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Governing Law in Sovereign Debt – Lessons from the Greek Crisis and Argentina Dispute of 2012

Committee on Foreign & Comparative Law

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New York City Bar Association

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**Governing Law in Sovereign Debt – Lessons from the Greek Crisis
and Argentina Dispute of 2012 – A Working Paper**

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The Committee on Foreign and Comparative Law appointed a working group to undertake a preliminary inquiry into current market practice regarding governing-law provisions (also known as “choice of law” provisions) in sovereign debt issues. The economic background of this project is the continuing sovereign debt crisis that is centered on southern Europe -- a crisis that is not near final resolution at the time of writing. This past March, the holders of Greece’s debt securities agreed with the government of Greece to exchange virtually all of their outstanding debt of approximately €205 billion for new debt having a face amount of about 46.5% of the original principal amount in the largest ever consensual sovereign debt restructuring using the private sector involvement, or “PSI” model. There have been reports that as much as 90% of the debt involved was embodied by documents that were governed by Greek law¹ and that did not contain so-called collective action clauses, a key feature of virtually all precedent sovereign debt swaps in recent years. The use of Greek governing law, on the other hand, allowed the architects of the restructuring to legislatively impose highly favorable collective action clauses on the lenders, years after the original debt had been negotiated and in the crisis context described above.

¹ See Gulati, Mitu and Buchheit, Lee C., *How to Restructure Greek Debt* (Duke Law Working Papers, Paper No. 47, 2010), available at http://scholarship.law.duke.edu/faculty_scholarship/2336.

The Committee thought that it might be useful to do two things at this juncture: first, make some observations about the legal consequences, to issuers and debt holders, of selecting the issuer's law as the contractually stipulated governing law; and second, make a very preliminary survey of market practice in this area, with the possible result that the views that led to the debt terms facilitating the Greek workout could be reexamined and the underlying theories held up for critical review. This memo is the result of the working group's efforts, as adopted by the Committee.

The focus on the governing law issue has also sharpened considerably in the wake of the recent decision of the Second Circuit to uphold a judgment against the Republic of Argentina regarding that nation's 2001 default on its sovereign debt which is governed by New York law.² This decision dealt in large part with New York contract law authority regarding the *pari passu* clause governing the debt, and is also discussed below. What follows is not a definitive study; rather it surveys some existing authority in this area, and attempts some initial legal analysis based on a sampling of recent transactions.

Choice of Law in International Debt Contracts; Market Trends. One major article on choice of law considerations in sovereign lending is M. Gruson, "Controlling Choice of Law," in a collection of articles published in 1984.³ This article displays Gruson's customary scholarship and thoroughness, but was written just prior to the enactment of New York's statutory validation of choice of law clauses in substantial commercial transactions (discussed in greater detail below). As to whether the law of the issuing sovereign is a sensible choice for the governing law of the debt contract, Gruson dismisses this prospect entirely: "It is particularly dangerous to have a loan agreement with a sovereign borrower governed by the law of the borrower because it is within its own power to change that law and frustrate the rights of the lender,"⁴ Most of the article is devoted

² *NML Cap., Ltd. v. Rep. of Arg.*, 699 F.3d 246, 259 (2d Cir. 2012).

³ Gruson & Reisner, *Sovereign Lending: Managing Legal Risk*, Euromoney Publications, 1984.

⁴ *Id.* at 51.

to the circumstances under which New York courts would support the selection of New York law, a matter now widely viewed as settled (at least for New York courts) by statute.

Philip Wood treats these issues in more depth in Volume 6, “*Conflict of Laws and International Finance*,” of his treatise, *The Law and Practice of International Finance* (2007) (“Wood”). While Wood’s viewpoint (like Gruson’s) is that of the creditor, his comparative treatment of U.S. and English authorities is illuminating, particularly as English and New York law are the two primary alternative choices when local law is not the governing law in a sovereign debt issue.

Wood observes that the fundamental issue in which choice of law comes into play in debt finance is discharge, i.e. what constitutes performance of the obligation and what constitutes defenses to payment. He states:

“The rules as to discharge are in practice of the greatest importance in financial contracts since a change in law resulting in, say, a moratorium may be recognized if it arises under the applicable law of the contract. The rules have been a strong incentive for the application of an external system of law, as is the applicable law of an international financial contract so as to exclude interference by the laws of the borrower’s country.”⁵

Wood then provides specific examples of how the laws of a borrower’s nation can affect issues of discharge and excuse for non-performance. Some of these are:

1. *Moratorium*: “A moratorium on payments modifies the obligation of a debtor if the moratorium law is enacted in the country of the governing law of the contract.”⁶
2. *Exchange Controls*, i.e. enactments that require governmental approval to obtain the currency of payment, or which limit or prohibit the transfer of such currency overseas. Wood states, “[t]he exchange control will be recognized where the legislation is part of the governing law of the

⁵ Philip Wood, *Conflict of Laws & International Finance*, 6 *The Law & Prac. of Int’l Fin.* 1 (2007).

⁶ *Id.* ¶ 2-106 at 70. As an example of a moratorium on payments that does not modify the obligation of the debtor, in the *NML Capital* case, beginning in 2001 the President of Argentina declared a “temporary moratorium” on principal and interest payments of more than \$80 billion of its external debt, including the debt that was the subject of the case. It may be debated whether the distinction between a moratorium declared by the sovereign debtor which binds the debt issued subject to domestic law from that which affects the debt subject to “neutral law” (eg. New York or English law) is truly meaningful when the result to the creditor is identical and the perceived leverage in workout negotiations illusory.

contract.”⁷ In the U.S., one leading case is *Allied Bank International v. Banco Credito Agricola de Cartago*, 757 F.2d 516 (2d Cir. 1985), in which a Costa Rican measure prohibiting a loan repayment in dollars was held not a defense to payment where the debt was governed by New York law and was stated to be payable in New York.

3. *Laws that annul contractual provisions*,⁸

4. *Legal Tender Laws*, a subset of (2) above, i.e. measures that authorize or require payment in local currency notwithstanding contractual requirements for payment in the obligation currency.⁹

Of these, exchange controls and legal tender laws are of special concern to debtholders. These measures, usually intended to conserve hard currency reserves, can be the precursor of national insolvency. Creditors in cross-border transactions are vitally concerned with ensuring receipt of the contractual currency, which is usually a “hard” currency relative to the currency of the debtor. If the debtor currency has been devalued, a lender that is legally bound to accept it in repayment will suffer a loss. Wood states that “exchange controls are a diminishing feature of international economic relations,”¹⁰ but in varied forms they have prompted a large proportion of the decided cases.

Is Sovereign Debt a Special Case for Choice of Law? Wood adds that state contracts, i.e. those entered into by a sovereign government, are not treated fundamentally differently from a conflicts standpoint than private contracts. He says: “There are no special rules applying to state commercial contracts. It does not follow that the law of the state is applied.”¹¹ Thus, at least in the U.S. and U.K. courts, there is no rule generally mandating the application of the law of the sovereign

⁷ *Id.* ¶ 3-106 at 78.

⁸ *Id.* ¶ 2-108 at 71.

⁹ *Id.* ¶ 3-023 at 85.

¹⁰ *Id.* ¶ 3-014 at 77.

¹¹ *Id.* ¶ 2-084 at 60.

debtor to substantive issues relating to the debt obligations. The next questions are: first, to what extent may the parties displace the sovereign's own law by agreement; and second, to what extent will such an agreement shift the crucial rules governing discharge and defenses to payment from the debtor's law to a more neutral law chosen by the parties?

Governing Law Clauses. Wood's summary of the international position on choice of law clauses is succinct: referring to the principle of party autonomy embodied in the Rome Convention of 1980, he states: "The EU freedom reflects English common law which allows virtually complete party autonomy in choice of law. Party autonomy is accepted now in most, if not all, developed systems, although in the U.S. there must sometimes be some connection and the parties must not intend to avoid important public policies of, the forum."¹²

Wood's reference to U.S. law is to Section 1-105 of the Uniform Commercial Code, which allows parties to contracts to select governing law so long as there is a "reasonable connection" to the jurisdiction chosen. This caveat reflects the traditional territoriality of U.S. conflicts law and a reluctance to permit untrammelled party autonomy. During the 1980s, in order to allow New York to compete more effectively with London as a situs for international transactions, there was a movement to liberalize the Code requirement for major financing transactions. This resulted in the enactment in 1984 of Section 5-1401 of New York's General Obligations Law ("G.O.L."), which validates stipulations of New York law without a requirement of a reasonable connection between

¹² *Id.* ¶ 2-054 at 43. In *Lehman Bros. Commercial Corp., et al. v. Minmetals Int'l Non-Ferrous Metals Trading Co., et al.*, 179 F.Supp.2d 118 (S.D.N.Y. 2000), a U.S. Federal court considering the application of the N.Y. General Obligations Law provisions discussed below, alluded to possible constitutional limitations on the ability of New York to apply its laws to contracts that have no relation to New York. However, the Court added that no such limitations had been identified. *IRB-Brasil Resseguros, S.A. v. Inepar Inv., S.A.*, 20 N.Y.3d 310, 313 (2012) in which G.O.L. section 5-1401 was applied to validate a selection of New York law in a guaranty signed by a Uruguayan corporation and sought to be enforced by a Brazilian noteholder. This recent case is also notable in that the Court of Appeals ruled on whether a reference in a choice of law clause to New York law includes New York's conflict of laws rules, thus potentially resulting in the application of non-New York substantive law by operation of those conflicts rules. A choice of law clause, according to the Court of Appeals, should be considered a reference to New York's internal laws only, not including its conflict of laws rules.

the transaction and New York. These G.O.L. provisions thus embody a legislative policy to support New York's pre-eminent position in global finance by providing legal certainty to contractual provisions selecting New York law. The New York position is thus a close approximation of that of English law, which may be selected by the parties even if the transaction has no real connection with the U.K. at all.

What the G.O.L. does not determine, however, is whether New York's validation of contractual stipulations of New York law will be respected in courts outside New York. Principles of conflict of laws are, generally, a matter of forum law (*lex fori*); thus a court outside New York dealing with a contract containing a New York governing law clause is typically required to apply its own conflicts rules rather than the G.O.L. in determining the validity of the choice of law provision. Thus, the jurisdiction in which the first filings are made in such a dispute may well be as deciding as the provisions agreed to in the contract. (In an attempt to ameliorate this potential for a party to avoid the intended result of the choice of New York law, the G.O.L., in Section 5-1402, provides for validity of choice of forum clauses in contracts covered by Section 5-1401, to better ensure the ability to file in and obtain judgments from a New York forum in cases where Section 5-1401 validates New York governing law.)

The presence of a governing law clause has somewhat different impact in the U.S. and the U.K. According to Wood, for instance, the English courts might treat a claim that would be treated in the U.S. as involving an "act of state" that precludes recovery on a debt, as a matter of the contract's governing law.¹³ In the U.S., the *Allied Bank* case, mentioned above, relied both on the New York governing law clause and on a somewhat more objective feature, the designated place of payment, in defeating application of the Costa Rican exchange control rule involved there, while in the *NML Capital* case the court used the New York governing law clause and its interpretation of

¹³ *Id.* ¶ 3.017 at 80 (discussion of *Libra Bank* case).

the New York *pari passu* clause to negate a variety of actions taken by Argentina to frustrate collection efforts by creditors holding bonds that had not participated in the swap effected in 2005.

Jurisdictions that generally give effect to governing law clauses will sometimes decline to apply the parties' agreement in cases where doing so conflicts with some mandatory law or public policy of the forum. Wood and Gruson agree that this "exception" to the application of choice of law agreements is best couched in terms of a strongly held public policy of the forum.¹⁴

Summary: At this juncture, to sum up, we may provisionally formulate a few general statements:

1. In the courts of the debtor country, a sovereign legal measure affecting repayment of the nation's external debt ("Debt Measure") is likely to be given effect as part of the national law.

2. Further, in those courts, a Debt Measure is likely to be considered mandatory in application, and thus not displaced by a contractual choice of law clause stipulating the law of a creditor nation.

3. In the courts of the country chosen by the creditor (e.g. U.S. or England), the Debt Measure will be given effect if, by operation of a choice of law clause or otherwise applicable conflicts principles, the debtor's national law governs issues of discharge and defenses to payment.

4. Further, in those courts, if a governing law clause is present that selects the law chosen by the parties, that law should preclude the debtor from using the Debt Measure as a defense. In New York, it would still be useful to call for payment in New York in the debt instrument.

Formats for Issuing Sovereign Debt. There are historically two general categories for sovereign debt incurrence: syndicated lending by banks or other institutional lenders; and debt offerings distributed through the capital markets. Each category has subdivisions: capital markets issues would include both bonds and shorter-term note offerings. Bank lending is quite varied, and

¹⁴ Gruson, supra note 2 at 64; Wood, supra note 5, ¶ 2-042 at 36 and ¶ 2-095 at 64.

can include credits supported by export credit agencies, lending to state-controlled enterprises, as well as straight credits to governments.¹⁵ An in-depth exploration of how these parallel markets differ is beyond the scope of the present memorandum.¹⁶ However, any thorough treatment of the issues raised here would require a study of how documentation practice differs between these categories, how distinct they really are in practice, and what the current market conditions are.

As indicated by the commentary by Gruson and Wood discussed above, bank lenders have tended to insist uniformly that their documentation include governing law clauses that provide for creditor-preferred jurisdiction law. We will therefore assume for purposes of this memorandum that adoption of debtor-nation governing law clauses has been a more recent feature of debt offerings through the capital markets for established foreign credits. Some anecdotal evidence for this view is furnished by a recent commentator on the Greek debt crisis: “[b]eing subject only to local law isn’t the norm for emerging market debt, but I guess buyers weren’t concerned because Greece is part of the Eurozone.”¹⁷

We will explore below the effect of selection of local governing law on creditors’ rights in the Greek context. To provide a context for this discussion, we have made an informal survey of about thirty relatively recent short and medium term debt offerings by sovereigns, by downloading offering memoranda from the internet. We tried to gather a range of issuers including both emerging markets and developed nations as issuers. These offering memoranda contain a summary of the principal terms of the offering, including governing law. We have not examined the operative debt instruments themselves; thus we have relied on the accuracy of the summaries. The results of

¹⁵ Interestingly these may also include the use of derivative instruments such as credit default swaps (CDS), an issue raised in the *NML Capital* case.

¹⁶ For an informative examination of some of these dynamics in the market for sovereign debt, see Das, Papaioannou, and Trebesch, *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts*, (IMF Working Paper 12/203, 2012), available at <http://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf>.

¹⁷ <http://practicalstockinvesting.com/2012/03/08/collective-action-clauses-greeces-deus-ex-machina>.

our market sampling is shown by the following table:

Governing Law in Debt Offerings

Debtor	Document	Date	Governing Law	Currency
Banco del Estado de Chile	1 Billion MTN Prospectus	01/25/2012	NY Law	Euro
Russian Federation	Bond Prospectus	05/25/2011	English law	Rubles
Czech Republic	Euro MTN Prospectus	02/10/2012	English Law	Euro
PEMEX	MTN Offering Circular	12/23/2011	New York	US \$
Republic of Poland	MTN Prospectus	02/09/2012	English Law	Euro
Northern Territory Treasury Corporation (Australia)	MTN OC	03/14/2001	English Law	US \$
Republic of Brazil	Offering Circular	12/22/2004 Notes due 09/2012	English law except that all matters governing authorization and execution by the Republic are governed by the laws of the Republic	Euro
Province of Manitoba (Canada)	Prospectus	05/31/2011	Manitoba law and Canadian law applicable in Manitoba	US\$
Republic of China	Offering Circular	10/21/2004	NY law, except authorization and execution: laws of China.	US\$ and Euro
Arab Republic of Egypt	Prospectus	07/16/2007	New York	Egyptian Pound
Federal State of Saxony-Anhalt	Information Memorandum	11/12/2004	German Law	Euro
Republic of Portugal	MTN Prospectus	01/07/2011	English Law – Bearer Notes Portugal Law – Notes held through the Portugal Stock Exchange.	Euro
Republic of Italy	Prospectus	04/15/2010	Italian Law	US\$
Hong Kong Monetary Authority	Information Memorandum	08/2003	Law of Hong Kong	HK Dollar
Republic of South Africa	Prospectus	02/14/2006	English Law	US \$
Kingdom of Spain	Offering Circular	10/8/2004	English Law	Euro
Republic of Turkey	Prospectus	11/11/2010	English Law	Euro
Province of Buenos Aires	Prospectus	01/26/2010	NY Law	US\$
Republic of Peru	Supplement Prospectus	04/26/2010	NY Law	US\$
Republic of Venezuela	Prospectus	11/30/2007	NY Law	US\$
Dominican Republic	Offering Memorandum	04/29/2010	NY Law	US\$
Republic of Senegal	Offering Memorandum	12/15/2009	English Law	US\$
Republic of Ivory Coast	Prospectus	04/16/2010	NY Law	US \$

*MTN – Medium Term Note

The chart appears to support a number of preliminary observations:

1. The offering by Manitoba is governed by local law, and in the experience of the authors, this is generally true of Canadian provincial and Federal issuances. However, Canada is obviously a developed nation with a strong pro-creditor legal tradition. Therefore, this issue may not be indicative for other nations. The same may be true of the Saxony-Anhalt offering.
2. Certain choice of law clauses specify New York or English law, but provide that authorization and execution is governed by local law.¹⁸
3. Two Southern European nations, Italy and Portugal, were able to issue debt under local law. In the case of Portugal, only debt held through the local securities exchange is governed by local law; presumably it was contemplated that this debt would be largely held locally. We do not have data on ownership of these issues. This may be the same “Eurozone” exception noted above in operation. Whether this principle will continue to apply, in light of the Greek experience, is our next topic.

The Case of Greece. The Greek debt crisis began in earnest in April 2010. The causes included a ballooning budget deficit, declining revenue from key industries such as shipping and tourism, and lax tax collection practices. On April 23, the Greek government requested an EU/IMF bailout package to cover the rest of 2010. On April 27, the rating agencies downgraded Greek sovereign debt to “junk” status. A second bailout package was approved in February 2012.

In March 2012, the Greek government announced that 85.8% of private holders of Greek debt (apparently, mostly Eurozone banks) that was governed by Greek law had agreed to a debt restructuring deal involving a “haircut” of 53.5%. The government then took advantage of the governing law clause to incorporate by legislative action a “collective action” clause into the bond terms requiring a vote of 66.7% of the holders of such debt to agree to the reduced principal amount. The government could not legislate collective action language into the remaining debt,

¹⁸ See footnote 27 and accompanying text.

which is governed by English law. The response of the holders of that debt is still outstanding on the date of writing, although in May 2012 Greece elected to make payments of both principal and interest on that debt, angering holders of the Greek law governed debt who participated in the debt swap due to assurances that non-participating holders would be receiving little consideration by the government in future should they not go along with the PSI restructuring. The negotiations with the debtholders has been overtaken (to a certain extent) by larger events involving Greece and the so-called “Troika” of the European Union, International Monetary Fund and the European Central Bank, including the adoption of succeeding EU-imposed austerity budgets, several general elections which involved significant levels of civil unrest, concerns regarding Greece’s continued membership in the European Union and the delay (and possible withdrawal) of bailout loans for failure to adhere to agreed austerity measures.

This episode has naturally focused much attention on collective action clauses. In general terms, these are familiar to any lawyer who has worked with group lending arrangements. A typical syndicated loan agreement, for instance, contains a provision for voting by the syndicate banks on modification of the terms of the loan. Traditionally, these voting arrangements do not permit alteration of key payment terms (e.g. timing and amount of repayment, release of collateral) without the consent of each affected lender. Corporate bond indentures are similar, mostly as a result of the US federal law in this regard.¹⁹ However, the clauses enacted by Greece do permit modification of these key terms; they were thus crucial in effectuating the reduction of Greece’s debt. Such provisions have been a subject of discussion in the sovereign debt markets since the mid-90s, when individual holders of sovereign debt became more active in seeking repayment through litigation.

In 2003, a working group of G10 ministers and central bankers issued a report recommending standard collective action clauses for sovereign issues.²⁰ According to a November

¹⁹ See § 316(b) of the Trust Indenture Act of 1939, as amended (“TIA”). Most sovereign debt is issued pursuant to a Fiscal and Paying Agency Agreement, rather than a bond indenture due to applicable exemptions from the TIA.

²⁰ <http://www.bis.org/publ/gten08.pdf>.

2004 study by the Bank of England,²¹ prior to 2003, few sovereign issues governed by New York law contained collective action clauses. In the nineteen months following, practice changed dramatically, so that at the time of the report, a majority of recent New York law issues contained such clauses. They typically provided for amendment of payment terms upon vote of a supermajority, e.g. 75%. This reversal was probably due to the success of individual creditors in pursuing enforcement action against sovereigns.

What is novel about the Greek situation is the imposition of collective action clauses post-issuance by national legislation. The discussion above should suggest that the selection of Greek law to govern the debt issue opened the door to this enactment, and could give sovereign debtors an array of legal weapons in dealing with creditors. What remains to be seen is whether the market will recognize the full implications of making this selection when documents are prepared.

Argentina. More recently, the sovereign debt bar has been focused on Argentina's efforts to resist payment on that portion of its external debt that was not surrendered under the terms of its 2005 exchange offer. Debtholders who participated in that offer received new bonds at the rate of 25-29 cents on the dollar, but some debtholders retained their bonds, obtained either in the original issue or via the secondary market. This holdout debt is governed by New York law, does not contain collective action clauses, and includes *pari passu* language that required Argentina to "rank" its payment obligations on the debt "at least equally...with all its other present and future unsecured and unsubordinated External Indebtedness." Argentina, in 2005, enacted a "lock law" prohibiting payment or settlement on the "holdout" debt.

The focus of the litigation in the U.S. Federal courts is whether Argentina violated that *pari passu* language and what remedies should be available to the debtholders who are not being paid. In October 2012, as mentioned above, the U.S. Court of Appeals for the Second Circuit affirmed the ruling of the District Court that the enactment of the lock law, taken together with other official

²¹ <http://www.bankofengland.co.uk/publications/Documents/fsr/2004/fsr17art9.pdf>.

measures, violated the New York *pari passu* clause, and that an injunction requiring ratable payment on the debt subject to that law should be issued.²² As of the date of writing, the courts are focused on the interpretation of the so called “equal treatment” section of the *pari passu* clause (i.e., whether it prohibits selective non-payment of the non-exchanged debt) and the *pari passu* scope of the injunction, particularly in relation to intermediaries in the international monetary payments system²³. Thus, *NML Capital* is not primarily about governing law issues. However, the decision and the briefs raise a number of points that are germane to the discussion here.

First, it may be asked what law governs interpretation of the *pari passu* language. The debtholders of course argue that the *pari passu* language is a matter of contract, and therefore covered by the New York governing law clause in the debt documentation. Argentina argued that under Argentine law, only an express legislative measure that alters the debt’s legal priority would violate the language. Argentine courts would also, it seems, regard refusal to pay the unexchanged bonds as a matter of Argentine “public policy” so that they would be bound not to recognize any right of payment, whether as a cause of action under New York law brought in Argentina or in an Argentinean proceeding to enforce a judgment rendered outside of Argentina by a court applying New York law.²⁴

The Second Circuit Court alluded to the issue of creditor vs. debtor governing law in its opinion. In commenting on Argentina’s claim that enforcement of the *pari passu* clause would aid

²² *NML Cap., Ltd. v. Rep. of Arg.*, 699 F.3d 246 at 260.

²³ *Id.* The Second Circuit remanded the case to the District Court pursuant to *U.S. v. Jacobson*, 15 F.3d 19, 22 (2d Cir. 1994) for clarification of two issues: precisely how the injunction’s payment formula is intended to function and more precisely determine the third parties to which the injunction will apply. The District Court issued an order in this regard on November 21, 2012 and jurisdiction over the review of the injunction then automatically returned to the Second Circuit, which is at the time of this writing reviewing the briefs submitted in this regard.

²⁴ *Id.* at 258. As to whether the *pari passu* language would be interpreted differently under English law, see the memorandum produced by Allen & Overy, available at: <http://www.allenoverly.com/SiteCollectionDocuments/The%20pari%20passu%20clause%20and%20the%20Argentine%20case.pdf>

holdouts in sovereign restructuring, the appeals court noted that “none of the bonds issued by Greece, Portugal or Spain – nations identified by Argentina as being next in line for restructuring – are governed by New York law.”²⁵ As the discussion above indicates, some of that debt is governed by English law, which is treated by the market as essentially equivalent to New York law; thus, if the Court was suggesting that those nations’ debt is governed by debtor law, the observation is not entirely apt. In any case, the Court was not moved by Argentina’s concern on this issue.

If the Southern District’s interpretation is sustained, sovereigns will lose a significant legal weapon in battling holdouts in restructuring debt that includes similar *pari passu* language. The focus of the Argentine litigation will presumably shift to enforcement and collection efforts. More broadly, Argentina’s aggressive legal defense based on the lock law may well further dampen whatever willingness remains on the part of investors and lenders to agree to debtor governing law in sovereign issues outside of a small group of select countries with well-understood legal and political systems. If that isn’t enough, investors affected by Greece’s legislative introduction of collective action clauses will be on alert regarding the menu of non-payment options that can flow from governing law choices.

Options for Sovereigns. The Second Circuit noted that “[c]ollective action clauses have been included in 99% of the aggregate value of New York-law bonds issued since January 2005.”²⁶ That fact alone should indeed stifle much *NML*-style litigation in the future. These clauses therefore appear to be the best protection for sovereigns against so called “holdout” litigation.

Sovereigns might also wish to consider more refined drafting of choice of law clauses. Some debt issues, as we have seen, contain negotiated choice of law provisions in which specific issues, such as internal authorization and execution, are reserved to debtors’ national law, while overall contract issues are still governed by New York or English law. This would seem to be a sensible “carve-out” on the basis that sovereign entities must follow their own national law on issues of

²⁵ *Id.* at 264.

²⁶ *Id.*

power, internal authority, execution, etc. However, this allowance is not without risk to the creditor. If this language is incorporated into a choice of law clause, it might lend support to claims of the defense of lack of authorization.²⁷

The long-term answer to piecemeal litigation, whether involving holdouts or other creditors, could be an internationally-agreed regime for resolving sovereign defaults.²⁸ An intensive evaluation of this topic is beyond the scope of this paper, but there is extensive literature on such proposals.²⁹ Until such an approach takes form, however, the issues discussed here will be resolved through litigation, and we will probably continue to read reports of sovereign debtors railing against “vulture” investors.

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²⁷ For an illustration of this risk, see *Indosuez Int'l Fin. B.V. v. Nat'l Reserve Bank*, 774 N.E.2d 696, 698 (2002). Here, a Russian bank owed approximately \$100 million on a series of currency forward agreements with Indosuez. The underlying ISDA masters and confirmations were governed either by New York or English law. The New York Court of Appeals rejected an argument by the Russian bank that authorization was governed by Russian law and was defective, and ruled instead that apparent authority principles under New York law validated the agreements.

²⁸ One such effort involves the International Centre for Settlement of Investment Disputes, a multinational body created by treaty designed to arbitrate and conciliate disputes between private investors and foreign governments or their commercial affiliates.

²⁹ See e.g. A. Gelper, *Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt*, 121 Yale L.J. 888 (2012). For a discussion of a convention-based proposal sponsored by the International Monetary Fund, see S. Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 Geo.J.Int'l L 299 (2005).

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