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SOVEREIGN DEBT RESTRUCTURINGS: MORE OPTIONS TO ADDRESS HOLDOUT CREDITORS

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INTRODUCTION

On April 22, 2016 Argentina settled a dispute with a group of its bondholders that was in respect of a default in 2001. The plight of Argentina has led the other members of the sovereign debt community including bankers, lawyers, investors, and academics alike to consider ways to reform sover-

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eign bond documentation to better protect sovereign debtors against so called "holdout" or "vulture" creditors in the event that a sovereign debtor finds itself in default on payments to its bondholders. There have been three main proposals put forward: first is introducing collective action clauses, which allow a vote of a supermajority of creditors to bind all creditors; second is implementing trust structures under which the enforcement of bondholder rights is vested in a trustee; and third is providing formal mechanisms for the appointment of creditor committees to represent bondholders (such provisions are known as "creditor engagement clauses"). Collective action clauses have been widely adopted by the market and have the official endorsement of the International Monetary Fund (IMF) and the International Capital Market Association (ICMA).[1] However, the jury is still out on trust structures and creditor committees. Accordingly, this Note will consider whether the more widespread use of trust structures and creditor engagement clauses would be beneficial for sovereign issuers looking to avoid problems with holdout creditors in the future. It will also consider whether sovereign bond investors would look upon such provisions favorably at the time they invest in an initial bond issuance.

Part I of this Note provides an overview of the recent history of sovereign debt restructurings with a focus on the recent Argentinean litigation. Part II considers the use of trust structures as a mechanism to limit the ability for holdout creditors to bring litigation against defaulting sovereign debtors. Part III considers whether the formalized use of creditors' committees mandated by creditor engagement clauses in sovereign bond documentation would be effective in facilitating more orderly sovereign debt restructurings. The conclusion of this Note is

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1. *See* IMF, STRENGTHENING THE CONTRACTUAL FRAMEWORK TO ADDRESS COLLECTIVE ACTION PROBLEMS IN SOVEREIGN DEBT RESTRUCTURING (2014) [hereinafter IMF (2014)]*; see also* IMF, PROGRESS REPORT ON INCLUSION OF ENHANCED CONTRACTUAL PROVISIONS IN INTERNATIONAL SOVEREIGN BOND CONTRACTS (2015) [hereinafter IMF (2015)]. For the ICMA standard provisions, see *Sovereign Debt Information*, INT'L CAPITAL MKT. ASS'N (Mar. 2017), http://www.icmagroup.org/resources/Sovereign-Debt-Information/; *see also* Deborah Zandstra, *Sovereign Pari Passu Clauses: NML Capital 2, Argentina 0*, CLIFFORD CHANCE (June 24, 2014), https://www.cliffordchance.com/briefings/2014/07/sovereign_pari_passuclausesnmlcapital2.html [hereinafter Zandstra (2014)].

that more widespread use of trust structures and creditor engagement clauses will make for more orderly sovereign debt restructurings and would benefit sovereign issuers and investors alike.

I. OVERVIEW OF SOVEREIGN DEBT RESTRUCTURINGS

When Argentina settled its dispute with its bondholders in April 2016, New York hedge fund Elliott Management received around $2.4 billion from the Republic of Argentina in respect of bonds on which Argentina defaulted in 2001.[2] Elliott, along with a number of other hedge fund holdouts, received staggering returns. Elliott was thought to have received around three or four times the principal of the bonds it held,[3] resulting in returns that are likely to have been much greater than that.[4]

The settlement of *NML v. Argentina* closes what some have labeled as "the Trial of the Century."[5] However, for the future of sovereign debt workouts, the saga has wide implications. For

2. Robin Wigglesworth & Elaine Moore, *Sovereign Debt: Curing Defaults*, FIN. TIMES (June 7, 2016), https://www.ft.com/content/90dc38fa-2412-11e6-aa98-db1e01fabc0c.

3. Katia Porzecanski, *Singer Makes 369% of Principal on Argentine Bonds in Debt Offer*, BLOOMBERG: MARKETS (Mar. 1, 2016, 3:52 PM), https://www.bloomberg.com/news/articles/2016-03-01/singer-makes-369-of-principal-on-argentine-bonds-in-debt-offer.

4. It is not possible to calculate Elliott's exact return without knowing what Elliott paid for the bonds initially, but one can presume that given Argentina was in default at the time Elliott purchased the bonds, the bonds were purchased at a steep discount to par. In addition, Argentina had many different series of bonds outstanding with different interest rates and interest rate formulas including one infamous series of "floating rate accrual notes" (FRANS). The interest rate on the FRANS increased as Argentina's probability of default increased and was at 101% per annum at the time of Argentina's default. (The rate was a product of a formula which was calculated by reference to the yields on Argentina's fixed rate bonds—as the probability of Argentina's default increased, the price of the fixed rate bonds dropped, increasing the effective yield of those fixed rate bonds and sending the interest rate on the FRANS sky high—at a time when Argentina was already in severe financial trouble. In effect, Argentina had sold a credit default swap on itself.). *See* Matt Levine, *Argentina's Bond Fight Comes Down to its Worst Bonds,* BLOOMBERG: VIEW (Feb. 8, 2016, 5:47 PM), https://www.bloomberg.com/ view/articles/2016-02-08/argentina-s-bond-fight-comes-down-to-its-worst-bonds.

5. Juan J. Cruces & Tim R. Samples, *Settling Sovereign Debt's "Trial of the Century,"* 31 EMORY INT'L L. REV. 5 (2016).

a long time, the only real remedy for creditors of defaulting sovereign nations was to block future access to the international capital markets. The shift to a more limited form of sovereign immunity over the second half of the 20th century provided sovereign creditors with legal remedies, and creditors were easily able to obtain judgments regarding a sovereign's default. However, these judgments were of limited practical use. Sovereign assets are generally held in their own country, subject to the laws of the sovereign issuer's jurisdiction, and are thus not available for attachment by creditors. Sovereign assets held outside the country are frequently protected from attachment by treaty (this is the case, for example, in relation to embassies and consulates).[6] This all changed with the *NML v. Argentina* litigation. Elliott Management obtained an injunction that prevented Argentina from making payments to any of its other creditors (in particular, it prevented Argentina from making coupon payments to the creditors that had accepted its previous restructuring offers) until it had paid Elliott and the other holdouts *in full*. The basis for this order was the *pari passu* clause of the applicable bond documentation—a boilerplate clause which, up until this point, was not generally understood by those in the sovereign debt community to have this meaning.[7]

6. Famously, at one point in 2012 Elliott managed to seize an Argentinean navy training vessel at a port in Ghana. The ship was returned shortly after, but not without causing considerable embarrassment to Argentina (a number of senior Argentinean officials resigned over the matter). *See* Emily Schmall, *Seizure of Ship From Argentina Forces Shake-Up*, N.Y. TIMES (Oct. 18, 2012), http://www.nytimes.com/2012/10/19/world/americas/seizure-of-argentine-ship-forces-shake-up.html; *see also* Sönke Häseler, Individual Enforcement Rights in International Sovereign Bonds 6 (Nov. 10, 2008) (unpublished paper), https://papers.ssrn.com/ sol3/papers.cfm?abstract_id=1299114) [hereinafter Häseler (2008)]; Foreign Sovereign Immunities Act of 1976, Pub. L. 94-583, 90 Stat. 2891 (1976); State Immunity Act 1978, c. 33, §1 (UK); Sönke Häseler, *Trustees Versus Fiscal Agents and Default Risk in International Sovereign Bonds*, EURO. J.L. ECON. 5 (2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1530690 [hereinafter Häseler (2010)]; Lee C. Buchheit & Elena L. Daly, *Minimizing Holdout Creditors: Carrots, in* SOVEREIGN DEBT MANAGEMENT 3 (Rosa M. Lastra & Lee Buchheit eds., 2014).

7. For a detailed analysis of the history of the *pari passu* clause see Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869, 894–906 (2004). Buchheit and Pam describe the so-called "ratable payment" interpretation of the *pari passu* clause a "fallacy." *Id.* at 917.

In addition, and crucially, the court order prohibited the array of third parties that form an essential part of the modern day international financial architecture (fiscal agents, paying agents, trustees, clearinghouses, etc.) from assisting Argentina to make any payments to its other (non-holdout) creditors.[8] Argentina and its advisors looked into a range of "creative" ways to pay its other bondholders without coming within the ambit of New York and the jurisdiction of the New York courts.[9] Ultimately this was not possible—in the modern world of interconnected global finance, an order that prohibits third parties with any connection to New York from assisting a sovereign issuer is in effect an order that makes unavailable to the sovereign issuer the payment mechanisms of modern international finance.[10]

A. *The Fallout from the Argentinean Litigation*

The fate of Argentina has caused a great deal of concern amongst participants in the sovereign debt community. Elliott's strategy (a strategy shared amongst many distressed debt funds) was to litigate to test the understood meanings of clauses buried in bond documentation. The *pari passu* clause is a boilerplate provision that appears in the back-end of most cross-border debt documents,[11] repeated in deal after deal (in many cases, probably by junior legal associates in the early hours of the morning without any particular attention being given to its intended or understood meaning). While *pari passu* clauses can be reworded, the concern remains that distressed debt funds will continue to come up with creative interpretations to clauses buried in debt documentation in order to disrupt sovereign debt restructurings.

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8. IMF (2014), *supra* note 1, at 8; Zandstra (2014), *supra* note 1, at 1–2.

9. *See* Matt Levine, *Now Argentina Can't Even Pay Bonds in Argentina*, BLOOMBERG: VIEW (Mar. 13, 2015, 1:21 PM), http://origin-www.bloombergview.com/articles/2015-03-13/now-argentina-can-t-even-pay-bonds-in-argentina; Matt Levine, *Argentina's Bonds Are Doing So Well, It Tried To Sell More*, BLOOMBERG: VIEW (Feb. 27, 2015, 6:22 PM), https://www.bloomberg.com/view/articles/2015-02-27/argentina-s-bonds-are-doing-so-well-it-tried-to-sell-more.

10. *See* Levine, *Now Argentina Can't Even Pay Bonds in Argentina*, *supra* note 9, at 4–5.

11. *See* Buchheit & Pam, *supra* note 7, at 871.

The big problem with the threat of holdout creditors in the sovereign context is that, in the absence of a bankruptcy regime for defaulting sovereigns, all sovereign restructurings must be negotiated, in one form or another, between the sovereign and its lenders. However, the greater the threat of holdouts, the less likely an ordinary creditor is to accept a restructuring package (bankers have an acute sense of injustice in relation to the preferential treatment of one creditor or class of creditors over another).[12] Protracted restructuring negotiations, and therefore a protracted state of default, are undesirable for all (with the possible exception of holdout creditors, who are nothing if not patient). For the ordinary creditor, protracted negotiations would mean a total suspension of payments of principal and interest on its debt instrument. For the debtor it could mean a prolonged state of default and lack of access to the international capital markets.[13]

Indeed, the immediate impact of Argentina's experience is evident in Venezuela. Venezuela is in a period of severe economic hardship that has resulted from low oil prices. It is experiencing triple-digit inflation, electricity rationing, and food

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12. Buchheit & Daly, *supra* note 6, at 4 (describing the delicate balance of power between a sovereign and its creditors as the "chemistry of sovereign debt workouts."); Brief for the United States as Amicus Curiae Supporting Appellants, NML Capital, Ltd. v. Republic of Arg., 699 F.3d 246 (2d Cir. 2012) (No. 12-105-cv(L)) ("The creation of new rights and new vehicles for enforcement alters and destabilizes the landscape of sovereign debt restructuring."); *see also* Häseler (2008), *supra* note 6, at 10 (describing how the danger of subsequent preferential treatment for holdout creditors creates a "prisoners dilemma" situation among bondholders, which reduces mainstream creditors' willingness to participate in restructurings); IMF (2014), *supra* note 1, at 5; PHILLIP WOOD, ALLEN & OVERY, THE PARI PASSU CLAUSE AND THE ARGENTINE CASE 12–13 (2012), http://www.allenovery.com/publications/en-gb/lrrfs/global%20risks/Pages/The-pari-passu-clause-and-the-Argentine-case.aspx.

13. Anna Gelpern, *Sovereign Debt Crisis: Creditor's Rights vs. Development*, ASIL PROCEEDINGS 229 (2003), http://www.cfr.org/world/sovereign-debt-crisis-creditors-rights-vs-development/p6554; Lee C. Buchheit & Elena L. Daly, *Minimizing Holdout Creditors: Sticks, in* SOVEREIGN DEBT MANAGEMENT 15–16 (Rosa M. Lastra & Lee Buchheit eds., 2014); Frederico Sturzenegger & Jeromin Zettelmeyer, *Has the Legal Threat to Sovereign Debt Restructuring Become Real?* 28 (Universidad Torcuato Di Tella Business School Working Papers, Paper No. 04/2006, 2006), http://econpapers.repec.org/paper/udtwpbsdt/legalthreat.htm.

and medicine shortages.[14] Its currency reserves are declining[15] and ratings on its bonds and the bonds of its state-owned oil company have been plummeting.[16] Some of its bonds have been trading at less than fifty cents on the dollar.[17] Despite all of this, the Venezuelan government continues to service its debts. Some consider the approach of paying international creditors while the country is running out of food to be an "odd moral choice."[18] One wonders whether the experience of Argentina is a factor in why Venezuela continues to pay its creditors. A large amount of the outstanding debt stock of Venezuela does not have collective action clauses (CACs—described in more detail below).[19] In addition, Venezuela is considered to be more exposed to attachment risk as it holds oil assets in the United States and the United States is a major export destination for its oil (although a number of experts have questioned whether this should be a significant concern).[20]

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14. Gillian B. White & Bourree Lam, *What's at Stake in Venezuela's Economic Crisis*, ATLANTIC (July 5, 2016), http://www.theatlantic.com/business/archive/2016/07/venezuela-economic-crisis/490031/; Joe Kogan, *Why Venezuela Should Default*, N.Y. TIMES (Dec. 21, 2016), https://www.nytimes. com/ 2016/12/ 21/opinion/why-venezuela-should-default.html; Sebastian Boyd, *Venezuela Refuses to Default. Few People Seem to Understand Why.*, BLOOMBERG (July 5, 2016, 2:26 PM), https://www.bloomberg.com/news /articles/2016-07-04/venezuela-refuses-to-default-few-people-seem-to-understand-why.

15. Kogan, *supra* note 14.

16. Along with the Venezuelan government, the Venezuelan state-owned oil company, Petróleos de Venezuela, also has an extremely large amount of debt, and although the government does not guarantee the debt of the oil company, some have argued that in practice it would be hard to disentangle a default and restructuring of the oil company from the state. *See* Robin Wigglesworth & Andres Schipani, *Venezuelan Oil Major's Debt Swap: The Beginning of the End?*, FIN. TIMES (Sept. 26, 2016), https://www.ft .com/content/aadf657c-7f4a-11e6-8e50-8ec15fb462f4/.

17. *See* Boyd, *supra* note 14.

18. *Id.* (quoting Harvard economist Ricardo Hausmann); *see also* Everett Rosenfeld, *Venezuela is Making 'Surreal, Suicidal' Debt Payments,* CNBC (Feb. 29, 2016, 12:28 PM), http://www.cnbc.com/ 2016/02/29/venezuela-is-making-surreal-suicidal-debt-payments.html.

19. Davide Scigliuzzo, *Argentina-Style Legal Drama Looms If Venezuela Defaults on Debt,* REUTERS (Jan. 21, 2016, 4:15 PM), http://www.reuters.com / article/venezuela-bonds-cac-idUSL2N1551WL.

20. *See* Kogan, *supra* note 14; Boyd, *supra* note 14.

B. *The Response: Collectivization of Bondholder Rights*

In response to the *NML v. Argentina* litigation (and the rise in holdout creditor behavior generally[21]), academics, practitioners, and policy makers in the sovereign debt community have looked for ways to address the now very real problem presented by holdout creditors in relation to future sovereign debt restructurings.[22] The theme of the solutions proposed and implemented is a shift towards "collectivizing" bondholder rights in sovereign debt documentation.[23] The general goal of collectivizing bondholder rights is to mirror, by contractual means, the supermajority creditor control principles that underpin most corporate bankruptcy regimes, given the absence of any such regime for defaulting sovereigns.[24]

The main focus of the collectivization of bondholder rights (and receiving the most attention) is the adoption of CACs. CACs allow a supermajority of creditors to accept a debt restructuring and to force (or "cram-down") the terms of the debt restructuring on all creditors (including the would-be holdout creditors).[25] CACs, and in particular "aggregated" CACs which provide for approval of restructuring proposals to be aggregated across multiple series of bond issuances which make it harder for a holdout to achieve a blocking position in any one series, are now the market standard.[26] They have been

21. *See* Häseler (2008), *supra* note 6, at 6.

22. *See, e.g.*, Lee C. Buchheit, *Supermajority Control Wins Out*, 26 INT'L FIN. L. REV. 21 (2007); IMF (2014) *supra* note 1, at 5; IMF (2015) *supra* note 1, at 4.

23. Häseler (2008), *supra* note 6, at 2; Buchheit, *supra* note 22, at 21; IMF (2014) *supra* note 1, at 5; IMF (2015) *supra* note 1, at 4. For a detailed analysis of the collectivization of bondholder rights in the context of U.S. corporate bonds see Marcel Kahan, *Rethinking Corporate Bonds: The Trade-Off Between Individual and Collective Rights,* 77 N.Y.U. L. Rev. 1040 (2002); Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L. J. 1317 (2002).

24. Lee C. Buchheit & G. Mitu Gulati, *The Coroner's Inquest: Ecuador's Default and Sovereign Bond Documentation*, 28 INT'L FIN. L. REV. 22, 22 (2008–2010). Buchheit and Daly observe that, given most bankruptcy codes that permit a reorganization of a corporate debtor's affairs will have some method for imposing the will of the majority of similarly situated creditors on any naysaying minority, "[c]orporate bankruptcies are not normally troubled by holdout creditors." Buchheit & Daly, *supra* note 13, at 15.

25. Buchheit, *supra* note 22, at 21; Buchheit & Gulati, *supra* note 24, at 22.

26. *See* IMF (2014), *supra* note 1; IMF (2015), *supra* note 1.

blessed by issuers, investors, the official sector (including the IMF), and trade associations, and the International Capital Market Association has released recommended wording for aggregated CACs to be included in sovereign bond documentation.[27] Anecdotal evidence indicates that CACs have not resulted in a premium, indicating that investors (at least, ordinary course bond investors as opposed to distressed debt investors) are in favor of mechanisms to prevent holdout creditors.[28]

Two other collectivization mechanisms have been considered, but have not been adopted to the same extent as CACs. The first is the issuance of sovereign bonds under trust structures (rather than fiscal agency structures) which centralize bondholder enforcement rights in a trustee, and therefore limit the scope for individual bondholders to bring enforcement actions against defaulting sovereigns.[29] The second is the implementation of "creditor engagement clauses" which mandate the use of, and engagement with, creditor committees in the event that a sovereign defaults or approaches default.[30] Given that the sovereign debt community remains unconvinced of the benefits of trust structures and creditor engagement clauses, they will be the focus of this Note.

II.
Trust Structures

Traditionally, sovereign bonds have been issued under a fiscal agency agreement whereby the fiscal agent carries out the administrative obligations of the issuer in respect of the relevant bonds (i.e., the fiscal agent distributes the payment of interest and principal due on the bonds to holders and relays information from the issuer to holders).[31] A fiscal agent is the

27. *See* IMF (2014), *supra* note 1; IMF (2015), *supra* note 1; *Sovereign Debt Information*, supra note 1; *see also* Zandstra (2014), *supra* note 1, at 2.

28. *See* IMF (2014), *supra* note 1, at 15; IMF (2015), *supra* note 1, at 9.

29. Buchheit, *supra* note 22, at 21; Häseler (2010), *supra* note 6, at 3; IMF (2015), *supra* note 1, at 11–12; Buchheit & Gulati, *supra* note 24, at 22.

30. *See, e.g.*, Lee C. Buchheit, *Use of Creditor Committees in Sovereign Debt Workouts*, 10 Bus. L. Int'l 205 (2009); Deborah Zandstra, Clifford Chance, Creditor Engagement in Sovereign Debt Restructuring (2016), https://www.cliffordchance.com/briefings/2016/04/creditor_engagement insovereigndeb.html.

31. Buchheit, *supra* note 22, at 21.

agent of the issuer and owes no duties to bondholders.[32] As such, fiscal agents are of no assistance in the context of negotiating a restructuring (other than perhaps performing administrative tasks on behalf of the issuer such as mailing out bondholder notices). In contrast, under a trust structure, where bonds are issued pursuant to a trust indenture if governed by New York law and trust deed if governed by English law, a trustee is appointed to represent bondholders and owes fiduciary duties to bondholders (subject to the exculpatory provisions in the relevant indenture or deed).[33]

Three aspects of a trust structure can deter bondholder litigation. First, the indenture or deed generally provides that the trustee has the exclusive right to initiate proceedings against the debtor for breaches of the trust deed or indenture or the terms of the bonds (subject to certain exceptions which are discussed below) and therefore precludes unilateral enforcement action by individual holders. Second, deeds and indentures generally require a vote of bondholders to accelerate a debt and often provide holders with the ability to vote to rescind an acceleration. Third, they provide for the proceeds of litigation to be shared equally among holders.[34]

Trust deeds and indentures generally provide that holders have no individual right to bring an action against the issuer. Instead, the trustee has the exclusive right to bring such action. A trustee will be required to bring an action after being directed to do so by holders (usually twenty-five percent by principal amount) and after holders indemnify it to its satisfaction.[35] English law trust deeds generally provide that holders are only able to bring a unilateral action if the trustee has failed to do so for a specified period (usually sixty days) in circumstances when it was required (i.e., after a bondholder vote and satisfactory indemnification).[36] New York law inden-

32. *See* Häseler (2010), *supra* note 6, at 4; Buchheit, *supra* note 22, at 21.

33. *See* Buchheit, *supra* note 22, at 21; *see also* Buchheit & Gulati, *supra* note 24, at 22; Häseler (2010), *supra* note 6, at 4–5.

34. IMF (2015), *supra* note 1, at 10–12; Buchheit & Gulati, *supra* note 24, at 22; Buchheit, *supra* note 22, at 21; Häseler (2008), *supra* note 6, at 2.

35. *See* Buchheit & Gulati, *supra* note 23, at 1332. For an example of a trustee "using" this provision to justify inaction, see Concord Trust v. Law Debenture Trust Corp. plc [2005] UKHL 27 (appeal taken from Eng.), discussed below.

36. Häseler (2010), *supra* note 6, at 5; IMF (2015), *supra* note 1, at 11–12.

tures are similar. However, they generally provide that individual holders have the right to bring an enforcement action in respect of any amounts of interest and principal not paid on their respective due dates. In this respect, market practice for New York law sovereign bonds reflects market practice for U.S. law corporate bonds, where this carve-out is required under the Trust Indenture Act of 1939 (TIA).[37] From the mid 2000s, however, some New York law governed bonds have provided for full centralization of enforcement powers in the trustee including Grenada (in 2005), Belize (in 2007), and the Republic of the Congo (in 2007).[38]

The practical difference between the traditional New York law and the English law approach to individual enforcement rights is reduced by the impact of collective acceleration clauses. Both English law trust deeds and New York law trust indentures generally provide that amounts due under the relevant bonds cannot be accelerated unless there has been (i) an event of default, and (ii) a direction by holders (usually twenty-five percent by principal amount) to the trustee to accelerate all amounts due.[39] In addition, many trust deeds and indentures provide that a majority of holders (usually fifty percent by principal amount) can vote to "rescind" a previously declared acceleration.[40] This can be an effective tool—holders that participate in an exchange offer as part of a restructuring may vote to rescind a previously declared acceleration immediately prior to exchanging their bonds.[41] The effect of this is that the power to sue for unpaid interest and principal under a New York-governed trust deed is not of such practical significance in the absence of the ability to accelerate amounts due

37. Häseler (2010), *supra* note 6, at 5; Buchheit & Gulati, *supra* note 23, at 1331–32. The TIA requires U.S. corporate bonds to be issued under a trust structure and specifies certain provisions that must be included in the trust documentation. It does not apply to sovereign bonds. It has, however, had a strong influence on New York law governed sovereign bond documentation—its prohibition on CACs explains the absence of CACs in New York law governed bonds prior to the early 2000s.

38. Häseler (2010), *supra* note 6, at 6; Buchheit, *supra* note 22, at 21.

39. Buchheit & Gulati, *supra* note 23, at 1330; Stephen J. Choi, Mitu Gulati & Eric A. Posner, *The Evolution of Contractual Terms in Sovereign Bonds*, 4 J. LEGAL ANALYSIS 131, 147 (2012).

40. Buchheit & Gulati, *supra* note 23, at 1330, 1331, 1347; Choi et al., *supra* note 39, at 147.

41. Buchheit & Gulati, *supra* note 23, at 1331.

to the relevant holder.[42] In addition, a trustee will generally have residual discretion to accelerate or commence enforcement action even in the absence of a direction from bondholders (particularly in English law trust deeds). However, trustees have tended to be reluctant to exercise such discretion.[43]

Finally, trust structures often provide that any recovery by the trustee in respect of litigation (whether directed by the holders or otherwise) is to be shared pro rata among holders, having the effect of creating a "sharing" provision in the terminology of syndicated loan agreements. This has the effect of reducing the potential payoff from litigation for individual bondholders.[44]

A. *Effectiveness of Trust Structures in Preventing Holdout Litigation*

At the outset it is important to recognize that trust structures, on their own, cannot prevent holdout litigation. Trust structures can be effective in preventing disruptive litigation between a default and the completion of a restructuring. However, after a restructuring has been completed, in the absence of a CAC, holdout creditors will (by definition) be the only holders remaining.[45] Accordingly, the holdout creditors will have the requisite majority to provide the directions to a trustee to accelerate and commence litigation against the debtor.[46] Traditionally, vultures have commenced litigation against defaulting sovereigns only after a restructuring has

42. Häseler (2008), *supra* note 6, at 7.

43. IMF (2015), *supra* note 1, at 12–13; Häseler (2010), *supra* note 6, at 6; Mark Brown, *Trustees Face Up to Heavier Burdens,* EUROMONEY (Jun. 2004), http://www.euromoney.com/Article/1001712/Trustees-face-up-to-heavier-burdens.html?utm_campaign=Email%2bverification&utm_content=2017-03-26&utm_term=. For an illustration of when a trustee declined to exercise such discretion when it might reasonably be expected to in relation to Ecuador's default in 2008, see Buchheit & Gulati, *supra* note 24, at 8 (stating that even though the issuer had publicly repudiated the instruments, which is considered a series provocation, the trustee did not exercise its discretion to accelerate either serious of bonds or to commence an enforcement action).

44. Buchheit & Gulati, *supra* note 23, at 1348; IMF (2015), *supra* note 1, at 12; Buchheit, *supra* note 22, at 21; FIN. MKTS. LAW COMM., ISSUE 62: TRUSTEE EXEMPTION CLAUSES 17 (2004).

45. IMF (2015), *supra* note 1, at 13.

46. *Id.*

been completed.[47] They wait for a restructuring to take place, refuse to participate (i.e., hold out) and then commence litigation against the debtor. In this regard, trust structures are only effective when used in conjunction with CACs.[48]

However, when taken together, the combination of these two contractual mechanisms can provide powerful protection against individual bondholder litigation. A trust structure can preclude litigation in the period between a default and the completion of a restructuring, and the CAC can prevent post-restructuring litigation by holdouts (under an effectively operating CAC, there will be no holdouts remaining), leaving little scope for unilateral bondholder action. When used together, these provisions can achieve, contractually, the same effect as a corporate bankruptcy regime.[49]

It is also important to note that while vulture creditors have traditionally waited until the post-restructuring period to commence litigation, vulture creditors may increasingly seek to commence litigation in the period between default and restructuring, given that aggregated CACs (which generally preclude holdout litigation) are becoming the market standard.[50] Accordingly, the importance of the effective "stay" provided by collective enforcement under a trust structure may increase in the future.

B. *Problems with Trust Structures*

Given the benefits of a trust structure described above, one might have expected the market to embrace trust structures in the same way it has embraced CACs.[51] There appear to be two primary reasons why this has not been the case—cost and trustee passivity. Implementing a trust structure is consid-

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47. Gelpern, *supra* note 13, at 226 (citing remarks by Robert B. Gray); Buchheit & Gulati, *supra* note 23, at 1347 (explaining that the Peruvian and Argentinean litigation described above were both commenced after the sovereign restructuring).

48. IMF (2015), *supra* note 1, at 13; Häseler (2010), *supra* note 6, at 3 (referring to the complementary of nature of CACs).

49. Buchheit & Daly, *supra* note 13, at 15.

50. IMF (2015), *supra* note 1, at 11, 12 (explaining CACs, and in particular aggregated CACs, are now standard in sovereign bonds; however, there are still large amounts of outstanding debt stocks that do not include CACs or aggregated CACs, so the vultures may not need to shut their doors just yet).

51. *Id.* at 12, 13.

ered to be more expensive than a fiscal agency structure.[52] Accordingly, for financially sound issuers (with a low risk of default) the added benefit of a trust structure is marginal and may not be considered to be worth the cost.[53] Many countries that have moved to trust structures in recent years are countries with a higher default risk.[54] At the time a bond issuance is arranged, the focus of the issuer is on the cost of the issuance, not the cost of a restructuring (which will hopefully never happen). The tangible cost of a trustee could easily be seen to outweigh the (somewhat harder to quantify) benefits of having a trustee in the event of a restructuring down the line.

However, when the wider costs of a bond offer are taken into account, a fiscal agent is "only marginally cheaper" than a trustee[55] (saving only "a basis point or two"[56]), particularly when compared to the size of a bond issue and other expenses associated with such an issue, including the costs of financial and legal advisors.[57] The second concern relates to the general perception in the market that trustees tend to be overly passive and ineffective in protecting bondholder rights.[58] Lee Buchheit and Mitu Gulati described the behavior of the trustee in relation to Ecuador's 2006 default as "bovinely passive."[59] Michael Chamberlain, Executive Director of the Emerging Markets Trade Association, observed that trustees

52. Buchheit, *supra* note 22, at 21; Häseler (2010), *supra* note 6, at 6; IMF (2015), *supra* note 1, at 13.

53. Häseler (2010), *supra* note 6, at 7.

54. *Id.* at 9; Choi et al., *supra* note 39, at 176 (observing that generally it is high political risk countries that are the first to adopt novel contractual terms on sovereign bond instruments given that for them the cost created by the uncertainty of implementing novel terms is most likely to be justified); *see also* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1112–13 (2004).

55. Buchheit, *supra* note 22, at 21.

56. A M H Smart, *Fiscal Agency or Trust Deed?*, 1 INT'L FIN. L. REV. 18, 18 (1982).

57. FIN. MKTS. LAW COMM., *supra* note 44, at 16 (speaking generally about the trustee fees in the context of international bond issues the FMLC states that "the fees charged by trustees are usually minimal in the context of the overall expenses of an issue"); *see also* Häseler (2010), *supra* note 6, at 5.

58. Häseler (2008), *supra* note 6, at 9.

59. Buchheit & Gulati, *supra* note 24, at 25.

were notable for their "caution, occasional incompetence and being subject to institutional constraints."[60]

This perception is not unique to the sovereign bond context. The role of the trustee in a Eurobond came under scrutiny in the dispute between a group of bondholders and the trustee in respect of bonds issued by former Polish state-owned enterprise Elektrim. The dispute ultimately resulted in the trustee getting a telling-off from the U.K. House of Lords.[61] Asian trustees have been described, in relation to a number of Asian defaults in the late 2000s, as "reluctant, uncooperative or even obstructive."[62] In New Zealand, passivity by trustees was considered to be a factor in a number of large-scale defaults in the late 2000s, leading to a drastic step-up in the regulation of the trustee sector.[63] Likewise, the shortcomings of the trustee sector in the U.S. corporate bond context have been subject to considerable academic analysis.[64]

The problem is that, at the time trust documentation is being negotiated, nobody at the table has any particular interest in structuring the trust arrangements in a way that encourages trustees to be active. The issuer wants trustees to be as cheap as possible, and market practice is for trustee fees to be

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60. *See* Häseler (2008), *supra* note 6, at 9; *see also* Charles P. Goodall, *Eurobonds Issued with the Benefits of Trust Deeds,* 2 INT'L FIN. L. REV. 19, 20 (1983) (observing that "investors often complain that trustees do not act positively enough").

61. *See* Concord Trust v. Law Debenture Trust Corp. plc [2005] UKHL 27 (appeal taken from Eng.) (coincidentally, the bondholder leading the litigation was an Elliott Associates affiliate). Mark Brown discusses the Elektrim dispute as well as other Eurobond trustee disputes. *See* Brown, *supra* note 43; *see also* James Roome & Gordon Singer, *What to Do When a Bond Issuer Defaults*, FIN. TIMES (June 13, 2005, 3:00 AM), http://www.ft.com/cms/s/1/1a3a1f46-dba8-11d9-913a-00000e2511c8.html?ft_site=falcon&desktop=true#axzz4VIK3wn9x.

62. Saptak Santra, *Bondholders, Fight Back*, INT'L FIN. L. REV., July–Aug. 2010, at 26.

63. *See* Financial Markets Supervisors Act 2011, s 3 (N.Z.)*; see also* OFFICE OF THE MINISTER OF COMMERCE, IMPROVING THE SUPERVISION OF ISSUERS BY TRUSTEES (2011), http://www.mbie.govt.nz/info-services/business/business-law/ past-work-older-topics/documents-and-images/cabinet-paper-licensing-trustees.pdf.

64. *See* Kahan, *supra* note 23*; see also* Yakov Amihud, Kenneth Garbade & Marcel Kahan, *A New Governance Structure for Corporate Bonds,* 51 STAN. L. REV. 447 (1999).

"modest."[65] Underwriters want as little interference from trustees as possible. Trustees, given the pressure on them to keep fees down, want a structure that requires them to do the least amount of work possible. The modest remuneration structure for trustees provides little incentive for trustees to actively monitor issuers. Nor does it provide any incentive for trustees to declare an event of default.[66] For the trustee, an event of default is likely to result in a significantly increased workload. However, market practice is that the trustee does not receive any additional compensation for the increased workload associated with an event of default. This provides a perverse incentive for trustees to bury their heads in the sand in the face of financial problems by the issuer.[67] In the words of Mark Adelson (former head of structured finance research at Nomura), "[i]f you want somebody who is prepared to tell the issuer to go to hell, you can't pay them $5000 or $15,000 . . . . You need to pay them $100,000."[68] The stakeholders who have an interest in trustees being active are the bondholders, who the trustee is appointed to represent.[69] However, bondholders are not involved in the negotiation of the finer points of the trust documentation (and probably will not be paying attention to the wording of a trustee indemnity during the marketing period for the bonds).[70] The rating agencies could conceivably take into account the trust structures. However, it is hard to quantify in a rating the impact that a trustee will have (in the event that a restructuring does happen) at the time the bonds are being rated (i.e., at the time of issue).

65. Brown, *supra* note 43; Kahan, *supra* note 23, at 1063.

66. Kahan, *supra* note 23, at 1064; Amihud et al., *supra* note 64, at 473; Santra, *supra* note 62, at 27.

67. Amihud et al. state that "if it becomes aware of a breach, the indenture trustee has a financial *dis*incentive to monitor intensively and to detect breaches," *supra* note 64, at 473 (emphasis in original)*; see also* Kahan, *supra* note 23, at 1064.

68. Brown, *supra* note 43; Santra, *supra* note 62, at 27 (stating in a similar manner "small fees lead to small risk tolerance").

69. Brown, *supra* note 43.

70. *See id.* (Stephen Norton, of the Association of Corporate Trustees, makes the point that "[i]f you were starting with a blank piece of paper and designing a system to accommodate trustee functions, you wouldn't have what you have now," referring to the inherent tension in the issuer appointing and paying the trustee while the trustee's duty is to the bondholders).

Balanced against the lack of incentive provided by the trustee's fees in the context of U.S. corporate bonds is the liability regime mandated under the TIA. Under the TIA, a trustee's duties prior to an event of default are limited (the trustee plays a more or less administrative role and is entitled to rely on "compliance certificates" provided by the issuer).[71] After an event of default is declared, the trustee's liability ratchets up and it is required to satisfy the "prudent person" standard, a "fairly high fiduciary standard."[72] In theory at least, the specter of liability for breaches of these duties provides an incentive for trustees to take an active role in relation to an issuer in financial trouble.[73] That being said, it is arguable whether this threat of liability alone is sufficient to (in the words of Marcel Kahan) "induce the trustee to take optimal actions to represent bondholder interests."[74]

In the sovereign debt context, however, the duty and liability requirements of the TIA do not apply. Accordingly, market practice has developed under which the trustee's liability is much more limited (and the exculpatory provisions much more broad) when compared with U.S. corporate bond arrangements.[75] The effect of this is that, in the sovereign debt context, neither the trustee's remuneration, nor its liability, incentivizes it to be proactive in relation to a default or potential default by a sovereign issuer.

As discussed above, New York law sovereign bond indentures generally mirror U.S. corporate bond market practice (i.e., reflecting the requirements of the TIA) in relation to the holder's right to take enforcement action in respect of unpaid interest and principal (although there have been some recent exceptions). Likewise, the prohibition on CACs under the TIA explains the traditional lack of CACs in New York law indentures.[76] Yet in relation to the trustee's liability, drafting practices depart from the TIA-mandated requirements. Arguably the common thread here is that when negotiating indentures

71. Kahan, *supra* note 23, at 1063–64; Amihud et al., *supra* note 64, at 473; Buchheit & Gulati, *supra* note 24, at 25.

72. Buchheit & Gulati, *supra* note 24, at 25*; see also* Kahan, *supra* note 23, at 1063–64.

73. Kahan, *supra* note 23, at 1064.

74. *Id.*

75. Buchheit & Gulati, *supra* note 24, at 25.

76. Buchheit & Gulati, *supra* note 23, at 1329.

with an issuer, the focus of the parties is on maximizing trustee passivity and minimizing trustee cost. Likewise, in the absence of overt market pressure or regulation, an issuer is unlikely to object to a legal structure that makes for a more passive, less costly trustee.[77]

The final aspect of trust documentation that makes for trustee passivity is the pre-litigation indemnification requirement. Trust documentation (both New York law trust indentures and English law trust deeds) generally requires holders to indemnify the trustee to its satisfaction prior to the trustee being required to accelerate or commence enforcement action against the issuer (i.e., following a direction from twenty-five percent of holders).[78] Trustees that are generally unwilling to take an active role can hide behind the requirement by seeking an overly broad and unqualified indemnity from holders that holders will (quite reasonably) be unwilling to provide.[79] In addition, issuers wanting to fend off action by trustees who otherwise might be proactive have been known to threaten legal action against the trustee, for example in respect of wrongful acceleration.[80]

As a result, trustees have a reputation for involving added expense, while being overly passive from the point of view of investors. This highlights the incongruous purpose of employing a trustee structure. Traditionally, the trustee was seen as an investor protection mechanism, mandated by securities laws to overcome the collective action problems that exist with a dispersed body of investors.[81] However, with increasing institutional ownership, particularly in the debt markets, combined with the looming threat of vulture funds such as Elliot Associates, the concerns regarding collective action (at least in a sov-

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77. FIN. MKTS. LAW COMM., *supra* note 44, at 18 (describing the effect of a proposed statutory limit on trustee exemption clauses in the U.K., stating "[t]he increased level of monitoring, coupled with the increase in fees, is likely to be unattractive to issuers").

78. *See* Concord Trust v. Law Debenture Trust Corp. plc [2005] UKHL 27 [5] (appeal taken from Eng.); Santra, *supra* note 62, at 26.

79. Santra, *supra* note 62, at 26, 27 (many institutional investors may have internal policies that either prevent them or make it difficult for them to provide such indemnities); *see also* Brown, *supra* note 43.

80. Brown, *supra* note 43*; see also* Concord Trust v. Law Debenture Trust Corp. plc [2005] UKHL 27 [7]–[8].

81. *See* Kahan, *supra* note 23, at 1043–44, 1059–60; FIN. MKTS L. COMM., *supra* note 44, at 16; Häseler (2008), *supra* note 6, at 9.

ereign bond context) have given way to concerns about overly litigious bondholders. These conflicting purposes may underpin the conflicting incentives on trustees in relation to modern sovereign bonds.

There is an argument, however, that more modest changes to sovereign bond trust documentation, together with the right incentives from the courts, could enhance the effectiveness of trust structures. To raise the expectations on trustees, more attention should be given by issuers and investors to the trustee's duties and liabilities in sovereign bond documentation. If the liability and exculpatory provisions that are market-standard in sovereign bonds were made consistent with TIA-compliant trust indentures, a trustee would be more likely to play a proactive role in the event that a sovereign debtor were in financial difficulty, given the potential for liability to bondholders from acting in an overly passive manner.[82] These provisions are market standard in U.S. corporate bonds. Accordingly, trustees should be comfortable with the expectations that they would place on them and, as such, they should not result in significant increases in trustee fees.

The courts could also have an important role in creating the appropriate incentives for trustees. Court decisions that reduce a trustee's concern about issuer liability (such as for wrongful acceleration) and increase their concern about potential liability from bondholders could encourage trustees to be more proactive. The House of Lords decision in *Concorde Trust* is encouraging in this regard. In *Concorde Trust*, the trustee was hesitant to accelerate the relevant debt following threatening correspondence from the issuer.[83] The question for the House of Lords was whether the trustee was entitled to request an indemnity from holders in respect of exposure to damages for wrongful acceleration (in addition to the usual indemnity for costs in respect of the litigation). The Court analyzed all of the potential claims by the issuer and concluded that none of them had a reasonable chance of success.[84] Accordingly, the Court concluded that the trustee was not entitled to require such an extensive indemnity.

82. Buchheit & Gulati, *supra* note 24, at 25.
83. *Concord Trust*, *supra* note 35, at 14–16.
84. *Id.* at 43.

The policy underpinning this decision is encouraging. It should reduce trustee concern about the threat of litigation from issuers (threats will need to be grounded in proper legal doctrine to be valid rather than based on an illusory claim of "wrongful acceleration"[85]). This decision also sends a message to trustees about unreasonably using the indemnification requirement as a justification for inaction. This approach from the courts should assist in reducing passivity and raising the expectations and performance of trustees in relation to sovereign bonds (particularly if U.S. courts were to take this approach, given the greater perceived risk of "lender liability" in the United States for wrongfully accelerating a debt).[86] In addition, trust deeds should prescribe the scope of the indemnity that trustees are entitled to seek from bondholders prior to accelerating or commencing litigation[87] (generally it will be much easier to agree such provisions on a "clear day"). Greater prescription should reduce the scope for trustees to justify inaction by seeking unreasonably broad indemnities. Following *Concorde Trust,* trustees may be prepared to accept greater prescription of such indemnities at the time trust deeds are negotiated.

One other potential solution would be to amend the TIA by (i) ratcheting up trustee duties and liabilities, and (ii) extending the reach of the TIA to bonds issued by sovereigns. In the context of U.S. corporate bonds, Amihud, Garbade, and Kahan proposed an overhaul of trust structures, suggesting what they described as a "supertrustee." The supertrustee would be a trustee with a revised compensation structure (one that incentivizes it to be active), with much more extensive information and inspection rights and subject to more onerous monitoring duties.[88] At least one author has suggested that the supertrustee structure should be adopted in the context of sovereign bonds.[89] The New Zealand approach of licensing and

85. The plaintiffs argued that the so-called claim regarding wrongful acceleration was a "mirage." *Id.* at 8.

86. *See* FIN. MKTS. LAW COMM., *supra* note 44, at 21 (referring to the perceived risk of "lender liability . . . particularly in the [United States]").

87. *See, e.g.*, Santra, *supra* note 62, at 27.

88. Amihud et al., *supra* note 64, at 473.

89. Robert Auray, *In Bonds We Trustee: A New Contractual Mechanism To Improve Sovereign Bond Restructurings,* 82 FORDHAM L. REV. 899 (2013).

actively regulating trustees could be another option.[90] However, at this stage there does not appear to be any appetite for such legislative change at this time.

In conclusion, despite trust structures having some shortcomings, there is good reason to believe that with a focus on improving trust documentation and trustee performance, the use of trust structures could be an effective mechanism to protect bondholder rights while insulating issuers from holdout creditor pressure. In that regard, more widespread use of trust structures could benefit issuers and investors alike and should be encouraged.

III. CREDITOR COMMITTEES

The use of creditor committees in sovereign debt restructurings is another mechanism borrowed from Chapter 11 of the U.S. Bankruptcy Code where the use of committees to represent the various groups of creditors is a fundamental aspect of the Chapter 11 process.[91] The idea underlying the use of the creditor committee is that engaging and consulting with creditors makes for a "quick and successful restructuring."[92] An effective committee that is representative of a large body of the sovereign's creditors can streamline communications and negotiations between a sovereign and its creditors.

A. *A Brief History of Creditor Committees*

In the 1980s and early-1990s, sovereign debt was largely held by commercial banks in the form of syndicated bank loans. In those days, a common feature of any sovereign debt restructuring was the presence of a "bank advisory committee" to represent the interests of the various commercial banks in the syndicate. While lacking a formal mandate (and any kind of express responsibility to the sovereign's other creditors) the

90. *See* Financial Markets Supervisors Act 2011 (N.Z.).

91. The Bankruptcy Code requires an unsecured creditors committee to be appointed and it is also possible for a committee to represent other classes of creditors and equity holders. Buchheit, *supra* note 30, at 205.

92. *See* ZANDSTRA, *supra* note 30, at 2–3*; see also* Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts* 29 (IMF, Working Paper No. 12/203, 2012).

bank advisory committees played an important role in negotiating the financial and legal terms of any restructuring package.[93] However, as the general body of sovereign debt shifted from bank loans to bonds, the typical body of sovereign debtholders became much more numerous and diffuse. Accordingly, the use of formal committees fell away and instead sovereign debtors would tend to appoint a financial advisor which would sound out creditors in order to get an idea of what kind of support a restructuring proposal would receive on a vote.[94] However, with the advent of holdout creditor litigation, committees have come back into discussions in the context of sovereign bonds.

As with CACs, the ICMA has released a standard form "creditor engagement clause" which can be included in sovereign bond documentation to mandate the appointment of a creditor committee. This clause provides for holders of at least twenty-five percent of the aggregate principal amount of the sovereign's securities outstanding to appoint a committee to represent their interests (as well as the interests of any other holders who wish to be represented) in the event of default or potential default.[95] The provisions require the issuer to engage with the committee in good faith, reimburse the fees (including legal and financial advisor fees) of the committee agreed in advance with the issuer and require the issuer to provide certain information to the committee (the same information required to be provided to creditors ahead of a vote to approve a restructuring, including financial and economic information as well as information regarding the terms of any restructuring proposal).[96]

Despite the obvious appeal of creditor engagement clauses, they have not been adopted on a widespread basis to the same extent as CACs. The Institute of International Finance and the U.N. General Assembly have both released principles on sovereign debt restructurings which address good

93. Buchheit, *supra* note 30, at 207.

94. *Id.* at 208*; see also* ZANDSTRA, *supra* note 30, at 1.

95. INT'L CAPITAL MKT. ASS'N, STANDARD AGGREGATED COLLECTIVE ACTION CLAUSES (CACS) FOR THE TERMS AND CONDITIONS OF SOVEREIGN NOTES GOVERNED BY ENGLISH LAW 25 (2015), http://www.icmagroup.org/resources/Sovereign-Debt-Information/.

96. *Id.* at 8–9.

faith engagement by sovereign debtors and creditors.[97] The IMF has acknowledged the benefits of engagement with committees but is understood to be in the process of producing a full paper on the subject.[98] Only a handful of sovereign issuers have included creditor engagement provisions in the bond documentation for recent issuances.[99]

B. *Why the Lack of Take-Up?*

As with trust structures, a key concern for sovereign issuers is cost. There is a concern on the part of issuers that the costs of creditor committees, together with the fees of their financial and legal advisors, can be high.[100] Indeed, in the most recent revision of the ICMA standard clauses for sovereign bonds, the revised creditor engagement clause was amended to provide that the expenses of the creditors' committee must be agreed in advance with the issuer, highlighting the concern on the part of issuers.[101]

However, there is reason to believe that these concerns are misplaced. In the context of a large-scale restructuring, the costs of a creditors' committee and its advisors could be minimal relative to the amount at stake in the restructuring itself.[102] Unlike trust structures, which involve a guaranteed additional cost for benefits that will never be realized absent financial problems, costs relating to a creditor committee will only be incurred in the event of financial problems. In addition, as discussed above, the evidence suggests that close engagement with creditors makes for a quick and successful restructuring.[103] A drawn-out restructuring process is also likely to result in significant advisor fees—not to mention the costs

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97. PRINCIPLES CONSULTATIVE GRP., PRINCIPLES FOR STABLE CAPITAL FLOWS AND FAIR DEBT RESTRUCTURING (2013), https://www.iif.com/news/capital-markets-and-emerging-markets-policy/2013-pcg-report-implementation-principles; G.A. Res. A/69/L.84 (July 29, 2015), http://unctad.org /meetings/en/SessionalDocuments/a69L84_en.pdf; ZANDSTRA, *supra* note 30, at 3.

98. ZANDSTRA, *supra* note 30, at 3.

99. *See id.*

100. *Id.* at 4; Buchheit, *supra* note 30, at 212; TIMOTHY B. DESIENO, CREDITOR COMMITTEES IN SOVEREIGN DEBT RESTRUCTURINGS: UNDERSTANDING THE BENEFITS AND ADDRESSING CONCERNS 3–4 (2014), http://www.un.org/esa/ffd////wp-content/uploads/2014/12/9Dec14-BS-statement.pdf.

101. INT'L CAPITAL MKT. ASS'N, *supra* note 95.

102. *See* ZANDSTRA, *supra* note 30, at 4.

103. Das et al., *supra* note 92, at 29; ZANDSTRA, *supra* note 30, at 2–3.

to an economy resulting from the uncertainty created by a country being in a prolonged state of default or potential default. One can presume that these costs could very easily far surpass the costs of a creditors' committee in a well-managed restructuring.[104] Furthermore, given the makeup of modern bondholders, absent a committee, the issuer is likely to incur significant costs dealing with a dispersed and diverse group of bondholders.[105] Their own financial advisors will likely incur huge costs in communicating, sounding out and negotiating with individual bondholders. Saving money on committees in the short run may come at the expense of the issuer.

The second concern with creditor committees is that once a committee is formed, it is very hard for a sovereign to divorce itself from the committee.[106] The concern of issuers is that if negotiations with the committee break down and the committee refuses to endorse a restructuring proposal, creditors will treat any such proposal with skepticism. In this respect, a sovereign debtor can be held to ransom. Complicating this is the concern that negotiations with the committee may break down for reasons unrelated to the debtor—that the internal jealousies and conflicts between committee members can jeopardize the committee process.[107] This was one of the problems that led to the downfall of the bank advisory committees. In those days, restructurings were frequently bogged down for reasons unrelated to the debtor.[108] For the bankers in the context of the restructuring, they have to worry (i) that the debtor is not seeking more concessions than are justified or necessary, and (ii) that no other creditor is getting a better deal.[109]

This is not a concern that is specific to restructurings that involve a committee. An important consideration in any restructuring proposal is that all creditors are treated fairly and

104. In DeSieno's view, the added expense of a committee "always pales in comparison to the benefit of a successful deal." *See* DESIENO, *supra* note 100, at 3.

105. ZANDSTRA, *supra* note 30, at 4.

106. Buchheit, *supra* note 30, at 210; *Id.* at 5.

107. *Id.* at 211.

108. *Id.* at 208, 211.

109. See Buchheit, *supra* note 30, at 211 n.16, for an example in the context of the Iraqi 2005 restructuring.

equally.[110] In addition, the ICMA standard provisions for noteholders' committees contain little detail regarding the procedures for committees formed under those provisions. While bank advisory committees always operated under a requirement for unanimity, there is no reason for creditors' committees formed to represent bondholders to do the same.[111] Indeed, the current trend in sovereign debt is a move towards supermajority creditor control (with the introduction of CACs) and there is no reason why the approval requirements for a vote of creditors not be matched in relation to committee decision making. More fundamentally, as both DeSieno and Clifford Chance observe, declining to get married because divorce might be difficult is not necessarily the best reasoning.[112]

Another reason that may prevent engagement clauses from getting adopted across the market is that, in a narrow sense, they are for the benefit of creditors. It is always an option for a debtor at the time of a restructuring to convene a committee, whereas including an engagement clause at the time of issue binds a debtor (if the requisite percentage of creditors request it) to convene a committee. That said, including an engagement clause at the time of issue, can act as a signal by an issuer that, if it does need to restructure its debts sometime in the future, it will engage with creditors in good faith. The bottom line is that good faith engagement between sovereign debtors and creditors makes for a successful restructuring.[113] Good faith efforts to engage are particularly important in the context of today's widely disbursed bondholders.

The extent to which debtors can engage in good faith will make for quicker and fairer restructurings and for better relations when issuers seek to re-access the capital markets after a restructuring. Including creditor engagement clauses in bond documentation when issued which prescribe the basic rules of

110. This is by no means an easy task given that sovereigns will have an array of classes of creditors (bondholders, banks, trade creditors, multilaterals, other sovereigns) and given that a sovereign may have a range of different series of bonds outstanding with different coupons, maturities, and other terms. As mentioned above, a contentious issue in the Argentinean settlement was how to value the floating-rate adjustable notes issued by Argentina.

111. *See* ZANDSTRA, *supra* note 30, at 4–5.

112. *Id.* at 5. DESIENO, *supra* note 100, at 5.

113. ZANDSTRA, *supra* note 30, at 5.

engagement, rather than relying on ad hoc committees at the time of distress, is a symbolic gesture by an issuer that if it does need to conduct a restructuring, it will act in good faith and engage with creditors. To that extent, the more widespread use of creditor engagement clauses should be encouraged and seen as beneficial for issuers and investors alike.

Conclusion

In conclusion, trust structures and creditor committees will not be a quick fix to all the problems associated with sovereign debt restructurings. However, if both are implemented alongside collective action clauses, there is good reason to believe that sovereign debt restructurings will be able to be completed in a much more orderly manner. The perceived cost involved with each structure appears to be a significant factor in why issuers have not adopted them on a more widespread basis. However, the marginal costs of trustees and committees, when compared to the additional steps an issuer would need to take in their absence, will in many instances be limited. The costs saved by completing an orderly restructuring are likely to far outweigh the marginal additional costs of trust structures and committees and, accordingly, their more widespread use would benefit both sovereign issuers and investors.