SOVEREIGN BOND RESTRUCTURING FROM A CONTRACTUAL PERSPECTIVE, CAVEAT BONDHOLDER?

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INTRODUCTION

Sovereign default is a paradox in and of itself. This is primarily because of the undeniable State power over creditors, but also because creditors would need to overcome a State's sovereignty to secure their

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rights.[1] Prior to the Second World War, so long as creditors were not nationals of the defaulting State and their national State was willing to pursue or force the return of investments through diplomatic or military means, creditors would rely on diplomatic protection by their nation State to secure their rights.[2] Indicatively, the Drago Porter Convention of 1907 provided States should first attempt to peacefully arbitrate claims arising from sovereign indemnity before resorting to military means.[3] If creditors' national States were unwilling or unable to assist in the creditors' claims, lenders were left without recourse, other than negotiating an acceptable settlement by trying to assert pressure on the State through the threat of denial of future lending.[4]

Resorting to litigation was not an option available for creditors because States enjoyed absolute immunity from suits in national courts.[5] This essentially rendered it impossible for a creditor to find a venue to pursue his claims, outside of the defaulting State's courts.[6] Using the defaulting State's courts provided little comfort to creditors.[7] However, following 1945, several studies suggest creditors began to shift away from this approach, and more sovereign default cases were brought before national courts.[8] This is partially because it became common practice for States to waive, in advance, their right to claim immunity from jurisdiction in the terms of issuance.[9] Additionally, developments in international law widely recognized challenges against States in national courts.[10] That stated, the issue of enforcement of a foreign judgment against a State is still a thorny issue and,

1. KENNETH H.F. DYSON, STATES DEBT & POWER: 'SAINTS' & 'SINNERS' IN EUROPEAN HISTORY & INTEGRATION 240 (2014).

2. MAX WINKLER, FOREIGN BONDS: AN AUTOPSY 146 (1999).

3. DYSON, *supra* note 1, at 240.

4. W. Mark C. Weidemaier, *Sovereign Immunity and Sovereign Debt*, 2014 U. ILL. L. REV. 67, 68 (2014).

5. *Id.*; *see also* NORBERT GAILLARD, WHEN SOVEREIGNS GO BANKRUPT: A STUDY ON SOVEREIGN RISK 13 (2014).

6. Weidemaier, *supra* note 4, at 68.

7. *Id.*

8. *See* Julian Schumacher, Christoph Trebesch, & Henrik Enderlein, *Sovereign Defaults in Court: The Rise of Creditor Litigation 1976 – 2010*, 2 (Feb. 13, 2013) (working paper) (on file with SSRN Electronic Journal).

9. Weidemaier, *supra* note 4, at 69.

10. *See, e.g.*, Republic of Arg. v. Weltover, Inc., 504 U.S. 607 (1992).

unsurprisingly, it is a long-standing belief in international macroeconomics that sovereign debt cannot be enforced.[11]

Hence, claiming and enforcing investors' rights against sovereign states is not an easy task. Indeed, unlike insolvency of other entities, there isn't any uniform legal framework regulating insolvency of sovereign States. Therefore, there is a regulatory vacuum not only in relation to substantive law, but also on enforcement.

This Article will address investors' rights in case of sovereign default from a contractual perspective and examine whether the legal framework available for breach of contract suffices to provide an efficient and complete framework for the satisfaction of investors' claims in case of sovereign default. This Article will primarily focus on the Greek bonds' restructuring of 2012, but will draw wider conclusions for bondholders' protection.

First, the Article examines the legal nature of sovereign bonds. Second, it reviews the applicable laws including: national law as it applies to state contracts, international law, choice of law, and *lex fori*. Third, it covers the basic contractual clauses including: "*pari passu*," collective action clauses, events of default clauses, other clauses, and waiver of immunity, while examining the development of these contractual terms in an attempt to better safeguard bondholders' rights.

I. THE LEGAL NATURE OF SOVEREIGN BONDS

The legal nature of sovereign bonds can be difficult to define. Bonds can be understood in a number of ways, including as investments, capital rising tools, financial instruments, and on balance-sheet debt security.[12] Additionally, sovereign bonds can take several forms, including *inter alia*, conventional bonds, convertible bonds, zero-coupon bonds, and floating rate notes.[13] To better evaluate sovereign bonds' legal nature, it is best to review how these bonds are issued, and the modus by which, they are offered to the public.

11. Carmen M. Reinhart & Kenneth S. Rogoff, *The Aftermath of Financial Crises*, 99 AM. ECON. REV. 466, 466–72 (2009).

12. STEFAN WEBER, THE LAW APPLICABLE TO BONDS 29 (Hans van Houte et al. eds., 1999).

13. For an analysis of the features of each bond instrument see MOORAD CHOUDHRY, HANDBOOK OF FINANCE 276–78 (Frank J. Fabozzi ed., 2008).

Generally, the legal framework regulating the issuance of bonds is different in each State.[14] An international bond market exists, which illustrates several similarities in the bond-issuance process set by such frameworks. Specifically, within the Eurozone, the process followed for the issuance of sovereign bonds by Member States is largely similar.[15] Such process can be broken down in roughly three phases: pre-issuance, issuance, and closing.

In the pre-issuance phase, following the legal documentation and prospectus preparation for a new bond, the issuer selects a Lead Manager, likely an investment bank, which undertakes to approach and negotiate with prospective underwriters for the syndicate formation.[16] The involvement of a Lead Manager is necessary because States do not have their own banking facilities.[17] At this stage, the Issuer would also proceed to announce the new issue and would send formal invitations, along with the preliminary Offering Circular and timetable, to prospective underwriters to take part in the syndicate.[18] Normally, the underwriters would be investment banks, commercial banks, or a combination of institutional investors.[19] Following the announcement, and in line with the timetable provided, the Lead Manager would liaise with other underwriters to form a Managing Group.[20] Then, that Managing Group would negotiate and finalize the issuance's terms with the issuer.[21] Next, the syndicate would need to accept or reject the finalized issuance terms within approximately twenty-four hours.[22]

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14. *See* Hans-Joachim Dübel, *Partial Sovereign Bond Insurance by the Eurozone: A More Efficient Alternative to Blue (Euro-)bonds*, 252 CTR. FOR EUR. POL'Y STUD. 1, 3 (2011).

15. *Id*. at 2.

16. Although notably a large number of countries no longer use syndicates, countries have been replaced syndicates with auctions. *See* G.J. Schinasi & R.T. Smith, *Fixed-Income Markets in the United States, Europe and Japan: Some Lessons for Emerging Markets* (IMF, Working Paper No. 98/173, 1998).

17. *See* EDWIN BORCHARD, STATE INSOLVENCY AND FOREIGN BONDHOLDERS: GENERAL PRINCIPLE, VOL. 1, 45 (1951).

18. MOORAD CHOUDHRY, THE BOND & MONEY MARKETS: STRATEGY, TRADING, ANALYSIS 386–87 (2001).

19. *Id*. at 383.

20. *Id*.

21. *Id*. at 386–87.

22. *Id*.

The issuance stage follows. If the terms are accepted, the Syndicate will enter into a Subscription Agreement with the Issuer, which contains all the details pertaining to the issuance.[23] Once the Subscription Agreement is entered into, the underwriting syndicate (i.e. the syndicate members that agreed to underwrite the bonds offered at the issuance) would "underwrite" the bonds by guaranteeing the Issuer a payment of the previously agreed price for the shares.[24] The Lead Manager would notify the underwriting syndicate members of their allotments, and then the final Offering Circular would be distributed.[25]

Following this, at the closing stage, members of the selling group offer the bonds in the secondary market, which are usually sold over the counter,[26] and the underwriting syndicate must pay the Issuer that agreed amount. Hence, despite the legal framework's complexity and the many intermediaries that exist during the bond issuance process, we can summarize that bonds are generally treated as loan contracts between the issuer and the subscriber.[27] They are transferrable debt securities issued to the initial subscribers.[28] Then the subscriber acquires the bonds and provides medium or long-term financing to the issuer in exchange for payment of the nominal amount plus interest upon maturity.[29] This is confirmed by the language found in several sovereign bonds when referring to the bonds' status stipulating: "The Notes constitute direct, unconditional, unsubordinated and unsecured obligations of the Issuer."[30]

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23. *Id*.

24. SHELAGH HEFFERNAN, MODERN BANKING 560 (John Wiley & Sons, Ltd. eds., 2005).

25. CHOUDHRY, *supra* note 18, at 387.

26. *See So Why do Bonds Trade OTC?*, INT'L CAP. MKT. ASS'N., https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/Bond-Market-Transparency-Wholesale-Retail/So-why-do-bonds-trade-OTC-/ (last visited May 22, 2018).

27. WEBER, *supra* note 12, at 29.

28. PHILIP R. WOOD, INTERNATIONAL LOANS, BONDS, GUARANTEES, LEGAL OPINIONS 193 (Sweet & Maxwell eds., 2d ed. 2007).

29. JOHN DOWNES & JORDAN ELLIOT GOODMAN, BARRON'S FINANCE & INVESTMENT HANDBOOK 12 (Barron's Educational Series, 7th ed. 2003).

30. *See, e.g.*, THE HELLENIC REPUBLIC, *Greek Offering Circular* (Apr. 10, 2014), https://ftalphaville-cdn.ft.com/wp-content/uploads/2015/03/Greece-Final-Offering-Circular-dated-10-April-2014.pdf.

For this Article's purposes, the closing stage is the only relevant stage, as this is the time sovereign bonds are granted to investors. Sovereign bonds are usually issued to investors by virtue of the following legal documents: (1) a fiscal agency agreement or trust agreement, (2) a contract that entails the terms and conditions applicable to the bonds; (3) a prospectus disclosing the necessary information under applicable legislation in relation to the bonds' issue, as well the issuer and the country itself; and (4) a registration statement.[31]

Therefore, the relationship between the issuer and bondholder is contractual. Hence, we will particularly examine the law applicable to State contracts and sovereign bonds to explore bondholders' rights under such contracts. Applicable law is of the utmost importance to determine investors' rights in case of sovereign default.[32] International investment law regulates both substantive and procedural issues and, as will be demonstrated, can be a powerful weapon either in the State or investor's hands. For these reasons, it is one of the "most sensitive legal issues."[33]

II. APPLICABLE LAW

To determine applicable law governing the relation between the State and the investor(s), we must first explore how this relation was created. Specifically, we must consider the legal basis for the relation. As already stipulated, for bond issuances cases, the underlying relationship between investors and the issuing State stems from sovereign bond contracts.

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31. Catalin Stefanescu, *Collective Action Clauses in International Sovereign Bond Contracts and Their Effect on Spreads at Issuance*, EUR. FIN. MGMT. ASSOC. 1, 10 (2016), http://www.efmaefm.org/0EFMAMEETINGS/EFMA%20ANNUAL%20MEETINGS/2016-Switzerland/papers/EFMA2016_0442_fullpaper.pdf.

32. *See* Committee on Foreign & Comparative Law, *Governing Law in Sovereign Debt – Lessons from the Greek Crisis and Argentina Dispute of 2012*, 1 N.Y.C. BAR (Feb. 2013), http://www.nycbar.org/pdf/report/uploads/20072390-GoverningLawinSovereignDebt.pdf.

33. RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 81 (2d ed. 2008).

The legal treatment of State contracts has been extensively discussed.[34] Although opposite views have been expressed,[35] generally, State contracts are treated differently than ordinary commercial contracts between non-state entities.[36] These differences exist because strong public policy considerations are usually applied in State contracts, and a State differs from any other contractual party due to its exorbitant powers.[37] These considerations are often interpreted in the application of public law, specifically, administrative law;[38] and the exercise of a State's discretion on the negotiation, conclusion, operation, and termination of such contracts.[39] Although different States may regulate State contracts differently within their national law, the distinction between ordinary commercial contracts between private parties and State contracts are nonetheless recognized universally in several national legal systems.[40]

Hence, the question of which law applies to such contracts is one that raises questions amongst scholars and arbitral tribunals, with various theories coming forward. According to such theories, we can distinguish between the following laws that can apply to State contracts: national law, international law, the law chosen by the parties, and *lex fori*.

34. *See* U.N. Conference on Trade and Development, *State Contracts*, U.N. Doc. UNCTAD/ITE/IIT/2004/11
(2004).

35. *See, e.g.*, PHILIP R. WOOD, CONFLICT OF LAWS & INTERNATIONAL FINANCE 60 (2007) (where it is stipulated that "there are no special rules applying to State commercial contracts").

36. U.N. Conference on Trade and Development, *supra* note 34, at 5.

37. Patrick R. Wautelet, *International Public Contracts: Applicable Law and Dispute Resolution*, U. LIÈGE (2015), https://orbi.uliege.be/bitstream/2268/136404/1/Wautelet%20-%20Applicable%20Law%20(final).pdf.

38. Charles Leben, *La théorie du contratd'etat et l'évolution du droit international des investissements* 302 Le RECUEIL DES COURS DE L'ACADÉMIE DE DROIT INTERNATIONAL DE LA HAYE [R.C.A.D.I.] 197 (2003) (Fr.).

39. U.N. Conference on Trade and Development, *supra* note 34, at 5.

40. *Id.*; *see also* COLIN TURPIN, GOVERNMENT CONTRACTS (1972). *But see* WOOD, *supra* note 35 (arguing State contracts entered into between a sovereign government and non-state entity, should not be treated fundamentally differently than private contracts).

A. National Law as Applicable to State Contracts

Several scholars support the application of national law in State contracts, absent a "choice of law provision" to the contrary.[41] This opinion was reinstated by the Permanent Court of International Justice in its early case concerning *The Payment of Various Serbian Loans Issued in France,* where the Court ruled:[42]

> Any contract which is not a contract between States in their capacity as subjects of international law is based on the municipal law of some country. The question as to which this law is forms the subject of that branch of law which is at the present day usually described as private international law or the doctrine of the conflict of laws.[43]

Accordingly, the law applicable to State contracts would be the State host's law.[44]

There are various reasons to support such a claim. According to the gravity test, a contract is governed by the law, which the contract is most closely connected to.[45] For example, in a sovereign bond agreement, the issuer's country is most likely the place where: the bonds will be issued, the agreement will be signed and delivered, the funds will be remitted to, and where they will be repaid.[46] Hence, the issuing State's law should also be applicable.[47] Additionally, a

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41. *See* F.V. Garcia Amador, *Fourth Rep. on State Responsibility*, U.N. DOC. A/CN.4/119, at 126 (1959); F.A. MANN, STUDIES IN INTERNATIONAL LAW 302 (Oxford U. Press eds., 1973).

42. Case Concerning the Payment of Various Serbian Loans Issued in France (Fr. v. Kingdom of the Serbs, Croats and Slovenes), Judgment, 1929 P.C.I.J. (ser. A) No. 20, at 41 (July 12).

43. *Id*.

44. HEGE ELISBETH KJOS, APPLICABLE LAW IN INVESTOR-STATE ARBITRATION: THE INTERPLAY BETWEEN NATIONAL AND INTERNATIONAL LAW 172 (Vaughan Lowe QC eds., 2013); *see also* GEORG SCHWARZENBERGER, INTERNATIONAL LAW 73–79 (Stevens eds., 1957) (discussing the conflict of laws criteria used by international Courts and Tribunals).

45. OLIVER J. ARMAS ET AL., INTERNATIONAL COMMERCIAL ARBITRATION IN NEW YORK 91 (James H. Carter & John Fellas eds., 2d ed. 2013).

46. Davidson Sommers et al., *Conflict Avoidance in International Loan and Monetary Agreements*, 21 LAW & CONTEMP. PROBS. 463, 466 (1956).

47. TONY COLE ET AL., INTERNATIONAL INVESTMENT LAW: THE SOURCES OF RIGHTS AND OBLIGATIONS 223 (Tarcisio Gazzini & Eric De Brabandere eds., 2012).

sovereign bond agreement is very closely related to the State's financial interests.[48] Furthermore, applying the law of the issuing State is in line with the notion of sovereignty.[49] In fact, the Committee established by the League of Nations to study international law contracts concluded: "every contract which is not an international agreement—i.e. a treaty between States—is subject (as matters now stand) to municipal law."[50] In these cases, the law of the nation governs State contracts.[51]

This is not only supported by the International Law Commission's Articles on State Responsibility, but also by tribunals' case law.[52] Indicatively, in *F. Wintershall A.G. v. Qatar*,[53] the Tribunal applied the gravity test and ruled that the law of Qatar was applicable.[54] Additionally, the International Centre for Settlement of Investment Disputes ("ICSID") reached the same conclusion in *Société Ouest Africaine des Bétons Industriels v. Senegal*, where the Tribunal considered that the law applicable "in respect of a project that was to take place in Senegal, can only be Senegalese law."[55] Notably, the ICSID Convention particularly regulates this matter in Article 42(1).[56] Article 41(1) provides, in the absence of a choice of law clause in the State Contract, the Tribunal will apply the "law of the Contracting State Party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable."[57] In fact, in *Noble*

48. *See* Stephen M. Schwebel, *The Alsing Case*, 8 INT'L & COMP. Q. 320, 324–29 (where despite Greece's argument that Greek law should apply to the loan agreement, the tribunal ruled in favor of the application of the law of the tribunal's seat, as indirectly chosen by the parties along with the seat of the tribunal). *But see* T.W. Wälde, *The Serbian Loans Case – A Precedent for Investment Treaty Protection of Foreign Debt?*, TRANSNAT'L DISP. MGMT. 4 (2004).

49. KJOS, *supra* note 44, at 172.

50. *Report of the Comm. for the Study of International Loan Contracts*, League of Nations Doc. II.A (1939).

51. U.N. Conference on Trade and Development, *supra* note 34, at 5.

52. KJOS, *supra* note 44, at 173.

53. F. Wintershall et al., v. A.G. v. Qatar, Partial Award of 5 February 1988 and Final Award of 31 May 1988, I.L.M. 795 (1989) (discussing a claim for expropriation of contractual rights by the Government of Qatar due to an alleged termination of an Exploration and Production Sharing Agreement).

54. *Id*.

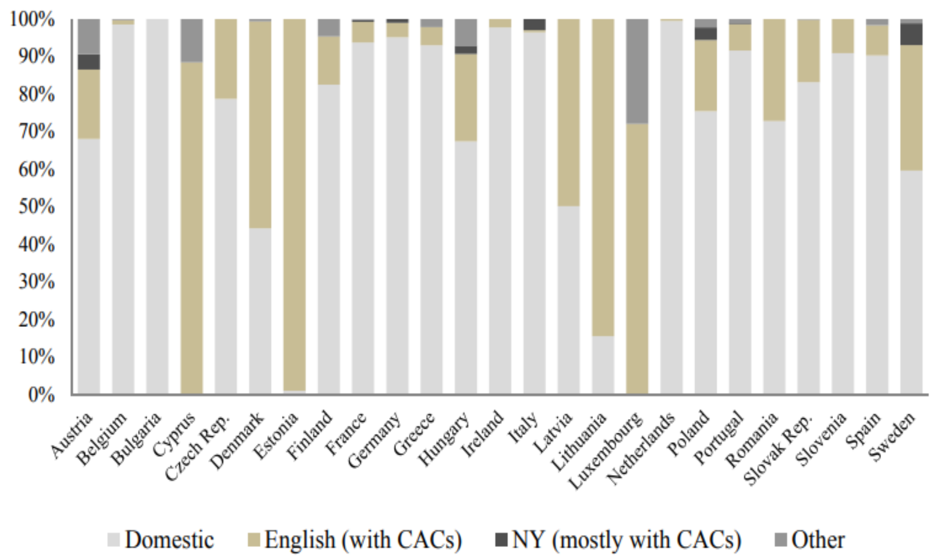
55. *Id*.

56. *Id*.

57. *Id*.

Ventures Inc. v. Romania, the ICSID Tribunal explicitly stated there is a distinction between national law and international law,[58] while in *Sea-Land Service, Inc. v. Islamic Republic*, the Tribunal applied Islamic law as the relevant law.[59]

Currently, the majority of sovereign bonds in Member States in the Eurozone are governed by the national law of their respective state as part of a choice of law clause.[60] The graph below illustrates this:[61]



58. *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/1, Award, ¶ 53 (Oct. 12, 2005).

59. Sea-Land Service, Inc. v. The Gov't of the Islamic Republic of Iran, Ports and Shipping Org., Award No. 135/33/1 (June 22, 1984). *But see* Anaconda-Iran, Inc. v. Iran and NICIC, Award No. 65/167/3 (Dec. 10, 1986) (where the ICSID Tribunal found that in the absence of a choice of law clause it could be inferred that that the parties had explicitly refuted the other party's national law).

60. Ignacio Tirado, *Current EU Mechanisms to Confront Sovereign Insolvency*, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW: THE UNCTAD PRINCIPLES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING 317 (C.Espósito, Y. Li & Juan P. Bohoslavsky eds., 2013).

61. Udaibir S. Das et al., *Sovereign Debt Restructurings 1950–2010: Concepts, Literature Survey, and Stylized Facts*, 42 (Int'l Monetary Fund, Working Paper No. 12/203, 2012).

It must be stated that in cases of sovereign bonds, applying the national law of the Debtor State can be highly prejudicial for investors' rights, as the State will maintain the legislative power to amend the law and frustrate investors' rights.[62] This is what happened to the Greek Sovereign Bond Exchange. On February 23, 2012, just days before the Exchange, Greece enacted the Greek Bondholders' Law, No. 4050/2012, which partially amended the terms of Greek sovereign bonds issued prior to December 31, 2011, by introducing Collective Action Clauses ("CACs").[63] These clauses allowed a two-thirds majority of the total number of Greek bondholders to bind all other bondholders with their decisions, and not allow individual investors to act solely by accelerating the bond or initiating litigation in the event of default.[64]

B. International Law as Applicable

The internalization of State contracts is another theory that has recently gained some traction. Under this theory, international law automatically overrides State contracts, regardless of the national law provisions.[65] Hence, regardless of the typical application of national law to a State contract, this cannot "entirely exclude the direct applicability of international law in certain situations."[66] Applying international law to override applicable national law is an important safeguard to investor's rights. Otherwise, a State may simply adjust its national law to benefit the State's interests at the expense of the investor's rights.

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62. MICHAEL GRUSON & RALPH REISNER, SOVEREIGN LENDING: MANAGING LEGAL RISK (1984).

63. *See* Rules Relating to the Adjustment of Securities their Issue or Guarantee by the Greek State with the Agreement of the Bondholders [Greek Bondholders' Law] art. 1, Feb. 23, 2012 [EPHEMERIS TES KYVERNESEOS TES HELLENIKES DEMOKRATIAS] [E.K.E.D.] A:36, Feb. 23, 2012 (Greece).

64. *See* Mitu Gulati & Lee C. Buchheit, *How to Restructure Greek Debt*, 9 (Duke Law Working Paper, Paper No. 47, 2010), http://scholarship.law.duke.edu/faculty_scholarship/2336.

65. A.F.M. Maniruzzaman, *State Contracts in Contemporary International Law; Monist versus Dualist Controversies*, 12 EUR. J. INT'L L. 309 (2001).

66. Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt, ICSID Case No. ARB/84/3, *Award and Dissenting Opinion*, ¶ 80 (1993).

To avoid such instances and ensure the application of international law, State contracts often provide "stabilization clauses," which aim to make the terms of a state contract stable and fixed, not subject to changes by legislation or other means, and thus minimizing non-commercial risks.[67] For example, in *Revere Copper & Brass, Inc. v. OPIC*, the tribunal concluded, despite the prohibition of State executives to enter into agreements, under international law and the constitutional principle of separation of powers, the State contract was still valid and binding under public international law by virtue of a stabilization clause.[68] Similarly, in *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic*,[69] the Tribunal held the contracts fell within the sphere of international law, and national regulatory measures, including nationalization, could not nullify the contracts.[70]

Despite the importance of such clauses for enhanced protection of foreign investors from regulatory changes, such clauses are hardly, if at all, found in sovereign debt instruments.

C. Choice of Law

From a conflict of laws perspective, not all scholars favor the view that State contracts should be treated differently than private commercial agreements. One such scholar, Phillip R. Wood, noted State contracts are not governed by specific rules and, therefore, the law of the State is not necessarily applicable.[71] In accordance with the conflict of laws rules in most countries, in the event the contract contains a choice of law provision, such term will be upheld.[72] Indicatively, Article 1 of the International Law Institute's Resolution, with respect to State contracts, provides State contracts "shall be

67. Lorenzo Cotula, *Stabilization Clauses and the Evolution of Environmental Standards in Foreign Investment Contracts*, 17 Y.B. INT'L ENVTL. L. 111, 120 (2006).

68. Revere Copper & Brass, Inc. v. OPIC, AAA Award 17 I.L.M. 1321 (Aug. 24, 1978).

69. Texaco Overseas Petroleum Co. & California Asiatic Oil Co. v. Gov't of the Libyan Arab Republic, 17 I.L.M. 1 (1978).

70. For an in-depth analysis, see A. A. Fatouros, *International Law and the Internationalized Contract*, 74 AM. J. INT'L L. 134 (1980).

71. *See* WOOD, *supra* note 35.

72. *See* 2008 O.J. (L 177) 6.

subjected to the rules of law chosen by the parties or, failing such a choice, to the rules of law with which the contract has the closest link."[73] This seems to indicate the applicable law is not based on a new theory designed to extend the reach of international law or impose the application of the State's national law to contracts concluded by States, but instead, by applying classical rules of private international law[74] whereby the parties' choice would be prevalent.

In such case, the starting point would be the will of the parties as expressed in the terms of the contract; in other words, the choice of law clauses are of utmost importance. Indeed, arbitral tribunals, as well as national courts, will uphold the parties' choice vis-a-vis applicable law, adhering to the universally accepted principle of the "proper law of the contract."[75] Such choice of law clauses are upheld, regardless of the provisions of the international private law of the State,[76] as this is permissible under international law.[77] Therefore, the law applicable to State contracts can be a law different than that of the national law of the State involved.[78] This raises the question of which law can or should be chosen by the parties.

Initially, the choice of enforcing another States' national law appeared as an unpopular one, due to States' unwillingness to submit to another State's laws. Only 10% of Greek bonds were governed by other national legislation (mostly English law) prior to introduction of the Greek Bondholders' Act.[79] This is what allowed the Greek government to retroactively introduce CACs to sovereign bonds governed by Greek Law, and to achieve high participation in the bond exchange.[80]

73. Wautelet, *supra* note 37.

74. Joe Verhoeven, *Droit international des contrats et droit des gens*, REVUE BELGE DE DROIT INT'L 203 (1978-79) (Fr.).

75. *See* Dalmia Dairy Industries v. Nat'l Bank of Pak., 1512 Int'l Chamber of Commerce, Arbitration Tribunal ¶ 130 (1976).

76. JULIAN D.M. LEW, APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION: A STUDY IN COMMERCIAL ARBITRATION AWARDS, OCEANA PUBLICATIONS 96 (1978).

77. R. D. BISHOP ET AL., FOREIGN INVESTMENT DISPUTES: CASES, MATERIALS, AND COMMENTARY 259 (2005).

78. M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 284 (2010).

79. Gulati & Buchheit, *supra* note 64, at 2.

80. *See id*.

However, the Greek Bondholders Law did not affect Greek sovereign bonds governed by foreign States. Thus, bondholders of such foreign law bonds were able to reject the terms of the bond exchange and hold out instead.[81] In fact, more than half of such bonds under English, Japanese, and Swiss law were not subject to the exchange and serviced according to their original terms.[82] Similarly, other larger economy states within the EU, such as the UK and Germany, issue almost all their bonds under national law.[83]

This raises the question: under which circumstances will a state accept to be subjected to a foreign state's law? The answer can be found by reviewing the present laws applicable to Greek sovereign bonds. After three years, Greece re-entered the capital markets on July 25, 2017, by offering five-year sovereign bonds equal to €3 billion, all of which were governed by English law.[84] In fact, Finland urged all EU members experiencing financial crisis to increase the number of foreign law bonds they would issue to remain attractive to investors in the capital markets.[85] Similarly, States with smaller economies, where the domestic investor base is limited (i.e. Cyprus), tend to issue foreign law bonds to render their bonds more attractive to foreign investors who view foreign law as a security element.[86] On the other hand, States with an abundance of domestic investors, mainly due to national financial stability and economic growth, tend to issue national law bonds.[87] The prime example here is Germany.[88] This goes to show that, although governments bonds are not negotiated, foreign investors may indirectly

81. Jeromin Zettelmeyer et al., *The Greek Debt Restructuring: An Autopsy* 25 (PIIE Working Paper series WP 13-8 2013).

82. M. Chamon et al., *Foreign Law Bonds: Can They Reduce Sovereign Borrowing Costs* 1 (Apr. 23, 2015), https://events.barcelonagse.eu/live/files/801-icf15-chamonpdf.

83. A. Clare & N. Schmidlin, *The Impact of Foreign Governing Law on European Government Bond Yields* (2014), https://ssrn.com/abstract=2406477 or http://dx.doi.org/10.2139/ssrn.2406477.

84. *See* Liz Alderman, *In Sign of Progress for Greece, Investors Eagerly Snap Up New Bonds*, N.Y. TIMES, July 25, 2017, at B7.

85. *See* Chamon, *supra* note 82.

86. Clare & Schmidlin, *supra* note 83.

87. *Id.*

88. R. W. KOLB, SOVEREIGN DEBT: FROM SAFETY TO DEFAULT 53 (2011).

avert pressure to secure better terms for their interests, but only when the interest from domestic investors is low.[89]

To this end, currently a very large number of sovereign bonds worldwide are issued under foreign law. Out of such bonds, New York or English law govern the large majority (approximately 90% of the foreign law bonds) because of an underlying choice of law provisions.[90] The choice of the applicable foreign law is important for many reasons. Primarily, because, in all likelihood, apart from choosing a foreign law as applicable to the bond contract, the courts of the said foreign State, whose law was chosen, will also be selected as competent.[91] This is largely because foreign national courts are deemed to be in a better position to interpret and implement their own laws.[92]

The competent courts are important not only for granting a favorable judgment for investors, but also for allowing investors to enforce such judgment. Additionally, depending on the applicable law, bonds may or may not contain certain clauses or the interpretation of those clauses may be different from one jurisdiction to another.[93] We shall explore below the treatment of the "pari passu" clause under United States and English Law.

In sum, so long as the national law of the issuing state does not govern the contract terms, investors are somewhat safeguarded. If foreign law governs the sovereign bonds, investors are able to resist a forced restructuring and hold out to insist on full repayment.[94] This is similar to the foreign law bondholders in the Greek debt restructuring. It is for these reasons that in times of financial distress, foreign law bonds of distressed States are often sold at a premium.[95]

89. Clare & Schmidlin, *supra* note 83.

90. *Sovereign Debt Management Forum*, WORLD BANK TREASURY, 2014, ://treasury.worldbank.org/documents/BREAKOUTSESSION8final_1.pdf. *See also* KOLB, *supra* note 89; Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997).

91. FRANCESCO PARISI, PUBLIC LAW AND LEGAL INSTITUTIONS 493 (2017).

92. *Id*.

93. Darius Miller & Natalia Reisel, Do Country Level Investor Protections Impact Security Level Contract Design? Evidence from Foreign Bond Covenants (May 25, 2011) (unpublished comment), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1392990.

94. *See* Chamon, *supra* note 82.

95. *Id*.

D. Lex Fori

Finally, in cases where state contracts, including sovereign bonds, have no underlying provisions regulating the choice of law, arbitral tribunals under ICSID, United Nations Commission on International Trade Law, and the International Chamber of Commerce adopt an almost identical simplified approach, provided the investment treaty contains arbitration clauses rendering one or more tribunals as competent to adjudicate a dispute stemming from a contract.[96] In particular, if the investment treaty does not offer guidance on the applicable law for disputes between the host State and the investor, the tribunals will apply *lex fori* (i.e. the law applicable to the relevant tribunal).[97]

In the case of Greece, contrary to the global Bilateral Investment Treaty ("BIT") practice, most BITs signed by Greece do not contain a reference to ICSID, but provide for investor-State provisions that are purely *ad hoc* clauses.[98] Accordingly, the Germany-Greece BIT specifically provides for the creation of an *ad hoc* arbitral body composed of three arbitrators, two of which are designated by each contracting party, while the third will be chosen by the two pre-selected arbitrators.[99] BIT further provides that, if it does not become possible for the parties to choose the arbitrators, the President or the Vice President of the International Court of Justice ("ICJ") will decide.[100] In such cases, the rules of procedure for the steps to be followed are prescribed in the BIT text and the investors must act accordingly.

96. OLIVER DÖRR & KRISTEN SCHMALENBACH, VIENNA CONVENTION ON THE LAW OF TREATIES: A COMMENTARY, SPRINGER SCIENCE & BUSINESS MEDIA 78 (2011).

97. *Id*.

98. RUDOLF DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENTS TREATIES, INTERNATIONAL CENTER FOR SETTLEMENT OF INVESTMENT DISPUTES 129 (2012).

99. Bilateral Investment Treat, Germany-Greece, Mar. 27, 1961, http://investmentpolicyhub.unctad.org/Download/TreatyFile/1329 (the treaty is not mapped, however, a German version of the treaty can be found at the aforementioned link).

100. *Id*.

III. BASIC CONTRACTUAL CLAUSES

Apart from the above, applicable law is also of utmost importance in the interpretation of contractual terms, and thus, to investors' cases for breach of contract. To examine bondholders' rights in cases of sovereign defaults, we must examine the common contractual terms found in sovereign bond contracts that may be affected from such default. For the purposes of this Article, the analysis is limited to the clauses found in Greek Sovereign Bonds.

A. The "Pari Passu" Clause

Sovereign Bond Contracts will, most likely, include a "pari passu" clause. These clauses usually state that the bonds rank *pari passu*, which means there will not be any preference among bondholders and the other unsecured obligations of the issuer.[101] Recently, in light of recent cases, the meaning of these clauses have puzzled both academia and practitioners. Summarily, the "pari passu" clause has been interpreted in two ways: in a narrow sense, whereby all obligations assumed under the bond rank will rank *pari passu* with all other unsecured debt, and in a broad sense, if a debtor is unable to pay all its obligations, such obligations will be paid on a pro-rata basis.[102]

The meaning of *pari passu* in the context of sovereign default was first examined in 1936, in the case of *AB Obligations Interessenter v. Bank for International Settlements* ("*AB Obligations*").[103] However, *pari passu* clauses were introduced in sovereign bonds as early as 1871.[104] In *AB Obligations*, the Swiss federal court, judging under Swiss law, had no difficulty interpreting the *pari passu* clause under the broad sense, as a promise that payment to investors would be made pro-

101. Rodrigo Olivares-Camina, *The Pari Passu Clause in Sovereign Debt Instruments: Developments in Recent Litigation* (BIS Papers No. 72, 2013), http://www.bis.org/publ/bppdf/bispap72u.pdf.

102. Financial Markets Law Committee, *Pari Passu Clauses*, 79 F.M.L.C. 1, 2 (2005).

103. Aktiebolaget Obligations Interessenter v. Bank for Int'l Settlements, Swiss Fed. Tribunal (1936).

104. Paolo Mauro et al., *Emerging Market Spreads: Then Versus Now*, 117 Q.J. ECON. 695, 695–96 (2002).

rata.[105] However, despite this interpretation, the Swiss court was not willing to enforce such a finding.[106] It was for this reason that the *pari passu* clauses, until recently, did not receive much attention, as they were considered "harmless relic[s] of historical evolution."[107] Still, the predominant belief amongst practitioners was the clause should be interpreted in the narrow sense.

However, *Elliott Associates v. Peru*[108] changed this belief by reaffirming the Swiss Court's judgment. There, the Court of Appeal of Brussels, examining New York law sovereign bonds, ruled investors could use the version of the clause, which used "payment" in relation to *pari passu* to effectively claim a State is not allowed to pay certain investors before it pays others.[109] In fact, the Court of Appeal concluded the *pari passu* clause "has as a result that the debt should be paid down equally towards all creditors in proportion to their claim."[110] To this end, the Court of Appeal granted injunctive relief to Elliot Associates.[111] In turn, this barred Chase Manhattan and, most importantly, Euroclear from making interest payment on Peru's Brady bonds to European bondholders, as Elliot Associates had a right of pro rate payment.[112] Faced with a potential new default on its restructured Brady Bonds, Peru entered into an agreement and paid Elliott Associates in full.[113]

105. Anna Gelpern, *Courts and Sovereigns in the Pari Passu Goldmines*, 7 CAP. MKTS. L.J. 2 (2016).

106. *Id*. at 3.

107. MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN 46 (2013).

108. Cours d'Appel [CA] [Court of Appeals], Brussels, 8 ch., 2000, Elliott Associates, L.P. v. Republic of Peru (2000) [hereinafter Elliot Associates, L.P.].

109. The wording of the 1983 sovereign bond contract provided, "The obligations of the Guarantor hereunder do rank and will rank at least *pari passu* in priority of payment with all other External Indebtedness of the Guarantor, and interest thereon." Declaration of Professor A. F. Lowenfeld, 'Il'll I, 8, Elliott Assocs., L.P. v. Banco de la Nacion (S.D.N.Y. 2000).

110. Elliott Assocs., L.P., *supra* note 109, ¶ 6.

111. *Id*.

112. *Id*.

113. Rodrigo Olivares-Caminal, *The Pari Passu Interpretation in the Elliott Case: A Brilliant Strategy but an Awful (Mid-Long Term) Outcome?*, 40 HOFSTRA L. REV. 44 (2011).

Similarly, the District Courts of New York were asked to examine the meaning of the *pari passu* clause in the context of the recent Argentine sovereign default concerning bonds of over $100 billion.[114] The case, brought by NML Capital, an affiliate of Elliot Associates, dealt with sovereign issued bonds under a Fiscal Agency Agreement. Argentina was unable to fully repay the nominal value and interest of such bonds, amounting to approximately $1.33 billion.[115] Accordingly, this resorted two offers to exchange bonds, whereby investors that held bonds under the Fiscal Agency Agreement could exchange their existing bonds for new, unsubordinated, and unsecured debt instruments of lesser value reduced at approximately a quarter of the original value.[116]

To ensure the success of such bond exchanges, Argentina passed a law restricting payment to bonds that did not participate in the exchange.[117] NML Capital argued this was breaching the *pari passu* obligations of Argentina under the sovereign bond contracts.[118] The *pari passu* clause examined by the New York courts was two-pronged. The first prong related to the securities themselves, while the second prong related to the payment obligations of the Republic under the Securities.[119] The District Court looking at the language of the clause, in line with United States standard legal principles of contract interpretation, noted the second prong of the clause meant Argentina was prohibited from making any payments on other bonds, unless

114. United Nations Conference on Trade and Development, *Argentina's 'Vulture Fund' Crisis Threatens Profound Consequences for International Financial System* (June 24, 2014), http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=783.

115. Ricardo W. Beller & Agustina Ranieri, *The PariPassu Clause As Applied In Argentina Sovereign Bonds Litigation*, FINANCIER WORLDWIDE (Mar. 2013), https://www.financierworldwide.com/the-pari-passu-clause-as-applied-in-argentina-sovereign-bonds-litigation/#.WcQFVbJJbIU.

116. *Id*.

117. Phillip Wood, *The Pari Passu Clause and the Argentine Case*, ALLEN & OVERY (Dec. 27, 2012), http://www.allenovery.com/SiteCollectionDocuments/The%20pari%20passu%20clause%20and%20the%20Argentine%20case.pdf.

118. *See* Lee C. Buchheit & G. Mitu Gulati, *Restructuring Sovereign Debt After NML v. Argentina*, 12 CAP. MRKT. L. J. 224, 225 (2017).

119. NML Capital, Ltd. v. Republic of Argentina, 699 F.3d 246, 259 (2d Cir. 2012).

payments were made also on the defaulted FAA bonds.[120] As such, the Court concluded Argentina breached the *pari passu* clause.[121] To reach such conclusion, the District Court relied solely on the wording of the clause and did not make any reference to previous case law.[122] The results of this judgment were monumental for Argentina, because Argentina was essentially barred from issuing new bonds or servicing its restructured debt instruments.[123]

Notably, the outcome of the above cases might have been different, had these been examined under English law. Indeed, the Financial Markets Law Committee issued a report on the role and meaning of *pari passu* clauses under English law.[124] The report was triggered after *Elliott Associates v. Peru* was decided, and the Committee noted, apart from the literal interpretation of the wording of the clause, the consequences of each interpretation should also be considered.[125] To this end, the Committee noted that as "a matter of English law[,] the ranking (narrow) interpretation is the proper interpretation of the *pari passu* clause in sovereign debt obligations."[126]

In the context of the Greek sovereign bond restructuring, the majority of investors could not use such clauses because, with a few exceptions, almost all Greek-law governed bonds did not contain such *pari passu* clauses.[127] Even in its newly issued English law bonds, that contain *pari passu* clauses, Greece has introduced specific wording to

120. *Id*. at 263.

121. *Id*. at 265.

122. *Id*. at 263.

123. Bob Van Voris & Katia Porzecanski, *Argentina Debt Injunction To Be Lifted In Blow To Hedge Funds*, BLOOMBERG (2017), https://www.bloomberg.com/news/articles/2016-02-19/argentina-bonds-judge-says-he-will-lift-injunctions-on-debt-iku9ykz3.

124. Lord Brown-Wilkinson et al., *Issue 79 – Pari Passu Clauses*, Financial Markets Law Committee (Mar. 2005), http://www.fmlc.org/uploads/2/6/5/8/26584807/79.pdf.

125. *Id*. at 8.

126. *Id*. at 25.

127. Mitu Gulati & Jeromin Zettelmeyer, Making a Voluntary Greek Debt Exchange Work, 7 (Jan. 31, 2012) (unpublished manuscript) (on file with Duke University).

avert the broad interpretation of such clauses.[128] Greece specifically denounced the pro rata payment to bondholders in line with the new *pari passu* model clause proposed by the International Capital Market Association ("ICMA").[129] The ICMA's proposed clause aims to exclude a pro-rata interpretation of the *pari passu* clause issuing explicit language to this end. In particular, the proposed clause reads:

> The Notes are the direct, unconditional and unsecured obligations of the Issuer and rank *pari passu*, without preference among themselves, with all other unsecured External Indebtedness of the Issuer, from time to time outstanding, provided, however, that the Issuer shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due on the Notes and vice versa.[130]

Hence, although *pari passu* clauses can protect some investors (usually the holdouts), they are not always present in sovereign bonds. Moreover, even when such clauses do exist, wording and applicable law can diminish their broad interpretation despite the holdout's aspirations. A limited interpretation was required to facilitate sovereign bond restructurings and, therefore, allow non-holdout bondholders to receive some compensation on their bonds.[131] It also served to limit the wide powers creditors enjoyed by holdouts under the broad interpretation of the clause.[132] This limitation prevented creditors from holding States hostage in a state of financial duress.[133]

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128. *See* James A Haley, *Sovereign Debt Restructuring, a Coasean Perspective*, *in* TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 164 (2016).

129. *Id*.

130. Gregory Makoff & Robert Kahn, *Sovereign Bond Contract Reform Implementing the New ICMA Pari Passu and Collective Action Clauses*, 56 CIGI PAPERS 5 (Feb. 2015).

131. William Bratton, *Pari Passu and a Distressed Sovereign's Rational Choices*, 53 EMORY L.J. 823, 833 (2004).

132. *Id*.

133. *See id*. at 849.

B. Collective Action Clauses

As demonstrated in the case of Argentina, holdout creditors can have negative implications, not only for the State and its ability to issue new bonds, but also for the entire restructuring process and, therefore, for other bondholders.[134] To this end, an effective tool to minimize hold-out creditors are Collective Action Clauses ("CACs").[135]

CACs take various forms, but despite their form they all aim to resolve coordination problems between bondholders, especially in times of bond restructuring.[136] CACs can be in the form of collective modification clauses, which allow a qualified majority of bondholders to decide for all bondholders, including dissenting bondholders.[137] CACs can also be in the form of acceleration clauses, whereby bondholders can accelerate or initiate legal action against the State only after a qualified majority of the bondholders have consented to this.[138] Additionally, there are other less prominent forms of CACs, such as representation clauses, aggregation clauses, and sharing clauses.[139]

The importance of CACs was demonstrated after the peso crisis in Mexico, where CACs were promoted as a contractual tool to facilitate sovereign debt restructurings and eliminate the increasing cost of adjudication.[140] A result, in 1995, the Ministers and G10 countries formed a working group to study sovereign defaults and the problems

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134. *See* Benu Schneider, *Sovereign Debt Restructuring: The Road Ahead*, *in* LIFE AFTER DEBT: THE ORIGINS AND RESOLUTIONS OF DEBT CRISIS 199 (J. Stiglitz et al. eds., 2014).

135. Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, *in* CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW 195, 206–11 (2008).

136. *See* Michael Bradley & Mitu Gulati, *Collective Action Clauses for the Eurozone*, 18 REV. FIN. 1, 1–2 (2013).

137. Mitu Gulati et al., *A People's History of Collective Action Clauses*, 54 VA. J. INT'L L. 52, 53 (2013).

138. *Id.*

139. Sean Hagan, *supra* note 135, at 205. Collective Action Clauses in International Sovereign Bond Contracts and Their Effect on Spreads at Issuance, 5 (unpublished manuscript) (on file with American Economic Association).

140. Sönke Haeseler, *Collective Action Clauses in International Sovereign Bond Contracts – Whence the Opposition?*, 23 J. ECON. SURVEYS 882, 882–84 (2007).

faced in the aforementioned context.[141] The Group issued its report in 1996 and noted that introducing CACs into sovereign bond contracts might prove beneficial in smoothing negotiations during sovereign debt crises.[142] However, despite the Group's recommendation, States met CACs with hesitation, and CACs were entirely absent in bonds issued under local law.[143] Indicatively, before January 2013, the vast majority of sovereign bond contacts issued by Eurozone members were governed by each State's national law and did not contain CACs.[144]

Greece was not an exception to this rule. As indicated above, before the adoption of the Greek Bondholders' Law, No. 4050/2012, the Greek sovereign bonds contained no collective action clauses, and instead, Greece unilaterally introduced such clauses retroactively by the Greek Bondholders' Law. The revision of the Treaty Establishing the European Stability Mechanism was led in part by the unilateral modification of Eurozone sovereign bonds' terms as a result of the issuing state's legislative intervention.[145] The treaty provides the model CAC, developed by a sub-committee of the Economic and Financial Committee on EU Sovereign Debt Markets, would be mandatorily included in all Eurozone sovereign bonds with a maturity of greater than one year issued as of January 1, 2013.[146] According to Gelpern and Gulati, this revision was enacted for two main reasons.[147] First, the bonds needed to inspire security to investors that such unilateral acts, as that of the Greek Government, would not take place again in the

141. John Drage & Catherine Hovaguimian, *Collective Action Clauses (CACS): An Analysis of Provisions Included in Recent Sovereign Bond Issues*, BANK OF ENGL. 1 (2004), www.finanzaonline.com/forum/attachments/ obbligazioni-titoli-di-stato/1986399d1414067331-venezuela-2027-us922646as37-vol-27-il-ritorno-dagli-inferi-cac.pdf.

142. *Id*.

143. Christian Hofmann, *Sovereign-Debt Restructuring in Europe Under the New Model Collective Action Clauses*, 49 TEX. INT'L. L. J. 383, 390 (2014).

144. Elena Carletti et al., The Price of Law: The Case of the Eurozone Collective Action Clauses, 3 (July 5, 2017) (unpublished comment) (on file with Duke University).

145. *Collective Action Clauses In Euro Area*, ECON. & FIN. COMM., https://europa.eu/efc/collective-action-clauses-euro-area_en (last updated May 23, 2018).

146. *Id*.

147. Anna Gelpern & Mitu Gulati, *The Wonder-Clause*, 41 J. COMP. L. 367 (2013).

future and bondholders could rely on the terms of the sovereign bond contracts.[148] Second, CACs have the ability to reduce bailouts because defaulting states would have the ability to restructure their debts.[149]

Similarly, in 2014 the International Monetary Fund and ICMA both stressed the importance of CAC in facilitating the restructuring processes and, to this end, suggested the reformation of sovereign bond contacts.[150] In fact, ICMA published proposed terms for aggregated CACs, which was revised again in May 2015.[151]

Now, we will briefly review the model CAC introduced in sovereign bonds in the Eurozone and shall explore if this can facilitate future investors' rights. Primarily, the model CAC is mandatorily applicable to bonds issued both internationally and domestically, regardless if offered in the stock market or privately, and it can refer to a single bond or series of bonds.[152] The model CAC sets a series of processes that need to be followed before adopting a binding modification on all bondholders.[153]

The model CAC distinguishes between reserved matters, pertaining to the most crucial bond terms, such as the payment date, interest rate, and non-reserved matters that relate to less crucial bond terms.[154] Regarding amendments of a reserved matter, a meeting of bondholders should be duly convened, in which bondholders holding at least 75% of the aggregate principal amount of outstanding bonds should vote in favor of the amendment.[155] The percentage drops to 66.66% of the aggregate principal amount of outstanding bonds in cases of written

148. *Id*.

149. *Id*.

150. Stefanescu, *supra* note 31, at 14.

151. *Sovereign Debt Information*, INT'L CAP. MKT. ASS'N, https://www.icmagroup.org/resources/Sovereign-Debt-Information (last visited May 22, 2018).

152. Mairéad N. Dhonncha, *EU Publishes Mandatory Collective Action Clause for Use in Eurozone Sovereign Bonds from 1 January 2013*, LINKLATERS (May 2012), https://www.investireoggi.it/forums/attachments/clientmemo-pdf.245501/.

153. *See* Bradley & Gulati, *supra* note 136.

154. EFC Sub-Committee on EU Sovereign Debt Markets, *Model Collective Action Clause Supplemental Explanatory Note*, EUROPA 2 (Mar. 26, 2012), https://europa.eu/efc/sites/efc/files/supplemental_explanatory_note_on_the_model_cac_-_26_march_2012.pdf.

155. *Id*.

resolutions.[156] On the contrary, an amendment of a non-reserved matter can be achieved by the positive vote of bondholders holding more than 50% of the aggregate principal amount of outstanding bonds present. This can be done either at a duly convened meeting or in the form of written resolution.[157] The model CAC also provides rules for the conveyance of the bondholders' meetings as well as the procedure to be followed during the meeting.

As explained above, the introduction of CACs in sovereign bonds is a step in the right direction for both defaulting States and bondholders. However, CACs primarily protect bondholders. Significantly, the latter can now facilitate debt restructuring negotiations, take binding decisions on issues that have a crucial bearing on the restructuring process, and reduce the threat of holdouts that may lead to the inability of all other bondholders to collect, even partially.[158] Indeed, even in the Greek debt restructuring, without the introduction of CACs, the restructuring of the sovereign debt might not have been possible.[159] This could have led to Greece's unregulated default.

Although the Greek debt restructuring CACs allowed the successful completion of the restructuring, the bondholders sustained significant losses, which raises the question of whether there is a contractual term that may address such losses. To this end, we shall explore the use of "Events of Default" clauses in such cases.

C. Events of Default

The "Events of Default" clause is particularly important to bondholders, because it allows them to accelerate the maturity of their bonds and take enforcement measures over the issuer's assets in

156. *Id*.

157. *Common Terms Of Reference*, ECON. & FIN. COMM. (Feb. 17, 2012), https://europa.eu/efc/sites/efc/files/docs/pages/cac_-_text_model_cac.pdf.

158. J.F. Hornbeck, *Argentina's Defaulted Sovereign Debt: Dealing with Holdouts*, Congressional Research Service CONG. RES. SERV. (Feb. 6, 2013), https://fas.org/sgp/crs/row/R41029.pdf.

159. Antonia E. Stolper & Sean Dougherty, *Collective Action Clauses: How the Argentina Litigation Changed the Sovereign Debt Markets*, 12 CAP. MKT. L.J. 239 (2017).

satisfaction of their claims.[160] In other words, bondholders may initiate proceedings against the issuing state to recover the nominal value of the bond plus interest only when an event of default occurs. When a default occurs, bondholders would be able to accelerate all amounts owed under the sovereign bond contract. Notably, however, bondholders rarely choose such acceleration as a result of an event of default. Instead, in most cases, bondholders will refer to an event of default to improve their bargaining power, however small that power may be.[161] Although bondholders have the right to accerelate and remove the issuing state's assets in default, they may not simply select this right.[162] Instead, they often enter into negotiations with the issuing state regarding modifying the contract terms, without forefeiting their right to accerelate and enforce their claims.[163]

As to what constitutes a default will depend on the wording of each sovereign bond contract. There are two broad types of defaults. The first includes instances of non-payment of amounts due.[164] The second refers to certain events of anticipatory non-payment.[165] Indicatively, the majority of Greek sovereign bonds prior to the 2012 restructuring would include the following definition of an event of default:

- failure to pay interest or principal (usually after a 30-day grace period);
- failure or other covenant obligation (usually a grace period is granted, and notice of default is required);
- a government order or presidential decree is issued preventing Greece from performing its obligations under the bonds; or

160. Mitu Gulati & George Triantis, *Contracts Without Law: Sovereign Versus Corporate Debt*, 75 UNIV. CIN. L. REV. 999 (2007).

161. Phillip Wood, *How protective are Ukraine's international bonds?*, ALLEN & OVERY 8 (Mar. 5, 2014), http://www.allenovery.com/SiteCollectionDocuments/GLIU_-_Ukraine_international_bonds_(Mar_2014).pdf.

162. YAN LIU, *Collective Action Clauses in International Sovereign Bonds* (IMF Design and Effectiveness of Collective Action Clauses, 2002).

163. *Id*.

164. VINOD AGARWAL, Negotiating and Drafting Clauses in Loan Agreements: Events of Default 5 (U.N. Inst. for Training & Res., 2001).

165. *Id*.

- a General Moratorium is declared on non-payment of principal.[166]

Therefore, the question that arises is when the sovereign bond restructuring may constitute a default. Notably, although the two terms intertwine, they are not identical. Generally, an event of default will precede a sovereign restructuring.[167] Indeed, when an event of default is directly linked to non-payment after the grace period has expired, a restructuring is required.[168] However, in the case of the Greek sovereign bond restructuring of 2012, there was no missed payment on the side of Greece vis-a-vis bondholders.[169] However, what is of interest is whether the unilateral introduction of CACs can prevent Greece from performing its obligations under the bonds.[170]

A similar issue was addressed by the International Swaps and Derivatives Association ("ISDA"), which examined whether the unilateral introduction of CACs, by the Bondholders' Law, was a "credit event" in the context of marketed credit default swaps ("CDS"). Although credit events are not limited to the types of defaults listed above, it is important to review how ISDA treated the Greek sovereign bond restructuring. Primarily, ISDA took the view that given the voluntary nature of the bond exchange, the latter did not constitute a credit event.[171] According to ISDA, if the bond restructuring is voluntary, no credit event takes place.[172] This reasoning does not stem from the CDS definitions, which make no distinction between voluntary and involuntary events. Rather, this argument derives from the purposive interpretation of restructuring, which intends to refer to an event binding on all bondholders, even those dissenting to it.[173] On these grounds, ISDA ruled the Greek restructuring of 2011 was not

166. *See, e.g.*, *Hellenic Republic*, OFFERING CIRCULAR (Feb. 21, 2005), http://s3cdn.observador.pt/wp-content/uploads/2015/07/greece-ecb-bond1.pdf.

167. Das, *supra* note 61.

168. AGARWAL, *supra* note 164.

169. Agustino Fontevecchia, *ISDA Says Greece in Default, CDS Will Trigger*, FORBES (Mar. 9, 2012), https://www.forbes.com/sites/afontevecchia/ 2012/03/09/on-greece-defaults-and-the-future-of-derivatives/#15e8e3ae69fd.

170. *See Greek Sovereign Debt Q&A (Update)*, ISDA (July 25, 2011), http://www2.isda.org/news/greek-sovereign-debt-qampa-update.

171. *Id*.

172. *Id*.

173. *Id*.

likely to entail payments under CDS contracts.[174] On the contrary, in 2012, ISDA concluded the introduction of CACs by Greece unilaterally amending the terms of Greek law governed bonds constituted a Restructuring Credit Event.[175] Thus, the CACs rendered the sovereign bond restructuring binding on all bondholders of Greek-law governed bonds, even those that dissent.[176]

Despite this determination within the CDS context, contractually, it is unlikely the unilateral introduction of CACs could constitute a default and, therefore, be in a position to award bondholders an additional card on the restructuring negotiation table. Indeed, given the nature of CACs clauses, these do not constitute a change in the bond's payment terms, nor did they prevent Greece from performing its obligations under the bonds. Instead, it appears in the context of the Greek sovereign debt restructuring, the introduction of CACs was used to avert an event of default by Greece.

D. Other Clauses

Other clauses that can usually be found in sovereign bonds include clauses such as "negative pledge clauses"[177] that prohibit the issuance of new collateralized debt, unless existing debt is enhanced in the same way. Additionally, "secured debt clauses"[178] and "cross default clauses"[179] define a default event as a State's default on another government bond.

Prior to the Greek sovereign debt restructuring of 2012, Greek Bonds did not provide any security or other guarantees for the

174. *Id*.

175. *ISDA EMEA Determinations Committee: Restructuring Credit Event Has Occurred with Respect to the Hellenic Republic* (Mar. 9, 2012), https://www.isda.org/2012/03/09/isda-emea-determinations-committee-restructuring-credit-event-has-occurred-with-respect-to-the-hellenic-republic/.

176. *Id*.

177. MAURO MEGLIANI, SOVEREIGN DEBT: GENESIS - RESTRUCTURING – LITIGATION 179 (2014).

178. FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 62 (2006).

179. Stephen J. Choi, Mitu Gulati, & Eric. A. Posner, *The Evolution of Contractual Terms in Sovereign Bonds*, 4 J. LEGAL ANALYSIS 131, 139 (2012).

satisfaction of creditors in case of default.[180] In addition, they did not entail negative pledge clauses protecting the bondholders who took out an unsecured loan.[181] Negative pledge clauses provide a State that has awarded unsecured loans, cannot subsequently take out other loan(s) with a different lender, securing the subsequent loan(s) by the same specified assets.[182] Use of the same assets as collateral would mean that the original lender would be disadvantaged because the subsequent lender may have a priority position to satisfy his claim by the assets in an event of default.

Following the restructuring, however, this has changed. Indeed, the bonds that were offered to bondholders at the time of the restructuring contained negative pledge clauses, preventing Greece from issuing any secured bonds for as long as any of the restructured bonds remained outstanding.[183] Interestingly, in the bonds issued during the 2012 Greek bond exchange, a wider definition of a default event was adopted, including any failure by the issuing state to comply with any of the covenants contained in the new bonds, subject to a thirty-day cure period.[184] Hence, a violation of the negative pledge clause would, under the new exchanged bonds, also constitute an event of default.

Thus, such clause may be a useful tool for investors' protection in case of future default, but such clauses are not relevant for investors' rights prior to the 2012 restructuring.

E. Waiver of Immunity Clauses

One of the most important clauses for bondholders' protection is the clause that specifically waives an issuing state's immunity for jurisdiction and enforcement.[185] Enforcement is the motive for investors to pursue their claims against the Host State.[186] Although it is a result of the judicial process, enforcement against States is neither

180. *See* Zettelmeyer, *supra* note 82; *see also* K. A. LAVDAS ET AL., STATENESS AND SOVEREIGN DEBT: GREECE IN THE EUROPEAN CONUNDRUM 125 (2013).

181. LAVDAS, *supra* note 180, at 125.

182. *Id*.

183. *Id*.

184. *Id*.

185. Choi, Gulati & Posner, *supra* note 179, at 139.

186. *See* Jeswald W. Salacuse, *The Treatification of International Investment Law*, 13 LAW & BUS. REV. AM. 155 (2007).

easy nor common. Indeed, up to the mid-twentieth century, courts and scholars treated claims under sovereign bonds as unenforceable.[187] Accordingly, in the English case of *Twycross v. Dreyfus*,[188] Sir George Jessel noted sovereign bonds are only "engagements of honour" and not enforceable contractual obligations as no tribunal would enforce them absent the consent of the issuing state.[189] Historically, States used to enjoy absolute immunity; however, since the late twentieth century, there has been a shift from States' absolute immunity to relative immunity.[190]

Here, we must distinguish between immunity from jurisdiction and immunity from enforcement. The former provides that the national courts of a foreign state do not have jurisdiction to hear a lawsuit against another state, unless the latter has so consented.[191] On the other hand, immunity from enforcement restricts the powers of national courts or other organs of the state against the property of another state found in its jurisdiction.[192] Absolute immunity provided States with immunity from foreign jurisdiction and enforcement,[193] while relative immunity provides that when a sovereign chooses to enter the international marketplace and act as a commercial actor, it cannot escape liability through invoking sovereign immunity, but instead shall be similarly accountable to the judicial process similar to other commercial actors.[194]

The Courts of Germany, in the context of the Greek Sovereign Bond Exchange, recently examined the issue of immunity from

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187. CHRISTIAN TIETJE, THE RULE OF LAW IN MONETARY AFFAIRS: TAKING STOCK 14 (Thomas Cottier et al., eds., 2014).

188. Twycross v. Dreyfus (1877) 5 Ch D at 605 (Eng.).

189. *Id*.

190. W. Mark C. Weidemaier & Mitu Gulati, *Sovereign Debt and the "Contracts Matter" Hypothesis*, *in* OXFORD HANDBOOK OF LAW AND ECONOMICS (forthcoming).

191. August Reinisch, *European Court Practice Concerning State Immunity from Enforcement Measures*, 17 EUR. J. INT. LAW 803, 806 (2006).

192. *Id*. at 803.

193. *Id*. at 804.

194. Lee Buchheit, *Sovereign Debt Restructurings: The Legal Context* 107 (BIS Papers No. 72, 2013).

jurisdiction.[195] Several German bondholders that acquired Greek sovereign bonds from German Banks in Germany resorted to German Courts to enforce actions against Greece claiming damages for the unilateral introduction of CACs in their bonds that led to them sustaining a haircut on their bonds.[196] Bondholders' claims were raised on two bases. First, a claim, based on tort, asserted the bond exchange was a wrongful exchange.[197] Second, bondholders raised claims for breach of contract.[198] In all cases, German Courts examined whether they were barred from hearing any claims against the Greek state by virtue of sovereign immunity.

Per German law, sovereign immunity does not apply to a State's commercial acts; in other words, immunity will only apply when a State is acting as sovereign.[199] Hence, the German courts examined whether bondholders' claims related to sovereign or commercial acts.[200] Based on this, the Federal Court of Justice concluded that claims in tort were inadmissible.[201] The Greek Bondholders Law and the Council of Ministers' subsequent decision to ratify the majority vote and extend its binding result on all bondholders were acts taken by Greece as a sovereign and, therefore, sovereign immunity applied.[202] However, the Court noted this was not necessarily the case for claims brought for breach of contract.[203]

Indeed, when German Courts examined bondholders' claims for breach of contract, two Higher Regional Courts in Oldenburg and Cologne noted that no sovereign immunity was applicable as the claims stemmed from a contractual relation and the Greek Bondholders' Law

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195. *See* Sebastian Grund, *The Legal Consequences of Sovereign Insolvency – A Review of Creditor Litigation in Germany Following the Greek Debt Restructuring*, MAASTRICHT J. EUR. & COMP. L. (forthcoming).

196. *Id*. at 18–21.

197. *Id*. at 25.

198. *Id*. at 43.

199. HAZEL FOX & PHILIPPA WEBB, THE LAW OF STATE IMMUNITY 223–30 (2d ed. 2008).

200. *See* Grund, *supra* note 195, at 13.

201. *Id*. at 28.

202. Richard M. Buxbaum, *Sovereign Debtors Before Greece: The Case of Germany*, 65 KAN. L.R. 101, 101–03 (2017).

203. *Id*. at 122.

could not change this.[204] However, the Schleswig Higher Regional Court contested that the significant point was not the non-payments by the Greek State, but the introduction of the Bondholders' Law, which was in fact a sovereign act.[205] As per the Schleswig Court, the issue in question was whether the introduction of CACs by the Bondholders' Law was legal, and whether examining the legality of foreign legislative acts was within the scope of immunity.[206] In all cases, however, German Courts did not proceed to examine the merits of the case, as even the Courts in Cologne and Oldenburg dismissed bondholders' claims as the Courts did not have jurisdiction under the old Brussels Regulation (EC) 44/2001.[207]

The scope and extent of State Immunity regarding enforcement is far more disputed than jurisdictional immunity, and there is no uniform global practice. Different States have adopted different approaches, and the practice of national Courts in Europe is anything but uniform in this field.[208] Nevertheless, some common elements have emerged as most States have abandoned the notion of absolute sovereign immunity against enforcement and have adopted a more limited application of the aforementioned relative immunity doctrine.

Specifically, one of the most decisive factors to determine the extent of immunity from enforcement is the prevailing purpose of the property against which enforcement measures are sought.[209] Indeed, in the *Philippine Embassy Bank Account Case*, the German Constitutional Court stated that:

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204. *Id*.

205. Wolf Bussian & Jan Erik Windthrost, *Germany: German Courts Dismiss Greek Government Bondholders' Claims Against Greece on State Immunity or Jurisdiction Grounds*, ALLEN & OVERY, http://www.allenovery.com/ publications/en-gb/lrrfs/continental%20europe/Pages/German-courts-dismiss-Greek-government-bondholders-claims-against-Greece-on-state-immunity-or-jurisdiction-grounds.aspx (last visited Apr. 15, 2018).

206. *Id*.

207. Sebastian Grund, *Enforcing Sovereign Debt in Court – A Comparative Analysis of Litigation and Arbitration Following the Greek Debt Restructuring of 2012*, 1 U. VIENNA L. REV. 34, 34–90 (2017).

208. *See* Reinisch, *supra* note 193.

209. Leo J. Bouchez, *The Nature and Scope of State Immunity from Jurisdiction and Execution*, 10 NETHERLANDS Y.B. INT'L L. 3, 17 (1979).

> There is a general rule of international law that execution by the State having jurisdiction on the basis of a judicial writ of execution against a foreign State, issued in relation to non-sovereign action (acta iure gestionis) of that State upon that State's things located or occupied within the national territory of the State having jurisdiction, is inadmissible without assent by the foreign State, insofar as those things serve sovereign purposes of the foreign State at the time of commencement of the enforcement measure.[210]

As evidenced by the aforementioned decision, differences exist between property for sovereign purposes that is immune from execution/enforcement and property for non-sovereign/commercial purposes that are not immune. This distinction is also found in the case law of other European countries, such as Spain, Italy, and the Netherlands.[211] This principal was also upheld in a Belgian judgment, while even Swiss Courts that used to deny absolute immunity have now accepted that, only, property used for commercial purposes may be the object of execution.[212] France also acknowledges the distinction between property used for sovereign purposes and property used for private/commercial purposes; however, it requires a link between the property against which execution is sought and the original claim is established.[213] The link need not be proven if the property is public but not sovereign.

Another limitation to the doctrine of immunity from enforcement is the private law characterization of the transaction.[214] French Law goes even further granting immunity only if the State's act is either an act of Government ("acte de puissance publique") or if it is carried out for public interest ("dansl'intérêt d'un service public").[215] Notably, States could easily invoke the aforementioned doctrine to avoid their obligations stemming from arbitral awards; any action taken against

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210. 46 BVERFGE 46, 342 2 BVM 1/76 "Philippine Embassy" (Ger.).

211. Reinisch, *supra* note 193.

212. *Id*.

213. VINCENT HEUZÉ & PIERRE MAYER, DROIT INTERNATIONAL 323 (L.G.D.J. ed., 2007).

214. D. Gaukrodger, *Foreign State Immunity and Foreign Government Controlled Investors* (OECD Working Papers on International Investment 2010/02, 2010), http://www.oecd.org/investment/investment-policy/WP-2010_2.pdf.

215. HEUZÉ & MAYER, *supra* note 213, at 325.

them and, in this case against Greece, would be without any purpose. Therefore, a State that successfully relies on State Immunity to prevent enforcement may be in violation of its obligation under Bilateral or Multilateral Investment Treaties, as well as European Law.[216] However, in cases of extreme financial distress, as in the case of Greece in 2012, where imminent default and collapse of the financial system was pending, it appears that Greece's actions were in fact for the public interest.

In the case of ICSID adjudication, as in the case of Argentina, it would be a treaty violation for a Contracting State to refuse to enforce an award.[217] It would also be non-compliant with Article 54, which would then carry the consequences of State responsibility, including the revival of diplomatic protection under Article 27(1) of the ICSID Convention.[218] On account of the above, it comes as no surprise that since ICSID's creation, all countries, with the exception of Argentina, have complied with their obligation to pay an arbitral award once its determination was finalized.

To address the issue and award bondholders' security that they would be entitled to enforce their claims in the case of default, new bonds contain a waiver clause for both immunity from enforcement and judgment. Accordingly, the bond issued in 2015 provided:

> *13. Waiver of Immunity*
>
> (a) The Republic hereby irrevocably waives, to the extent permitted by applicable law and international conventions;
>
> (i) any immunity from jurisdiction it may have in any Proceeding in the courts of England; and

216. *See* Michel Tison, *Who's Afraid of Peter Paul? The European Court of Justice to Rule on Banking Supervisory Liability*, THE FIN. REG. (Dec. 2004), http://www.law.ugent.be/fli/wps/pdf/WP2004-11.pdf (although in such instance it was found that invoking state immunity was not a violation of German Constitutional and EU law).

217. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States art. 53, Oct. 14, 1966, 575 U.N.T.S. 159.

218. *See* Stanimir Alexandrov, *Enforcement of ICSID Awards: Articles 53 and 54 of the ICSID Convention*, *in* INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY: ESSAYS IN HONOUR OF CHRISTOPH SCHREUER 322, 326 (Christina Binder et al., eds., 2009).

(ii) except as provided below, any immunity from attachment or execution to which its assets or property might otherwise be entitled in any Proceeding in the courts of England, and agrees that it will not claim any such immunity in any such Proceeding.

(b) Notwithstanding the foregoing, the above waiver shall not constitute a waiver of immunity from attachment or execution with respect to:

i. assets and property of the Republic located in the Republic;

ii. the premises and property of the Republic's diplomatic and consular missions;

iii. assets and property of the Republic outside the Republic not used or intended to be used for a commercial purpose;

iv. assets and property of the Republic's central bank or monetary authority;

v. assets and property of a military character or under the control of a military authority or defense agency of the Republic; or

vi. assets and property forming part of the cultural heritage of the Republic.

(c) For the purposes of the foregoing, "property" includes, without limitation, accounts, bank deposits, cash, revenues, securities and rights, including rights against third parties.

(d) The foregoing constitutes a limited and specific waiver by the Republic solely for the purposes of the Notes, and under no circumstance shall it be construed as a general waiver by the Republic or a waiver with respect to proceedings unrelated to the Notes. [219]

Thus, immunity waiver clauses are important tools in the protection of sovereign bondholders in case of sovereign default, although insufficient on their own. Moreover, although the vast majority of sovereign bonds currently contain these immunity waiver clauses, as pointed out by Professor Weidemaier, it has not "played much of a role in the broader drama of sovereign debt."[220]

CONCLUSION

Sovereign bonds, despite their particular nature of being contracts with the sovereign, nonetheless continue to be contracts. To this end,

219. *Hellenic Republic*, *supra* note 166.

220. Weidemaier, *supra* note 4, at 112.

the terms included in such contracts are of importance, especially in cases of sovereign debt restructuring or sovereign default. Recent caselaw on sovereign defaults have illustrated this importance. Although, undoubtedly in some cases, a default event will occur and political concerns will also come into play, contractual terms are still important. Perhaps, the most important clause in a sovereign bond contract is the choice of law, as it has wide ramifications on the entire interpretation of the sovereign bond contract. Traditionally, states used to "impose" their own national law, as this granted them power to control their debt. Indeed, in cases where the governing law of a sovereign bond contract is that of the issuing state, then the latter retains the power to change that law to its favour.

This is what happened during the Greek Sovereign Debt Restructuring in 2012, when Greece adopted the Bondholder's Law, unilaterally amending the terms of the sovereign bonds' contracts by the introduction of CACs that made the bondholder majority's resolution for restructuring binding even on dissenting bondholders. Prior to 2012, Greek bonds were issues under Greek law and contained no standard creditor protection clauses, such as *pari passu*, secured debt, CAS, negative pledge or immunity waiver clauses.

However, since 2012, there has been a significant change in the terms of sovereign bonds issued by the Greek Government. New bonds are issued under English law and contain *pari passu*, negative pledges, and immunity waiver clauses. Moreover, responding to the Greek unilateral amendment of the sovereign bond contract's terms in 2012, the Eurozone has requested that all Euro-denominated sovereign bonds contain CACs. This reformation of contractual terms was brought about to restore investors' faith in Greek bonds and demonstrate the importance and power of contractual terms.

Although holders of Greek sovereign bonds have not been successful in claiming damages due to the Greek Bond Restructuring of 2012, recent changes to bond terms strongly reinforced their positions. In the unfortunate event of a new sovereign bond restructuring or a future sovereign default, investor's rights will be better protected from negotiation to actual contract enforcement.