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Vultures in Courts: Why the UNCTAD Principles on Responsible Financing Cannot Stop Litigation

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Abstract

The decision of the US Supreme Court rendered in *NML* v. *Argentina* has enabled the vulture funds to enforce in full their claims against the payments to be made by Argentina in favour of those holders who had tendered their bonds under a previous exchange offer. This scenario may have a disruptive impact on the functioning of the financial markets and endanger the restructuring processes of sovereign debt. The race to the courts by the vulture funds could be stopped under the UNCTAD Principles on Responsible Financing where the behaviour of those creditors who acquire debt instruments of sovereigns in distress and remain aloof from a restructuring to secure preferential treatment is marked as abusive. Unfortunately, so far the legal status of this abusive behaviour is unable to overturn the interpretation of the *pari passu* clause under New York law given by the US Federal Courts which stands at the base of the problem. To overcome this impasse the suggestion is to insert in the UN proposal of a multilateral legal framework for sovereign restructuring processes a specific provision qualifying as overriding a mandatory restructuring plan approved through a certain quorum which has received certification by the IMF. This qualification would serve the purpose of applying the plan to all creditors, and not just to those who register under the process. Moreover, this qualification would be considered as part of the public policy of the states participating to the UN proposal so as to block the enforcement of judgments rendered in non-participating fora.

Key words

abuse of rights cannot overrule New York interpretation; *pari passu* clause interpretation in New York federal courts; proposals; UNCTAD Principles on responsible financing; UN multilateral legal framework for sovereign restructuring processes; vulture funds litigation

1. Introduction

In June 2014 the US Supreme Court denied the petition for writ of *certiorari* submitted by the Republic of Argentina against NML Capital,[1] a vulture fund that specializes in the purchase of debts of sovereigns and corporations in distress at a discounted price on the secondary market. The petition was filed by Argentina in August 2013, after the Court of Appeals for the Second Circuit rejected the appeal against an order issued in February 2012 by Judge Griesa of the Southern District Court of New York

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1 *Republic of Argentina v. NML Capital Ltd*, 2014 US Lexis 4259 (16 June 2014).

that enjoined Argentina from making payments on its restructured debt without making ratable payments to NML. Under this decision, Argentina was not allowed to make full payment on its restructured debt without also making full and contextual payment to the holdout vulture funds. The enforcement of the decision was stayed pending a writ of *certiorari* before the Supreme Court but, following the Supreme Court decision to dismiss the case, the judgment of the Court of Appeals became enforceable. This enforcement has led to a dramatic outcome as Argentina does not have the funds to pay all the holdout creditors on the basis of the nominal amount of their credits.

This article explores the lawsuits brought by vulture funds before US courts, discusses the role of abuse of rights under the United Nations Conference on Trade and Development (UNCTAD) Principles on Responsible Lending and Borrowing in blocking these lawsuits, and concludes that the most viable route to stop vulture fund litigation coincides with the insertion of specific provisions within the proposal of the United Nations to establish a multilateral legal framework for sovereign debt restructuring.

2. The vultures

The holdout creditors made their appearance on the sovereign debt scene in the late 1980s in connection with the creation of a secondary market for loans of debtors in distress.[2] Their policy was to buy, at a discounted price, debt instruments owed by sovereigns, semi-sovereigns, and corporations in default, and then avoid taking part in restructuring workouts in order to secure a better treatment. An evolutionary step in this phenomenon was brought by the so-called 'vulture funds', i.e. funds buying these instruments for the specific purpose of getting their full nominal amount in court.[3]

Sovereign debtors tried to neutralize this legal action by resorting to the defence of Champerty. Champerty is an ancient common law rule which prohibits instrumental recourse to the courts of justice.[4] The reluctance of US tribunals to apply Champerty in this field is epitomized by the divergent decisions given by the New York federal courts in *Elliott* v. *Republic of Peru and Banco de la Nacion*. In the first instance, the Southern District Court of New York found an infringement of the New York Champerty law on the grounds that the intention and purpose to sue could be inferred from the fact that no serious steps were taken towards reaching agreed restructuring.[5] Nevertheless, the judgment was reversed by the Court of Appeals for the Second Circuit on the grounds that Elliott's intention to bring a lawsuit was incidental and contingent: incidental as its primary goal was to be paid in full, and

2 At that time sovereign private debt was mainly constituted by syndicated debt, R. Buckley, 'The Transformative Potential of a Secondary Market: Emerging Markets Debt Trading From 1983 to 1989', (1998) 21 *Fordham International Law Journal* 1152.

3 See P. Wautelet, 'Les fonds vautours', in M. Audit (ed.), *Insolvabilité des Etats et dettes souveraines* (2011), 99.

4 See M. Radin, 'Maintenance by Champerty', (1935–1936) 24 *California Law Review* 48.

5 The Court endorsed the characterization of Elliott's conduct made by Peru as 'international piracy', *Elliott Associates L.P. v. Republic of Peru*, 12 F Supp. 2d 328, 336, 343, and 356 (SDNY 1998).

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contingent as its lawsuit followed the refusal of the debtor to pay its dues.[6] The Court relied upon a policy argument to support its interpretation of the New York Champerty law, namely that should the Champerty defence prevail, the lenders would encounter difficulties in selling their credits and the secondary market of sovereign loans would be disrupted.[7]

Had the outcome of this defence been different, it would have put an end to the strategy of exploiting sovereign debt litigation for speculation. As a result, a second chapter of the saga was opened whereby the vulture funds tried to enforce victorius judgments against sovereign debtors on the basis of the *pari passu* clause.[8]

2.1. Pari passu

The *pari passu* clause is a covenant generally incorporated into the terms of sovereign loans, intended to avoid discrimination among the borrower's unsecured external creditors.[9] This clause originates from municipal bankruptcy law where it is used to ensure parity of treatment among unsecured creditors.[10] It can be drafted and/or interpreted either narrowly or widely: under the narrow meaning all the creditors 'rank *pari passu*', while under the wider meaning they are to be paid *pro rata* when a payment in favour of one of them is made.[11] This divergence in understanding has an impact in practice. In 2000, Elliott, a vulture fund having in its holding unrestructured commercial loans, submitted a motion to the president of the *Tribunal Commercial* of Brussels to prevent the Morgan Guaranty Trust from applying any payment received by Peru to the Brady Bonds. The motion was dismissed, but Elliott appealed to the *Cour d'Appel* of Brussels, which reversed the decision of the lower court and granted the injunction. The *Cour d'Appel*, in granting the requested remedy, followed an interpretation of the *pari passu* clause contained in the affidavit of Professor Lowenfeld, according to whom the clause implied that each creditor must be paid *pro rata* instead of each creditor ranking *pari passu*.[12] Following this ruling, Peru was obliged to seek a settlement with Elliott which realized a nearly 500 per cent return on its purchase.[13]

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6 *Elliott Associates L.P. v. Banco de la Nacion*, 194 F 3d 363, 379 (2nd Cir. 1999).

7 Ibid., 380.

8 See J. Blackman and R. Mukhi, 'The Evolution of Modern Sovereign Debt Litigation: Vultures, Alter Egos, and Other Legal Fauna', (2010) 73 *Law & Contemporary Problems* 47, at 53–55.

9 The acknowledgment of the *pari passu* clause in the loan agreements with sovereign borrowers pursues three main purposes: to prevent the earmarking of particular assets; to prevent the risk that a legal act of the borrower could alter the ranking of the existing debts; to prevent the risk of an involuntary subordination, since in certain legal systems it is possible to acquire seniority by a notarization of the debt instruments. See L. Buchheit and J. Pam, 'The *Pari Passu* Clause in Sovereign Debt Instruments', (2004) 53 *Emory Law Journal* 869, at 901–4 and 911–14.

10 See P. Wood, *Principles of International Insolvency* (2007), 237.

11 According to L. Buchheit, 'The *Pari Passu* Clause *Sub Specie Aeternitatis*', (1991) *International Financial Law Review* 11, at 12, the aim of the clause is '[to] prevent the sovereign from attempting to legitimise the discrimination by enacting laws or decrees which purport to bestow a senior status on certain indebtedness or give a legal preference to certain creditors over others'.

12 The affidavit submitted by Professor Lowenfeld became the object of much criticism, G. Gulati and K. Klee, 'Sovereign Piracy', (2001) 56 *Business Lawyer* 635, at 635–9.

13 See C. Wheeler and A. Attaran, 'Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Litigation', (2003) 39 *Stanford Journal of International Law* 253, at 257–8.

In December 2011, the Southern District Court of New York granted a partial summary judgment in favour of certain non-exchanging creditors, finding that Argentina had infringed the *pari passu* clause in lowering the rank of the bonds in the plaintiffs' hands below that of any other unsecured and unsubordinated external debt.[14] In October 2012, the Court of Appeals for the Second Circuit affirmed the decision of the District Court dated February 2012 under which Argentina was obliged to make specific performance of its obligations under the *pari passu* clause in connection with payments on the exchange bonds.[15] In terms of the *pari passu* clause, the Court did not firmly emphasize the payment limb of the clause, but rather relied on its subordination element.[16] While Argentina had paid the exchange bonds regularly, it had not done this in relation to the old non-exchanged bonds. Furthermore, it had never appropriated the necessary sums in the national budget, and had stated in the exchange offer prospectuses that it had no intention to resume payments on them. Finally, the Lock Law precluded Argentine officials from paying defaulted bondholders and Argentine courts from recognizing foreign default judgments.[17] By contrast, in relation to default on the exchange bonds, foreign judgments could be recognized by the Argentine courts.[18] Against this background, the Court ruled that the debtor was in breach of contract even under Argentina's proposed interpretation of the clause.[19]

The case was remanded to the District Court for the determination of the third parties and the payment formula. On 21 November 2012, the District Court ruled on these two points. In relation to the payment formula, the Court held that the reference to the 'ratable payments' contained in the 23 February 2012 order was to be understood as follows: if paying 100 per cent of the interest on the exchange bonds in December 2012, Argentina was to pay 100 per cent of the accelerated principal and accrued interest on the old bonds.[20] In the face of the firm intention by Argentina to pay the exchange holders but not the holders of the old bonds, the District Court ordered the debtor to pay into an escrow account the total amount due as of 15 December 2012.[21]

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14 In detail, the Court identified the lowering of the rank of the bonds in the payments made on the exchange bonds against the persistent refusal to honour the non-exchange bonds and the enactment of the Lock Law, A. Gelpern, 'Contract Hope and Sovereign Redemption', (2013) 8 *Capital Markets Law Journal* 132, at 138–9.

15 *NML Capital Ltd. et al. v. The Republic of Argentina*, 2012 US App Lexis 22281 (26 October 2012, 2nd Cir.).

16 'Thus, the two sentences of the *Pari Passu* Clause protect against different forms of discrimination: the issuance of other superior debt (first sentence) and the giving of priority to other payment obligations (second sentence)', *NML Capital Ltd. et al. v. The Republic of Argentina, supra* note 15, at 18–19.

17 See G. Gulati and R. Scott, *Three Half and a Minute Transaction. Boilerplate and the Limits of Contract Design* (2013), 172.

18 Ibid.

19 'In short, the combination of Argentine's executive declarations and legislative enactments have ensured that plaintiffs' beneficial interests *do not* remain direct, unconditional, unsecured and unsubordinated obligations of the Republic and that any claims that may arise from the Republic's restructured debt *do* have a priority in Argentinian courts over claims arising out of the Republic's unrestructured debt', *NML Capital Ltd et al. v. The Republic of Argentina, supra* note 15, at 20.

20 *NML Capital Ltd. v. the Republic of Argentina*, 2012 US Dist Lexis 167272 (21 November 2012 SDNY), at 9–14.

21 'The less time Argentina is given to devise means of evasion, the more assurance there is against such evasion', *NML Capital Ltd. v. Republic of Argentina, supra* note 20, at 10.

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The orders of November 2012 were subsequently challenged before the Court of Appeals for the Second Circuit, which dismissed the appeal in August 2013.[22] In June 2014, the Supreme Court denied the petition for the writ of *certiorari* and Argentina was faced with the impossibility of paying the exchange holders without paying the non-exchange holders in full.[23]

2.2. Debt restructuring and voluntary participation

In the absence of contractual clauses providing for the possibility of modifying the terms of payment for the loan, any amendment may take place solely with the unanimous consent of all the holders; therefore, the participation in an exchange offer remains fundamentally a question of free will.[24]

In *Allied Bank II* the Court of Appeals for the Second Circuit laid down the general rule that, pending a restructuring process, the obligations connected to the credits remain valid and enforceable.[25] As affirmed in *National Union Fire Insurance*, non-restructuring creditors maintain the right to pursue legal remedies; if this were not the case, their right to choose freely between joining a restructuring process and enforcing their obligations would be seriously impaired.[26] This point received further clarification in *Pravin Banker IV* where, after weighing up the two competing policies of debt restructuring and creditor rights, the Court of Appeals for the Second Circuit came to the conclusion that the latter must prevail over the former.[27] This rule, a corollary of the doctrine of the sanctity of contracts,[28] has been followed by the US courts,[29] even during financial crises.[30] Along the same lines, the Court of Appeals for the Second Circuit in *Elliott* v. *Banco de la Nacion* held that, should the restructuring concerns prevail, the short-term benefits for the borrower would be counterbalanced by the long-term difficulties in securing further resources.[31]

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22 *NML Capital Ltd v. Republic of Argentina*, 2013 US App Lexis 17645 (23 August 2013 2nd Cir.).

23 In July 2014 District Court Griesa made an order blocking payments on bonds held by exchange holders, *The Economist*, 9 August 2014, 40.

24 'Participation in international debt rescheduling is voluntary', *National Union Fire Insurance v. People's Republic of the Congo, National Union Fire Insurance v. People's Republic of the Congo*, 729 F Supp 936, 944 (SDNY 1989).

25 '[T]he underlying obligations to pay nevertheless remain valid and enforceable', *Allied Bank International v. Banca Credito Agricola de Cartago*, 757 F 2d 516, 519 (1985).

26 'This Court will recognize and enforce the default judgment despite the existence of the London Club Agreement;' otherwise, 'it would have the effect of depriving a creditor of its right to choose whether to reschedule a debit or to enforce the underlying obligation to pay', *National Union Fire Insurance v. People's Republic of the Congo*, *supra* note 24, at 944.

27 'This second interest limits the first so that, although the United States advocates negotiations to effect debit reduction and continued lending to defaulting foreign sovereigns, it maintains that creditor participation in such negotiations should be on a strictly voluntary basis', *Pravin Banker Associates Ltd. v. Banco Popular del Peru*, 109 F 3d 850, 855 (2nd Cir. 1997).

28 See Art. 1, sec. 10, cl. 1 of the US Constitution under which states are called to refrain from enacting laws which impair the obligations of contract.

29 See J. Gathii. 'The Sanctity of Sovereign Loan Contracts and its Origins in Enforcement Litigation', (2006) 38 *George Washington International Law Review* 251, at 303.

30 '[I]t is not the function of a federal district court in an action such as this to evaluate the consequences to the debtor of its inability to pay,' *A.I. Corporation v. Government of Jamaica*, 666 F Supp 629, 633 (SDNY 1987).

31 *Elliott Associates L.P. v. Banco de la Nacion*, 194 F 3d 363, 380 (2nd Cir. 1999).

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Nevertheless, a suspension of the proceedings pending a restructuring process could be justified under certain circumstances. In *Pravin Banker IV*, the Court of Appeals emphasized that an indefinite suspension of the proceedings pending the outcome of a restructuring process would contradict the prevailing principle that creditors' rights should be safeguarded, implicitly leaving the door open to a circumscribed suspension of the proceedings on the verge of a definition of the restructuring process.[32]

The point was subsequently restated in *E.M. LTD* v. *The Republic of Argentina*, where the Court of Appeals for the Second Circuit held that the lower court was correct in using its discretion on vacating the remedies in order to avoid a substantial risk to the restructuring process which was 'of critical importance to the economic health of a nation'.[33] Apparently, this decision would add a new element in the balancing test between free participation and the restructuring process. However, a deeper analysis reveals that this novelty is not to be overestimated. The contractual rights of the holdout creditors were 'frozen' solely in so far as they were capable of endangering the restructuring rights of the exchanging holders and the restructuring process was close to its end, which is in line with the view previously expressed in *Pravin Banker IV*.[34]

In *NML Capital* v. *Argentina*, the Court of Appeals for the Second Circuit found that the insertion of collective action clauses (CACs) in bonds governed by New York law would prevent recurring lawsuits by vulture funds.[35] Until recently, bond issues governed by New York law did not contain CACs which provide, inter alia, for the amendment by majority of all the terms of the loan, including the payment terms.[36] The UNCTAD Principles, acknowledging the lack of a sovereign debt restructuring mechanism in the present stage of development,[37] have focused on CACs as a consensus-driven restructuring process to limit the room for manoeuvring of holdout creditors.[38] However, even in the presence of CACs, in small issues the holdout creditors may purchase a quantity of bonds large enough to create a blocking minority capable of neutralizing any adverse modification of the terms of the loan.[39]

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32 The Court implicitly affirmed that a temporary suspension of the proceedings or of the execution of the judgment was consistent with the respect of the creditors' rights, *Pravin Banker IV*, *supra* note 27, at 855.

33 'The District Court declined to use its discretionary authority in a manner that would entail such risk, and we will not disturb the Court's exercise of its discretion,' *E.M. LTD et al. v. The Republic of Argentina*, 131 Fed Appx 745, 747 (2nd Cir. 2005).

34 This analysis is coherent with the opinion expressed by the Department of State in its Statement of Interest. This emphasised that if the holdout creditors were allowed to pursue these remedies with the purpose of collecting payments due to them under the bonds, the voluntary participation in the restructuring process by the exchanging creditors would have been endangered. See C. Schmerler, 'Restructuring Sovereign Debt', in J. Silkenat and C. Schmerler (eds.) *The Law of International Insolvencies and Restructurings* (2006), 431, at 454.

35 *NML Capital Ltd. et al. v. The Republic of Argentina*, *supra* note 15, at 27.

36 CACs include not only majority action clauses, but also collective representation clauses, majority enforcement clauses and engagement clauses, R. Ahdieh, 'Between Mandate and Market: Contract Transition in the Shadow of the International Order', (2004) 53 *Emory Law Journal* 691, at fn. 15.

37 See *infra*, § 3.1.

38 See comment sub Principle 15.

39 See Gelpern, *supra* note 14, at 145.

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3. Abuse of rights under international law

The doctrine of abuse of rights (*abus de droit*) establishes that each right is to be exercised in a manner that does not impair the rights of others.[40] However, whether the abuse of rights is accepted as an autonomous general principle of law remains uncertain. In the view of certain scholars, it would be a mere application of other principles, such as good faith or equity.[41] Substantively, the defence of abuse of rights may present itself in three different scenarios: (i) when a state exercises its rights in a manner hindering the rights of another state, such as in cases of misuse of shared resources; (ii) when a right is exercised for a purpose other than that for which it was created; and (iii) when a state causes injury to other states by arbitrarily exercising its rights even where this does not constitute a violation of their rights.[42]

Although it has been referred to in several cases, the principle has not been used as a basis for condemnation.[43] In the *Case Concerning Certain German Interests in Polish Upper Silesia*, the Permanent Court of International Justice (PCIJ) found that Germany's alienation of a nitrate factory at Chorzów (Polish Upper Silesia) did not amount to an abuse of right as it was a normal act of administration not intended to prejudice Poland's rights.[44] In the *Free Zones of the Upper Savoy and Gex Case* the PCIJ emphasized that France could not evade its obligation to maintain the free zones by erecting a customs barrier, but neither could an abuse be presumed by the Court.[45] In the *Shrimp-Turtle Case*, the WTO Appelate Body underscored that '[a]n abusive exercise by a Member of its own treaty right thus results in a breach of the treaty rights of the other Members and, as well, a violation of the treaty obligation of the Member so acting'.[46]

The interdependence of rights and obligations is not confined to treaty law but plays a role even within the domain of general law. This is so as every right is subject to those limitations necessary to make its exercise compatible not only with the

40 See G. Ripert, 'Les régles du droit civil applicables aux rapports internationaux', (1933-II) 44 RCADI 565, at 618. N. Politis, 'Le probléme des limitations de la souverainité et la théorie de l'abus des droits dans les rapports internationaux', (1925) 6 RCADI 1, at 86–94, emphasized that in the exercise of non-regulated freedoms states are called upon to temper their individualistic action with the superior interest of the international community, on this point see also H. Lauterpacht, *The Function of Law in the International Community* (2011), 306–30.

41 See A. Kiss, 'Abuse of Rights', in R. Wolfrum (ed.), MPEPIL (2006), para. 10. The uncertainties on its reception within the general principles of law originated from the fact that the doctrine is not universally acknowledged in every municipal legal system, see G. Schwarzenberger, 'Uses and Abuses of the "Abuse of Rights" in International Law', (1956) 42 *Transactions of the Grotius Society* 147, at 150–2.

42 See Kiss, *supra* note 41, at paras 4–6.

43 Ibid., at para. 12.

44 '[The alienation] was not designed to procure for one of the interested Parties an illicit advantage and to deprive the other of an advantage to which he was entitled', *Case Concerning Certain German Interests in Polish Upper Silesia (Merits)* (1926) PCIJ Series A No. 7, at 37–38.

45 *Free Zones of the Upper Savoy and the District of Gex*, PCIJ (1932) Series A/B No. 46, at 167.

46 *United States- Import Prohibition of Certain Shrimp and Shrimp Products*, decision of 12 October 1998, WT/DS58/AB/R, para. 158, at www.wto.org (accessed 12 August 2015). The Appellate Body referred to this principle as an means to interpret the rule contained in Art. XX of the GATT, concerning the conservation of exhaustible natural resources, in order to avoid an application by the United States of a measure amounting to unjustifiable or arbitrary discrimination. In this regard, the principle of abuse of rights may be used to solve normative conflicts, M. Byers, 'Abuse of Rights: An Old Principle, A New Age', (2002) 47 *McGill Law Journal* 389, at 419–20.

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specific contractual obligations of one party, but also with its obligations under general law.[47] However, to file a lawsuit is an action so permeated with discretion that under international law it could be characterized as an abuse of rights solely when an 'unlawful intention or design can be established'.[48]

3.1. Abuse of rights under UNCTAD principles

In January 2012 UNCTAD, following a Resolution by the UN General Assembly that stressed the importance of responsible financing under which public and private creditors and sovereign debtors share responsibility for preventing unsustainable debt situations,[49] adopted the Principles on Promoting Responsible Sovereign Lending and Borrowing.[50] Formally, the Principles have not been incorporated into a binding instrument for two reasons: first, this choice is coherent with the soft law character of international financial law;[51] second, their purpose is not so much to establish rights and obligations but rather to identify basic rules and best practices. The second reason reflects the dynamic and flexible nature of the Principles,[52] and is also indicative of their non-uniform legal status.[53]

With particular reference to abuse of rights, Principle 7 affirms that when a sovereign debtor is clearly unable to service its debt, all lenders must behave in good faith and with a co-operative spirit towards a restructuring process, and that creditors should operate in favour of a quick and orderly resolution of the problem. This implies that a creditor who purchases a debt instrument of a sovereign in distress with the aim of forcing a preferential treatment outside a consensual workout process is acting abusively.[54] However, this implication must be carefully appreciated – the abuse does not lie in the mere purchase of the debt instrument, but in the attempt to secure a more favourable settlement of the claims. This involves not just a mere lack of participation in the restructuring process, but any attempt to enforce preferential claims by filing lawsuits in court.

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47 See B. Cheng, *General Principles of Law* (1987), 130. In the *North American Dredging Company Claim* (1926) IV RIAA 26, 27, the Mexican-United States General Claims Commission held that its task was to find 'such limitation of both rights as will render them compatible with the general rules and principles of international law'.

48 See Cheng, *supra* note 47, at 134.

49 A/RES/65/144 (2011), point 3.

50 At www.unctad.org (accessed 12 August 2015). The Principles are the outcome of the UNCTAD Project on Promoting Responsible Sovereign Lending and Borrowing.

51 See C. Brummer, 'Why Soft Law Dominates International Finance – and Not Trade?', (2011) 13 *Journal of International Economic Law* 623.

52 See J. Bohoslavsky and C. Esposito, 'Principles Matter: The Legal Status of the Principles on Responsible Sovereign Financing', in C. Esposito, Y. Li, and J. Bohoslavky (eds.) *Sovereign Financing and International Law* (2013), 86.

53 The Principles have been derived by analogy from domestic legal systems: only a few reflect customary law (corruption, necessity); most of them may be classified as general principles of law (agency, authorisation, bindingness), emerging principles (assessment of borrower's capacity, lender's due diligence), guiding principles (audits, disclosure of information), or structural principles (avoiding overborrowing). See M. Goldmann, *Responsible Sovereign Lending and Borrowing: The View From Domestic Jurisdictions* (2012).

54 See the comment sub Principle 7, at www.unctad.org (accessed 12 August 2015); see also A. Bredimas, A. Gourgourinis, and G. Pavlidis, 'The Legal Contours of Sovereign Debt Restructuring under the UNCTAD Principles: Antagonism and Convergence Between Standards of Domestic Insolvency Law and International Investment Protection Law', in Esposito et al., *supra* note 52, 135, at 148–9.

4. UNCTAD PRINCIPLES IN US COURTS

In *Lightwater*, Argentina played the abuse of rights card, arguing that plaintiff would have been barred from suing on bonds as the debtor was facing a severe economic crisis.[55] However, the District Court dismissed the defence as it found no merit in it.[56] The UNCTAD Principles set out as a general rule the requirement to behave in good faith in consensual debt workouts (Principle 7) and as a corollary, a creditor that acquires a debt instrument of a sovereign in distress with the purpose of securing better treatment outside a restructuring process is acting abusively. Against this background, the question is whether and to what extent the applicability of this principle could have changed the outcome of the *NML* decision.

4.1. Abusive behaviour

Broadly speaking, the US Constitution does not put customary law and the general principles of law on the same plane. Customary international law is considered the supreme law of the land in so far as the law of nations is comprised in the laws of the United States (Article VI, clause 2).[57] General principles are not covered by this umbrella and, although federal courts have on more than one occasion made reference to principles of customary law, these are altogether different from general principles of law.[58]

With particular reference to abuse of rights in relation to sovereign debt, under the UNCTAD Principles it is uncertain whether the rule that holdout litigation must not impair sovereign debt workouts is a general principle of law or rather a guiding principle.[59] In either case, it may be used to interpret and supplement the governing law (in the case, New York law as the governing law of the loan agreement).[60] But it is unlikely that it can overturn the rule under which a suspension of proceedings pending a restructuring process may operate solely within a reasonable lapse of time.

The guiding nature of this principle is implicitly acknowledged in the Human Rights Council (HRC) Guiding Principles on Foreign Debt and Human Rights.[61] The HRC Principles deal with these problems under two regards: upstream, loan agreements should contain legal restrictions on the assignment or sale of credits

55 *Lightwater Corp. Ltd. et al. v. Republic of Argentina*, 2003 US Dist 6156, at 13 (SDNY 14 April 2003).
56 Ibid.
57 In this respect in *Paquette Habana*, 20 S Ct 290, 329 (1899), Justice Gray specified that 'where there is no treaty, and no controlling executive or legislative act or judicial decision, resort must be had to the customs and usages of civilized nations'.
58 See H. Schrader, 'Custom and General Principles as Sources of International Law in American Federal Courts', (1982) 82 *Columbia Law Review* 751, at 765–7.
59 See A. von Bogdandy and M. Goldman, 'Sovereign Debt Restructurings as Exercises of International Public Authority', in Esposito et al., *supra* note 52, 39, at 68.
60 Cf. the Preamble of the UNIDROIT Principles 2010.
61 The Guiding Principles are annexed to the 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 rights, particularly economic, social, and cultural rights, A/HRC/20/23 (2012), and received endorserment by Human Rights Council Resolution A/HRC/20/10 (2012). The normative contribution of the HRC Guiding principles lies in identifying existing basic human rights standards applicable to sovereign debt and related policies, as well as in elaborating the implications of these standards (point 17).

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to third parties without the informed consent of the debtor (point 59) and, in any case, credits cannot be sold to holdout creditors (point 62); downstream, the amount recoverable by those who have acquired sovereign debts after the failure of negotiations cannot surpass what laid down in the terms of the loan (point 60), and in any case, as far as highly indebted poor countries (HIPC) are concerned, cannot exceed that received by other creditors (point 61).

The rules within the HRC Guiding Principles reflect a number of national legislative initiatives. In 2007, a bill was introduced in the French parliament under which a French judge would have discretion in enforcing payments against a foreign sovereign debtor in default.[62] In 2008, the Belgian Parliament passed legislation designed to prevent funds appropriated by the Belgian government for international development co-operation from becoming objects of attachment.[63] More extensively, in 2010 the UK Parliament passed the Debt Relief (Developing Countries) Act 2010. Under this piece of legislation, a UK court cannot render a judgment or enforce a foreign judgment or arbitral award against HIPC under which private creditors are enabled to recover their credits in excess of the sustainable level as calculated under the HIPC Initiative.[64] The Act, originally intended to remain in force for one year, was adopted after a public consultation strongly backed by the Jubilee Campaign.[65]

In the same vein, in 2009, a bill was introduced in the US House of Representatives to prevent speculation and profiteering in the defaulted debt of certain poor countries.[66] In contrast, in June 2010 the Judgment Evading Foreign States Accountability Act was introduced in the House of Representatives and this denies access to US capital markets to middle-income and wealthy countries and their corporations in default for more than two years on US court judgments totalling US $100 million or more.[67]

All these pieces of national legislation, both passed and aborted, are too few, too limited, and too controversial in scope to indicate the emergence of a norm of truly international public policy[68] capable of blocking the enforcement of loan agreements or related foreign judgments and awards in national fora. In effect, their purpose is not so much to set a limit on holdout litigation, but rather to protect the financial resources of bilateral and multilateral creditors.[69]

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62 The proposed French piece of legislation was modelled on Art. 1699 of the French Civil Code which forbids champertous litigation. See Wautelet, *supra* note 3, at 120–1.

63 See Wautelet, *supra* note 3, at 124–5.

64 See M. Waibel, 'Debt Relief to Poor Countries: Rules v Discretion', (2010) 25 BJIBFL 295.

65 See Wautelet, *supra* note 3, at 124. The UK initiative induced two holdouts on Liberia to accept the terms on offer from the IDA managed Debt Reduction Facility; see IMF and IDA, *Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – Status of Implementation and Proposals for the Future of the HIPC Initiative* (2011), at 17.

66 See D. Sookun, *Stop Vulture Funds Lawsuits. Commonwealth Secretariat* (2010), at 90–91.

67 HR 5564.

68 The content of this truly international public policy or transnational public policy 'is the one that establishes universal principles, in various fields of international law and relations, to serve the higher interests of the world community, the common interest of mankind, above and sometimes even contrary to the interests of individual nations', J. Dolinger, 'World Public Policy: Real International Public Policy in the Conflict of Laws', (1982) 17 Texas J Int'l L, 167, at 172, although its emergence and formalization remain *in fieri*, M. Forteau, 'L'ordre public "transnational" ou "réellement international"', (2011) 138 JDI 3, at 10–11.

69 See R. Bismuth, 'L'émergence d'un "ordre public de la dette souveraine" pour et par le contrat d'emprunt souverain? Quelques réflexions inspirées par une actualite´ trés mouvementée', (2012) 58 AFDI, 589, at 502–3.

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5. Towards a global restructuring mechanism

In the absence of a contractually driven debt restructuring mechanism or in the presence of a bondholders' blocking minority impeding its operation, the status of abuse of rights under the UNCTAD Principles is unable to overturn the interpretation of a term of the loan (say the *pari passu*) given by the seized forum under the applicable law. To overrule this problem, the UN General Assembly resolved in September 2014 to elaborate through an intergovernmental process a Multilateral Legal Framework for Sovereign Restructuring Processes.[70] To this purpose, the General Assembly decided to establish an ad hoc committee composed of all the member states and observers of the United Nations. Participation in the committee is open to bodies and organizations of the UN system, with particular reference to the World Bank and the IMF, as well as other intergovernmental and non-governmental organizations, the private sector, and academia.[71] The committee is entrusted with the task of elaborating, as a matter of priority, a multilateral legal framework for sovereign debt restructuring with the aim of increasing 'the efficiency, stability and predictability of the international financial system and achieving sustained, inclusive and equitable economic growth and sustainable development, in accordance with national circumstances and priorities'.[72] The outcomes of this process are expected by the end of 2015.

Such a proposal is not a novelty in the landscape of international debt. In 1939, the Committee for the Study of International Loan Contracts created by the League of Nations produced a report recommending that loan contracts should include an arbitration clause and suggesting the establishment of an arbitration tribunal composed of three persons appointed by the President of the PCIJ from a panel of nine persons. In the same report, the Committee indicated that the most workable solution to this problem would be achieved through the creation of a proper 'International Loans Tribunal', with competence for all international loans, composed of three judges appointed by the PCIJ.[73] Although the outbreak of the Second World War caused the proposal to be set aside, the International Institute for the Unification of Private Law, which had worked along with the Committee, pursued the work and formalized a proposal for the establishment of a proper *Tribunal des Emprunts Internationaux*.[74] However, such a tribunal would also have been characterized by an intrinsic limit – it would have enjoyed the competence to decide on the rights and obligations of the parties without the power to modify the terms of a loan.[75]

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70 A/RES/68/304 (2014).

71 The ad hoc Committee was established pursuant to General Assembly Resolution A/RES/69/247 (2014).

72 A/69/466/Add.3. Within the Second Committee the draft resolution encountered the fierce opposition of a significant number of countries, among which the United States whose courts have triggered the problem with the vulture funds. The adoption of the resolution by the General Assembly was deferred for budgetary reasons, A/C.2/69/L.59.

73 See M. Hudson, *International Tribunals* (1944), 210–12.

74 The proposal was not fated to meet the enthusiasm of the financial circles, M. Domke, 'Dispute Settlement of International Loans', in J. F. McDaniels (ed.) *International Financing and Investment* (1964), 525, at 533.

75 See E. Robert, 'Rééchelonnement de la dette ou réglement judiciare?', in D. Carreau and M. Shaw (eds.) *La dette extérieure/The External Debt* (1995), 608, at 633–4.

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The project fell into oblivion and was resumed at the beginning of the new millennium when the IMF launched the proposal to establish a Sovereign Debt Restructuring Mechanism (SDRM), focused on a Sovereign Debt Dispute Resolution Forum (SDDRF).[76] Under this scheme, a debt restructuring agreement would have been binding for all the registered creditors once the vote had received certification by the SDDRF. The certification would not bind non-registered creditors, although the SDDRF might issue an order providing for a stay of enforcement in contracting fora pending a restructuring process.[77] The SDRM should have been established through an amendment to the IMF Articles of Agreements accepted by three fifths of the members that have 85 per cent of the total voting power (Article XXVIII). Unfortunately, the SDRM encountered the opposition of the United States, which, having nearly 17 per cent of the voting power, was able to block any amendment of the IMF Articles of Agreement.[78] This impasse marked the passage from a statutory approach based on the SDDRF to a contractual approach based on the adoption of CACs. This precedent casts a shadow over the outcome of the UN project.[79]

5.1. A barrier to holdouts

The problem of the holdouts may not be solved under a debt restructuring framework as long as registered creditors taking part in the restructuring process are bound by it while non-registered creditors are merely affected by a temporary stay of enforcement. Against this background, the capacity of the UN multilateral legal framework to rebut the action of the holdouts depends on the presence of specific rules capable of binding them all. To be effective, these rules presuppose that the legal framework be formalized as a multilateral convention.[80]

In this framework, the starting point would consist of the assignment to the IMF of the task of certifying that a debt restructuring plan is consistent with the debt sustainability analysis of the country at issue.[81] When the restructuring plan received such a certification, it would need to be approved with at least 50 per cent of the outstanding value of each class of debt (e.g., bonded debt). This majority is calculated on the whole aggregate amount of a class, with the result that in

76 IMF, *The Design of the Sovereign Debt Restructuring Mechanism – Further Considerations* (2002).

77 See M. Megliani, *Sovereign Debt: Genesis, Restructuring, Litigation* (2015), 571–3.

78 See E. Bartholomew, A. Liuzzi, and E. Stern, 'Two-Step Debt Restructuring: A Market-Based Approach in a World Without International Bankruptcy Law', (2004) 35 *Georgetown Journal of International Law* 859, at 859–60.

79 See *supra*, § 2.2.

80 The draft may be simply endorsed by the General Assembly along the same lines as the Articles on State Responsibility, may be approved like the UNCITRAL Arbitration Rules, or adopted as a multilateral convention opened to the signature of the member states.

81 The DSA depends upon the countries at hand: for middle-income countries a debt is considered sustainable as long as the debtor is able to continue servicing the debt without an unrealistically large future correction in the balance of income and expenditure, IMF, *Assessing Sustainability* (2002); while for low-income countries, the IMF and the World Bank have introduced a Joint Debt Sustainability Framework, under which a DSA consists of an analysis of a country's projected debt burden over 20 years and its vulnerability to external and policy shocks, an assessment of the risk of debt distress in that period in the light of indicative debt burden thresholds, and recommendations for borrowing and lending aimed at limiting the risk of debt distress, The Joint World Bank-IMF Debt Sustainability Analysis for Low-Income Countries (2005), at http://imf.org/external/np/exr/facts/jdsf.htm (accessed 12 August 2015).

each single loan facility the threshold of 50 per cent might not be met.[82] Under an IMF certification, this relatively low approval threshold is termed as an overriding mandatory provision.[83] This means that it can be applied in a state party to the convention encapsulating the legal framework irrespective of the law governing the loan agreement. A similar escamotage was used under the Greek debt restructuring of spring 2012, where the Greek Bondholder Act 2012 (Law 4050/2012) introduced *ex post* CACs in domestic bonds issued under Greek law, specifying that relevant provisions, amounting to overriding mandatory provisions (Article 1(10)), were of the highest public interest.[84] This approach would solve the holdout problem as long as the seized fora belong to contracting states, but leaves the issue unaffected with reference to lawsuits brought in the fora of non-contracting parties. To deal with this point, the draft convention should be completed by a provision establishing that judgments rendered in non-contracting parties' fora, contrasting with this mandatory rule, cannot be enforced in contracting parties fora as contrary to public policy.[85] This second provision sounds particularly significant as the United States, a very important litigating forum for sovereign debt, is unlikely to join an international instrument on multilateral debt restructuring.[86]

6. Conclusions

The final episode of *NML* v. *Argentina* has shown that the interpretation by US courts of a contractual clause in sovereign loan agreements governed by New York law is capable of disrupting the financial system by imposing on sovereign debtors

82 This voting requirement corresponds to the voting requirement under the EU Common Terms of Reference, at http://europa.eu/efc/sub_committee/cac/index_en.htm (accessed 12 August 2015), where it is necessary that reserved matters be modified through an affirmative vote of not less than 75 per cent of the aggregate principal amount of the outstanding bonds present at the meeting or by the written consent of not less than two-thirds of the aggregate principal amount of the outstanding bonds; cross-series modifications require also the affirmative vote of more than two-thirds of the aggregate principal amount represented at separate meetings of each series affected by the proposed modifications or the written consent of more than half the aggregated principal amount of each series affected by the proposed modifications. These percentages are calculated on a voting quorum of two-thirds of the outstanding bonds, with the result that what is needed is an affirmative vote of 50 per cent of the principal amount of the debt class coupled with 45 per cent in each series. See C. Hofmann, 'Sovereign-Debt Restructuring in Europe Under the New Model Collective Action Clauses', (2014) 49 *Texas International Law Rev* 383, at 402.

83 See Art. 9(1) of Rome I Regulation which defines overriding mandatory provisions as: 'provisions the respect of which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope', European Parliament and of the Council Regulation (EC) 593/2008 of 7 June 2008 on the law applicable to contractual obligations (Rome I) [2008] OJ L 177/6.

84 Unofficial translation in English available at http://www.bondgreci-azionilegali.it/wp-content/uploads/2012/05/Greek-Bondholders-Act.pdf (accessed 12 August 2015).

85 Such a provision would resemble Art. VIII(2)(b) of the IMF Articles of Agreement where exchange contracts involving the currency of any member and contrary to the exchange control regulations of that member, maintained or imposed in accordance with the Agreement, cannot be enforced in the territories of any member, see C. Proctor (ed.) (2005) *Mann on the Legal Aspect of Money* (2005), 378–407. The alternative choice could be to immunize the assets of foreign debtors located in contracting fora, but this umbrella would operate within a limited lapse of time at the end of which vultures' action can resume, see L. C. Buchheit, M. Gulati, and I. Tirado, 'The Problem of Holdout Creditors in Eurozone Sovereign Debt Restructurings', (2013) 4 BJIBFL 191.

86 The attitude of the United States may be easily inferred from the previous contrariety to the SDRM and to actual adversity to the framework expressed within the UN GA Sixth Committee.

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the burden to pay non-restructuring creditors, in this case vulture funds, in full. Although this problem may be largely overcome through the widespread adoption of CACs, which permit the modification by majority of payment terms, in small bond issues a vulture fund may be able to raise a sufficient number of bonds to block the proposed amendments. This problematic scenario cannot be solved under the UNCTAD Principles on Responsible Sovereign Financing as the prohibition on abusive behaviour by these funds has an uncertain legal status whose concrete appreciation and application is deferred to the seized court.

To address the problem, the UN General Assembly has established an ad hoc committee to elaborate a multilateral legal framework for sovereign debt restructuring. To be really effective, the outcome should be captured in an international convention. Two provisions should be acknowledged in that context. The first is centred on the qualification of the restructuring, certified as debt sustainable by the IMF and approved with a voting quorum of at least 50 per cent of the value of each class of loan, as a mandatory rule for each contracting party. The second is focused on the indication that a judgment against a restructuring debtor rendered in a forum of a non-contracting state cannot be enforced in a forum of a contracting state as contrary to the international public order of that forum. Even though this machinery cannot extend to decisions rendered and enforced in non-contracting state fora, the judgments delivered in contracting fora may contribute towards establishing this rule as one of truly international public policy and thereby constitute a benchmark for non-contracting fora.