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Market Failure, *Pari Passu*, and the Law and Economics Approach to the Sovereign Debt Crisis

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I. INTRODUCTION

In August 2013, the international community closely followed *NML Capital, Ltd. v. Republic of Argentina* (*NML Capital IV*)[1] to see whether the United States Court of Appeals for the Second Circuit would, or even could, compel the Republic of Argentina to honor its debts.[2] Argentina's history of refusing to pay creditors[3] has drawn, to date, a number of adverse judgments from foreign courts[4] and arbitral tribunals[5]—rulings that the Republic has obstinately ignored.[6] The problem facing the creditors is that after winning a judgment, they must seek a venue in which Argentina holds property to enforce their award.[7] The creditors soon learn that the doctrine of foreign sovereign immunity bars most national courts from attaching or executing upon another sovereign's property,[8] which, in effect, renders their judgments worthless.[9] Some commentators posit that the creditors' vulnerability has

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1. 727 F.3d 230 (2d Cir. 2013).
2. The United States District Court for the Southern District of New York had already ruled against Argentina, and the Second Circuit affirmed in *NML Capital, Ltd. v. Republic of Argentina* (*NML Capital II*), 699 F.3d 246 (2d Cir. 2012). Questions remained, though, regarding the district court's injunction—an essential element of its order. The Second Circuit harbored deep concerns about this novel remedy fashioned by the district court and was set to rule on its validity in *NML Capital IV*. *See id.*
3. *See Argentina's Unpaid Loans—What Are the Risks for Europe?*, EUROPEAN POLICY CTR. (June 28, 2012), http://www.epc.eu/events_rep_details.php?cat_id=6&pub_id=2819 (discussing the extent to which Argentina has avoided paying creditors and remains deeply in debt).
4. *See, e.g.*, Elliott Assocs., L.P., Hof van Beroep [HvB] [Court of Appeal] Bruxelles, 8ème Sept. 26, 2000, AQR 2000/QR/92 (Belg.).
5. *See, e.g.*, Abaclat v. Argentine Republic, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (Aug. 4, 2011) (ruling that Argentina had violated its bilateral investment treaty with Italy when it coerced investors into accepting modified bonds of reduced value).
6. Even before the current cases over defaulted Argentine bonds, Argentina was involved in what was previously history's largest sovereign default in 2001. Indeed, Argentine borrowing and defaulting has been cyclical for decades. *See* Sophie Arie, *Argentina Makes Biggest Debt Default in History*, TELEGRAPH (Dec. 24, 2001, 12:01 AM), http://www.telegraph.co.uk/news/worldnews/southamerica/argentina/1366218/Argentina-makes-biggest-debt-default-in-history.html. For a discussion of Argentina's debt history, see Mario Damill et al., *The Argentinean Debt: History, Default and Restructuring*, ANPEC 69 (Dec. 2005), http://www.anpec.org.br/revista/vol6/vol6n3p29_90.pdf.
7. *See* Jonathan I. Blackman & Rahul Mukhi, *The Evolution of Modern Sovereign Debt Litigation: Vultures, Alter Egos, and Other Legal Fauna*, 73 LAW & CONTEMP. PROBS. 47, 55 (2010).
8. *See infra* Part II.B.2.
9. *See* NML Capital, Ltd. v. Banco Cent. de la Republica Arg., 652 F.3d 172, 196 (2d Cir. 2011) (discussing how the FSIA has produced plenty of creditor frustration by stripping the courts of the authority to enforce their judgments against unwilling sovereign debtors).

encouraged debtor nations to reduce the value of their bonds[10] or even to deny the entire debt.[11]

Without a means to enforce their contracts, most creditors reluctantly accept whatever amount a sovereign offers to settle the dispute.[12] This becomes especially inefficient when creditors sell off their bonds for pennies on the dollar in hopes of salvaging a portion of their investment.[13] Those who purchase defaulted bonds—typically New York City hedge funds—gamble that the low cost of bad debt relative to its high face value may produce a windfall after much litigation.[14] The lawsuits themselves could bear fruit or the sovereigns might acquiesce to the substantial cost thereof.[15] Critics use the term "vulture funds" to describe such debt litigants, accusing them of bleeding impoverished nations[16] and interfering with the processes by which sovereigns and creditors ordinarily restructure debt.[17] Others counter that vulture funds

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10. *See* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1044 (2004) (observing that sometimes sovereigns are unable to repay creditors, but other times, sovereigns choose to have an "opportunistic default" in that they elect not to pay, considering the lack of mechanisms to enforce them to honor the contract).

11. *See* Jonathan Goren, *State-to-State Debts: Sovereign Immunity and the "Vulture" Hunt*, 41 GEO. WASH. INT'L L. REV. 681 (2009-10) (using as an example a $40 million loan provided to Zambia from Romania, on which Zambia elected to default).

12. *See* Landon Thomas Jr., *Greece Is in a Face-Off with Its Bond Holdouts*, N.Y. TIMES (Apr. 3, 2012), http://www.nytimes.com/2012/04/04/business/global/greece-faces-off-with-holdout-investors-over-debt.html?pagewanted=all&_r=0 (observing that most creditors accepted Greece's 75% haircut, with the holdouts representing only about 2-3% of the creditors).

13. *See* Jonathan C. Lippert, *Vulture Funds: The Reason Why Congolese Debt May Force a Revision of the Foreign Sovereign Immunities Act*, N.Y. INT'L L. REV., Summer 2008, at 1, 8 ("The Congo is so deeply in debt that no realistic businessperson actually believes it will ever be able to pay off its loans. As a result, these vulture funds are able to buy defaulted Congolese debt for pennies on the dollar from its creditors." (footnote omitted)).

14. *Id.*

15. *See* Blackman & Mukhi, *supra* note 7, at 50 (noting that vulture funds often endeavor "[to extract] profitable settlements because their lawsuits may have a significant nuisance value for the sovereign defendant").

16. Goren, *supra* note 11, at 682. Internationalists condemned the head of one vulture fund, Michael Sheehan of Donegal:

> A British journalist staked out Sheehan's home and ambushed him one morning, asking "[W]hy are you squeezing the poor nation of Zambia for $40 [sic] million—doesn't that make you a vulture?" One commentator observed that Sheehan "attracted the vilification suitable for mid-level [James] Bond villains" and marveled at the over 60,000 results of a Google search for the words "Sheehan" and "vulture."

Id. (footnote omitted).

17. Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253, 254 (2003) ("The vulture fund not only refuses to participate in any voluntary restructuring, but attempts to use litigation to collect from the sovereign debtor the full face value of its claim. Its disruptive impact on any restructuring process therefore exceeds that of the typical holdout

dissuade sovereigns from defaulting[18] and help original creditors to mitigate losses.[19] Nevertheless, the rise of vulture funds most likely reflects a natural—and costly—response to a system that has failed to provide an effective mechanism to resolve disputes.[20]

Recently though, in *NML Capital, Ltd. v. Republic of Argentina* (*NML Capital II*), a vulture fund found a way to upset this traditional balance of power when it successfully alleged that Argentina's latest default violated an obscure contract term found in most debt instruments—the *pari passu* clause.[21] Unless the United States Supreme Court overturns this verdict, the creditors may have finally found a way to topple the previous system and wrest away the sovereigns' power; yet paradoxically, this event would likely create a mirror image of the same problems and inefficiencies that existed before—except this time the creditors would be the beneficiaries. Indeed, the *NML Capital* decisions exemplify the consequences arising when a vulnerable party lacks an equitable process to address a breached contract, considering that market inefficiencies often result when contractees adopt self-help remedies to minimize losses and/or avoid forfeiture. Shifting the power from the debtors to the creditors will hardly change this dynamic.

This Article contributes to the sovereign debt literature and contract scholarship in general by using a law and economics approach to generate expectations regarding when and why some contracts lead to market failure. The research herein finds that contracting parties must have an adequate remedy to assuage a breach; otherwise, vulnerable parties—such as the creditors in the *NML Capital* decisions and the greater sovereign debt market—will likely initiate costly self-help strategies, leading to systemic inefficiencies.

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creditor. Not only does the defection of the vulture fund deter participation, but the subsequent litigation threatens to derail any restructuring ultimately agreed upon.").

18. *See* Fisch & Gentile, *supra* note 10.

19. For example, Zambia defaulted on a loan from Romania, a developing country itself. Donegal International then purchased Romania's Zambian bonds, allowing Romania to recoup at least a fraction of its investment. *See* Goren, *supra* note 11, at 681 (citing Donegal Int'l Ltd. v. Zambia, [2007] EWHC (Comm) 197, [6] (Eng.)).

20. For example, vulture fund NML International took control of an Argentine ship positioned in Ghana in hopes of using the boat to fulfill some of the $370 million owed it by Argentina. The International Tribunal for the Law of the Sea ordered the boat released to Argentina upon a notion of foreign sovereign immunity. David Smith, *Seized Argentinian Sailing Ship Leaves Ghana: Argentinian Navy Vessel Detained over U.S. 'Vulture Fund' Claim Is Released After International Court Ruling*, GUARDIAN (Dec. 20, 2012, 9:54 EST), http://www.guardian.co.uk/world/2012/dec/20/argentina-sailing-ship-ghana-release.

21. *See* 699 F.3d 246 (2d Cir. 2012). For a discussion of the debate surrounding the current and historical meaning of the *pari passu* clause, see Mark Weidemaier et al., *Origin Myths, Contracts, and the Hunt for* Pari Passu, 38 LAW & SOC. INQUIRY 72 (2013).

The advantage of law and economics lies in how it assumes rational actors seek to maximize their utility and thus respond predictably to defined incentive structures. The deductions rendered explain the logic underlying many behaviors that may initially appear perplexing and can even help to identify important similarities among diverse legal institutions. This runs contrary to most prior approaches to sovereign debt that have emphasized the qualities distinguishing sovereign bonds from more standard debt.[22] Economic principles instead suggest that sovereign bonds are promises to fulfill a duty just like any other contract, and likewise, their shortcomings are not unique. By identifying relevant commonalities shared among modern and historic contract types,[23] this Article seeks to identify other agreements that have sought to guard against these same inefficiencies in pursuit of a possible solution.

Part II details how the law governing sovereign bonds created an allegedly anarchic legal regime in which little authority compels a debtor nation to abide by the terms of its contracts. This explains how the *NML Capital* decisions, and other similar *pari passu* litigation, threaten to upend the system while providing no tenable solution to the greater problem. Part III offers a discussion of the law and economics of breaching a contract in order to explain the reasons why the sovereign debt market's rampant inefficiencies are both logical and predictable. Part IV proposes solutions to these inefficiencies, including a discussion of how nineteenth-century agrarian lending practices could offer an equitable resolution mechanism relevant to the bond market.

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22. The sovereign debt market lacks a bankruptcy court to reorganize distressed assets and officiate hostile parties. *See* Blackman & Mukhi, *supra* note 7, at 47-48 (explaining how traditional bankruptcy protections afford efficient resolution processes in contrast to sovereign debt contract breaches). Most sovereign bonds lack a self-enforcing remedy that allows contractees to settle a breach without involving the judiciary, and making matters worse, most courts will not, or cannot, enforce the contracts. *See, e.g.*, Exp.-Imp. Bank of China v. Grenada, 876 F. Supp. 2d 263, 265-66 (S.D.N.Y. 2012) (finding that creditors could not attach funds derived from an arbitral award because they are not the result of a commercial activity).

23. For instance, some contract claims may be meritorious yet the demand for relief is for such a small amount that it makes little economic sense to sue. Class actions allow those with relatively low-cost injuries to combine claims into one lawsuit, making it feasible to sue. Arbitration clauses found in many consumer contracts often stipulate that each party foregoes the right to sue as part of a class action, forcing prospective litigants to bring their claims alone and without the economic benefits of the class. *See* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1753 (2011).

II. THE COMPETING LEGAL FRAMEWORKS TO SUE AND COLLECT FROM A DEFAULTING SOVEREIGN

Lawsuits involving a defaulted sovereign implicate the Foreign Sovereign Immunities Act (FSIA), which, until the *NML Capital* decisions, had defeated almost every creditor claim. Whether or not the *NML Capital* decisions will actually revolutionize the sovereign bond market, or become a historical anecdote, remains unclear. The following Part first addresses the pre-*NML Capital* framework before turning to the *NML Capital* decisions' effect upon the current landscape.

*A. Pre-*NML Capital*: Why the Law Defeated Nearly All Creditor Claims*

Prior to the *NML* decisions, sovereign bonds[24] resembled most other types of debt except for when the sovereign breached because no mechanism could compel a sovereign to honor its contracts. After a sovereign's breach, both sources of authority governing the bonds—the actual terms of the bonds and the laws of the state in which the creditor brings suit—have proven unable to remedy a resulting contract dispute.[25] Any solution must thus understand the ineffectiveness of both the contracts and the courts.

The language of most sovereign bonds requires a defaulting sovereign to pay the contract's remaining balance immediately upon the creditor's request. For instance, the instrument in the *NML Capital* decisions contained both breach and default clauses, defining "nonpayment" as when "the Republic fails to pay any principal of any of the Securities of such Series when due and payable or fails to pay any interest on any of the Securities of such series when due and payable and

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24. When countries desire to raise money, they primarily issue state bonds. Creditors purchase them for a principal amount, which the sovereign must repay at the bond's maturation date. Along the way, the sovereign must make interest payments, the rate of which is determined by the demand for sovereign bonds, the length of time until the bond matures, and the sovereign's credit history. *See* MICHAEL WAIBEL, SOVEREIGN DEFAULTS BEFORE INTERNATIONAL COURTS AND TRIBUNALS 11-13 (2011). Historically, sovereigns sold these bonds to other countries, although now private banks and other financial institutions purchase a majority of them. Currently, a large secondary market exists where both good and bad debt are resold as investments. *See id.*; Fisch & Gentile, *supra* note 10, at 1064-65 (mentioning that the secondary market for debt has grown). *See generally* MICHAEL TOMZ, REPUTATION AND INTERNATIONAL COOPERATION: SOVEREIGN DEBT ACROSS THREE CENTURIES (2007).

25. *See, e.g.*, *Exp.-Imp. Bank of China*, 876 F. Supp. 2d at 265-66 (holding that the sovereign was not using the funds in a commercial activity and thus the creditors could not attach the funds to their award).

such failure continues for a period of 30 days."[26] Upon such an event, "each holder of Securities of such Series may by such notice in writing declare the principal amount of Securities of such Series held by it to be due and *payable immediately*."[27] A breach referred to a failure to "perform or comply with any one or more of its *other* obligations,"[28] which, if materially prejudicial, would require Argentina to "deposit with the Fiscal Agent *a sum sufficient to pay all matured amounts of interest and principal* upon all the Securities which shall have become due," after allowing Argentina an opportunity to cure such defect.[29] Thus, both forms of default required Argentina to compensate the creditor fully.

While sovereign bonds usually specify the remedies available after a breach or default, they do not provide a method to exercise these remedies.[30] This is notable, considering that other international contracts, such as the letter of credit, accommodate potential enforcement problems with nonjudicial resolution mechanisms.[31] But if a debtor nation

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26. Exhibit 1: Fiscal Agency Agreement at 17, NML Capital, Ltd. v. Republic of Argentina (*NML Capital I*), No. 1:08cv02541, 2009 WL 562270 (S.D.N.Y. Mar. 4, 2009) (attached to Declaration of Susan Y. Shamoto on Support of Plaintiff's Motion for Summary Judgment).

27. *Id.* at 18 (emphasis added).

28. *Id.* at 17 (emphasis added).

29. *Id.* at 18 (emphasis added).

30. *See, e.g.*, Libancell S.A.L. v. Republic of Lebanon, No. 06 Civ. 2765(HB), 2006 WL 1321328, at *4-5 (S.D.N.Y. May 16, 2006) (ruling that even though the creditors won a judgment in a French court and through UNCITRAL, the court could not enjoin Lebanon from transferring funds out of the United States before the creditors sought to attach the award in the United States).

31. The letter of credit—an independent contract used in the international sale of goods—solves what could have been a pervasive payment problem: when selling goods across borders, the national courts have little power to force foreign firms to pay once receiving the goods or to force shipment after payment. To solve this problem, most foreign sales contracts are accompanied by a letter of credit—a separate, independent contract between the buyer and the buyer's bank—which obligates the buyer's bank to pay the seller when the seller gives to the bank the bill of lading evidencing that the buyer accepted the goods. The independence principle instructs that banks must pay upon the letter of credit without considering whether the parties have properly and completely fulfilled the sales contract. By making payment a black-and-white issue, letters of credit clearly instruct banks to pay upon receiving the bill of lading from the seller, which has the effect of creating a pure contractual mechanism to solve conflicts and almost always excluding the judiciary from the process. *See, e.g.*, Maurice O'Meara Co. v. Nat'l Park Bank of N.Y., 146 N.E. 636, 639 (N.Y. 1925). The bank must concern itself with its share of the process whether or not the seller has delivered proof of delivery:

> The bank issued to plaintiff's assignor an irrevocable letter of credit, a contract solely between the bank and plaintiff's assignor, in and by which the bank agreed to pay sight drafts to a certain amount on presentation to it of the documents specified in the letter of credit. This contract was in no way involved in or connected with, other than the presentation of the documents, the contract for the purchase and sale of the paper mentioned. That was a contract between buyer and seller, which in no way concerned the bank. The bank's obligation was to pay sight drafts when presented if accompanied

breaches a sovereign bond and then refuses to abide by its default clause, then creditors must find a court or international body that is both willing and able to enforce the contract. Without such a venue, creditors will be unable to find relief in the contract language alone.

A creditor who rejects modification and chooses to litigate must succeed in two stages. First, a creditor must win a judgment on the merits in either a court or arbitral body. Importantly, this step provides only a sheet of paper stating that the creditor is *entitled* to an award but no actual payment accompanies. Second, to receive payment, a creditor must then succeed in the much more formidable step of finding a venue in which the sovereign holds assets that is willing to attach a sovereign's property to the judgment.

1. Step One: The Process of Winning a Judgment

Creditors have three forum options to seek a judgment: in the breaching sovereign's courts, in a foreign court, or through an arbitral body. Creditors usually avoid the first option out of fear of receiving prejudicial treatment.[32] These debt disputes also seldom arbitrate because arbitral bodies lack legal authority to preside unless all parties either provide consent to arbitrate or have already agreed to arbitrate via a relevant treaty or clause in the sovereign bond.[33] And unsurprisingly, debtor nations rarely give ad hoc consent, and sovereign bonds seldom include arbitration clauses.[34] A treaty between the debtor and creditor's

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> by genuine documents specified in the letter of credit. If the paper when delivered did not correspond to what had been purchased, either in weight, kind or quality, then the purchaser had his remedy against the seller for damages. Whether the paper was what the purchaser contracted to purchase did not concern the bank and in no way affected its liability.

Id.; *see also* 11 BUSINESS TRANSACTION SOLUTIONS § 57:126 (2014).

32. *See, e.g.*, *NML Capital II*, 699 F.3d 246, 254 (2d Cir. 2012) (stating that ruling in the creditors' favor would contravene Argentina's Lock Law and that the Argentine courts had made clear that they would refuse a creditor's claim). This should not be much of a surprise; in the United States, the process allowing residents of other states to remove their cases from state to federal court is predicated on the concept that outsiders may receive prejudicial treatment when litigating in the opposing party's home venue. *See* Rodney K. Miller, *Article III and Removal Jurisdiction: The Demise of the Complete Diversity Rule and a Proposed Return to Minimal Diversity*, 64 OKLA. L. REV. 269, 285 n.64 (2012) (arguing that this concern, in some circumstances, may no longer be relevant).

33. *See* W. Mark C. Weidemaier, Contracting for State Intervention: The Origins of Sovereign Debt Arbitration, 73 LAW & CONTEMP. PROBS. 335, 336-37 (2010).

34. *Id.* (explaining that arbitration clauses were once common place in sovereign debt agreements, decades ago, but now most contracts prefer national courts).

nation is nearly the exclusive avenue to authorize arbitration for this type of dispute, though such events remain rare.[35]

The most common forum used to win a judgment is a foreign court.[36] Because most debt instruments facilitate payment through a U.K. or U.S. bank[37] and include both choice-of-law and jurisdiction clauses enumerating the United States or United Kingdom, courts in London and New York City hear the majority of these disputes.[38] In either country, creditors face two distinct legal hurdles: (1) their claim must survive the doctrine of foreign sovereign immunity, at which point (2) they must win on the merits.[39]

Creditors have found that the doctrine of foreign sovereign immunity defeats most claims. The theory underlying it assumes that the Executive Branch is best equipped to handle international disputes and thus ought to have exclusive subject matter jurisdiction over conflicts

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35. Again, this rarely occurs because few sovereign debt contracts include an arbitration clause and only recently has an international arbitral body found, amongst much controversy, that an international treaty vested the organization with authority to arbitrate the dispute. *Id.* at 341; *see also* Jessica Beess und Chrostin, *Sovereign Debt Restructuring and Mass Claims Arbitration Before the ICSID, the* Abaclat *Case*, 53 HARV. INT'L L.J. 505 (2012) (discussing the implications of Abaclat v. Argentine Republic, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (Aug. 4, 2011)). For instance, the International Centre for Settlement and Investment Disputes (ICSID) recently found that a bilateral investment treaty between Argentina and Italy vested ICSID with jurisdiction to settle a conflict arising out of Argentina's default. *See Abaclat*, ICSID Case No. ARB/07/5, ¶ 316. Despite winning a judgment from an international arbitral body, the next step of enforcing the judgment remains. Indeed, sovereigns, including Argentina, have defied several arbitral judgments, forcing creditors to seek a national court willing to attach the sovereign's property. Anoosha Boralessa, *Enforcement in the United States and United Kingdom of ICSID Awards Against the Republic of Argentina: Obstacles that Transnational Corporations May Face*, N.Y. INT'L L. REV., Summer 2004, at 53, 68-69. The courts of Argentina and other debtor nations seldom acknowledge and honor these arbitral awards, rendering them worthless. Tsai-Yu Lin, *Systemic Reflections on Argentina's Non-Compliance with ICSID Arbitral Awards: A New Role of the Annulment Committee at Enforcement?*, 5 CONTEMP. ASIA ARB. J. 1, 2 (2012).

36. *See* Weidemaier, *supra* note 33, at 335-36 (explaining that in modern times, most creditors prefer litigating these disputes in a national court).

37. *See id.* at 343 tbl.2 (demonstrating how English banks typically write most sovereign bonds).

38. Jeffrey M. Loeb, Strengthening Bond Creditors' Remedies Under the Foreign Sovereign Immunities Act (Apr. 27, 2004) (unpublished manuscript), http://www.law.harvard.edu/programs/about/pifs/education/llm/2003--2004/sp24.pdf.

39. *See* Republic of Argentina v. Weltover, Inc., 504 U.S. 605, 620 (1992) (holding that because the dispute fell within an exception of the FSIA, the court could properly find Argentina in breach of contract for rescheduling the payment of sovereign debt bonds). This same process is followed by most nations subscribing to the restrictive theory of foreign sovereign immunity. *See* Weidemaier, *supra* note 33, at 341 (noting that both the United States and England have adopted a restrictive theory of foreign sovereign immunity, whereby the courts may hear a dispute involving a sovereign in only a few, specific circumstances).

involving foreign nations.[40] At one time this doctrine barred U.S. courts from hearing any case implicating a sovereign.[41] Now its current statutory form "provides the 'sole basis' for obtaining jurisdiction over a foreign sovereign in the United States,"[42] requiring U.S. courts to dismiss all lawsuits against a sovereign unless the complained of act satisfies an enumerated exception.[43] The most common exception arises when a sovereign has engaged in a "commercial act," described as an activity

> carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.[44]

In making this determination, the courts must disregard any purpose motivating the sovereign's act and assess only whether a private party could have engaged in that same behavior. Said differently, the FSIA shields only distinctly sovereign behavior.[45]

The Supreme Court clarified the commercial act exception in *Republic of Argentina v. Weltover* after Argentina unilaterally reclassified and devalued a series of bonds via legislation in response to its mid-1980s financial crisis.[46] Argentina argued that because only a sovereign can enact legislation to mitigate a state credit crisis, this restructuring could not qualify as a commercial act.[47] The Court found that, pursuant to the FSIA's commercial act exception, a sovereign dispute is reviewable only if the sovereign's conduct was "(1) 'based . . . upon an act outside the territory of the United States'; (2) that was taken 'in connection with a commercial activity' of Argentina outside this country; and (3) that

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40. *See* Republic of Austria v. Altmann, 541 U.S. 677, 689 (2004) (quoting Verlinden B.V. v. Cent. Bank of Nigeria, 461 U.S. 480, 481 (1983), in finding that the Court has "'consistently . . . deferred to the decisions of the political branches—in particular, those of the Executive Branch—on whether to take jurisdiction' over particular actions against foreign sovereigns and their instrumentalities").

41. *Id.*

42. *Weltover*, 504 U.S. at 610-11.

43. *See* Foreign Sovereign Immunities Act of 1976, 28 U.S.C § 1604 (2012); *Weltover*, 504 U.S. at 610-11 ("[The] foreign state shall be immune from jurisdiction of the courts of the United States and of the States except as provided [by the FSIA].").

44. 28 U.S.C. § 1605(a)(2); *see also Weltover*, 504 U.S. at 611.

45. *See* 28 U.S.C. § 1603(d). The FSIA defines a "commercial activity" as one that resembles "either a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose." *Id.*

46. 504 U.S. at 609-11.

47. *Id.* at 616.

'cause[d] a direct effect in the United States.'"[48] Applying the facts of the case, the Court found that the contested act occurred in Argentina, satisfying the first element.[49] Argentina fulfilled the second element when it performed a commercial act "not as a regulator of a market, but in the manner of a private player within it."[50] Indeed, issuing bonds to raise money constitutes an activity in which any private actor can partake.[51] The Court then held in favor of the creditors, finding the third element satisfied because Argentina's restructuring rendered a direct effect in the United States.[52] The apparent simplicity of winning a judgment against a sovereign, though, is deceiving; it is only when the creditors win the right to payment, as in *Weltover*, does the more formidable challenge begins.

2. Step Two: The Process of Collecting from a Sovereign

Many debtor nations refuse to comply with a court order to pay damages after being found liable for defaulting on sovereign bonds.[53] Possessing a judgment but no payment, a creditor's only recourse is to take their award to a jurisdiction in which the debtor nation owns assets in hopes that a forum court will confiscate and attach the sovereign's property.[54] Again, the doctrine of foreign sovereign immunity makes this difficult, especially because a more scrutinizing section of FSIA now applies.[55] Section 1609 of the FSIA states, "[P]roperty in the United States of a foreign state shall be immune from attachment arrest and execution except as provided in sections 1610 and 1611 of this chapter."[56] Sections 1610 and 1611 then provide the only two avenues in which a creditor can attach a sovereign's U.S. property to an award, § 1610 pertaining to property owned by the actual sovereign or by its instrumentalities and § 1611 governing central bank accounts.[57]

48. *Id.* at 611 (quoting 28 U.S.C § 1605(a)(2)).
49. *Id.* at 611-12.
50. *Id.* at 614.
51. *Id.* at 615.
52. *Id.* at 620.
53. *See* Anna Gelpern, *Contract Hope and Sovereign Redemption*, 8 CAP. MARKETS L.J. 132, 132 (2013) ("Sovereign debt is unenforceable. The law can do little to make an unwilling government pay, or hand over its property to the creditors.").
54. *Id.*
55. *See, e.g.*, EM Ltd. v. Republic of Argentina, 473 F.3d 463, 472 (2d Cir. 2007) (finding that it was unable to enforce the award because "[t]he FSIA protects foreign states' property from attachment and execution . . . except under the conditions set forth in two other provisions of the FSIA" and neither exception had been met).
56. 28 U.S.C. § 1609 (2012).
57. *Id.* §§ 1610-1611; *see also* Conn. Bank of Commerce v. Republic of Congo, 309 F.3d 240, 252 (5th Cir. 2002).

Under § 1610, a private party may not attach a sovereign's property in the United States unless the sovereign has *used* that asset for a commercial activity in the United States.[58] Against this backdrop, the courts have rarely permitted creditors to attach a sovereign's property.[59] The difficulty of this situation was illustrated when creditors sought to attach assets held by two oil companies owned by the Republic of the Congo, arguing that because a commercial activity generated such assets, they were not protected by the FSIA.[60] The United States Court of Appeals for the Fifth Circuit disagreed, ruling that the FSIA requires assets to be *currently* used for a commercial activity regardless of how they were created or accrued.[61] The creditors protested that this reading would immunize nearly all sovereign property—a result that the court observed was the U.S. Congress's intent.[62]

The other section, 1611, provides special central bank safeguards to encourage nations to hold funds in the United States, considering that central banks technically constitute the more vulnerable "agencies and

58. 28 U.S.C. § 1610. The funds must actually be used for a commercial purpose; the court must dismiss how the funds were generated or produced. *Conn. Bank of Commerce*, 309 F.3d at 251. The agencies and instrumentalities subsection provides a slightly more lenient standard, because creditors may attach *any property of the sovereign's agency* if the sovereign itself has conducted commercial activity in the United States. *See* 28 U.S.C. § 1610(b); First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba, 462 U.S. 611, 627-28 (1983) ("Congress clearly expressed its intention that duly created instrumentalities of a foreign state are to be accorded a presumption of independent status. In its discussion of FSIA § 1610(b), the provision dealing with the circumstances under which a judgment creditor may execute upon the assets of an instrumentality of a foreign government, the House Report states: 'Section 1610(b) will not permit execution against the property of one agency or instrumentality to satisfy a judgment against another, unrelated agency or instrumentality. There are compelling reasons for this. If U.S. law did not respect the separate juridical identities of different agencies or instrumentalities, it might encourage foreign jurisdictions to disregard the juridical divisions between different U.S. corporations or between a U.S. corporation and its independent subsidiary.'" (quoting H.R. REP. No. 94-1487, at 29-30 (1976))). In other words, the FSIA immunizes most sovereign property, although it grants more leeway for creditors to attach property belonging to a sovereign's agencies and instrumentalities. In either case, the property must be physically located in the United States. *See* Aurelius Capital Partners, LP v. Republic of Argentina, Nos. 07Civ.2715(TPG), 07Civ.11327(TPG), 07Civ.2693(TPG), 2010 WL 2925072, at *4 (S.D.N.Y. July 23, 2010) ("The court therefore holds that the situs of the Trust Bonds is Argentina. It follows that, because the Trust Bonds are not property 'in the United States' of a foreign state, they are immune from attachment and execution under the terms of the FSIA.").

59. *See* Paul L. Lee, *Central Banks and Sovereign Immunity*, 41 COLUM. J. TRANSNAT'L L. 327, 394-95 (2003).

60. *See* Conn. Bank of Commerce, 309 F.3d at 251.

61. *Id.* at 254.

62. *Id.* at 257-58; *see also* Walker Int'l Holdings Ltd. v. Congo, 395 F.3d 229, 235 (5th Cir. 2004) (holding that the funds were not *currently* attachable even though the Congo had *previously* used them for a commercial purpose).

instrumentalities" category.[63] This protection flows to all funds "held for the bank's . . . own account—*i.e.*, funds used or held in connection with central banking activities, as distinguished from funds used solely to finance the commercial transactions of other entities or of foreign states."[64] Seldom can creditors crack this stiff firewall because it matters little how the sovereign accrued the money or how the sovereign will most likely spend it—the plain text emphasizes *current* usage.[65]

Some commentators believe that sovereigns, on occasion, deposit funds in the Federal Reserve Bank of New York (FRBNY) to shield vulnerable assets, exploiting the FSIA's central bank immunity.[66] In *EM Ltd. v. Republic of Argentina*, creditors won a judgment against Argentina and then sought to attach funds owned by Argentina's central monetary authority, Banco Central de la Republica Argentina (BCRA), held in the FRBNY.[67] These creditors specifically targeted funds that Argentina transferred to the International Monetary Fund (IMF), arguing that because Argentina used the central bank's funds to repay a debt, the Republic had exercised such dominion and control that Argentina—not the BCRA—actually owned the money.[68] If correct, this theory would strip the funds of the FSIA's central bank shield, allowing Argentina's creditors to enforce their default judgments. The court disagreed, holding that Argentina's ultimate control over the account was immaterial and denying the writ of attachment.[69] The court also mentioned that even if Argentina was the funds' true owner, the act of repaying the IMF was not a commercial activity under § 1610 because private actors cannot borrow from the IMF and the IMF's greater organizational scheme

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63. *See* Banque Compafina v. Banco de Guatemala, 583 F. Supp. 320, 323 (S.D.N.Y. 1984) (mentioning § 1611's "policy of encouraging the deposit of central bank reserves in the United States").

64. Ernest T. Patrikis, *Foreign Central Bank Property: Immunity from Attachment in the United States*, 1982 U. ILL. L. REV. 265, 277 (quoting the Executive section-by-section analysis submitted with the FSIA bill, Letter from the Dep't of State to the President of the Senate (Oct. 31, 1975) (internal quotation marks omitted)). The Second Circuit further clarified the "held for its own account" standard in *NML Capital, Ltd. v. Banco Central de la Republica Argentina*, 652 F.3d 172, 194 (2d Cir. 2011) ("[P]roperty of a central bank is immune from attachment if the central bank uses such property for central banking functions as such functions are normally understood, irrespective of their commercial nature." (quoting Patrikis, *supra*, at 277 (internal quotation marks omitted))).

65. *Id.*

66. *See* Lee, *supra* note 59, at 394 n.250 ("In the event of a financial problem in the home country, the dollar accounts of the central bank will likely swell as the government directs its agencies, instrumentalities and private sector entities to consolidate their dollar holdings in the accounts of the central bank.").

67. 473 F.2d 463, 468-69 (2d Cir. 2007).

68. *Id.* at 474.

69. *Id.* at 480.

regulates intersovereign relationships.[70] Therefore, FSIA places almost all funds held by sovereign bank accounts out of reach from creditors.

Others believe creditors would have more success enforcing judgments delivered by an international arbitral body[71]—a contention that the record does not support.[72] This theory follows that because the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention)[73] requires signatories to honor foreign arbitral awards, it thus compels the facilitation of a creditor's judgment.[74] Some arbitral organizations also receive their authority from the same international organizations on which most developing nations depend, such as the relationship between the International Centre for Settlement and Investment Dispute's (ICSID) and the IMF, which possibly incentivizes debtor nations to honor arbitral judgments.[75] The problem is that enforcement of arbitral awards requires the same FSIA analysis that has made judgments rendered by foreign courts moot,[76] and, indeed, Argentina has recently ignored several ICSID

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70. *Id.* at 483 ("The Republic agreed to many economic policy and regulatory reform measures in exchange for the IMF loans that were ultimately repaid in 2005.").

71. *See* Ellie Norton, *International Investment Arbitration and the European Debt Crisis*, 13 CHI. J. INT'L L. 291, 301 (2012) ("While the ICSID Convention does recognize sovereign immunity, ICSID awards are more likely to be followed than the awards of national courts or other international arbitral panels . . . .").

72. *See, e.g.*, Lin, *supra* note 35, at 2 (demonstrating that Argentina rejects ICSID awards just like any other adverse judgment).

73. June 10, 1958, 330 U.N.T.S. 38 [hereinafter New York Convention].

74. *See* Yusuf Ahmed Alghanim & Sons, W.L.L. v. Toys "R" Us, Inc., 126 F.3d 15, 19 (2d Cir. 1997) (stating that U.S. courts must enforce a nondomestic arbitral award, rendered by another signatory country, unless one of five enumerated exceptions exist, including incapacity, lack of proper notice, the subject matter was not agreed to be arbitrated, the composition of the arbitral panel differed from upon which was agreed, and the award was annulled by a court at the seat of arbitration).

75. *See* Norton, *supra* note 71, at 301 ("[D]ebtor countries may fear that noncompliance with ICSID awards will result in negative attention from the World Bank and its partners. . . . If noncompliance did become an issue, the World Bank and/or the IMF could threaten debtor countries with a funding cut-off, or refuse to extend further loans, for failure to recognize ICSID awards. This would truly give ICSID rulings bite." (footnotes omitted)).

76. *See* Exp.-Imp. Bank of China v. Grenada, 876 F. Supp. 2d 263, 265-66 (S.D.N.Y. 2012) (applying the standard statutory analysis of the FSIA to an arbitral award and ruling that the sovereign's property was not being used for a commercial purpose and thus could not be attached pursuant to 28 U.S.C. § 1610 (2012)); George K. Foster, *Collecting from Sovereigns: The Current Legal Framework for Enforcing Arbitral Awards and Court Judgments Against States and Their Instrumentalities, and Some Proposals for Reform*, 25 ARIZ. J. INT'L & COMP. L. 665, 672 (2008).

rulings.[77] As long as most foreign sovereign immunity statutes deny courts subject matter jurisdiction, creditors will find payment elusive.[78]

B. The NML Capital *Decisions: How the* Pari Passu *Clause May Overhaul the Process of Collecting from a Sovereign*

A couple of vulture funds may have finally found a way to avoid the obstacles set forth by the FSIA by alleging that Argentina breached a common sovereign-bond term known as the *pari passu* clause. Even though creditors have sought repayment using numerous legal theories, they had ignored the *pari passu* clause, possibly because its history and meaning remain a source of confusion.[79] The phrase literally interpreted from Latin means "in equal step."[80] Almost all debt instruments include a variation thereof, adopting language akin to, "The bonds and the coupons are direct, unconditional and unsecured obligations of the issuer and rank and will rank at least *pari passu*, without any preference among themselves, with all other outstanding, unsecured and unsubordinated obligations of the issuer, present and future."[81] Buchheit and Pam's survey found one historical source that explained:

> There is no special virtue in the words "*pari passu*," "equally" would have the same effect, or any other words showing that the [debt instruments] were intended to stand on the same level footing without preference or priority among themselves, but the words *pari passu* are adopted as a general term well recognized in the administration of assets in courts of equity.[82]

This explanation though does not necessarily resolve what the "equal payment" declaration requires.

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77. *See, e.g.*, Lin, *supra* note 35, at 2 (mentioning Argentina's rejection of an adverse ICSID judgment).

78. Gelpern, *supra* note 53, at 148.

79. *See, e.g.*, *NML Capital II*, 699 F.3d 246, 265 (2d Cir. 2012) (affirming the district court's ruling that *pari passu* means ratable payments); Elliott Assocs., L.P., Hof van Beroep [HvB] [Court of Appeal] Bruxelles, 8ème Sept. 26, 2000, AQR 2000/QR/92 (Belg.). *But see* 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. 39, 47-48 (2011) (arguing that the cases in which the courts found that *pari passu* requires ratable payment were errant because the purpose "is to ensure that if one creditor is paid more, the others will be paid as well—it works as an inverse cross-default clause").

80. Lee C. Buchheit & Jeremiah S. Pam, *The* Pari Passu *Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869, 871 (2004).

81. Blackmun & Mukhi, *supra* note 7, at 55 n.45; *see also* Buchheit & Pam, *supra* note 80, at 871 ("The Notes rank, and will rank, *pari passu* in right of payment with all other present and future unsecured and unsubordinated External Indebtedness of the Issuer.").

82. Buchheit & Pam, *supra* note 80, at 871 (quoting FRANCIS B. PALMER, COMPANY PRECEDENTS 109-10 (8th ed. 1900)).

One interpretation is that the *pari passu* clause demands equal ranking, not payments, meaning that debtors may not issue new bonds with a superior rank.[83] Another theory indicates that because "*pari passu*" is a term meant for bankruptcy courts—a venue in which foreign sovereigns will never litigate—the term must carry a unique meaning when used in sovereign bonds.[84] Accordingly, Olivares-Caminal found that because sovereigns are free to subordinate creditors without following bankruptcy guidelines, *pari passu* most likely bars sovereigns from using noncontractual methods to pay favored creditors.[85] This would refer to the act of issuing more favorable bonds, side payments, or other benefits to a specific group of creditors. Another possible reading prevents sovereigns from using legislative tools to reduce a creditor's priority below that of other creditors, which was once a common technique.[86] Adopting this interpretation, though, may contravene historical practices, considering that sovereigns have always paid international organizations, such as the World Bank and the IMF, before private parties.[87] Indeed, this greater lack of consensus appears quite odd considering that corporate lawyers typically embrace predictable and clear terms;[88] nevertheless, little agreement exists despite *pari passu*'s popularity.[89] It was not until the year 2000 that the vulture fund Elliott Associates, L.P. (Elliott), in a claim against Peru, first achieved a level of success litigating the *pari passu* clause.[90]

1. *Elliott Associates, L.P.*

Peru offered its creditors modified government bonds, devalued from their original issue, and then threatened to deny future payments to those who refused restructuring.[91] Elliot declined and alleged, in a

83. *See* Umakanth Varottil, *Sovereign Debt Documentation: Unraveling the* Pari Passu *Mystery*, 7 DEPAUL BUS. & COM. L.J. 119, 126 (2008).

84. *See id.* at 127; Buchheit & Pam, *supra* note 80, at 874.

85. Olivares-Caminal, *supra* note 79, at 46.

86. *See* Varottil, *supra* note 83, at 121-22.

87. *Id.*

88. *See* Weidemaier et al., *supra* note 21, at 72 (noting that the authors approached the subject of their work after wondering why sovereign debt lawyers continued to include the *pari passu* clause in future contracts even after most thought that the courts poorly understand the term).

89. *See id.* at 72-74; Olivares-Caminal, *supra* note 79, at 46.

90. Elliott Assocs., L.P., Hof van Beroep [HvB] [Court of Appeal] Bruxelles, 8ème Sept. 26, 2000, AQR 2000/QR/92 (Belg.). While possibly some other creditors sought to litigate the *pari passu* clause, the historical record is bereft of recent examples. For instance, most books covering the sovereign bond disputes written before the *Elliott* litigation do not mention the *pari passu* clause a single time. *See, e.g.*, TOMZ, *supra* note 24.

91. Varottil, *supra* note 83, at 121.

Belgian court, that Peru breached their bonds' *pari passu* clause by subordinating Elliott's claim below those who had agreed to the exchange.[92] Said differently, Elliott argued that *pari passu* means Peru could not favor creditors who agreed to the discount over the holdouts, but both must be paid *ratably* regardless of one's willingness to restructure.[93] The Belgian court agreed, issuing an injunction against Chase Manhattan and Euroclear (the banking system tasked with paying the bonds),[94] paralyzing Peru's ability to service its loans.[95] Fearing that the court's holding would lead to a total default,[96] Peru settled with Elliott, paying almost the entire value of the original bonds.[97] The vultures had finally won.

Many observers, including most academics, were shocked and dismayed by *Elliott Associates, L.P.*.[98] There was something distasteful about a powerful hedge fund purchasing bad debt in order to siphon money out of a developing nation.[99] More problematic was how *Elliott* might encourage other vulture funds to seek bad debt on the secondary market with the purpose of dragging developing nations, and their scarce resources, into litigation.[100] This prediction proved accurate. NML Capital, Ltd. (NML) initiated a similar strategy against Nicaragua, which prompted Brussels to enact legislation barring its courts from issuing

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92. *Id.* at 120-21.

93. *See* Corrected Joint Response Brief of Plaintiffs at 22-27, *NML Capital II*, 699 F.3d 246 (2d Cir. 2012) (No. 12-105-cv(L)).

94. Olivares-Caminal, *supra* note 79, at 43.

95. Varottil, *supra* note 83, at 121.

96. Sovereigns are primarily motivated to repay loans because default would hurt their lending reputation. Similar to how credit ratings work for private parties, a greater severity of nonpayment, such as a bankruptcy, does more to harm a credit rating than a minor breach. Therefore, sovereigns will most likely be much more hesitant to completely default, as opposed to devalue the bonds. *See* TOMZ, *supra* note 24, at 26-27.

97. *Id.*

98. *See* Weidemaier et al., *supra* note 21, at 74 (writing that most people disagreed with the holding).

99. *See, e.g.*, Elizabeth Broomfield, *Subduing the Vultures: Assessing Government Caps on Recovery in Sovereign Debt Litigation*, 2010 COLUM. BUS. L. REV. 473, 475 ("[A vulture fund, as an actor in the secondary market,] not only refuses to participate in any voluntary restructuring, but often attempts to use litigation to collect the full face value of its claim from the sovereign debtor. Many poor countries, especially in African and Latin America, are considered easy prey for these funds. . . . Vultures also cause damage by interfering with the orderly restructuring of sovereign debt.").

100. *See* Buchheit & Pam, *supra* note 80, at 880-81 (enumerating a list of cases brought by creditors using a *pari passu* theory immediately after the *Elliott* decision); Olivares-Caminal, *supra* note 79, at 49 ("After the decision of the Belgium court in the *Elliott* case, other cases followed. Creditors were willing to benefit from the broad or 'payment' interpretation." (footnote omitted)).

injunctions against Euroclear.[101] English courts have also refused to follow *Elliott*'s lead by ruling that *pari passu* does not stand for ratable payment.[102] But nonetheless, *Elliott* foreshadowed how future creditors could possibly find success.

2. The *NML Capital* Decisions

The next chapter began soon after Argentina's 2001 financial crisis, when the Republic sought creditor approval to modify and devalue bonds down to 25-30% of their original issuance.[103] Fearing that some creditors would not accept these new bonds, Argentina passed the Lock Law, which denied payment to those who refused to participate in the restructuring.[104] Argentina's creditors faced a Hobson's choice about whether to accept the new bonds or to hold out and possibly forfeit their entire investment.[105] Considering the dim chance of overcoming the doctrine of foreign sovereign immunity, more than nine out of every ten creditors agreed to Argentina's terms.[106]

Encouraged by *Elliott*, NML brought suit in the United States District Court for the Southern District of New York, where a veteran judge of the debt crisis, Thomas Griesa, presided.[107] It immediately became clear that years of sovereign defiance had turned Judge Griesa unsympathetic towards Argentina's traditional defenses.[108] Following *Elliott*'s lead, Judge Griesa determined that the bonds' *pari passu* clause

101. *See* Olivares-Caminal, *supra* note 79, at 52 ("Although the EU Settlement Finality Directive does not prevent attachments, the objective in reinforcing the law implementing this Directive was to shield the flow of funds through Euroclear.").

102. *See* Buchheit & Pam, *supra* note 80, at 881 ("In April 2003, Kensington International Ltd., a creditor of the Republic of Congo (Congo-Brazzaville), sought summary judgment in London on a money claim against Congo-Brazzaville, as well as an order from the High Court in London restraining the defendant from paying its other creditors without making a pro rata payment to Kensington. The legal basis for the requested order was a *pari passu* clause in a loan agreement. The English trial judge apparently viewed this motion for injunctive relief as 'novel and unprecedented,' and he denied it. On appeal, the Court of Appeals affirmed that denial." (footnotes omitted)).

103. *See NML Capital II*, 699 F.3d 246, 251-52 (2d Cir. 2012).

104. *Id.*

105. Argentina provided a prospectus with the modified bond offering, warning creditors: "Existing defaulted bonds eligible for exchange that are not tendered may remain in default indefinitely. . . . The Government has announced that is has no intention of resuming payment on any bonds eligible to participate in [the] exchange offer . . . ." *Id.* at 252 (emphasis omitted).

106. *See* Gelpern, *supra* note 53, at 178; Boris Van Voris, *Argentina Loses U.S. Appeal of Defaulted Bonds Case*, BLOOMBERG NEWS (Aug. 23, 2013, 3:02 PM), http://www.bloomberg.com/news/2013-08-23/argentina-loses-u-s-appeal-of-defaulted-bonds-case.html.

107. *See NML Capital II*, 699 F.3d at 250 (mentioning that the case arrived at the Second Circuit for the first time after Judge Griesa issued an initial injunction).

108. *See* Gelpern, *supra* note 53, at 139.

required ratable payments, which Argentina breached when it paid only those who accepted restructuring. Said differently, the court determined that *pari passu* bars favoritism, requiring Argentina to pay the full value of the holdout creditors' bonds as long as it chooses to make payments on the modified bonds. The court then issued an injunction estopping Argentina from making payments without likewise compensating the holdouts.[109]

Considering that many courts had already issued hollow judgments against Argentina, Judge Griesa added teeth to his order by enjoining those "in active concert or participation," including the banks and financial systems that facilitate bond payment.[110] Because banks must adhere to the injunction—since they cannot rely upon the FSIA[111]—they now have only two options: pay both the submissive and holdout creditors alike or pay neither one. Like in *Elliott*, this result could compel Argentina to pay the debt's entire principle and interest, assuming that Argentina wishes to avoid the fallout attendant to a complete and total breach.[112] Judge Griesa's order also showed little sympathy to the creditors who participated in the restructuring, ruling that they would have to survive on the modified value to which they agreed.[113]

Argentina appealed the injunction, and in August 2013, the Second Circuit affirmed the district court's equitable remedy in favor of NML.[114] From the start, the Second Circuit expressed agreement with the district

109. *NML Capital II*, 699 F.3d at 250.

110. *See id.* at 255.

111. *Id.*; Gelpern, *supra* note 53, at 134 ("The unique significance of the *pari passu* remedy is that by its very nature, it targets everyone 'but' Argentina. Argentina could do no worse than it has done already: it has refused to pay judgments in favor of the holdouts, and has been squirrelling away its things to avoid seizure. A country cannot be jailed or held in contempt of court. . . . In contrast, the various market actors heretofore on the sidelines in the fight between Argentina and NML have suddenly become NML's principal targets, levers and opponents." (footnote omitted)).

112. In a case with very similar facts and legal analysis, Peru almost fully compensated its creditors when a Belgian court enjoined its payments to participating creditors when Peru refused to compensate the holdouts, violating the *pari passu* clause. Peru felt compelled to honor the full value of the bonds rather than default, considering that a total default would have most likely destroyed Peru's credit reputation and attendant ability to receive credit in the future. In contrast, a modest restructuring can harm a sovereign's creditor rating, though not to extent of a total bankruptcy. *See* Olivares-Caminal, *supra* note 79, at 44-45 ("This scenario forced Peru to reach an agreement with Elliott in order to avoid a new default on its restructured debt under the auspices of the 'Brady Plan.'").

113. *See* NML Capital, Ltd. v. Republic of Argentina (*NML Capital III*), No. 08 Civ. 6978CTPG, 2012 WL 5895786 (S.D.N.Y. Nov. 12, 2012).

114. *NML Capital IV*, 727 F.3d 230, 238 (2d Cir. 2013). The Second Circuit's August 2013 ruling in *NML Capital IV* concerned only the legality of the injunction. The district court's holding that Argentina violated the *pari passu* clause was affirmed by the Second Circuit in their 2012 *NML Capital II* decision. *See* 699 F.3d 246.

court's description of Argentina's almost cavalier willingness to default, recounting many of the ways in which the Republic breached expressed terms of its bonds:

> Argentina promised periodic interest payments. Argentina promised that the bonds would be governed by New York law. Argentina promised that, in the event of default, unpaid interest and principal would become due in full. Argentina promised that any disputes concerning the bonds could be adjudicated in the courts of New York. Argentina promised that each bond would be transferable and payable to the transferee, regardless of whether it was a university endowment, a so-called "vulture fund," or a widow or an orphan. Finally, Argentina promised to treat the [Fiscal Agency Agreement (FAA)] Bonds at least equally with its other external indebtedness.[115]

The court then upheld the creditors' injunction, finding that the district court's order complied with the FSIA, did not improperly affect the intermediary banks,[116] and would not inequitably harm those creditors who voluntarily joined the restructuring effort[117] because, after all, Argentina *could* pay all of its creditors even though it would rather not.[118] Furthermore, the Second Circuit ruled that the public policy concerns raised by Argentina were overstated and hyperbolic.[119] But despite the court's seemingly clear language, these holdings left plenty of room for

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115. *Id.* at 237.

116. *Id.* The court ruled that the district court had not improperly overstepped its bounds by issuing an injunction affecting the intermediary banks, such as Euroclear, which only facilitate capital transfers. The court noted that the injunctions enjoined only Argentina, though common legal practices prevent third parties from pursuing acts that would impede a lawful injunction. In other words, the injunctions were proper despite their adverse effect on the banks. *Id.* at 239. Properly issued injunctions can enjoin behavior that occurs beyond the court's jurisdiction, allowing the injunction's extraterritorial application. *Id.* at 243. The court then also disagreed with Argentina's contention that the district court ruling violated section 502 of the U.C.C.: "Section 502 is not controlling because the amended injunctions do not constitute, or give rise to, 'creditor process,' essentially defined in the statute as a levy or attachment. The cases cited by Argentina are inapposite because they deal with attachments, and as we have seen, none has occurred here." *Id.* at 244. The court then dismissed the U.C.C. section 503 complaint. *Id.* at 245.

117. The intermediaries presented this argument using several different theories. The court recounted:

> The arguments include that (1) the district court lacks personal jurisdiction over payment system participants and therefore cannot bind them with the amended injunctions, (2) the amended injunctions cannot apply extraterritorially, (3) payment system participants are improperly bound because they were denied due process, and (4) the amended injunctions' application to financial system participants would violate the U.C.C.'s protections for intermediary banks.

Id. at 242-43.

118. *Id.* at 238 ("Moreover, Argentina's officials have publicly and repeatedly announced their intention to defy any rulings of this Court and the district court with which they disagree.").

119. *Id.* at 246.

interpretation, clouding predictions of what this case means to the future of the sovereign debt market.

C. Analysis and the (Most Likely) State of Sovereign Debt After the NML Capital *Decisions*

The question now is whether the sovereign debt market will continue as before—where the doctrine of foreign sovereign immunity defeated nearly all lawsuits—or whether it will resemble the *NML Capital* decisions where sovereign debtors must honor the value of their bonds. Considering that the court's interpretation of the FSIA and the *pari passu* clause could substantially alter the sovereign bond market, the court's failure to issue an articulate opinion might frustrate future debtors, creditors, and courts.[120] After all, the Second Circuit found that the district court's injunction did not violate the FSIA because it did not "attach, arrest, or execute upon" Argentina's property since Argentina may still honor their bonds however it prefers.[121] Said differently, the Second Circuit ostensibly asserted a legally significant distinction separating the act of forcibly seizing *specific resources* from staking a claim over an equivalent dollar amount. According to the Second Circuit, the FSIA only governs actual "seizure and control," although its holding effectively creates restraints and obligations upon Argentina's funds—a scenario that the court suggested only "incidentally" affected sovereign property.[122] Even though both acts exercise some form of "control" over Argentinian assets, providing the sovereign with a choice in how it must pay creditors pulled the injunction out of the FSIA.

This rationale lacks persuasiveness. In coming to this conclusion, the Second Circuit's distinction dismissed the spirit and function of the FSIA, and while that does not necessarily mean it ruled erroneously, a more tenuous inference should give way to concrete direction. Here, at least two of the FSIA's foundational principles apply, and both suggest that the holding misinterpreted the statute. First, Congress enacted the FSIA to vest the Executive Branch with primary authority over disputes implicating international affairs.[123] If the Judiciary harbored uncertainty

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120. *See* Felix Salmon, Elliott v. Argentina*: It's Not Over Yet*, REUTERS (Aug. 23, 2014, 2:35 PM), http://blogs.reuters.com/felix-salmon/2013/08/23/elliott-vs-argentina-its-not-over-yet/ ("The ruling, written by judge Barrington Parker, is not exactly a model of pellucid clarity; rather, it's messy and scrappy and very narrowly argued.").

121. *NML Capital IV*, 727 F.3d at 240.

122. *Id.* at 262.

123. *See supra* notes 40-41 and accompanying text.

about whether the FSIA applied, and it did,[124] the court should have chosen an option allowing the Executive an opportunity to determine Argentina's fate. Several cases have also noted that Congress drafted the FSIA to set a high bar safeguarding sovereign property,[125] and thus, when uncertain about how to interpret the FSIA, courts should err in a direction leaving a sovereign's property untouched.[126] Considering these presumptions, the court could have, and probably should have, interpreted the FSIA as immunizing Argentinian resources. But now the injunction compelling ratable payment has the effect of seizing or arresting funds handled by Argentina provided that the Republic abides by the terms of the exchange bonds. The court did, however, invite the Supreme Court to disagree with its rationale.[127]

Equally as troubling was the Second Circuit's inability to provide guidance regarding which future cases the *NML Capital* decisions would control, further clouding where the law stands. After all, the Second Circuit went to great lengths to suggest that *NML Capital IV*'s holdings do not control all future sovereign bond disputes, including those implicating the *pari passu* clause, stating, "We simply affirm the district court's conclusion that Argentina's extraordinary behavior was a violation of the particular *pari passu* clause found in the FAA."[128] But what exactly does that mean? The court paid particular attention to Argentina's lengthy and sordid history of defaulting, though this hardly seems relevant in assessing the merits of an independent contract dispute.[129] But because the court failed to issue guidance or a principled method for future courts to distinguish the cases in which a sovereign has even implicated the *pari passu*, not to mention breached it, the traditional debtor-friendly approach may continue to apply unless an extreme case, such as that of the *NML Capital* decisions, surfaces. The other possibility is that future courts could routinely demand ratable payments because the *NML Capital* decisions seem to control all similar cases. There is little to distinguish between either outcome.

Regardless of whether the *NML Capital* decisions will alter the sovereign bond landscape, market failure and inefficiency will likely

124. *NML Capital IV*, 727 F.3d at 241 (noting that while the court expressed confidence in its interpretation, if the Supreme Court disagreed, it should review and overrule).

125. *See supra* Part II.B.2.

126. *See* Conn. Bank of Commerce v. Republic of Congo, 309 F.3d 240, 257-58 (5th Cir. 2002); Walker Int'l Holdings Ltd., 395 F.3d 229, 235 (5th Cir. 2004).

127. *NML Capital IV*, 727 F.3d at 241 ("Absent further guidance from the Supreme Court, we remain convinced that the amended injunctions are consistent with the FSIA.").

128. *Id.* at 247.

129. *Id.* at 237-38.

continue for several reasons. After a private party defaults, a bankruptcy court can offer an equitable process whereby creditors suffer some loss and debtors repay a fair share. In contrast, creditors in the sovereign debt market must seek self-help mechanisms, often leading to inefficient litigation. Transferring the debtors' power to the creditors will likewise encourage sovereigns to adopt wasteful behavior to circumvent the rules imposed by the Second Circuit. If the *NML Capital* decisions now control, sovereigns will likely just draft around it. For instance, after *Elliott*,[130] Europe passed legislation to impede vulture funds and negate the *pari passu* clause, which could persuade debtors to draft bonds using European banks and payment systems instead of the New York counterparts.[131] Many, including the Second Circuit, also believe that the recent introduction of collective actions clauses could provide sovereigns with a contractual mechanism to restructure bonds without running afoul of the *pari passu* clause.[132] Or the banks could simply exclude the *pari passu* clause in future bonds. These considerations suggest that even if the *NML Capital* decisions become the rules by which courts interpret *pari passu* clauses, sovereigns could navigate future disputes out of New York and into more friendly jurisdictions. The point is that as long as one party dominates a lending relationship, the other will likely adopt costly strategies to avoid forfeiture. Switching the power to the creditors would just re-create the prior system, but instead, place the sovereigns on the offensive.

The Second Circuit declined to review *NML Capital IV* en banc,[133] and in light of the parties who have shown a significant interest, many

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130. Elliott Assocs., L.P., Hof van Beroep [HvB] [Court of Appeal] Bruxelles, 8ème Sept. 26, 2000, AQR 2000/QR/92 (Belg.).

131. *See* Olivares-Caminal, *supra* note 79, at 52 ("[T]he EU Settlement Finality Directive does not prevent attachments, the objective in reinforcing the law implementing this Directive was to shield the flow of funds through Euroclear.").

132. Most bonds can only be modified if all of the creditors agree to the change. This dynamic requires sovereigns to seek creditor consent, even if some of the tactics use may be coercive. Collective actions clauses (CACs) are contract terms that endeavor to help sovereigns restructure by reducing the critical number of creditors needed to consent a supermajority. CACs have become modern practice, though the FAA bonds in the *NML Capital* decisions lacked it. Some commentators, including the *NML Capital IV* court, believe that this case would never have occurred if the bonds included a CAC. *See* 727 F.3d at 247. Though it has been noted, including from the *NML Capital IV* court, that these terms may be ineffective because a supermajority of creditors may logically refuse to restructure if a larger payout can be expected from holding out. *Id.* at 247-48. For more on the subject, see W. Mark C. Weidemaier & Mitu Gulati, *A People's History of Collective Action Clauses*, 54 VA. J. INT'L L. 51 (2013).

133. *See* Lawrence Hurley, *U.S. Top Court Agrees To Hear Argentina Bank Subpoenas Case*, REUTERS (Jan. 10, 2014, 3:30 PM), http://www.reuters.com/article/2014/01/10/us-usa-court-argentina-idUSBREA0914420140110 (stating that the Supreme Court agreed to hear a related case between Argentina and NML).

believe that the Supreme Court will grant certiorari.[134] The Obama Administration, for instance, warned that if NML prevails, foreign nations could abandon U.S. banks in favor of more hospitable venues.[135] U.S. property abroad could also come under threat from debtor nations, miffed by the Second Circuit's circumvention of foreign sovereign immunity.[136] The global community has also argued that the Second Circuit has undermined how restructurings occur within the international system, as a ratable payment scheme would bar sovereigns from prioritizing the IMF and World Bank.[137] Others have noted that bankruptcy and reorganization principles instruct that all loans come with risk, and thus, an equitable settlement should result in a creditor "haircut."[138] Instead, the Second Circuit's affirmation essentially makes the court a complete insurer of sovereign debt.[139] Equally as distasteful was the perception that the Second Circuit has encouraged vulture funds to purchase more distressed debt with the purpose of waging costly litigation. The point is that both routes lead to the same inefficient location, and thus, it matters little—in a market economy sense—which legal framework prevails.

III. THE LAW AND ECONOMICS OF REMEDIES AND BREACHED CONTRACTS

This Part introduces a law and economics approach which seeks to explain when and why rational actors breach (sovereign) bonds in a manner producing market failure. Economic principles assume that rational actors—such as sovereign debtors and creditors—respond predictably to defined conditions and stimuli and, thus, the incentive structures in which they operate explains their behavior. Here, it becomes apparent that market failure results from rational behavior

134. *See* Petition for Writ of Certiorari, *NML Capital II*, 699 F.3d 246 (2d Cir. 2012) (No. 12-105-cv(L)), *and NML Capital IV*, 727 F.3d 230 (2d Cir. 2013) (No. 12-105-cv(L)); Hurley, *supra* note 133. In October 2013, the Supreme Court denied Argentina's petition for writ of certiorari from the Second Circuit's 2012 decision in *NML Capital II*. Republic of Argentina v. NML Capital, Ltd. (*NML Capital V*), 134 S. Ct. 201 (2013). In February of this year, Argentina filed another petition for writ of certiorari from both the Second Circuit's 2012 decision in *NML Capital II* and 2013 decision in *NML Capital IV*. *See* Petition for Writ of Certiorari, *supra*.

135. *See* Brief for the United States of American as *Amicus Curiae* in Support of the Republic of Argentina's Petition for Panel Rehearing and Rehearing *En Banc* at 1, 5, *NML Capital II*, 699 F.3d 246 (No. 12-105-cv(L)).

136. *Id.*

137. *See* Brief for *Amicus Curiae* Professor Anne Krueger in Support of the Republic of Argentina and Reversal at 11, *NML Capital II*, 699 F.3d 246 (No. 12-105-cv(L)).

138. "Haircut" is a commonly used industry term meaning the diminished value received by a creditor relative to the value the creditor expected at the time of making the investment.

139. *See* Broomfield, *supra* note 99, at 487-88.

whenever a contracting party lacks (to some degree) a predictable, affordable, and/or effective remedy after a breach. This approach also provides guidance about how these incentive structures can be altered or amended so that sovereign bonds can, instead, produce a net sum of socially beneficial externalities. Indeed, because sovereign bonds are contracts traded within a market like other debt instruments, a solution used by similar types of contracts may apply to sovereign debt by analogy. In fact, this Article suggests in Part IV that the nineteenth-century agrarian loan market suffered from similar inefficiencies, prompting farmers and bankers to create a remedy which could possibly be incorporated into sovereign lending practices. But in order to do so, this Article first explores, theoretically, why contracts like sovereign bonds should be expected to function so poorly.

Contract performance significantly affects economic efficiency,[140] which is defined as a condition "when market transactions render the greatest sum of goods for the lowest possible cost."[141] While the law generally seeks to encourage efficiency, it is important to note that effective contracts do not, and should not, always compel contracting parties to perform their specified promise. The corollary suggests that

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140. Benjamin E. Hermalin et al., *Contract Law*, *in* HANDBOOK OF LAW AND ECONOMICS 7 (A. Mitchell Polinski & Steven Shavell eds., 2007) ("The essence of a free-market economy is the ability of private parties to enter into voluntary agreements that govern the economic exchange between them. Consequently, the law that governs such agreements is critical to the functioning of such economies."). The most common avenues of study with respect to the adequacy of contractual remedies upon market efficiency involve the manner in which private parties contract or conduct business in lesser-developed countries when the courts cannot be expected to adequately remedy private disputes and how the effects thereof can hinder economic growth. *See, e.g.*, HERNANDO DE SOTO, THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE (2000); WITOLD JERZY HENISZ, POLITICS AND INTERNATIONAL INVESTMENT: MEASURING RISKS AND PROTECTING PROFITS (2002); NATHAN M. JENSEN, NATION-STATES AND THE MULTINATIONAL CORPORATION: A POLITICAL ECONOMY OF FOREIGN DIRECT INVESTMENT (2006); LOUIS T. WELLS & RAFIQ AHMED, MAKING FOREIGN INVESTMENT SAFE: PROPERTY RIGHTS AND NATIONAL SOVEREIGNTY (2007); S.F. Joireman, *The Mystery of Capital Formation in Sub-Saharan Africa: Women, Property Rights and Customary Law*, 36 WORLD DEV. 1233, 1234 (2008). Few works, however, have examined the effect on developed countries from a distinctly legal perspective. Indeed, it is typically assumed as a given that sophisticated parties in established legal systems have an available and constant legal remedy to redress harm.

141. *See* ROBIN PAUL MALLOY, LAW IN A MARKET CONTEXT: AN INTRODUCTION TO MARKET CONCEPTS IN LEGAL REASONING 27 (2004) ("[Economists assume] that in competitive markets, marginal private benefits equal marginal social benefits, and marginal private costs equal marginal social costs. This means that self-interest equals the public interest, and that there are no negative or positive externalities from market exchange. . . . The same idea dates back all the way back to Adam Smith and his notion of the invisible hand. Smith argued, for instance, that when individuals pursue their own self-interest, they end up promoting the public interest even though it is not part of their original intention." (footnotes omitted)).

sometimes efficient markets actually prefer a breach.[142] Judge Richard Posner argued that a breach does not necessarily imply that a party has acted badly or even undesirably, since the refusal to perform can lead to a more efficient and/or mutually beneficial outcome.[143] An unforeseen event, for example, can both substantially raise a seller's performance cost and create unnecessary delay, in which case all parties would probably prefer the seller to pay expectation damages instead of doggedly adhering to the contract's express terms.[144] Said differently, well-functioning markets encourage contracting parties to breach an agreement when doing so would more efficiently allocate resources.

This logic holds only as long as an injured contractee has a remedy available because otherwise, parties would routinely refuse performance upon receiving their side of the bargain.[145] Consider the economics of a breach. Economists assume that self-interested actors choose strategies that will likely produce their greatest set of benefits. When an adequate contractual remedy exists, the nonbreaching party will receive either the contract's explicit promise or replacement consideration of the same value.[146] This dynamic gives the first party the choice of either breaching or fulfilling the contract (whichever option will produce that party's greatest benefit under the circumstance) without making the second party any worse off from what was originally expected.[147] Said differently, adequate remedies encourage socially efficient behavior because the party who is contemplating a breach will typically choose their best option when considering the cost of paying damages while the other

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142. *See* RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 149-51 (8th ed. 2010) (citing Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897)). Some breaches are efficient and efficiently distribute resources; for instance, society should and does actually encourage some forms of breach if the breach puts at least one of the parties in a better situation and the other is not actually harmed. *Id.*

143. *Id.*; *Richard Posner: "Let Us Never Blame a Contract Breaker*,*"* U. CHI. L. SCH. (Jan. 15, 2009), http://www.law.uchicago.edu/node/1523 (explaining that scholars should avoid speaking of contract breaches using normative terms; instead, contracts should be viewed generally as an option to perform or to put the other party into the same place she would have been if the breaching party performed).

144. POSNER, *supra* note 142, at 152.

145. E. Allan Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145 (1970) ("Why do men keep their promises?"); *see also* HERMALIN ET AL., *supra* note 140, at 103 ("[A] remedy of expectation damages creates exactly this incentive, as long as those damages are accurately measured.").

146. *See* HERMALIN ET AL., *supra* note 140, at 102 ("Suppose that a seller must decide whether to perform a contract, at a cost c, when performance will confer on the buyer a value v. Total welfare is maximized if the seller performs when and only when $v \geq c$. Otherwise, it would be more efficient for the seller not to perform, an outcome often referred to as 'efficient breach.'").

147. *Id.*

party will receive the same value either way.[148] But without an effective remedy, self-interested behavior will often rob the nonbreaching party of their contracted benefit especially if they have already performed. More importantly, these forms of breaches harm the marketplace because the contract has now produced a diminished sum of goods for the same value.[149]

Adequate remedies need not always come from the Judiciary because there are a few scenarios that encourage cooperation without an enforcement mechanism. For example, those who interact frequently tend to guard their reputation in order to promote future dealings.[150] If a party refuses to perform their side of the bargain after receiving their agreed-upon benefit (without paying damages), then those who witnessed the cheating may avoid interacting with that party in the future.[151] Accordingly, parties tend to voluntarily and routinely abide by agreements when the attendant reputational damages exceed the benefits gained from breaching.[152]

This analysis has so far omitted a substantial assumption: the proposition that breached contracts will put the injured party into the same place as the bargained for promise ignores the looming presence of transaction costs. Transaction costs refer to all of the more hidden costs necessary to complete a transaction, which influence the deal's overall efficiency and wisdom.[153] For example, paying $1000 for a used car often costs the buyer substantially more than the sticker price because the buyer must spend time and resources investigating the reliability of the car, hire a mechanic to inspect the automobile, and invest time and resources to haggle with the dealer. Similarly with sovereign debt, even

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148. *Id.*; *see also* POSNER, *supra* note 142, at 150-51 (discussing the concept of the efficient breach).

149. *See* Jules L. Coleman et al., *A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law*, 12 HARV. J. L. & PUB. POL'Y 639, 640 (1989). A Pareto optimal contract "puts the parties to it in a position where neither can improve his or her lot except at the other's expense." *Id.* It then follows that breaches that make one side worse off—typically due to a lack of a remedy—decrease the efficiency of the relationship. *Id.*

150. Uri Benoliel, *Reputation Life Cycle: The Case of Franchising*, 13 CHAP. L. REV. 1, 6 (2009) (explaining how actors can suffer future costs from obtaining a bad reputation and thus may willingly perform under a contract even if a breach would be immediately beneficial).

151. *See* Robert Axelrod & William D. Hamilton, *The Evolution of Cooperation*, 211 SCIENCE 1390 (1981) (explaining how, using game theory, a party may defect from an agreement if it is a one-time play, but when the game is often repeated, the game's partner and other witnesses may impose a reputational cost after witnessing cheating, which leads to longer term costs).

152. See id.

153. *See* Posner, *supra* note 142, at 4 ("Information is costly, and often the costs are prohibitive, especially when the information one would like have concerns the future.").

if a creditor were able to overcome the FSIA and collect from the sovereign, the creditor would probably have preferred that the sovereign had honored the bonds in the first place—so as to avoid the transaction costs of employing lawyers and the courts. While an adequate remedy need not mimic the efficiency of the original promise perfectly, it should at least protect the benefit of the bargain.[154] And as will be demonstrated, the consequence of failing to provide efficient remedies to a market can be devastating.[155]

In turn, considering transaction costs, relief must be predictable. Wasteful litigation grows more likely if incomplete information prevents an injured party from accurately gauging whether a potential remedy can and will provide the relief sought and, if so, at what cost.[156] Economists consider most contests—whether litigation or war—to be inefficient by definition because feuding parties could have almost always privately struck the same bargain that the contest produced, but without the added cost.[157] For example, if a court rules that two parties must split $100 into two equal portions and each pay $20 in court fees, then each party will receive $30. It actually would have been more efficient for the parties to have made that same agreement privately ($50 each) and avoided the transaction costs of litigation ($20 each), thereby each receiving $50.

Parties sometimes fail to settle their case *ex ante* because incomplete information prevents disputants from accurately determining the effectiveness of their position and the costs required to argue it.[158]

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154. *See, e.g.*, John F. Barry III, *The Economics of Outside Information and Rule 10b-5*, 129 U. PA. L. REV. 1307, 1335-36 (1981) (explaining that a system to trade stocks generally performed better than average, but the number of transactions required to make the system effective incurred such transactions costs such as to eliminate its benefits).

155. For example, viewing the car market, failure to shield consumers from purchasing lemons would devastate the car market. If buyers had no way to distinguish a lemon, and if the courts provided no remedy, then dealers would have little incentive to guarantee that a car worked properly. Buyers would then avoid buying expensive cars—or even avoid cars at all—considering the pitfalls that would bely the market. Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 1002 (1984).

156. *See* Robert Bovarnick, *When Is Litigation Worth the Hassle?*, FORBES (July 21, 2010, 6:40 PM), http://www.forbes.com/2010/07/21/when-to-sue-entrepreneurs-law-taxation-bovarnick.html ("The decision to sue or settle should, in almost all cases, be seen as a business decision. Parties tend to litigate when at least one side is overly optimistic about its case. Settlements occur when reality converges with expectation.").

157. *See* James D. Fearon, *Rationalist Explanations for War*, 49 INT'L ORG. 379, 383 (1995) (explaining in the international conflict context that the occurrence of war is a scholarly puzzle because the same postwar distribution of goods could have been achieved during an ex ante agreement).

158. *See* Daniel Friedman & Donald Wittman, *Litigation with Symmetric Bargaining and Two-Sided Incomplete Information*, 23 J.L. ECON & ORG. 98, 99 (2006) ("Plaintiffs and defendants have access to different information and, therefore, have different expectations about

Said differently, if both sides honestly believe that they will win in court, then a mutually acceptable settlement point becomes more difficult to locate. This is because each party may harbor contradicting beliefs about how a court will likely rule and become more likely to waste resources seeking a judicial resolution. Making matters worse, each party has an incentive to bolster their position by misrepresenting key elements of the dispute—including willingness to settle or probability of winning the contest—increasing the sum of incomplete information.[159]

The inefficiency of litigation can even become part of the negotiation strategy. Bargaining theory indicates that when parties conflict, the outcome often depends upon each party's ability to inflict and accept costs.[160] The costliness of litigation is sequential in that one party's actions will cause the other party to respond—both conducts coming at a price. For instance, when conflicting parties have access to asymmetric resources, the more moneyed party may choose to expend substantial resources on litigation until the poorer party can no longer afford to continue.[161] Few consider wars of attrition to be socially desirable because the resources spent on bargaining and litigation render almost no productive value.[162] Therefore, when contractual remedies are expensive and unpredictable, parties will sometimes drag out litigation—not to allow the courts the opportunity to decide the case, but to suffocate the opposition.

Similarly, a clearly expensive remedy might encourage parties to breach an agreement if they believe that the injured party will consider the remedy too costly to pursue.[163] Those with modest injuries rarely sue

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the outcome of a trial."). The magnitude of this access influences whether the parties will elect to pay the costs of a trial.

159. *See* Fearon, *supra* note 157, at 391 (explaining that parties seek to improve their bargaining strength by embellishing their strength and the point at which they are willing to settle and that the effect of this increases the level of bad information flowing between the parties, making it less likely that the parties will perceive the contest similarly, leading to conflict).

160. *See* Branislav L. Slantchev, *The Power To Hurt: Costly Conflict with Completely Informed States*, 97 AM. POL. SCI. REV. 123 (2003) (indicating that conflicts (referencing war) are a process in which the decision to fight and settle is often predicated upon each side's ability to take and deliver costs and that as costs grow, one side will become compelled to settle).

161. *See* POSNER, *supra* note 142, at 781 ("It is often argued that wealthy individuals or large firms may try to overwhelm their litigation opponents by heavy spending.").

162. *See id.* at 779-80 (explaining that the resources spent on litigation can provide information to the court, helping it to arrive at a correct decision, which has societal value; however, generally this benefit is limited because, especially in simpler cases, the value spent on litigation does not justify the manner in which litigation expenses can compound and exceed their marginal benefits).

163. *Id.* at 791 (discussing the economics of the nuisance lawsuit, wherein the claim has a legal foundation but the relief sought is so low that it does not validate the costs of litigation,

the breaching party if the cost of litigation exceeds the possible benefits. Class action lawsuits are designed to avoid this harm by allowing claimants to aggregate claims and split one litigation bill, making it more economically feasible to act on smaller injuries.[164] This has led some contracting parties to insert contract clauses barring class actions or compelling arbitration in order to eliminate the claim altogether. After all, few would choose to spend more on a contest than what can be gained from winning it.[165]

Upon a breach, though, practitioners have found several methods to increase efficiency using both private and public means. For instance, an understudied economic device is the secured loan, which is often favored because, theoretically, creditors can satisfy at least part of their debt with the collateral. This allows parties to remedy a default without much involvement of the courts, providing quick and cheap finality to the dispute. While the collateral may not always satisfy the entire debt owed, much of the loss can often be offset by the transaction costs and resources saved by not having to seek a judicial resolution. Another strategy is to include a liquidated damages clause establishing the value of *ex ante* relief. This avoids disputes regarding the amount owed and provides information about the true cost of a breach. Similarly, the doctrine of stare decisis indicates the likely outcome of a claim in court, providing both predictability and an incentive to settle cases privately.[166]

These general economic concepts of contracts seem to speak directly to the problems of the sovereign debt market. Sovereigns have typically honored their debts even though few courts will compel payment considering that a total and complete breach would destroy the sovereign's credit score and reputation making future borrowing increasingly difficult.[167] This partly explains why defaulting sovereigns are more likely to restructure their bonds, as opposed to completely

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which can compel the defendant to pay off the plaintiff without assessing the case's merits, because it is the less costly route).

164. George Priest, *Economics of Class Actions*, 9 KAN. J.L. & PUB. POL'Y 481 (1999) (mentioning that the aggregation of claims serves to create an economy of scale, providing efficiency to the trying of numerous smaller claims).

165. *See, e.g.*, AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1744 (2011). In *Concepcion*, the Court ruled on a case where a company added a clause in a contract of adhesion that ordered all claims to be heard exclusively by arbitration, denying class action lawsuits as a remedy. *Id.*

166. *See* POSNER, *supra* note 142, at 743-44 ("The body of precedents in an area of law can be thought of a stock of capital goods—specifically, a stock of knowledge that yields services over many years to potential disputants in the form of information about legal obligations.").

167. *See* TOMZ, *supra* note 24.

defaulting.[168] The problem is that reputation costs have not universally compelled payment. Leaders understand that their grasp on power is tenuous,[169] especially now that most countries hold regular elections, and, in turn, poor credit scores are unlikely to worry a leader who must win an election next year.[170] This has made defaulting a much more attractive option, and when no authority can institute a remedy, the breach creates systemic inefficiency.

The true market failure of the sovereign debt market occurs when vulture funds, acting upon incomplete information, conjure up inventive methods to seek relief. The economics of seeking relief, as mentioned before, indicates why most creditors reluctantly accept restructuring: the cost of suing a sovereign (high transaction costs) based upon an unlikely legal strategy (low probability of a benefit) provides less utility than simply accepting a devalued bond or selling the bad debt to a vulture fund. Vulture funds, however, respond to different incentives. By purchasing bonds with high face values for only a small fraction of the debt, the economics of the transaction suggests that they can rationally spend substantial amounts on litigation and still turn a profit.

There are many ways to *try* to force a sovereign to repay frustrated creditors, and while most strategies will not be successful, vulture funds assume that a remedy exists—one just has to litigate for it. Because creditors can seek a judgment in numerous forums and pursue attachment in any jurisdiction in which a sovereign holds property, the number of possible litigation strategies is nearly boundless. As mentioned, this has led creditors to spend extraordinary sums globally, for example, seizing an Argentinian ship in Ghana.[171] Some have even accused vulture funds of incorporating such spending into their strategies, suggesting that they have more available capital than the sovereigns and are more willing to spend it.[172]

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168. *See* Olivares-Caminal, *supra* note 79, at 44-45 (explaining that Peru sought to restructure bonds to reduce the amount the nation owed and when they were compelled to either pay the entire sum or none at all, Peru opted to pay the entire sum to avoid a complete breach).

169. *See* BRUCE BUENO DE MESQUITA ET AL., THE LOGIC OF POLITICAL SURVIVAL 7-9 (2003). The primary underlying motivation of leaders is to remain in power. *Id.* Even if they endeavor to produce social good, they can only do so if they are in office. *Id.* Thus all behavior of leaders is predicated on the desire to remain in office. *Id.*

170. *See* William W. Bratton, Pari Passu *and a Distressed Sovereign's Rational Choices*, 53 EMORY L.J. 823, 837 (2004) (explaining that a sovereign will breach when the benefits of breaching exceed the costs to its reputation and that the leaders who decide to breach consider domestic political considerations when coming to their decision).

171. Smith, *supra* note 20.

172. *See* Blackman & Mukhi, *supra* note 7, at 50.

In sum, economic theory indicates that efficient markets must enforce contracts, but this means only that signatories may choose to perform the promise specified in the agreement or pay its comparable expectation damages—whichever option provides the greatest sum of societal value. When assuming the presence of transaction costs, this principle raises several subissues. First, contracting parties must be able to predict with some level of confidence how the remedy will resolve the dispute because otherwise, litigation becomes more likely, especially if the parties harbor different expectations about how a court would likely rule. And once the parties go to court, it often requires a substantial investment just to determine the strength of one's claim. The parties may even forego contracting in the first place if they question whether a remedy can ameliorate a potential breach. Second, the remedy must also be affordable, considering that transaction costs can make a remedy cost prohibitive.

IV. NINETEENTH-CENTURY AGRARIAN PRACTICES AND A POSSIBLE SOLUTION TO SOVEREIGN DEBT'S SYSTEMIC INEFFICIENCIES

A potential solution to the sovereign debt market's costliness, all-or-nothing stakes, lack of finality, and ineffectiveness may exist within a lending practice that was once used in agricultural financing. During the nineteenth century, a credit problem dominated agriculture; few banks would lend to farmers who needed, yet did not have, the resources necessary for the next harvest.[173] This credit obstacle was caused by the fact that the banks lacked a remedy with respect to the farmers and thus had little recourse if the farmers defaulted. Today, most lenders require a form of collateral or other guarantee to secure a significant loan;[174] western banks prefer real estate or land due to their valuable and immoveable qualities.[175] Historically, many farmers, however, lived in communal land tenure systems, whereby each member of the community possessed an equal right to use the entirety of the land.[176] In other words, each member enjoyed a usage right or license to farm, but no member

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173. Roger L. Ranson & Kerry Ann Odell, *Land and Credit: Some Historical Parallels Between Mexico and the American South*, 60 AGRIC. HIST. 4, 11 (1986) (detailing the reasons why credit was scarce during the nineteenth century in both the United States and Mexico).

174. Id.; Parker Shipton, Debts and Trespasses: Land, Mortgages, and the Ancestors in Western Kenya, 62 J. INT'L AFRICAN INST. 357, 358 (1992).

175. *Id.*

176. William W. Winnie, Jr., *Communal Land Tenure in Chile*, 55 ANNALS ASS'N AM. GEOGRAPHERS 67, 68 (1965) (explaining some of the varieties and functions of the communal or tribal land tenure system, with particular emphasis on Chile's).

had an exclusive legal title.[177] Banks would then refuse to lend because farmers lacked individual authority to allow the bank to attach a lien to the property's title. A similar problem arose in societies that opted not to document land ownership, preventing farmers from collateralizing their property titles.[178] Without a transferrable title, prospective creditors could not establish with certainty who owned the property. In either situation, farmers rarely possessed anything of value with which they could secure a loan.[179] Lending practices were paralyzed due to a lack of remedies available upon a contract breach.

In many countries, the solution was for farmers to pledge to the banks a portion of the next season's harvest as security.[180] While this system varied by country,[181] most often, if a farmer did not repay, the bank reserved the right to take title to a set amount of crops equaling a fraction (or the entire sum) of the loan's remaining balance.[182] This arrangement provided the banks with a mechanism able to remedy a default without using the courts, and the farmers benefited from not being required to put up scarce resources that they seldom had. Indeed, the farmers retained an incentive to make regular payments and the banks could lend without possessing tangible collateral.

An arrangement similar to the crop lien could provide a solution to the sovereign debt quandary. I propose that drafters of sovereign debt instruments should write into the contracts a "minimum default value" (MDV), defined as a clause stipulating that upon a nonpayment or material breach, creditors may claim a predetermined percentage of the original investment. This arrangement would be made possible by the fact that most national central banks already hold significant amounts of

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177. *Id.*

178. *See* DE SOTO, *supra* note 140, at 63-64. Because some societies do not keep written records of land, banks cannot be sure whether those living on the land actually own the land. *Id.* Without this reassurance, landowners cannot use their land to securitize a loan. *Id.*

179. Ranson & Odell, *supra* note 173, at 12 (explaining that communal land systems in Mexico frustrated attempts by farmers to provide collateral for loans); Shipton, *supra* note 174, at 358 (writing that Kenyans rarely title land and almost never use land to secure a loan).

180. *See* Peter J. Heffernan & Stephen K. Pollard, *The Determinants of Credit Use Among Small Farmers in Jamaica*, 32 SOC. & ECON. STUD. 23 (1983) (finding that in countries with low levels of formal borrowing, farmers are more likely to leverage expected crop bounties).

181. In the American South, banks employed an equitable crop-lien system, whereby farmers had to pay back the loan using the actual crops produced. This allowed banks to dictate what the farmers grew, redirecting growing efforts away from staple food for the family in favor of cotton. Historically, this sort of practice has been considered inequitable to the farmers, considering the banks' superior bargaining position. *See* E.W. Kemmerer, *Agricultural Credit in the United States*, 2 AM. ECON. REV. 852 (1912); Roger L. Ransom & Richard Sutch, *Debt Peonage in the Cotton South After the Civil War*, 32 J. ECON. HIST. 641, 642 (1972).

182. *See* Shipton, *supra* note 174, at 365 (noting all of the nonland items, including crops, used by Kenyan farmers to secure a loan).

capital in foreign banks in order to guard against inflation, currency devaluation, and bank runs.[183] In fact, the most common foreign location for sovereign debtors to deposit funds is the FRBNY followed by several private New York banks.[184] The sovereigns would have to transfer the MDV sum over to a related bank account from which it could withdraw funds only in proportion to the amount that it has repaid creditors. Therefore, if a sovereign bond listed an MDV as 20% of a $1 million loan, then, upon a nonpayment, the creditor could demand $200,000 from the bond's fiscal agent to be drawn from the debtor nation's foreign central bank account, immediately terminating the contract. The inclusion of an acceleration clause would allow the creditor to demand prompt and immediate payment directly from the facilitating bank, bypassing the sovereign.

This system would have numerous advantages. First, because sovereign bonds currently lack a termination clause, subsequent disputes persist for years in large part because of their high risk-high reward nature. An MDV would provide a predetermined middle ground, whereby creditors could seize upon a self-enforcing mechanism, similar to a letter of credit, rendering a more equitable quick resolution.[185] To be clear, having to invoke an MDV clause would not reflect a creditor's preferred route because the creditor could only recoup a fraction of the original investment. However, the clause would allow the creditor to mitigate losses while avoiding the costs of expensive litigation. The debtors would still have an incentive to honor the original bonds, considering that the sovereign's reputation has always been its primary

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183. *See* Lee, *supra* note 59, at 394 n.250 ("A litigant need look no further than the Federal Reserve Bank of New York as one of the most likely depositories for a central bank's dollar accounts. . . . In the event of a financial problem in the home country, the dollar accounts of the central bank will likely swell as the government directs its agencies, instrumentalities and private sector entities to consolidate their dollar holdings in the accounts of the central bank. This action has the effect both of husbanding the dollar reserves of the country and of providing additional protection to the funds against attachment because central bank funds held for its own account are absolutely immune from prejudgment attachment.").

184. *Id.*; Note, *Too Sovereign To Be Sued: Immunity of Central Banks in Times of Financial Crisis*, 124 HARV. L. REV. 550 (2010). For U.S. counterparties to transactions with sovereign governments, central bank accounts with the Federal Reserve Bank of New York (FRBNY) are a ripe target for attachment. *Id.* The FRBNY holds "$3 trillion in U.S. dollar-denominated assets at the Bank, more than half of the world's official U.S. dollar reserves." *Services for Central Banks*, FED. RESERVE BANK OF N.Y., http://www.newyorkfed.org/banking/services_centralbank.html (last visited Mar. 30, 2014)).

185. For a discussion of the mechanics and advantages of a letter of credit, see Miller, *supra* note 32.

motivation to pay.[186] Thus, upon a default, this system would provide finality in that the defaulted bonds would terminate with a prearranged settlement with the dispute's lowest possible transaction cost, and creditors could no longer engage in a war of attrition wherein the party most willing and able to waste resources wins.

Second, an MDV could help neutralize vulture funds. For instance, Romania lent Zambia $40 million dollars, which was never repaid.[187] With little hope of recouping its investment, Romania then sold its debt to a vulture fund for $1 million, or around two cents on the dollar.[188] Had the parties secured the debt with a 20% MDV, Romania could have demanded $8 million from the bond's financial agent. Not only could Romania have achieved a more equitable payment, but also the debt's minimum value would have been at least $8 million—substantially more than what the vultures paid. Because the bargain basement values of defaulted bonds is what incentivizes vulture funds to sue sovereigns, adding an MDV would make these bonds prohibitively expensive. Or, at least, the original bondholder (such as Romania) will become less likely to dump distressed debt onto the secondary market because an MDV would guarantee an elevated payoff. Either way, increasing the base value of defaulted bonds should help to ward off needless, costly litigation.

Third, MDVs would provide a more equitable system than the current winner-takes-all framework. Bankruptcy courts seek to create a sensible outcome where the debtor and creditor share the burdens of bad debt. In contrast, most commentators agree that a flaw of the current international sovereign debt arrangement is that even after much litigation, debtor nations can almost freely deny their obligations,[189] or, in the case of the *NML Capital* decisions or *Elliott*, vulture funds can force the entire sum of the defaulted loan.[190] An MDV could provide a more sensible middle ground rendering whatever the parties agreed, *ex ante*. In fact, sovereigns may become less likely to default because the MDV could raise the sovereign's cost of default above a level where it is worth sacrificing reputation.[191] For example, if a sovereign issues a $10 million

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186. TOMZ, *supra* note 24, at 14 (explaining that sovereigns have generally made regular payments on sovereign debt despite the international system's anarchic nature because of the reputation harm occurring after default).

187. For more information about this defaulted loan, see Goren, *supra* note 11, at 681.

188. *Id.* at 695.

189. *See* Gelpern, *supra* note 53, at 147.

190. Varottil, *supra* note 83, at 121.

191. *See* TOMZ, *supra* note 24, at 14 (explaining that the sovereign's reputation is the key factor dissuading it from defaulting).

bond without an MDV, the country could perceive that its reputation is worth $6 million, and thus, it would be wiser to incur the reputation cost than pay the entire bond ($10 million default - $6 million reputation cost = $4 million savings over honoring the bond). But if the bond sets the MDV at 50%, equaling $5 million, defaulting would cost more ($5 million default - $6 million reputation cost = $1 million loss under honoring the bond), incentivizing the sovereign to honor the entire bond.

Maybe most importantly, an MDV would likely work. Most sovereign debt disputes arise not because the contracts fail to include a breach or default clause, but because the courts refuse to or cannot enforce the terms. A creditor who invokes an MDV will deal only with the foreign bank where the sovereign's central bank has an account, avoiding the sovereign itself. Even if the sovereign endeavors to enjoin the bank from honoring the MDV, this arrangement should survive the FSIA. Recall that the FSIA makes attachment of a foreign sovereign's assets nearly impossible, especially with respect to its central bank.[192] Here, the creditor could receive payment because the FSIA only immunizes a central bank's funds "held for its own account."[193] In this situation, money pledged in a security deposit would not be "held for its own account"; indeed, it would be held for the account of the creditors.[194] For instance, in *Banco Central de Reserva del Peru v. Riggs National Bank of Washington D.C.*, Peru's central bank sought to impermissibly withdraw money that it had placed as a deposit in a private bank.[195] When the bank attempted to block Peru's withdrawal, the court held:

> Section 1611 covers property of a foreign bank "held for its own account." In other words, it exempts only those funds "used or held with central banking activities, as distinguished from funds used solely to finance the commercial transactions of other entities or of foreign states." H. Rep. 94-1487, 94th Cong., 2d Sess. 31 (1976), U.S. Code Cong., & Admin. News 2886, 2925. The $2 million deposit, as stated above, was placed by BCR to guarantee the loans extended to BPP, COFIDE, and Banco de la Nacion. In other words, it was placed to finance the commercial transactions of other entities, not as part of BCR's central banking activities. Thus, the

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192. *See, e.g.*, EM Ltd. v. Republic of Argentina, 473 F.3d 463, 468-69 (2d Cir. 2002) (denying attachment of funds in Argentina's central bank, explaining the very limited grounds in which this may occur).

193. *Id.* at 485.

194. For a leading review of what it means to hold money "for its own account," see *NML Capital, Ltd. v. Banco Central de la Republica Argentina*, 652 F.3d 172, 194 (2d Cir. 2011) (discussing and applying Patrikis, *supra* note 64).

195. 919 F. Supp. 13, 15 (D.D.C. 1994).

> § 1611 exemption does not apply and the FSIA does not bar Riggs' action.[196]

Thus, case law indicates that security deposits, such as an MDV, would comply with the FSIA's central bank exemption. The *NML Capital* decisions also make it clear that third-party financial institutions, such as indentured trustees and fiscal agents, must comply with the terms of the bond.[197] In turn, an MDV should have the advantage of skipping the courts to provide creditors with a self-executing remedy that would survive the FSIA and judicial scrutiny.

One can question why foreign countries would agree to the inclusion of MDVs, but the answer is that they may not have a choice. First, sovereigns possess most of the leverage after the investor has purchased its bonds;[198] however, they must still entice the market to buy their debt. In other words, consumers have the power to demand that sovereign bonds include certain safeguards because when investing, they can choose amongst all available bonds on the market—or they could elect to purchase none. If investors begin to demand MDVs and if developed nations begin to include them in their bonds, then developing nations may need to conform to this new industry standard or risk communicating that default is likely.[199] In fact, the security of an MDV may allow developing nations to sell sovereign bonds at a lower interest rate, while the absence of an MDV would come with an elevated interest rate and a "buyer beware" sign. Reputable developing nations may actually enjoy this system, considering that, most likely, they must currently overcome the stigma that comes along with borrowing from the southern hemisphere. In addition, some subsequent litigation has become so costly that the capital saved by defaulting is spent on litigation. If the MDV's payoff point falls somewhere around expected litigation costs, then a sovereign may willingly agree to its insertion to avoid the resources spent defending a claim.

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196. *Id.* at 17.

197. *See NML Capital IV*, 727 F.3d 230 (2d Cir. 2013); *NML Capital II*, 699 F.3d 246, 250 (2d Cir. 2012).

198. For a discussion of the problem that creditors face after purchasing sovereign bonds, see *supra* Part II.

199. Sovereigns have less power when drafting their bonds. Most use the banking and legal systems in the United States of the United Kingdom because investors prefer these developed legal systems—not because sovereigns prefer to litigate debt disputes abroad. This also helps to explain why the absolute form of sovereign immunity fell to the restrictive form. *See* Weidemaier, *supra* note 33, at 337-42; Loeb, *supra* note 38.

V. CONCLUSION

In short, the *NML Capital* decisions reflect the breakdown of a chaotic international debt system where foreign sovereigns exercised a near monopoly of power to deny their debts and creditors conjure up inventive, costly ways to pursue a lucrative payday—or just to mitigate losses. Debtor nations have historically defeated the creditors, but NML may have fallen into an astronomical payoff when the Second Circuit agreed to handcuff New York's banking system. And now the U.S. and international banking systems, the U.S. government, the entire international infrastructure, creditors, and foreign sovereigns are carefully monitoring how the Supreme Court will respond. Whether *NML Capital IV* stands will not rectify the problems of the sovereign debt market because the system will continue to incentivize litigation. This Article proposes that the answer may lie in contract. An MDV clause would allow creditors to solve a dispute by interacting directly with the facilitating financial institutions—an arrangement that could survive a FSIA challenge. Most importantly, this contract term would increase the minimum value to ward off the vulture funds quickly add finality, diminish the chances that a sovereign will default, and provide the creditors with an equitable, prearranged pay-off.

Because banks prefer secure loans, communal land tenure systems prevented farmers from borrowing against their land and real property.[200] The crop lien allowed farmers who had little collateral to obtain a loan by securitizing a percentage of their upcoming harvest.[201] Analogously, sovereign bonds should include an MDV whereby creditors collateralize a set percentage of capital that their central banks currently hold in U.S., U.K., and other European banks. The advantages of this would be numerous: not only would an MDV allow capital-starved debtor nations to secure a loan, it would also bolster the loan's minimum value to deter vulture funds, create a mechanism able to survive foreign sovereign immunity, ease the wheels of restructuring, provide finality to disputes, and signal the true value of the bonds.

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200. *See* DE SOTO, *supra* note 140, at 63-64 (detailing how the failure to title land severely hinders the credit and lending market).

201. *See* Heffernan & Pollard, *supra* note 180.