091, 2012); Margaret G. Myers, *The League Loans*, 60 *POLITICAL SCIENCE QUARTERLY* 492 (1945).

36. *Id.*

37. *Id.*

38. E. Joergensen & Jeffrey D. Sachs, *Default and Renegotiation of Latin American Foreign Bonds in the Interwar Period*, in *THE INTERNATIONAL DEBT CRISIS IN HISTORICAL PERSPECTIVE* 74 (Barry Eichengreen & Peter H. Lindert eds., 1989).

39. Dieter Fleck, *Dawes Plan (1924) and Young Plan (1930)*, in *MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW* ¶ 7 et seq. (Rüdiger Wolfrum ed. 2015).

40. Carmen M. Reinhart & M. Belen Sbrancia, *The Liquidation of Government Debt* (NBER Working Paper Series No. 16893, 2011), available at <http://www.nber.org/papers/w16893>.

41. Cf. MICHAEL WAIBEL, *SOVEREIGN DEFAULTS BEFORE INTERNATIONAL COURTS AND TRIBUNALS* 84 et seq. (2011).

42. Case Concerning the Payment of Various Serbian Loans Issued in France (France v. Serbia), 1029 P.C.I.J. (ser. A) No. 20, at 3 (July 12).

Mediterranean area.<sup>43</sup> Restructurings largely maintained their consensual and horizontal structure, consisting of negotiations between debtor states and creditors' committees, although the need of debtor states to quickly return to capital markets seems to have accelerated restructurings compared to earlier periods.<sup>44</sup> Debt repudiation remained the exception.<sup>45</sup> In a few cases, the United States State Department had to exert pressure on creditors' committees.<sup>46</sup> Nevertheless, most countries had a hard time regaining access to capital markets due to the protracted economic crisis, which should soon develop into political disaster.<sup>47</sup> For this reason, the League Committee for the Study of International Loan Contracts recommended the adoption of contractual restructuring clauses, as well as recourse to arbitration.<sup>48</sup> However, the outbreak of the Second World War prevented these proposals from gaining traction.<sup>49</sup>

After the Second World War, a more elaborate international economic order came into existence that provided for greater capacity to deal with sovereign debt issues. In particular, international institutions began extending credit. The International Monetary Fund (IMF) supplied developed economies with funds in case of capital account difficulties.<sup>50</sup> Developing and emerging economies benefited from credit extended by multilateral institutions and bilateral lenders.<sup>51</sup> While some countries, like the United States and the United Kingdom, inflated away their mostly domestic debt,<sup>52</sup> other restructurings became a concern for international law. The London Agreement (a debt relief treaty between the Federal Republic of Germany and some of its creditor states) restructured German debt from the interwar period.<sup>53</sup> It underlined the significance of stable debt for economic prosperity, but also for peace. For developing and emerging economies requiring a restructuring of their bilateral debt, the Paris Club has provided a fairly comprehensive forum for negotiations since the mid-1950s. However, sovereign debt sustainability did not seem to be a prevailing concern for the Paris Club at the time. It was largely focused on safeguarding bilateral creditors' interests. For examples,

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43. Reinhart & Rogoff, *supra* note 19, 96; Peter H. Lindert & Peter J. Morton, *How Sovereign Debt Has Worked*, in *DEVELOPING COUNTRY DEBT AND THE WORLD ECONOMY* 227 (Jeffrey D. Sachs ed. 1989).

44. Feldmann, *supra* note 21, 261 et seq., 383 et seq.

45. For a discussion of the Soviet and Costa Rican examples, see ODETTE LIENAU, *RETHINKING SOVEREIGN DEBT. POLITICS, REPUTATION, AND LEGITIMACY IN MODERN FINANCE* 57 et seq., 100 et seq. (2014).

46. Adamson, *supra* note 28, 485, 499 et seq.

47. Feldmann, *supra* note 21, 420 et seq.

48. In 1935, the Netherlands sponsored a resolution of the League of Nations creating a Committee for the Study of International Loan Contracts with the goal of improving contracts relating to international loans issued by governments and model provisions. See *Report of the Committee for the Study of International Loan Contracts*, League of Nations Doc. C.145.M.93.1939. II. A. (1939).

49. Mark C. Weidemaier, *Reforming Sovereign Lending Practices: Modern Initiatives in Historical Context*, in *SOVEREIGN FINANCING AND INTERNATIONAL LAW* 329 et seq. (Carlos Esposito et al. eds., 2013).

50. ANDREAS LOWENFELD, *INTERNATIONAL ECONOMIC LAW* 597 et seq. (2nd edn. 2007).

51. *Id.*

52. Cf. Herschel I. Grossman, *The Political Economy of War Debts and Inflation* (NBER Working Paper Series No. 2743, 1988) 18.

53. Agreement on German External Debts, Feb. 27, 1953, 333 U.N.T.S. 4764.



restructurings did not include debt relief at the time.<sup>54</sup> Thus, on the whole, the private law paradigm still prevailed, although a nascent global public concern for sovereign debt sustainability had become discernible.

*C. After Bretton Woods: The Emergence of Sovereign Debt Sustainability*

After the demise of the Bretton Woods system, the structure of sovereign debt changed dramatically. As a consequence, and with some delay, debt-restructuring practice changed, too. In a fairly consistent pattern, debt sustainability is today reflected in international legal practice and may be considered a principle of public international law. It recognizes two important public interests, namely a concern for economic development and growth, and increasingly also for the protection of human rights.

In the 1970s, due to a massive recycling of petrodollars held by commercial banks in Europe and the United States, and to bank regulation that encouraged loans to emerging and developing economies in the absence of global prudential standards,<sup>55</sup> new possibilities for commercial lending in the sovereign debt market emerged. To diversify risks, banks formed consortiums that extended huge amounts of loans to emerging and developing states well beyond their repayment capacity. Loans were extended to developing countries by commercial banks that actively and systematically pushed these loans in violation of basic principles of prudential risk management, leading to a huge credit bubble.<sup>56</sup>

At the beginning of the 1980s, the abrupt and significant increase in interest rates for loans caused by the United States Federal Reserve's effort to fight inflation with high interest rates and the continuous deterioration in the terms of trade for the debtor states due to falling commodity prices rendered them unable to repay those loans.<sup>57</sup> As a consequence, the banks faced a high risk of collapse due to the failure of their sovereign debtors to repay their debts.<sup>58</sup> This led multilateral financial institutions to intervene by granting even more loans (under the premise that the problem was one of short-term liquidity only) and by promoting the implementation of adjustment programs.<sup>59</sup> The Paris Club engaged in restructurings of bilateral debt, but it still categorically excluded debt relief.<sup>60</sup> Whatever the merits of this approach, the fact that it deserved the attention and intervention of multilateral

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54. William N. Eskridge Jr., *Les Jeux Sont Faits: Structural Origins of the International Debt Problem*, 25 VA. J. INT'L L. 281, 328 et seq. (1985).

55. Cynthia C. Lichtenstein, *The US Response to the International Debt Crisis: The International Lending Supervision Act of 1983*, 25 VA. J. INT'L L. 401 (1984).

56. WILLIAM A. DARITY & BOBBIE L. HORN, *THE LOAN PUSHERS: THE ROLE OF COMMERCIAL BANKS IN THE INTERNATIONAL DEBT CRISIS* (1988).

57. KUNIBERT RAFFER & HANS WOLFGANG SINGER, *THE ECONOMIC NORTH-SOUTH DIVIDE. SIX DECADES OF UNEQUAL DEVELOPMENT* 13 (2001).

58. Lichtenstein, *supra* note 55; Manuel Monteagudo, *The debt problem: The Baker Plan (1985) and the Brady initiative (1989) – History, experience, practice and prospects*, in *LA DETTE EXTÉRIEURE – THE EXTERNAL DEBT* 139 (Dominique Carreau & Malcolm Shaw eds., 1995).

59. Raffer & Singer, *supra* note 57, 164 et seq.

60. MARTIN WEISS, CONG. RESEARCH SERV., RS21482, *THE PARIS CLUB AND INTERNATIONAL DEBT RELIEF* (2013), available at <https://www.fas.org/sfp/crs/misc/RS21482.pdf>.

institutions shows the growing concern of the international level for debt sustainability, if only for the sake of stabilizing the banking system in developed economies.

Gradually, the new situation led to the emergence and consolidation of debt sustainability as a principle in international law that recognizes a public interest in debt practices that foster economic development and growth. Towards the end of the 1980s it became clear that there was an unavoidable need to actually reduce the debt. The Brady Plan, an initiative of the U.S. government, aimed at alleviating the debt burden by converting the “hot” loans (i.e. loans with low chances of being fully and timely repaid) into tradeable bonds that could be sold to other private investors and allow creditors to better diversify risks.<sup>61</sup> At the same time, the “Washington Consensus” foresaw that debtor states should adopt incisive, radical economic reforms including measures facilitating trade and investment in order to bring them back on track.<sup>62</sup> Again, the need for international coordination to at least channel the crisis tells volumes about international concern for debt sustainability. In line with this policy change, the Paris Club adopted its Naples terms in 1994, which for the first time granted debt relief.<sup>63</sup> In addition, the IMF liberalized its lending practice and opened its facilities for states in default against their private creditors (“lending into arrears”).

However, the initial optimism generated by these plans was soon revealed to be unfounded. The 1990s saw increased financial indebtedness of sovereign debtors that received a significant amount of speculative short-term investment, mainly through sovereign bonds. New defaults were confronted by the IMF with adjustment policies and rescue packages. It was not until the Heavily Indebted Poor Countries Initiative (HIPC) and the Multilateral Debt Relief Initiative that debt sustainability became recognized in the context of multilateral debt, leading to a significant policy change.<sup>64</sup> During the same period, the Paris Club further extended the possibility of debt relief, notably through the introduction of the Evian terms in 2003.<sup>65</sup> These measures were based on the conviction that debt sustainability is a precondition for economic development and growth.<sup>66</sup> This shift in perspective finally led to the discarding of the traditional private law paradigm and entrenched debt sustainability as a global public concern in international law. It is the reason why contemporary, internationally orchestrated debt restructurings may be

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61. Lowenfeld, *supra* note 50, 683 et seq.

62. John Williamson, *Democracy and the “Washington consensus”*, 21 WORLD DEVELOPMENT 1329 (1993).

63. These are the Paris Club’s terms for cancelling and rescheduling the debts of very poor countries, see Weiss, *supra* note 60.

64. On these initiatives and their implementation see <https://www.imf.org/external/np/exr/facts/hipc.htm> and <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:20634753~menuPK:4876270~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html>

65. Weiss, *supra* note 60.

66. Barry Herman, José Antonio Ocampo & Shari Spiegel, *Introduction: The Case for a New International Reform Effort*, in OVERCOMING DEVELOPING COUNTRY DEBT CRISES 18 (Barry Herman, José Antonio Ocampo & Shari Spiegel eds., 2010).

considered as exercises of international public authority.<sup>67</sup>

The conviction underlying this shift found expression in other international documents that corroborate the idea of debt sustainability as a principle in international law. The Monterrey Consensus of 2002, the outcome of a United Nations conference on financing for development, highlighted the broad international consensus around the relevance of sustainable debt financing in order to mobilize resources for public and private investment:

“While recognizing that a flexible mix of instruments is needed to respond appropriately to countries’ different economic circumstances and capacities, we emphasize the importance of putting in place a set of clear principles for the management and resolution of financial crises that provide for fair burden-sharing between public and private sectors and between debtors, creditors and investors.”<sup>68</sup>

In the same direction, the Doha Declaration on Financing for Development of 2008 (a Follow-up Conference to review the implementation of the Monterrey Consensus) enhanced the importance of debt sustainability:

“While welcoming the Evian approach, we emphasize the importance of sustained efforts by all towards achieving sustainable debt of middle-income countries, including by improving their sustainable debt management and through debt relief based on current debt mechanisms and debt swap mechanisms on a voluntary basis.”<sup>69</sup>

The annual United Nations General Assembly resolutions on external debt from 2010 to 2013<sup>70</sup> stressed the importance of responsible lending and borrowing. The United Nations Conference of Trade and Development (UNCTAD) also addressed the issue on its 6th, 7th and 8th Debt Management Conferences in November 2007, November 2009 and November 2011, respectively.<sup>71</sup> The two UNCTAD initiatives in this area, one on Principles on Responsible Sovereign Lending and Borrowing of 2012, and the Roadmap and Guide on Sovereign Debt Workouts of 2015,<sup>72</sup> extensively elaborate why and how debt sustainability needs to be observed in sovereign debt management and restructuring. The Roadmap lists debt sustainability as one of five key principles.

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67. Armin von Bogdandy & Matthias Goldmann, *Sovereign Debt Restructurings as Exercises of Public Authority: Towards a Decentralized Sovereign Insolvency Law*, in RESPONSIBLE SOVEREIGN LENDING AND BORROWING: THE SEARCH FOR COMMON PRINCIPLES 39 (Carlos Esposito et al. eds., 2012).

68. Report of the International Conference on Financing for Development ¶ 56, Monterrey, Mexico, 18-22 March 2002, UN Doc. A/CONF.198/11, available at <http://www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf>.

69. Doha Declaration on Financing for Development: outcome document of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus ¶ 56, Doha, Qatar, 29 November – 2 December 2008, available at [http://www.un.org/esa/ffd/doha/documents/Doha\\_Declaration\\_FFD.pdf](http://www.un.org/esa/ffd/doha/documents/Doha_Declaration_FFD.pdf).

70. G.A. Res. 65/144 (Dec. 20, 2010); G.A. Res. 66/189 (Dec. 22, 2011); G.A. Res. 67/198 (Dec. 21, 2012); G.A. Res. 68/202 (Dec. 20, 2013), each one addressing external debt sustainability and development.

71. UNCTAD, Sixth International Debt Management Conference, Geneva, Nov. 19-21, 2007; UNCTAD, Seventh International Debt Management Conference, Geneva, Nov 9-11 2009; UNCTAD, Eighth International Debt Management Conference, Nov 14-16, 2011.

72. UNCTAD, *Sovereign Debt Workouts: Going Forward. Roadmap and Guide* (2015), available at [http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf).

The IMF, for its part, has recognized debt sustainability as a goal at several occasions. It defines debt sustainability as “a situation in which a borrower is expected to be able to continue servicing its debts without an unrealistically large future correction to the balance of income and expenditure”.<sup>73</sup> Similarly, the IMF-World Bank Joint Sustainability Framework for Low-Income Countries defines debt sustainability as “the condition that this debt can be serviced without resort to exceptional financing or a major future correction in the balance of income and expenditure”.<sup>74</sup> In order to pursue this goal, the IMF has not only made its lending more generous, especially in the aftermath of financial crises. It has also led initiatives pursuing a more preventive objective, such as the Code of Good Practices on Fiscal Transparency.<sup>75</sup> The fact that IMF-led efforts to establish a Sovereign Debt Restructuring Mechanism failed in 2003 does not defeat the emergence of debt sustainability as a principle of international law. Rather, the project was abandoned because contractual solutions were deemed sufficient for reaching debt sustainability by major stakeholders at the time.<sup>76</sup> The IMF has promoted the contractual approach ever since.<sup>77</sup>

Dissatisfied with the current situation, the UN General Assembly passed Resolution 68/304 on 9 September 2014. The resolution established an ad hoc committee to elaborate a multilateral legal framework for sovereign debt restructuring processes to increase the efficiency, stability and predictability of the international financial system and achieve sustained, inclusive and equitable economic growth and sustainable development. The process so far culminated in UN General Assembly Resolution 69/319 of 10 September 2015. Rather than proposing an international treaty, the resolution follows in the footsteps of the UNCTAD Roadmap and Guide<sup>78</sup> and stipulates a set of “Basic Principles on Sovereign Debt Restructuring Processes”.<sup>79</sup> They comprise the principles of sovereignty, good faith, transparency, impartiality, equitable treatment, immunity, legitimacy, sustainability, and majority restructuring. It defines sustainability in the following terms:

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73. International Monetary Fund, *Assessing Sustainability*, IMF Policy Paper 4 (May 28, 2002). In equivalent terms, the IMF has defined unsustainable debt as follows: “[T]he fiscal policy stance can be regarded as unsustainable if, in the absence of adjustment, sooner or later the government would not be able to service its debt”, International Monetary Fund, *Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis* 5-6 (IMF Staff Paper, 2011). On the legitimacy of debt sustainability assessments and the indicators used for that purpose, see Michael Riegner, *Legal frameworks and general principles for indicators in sovereign debt restructuring*, 41 YALE J. INT’L L. ONLINE (2016), in this special issue.

74. International Monetary Fund & International Development Association, *Debt Sustainability in Low-Income Countries—Proposal for an Operational Framework and Policy Implications* 7 (Staff Paper, 2004).

75. International Monetary Fund, Code of Good Practices on Fiscal Transparency (2007), available at <https://www.imf.org/external/np/pp/2007/eng/051507c.pdf>.

76. Randall Quarles, *Herding Cats: Collective-Action Clauses in Sovereign Debt - The Genesis of the Project to Change the Market Practice in 2001 through 2003*, 73 L. & CONTEMP. PROBS. 29 (2010).

77. International Monetary Fund, *Sovereign Debt Restructuring - Recent Developments and Implications for the Fund’s Legal and Policy Framework*, IMF Policy Paper (2013); International Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, IMF Policy Paper (2014).

78. *Supra* note 72.

79. G.A. Res. 69/319 (Sept. 29, 2015).

“Sustainability implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors’ rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights.”<sup>80</sup> The latter definition of sustainability highlights a further aspect of sustainability that has gained traction more recently. While the IMF and the World Bank define debt sustainability in purely financial terms, other stakeholders adopt a broader approach that looks at the social and economic implications of adjustment policies, in particular their impact on human rights. In this vein, many resolutions of the UN General Assembly, the Committee on Economic, Social and Cultural Rights, the Commission on Human Rights and then the Human Rights Council have periodically stressed that structural adjustment programs have serious implications for the ability of developing countries to abide by the Declaration on the Right to Development and to formulate national development policies that effectively improve the economic, social and cultural rights enjoyment of their citizens.<sup>81</sup>

The aftermath of the last financial crisis has affirmed this trend. In 2011, the UN Human Rights Council endorsed the UN Guiding Principles on Foreign Debt and Human Rights.<sup>82</sup> They establish that “[i]nternational financial organizations and private corporations have an obligation to respect international human rights. This implies a duty to refrain from formulating, adopting, funding and implementing policies and programs which directly or indirectly contravene the enjoyment of human rights.”<sup>83</sup> While human rights are often held to oblige only the state exercising jurisdiction over the citizens holding these rights, the resolution also specifies that “[c]reditors and debtors share responsibility for preventing and resolving unsustainable debt situations.”<sup>84</sup> This is in line with the recognition of extraterritorial effects of economic and social rights as set out by an expert committee in the Maastricht Principles.<sup>85</sup> This includes calls for holding private creditors accountable.<sup>86</sup> Thus, on October 3, 2014, the UN Human Rights Council condemned the

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80. *Id.*

81. E.g. U.N. Commission on Human Rights Res. 1999/22, Effects on the full enjoyment of human rights of the economic adjustment policies arising from foreign debt and, in particular, on the implementation of the Declaration on the Right to Development, E/CN.4/RES/1991/13 (April 23, 1999). For a list of relevant human rights related resolutions, see <http://www.ohchr.org/EN/Issues/Development/IEDebt/Pages/Resolutions.aspx> (April 25, 2016, 10:40AM).

82. Human Rights Council Res. 20/10, The effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, A/HRC/RES/20/10 (July 18, 2012).

83. *Id.*, ¶ 9.

84. *Id.*, ¶ 23.

85. Cf. Olivier De Schutter, *Commentary to the Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights*, 34 HUM. RTS. Q. 1084 (2012).

86. For a doctrinal analysis of the human rights responsibilities of private creditors, see Matthias Goldmann, *Human Rights and Sovereign Debt Workouts*, in MAKING SOVEREIGN FINANCING AND HUMAN RIGHTS WORK 98-9 (Juan Pablo Bohoslavsky & Jernej L. Cernic eds., 2014).

activities of vulture funds for the direct negative effects of debt repayment to those funds on the capacity of governments to fulfill their human rights obligations.<sup>87</sup> It also invited States participating in the General Assembly negotiations to ensure that such a multilateral legal framework will be compatible with existing international human rights obligations and standards.<sup>88</sup> Moreover, the European Committee of Social Rights, responsible for complaints against violations of the European Social Charter, specified that adjustment measures must respect a minimum level of social rights enjoyment and need to be proportionate,<sup>89</sup> and domestic courts have scrutinized the compatibility of adjustment measures with constitutional guarantees.<sup>90</sup> Only the European Court of Justice denied the application of the Charter of Fundamental Rights to the European Union to the European Stability Mechanism, albeit on the basis of a highly formalistic reading of the Charter.<sup>91</sup>

In conclusion, sovereign debt sustainability is today widely recognized in international legal practice. It guides the policies of all major multilateral institutions dealing with sovereign debt, including informal organizations like the Paris Club, and should therefore be considered a principle of public international law. It signifies a shift in sovereign debt restructuring practice away from an almost exclusive focus on creditors' rights towards a global public interest in both the financial well being of a debtor state, and in mitigating the impact of debt crises on the broader economic, social and human rights situation in the country.<sup>92</sup> Its emergence resonates with the coincidental rise of solidarity as a principle in international law that has elevated issues formerly belonging to states' *domaine réservé* to the level of global concerns.<sup>93</sup> This does not mean that private interests of creditors can no longer play a role in debt restructurings. Rather, they need to be balanced

87. Human Rights Council Res. 27/30, Effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights: the activities of vulture funds, A/HRC/RES/27/30 (Oct. 3, 2014).

88. *Id.*

89. Complaints No. 65/2011 and 66/2011, Decisions on the merits (European Committee of Social Rights May 23, 2012).

90. Overview: Claire Kilpatrick, *Constitutions, social rights and sovereign debt states in Europe: a challenging new area of constitutional inquiry* (EUI Working Paper EUI LAW 2015/34, 2015), available at <http://hdl.handle.net/1814/36097>; Federico Fabbrini, *The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective*, 32 BERKELEY J. INT'L L. 65 (2014). Most domestic courts did not hold that rights had been violated, though. But the fact that they examined certain adjustment measures thoroughly confirms the relevance of human rights for debt sustainability.

91. Case C-370/12, Thomas Pringle v. Government of Ireland, Ireland and The Attorney General ¶ 179-80, EUR-Lex 62012CJ0370 (Nov. 27, 2012). However, Advocate General Kokott had argued that the European Commission was bound by the Charter of Fundamental Rights of the EU when acting in the frame of the European Stability Mechanism, see *id.*, View of Advocate General Kokott ¶ 176, EUR-Lex 62012CP0370 (Oct. 26, 2012). On the human rights obligations of the ESM, see Margot E. Salomon, *Of austerity, human rights and international institutions*, 21 EUROPEAN LAW JOURNAL 521, 537-40 (2015).

92. On comparable shifts in domestic bankruptcy law: Joseph Spooner, *Long Overdue: What the Belated Reform of Irish Personal Insolvency Law tells us about Comparative Consumer Bankruptcy*, 86 AM. BANKR. L.J. 243 (2012).

93. E.g. SOLIDARITY: A STRUCTURAL PRINCIPLE OF INTERNATIONAL LAW (Rüdiger Wolfrum & Chie Kojima eds., 2010); Markus T. Kotzur & Kirsten Schmalenbach, *Solidarity Among Nations*, 52 ARCHIV DES VÖLKERRECHTS 68 (2014), listing disaster relief and development cooperation as relevant fields.

against the public interests reflected in sovereign debt sustainability. Whether sovereign debt sustainability also constitutes a general principle of law (i.e. a source proper of international law) is a different question—one that would require an in-depth analysis of *domestic* legal practice.<sup>94</sup> As welcome and useful as such an analysis would be, it is not necessary for the thesis advanced in this paper in the following, as we focus here on the significance of sovereign debt sustainability for debt restructuring practice in general rather than on the specific legal consequences of this principle.

#### IV. HOLDOUT LITIGATION: A LITMUS TEST FOR DEBT SUSTAINABILITY

Sovereign debt sustainability as a principle of international law has no basis other than current debt restructuring practice. It therefore needs to be examined whether the rise in holdout litigation is in a position to dilute sovereign debt sustainability as a principle of international law by watering down its normative status or content.

Sovereign debt restructurings today face a high chance to be inflicted by holdout litigation. Vulture funds buy bonds of troubled states at a significant discount from the nominal value. As participation in debt restructurings is voluntary, they refuse to exchange their old bonds into new ones. Instead, they sue very aggressively for repayment of their debts at face value plus interest, arrears and litigation costs, amounting to rates of return of between 200 percent and 3.000 per cent.<sup>95</sup> As explained by Schumacher, Trebesch and Enderlein,<sup>96</sup> holdout litigation constitutes by now a widespread an increasing practice in debt restructurings. Between 1976 and 2010 there have been about 120 lawsuits by commercial creditors against 26 defaulting Governments in the United States and the United Kingdom alone, the two jurisdictions where most sovereign bonds are issued. While in the 1980s only about 5 per cent of debt restructurings were accompanied by legal disputes, this figure has rocketed high to almost 50 per cent and the total volume of principal under litigation reached USD 3 billion by 2010.<sup>97</sup> The trend has since continued with suits being filed, among others, against Ecuador,<sup>98</sup> Grenada,<sup>99</sup> and several ones against Greece.<sup>100</sup>

Holdout litigation causes serious legal risks for the recognition of debt sustainability as a principle. It also has severe negative factual effects on debt

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94. See Matthias Goldmann, *Responsible Sovereign Lending and Borrowing: The View from Domestic Jurisdictions. A Comparative Survey* (UNCTAD Working Paper, 2012), available at [http://unctad.org/en/PublicationsLibrary/gdsddf2012misc3\\_en.pdf](http://unctad.org/en/PublicationsLibrary/gdsddf2012misc3_en.pdf).

95. Data from the African Development Bank (AfDB), available at <http://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/> (April 25, 2016, 10:38AM).

96. *Supra* note 3.

97. *Id.*

98. *GMO Trust v. The Republic of Ecuador*, No. 1:14-cv-09844 (S.D.N.Y. March 23, 2015). The case was settled in March 2015.

99. See, *i.a.*, *Export-Import Bank of China v. Grenada*, No. 13 Civ. 1450 (HB), 2013 WL 4414876 (S.D.N.Y. Sept. 19, 2013).

100. See, *i.a.*, *Case C-226/13, Fahnenbrock v. Greece*, EUR-Lex 62013CJ0226 (June 11, 2015); *Poštová banka, a.s. and Istrokapital SE v. Hellenic Republic*, ICSID Case No. ARB/13/8, Award (April 9, 2015).

restructurings. However, as we will explain, recent developments affirming debt sustainability as a principle might offset these countercurrents. This demonstrates the operation of the incremental approach and confirms its viability.

*A. Holdout Litigation as a Legal Challenge to Debt Sustainability*

Holdout litigation challenges the principle of debt sustainability on a normative level. Given the increase in holdout litigation, sovereign debt restructuring practice might not be focused as much on sustainability as we claim. We identify three major legal challenges in this respect. They are related to the debtor state's legal defenses, enforcement, and conflicts of jurisdiction.

First, courts around the world faced with holdout litigation have given relatively little consideration to various defenses raised by debtor states that invoked sovereign debt sustainability as a goal. Courts in the United States have persistently ruled that, in the absence of contractual clauses providing for majority vote, the sanctity of contracts prevails so that unanimity of creditors is needed to make a restructuring agreement binding for every creditor.<sup>101</sup> Invoking sovereign immunity has mostly been unsuccessful since the deliberate turn to sovereign debt litigation and the regular inclusion of waivers of immunities in the terms of debt instruments since the 1990s.<sup>102</sup> Debtor states have often claimed a state of necessity, but this has also been rejected by many courts around the world, demonstrating their unawareness of developments in debt restructuring practice and the emergence of the principle of debt sustainability. Courts refused to recognize a state of necessity as a defense because they thought this defense would only apply between states (overlooking that, as a general principle, it might also apply to private parties),<sup>103</sup> or because they believed that necessity could not be invoked if the debtor state had contributed to the state of necessity (rendering the defense toothless for sovereign debt litigation without providing for compensation).<sup>104</sup> In 2015, the German Federal Court of Justice rejected not only the view that there was a rule of customary international law making majority restructurings binding even for the dissenting minority. It also held that good faith did not constitute a defense against holdout litigation.<sup>105</sup>

Second, on top of rejecting debtor states' defenses, New York courts provided holdout creditors with a new, indirect way of enforcement through

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101. See *Allied Bank International v. Banco Credito Agricola de Cartago*, 757 F.2d 516 (2d Cir. 1985); *Pravin Banker Associates v. Banco Popular del Peru*, 109 F. 3d 850, 854 (2d Cir. 1997); *Elliot Associates v. Banco de la Nacion and the Republic of Peru*, 12 F.Supp. 2d 328 (S.D.N.Y. 1998).

102. For the U.S.: *Argentina v. Weltover, Inc.*, 504 U.S. 607 (1992); for the U.K.: *NML Capital Limited (Appellant) v Republic of Argentina (Respondent)* [2011] UKSC 31, [2011] 2 A.C. 495 (U.K.).

103. *Bundesverfassungsgericht* [Federal Constitutional Court], May 8, 2007, 118 BVerfGE 124 (Ger.).

104. On the diverging case law of ICSID tribunals see Michael Waibel, *Two Worlds of Necessity in ICSID Arbitration: CMS and LG&E*, 20 LEIDEN JOURNAL OF INTERNATIONAL LAW 637 (2007).

105. *Bundesgerichtshof* [Federal Court of Justice], Feb 2, 2015, *Neue Juristische Wochenschrift* 2328, 2015 (Ger.).



injunctions by giving an unexpected interpretation to the *pari passu* clause.<sup>106</sup> This clause is widely used in sovereign debt contracts.<sup>107</sup> According to a traditional reading, it is supposed to ensure that all unsecured creditors have the same rank with no priority among themselves.<sup>108</sup> NML Capital, a seasoned vulture fund, holds bonds issued prior to Argentina's 2001 default. It did not accept Argentina's 2005 and 2010 exchange offers, but decided to litigate. In 2012, following an earlier Belgian case,<sup>109</sup> the United States federal District Court for the Southern District of New York saw in the *pari passu* clause an obligation of Argentina to make ratable payments to NML each time it pays its restructured bondholders.<sup>110</sup> More specifically, the District Court's injunctions forbid any financial intermediary, including Euroclear and Clearstream, to collaborate with Argentina in paying exchange bondholders unless they are notified that holdouts have received ratable payment.<sup>111</sup> As a consequence, the ruling effectively prohibits Argentina from complying with its obligations towards holders of restructured bonds without paying on the bonds held by NML, irrespective of the law applicable to the restructured bonds and their location.

A third legal risk associated with holdout litigation consists in protracted conflicts of jurisdiction that find no easy solution. Three cases demonstrate the risk. First, Argentina complained that the injunctions based on the ratable payment interpretation of the *pari passu* clause profoundly disrupted Argentina's financial relations and threatened its economic and financial development. In 2014, it therefore filed a lawsuit against the United States before the International Court of Justice, arguing that the judgment violated her sovereignty.<sup>112</sup> The lawsuit did not get anywhere for lack of jurisdiction.<sup>113</sup> Second, in another lawsuit filed by holders of restructured Argentine Eurobonds who wish to receive their payments even after NML Capital, the High Court of England and Wales ruled in February 2015 that the trusteeship established with the Bank of New York Mellon (BNYM) for the purpose of processing Argentina's payments on bonds issued under English law was

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106. NML Capital et al. v. Argentina, 699 F.3d 246, 263 (2d Cir. 2012).

107. Lee C. Buchheit & Jeremiah S. Pam, *The pari passu clause in sovereign debt instruments*, 53 EMORY L.J. 869 (2004).

108. *Id.*

109. Elliott Assocs., L.P., General Docket No. 2000/QR/92, Cour d'Appel [Court of Appeal] Bruxelles, 8<sup>ème</sup> ch., Sept. 26, 2000 (Belg.).

110. NML Capital, Ltd. v. Republic of Argentina, No. 08 Civ. 6978 (TPG), 2012 WL 5895784 (S.D.N.Y. Nov. 21, 2012): "Whenever the Republic pays any amount due under [...] the [Exchange Bonds]... the Republic shall concurrently or in advance make a 'Ratable Payment' to NML [...]. Such 'Ratable Payment' shall be an amount equal to the 'Payment Percentage' [...] multiplied by the total amount currently due to NML in respect of the bonds at issue in these cases [...]. Such 'Payment Percentage' shall be the fraction calculated by dividing the amount actually paid or which the Republic intends to pay under the terms of the Exchange Bonds by the total amount then due under the terms of such Exchange Bonds."

111. *Id.*

112. I.C.J., Press Release No. 2014/25 (Aug. 7, 2014), available at <http://www.icj-cij.org/presscom/files/4/18354.pdf>.

113. Joseph Ax & Andrew Chung, UPDATE 4—Argentina threatened with contempt order by U.S. judge, Reuters (Aug. 8, 2014), available at <http://www.reuters.com/article/argentina-debt-idUSL2N0QE12D20140809>.

governed by English law.<sup>114</sup> But it refrained from deciding whether the injunctions of the U.S. District Court might constitute a defense of BNYM under English law.<sup>115</sup> Third, a ruling by the European Court of Justice paved the way for the judicial authorities of any EU member state to serve a writ to Greece that will trigger holdout litigation.<sup>116</sup> This means that an array of domestic courts of different member states might have to decide about the constitutionality under Greek law of Greek legislation facilitating the restructuring of its domestic debt.<sup>117</sup>

### *B. Holdout Litigation as a Factual Challenge to Debt Sustainability*

While some argue on the basis of highly theoretical models that vulture litigation would improve the functioning of sovereign debt markets in accordance with the efficient capital market hypothesis,<sup>118</sup> reality looks quite different. In fact, holdout litigation under present circumstances threatens debt sustainability in more factual, practical ways. First, as has been said, the injunctions against Argentina's banks seriously disrupt Argentina's financial relations and thereby threaten its economic and financial development. Every financial intermediary of Argentina with business in the United States is affected. Given the global scope of many financial intermediaries, the judgment potentially has universal reach. The same applies to Argentina's cooperative creditors who are cut off their legitimate proceeds.<sup>119</sup>

Second, the expansive interpretation of the *pari passu* clause makes future restructurings of other countries' debt much more difficult than they are already, as it provides stronger incentives to creditors not to give their consent to debt restructuring agreements. The amplification of this judgment to other debt restructurings would have disruptive implications for global debt sustainability. This is a concrete possibility.<sup>120</sup>

Third, holdout litigation makes restructuring more costly. For example, right before the Greek haircut, vulture funds bought Greek bonds issued under English law that did not allow Greece to activate CACs.<sup>121</sup> The government decided to pay 435 million euros to investors who had refused to participate in the restructuring one month after the completion of the haircut. The vulture

114. *Knighthood Master Fund LP v. The Bank of New York Mellon* (2014), HC-2014-000704, [2015] EWHC (Ch) 270 (Eng.).

115. *Id.*, ¶ 49.

116. *Fahnenbrock v. Greece*, *supra* note 100.

117. Nomos 4050/12 Kanones tropoioiseos titlon, ekdoseos e eggeseos tou Ellenikou Demosiou me symphonia ton Omologiouchon [Rules for the amendment of bonds, issued or guaranteed by the Greek government by virtue of a bondholder agreement], EPHEMERIS TES KYVERNESEOS TES HELLENIKES DEMOKRATIAS [E.K.E.D.] 2012, A:36 (Greece).

118. Robert W. Kolb, *The Virtue of Vultures: Distressed Debt Investors in the Sovereign Debt Market*, 40 THE JOURNAL OF SOCIAL, POLITICAL AND ECONOMIC STUDIES 368 (2015).

119. Cf. W. Marc C. Weidemaier & Anna Gelpern, *Injunctions in Sovereign Debt Litigation*, 31 YALE J. ON REG. 189 (2014).

120. Cf. the cases listed in notes 98 to 100. *But see* Natalie Wong, *NML Capital, Ltd. v. Republic of Argentina and the Changing Roles of the Pari Passu and Collective Action Clauses in Sovereign Debt Agreements*, 53 COLUM. J. TRANSNAT'L L. 396 (2015), pointing out the more cautious approach in cases against Granada.

121. Stratos D. Kamenis, *Vulture Funds and the Sovereign Debt Market: Lessons from Argentina and Greece* 15 (Crisis Observatory Research Paper No. 13/2014, 2014).

funds took advantage of the financial turmoil engulfing the country at that moment. In June and July 2013 the Greek government made two additional and higher payments of 790 and 540 million euros each to holdout creditors. The same applies to Argentina now that the new government found agreement with her creditors. The price to be paid is high indeed.<sup>122</sup>

Fourth, as concerns the broader financial repercussions, holdout litigation has been particularly disruptive with respect to the realization of economic, social and cultural rights in the context of multilateral efforts to relieve heavily indebted poor countries of their external debt burden.<sup>123</sup> In practice, such litigation has significantly eroded the (limited) fiscal space created by debt relief initiatives for resources to alleviate poverty and foster economic development in these countries. At least eighteen heavily indebted poor countries have been threatened with or have been subjected to legal actions by these creditors since 1999, giving rise to an estimated number of more than 50 lawsuits by commercial creditors of such a kind.<sup>124</sup> Most lawsuits were filed in the US, the United Kingdom, and France. For example, in a case against Zambia, Donegal International, a vulture fund based in the British Virgin Islands, having bought debt instruments for USD 3.28 million, sued the debtor for their nominal value of USD 55 million. The High Court of England and Wales, with notable political and moral disapproval, ruled that the government pay the vulture fund USD 15.4 million,<sup>125</sup> which represented 65 percent of what Zambia had saved in debt relief delivered through the Multilateral Debt Relief Initiative (MDRI) in 2006.

Summing up, holdout litigation has become a serious challenge for debt restructurings both in quantity and in quality, legally and factually, for debtors and cooperative creditors. Notwithstanding the fact that many debt restructurings do not give rise to litigation,<sup>126</sup> it potentially threatens debt sustainability.

### *C. Recent Affirmations of Debt Sustainability*

One might ask whether the observed challenges to debt sustainability might defeat debt sustainability as a principle in international law. As has been set out above, principles of international law are rooted in practice so that a dramatic change in practice will change the principle.<sup>127</sup> Certainly, principles

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122. Anna Gelpern, *Sovereign Debt. Now What?*, 41 YALE J. INT'L L. ONLINE (2016), in this special issue; Martin Guzman & Joseph Stiglitz, *How Hedge Funds Held Argentina for Ransom*, N.Y. Times, April 1, 2016, available at [http://www.nytimes.com/2016/04/01/opinion/how-hedge-funds-held-argentina-for-ransom.html?\\_r=0](http://www.nytimes.com/2016/04/01/opinion/how-hedge-funds-held-argentina-for-ransom.html?_r=0).

123. Human Rights Council, Promotion and Protection of All Human Rights, Civil, Political, Economic, Social and Cultural Rights, Including the Right to Development, Report of the independent expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Cephias Lumina, A/HRC/14/21 (April 29, 2010).

124. Dem. Rep. of Congo, Rep. of Congo, Ethiopia, Honduras, Niger, Sierra Leone, Sudan, Tanzania, Uganda, Cote d'Ivoire, Burkina Faso, Angola, Cameroon, Liberia, Madagascar, Mozambique, Niger, and Sao Tome and Principe.

125. Donegal International Ltd. v. Zambia, [2007] EWHC 197 (Comm.) (Eng.).

126. See Schumacher, Trebesch & Enderlein, *supra* note 3.

127. See *supra* section B.

are always to some extent counterfactual as they also reflect trends. But this must not become their dominant trait. In this respect, it must be recognized that holdout litigation transforms the character of debt restructurings to some extent. While it does not lead to a relapse into the private law paradigm, it gives rise to an unprecedented asymmetry that benefits some investors who strive towards extracting a benefit from a fragmented legal order governing the global public interest in sovereign debt sustainability.

Nevertheless, there are strong signals that confirm debt sustainability as a principle despite the increase of holdout litigation. Thus, on many of the above-cited cases, the last word has not yet been spoken. Courts in EU member states with pending holdout suits might decide that they do not have jurisdiction as the case involves questions regarding the constitutionality of another member states' legislation, which in many member states only the highest courts may decide. Encouraging in this respect is the decision of the ICSID tribunal in the *Poštová banka* case. In its decision on jurisdiction, it concluded that

“sovereign debt is an instrument of government monetary and economic policy and its impact at the local and international levels makes it an important tool for the handling of social and economic policies of a State. It cannot, thus, be equated to private indebtedness or corporate debt.”<sup>128</sup>

The German Federal Court of Justice's decision is now pending before the Federal Constitutional Court.<sup>129</sup> Argentina claims that the former court violated its constitutional right to a legally assigned judge by not referring the case to the Federal Constitutional Court – the sole authority competent for deciding questions relating to the existence of customary international law or general principles in the German legal order. Should the Federal Constitutional Court decide in favor of Argentina, there is a high chance that the outcome will be different. In fact, the Federal Court of Justice did not specifically investigate the issue whether good faith as a general principle might constitute a defense against holdout litigation. It only relied on the Federal Constitutional Court's previous judgment rejecting the application of the necessity defense in relations involving private parties<sup>130</sup> – a very weak basis for an argument relating to good faith. Ironically, the Federal Court of Justice chose this avenue in order to avoid a referral to the Federal Constitutional Court.

Further, there have been some rare cases where courts recognized sustainability concerns. Because of the potential global effects of the restructuring at stake, US courts acknowledged at times a legitimate interest in debt restructurings in order to safeguard financial stability.<sup>131</sup> In other

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128. *Poštová banka, a.s. and Istrokapital SE v. Hellenic Republic*, ICSID Case No. ARB/13/8, Award ¶ 324 (April 9, 2015).

129. *See supra* note 105.

130. *Supra* note 103.

131. *Crédit français, s.A. v. Sociedad financier de comercio, C.A.*, 128 Misc.2d 564 (S.C.N.Y. 1985); *EM Ltd. v. Argentina*, No. 05-1525-cv, Summary Order (May 13, 2005), 2d Cir. R. 32.1. (obiter

jurisdictions, courts have given broader recognition to the interests reflected in the principle of debt sustainability, by granting immunity to debt repudiation aimed at safeguarding the basic human rights of citizens in the debtor states.<sup>132</sup>

Besides these encouraging signals from the judiciary, holdout litigation has received strong negative responses and explicit disapproval on the part of governments and in many decisions of international organizations. Regarding the former, the United States government's *amicus* brief in NML Capital before the Court of Appeals for the Second Circuit, as well as of other governments before the US Supreme Court, are testament to their concern for debt sustainability in the light of holdout litigation.<sup>133</sup> The United Kingdom and Belgium adopted anti-vulture legislation,<sup>134</sup> the latter in reaction to the Donegall case. It prevents claims against heavily indebted poor countries that exceed the amount that a holdout creditor would have received had he accepted the restructuring.<sup>135</sup> International organizations' rejection of holdout litigation is reflected, among others, in proposals by the IMF for strengthening contractual clauses:<sup>136</sup> in GA Resolution 69/319, which affirms the need for equitable treatment and good faith in sovereign debt restructurings and in the 2014 resolution of the Human Rights Council condemning holdout litigation.<sup>137</sup>

Above all, citizens in debtor states have voiced concerns over the effects of structural adjustment programs that might compromise their social and economic rights enjoyment.<sup>138</sup> In debtor states, there is a notable backlash against the structural adjustment programs related to debt restructurings, which are perceived as deeply illegitimate.<sup>139</sup> This sentiment has found support in decisions of domestic and international judicial bodies that have critically scrutinized their conformity with various fundamental rights guarantees.<sup>140</sup> It remains to be hoped that human rights impact assessments will become a standard step in the procedure in the design of structural

dictum lacking precedential value).

132. See, e.g., the case about judicial immunity of Argentina in Italy: Corte di Cassazione, Sezione Unite Civile, n. 11225 (May 27, 2005), 88 RIVISTA DI DIRITTO INTERNAZIONALE (2005) 856 (Ital.); or the holdout litigation cases before Argentinean courts: Juzgado Nacional en lo Contencioso Administrativo Federal N° 1 [Lower National Court for Administrative Matter No. 1], 12/10/ 2006, La Ley [L.L.], Suplemento Derecho Constitucional L.L., Feb. 27, 2007.

133. NML v. Republic of Argentina, Brief for the United States of America as Amicus Curiae in Support of Reversal, 6 et seq., case 12-105-cv(L) (2nd Cir.) (April 4, 2012); for briefs of other states and interested parties, see <http://www.scotusblog.com/case-files/cases/republic-of-argentina-v-nml-capital-ltd/>. (April 25, 2016, 11:00AM).

134. *Supra* note 169 and accompanying text.

135. United Kingdom Debt Relief (Developing Countries) Act, 2009-2010, H.C. Bill [22], available at <http://www.legislation.gov.uk/ukpga/2010/22/contents>.

136. E.g. International Monetary Fund, *supra* note 77); see also the list of UN General Assembly resolutions in note 70.

137. Human Rights Council Res. 27/33, Effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights: the activities of vulture funds, UN Doc. A/HRC/RES/27/33 (Oct. 3, 2014).

138. Sigrun Skogly, *Structural Adjustment and Development: Human Rights--An Agenda for Change*, 15 HUM. RTS. Q. 751 (1993); Daniel D. Bradlow, *The World Bank, the IMF, and Human Rights*, 6 TRANSNAT'L L. CONTEMP. PROBS. 47 (1996); ECONOMIC AND SOCIAL RIGHTS AFTER THE GLOBAL FINANCIAL CRISIS (Aoife Nolan ed., 2014); Goldmann, *supra* note 86.

139. Comprehensively: von Bogdandy & Goldmann, *supra* note 67.

140. *Supra* note 89.

adjustment.<sup>141</sup>

Thus, while it cannot be excluded that the principle of debt sustainability will be modified, attenuated, or even fade someday, the challenges constituted by holdout litigation do not give reason to doubt its existence at present. Rather, litigation strategies viewed as problematic under the principle of debt sustainability have been met with strong responses. This confirms the incremental approach, and it also illustrates its operation. The incremental approach cannot be as straightforward as a treaty or a grand legislative project. Rather, it moves ahead in tiny steps, from action to reaction, by and by forming consensus among stakeholders.

#### V. SAFEGUARDING DEBT SUSTAINABILITY: AN INCREMENTAL APPROACH TO SOVEREIGN DEBT RESTRUCTURING

This Section assesses current reform proposals for sovereign debt restructuring in light of sovereign debt sustainability's status as a principle of public international law. Contractual approaches appear normatively insufficient. With statutory solutions being politically unavailable, we propose an incremental strategy that relies on sovereign debt sustainability and other legal principles.

##### *A. Contractual and Other Bilateral Approaches*

A first set of reform proposals for sovereign debt restructuring advocates innovations in contractual clauses.<sup>142</sup> Improved CACs, which allow a supermajority of bondholders to agree to changes in bond payment terms binding for all bondholders, might facilitate debt restructurings on a practical level and thereby contribute to debt sustainability. Nevertheless, they have well-known loopholes, which differ from one generation of CACs to another. Traditional single-series CACs, which require a qualified majority of bondholders of each single issue to give their consent,<sup>143</sup> can easily be disabled by holdout creditors who buy a blocking minority. In the case of the 2012 Greek private sector involvement, holdouts amounted to € 6.4bn, or twenty-nine percent of the outstanding face value, dispersed over twenty-four bonds governed by English law with single-series CACs, as well as one bond governed by Greek law.<sup>144</sup>

More promising are second-generation CACs with so-called aggregation clauses. They require a lower qualified majority of the holders of each single

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141. James Harrison & M.-A. Stephenson, *Assessing the Impact of the Public Spending Cuts: Taking Human Rights and Equality Seriously*, in HUMAN RIGHTS AND PUBLIC FINANCE 234 et seq., (Aoife Nolan, et al. eds., 2013); see also Human Rights Council, Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights on his mission to Greece, UN Doc. A/HRC/31/60/Add.2 (Feb. 29, 2016).

142. For many: International Monetary Fund (2014), *supra* note 77.

143. On the difference between the quorum approach and the outstanding principal approach, see Sergio J. Galvis & Angel L. Saad, *Collective action clauses: recent progress and challenges ahead*, 35 GEO. J. INT'L L. 713 (2003).

144. Jeromin Zettelmeyer, et al., *The Greek debt restructuring: an autopsy*, 28 ECONOMIC POLICY 513, 527 (2013).

issue (usually 66 2/3%) as well as of the holders of all covered issues (usually 75%).<sup>145</sup> They reduce the risk of holdouts of single issues as they make it more difficult for holdouts to acquire a blocking minority. Being a recent innovation, aggregation clauses have not yet had to pass many practice tests. They worked fairly well in the case of Greece where legislation had introduced them retroactively into bonds governed by domestic law. As far as we can see, only one bond with second-generation aggregation clauses was not restructured.<sup>146</sup>

A third generation of so-called single-limb CACs does not require voting by issue, but the participation of 75 percent of all covered categories of outstanding debt.<sup>147</sup> One might doubt whether such clauses will be superior to second-generation aggregation clauses on a practical level. While it might be difficult even for very large investors to acquire a blocking minority in case of single-limb CACs, the operation of such clauses – which are yet to stand the test of practice – requires that all creditors are offered identical conditions under the restructuring agreement, regardless of the conditions of their old bonds.<sup>148</sup> Without this condition, there would be a huge risk that the restructuring is carried out at the expense of some bond series whose volume does not amount to a blocking minority. However, this condition at the same time provides a basis for inter-creditor discrimination. One-size-fits-all restructuring agreements will necessarily disadvantage the holders of bonds with higher yields than those of the majority. To ensure a majority for the restructuring, debtor states might exempt such bond issues from restructurings under the clause. This would reduce the reach of single-limb clauses, making its aggregating effect not so aggregate any more. A further practical obstacle with single-limb CACs is that they might require legislative amendments in some jurisdictions in order to protect them against standard terms review by courts:<sup>149</sup> Many legal orders protect contractual parties against boilerplate terms used by one party which unduly compromise the rights of the former. To be on the safe side, legislation would have to determine that certain CACs do not fall in that category.

But apart from these more practical difficulties, contractual approaches raise a number of normative concerns from the perspective of the principle of sovereign debt sustainability that are not easy to overcome. First, contractual approaches have a very narrow focus that misses important features necessary for ensuring debt sustainability effectively. They only apply to bonds and do not include other classes of creditors. Also, they do not ensure a fair burden-sharing among different creditor group, and these features of the contractual

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145. International Monetary Fund, *Sovereign Debt Restructuring - Recent Developments and Implications for the Fund's Legal and Policy Framework*, IMF Policy Paper 29 (April 26, 2013).

146. Zettelmeyer, *supra* note 144, 538.

147. This reflects the model proposed by the International Capital Markets Association, *supra* note 4. On pre-war examples, see W. Marc C. Weidemaier & G. Mitu Gulati, *A People's History of Collective Actions Clauses*, 54 VA. J. INT'L L. 51, 70 et seq. (2013).

148. International Capital Markets Association, *supra* note .

149. Cf. Gesetz über Schuldverschreibungen aus Gesamtemissionen (Schuldverschreibungsgesetz) [SchVG] [Bond Issuance Act], July 31, 2009, BGBl. I at 2512, last amended by Gesetz [G], Sept. 13, 2012, BGBl. I at 1914, art. 2, § 5 (Ger.).

approach might delay debt restructuring. Further, the contractual approach is only loosely connected to the provision of interim financing to a debtor during a restructuring.<sup>150</sup> By definition, these tasks pertain to the international community of states by virtue of the global *public* interests recognized by the principle of debt sustainability.

Second, contractual approaches continue considering debt restructurings as a matter to be figured out between the debtor state and its creditors alone. The principle of sovereign debt sustainability demonstrates this is no longer a viable position. Leaving the debtor state ultimately at the mercy of the majority of the creditors, no matter which thresholds apply, does not seem to do justice to the role assigned to states as protectors of their citizens and providers of welfare, including their responsibility to ensure the progressive enjoyment of economic, social and human rights. As has been shown, this dimension is today a component of the principle of sovereign debt sustainability. It needs to be ensured even against the wishes of private creditors, ideally by way of a crackdown provision or similarly effective instruments. The global public interest in the resolution of debt crises expressed in the principle of debt sustainability requires putting strings on the powers of creditors, including private bondholders. This means that the private law paradigm prevailing during the 19th and most of the 20th century needs to be effectively laid to rest, but CACs do not go far enough in that respect.

It is for these reasons that we think that arbitration, such as investor-state dispute settlement under the aegis of the International Centre for Settlement of Investment Disputes (ICSID), cannot by itself provide a solution to sovereign debt disputes that would respect debt sustainability. This would simply reproduce the private law paradigm that essentially requires the consent of the parties for restructurings, whether they are governed by domestic private law or by bilateral treaty relations. It is for its disregard of public interests that ICSID has been under strong criticism over the last decade that focused mainly on its lack of transparency and accountability. This criticism has led a number of countries discontinuing their membership. As an institutional forum that solves debt disputes needs to be based on a broad international consensus, it is hard to believe that stakeholders involved in debt restructurings see the ICSID as a proper forum to settle debt disputes. Besides, the expansive interpretation of investors' rights against host states that arbitrators often apply in investment disputes significantly reduces the fiscal and regulatory space required for economic development.<sup>151</sup> Investment arbitration therefore seems inadequate as a means for achieving debt sustainability. A radical change in the institutional design of ICSID tribunals would be required in order for them to become good candidates for the sustainable solution of sovereign debt crises.

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150. Anne O. Krueger & Sean Hagan, *Sovereign workouts: an IMF perspective*, 6 CHI. J. INT'L L. 203, 214-5 (2005).

151. See generally UNCTAD, TRADE AND DEVELOPMENT REPORT (2014).



### B. The Difficulty with a Treaty Option

Others favor a treaty-based sovereign debt restructuring organization.<sup>152</sup> A widely-ratified international treaty establishing a predictable, effective, fair and independent debt workout mechanism with the option of enforcing the terms of the agreement if needed would most likely create proper incentives for debtors and creditors to reach acceptable debt restructuring agreements within a reasonable amount of time. Compared to contractual approaches, a comprehensive treaty option could in principle comprise all debt, irrespective of its type, creditor, or specific contractual clauses.<sup>153</sup> Moreover, a treaty option would potentially overcome the bilateralism of contractual approaches. It could include a standstill provision that would make holdout litigation impossible, except for legal review explicitly provided by the treaty.<sup>154</sup> Such treaty provisions, as well as any agreement on debt restructuring reached under their terms, would be enforceable in any jurisdiction. This would satisfy the requirements of the principle of sovereign debt sustainability.

However, this is not a highly realistic option in the current political landscape. UN General Assembly Resolution 68/34 of 2014 received 124 votes in favor, 11 votes against<sup>155</sup> and 41 abstentions.<sup>156</sup> A year later, UN General Assembly Resolution 69/319, which does not even call for a treaty, still received 136 votes in favor, 6 votes against,<sup>157</sup> and 41 abstentions.<sup>158</sup> There is thus considerable support for a multilateral solution in large parts of the community of states. The voting pattern suggests, however, a number of influential developed countries are not willing to go in this direction, even if it is only because they favor the International Monetary Fund (IMF) as a venue.<sup>159</sup> Any proposal of an international treaty is at present unlikely to

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152. Cf. Krueger & Hagan (note 150); Mathias Audit, *Ingénierie juridique pour la création d'un centre international pour la sauvegarde financière des états*, 142 JOURNAL DU DROIT INTERNATIONAL 1057 (2015); for a de-politicized resolency court on a contractual or treaty basis: Christoph G. Paulus, *Should Politics be Replaced by a Legal Proceeding?*, in A DEBT RESTRUCTURING MECHANISM FOR SOVEREIGNS: DO WE NEED A LEGAL PROCEDURE? 191 (Christoph G. Paulus ed. 2014).

153. Note, however, that not all proposals for a treaty mechanism are comprehensive in this way. The proposal by Audit, *supra* note 152, seems to cover bonds only.

154. On the controversies regarding the inclusion of a standstill clause in the SDRM proposal, see International Monetary Fund, *Proposed Features of Sovereign Debt Restructuring Mechanisms*, IMF Policy Paper (2003). The standstill clause was ultimately removed from the proposal. However, this happened while the rise of holdout litigation was still very much at the beginning. Contractual clauses were deemed sufficient to bring it under control. See Matthias Goldmann, *Necessity and Feasibility of a Standstill Rule for Sovereign Debt Workouts 2-4* (UNCTAD Working Paper, 2014). For a concise argument why standstill is necessary, see HOLGER SCHIER, TOWARDS A REORGANISATION SYSTEM FOR SOVEREIGN DEBT AN INTERNATIONAL LAW PERSPECTIVE 183-7 (2007).

155. Australia, Canada, Czech Republic, Finland, Germany, Hungary, Ireland, Israel, Japan, United Kingdom, United States of America.

156. Albania, Andorra, Armenia, Austria, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Denmark, Estonia, France, Georgia, Greece, Iceland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Monaco, Montenegro, Netherlands, New Zealand, Norway, Papua New Guinea, Poland, Portugal, Republic of Korea, Republic of Moldova, Romania, San Marino, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Ukraine.

157. Canada, Germany, Israel, Japan, United Kingdom, United States.

158. G.A. Res. 69/319 (Sept. 29, 2015).

159. See European Union, EU Explanation of Vote – United Nations General Assembly: Sovereign Debt Restructuring Process, Statement on behalf of the Member States of the European Union, EUUN14-112EN (Sept. 9, 2014).

become binding for the jurisdictions in which most external debt of developing and emerging economies is usually issued. Certainly, an international agreement signed by only a limited number of countries might still create an area for smooth debt restructurings. Debtor states might prefer such a jurisdiction for issuing sovereign debt because it adheres to rules for debt restructurings. This may be an attractive option for an existing or rising financial center to strengthen its position on the sovereign debt market. Nevertheless, a limited geographic reach would come at the price of limited effectiveness.

The multilateral treaty option brings further complexities: Treaties are rigid legal instruments. Their ratification as well as potential amendments take time and are politically difficult to achieve. In a rapidly changing field like the sovereign debt market, the legal framework needs to be able to react quickly to unforeseen changes. Beyond such practicalities, an international debt workout mechanism would have to take decisions concerning the allocation of money that have serious distributive consequences. Decisions of that kind call for a mechanism that enjoys a high level of democratic legitimacy, which is notoriously difficult to achieve on the international level.<sup>160</sup> This calls for an approach that goes beyond the contractual and statutory ones.

### *C. An Incremental Approach Based on Legal Principles*

In the following we propose an incremental approach to sovereign debt restructuring that would promote debt sustainability in the absence of an international treaty. This approach takes sovereign debt sustainability seriously as a global public interest, i.e. a matter of concern for the international community, not only for the debtor state and its creditors. It tries to overcome the private law paradigm by making any decision relating to debt restructuring – whether on the domestic or international levels, whether taken on the political level, in the frame of debt restructuring negotiations, or by courts – subject to a set of legal principles promoting debt sustainability. The approach requires consolidating legal principles, both principles of public international law and general principles of law, which reflect progressive trends in current practice that corroborate the principle of sovereign debt sustainability.<sup>161</sup> Such principles complement, rather than replace, existing mechanisms, including contractual approaches and the activities of the International Financial Institutions or the Paris Club, and guide their operation. The principles give, where necessary, a new reading to existing practice in line with the global public interest in sovereign debt sustainability. They use the interpretative space between the factual and the normative, between apology

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160. Cf. Jan Klabbers, *On Functions and Finance: Sovereign Debt Workouts and Equality in International Organizations Law*, 41 YALE J. INT'L L. ONLINE (2016), in this issue.

161. For a list of necessary economic principles, see Martin Guzman & Joseph Stiglitz, *Creating a Framework for Sovereign Debt Restructuring That Works*, in TOO LITTLE, TOO LATE. THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 20 (Martin Guzman, José Antonio Ocampo & Joseph Stiglitz eds., 2016). For a similar proposal based on general principles of law, see Schier, *supra* note 154, 109 et seq. However, Schier might have been too optimistic in deriving a fully-fledged insolvency regime from general principles, instead of a number of broad guidelines that allow improving current practice.

and utopia, in order to highlight and strengthen trends in current practice that support debt sustainability.

The incremental strategy has inspired the 2015 UNCTAD Roadmap and Guide.<sup>162</sup> The UN General Assembly followed this approach in its 2015 resolution.<sup>163</sup> The incremental strategy follows what emerged as a possible compromise between those advocating statutory solutions in the frame of UN and those strictly opposed to such a bold endeavor, at least in the frame of the UN. Thus, in 2014, when taking the floor in the process that led to the adoption of GA Resolution 69/319, Italy, on behalf of the EU, expressed that

“[t]he ad-hoc committee must be limited to the elaboration of a non-binding ‘set of principles’ which builds upon a market-based voluntary contractual approach to sovereign debt restructuring and aims at furthering its implementation and use. Neither the EU nor Member States will participate in discussions aiming at the establishment of a binding multilateral legal framework for sovereign debt restructuring processes.”<sup>164</sup>

What is the purpose of the envisaged ‘set of principles’? Such principles might help establish consensus among decision-makers about sovereign debt restructuring practices that foster sovereign debt sustainability. Certainly, the emergence of such consensus does not immediately improve debt-restructuring practice. Principles do not have the same legal quality as international treaties. Compared to treaty law, they tend to be less precise in scope and more contested regarding their legal status and content, as one might disagree to some extent about the state and direction of current sovereign debt restructuring practice.

One might therefore doubt whether the incremental approach will be effective and meet the expectation to further develop current practice towards debt sustainability. A particularly hard case is holdout litigation, as explained in Section D. Some deem the incremental approach insufficient to fight it effectively. Accordingly, principles of international law are not widespread and clear enough to provide an effective remedy against such litigation.<sup>165</sup> Yet, as we showed, holdout litigation triggered a series of unambiguous signals confirming debt sustainability as a principle of international law, manifested in the overwhelming rejection to abusive vulture funds litigation.<sup>166</sup>

In any case, there are several avenues by which debt sustainability, including the concern for human rights, might gain traction and make sovereign debt restructurings more sustainable. First, as Robert Howse has recently pointed it out,<sup>167</sup> informal norms have been actually ruling the management of sovereign debt crises. While it is true that most of these

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162. *Supra* note 72.

163. *Supra* note 79.

164. *Supra* note ~~159~~159.

165. With respect to the 2012 UNCTAD Principles on Responsible Sovereign Lending and Borrowing: Mauro Megliani, *Vultures in Courts: Why the UNCTAD Principles on Responsible Financing Cannot Stop Litigation*, 28 LEIDEN JOURNAL OF INTERNATIONAL LAW 849 (2015).

166. *Supra*, section D.III.

167. Robert Howse, *Toward a Framework for Sovereign Debt Restructuring: What Can Public International Law Contribute?*, in TOO LITTLE, TOO LATE. THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 241 (Martin Guzman, José Antonio Ocampo & Joseph Stiglitz eds., 2016).

standards do not have the binding force of public international law, the point to make here is that soft law should not *a priori* be ruled out as an instrument to effectively deal with debt issues. It has the capacity to set out standards of fairness that might exert a “compliance pull” on debtors and creditors.<sup>168</sup>

Second, states could choose to endorse such principles unilaterally, like a limited, non-binding treaty option. For states as debtors, adherence to the principles might tilt competition for sovereign debt market shares in their favor. For states as creditors, adherence to the principles might secure better outcomes for debt restructurings of other states in which they participate, as this will help to mitigate the “too little, too late” problem. States might even choose to adopt legislation that implements such principles in their domestic legal order, like the UK 2010 Debt Relief (Developing Countries) Act or the analogous Belgian legislation.<sup>169</sup> In the long run, such domestic legislation might corroborate the respective principles of international law through the incremental formation of corresponding general principles of law. This solution would have the advantage of allowing states greater discretion in the concretization of internationally agreed principles.

Third, courts might implement such principles when they interpret and apply the law relating to a sovereign debt case brought before them, whether the case turns on a question of contractual law, domestic private law, or international law. In principle, judges may interpret any provision relevant to a case in light of the principles, though some types of legal provisions might provide better gateways for such principles than others. For example, in civil law jurisdictions, general clauses like good faith lend themselves for the application of principles to give meaning and content to their broad scopes of application.<sup>170</sup> In common law jurisdictions, comity or equity might lead to equivalent results.<sup>171</sup> Further, to the extent that the principles constitute general principles of law, they might be directly applicable in some legal orders by virtue of legislative or constitutional incorporation.<sup>172</sup>

But the drawback of principles is that they require activist governments and courts for their implementation. There are plenty of examples where courts have used principles or general clauses to advance the law decisively.<sup>173</sup> However, their focus on individual cases might tilt courts structurally towards taking a more narrow perspective on policy issues. The need to achieve justice in a specific case comes at the risk of losing the grand picture out of sight and ignoring the development of sovereign debt restructuring practice over the last decades epitomized by the principle of sovereign debt sustainability. The

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168. THOMAS M. FRANCK, *THE POWER OF LEGITIMACY AMONG NATIONS* 43 (1990).

169. *Projet de loi relative à la lutte contre les activités des fonds vautours art. 2*, Chambre des représentants de Belgique, Doc. 54 1057/005 (July 1, 2015).

170. On good faith, see Goldmann, *supra* note 7.

171. 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 (2003).

172. E.g. Art. 25, Grundgesetz für die Bundesrepublik Deutschland [Grundgesetz] [Basic Law], May 23, 1949, BGBl. I (Ger.).

173. Thus, the German Reichsgericht developed and applied the *clausula rebus sic stantibus* doctrine in cases of hardship deriving from the effects of the First World War, see Reichsgericht [RG] [Imperial Court] Sept. 21, 1920, 100 RGZ 129, *English translation available at* <https://law.utexas.edu/transnational/foreign-law-translations/german/case.php?id=955>.

codification of principles in soft law instruments might mitigate this bias to some extent and remind governments and courts of the grand picture. This seems the purpose behind the adoption of principles by the UN General Assembly's "Basic Principles on Sovereign Debt Restructuring Processes" and the UNCTAD Roadmap and Guide.<sup>174</sup> Courts can refer to such principles as they interpret the applicable law, in accordance with the rules of interpretation applicable to their legal order. In international law, the use of principles for interpretative purposes, though frequent practice,<sup>175</sup> is not clearly regulated by Arts. 31 and 32 of the 1969 Vienna Convention on the Law of Treaties (VCLT).<sup>176</sup> In any event, international courts may refer to soft law instruments by considering them as subsequent agreements (Art. 31(3)(a) VCLT),<sup>177</sup> subsequent practice (Art. 31(3)(b) VCLT),<sup>178</sup> relevant rules of international law (Art. 31(3)(c) VCLT),<sup>179</sup> or as supplementary means of interpretation (Art. 32 VCLT).<sup>180</sup>

In addition to soft law codifications, the incremental approach would benefit from "soft" means of enforcement. By that we think in particular of a debt workout institution facilitating the implementation of the principles through recommendations and technical assistance. A debt workout institution does not need to be based on a treaty. It could also be conceived as a soft institution like a universal version of the Paris Club. Such an institution could help debtors and creditors to ensure that debt restructuring negotiations contribute to sovereign debt sustainability, in particular that they are legitimate, transparent, assisted by independent institutions, respect good faith and creditor equality. Optionally, the institution could maintain a list of uncooperative holdout creditors and their parent companies. This list, provided it respects due process rights, would incentivize individuals, companies and public entities not to make business with them. It would also guide domestic and international courts when called upon to decide whether certain creditors acted abusively in violation of good faith.

On the whole, given that a multilateral, coordinated solution appears politically unavailable, the present decentralized restructuring practice would be brought further in line with the principle of debt sustainability by an incremental approach that uses a set of principles as brackets that bend practice further towards debt sustainability. Even when there is presently no agreement as to how the principles should be further developed and implemented, it seems that the process in the General Assembly has so far broadened international consensus around a global set of principles guiding

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174. *Supra* notes 72 and 79.

175. For many: *Monetary Gold Case (Italy v. France, U.K., and U.S.A.)*, 1954 I.C.J. 19, 32 (June 15): "To adjudicate upon the international responsibility of Albania without her consent would run counter to a well-established principle of international law embodied in the Court's Statute, namely, that the Court can only exercise jurisdiction over a State with its consent."

176. Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331.

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.* The extent to which references to soft law are permissible under the mentioned provisions is controversial. See ANTHONY AUST, *MODERN TREATY LAW AND PRACTICE* 212 et seq. (3rd ed. 2013).

debt restructurings. This consensus becomes all the more apparent if one looks at the substance of the principles instead of their number, the scope of each principle, or the way they are called. Thus, while the UNCTAD Roadmap and Guide list five principles, the UN General Assembly has extended the list to nine. But on substance, both sets of principles broadly overlap. The General Assembly only added two principles which stress state sovereignty: principle 1 emphasizes states' sovereign powers with respect to macroeconomic policy-making; principle 6 with respect to sovereign immunities. These principles are compatible with the UNCTAD proposal as both are well established in international law. Apart from that, the UN General Assembly only rephrased the UNCTAD proposal or emphasized certain aspects, such as equitable treatment, which the UNCTAD proposal had included under the heading of the principle of good faith. This broad consensus is remarkable as the principles emerge from a complex pattern of practice that can be assessed and structured in different ways. To achieve consensus on substance is also important for the legitimacy of such principles. In fact, while legal scholarship and expert advice can provide input into a consensus building process, consensus in international law ultimately hinges on the establishment of agreement among states, international organizations, and other actors with the capacity to make international law. This dynamic demonstrates how the complex politics of deformalization in international law<sup>181</sup> might ultimately turn out to strengthen the international legal order through principles of international law.

## VI. CONCLUSION: CHALLENGES AHEAD

Since the beginning of the 20th century, debt-restructuring practice has come a long way. The recognition of debt sustainability as a principle in international law marks an important step ahead which takes into account the global nature of financial, economic and social relations in today's world and the ensuing interconnections. Debt sustainability demands expedient restructurings, and provides a gateway to the application of human rights provisions, including to non-state actors.<sup>182</sup> It opens the door towards an incremental approach to sovereign debt restructuring, of which it constitutes the normative center. Other principles, both principles of international law and general principles of law, such as good faith, transparency, and impartiality, further corroborate this process.<sup>183</sup> Certainly, an international treaty's binding force would greatly advance the potential of debt restructurings to achieve debt sustainability. For the time being, however, the incremental approach, which comprises and complements contractual strategies, appears to be the best available option to strengthen debt sustainability as a global public

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181. Sceptical about the politics of deformalization: Jean d'Aspremont, *The Politics of Deformalization in International Law*, 3 GOETTINGEN JOURNAL OF INTERNATIONAL LAW 528 (2011).

182. See Daniel D. Bradlow, *Can Parallel Lines Ever Meet? The Strange Case of the International Standards on Sovereign Debt and Business and Human Rights*, 41 YALE J. INT'L L. ONLINE (2016), in this issue.

183. On good faith, see Goldmann, *supra* note 7; on transparency, see Goldmann, *supra* note 17; on legitimacy and impartiality, see Odette Lienau, *Principles of Legitimacy and Impartiality for a Sovereign Debt Workout Mechanism*, 41 YALE J. INT'L L. ONLINE (2016), in this issue.

interest, and to overcome the structural bias in court decisions about holdout litigation. The principles may play the role of a social architect more than that of a policeman.<sup>184</sup>

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184. Georges Abi-Saab, *Eloge du "droit assourdi"*. *Quelques réflexions sur le rôle de la soft law en droit international*, in NOUVEAUX ITINERAIRES EN DROIT: HOMMAGE A FRANÇOIS RIGAUX 68 (Bibliothèque de la Faculté de Droit de l'Université Catholique de Louvain 1993).