UNIVERSITY of RWANDA

ANALYSIS OF RECENT TRENDS OF THE LEGAL ENFORCEMENT OF SOVEREIGN DEBT CONTRACTS

By

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DECLARATION

I, Musika Béatrice, LLM student in Business Law at University of Rwanda, hereby declare that the work contained in this dissertation is my own work except where specifically acknowledged, and that in my knowledge this work has not been submitted for any other degree at the University of Rwanda or other institution. I also declare that this piece of work has been passed through anti- plagiarism system and found to be compliant and this is the approved final version of the Dissertation.

Signature …………………………………… Date ……………………………………

DEDICATION

For my husband and best friend Cabin;

For our two precious sons Ganza & Kenny;

Your prayers and hugs when I left you every morning during weekends only to come back to you at night so exhausted to take care of you, your patience, understanding and support in what I was doing, meant a lot to me.

Learning never ends but now that I'm done with this cycle, I'm available to spend a lot of time with you and take good care of you!

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ABSTRACT

States or their entities, for different reasons borrow money from private organizations, other States or government and international financial institutions. Like any other person, to be eligible to acquire such loan there need to be formal sovereign contract or agreement that set out every term and condition that shall regulate both the lender and the borrower.

However, States as subjects of public international law, are customarily protected by the absolute immunity principle, in the way that no States are sued in foreign courts without their consents and the sovereign immunity has been long an impediment to the enforcement of sovereign debts agreement or contract talked above, except when the State was engaged into commercial transactions or activity. Nevertheless, issues related to the enforcement of sovereign debt contracts are not only limited to the sovereign immunity, but also on how contracts governing the matter are negotiated and drafted in order to have a balanced document towards a win-win situation.

The aim of this study is to examine challenges associated with the enforcement of sovereign debt contracts, how those issues have been addressed and the role that could be played by an optimal sovereign debt contract for reaching a fair and effective enforcement.

By analyzing sovereign debt contract, it has been noticed that most of those agreements are model law contracts in which sometimes sensitive clauses like restructuring and enforcement are not exhaustively drafted while they are very important as long as they govern the enforceability of the contract in case of default. Creditors and debtors should create effective and innovative contractual provisions to govern their relationship through contract. If the role of contracts in the enforcement of sovereign debt was emphasized by reserving a particular attention to key clauses, uncertainty would be reduced and market would operate more efficiently. This will considerably reduce defaults and therefore contracts become a solution to the attainment of sovereign debt enforceability.

CHAPTER ONE: GENERAL INTRODUCTION

This chapter briefly deals with how sovereign debt contracts are enforced with different mechanism and strategies in place reviewed by different authors. It brings forth the background of the study to enable understanding of conceptual framework and tackles the problem statement underpinning the research paper.

I.1 Background to the study

When an individual or an enterprise is in the process of starting or expanding its activities, it will definitely require additional funding or capital. These financial resources can be acquired from financial institutions like banks or any third party disposed to give a loan the to the business. In case Where money is lent to a business, the lender and the borrower will enter into a loan agreement that describes essential issues about that loan.

It is the same for countries. Debt acquired by sovereign equally known as public debt are as well government debt. Although both terms(sovereign and Government debts) are used interchangeably, they differ in currencies there are issued in, whereby the Sovereign debt is issued in foreign currency whereas the government debt is in the domestic one .[1] Sovereign debts are sold to foreign investors in a foreign currency in a form of bonds issued by a national government in order to finance the issuing country's growth.[2] In simple words, sovereign debt is a promise from the government to lenders, assuring them to pay back the money lent. It is the value of bonds issued by the government of that country.

However, most especially governments borrow to increase expenditure and cut taxes for health, education, defense, infrastructure and research but on the contrary some

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[1]Brent Radcliffe, HOW COUNTRIES DEAL WITH DEBT, http://www.investopedia.com visited on 23/10/2015
[2] ibid

Government borrow purposely for investment promotion and consumption raising rate for economic growth and employment boosting. [3]

More to that, emerged markets and advanced economies issue government bond and sell them to private investor to borrow money in the sense that bonds are sold foreign investors or local investors.

To elaborate the above for instance in Japan and Italy, bonds are sold to local investors in a sizeable portion whereas in the United States they are sold to foreigners at a half of its federal debt, but borrowing strategy to developing country's economy may be extended to other government or international financial organizations like World Bank or IMF .[4]

I.2 Statement of problem

It is admitted that "before buying a government's sovereign debt, investors determine the risk of the investment. The debt of some countries, such as the United States, is generally considered risk free, while the debt of emerging or developing countries carries greater risk. Investors have to consider the government's stability, how the government plans to repay the debt, and the possibility of the country going into default. In some ways, this risk analysis is similar to that performed with corporate debt, though with sovereign debt investors can sometimes be left significantly more exposed." [5]

Different analysis revealed that sovereign debt shifted from syndicated loan to bonds strategy in loan guarantees which was mainly accelerated in tradable bonds to be

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[3]Rebecca M. Nelson, CRS Report for Congress: Sovereign Debt in Advanced Economies: Overview and Issues for Congress, November 2013

[4] U.S. Department of the Treasury, "Major Foreign Holdings of Treasury Securities,"

[5]Supra note 1

issued in exchange of loans. This brought some innovations in modern market that were viewed much attractive to raise funds.[6]

P. Francina points out that, although the issuance of state bonds does not represent, as such, an expression of sovereignty, a structural disparity exists between sovereign issuers and their creditors, since the former have the power to enact legal rules and may in fact exercise this prerogative throughout the life of the loan, thereby possibly affecting the rights of creditors.[7]

Thus, where sovereign securities are at stake, the problem arises as to what extent and by which legal means the rights of private creditors may be effectively shielded from the sovereign prerogatives of the debtor, as may be used, in particular, when the borrowing State finds itself unable to service its debt or is unwilling to honor its commitments in full and on the agreed maturity dates.

It is important to point out that States may not be subject to formal bankruptcy proceedings or proceedings having comparable effects. However, they may want to apply their sovereign powers to avoid the risk of default or to deal with the consequences of a default, thereby depriving their creditors of remedies they might otherwise have in a solely private scenario.

However financial transactions operated by States itself or its entities are subjected to commercial activity governed by commercial loan rules and bonds attached thereto.[8]

It the view of P. Francina, sovereign bonds almost invariably display a transnational nature. On the one hand, the market where the securities are meant to be traded is, today, a borderless one, virtually embracing all the countries in the world. On the other hand, issuing procedures tend to involve a variety of players such as loan underwriters

[6]Kevin E. Davis, Financing development, http://www.iilj.org/courses/fdsovereigndebtbackground.asp, accessed on 24/10/2015

[7] Pietro Franzina, SOVEREIGN BOND AND THE CONFLICT OF LAWS: A European prespective, University of Ferrara, Departement of Law, P.1

[8] Ibid

lead managers, trustees etc. whose places of business are often situated outside the territory of the borrowing country.[9]

International transactions involve various legal systems claiming monopoly power within their respective boundaries. The international legal system is characterized by collisions of norms and gaps between different norm systems. Consistency of court decisions is often merely coincidental and the assistance of the judicial and penal institutions in foreign countries is not always reliable.[10]

Finally, the evolution of sovereign bonds implicates questions of contract theory. According to Mark L.J. Wringht, in his journal entitled theory of sovereign debt and default, brought the attention that lack of legal contract system enforcement on a supranational level of transaction entails greater risks of defaults on payments than local financial transactions.

The Author above continued to argue that the above risk talked about is severely viewed when the asset attached thereto are sovereign or government debt under operation of foreign legal system sizeable or subject to legal remedies denial through domestic political system. [11]

The Author went on to argue that domestic debt defaults are determined the legal system of the States or institutional framework governing bankruptcy and legal remedies are limited by the immunity from jurisdiction bringing in some exception to law suits and vulture funds are used for indirect legal recourse of States defaulters.[12] It is in this regards that the main questions that this research seeks to answer are the following:

- What is the legal framework governing sovereign debts?

- Is sovereign immunity an impediment to the recovery of sovereign debt?

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[9] Supra note 7

[10] Dieter Schmidtchen, Roland Kristein and Alexander Neunzig, CONFLICT OF LAW RULES AND INTERNATIONALTRADE, Discussion Paper 2004-01, http://www.uni-saarland.de/fak1/fr12/csle/publications/2004-01_conflict.pdf accessed on 30/10/2015

[11] Mark L.J.Wringht (2011), THEORY OF SOVEREIGN DEBT AND DEFAULT, University of California, los Angeles

[12] ibid

- Are there remedies in place to effectively enforce sovereign debt contracts?

I.3 Hypotheses

To address the aforementioned legal questions, the researcher will cater for the following hypotheses:

1.The transnational nature of sovereign debts involves international legal system.

2. Sovereign immunity can be an impediment to the recovery of sovereign debt.

3.There are remedies in place to effectively enforce sovereign debt contracts.

I.4 Research Methodology

The research method used in this dissertation is desk- based research in examining various literature published in the area of sovereign debt, especially, case laws and various provisions of sovereign or bond contracts put forward with regard to their effective enforcement.

I.5 Subdivision of the work

Apart from the General Introduction that covers a background to the study, the problem statement and research questions that are the backbone of the research, this work is subdivided in other three chapters. Chapter two examines the legal framework of sovereign debts and impediments pertaining to its transnational nature. With regards to this chapter, international transactions include numerous legal system claiming monopoly power within their respective limits. The global legal system is characterized by collisions of norms and loopholes between different norm systems which have been assessed under this chapter. The third chapter deals with the decline of sovereign protection through restriction to sovereign immunity. It asses the legal framework of the

waiver of state immunity and exceptions pertaining to it. Chapter four outlines remedies to the enforcement of sovereign debts by emphasizing on provisions of an optimal sovereign debt contract. A conclusion driven by the research results in prior chapters draws how the enforcement of sovereign debts may be enhanced by modifying contractual terms to address mainly the problem resulting from restructuring process, which is the main puzzle during the enforcement of contract.

CHAPTER II: THE LEGAL FRAMEWORK OF SOVEREIGN DEBTS AND IMPIDIMENTS PERTAINING TO ITS TRANSNATIONAL NATURE

This chapter aims at establishing the legal framework governing sovereign debts contracts by taking into consideration the status of all the players involved in sovereign debt contracts which may help to understand some behaviors or contentious tactics of those players.

II.1 Legal framework of sovereign debts

The legality part will review two aspects relating to private law contracts and private International Contract Law and Party Autonomy and draw a conclusion attached to the next section which brings in depth analysis pertaining with sovereign debts and impediment to sovereign immunity in the sense that the legal part shall be addressed accordingly.

II.1.1 Private Contract Law System

Sovereign or private corporation's loans are achieved through legal loan contracts imposing rights and obligations on each party to the contract and sovereign loans are offered by private banks, States, International financial institutions or sovereign bonds.

Sovereign states relationship is regulated by the public international law in the sense that States are free to legislate internal affairs and monitor judicial function but the exception comes in while the States has been engaged in commercial transaction viewed as commercial activity.[13] Contracts related to sovereign debts are constituted on the principle of private autonomy of countries. Simply put, states' loans or those

[13] GUIDITTA Cordero Moss, INTERNATIONAL COMMERCIAL CONTRACTS: Applicable Sources and Enforceability, Cambridge university press, June 2014. Found at https://www.cambridge.org/core/books/international-commercial-contracts/EE1D6BACEB5321E87ABDCA1851C91359, visited on 15/09/2019

contracted by state entities, comprising financial transactions sometimes performed by issuing bonds, are naturally private transactions based on the rules governing commercial loans. This is better illustrated in the case law concerning the payment of various Serbian loans issued in France .[14]

This case concerned the payment of various Serbian loans issued in France and Serb-Croat-Slovene government made a subsidiary contention to the effect that the obligations entered into were governed by the French law. Regarding the issue of whether it is the law of France which governs the contractual obligation in this case, the court made the following observations: "*Any contract which is not a contract between States in their capacity as subjects of international law is based on the municipal law of some country".[15]*

The seized Court over the matter of the law governing the contractual obligations, may determine the nature of that law solely by reference to the actual nature of those obligations and the circumstances which led to their creation. It may also take into account the expressed or presumed intention of the parties.[16]

II.1.2 Legal Autonomy of Private International Contract

Based on what said in the previous section, to establish that sovereign's loan contracts fall under private law, it is relevant to think about the court or tribunal, which has jurisdiction over disputes related to sovereign debts, the applicable law to those kind of contracts and the law to be followed with regard to procedure. However, the private international law on contract, provides solutions to the questions raised. Conflict rules or choice of law rules within Private International law, seeks to identify the governing law of international relationship.[17]

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[14] Permanent Court of International Justice, case law concerning the payment of various Serbian loans issued in France, France v. Kingdom of the Serbs, Croats and Slovenes (1929) paragraphs 84-86 available at https://www.worldcourts.com/pcij/eng/decisions/1929.07.12_payment1.htm
[15]Ibid
[16]Idem paragraph 87
[17] Supra note 13

It is important to note that the term “international” in private international law context does not invoke the source of law; rather it is interpreted as the object meant to be on international framework[18]

Often, a number of international features characterizes sovereign debt contracts, seeing that parties to a sovereign bond or loan contract reside in different jurisdiction most of the time, which means that investor’s country residence and the debtor one are different. Additional to that, several debt contracts of sovereigns including bonds are governed by international jurisdiction instead of the sovereign’s or domestic one. This is done in order to secure the contract from eventual changes which may be caused by later national legislations. The issue of contract by whatever way it may be of international dimension or not, and whether private international law is applicable to sovereign debt contracts is not disputed in sovereign debt context. The puzzle turns on the governing law of sovereign contract as well as the court which has jurisdiction over sovereign debt disputes.[19]

As each country has its own conflict of law rules, contract governing law must be identified by conflict rules of the state under which the court was petitioned.[20] National choice of law rules whose sources are found in supranational regulation are of international origin and their applicability is materialized through international conventions ratified by the state.[21] National legislations contain some national chosen rules, others are based on customs and precedents or jurisprudence. In private international law, most sovereign states involved in business transactions recognize party autonomy principle as a conflict of law rule in contractual matters.[22] As result, the contracting parties have the freedom of choosing the law which will be applied by the court in the event of dispute, or in other words the law that governs relationship in contractual matters is determined by the parties themselves. .

[18] Cordero-Moss (2013) 19.

[19] Supra note 13

[20]ibid

[21] Rome I Regulation (2008)

[22]Supra note 13

The contracting parties can also make a choice of the forum where they want they future disputes to be dealt with. Through a forum selection clause, the parties may agree on a specific court in a given jurisdiction or opt for alternative dispute resolutions by determining whether their disputes will be handled via mediation or arbitration. Governing law and forum selection clauses are contained in modern loan agreement and sovereign bond in order to ensure that the interpretation of contract provisions is given to a specific court applying one or several specific sets of rules.[23] Conflicts over choice of the governing law and the forum still arise, despite the fact that parties can choose them.

However it is partially enlightened that conflict of law differs from country to country and may consequently define differently laws governing the same relationship.[24] In addition, requirements to exercise the autonomous will of the parties depends on the rules of private international law in force in respective states.[25]

With the above mentioned findings, it is in this regard that the research draws deeper in the next section to analyze the impediment to the recovery of sovereign debts due to sovereign immunity often invoked by sovereign debtors.

II.2 Analysis of sovereign debts and impediment pertaining to sovereign immunity

This section will make an analysis of sovereign debts and key concepts related to sovereign immunity and shed light common problems associated with contracting with a sovereign entity.

II.2.1 Analysis of sovereign debt

Most of the time Developing countries borrow the money they need to cover expenditures that will ultimately promote development. For many countries, money

[23] Supra note 13
[24] Ibid
[25] Ibid

raised from taxation cannot be sufficient to pay for investment that will increase economic output. Others require temporary assistance to pay for necessary social services during a period of economic downturn. There are a number of different forms of debt financing available to a country seeking to raise funds, from issuing bonds to taking out loans from private banks.[26]

The difference between Sovereign debt and corporation's debt is of two fold as highlighted below:

Firstly, contrary to domestic setting whereby private corporations as borrowers normally do not refuse to repay debts to creditors, in international context, the problem is on implementation level whereby there is no international bankruptcy court in place to enforce debt contracts between private investors and sovereign States.

In Domestic context, national courts enforce debtors to turn over existing assets to creditors and put the debtor through bankruptcy proceedings and liquidation process. This is not the case in international context due to the fact that there are no internationally accepted laws or bankruptcy courts to provide creditors recourse against governments that refuse to repay their debts.[27]

Generally, public assets are immune from seizure, even if there is a ruling in favor of the creditors against a government in default. The properties of the sovereign debtor which are within its national borders beneficiate from sovereign immunity and get special protection like the one owed by embassies, central bank funds.[28]

Debt contracts between governments and private creditors often include provisions that stipulate what jurisdiction's law is to be applied in the event of a dispute about the contract. However, there is no way government is to be forced to pay defaulted debt to abide by another country's court ruling. Proposals for creating internationally accepted

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[26] http://www.iilj.org/courses/fdsovereigndebtbackground.asp

[27] Anne O. Krueger, A New Approach to Sovereign Debt Restructuring, International Monetary fund, April 2002. Available at https://www.imf.org/external/pubs/ft/exrp/sdrm/eng/index.htm, visited on 15/9/2019

[28] Susana Nudelsman, IS IT POSSIBLE TO IMPROVE SOVEREIGN DEBT RESTRUCTURING, Revista Problemas del Desarrollo Volume 47, Number 184, January-March 2016, available at http://www.scielo.org.mx/pdf/prode/v47n184/0301-7036-prode-47-184-00163-en.pdf, accessed on 09/11/2019

bankruptcy proceedings to be overseen by the IMF have been made but without fruitful results.[29]

More to the above, the second difference is that sovereign debt is “unsecured,” in other words they are not backed by collateral.

However, Governments hardly commit to turn over assets in case there are defaults and are unable to repay their debts, and the question of contest reside in the sense that there is no international enforcement authority to compel them to pay debt. This contrasts with private sector in most countries where loans, especially mortgage are backed by collateral. But it exists also some private sector debts which are not backed by collateral such as credit card debts. They are for sure unsecured.[30]

Moreover, researchers do not mean the public debt is naturally riskier than private debt, rather some credit rating agencies use the credit rating of the sovereign as an upper limit for the ratings that domestic borrowers in that country can receive. However, the strict use of a sovereign credit rating ceiling for domestic borrowers has decreased in recent years and Sovereign debt may be less risky than private-sector debt because governments have the power of taxation to raise money in order to service debt, unlike private borrowers.[31]

More to the above, analysis proved that each creditor holds valid, legal and binding debt instruments that are enforceable under the laws of a given jurisdiction and creditors may choose the law of the sovereign’s own jurisdiction or may choose a foreign law for enforcement plan of repayment.

Sovereigns are uniquely vulnerable in the sense that there is no bankruptcy code of law that applies to a sovereign debtor. This is to mean that, an over-extended sovereign confronted with a maturing debt obligation has only two choices which are to pay it or face the prospect of a lawsuit and be compelled to pay it. In other words, a sovereign

[29] Supra note 28
[30] Supra note 27
[31] Supra note 3

States cannot seek the protection of bankruptcy courts, that's why in that sense, sovereigns are considered as uniquely vulnerable of all the debtors in the world.[32].

Another uniqueness is found in the context that most countries do recognize a theory of absolute sovereign immunity whereby a sovereign could not be sued in courts of another country without its consent.

Indeed, sovereigns are uniquely vulnerable in the sense that they face lawsuits, but no general legal protection against them due to the fact that after obtaining a judgement, the creditor may realize that the judgment only bears emotional satisfaction but put aside financial satisfaction unless there is an asset outside the territory of the sovereign which would be the object of enforcement in order to satisfy the judgement. In that mixture of unique vulnerability and unique protection reside the chemistry of all sovereign debt workouts in the way that debtor and creditor, comes to the table with a unique advantage and a unique weakness knowing that. they will be able to get judgments against the sovereign if they want to with very little doubt about it.[33]

However, N. Long brought the example of an article citing the case of **NML Capital, Ltd. v. Republic of Argentina** bringing into litigation the issue of the 'Changing Roles of the Pari Passu and Collective Action Clauses in Sovereign Debt Agreements' where she showed how the Second Circuit's decision in **NML Capital, Ltd. v. Republic of Argentina**, awarded holdout creditors legal rights to ratable payment via a special injunction against Argentina. The author further showed how it was particularly controversial given the fact that it was a radical departure from previous decisions attempting to restrain holdout creditors from disrupting the debt restructuring process. [34]

At the end, the author anticipated drastic responses from the legislature, courts, and sovereign debt markets which did not occur.[35]

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[32] L. Buchheit, Sovereign debt restructurings: the legal context, BIS Papers No 72, available at https://www.bis.org/publ/bppdf/bispap72s.pdf,visited on 09/11/2019

[33] ibid

[34] Case Law NML Capital V. Argentina, http://jtl.columbia.edu/nml-capital-ltd-v-republic-of-argentina-and-the-changing-roles-of-the-pari-passu-and-collective-action-clauses-in-sovereign-debt-agreements/ accessed on 8/11/2019

[35] Ibid

More to the above ALLEN and OVERY also analyses the pari passu clause and the case of Argentine showing how creditors sought a court order against a sovereign State defaulter, which in this particular case, showed how the case of *NML Capital Ltd v Argentina* decided by a U.S. Federal court of appeals held that Argentina violated a standard *pari passu* clause in its old unstructured bonds and by that consequence Argentina was ordered not to make any payments on new bonds unless it made a ratable payment to the holders of the old bonds.[36]

The Authors continued to show that the court's reasoning against Argentina was that violations were a combination, amongst other things, of a statute passed by Argentina preventing Argentina from paying the holders of the old bonds as holdouts, and declarations made by Argentina that it would not pay the holdouts and the persistent non-payment of the holdouts for six years.[37]

II.2.2 Notion of Sovereign Immunity

Sovereign immunity is an international legal concept that means the exemption of a state or a person in relation to the state from the jurisdiction of another state. Immunity limits the exercise of the power (jurisdiction) of courts or other state authorities over foreign states and certain persons or entities and their property.[38]

It could either apply to the exercise of the jurisdictional competence called jurisdictional immunity, or to the exercise of punitive measures called enforceable immunity. Sovereign debtors are customarily protected by the principle of absolute sovereign immunity, which provides that sovereigns cannot be sued in foreign courts without their consent. The principle comes from the equality of sovereign nations in international law

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[36] Allen and OVERY, pari pasu clause and the Argentina case, Global law intelligence Unit available at *www.allenovery.com › SiteCollectionDocuments › The pari passu clause and Argeintana case. Accessed on 08/11/2019.*

[37] Ibid.

[38]State Immunity under International Law and Current Challenges at https://rm.coe.int/final-publication-state-immunity-under-international-law-and-current-c/16807724e9, accessed on 08/11/2018

according to which legal persons of equal rank cannot settle their differences by the court of one of them.[39]

Under absolute immunity, which prevailed in the nineteenth century and in the first half of the twentieth century as stated above, sovereign immunity was carried out in the same way. From the point of view of governments, this showed that commercial interests did not interfere with diplomatic and political relations. diplomatic and political relations.[40] As a result, unless an aggrieved creditor could persuade his own government to apply pressure, he was deprived of legal remedies to enforce repayments.[41]

Moreover, from the notion of sovereign immunity, it is very important that the research point out how sovereign immunity has impediments in practice. It is in this regard that the next section shall discuss and review deeper those impediments in order to show how they link up with immunity of State.

II.3 Impediments towards the sovereign immunity

In the business world, debt contracts are enforced by the court of law. A company simply cannot refuse to repay its debts. If tried, it would be prosecuted and the courts would force it to hand over the assets to the creditor, restructure or close down the limit and liquidate the remaining asset.[42]

This enforcement mechanism is much more limited in a sovereign debt for two reasons:

Firstly, few sovereign assets are located in foreign jurisdictions and a sovereign cannot credibly commit to hand over assets with its jurisdiction in the event of default;

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[39] Supra note 38

[40] FEDERICO STURZENEGGER AND JEROMIN ZETTELMEYER, debt defaults and lessons from decade of crises, MIT press, 2006

[41] Ibid.

[42]UGO PANIZZA, FEDERICO STURZENEGGER, AND JEROMIN ZETTELMEYER, the Economics and Law of Sovereign Debt and Default, Journal of Economic Literature, Vol. XLVII, September 2009

Secondly, there are legal principles that protect sovereign assets even when they are located in a foreign jurisdiction.

However, as it will be reflected in the next chapter, through statutory change and case law opening a window for legal enforcement, the strength of this protection has declined over time.

II.3.1challenges associated with enforcement measures

When it comes to enforcement against a State in the process of debt recovery, there are always be challenges associated with immunity whereby State defaulters take them as defense mechanism to halt parties not to use stringent enforcement measures. It is very important that this sub section discuss those challenges and look deeper how to deal with them.

II.3.1.1 Lack of international Law of Bankruptcy

Within the legal framework of sovereign debt, it has been noticed that the conflicting area of study proved the lack of rules governing bankruptcy at national or international level to ensure an orderly restructuring of the debt of an insolvent sovereign.[43]

Since the time of Adam Smith, various proposals have been made on the need of having a well-defined bankruptcy and restructuring procedures. This is said because in the event that a state announces its bankruptcy in the way it is done by individuals, that bankruptcy self-confessed is the least shameful and hurtful for debtor and creditor respectively. [44]

So far an international system for a comprehensive sovereign debt restructuring procedure has not been yet embraced. It is the responsibilities of sovereign debtors to negotiate with its creditor's, which makes it a mixture of public and private entities with

[43] A sovereign states facing serious difficulties to repay its debts and fails completely to meet its payment obligations is considered as bankrupted state

[44] JEFFREY D. SACHS, Resolving the Debt Crisis of Low income Countries, Harvard University, found at https://www.earth.columbia.edu/sitefiles/file/about/director/pubs/BPEA_Sachs1_2002.pdf, accessed on 13/11/2019

disparate agendas to seek an acceptable restructuring of its debts in case of inability of a sovereign state to meet its financial obligations.[45]

But then again, instead of accepting voluntary restructuring, a creditor may choose to hold out which is a kind of pressure put on the debtor to ensure that it satisfies its contract obligations or at least improves conditions of restructuring. In case of default of the sovereign debtor, the hold-out creditor uphold its rights under the contract to file a case.[46]

II.3.1.2 Judicial effects of Judgment on the Merits and Enforcement

In the event the hold out creditor has the willingness to uphold his rights under the original contract, thus it fundamental to him to obtain the judgment confirming his petition. As explained earlier, based on the principle of party autonomy in private international law, the holdout creditor normally seize the court agreed upon in the contract which order the debtor to satisfy its contract obligations. [47]

In case the holdout creditor obtains a judgement confirming that the sovereign debtor must repay the loan, its interests and additional legal charges, consequently the puzzle becomes the execution of that judgement and how the attachment of property belonging to the debtor should be done.[48]

An attachment order from the court to seize specific property is used for provisional remedy or for final judgement. Thereby, courts may order to attach debtor's property for creditors sake of payment , either by direct transfer of the property to the creditors in question or by selling it."[49]

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[45] Official sovereign lenders under Paris Club and private lenders under London club got together to defend their interests in case of restructuring.

[46] Iversen, Astrid, Holdout Creditor Litigation: An Assessment of Legislative Initiatives to Counter Aggressive Sovereign Debt Creditor Litigators (June 2, 2015). University of Oslo Faculty of Law Research Paper No. 2015-13. Available at SSRN: https://ssrn.com/abstract=2613280, accessed on 13/11/2019

[47] Syncom Indus. Vs Wood, Supreme Court of New Hampshire Rockingham Mar 16, 2007Wood case (2007) 155. Available at https://casetext.com/pdf-sent?returnPath=case%2Fsyncom-indus-v-wood, accessed on 08/11/2019

[48] Ibid

[49] Attachment, available at https://www.law.cornell.edu/wex/attachment (2015)

However, in cases implicating sovereign states' property, the procedure of attachment is frequently more complex and challenging in the sense that a creditor holding a payment order in the context of sovereign litigation faces various problems such as to find attachable objects, insufficient assets of the debtor within the jurisdiction where proceedings have taken place or other attachable property which may be located all around the world.[50]

In such situation, the query is know if the judgement order obtained is directly enforceable in other jurisdictions, for the holder of the judgement to be able to have execution over assets of the borrower located in those jurisdictions. Generally legal proceedings have judicial effect only within the boundaries of national jurisdictions and it is worldwide recognized that it is not automatic for a creditor to enforce a judgement in a third country.[51]

However, freer movement principally of money judgement between jurisdiction have been facilitated by different international treaties and bilateral agreements. For Example, the main objective of Lugano convention on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters was to determine the international jurisdiction of the courts, to facilitate recognition, and to introduce an expeditious procedure for securing the enforcement of judgements, authentic instruments and court settlements.[52] The same facilitation, specifically with regard to arbitral awards is provided in New York convention on the recognition and Enforcement of foreign arbitral awards [53]

In line with the above mentioned international instruments, domestic court enforce judgements or arbitral awards in case such judgments or awards are made within the jurisdiction of a member state of those international instruments referred to.[54]

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[50] Supra note 47

[51]ibid

[52] Lugano Convention (1968) and its revised version (2007). on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, in Official Journal of the European Union L 339 of 21/12/2007

[53] New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, (New York,1958).

[54]It important to know the difference between recognition and enforcement of foreign judgement. Recognition refers to the fact that a court of a given country accepts a judicial decision rendered by a court of another country,

The fact that there are several conventions in place, a country may sign more than one convention, which varies the enforcement of foreign judgement depending on countries membership and makes it subject to different conditions and restrictions.

In this chapter, it was shown that sovereign immunity matters a lot in the recovery of debt evidenced by sovereign contracts, whereby pari passu clause is the main feature clause dealt with in this chapter and they are a lot of challenges when it comes to enforcement against the State defaulter.

However, the above chapter shows that it is always possible no matter the challenges encountered that a creditor can seek a court order against a sovereign State as that was the case of NML Capital Ltd V. the Republic of Argentina over *pari passu* violation concerning bonds and the creditor got remedies from court and enforcement highlighted among other challenges not overturned and there are still other more issues to address.

In the next chapter, the decline of sovereign protection through restriction towards sovereign immunity is discussed, especially subjects which seem to be irredeemable towards creditors while debtors who are Sovereign States are reluctant to clear their debts.

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while enforcement is the execution or implementation of the judgement. Then the winner can seek enforcement in the foreign country which has recognized the judgement. See more in Syncom Indus. Vs Wood (2007) 156

CHAPTER III: THE DECLINE OF SOVEREIGN PROTECTION THROUGH RESTRICTION TO SOVEREIGN IMMUNITY

Countries as Sovereigns under international law system have privileges of jurisdiction and do not to allow their domestic courts to handle claims filed by privates corporations or Sovereign States against foreign countries.[55].

Withstanding the privilege of jurisdiction, countries involved in commercial activities, loose the above privilege entitled as sovereign immunity. which was perceived as an unfair treatment with regard to private contractors. Currently, the majority of commercially important countries subscribe to the restrictive theory of sovereign immunity.[56]

However, argument justifying the relevance of a more restrictive approach is that in case a sovereign States enters the market and be involved in commercial activities, it must be subject to the rules of the market including sanctions.

In this chapter, the doctrine of restrictive state immunity is going to be discussed as well as the challenges associated to it.

III.1 Legal basis of restrictive aspect of sovereign immunity

The legal basis of restrictive doctrine of state immunity comes from various Case laws, and later restrictive doctrine of state immunity has been established by both US and UK laws as of the Foreign Sovereign immunity act (FSIA) and State Immunity Act (SIA) 1978 respectively.

However domestic or State level, the transition to the restrictive immunity has been materialized by different courts including Iranien v. Société Levan Express Transport (1969) by Cour de cassation de France, Alfred Dunhill of London inc v. Republic of

[55] Supra note 47 paragraph 557

[56] Idem, paragraph 557 and 560-570. The principle of restrictive immunity is codified in national law in some jurisdictions, such as the Foreign Sovereign Immunities Act (FSIA) in the United States.

Cuba (1976) by US Supreme Court, Trendtex Trading Corporation Ltd v. Central bank of Nigeria (1977) by English Court of Appeal.

In the three case laws, courts had analyzed the sovereign immunity in respect of the nature of the activity, and not on the quality of the one who exercises it.

In the case Trendtex Trading Corporation Ltd v. Central bank of Nigeria, the issue was as follow: *"by writ of November 1975 the plaintiff claimed the central bank for payments due in respect of the bank's breach and repudiation of the letter of credit. Mocatta J. granted the plaintif an injuction ordering the bank to retain $13,968,190 within the jurisdiction until the trial of the action or further order. Donaldson J., on the bank's application, set aside the writ and stayed further proceedings in the action on the ground that the bank was a department of state of Nigeria and was therefore immune from suit"*[57]

In the Court of Appeal, Lord Denning M.R and LJ argue that: *"even if the bank were part of Government of Nigeria, since international law now recognized no immunity from suit for a government department in respect of ordinary commercial transactions as distinct from acts of a governmental nature, it was not immune from suit on the plaintiff's claim in respect of the letter of credit."*[58]

In my view, the issue here is the issuance of letter of credit and the latter should be analyzed in its intrinsic nature rather than its purpose. In determining whether the Central Bank of Nigeria by doing that transaction it was a commercial activity or an exercise of sovereign authority should be based on the nature of the activity instead of the purpose of the action or the quality of the one who exercise that activity.

At international level, prior to 2004, no authoritative source of the doctrine concerning restrictive immunity due to the fact that restrictive immunity was delivered from international custom including treaties, court decisions and other State practices.[59]

[57] TRENDTEX TRADING CORPORATION v. CENTRAL RANK OF NIGERIA available at http://www.uniset.ca/other/css/19772WLR356.html accessed 21/11/2019
[58] ibid
[59] Supra note 46

However from the above sources, International Law Commission (ILC)[60] conducted a study on Jurisdictional Immunities of state and their Property. Findings from the study revealed that there was a steady trend with the exception of the Peoples's Republic of China, towards all States accepting a restrictive doctrine and this served the basis on which ILC framed its draft articles in 1991. The UN General Assembly to legalize the customary adopted the convention on Jurisdictional Immunities of States and their Property (the Convention)[61] based on the 1991 ILC Draft Articles.

Although not yet in force, the convention on Jurisdictional Immunities of States and their Property is widely taken into consideration to reflect the current customary international law.[62]

III.1.2 Immunity from jurisdiction Restriction

The restriction on Immunity from Jurisdiction is regulated by the UN Convention on jurisdictional immunities of States and their property enacted in 2004, which convention extends States and their Property to enjoy immunity from jurisdiction and enforcement in domestic courts of other Sovereign States. The starting point of such restriction is provided in article 5 of the aforementioned convention, where it is stipulated that: "*a sovereign state enjoys immunity, in respect of itself and its property, from the jurisdiction of the courts of another State".* The same is provided under section 1604 of US FSIA and Section 1(1) of UK State Immunity Act of 1978.

The "restrictive theory" part of sovereign immunity talked about in the UN convention, which intends to codify that a foreign State's immunity is subject to various exceptions. Those exceptions are often at the heart of sovereign litigations.[63]

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[60]It is a specialized agency of the General Assembly of the United Nations, established in 1947 with the mission to initiate studies and make recommendations for the purpose of encouraging the progressive development of international law.

[61] The Convention on Jurisdictional Immunities of States and their property although not yet in force, as of October 2014, it had been signed by 28 parties and 16 countries have already ratified the Convention

[62] UN Convention in complementarity with other legislation and most England and USA case laws, plays a vital role in handling sovereign debt litigation with regard to the restrictive doctrine of sovereign immunity

[63] JONATHAN I. BLACKMAN & RAHUL MUKHI, The evolution of modern sovereign debt litigation: vultures, alter egos, and other legal fauna, (2010) 49. Available at https:scholarship.law.duc.edu visited on 11/9/2019

The Express consent to exercise of jurisdiction provided by article 7 of UN Convention is the most important exception to the immunity from jurisdiction. In case a State has consented to the exercise of jurisdiction on the basis of agreement, a written contract, or by declaration before the court in specific proceedings, that State should not invoke immunity from jurisdiction in a proceeding before a court of another State. The US FSIA in its section 1605 and UK SIA section 2(2) provide similar exception.

Article 10 of the UN convention on jurisdictional immunities of States and their property provides also a relevant exception concerning immunity in relation to commercial transactions. According to that article, in the in the event a State engages in a commercial transaction with a foreign natural or juridical person and, by virtue of the applicable rules of private international law, differences relating to the commercial transaction fall within the jurisdiction of a court of another State, and the State cannot invoke immunity from that jurisdiction in a proceeding arising out of that commercial transaction.[64] By commercial transactions, the UN convention has defined it under article 2 (c).

The same article in its second paragraph goes further and gives what should be considered to qualify a contract as a commercial transaction. The article stipulates as follows: "in determining whether a contract or transaction is a "*commercial transaction*" reference should be made primarily to the nature of the contract or transaction, but its purpose should also be taken into account if the parties to the contract or transaction have so agreed, or if, in the practice of the State of the forum, that purpose is relevant to determining the non-commercial character of the contract or transaction."[65]

From the above, the immunity aspect applies and courts arrest suit only in the event the activity is of a governmental nature. The Puzzle remains to know precisely the activities which are to be characterized as governmental in nature (as opposed to *jure gestionis)* but the positions seem to converge on an agreement that the correct test is to determine what constitutes the nature of the activity. However, although an act may

[64] United Nations Convention on Jurisdictional Immunities of States and Their Property 2004. See Article 10 (1)
[65] Idem Article 2(2)

have a public purpose, recourse to private means for its achievement will lead the courts to consider it as a commercial act and therefore the state will not be immune.[66]

Immunity from jurisdiction on matters concerning different commercial activities carried out by States is also accepted under the US FSIA.[67]

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.[68] In the United States Several court cases have examined what is meant by the 'nature of the act' which may also shed light on the interpretation of UN Convention on jurisdictional immunities of States and their property.

However, courts to determine the nature of a foreign act, decide whether the particular actions that the foreign state performs whatever the motive behind them are the type of actions by which a private party engages in trade and traffic or commerce.[69] Courts often start by examining the foreign sovereign court that serves as the basis for the plaintiff's claim.

As illustration through the case of Republic of Argentina versus Weltover, the Supreme Court concluded that when in the market, a sovereign purchases goods, it has engaged the State in a commercial activity because such a purchase is the same type of action by which a private party engages in trade and traffic or commerce"[70]

The Supreme Court further held that "a state carries out a commercial activity when it exercises only the powers which can also be exercised by private citizens, as distinct from those powers peculiar to sovereigns" [71]

As mentioned in section 1(a) of the UK State Immunity Act, the immunity does not count on State in respect of proceedings relating to a commercial transaction entered

[66] Philip R. Wood, Conflict of Laws and International Finance, Sweet & Maxwell (2007) 561.
[67] Foreign sovereign immunity act, 1976 see 1605(a) (2).
[68] United State Foreign Sovereign Immunity Act (FSIA) of 1976, section 1603(d)
[69] Republic of Argentina v. Weltover(1992). Available at https://www.casebriefs.com/blog/law/international-law/international-law-keyed-to-damrosche/chapter-12/republic-of-argentina-v-weltover-inc/ accessed on 08/11/2019
[70] Ibid paragraph 258
[71] Supra note 69

into by a State, and section 3(3) of the above Act, further defines that any contract for the supply of goods or services and any loan or transaction for the provision of finance and any guarantee indemnity in respect of any such transaction or of any other financial obligations.[72]

However, the State Immunity Act does not manage to avoid the distinction between public and commercial completely, as section 3(3)(c) states that commercial transaction also means "any other transaction or activity (whether of a commercial , industrial, financial, professional or other similar character) into which a State enters or in which it engages otherwise than in the exercise of sovereign authority"[73]

Article 10(2) of the UN Convention as well as section 3(2) of the UK SIA provide for an exception to the exemption from immunity from jurisdiction. The two provisions stipulate that immunity from jurisdiction can still be invoked in cases of commercial transactions between States or if parties to the commercial transaction have expressly agreed otherwise.

There is a kind of international consensus with respect to sovereign debt. The consensus is found on the argument that borrowing is a commercial act due to its commercial nature and therefore not immune as such, even if the proceeds are to be used for a government purpose. Various legislations and case laws on sovereign debt disputes around the world have proved such consensus.[74] However, what is deemed more problematic is the question of which assets must be considered immune from enforcement measures.

III.1.3 Restriction to the Immunity from Execution (Enforcement Measures)

State immunity from measures of constraint in connection with proceedings before a court of another states is regulated by UN convention on jurisdiction immunities

[72] UK SIA, section 3(3)(a) and (b)

[73] Idem section 3(3)(c)

[74] See UK State Immunity Act (1978), the US Foreign State immunities Act FSIA (1976) and case law Syncom Indus. vs Wood (2007) 561.

especially in its article 18-21. The Same convention, specifically article 18 and 19 state only of a 'Proceeding before a court of another State' which refers to the court of state where the specific property is situated irrespective of the State in which the main proceedings are or have been taking place.[75] The introductory phrases of articles 18 and 19 include the general principle of State immunity from measures of constraint and the following subparagraphs lay down the exceptions to that principle. As per the convention, there is similarities from article 18 and 19 whereby pre-judgment versus post judgment measures against State can only be executed or enforced against States only in case that such States have consented to take such measure. Recognized channels through which the consent is provided are International agreements, arbitration agreements, written contracts or declaration before the court. It is also legally admitted for a State to allocate or earmark property for the satisfaction of the claim which is the object of the proceeding.[76]

However, the only difference lies on the post judgment measure constraint whereby for the execution to be effective against the State property, that property shall be in use or intended for use by the State for other than government non-commercial purposes. Additional to that, the concerned property shall be in the territory of the State of the forum, provided that post-judgment measures of constraint may only be taken against property that has a connection with the entity against which the proceeding was directed. For pre-judgment measure of constraint, there is no such condition expressly provided in the Convention.[77]

The United Sates Foreign Sovereign Immunity Act of 1976 is quite similar to the UN Convention on Jurisdictional immunity of States and their property of 2004 with regard to immunity from enforcement measures. The FSIA in the first paragraph of article 1609, it is stipulated that the property of a foreign State in the United States is immune from

[75] United Nations Convention on Jurisdictional Immunities of States and Their Property, 2004 available at https://treaties.un.org/doc/source/RecentTexts/English_3_13.pdf accessed on 10/10/2019
[76] Idem article 18 and 19

[77] Supra note 75

execution, even in the event of satisfaction of a debt.[78] Moreover, such property may only be attached and executed upon when it has been used for commercial purposes and it has been expressly consented up on it. The UK States Immunity Act of 1978, provides the same in section 13(2)(b) where it is stipulated that a foreign State enjoys immunity from enforcement measures. The property of a State shall not be subject to enforcement of a judgement or arbitral award, or sale except when there has been written consent of such State proving the prior agreement.

August. Reinisch in his research paper examined European court practice related to enforcement immunity, and concludes that it is far from uniform. However, according to the study, certain common principles have emerged over the last decades, and these principles are reflected in recent codification in the UN Convention on Jurisdictional immunity of States and their property of 2004.[79]
Exceptions to immunity from enforcement measures are examined in the next section.

III.1.3.1 Immunity from Enforcement Exception

As stipulated earlier, immunity from enforcement may be waived by the State when a State expressly consent to waive its immunity from measures of constraint in the form of written international agreement, written contract or by a formal declaration before a court after a dispute between the parties has arisen. Likewise, a State can as well waive the immunity in respect of specific assets in case it has earmarked the property for the satisfaction of the claim which is the object of the proceedings[80]

Moreover article 20 of the convention is clear on immunity from jurisdiction with immunity from enforcement in the sense that in the United States of America, property belonging to a foreign State and "used for a commercial activity in the US, shall not immune from attachment… or from execution if … the foreign State has waived its

[78] See NML Capital, Ltd., EM Ltd. V. Republic of Argentina (30 Mar. 2013).
[79] Reinisch, August, European Court Practice Concerning State Immunity from Enforcement Measures, September 2006. European Journal of International Law Vol. 17, issue n°4. 2006. Available at https://papers.ssrn.com /sol3/papers.cfm?abstract_id=1098614. Accessed on 15/9 2019
[80] Articles 18(b) and 19(b) of the UN convention on Jurisdictional Immunities of States and Their Property, 2004

immunity from attachment in aid of execution or from execution either explicitly or by implication" [81]

Cases of post- judgement and pre-judgement attachments are regulated under sections 1610 (a)(1) and (d)(1). However, the above exception to immunity from enforcement by the way of written consent measure of the State is as well provided by the UK SIA in its section 13(3).

III.1.3.2 Commercial Activity

The UN convention provides in its article 19(c) the exception to State immunity on post–Judgement measures of constraint in the context that the property is in use or intended for use for non-commercial purposes and is in the territory of the State of the forum. Post-judgement measures of constraint may only be taken against property that has a connection with the entity against which the proceeding was directed.[82]

An almost identical exception is provided by the 1978 UK SIA in its section 13(4) stating that the exception is only when the State property is for the time being in use or intended use for commercial purposes.

However following the Philippine case against its Embassy Bank Account , it was decided in the view that Embassy bank accounts are not immune and are subject of attachment by creditors to some extent.[83] International instruments upheld that State immunity from execution regarding bank accounts, State practice largely from measures of attachment apply a presumption that funds in embassy bank accounts are used for non-commercial purposes and that domestic courts should require the State, at least partially, to discharge the burden of proof on the commercial nature of the funds in the

[81] Section 1610 (1) of US FSIA

[82] Article 19(c) of the UN Convention

[83] CEDRIC RYNGAERT, Embassy Bank Accounts and State Immunity from Execution: Doing Justice to the Financial Interests of Creditors, available at https://www.cambridge.org/core/journals/leiden-journal-of-international-law/article/embassy-bank-accounts-and-state-immunity-from-execution-doing-justice-to-the-financial-interests-of-creditors/4635E0AB6B11EB40F89CFC59E3647E96. accessed on 01/01/2020

bank account which default results in a rejection of immunity to balance the interests of states and creditors, and provide sufficient justice to the creditor's right of access to a court for payment purposes.[84]

Coupled with the above mentioned argument in international law, execution by the State against another State having jurisdiction on the basis of a judicial writ of execution is issued in relation to non-sovereign action (*acta iure gestionis*) of that State's things located or occupied within the national territory of the State having jurisdiction.[85]

However, some examples on consented exceptions to immunity from execution or enforcement are accepted, in case the property is in use or intended use for commercial purposes.

Determination of the requirement of a commercial purpose forms the main issue of the majority of enforcement immunity decisions. There are certain categories of State property as listed in article 21 of the UN Convention such as

- *"Property, including any bank account, which is used or intended for use the performance of diplomatic mission;*
- *Property of military character or used or intended for use in performance of military functions;*
- *Property of the central bank or other monetary authority of the state;*
- *Property forming part of the culture heritage of the State or pert of its archives and not placed or intended to be placed on sale;*
- *Property forming part of exhibition of object of scientific, cultural or historical interest and not [placed or intended to be placed on sale"[86].*

They are all the property in use or intended for use by State for noncommercial purposes.

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[84] Supra note 83.

[85] Crawford, J., Execution of Judgments and Foreign Sovereign Immunity, *The American Journal of International Law,* Cambridge University Press, Vol. 75, No. 4 (Oct., 1981), pp. 820-869

[86] The UN Convention on jurisdictional immunities and State properties, 2004 (see article 21)

August Reinish in his research paper as mentioned previously, attempted to identify types of property considered to be sovereign or non-commercial purposes as reiterated by the European case law. The findings of the research is that the above case law normally portrays a list of property under the UN Convention and other immunity instruments.[87] The UK SIA has a similar list to the one of UN Convention. For example, under UK SIA commercial purpose is defined as commercial transactions or activities as mentioned in section 3(3), referred to sales of goods or supply of services, a financial transaction provision, or commercial industrial activity.[88]

Moreover, The German Federal Constitutional Court stated that: *"…the distinction between sovereign and non-sovereign cannot be drawn according to the purpose of the state transaction and whether it stands in a recognizable relation to the sovereign duties of the State. For, ultimately, activities of the State, if not wholly, then to the widest degree, serve purposes and duties and stand in a still recognizable relationship to them."* [89]

However the interpretation above based on the Germany Court, shows that almost all acts of a State are acts for public purposes and their interpretations normally agreed that governmental purpose test is meant greater immunity for the State and its property, than the nature test applied in relation to jurisdictional immunity.[90]

Moreover the use of the word 'purposes' indicates a more cautious stand compared to the requirements for exception from immunity from jurisdiction, referred thereto as the nature of the act.[91]

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[87] Vienna Convention on Diplomatic Relations 24 April 1961 available at https://legal.un.org/ilc/texts/instruments/english/conventions/9_1_1961.pdf. accessed on 01/01/2020

[88] Section 17 of UK SIA

[89] see *Berizzi Bros v. Pesaro* (1925) available at https://casetext.com/case/berizzi-bros-co-v-ss-pesaro visited on 5/11/2019

[90] ibid

[91] Supra note 79

In the same vein, exceptions based on post- judgement for property used for commercial purpose activity from immunity from execution are provided for in the US FSIA whereby in its section 1610(a)(2) it is provided that the property located in the US belonging to a foreign State in use or intended use for a commercial activity, is not immune from attachment or enforcement. Further to that, "commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transactions or act, rather than by reference to its purpose". [92]

III.1.3.3 Nexus Part of Exception

Immunity from execution against property used as non-governmental purposes exception, many jurisdictions oblige additional requirement like for example varying degrees, national and international legislations and instruments demand some connection between the property against which enforcement measures are sought and the underlying claim.[93]

However, that connection that has the direct link between the property against which there are attached claim thereto is not a requirement under UN convention on jurisdictional immunities and the property intended to be attached have an additional connection over its commercial purpose.

The convention requires State property to be connected with the entity against which the proceeding was directed."[94] Furthermore the expression 'entity' referred to in article 19 (c) of the UN Convention on jurisdictional immunities, means that the state as an independent legal personality, a constituent unit of a federal State, a subdivision of a state, an agency or instrumentality of a state or other entity, which enjoys independent legal personality.[95]

[92] Section 1603(d) US FSIA
[93] Supra note 81
[94] Article 19 (c) UN convention on Jurisdictional Immunities of States and Their Property, 2004
[95] Annex to the convention with respect to article 19

In other words, the nexus requirement in article 19 (c) must be read as bringing within its exception all property owned or possessed by the entity. Articles 19 and 25 of the said UN Convention on jurisdictional immunities provide an exception to immunity from attachment for property of a State agency wholly engaged in commercial activities, in respect of judgements rendered against it.

The US FSIA clearly requires a connection between the property and the underlying claim, where in its section 1610 (a)(2) execution measures is permitted if "the property is or was used for the commercial activity upon which the claim is based".[96]

Nexus requirement under US FSIA seems to serve two purposes whereby on one hand, it brings execution of State property only to take place in respect of commercial activity referred to under section 1605(a)(2) of FSIA bringing about exemption to immunity and for which the US courts have jurisdiction.

On the other hand, nexus limits the property to satisfy the judgement to resources of the State already committed to the non-immune commercial transaction and nexus is only justified when the execution is required against the property of the State itself, but execution sought against a State agency or instrumentality, attachment of all property used for commercial activity is allowed.[97]

However, it is important to point out the difference between the US nexus requirement from the requirement in the UN Convention on jurisdictional immunities of States and their property of 2004. The latter provides for attachment of all State entities property and not just those used for the commercial activity upon which the claim is based. The above UN Convention also refers to the property of State entity which is a party to the proceedings and which against whom a judgement has been obtained.

On this point, the convention talked above have more similarities to the US FSIA in the sense that UK SIA is quite liberal referring to its Section 13(4) that only requires that the property against which enforcement is being sought is for the time being in use or intended for use for commercial purposes.

[96] US FSIA section 1610(a)(2)
[97] Supra note 45

In concluding this chapter, it is worth noting that the decline of sovereign protection through restriction to sovereign immunity is possible and is backed by different legal instrument discussed herein above. The study also shed light on their applicability and exceptions related to the issue of sovereign immunity in commercial transactions as regards the enforcement of those transactions. The question as whether States can waive such an immunity when entering into international agreements remains controversial, which renders contracting with a sovereign entity a risky operation.

The next chapter will discuss about the remedies to the enforcement of sovereign debt contracts.

CHAPIV. REMEDIES TO THE ENFORCEMENT OF SOVERIGN DEBT CONTRACTS

Issues outlined along this dissertation present a number of questions surrounding the enforcement of sovereign debts. How the dilemma of sovereign debt recovery has to be resolved? We have seen that sovereigns raise money through borrowing or by issuing bonds. By doing so, a legal framework governing the relationship between the lender and the sovereign borrower in a form of contract should be established. Contracts create legal obligations that may be enforceable by courts in case of non-voluntary execution and they are drafted in anticipation of possible litigation. This chapter seeks to discuss on terms of an optimal sovereign contract as well as analyze if creditors and debtors should create effective and innovative contractual provisions to govern their future contracts.

IV. 1 Characteristics of sovereign debt contracts

Concerning sovereign debt contracts, S. J. Choi, et al. assert that in order to mitigate risks of defaults, issuers and creditors strengthen the terms in sovereign debt contracts that permit creditors judicial enforcement of their debts, and that allow sovereigns to restructure their debts.[98]

The said authors argue that the above approaches set forth are contradictory in the sense that they attempt to solve an incomplete contracting problem in which debtors need to be forced to repay debts in good States of the world; and also debtors need to be granted partial relief from debt payments in bad states. They may also engage in excessively risky activities using creditors ‘money; and debtors and creditors may attempt to externalize costs on the taxpayers of other countries.[99]

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[98] S. J. Choi, M. Gulati & .E. A. Posne, “The Evolution of Contractual Terms in Sovereign Bonds,” in Journal of Legal Analysis, Volume 4, Issue 1, Spring 2012, https://academic.oup.com/jla/article/4/1/131/838388, accessed on 23rd November 2019.

[99] S. J. Choi, M. Gulati & .E. A. Posne , p 34.

The same authors went on to say that sovereign debt contracts must balance several goals including encouraging sovereign States stand in the good state; to enable them value increasing restructurings in bad states; by preventing debtors from seeking to exploit divisions among creditors in order to opportunistically reduce their debt burden; and preventing them from taking risks in order to externalize the cost of default on creditors.[100]

The authors also stated that governments not involved in the transactions are compelled by domestic interests and political circumstances to bail out countries that default. Governments have an interest in ensuring that sovereign debt contracts are well designed, so that investors can consent to restructuring rather than pressure their own government to intervene.[101]

However, differentiating a good state from a bad one seems difficult because a crisis can be manufactured by sovereigns to appear as if they were in bad financial standing and this can be manifested through reduction in tax revenues dramatically to create a budget deficit.

Moreover, it can also involve government inciting their populace to riot against further debts payment by cutting popular public programs like public pensions when in reality the sovereign has from other sources enough funds to repay its debt, or could find other sources of revenue. Therefore, qualify a country as bad state is difficult ex ante for creditors entering into a sovereign contract.[102]

Sovereign contracts must balance providing terms that encourage sovereigns to repay in good states while at the meantime permitting for value increasing restructurings in bad states without any direct ability to contract on whether the sovereign in fact is in a good or bad state. Countries and investors design sovereign debt contracts so as to increase the cost for the country of defaulting in the god state and minimize the cost

[100] Supra note 98.

[101] ibid.

[102] Eric A. Posner Stephen J. Choi G. Mitu Gulati, Political Risk and Sovereign Debt Contracts, (Coase-Sandor Working Paper Series in Law and Economics), university of Chicago Law School, 2011

from debtors seeking to exploit divisions among creditors in order to opportunistically reduce their debt burden.[103]

Both parties will draft contract that encompasses terms that mitigate both enforcement and renegotiation issues. Enforcement issue mostly results from the reluctance of some sovereigns to pay full compensation although they are god state. With regard to renegotiation, the contract must allow the room for renegotiation for debt restructuring in the event of bad state.[104]

It is also important to mention that, frequently, governments not involved in the financial transaction are constrained by national interests and political situations to rescue defaulting countries and when drafting sovereign debt contracts have to make sure that they are designed in the way that investors agree on restructuring form instead of lobbying their own government to intervene.[105]

However sovereign contracts indeed impose relevant constraints on sovereigns whereby creditors have sometimes successfully pursued contract claims in court against sovereign States for attachment of assets that are located outside of its territory. In case the investor looks to contract as way of minimizing political risk from investing in a sovereign, the expectation is to see contract terms adjusting as events affect the overall risk of default including the ability of investors to collect collateral from the sovereign in the event of default.[106]

In a world characterized by comprehensive and verifiable information the first optimal contract will take into account issues of implementation, renegotiation, creditor-versus-creditor conflict, and risk taking of sovereign. Contracts may also reflect the influence of third countries seeking to reduce the risk of nonpayment. Sovereign debt contracts need to put balance in their terms in order to reach optimal clauses that cater for parties' respective interests.

Therefore, the next section examines terms of an optimal sovereign debt contracts.

[103] Supra note 98
[104]ibid
[105] ibid
[106] ibid

IV.2 Terms of optimal sovereign debts contract

For an optimal sovereign debts contract, the most attracting clauses for parties, especially debtors for the enforceability of the contract are, the waiver of sovereign immunity, the jurisdiction clause, and the governing law clause.

IV.3.1 Waiver of sovereign immunity

In the context of sovereign immunity, Public International Law provides sovereign immunity of States which stop creditors from suing countries in foreign courts. But countries in the need of borrowing normally renounce or waive that sovereign immunity in bonds contract so that creditors will be able to obtain foreign judgements without being obstructed by that immunity. However, that waiver of sovereign immunity is not a solution to creditors seeking to collect their debts, the waiver only allows creditors to file a case in court.

More to the above public International law deprives courts of the entitlement to order that a State's assets be seized to satisfy judgement. It is not forbidden for a State to waive immunity from execution, but it has limited utility as long as the State has the right of withdrawing unilaterally the waiver of sovereign immunity.

In this context the only thing that would stop states from doing so is the concern about reputation or creditor revenge. Even when States do not formally withdraw sovereign immunity, as a practical matter, national courts almost never compel government to reimburse. National courts might refuse to hear the case, and even if they do, they can't force government to respect their judgements.[107]

[107] Supra notes 91

IV.3.2 Jurisdiction clause

For creditors, foreign jurisdictions are independent from the government of the sovereign debtor and hence, more willing to hear the case. In order to avoid this problem of jurisdiction, creditors and debtors have opted for foreign jurisdictions.

Under a foreign jurisdiction clause, sovereign debtors agree to subject themselves to the jurisdiction of a foreign legal system in the sense that the consent to jurisdiction clause must be linked with the waiver of sovereign immunity for the foreign court to not refuse to hear the case based on the principles of public international law. However, the problem remain in the event sizable assets are located in the territory over which the foreign court has jurisdiction.[108]

IV.3.3 Governing law clause

The most important and relevant operational clause for the purpose of lawsuits is the applicable law clause. This provides for the applicable law which governs the loan agreement in case of disagreement between the parties or default in their obligations. Usually, both parties determine the applicable law.

Parties tend to opt for a sufficiently developed jurisdiction; the UK of New York jurisdictions have been favored because of their reputation of fairness. In the U.S. and U.K. courts, there is no rule generally mandating the application of the law of the sovereign debtor to substantive issues relating to the debt obligations.[109] The borrower should always opt for a jurisdiction where it will be equally protected in its rights.

In the absence of a specific governing law, National and foreign courts will apply the national law of the debtor. The application of the later doesn't secure the borrower as long as the debtor could change its law to escape paying back the money. The situation becomes more complicated in case the sovereign debtor amends a number of laws

[108] Supra note 98 Page 139
[109] ibid

giving access to courts, which would incidentally proliferate the cost of recover sovereign debt.

It is for that reason to avoid such a risk, parties to sovereign debt contract opts for foreign law though the foreign country may change its law in adverse ways, the risk will be less likely that a major developed country will interfere with its law governing contract for strategic reason than a developing country will do the same way.[110]

IV.4 Sovereign debt restructuring

The provision for restructuring is normally embodied in a specific debt instrument as part of contractual clauses. and whenever a debtor under a loan arrangement is unable to discharge its obligation for any reason, such debtor may invoke the contractual clause that avails a mechanism for debt restructuring.[111]

In doing this, the parties to the contract seek to import the restructuring schemes normally embedded in municipal insolvency laws. The contractual clauses that provide for debt restructuring arrangement in individual contracts are known as Collective action Clause (CACs).[112]

IV.4.1 Collective Action Clauses

Collective Action Clauses (CACs) are clauses incorporated into debt contracts or instruments and which have the effect of enabling a supermajority of creditors of the contracting parties in a loan arrangement to amend the terms of the agreement[113].

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[110] Supra note 108

[111] US Das, MG Papaioannou & C Trebesch, ‗Sovereign Debt Restructurings 1950-2010: Literature Survey, Data and Stylized Facts (2012) IMF Working Paper WP/12/203, 7.

[112] Ibid.

[113]Francis Palmer was arguably the first scholar to call for majority action clauses in trust deeds and debenture documents that bind other minority creditors in what he referred to as power of majorities ‘. See Francis B

In a situation a sovereign becomes enable to honor its debt obligation, it usually needs or tries to restructure its debt to extend the period of repayment or lower the premiums paid. Mostly, Creditors increase their collective welfare by granting partial relief to the sovereign.[114]

There are various contractual clauses that facilitate both creditors and borrowers to renegotiate the debt. Those contract terms are of three types:

The first is a provision known as non-payment modification, governing the modification of the conditions of non-payment, that is conditions other than the principal, the interest and the time of payment. The second term is payment modification that governs the modification of payment terms and varies based on the New York or English law.[115]

For instance in the New York law on bonds concern, the conditions of payment may be varied on vote by representation of 75% of the bonds, whereas in English law the requirements are often necessary for holders to meet physically and as a general rule, the quorum is set on 50% and 75% of the holders to vote for a binding change to the payment terms. [116]

The third type is aggregation which is a typical modification clause operating within a single bond issue. For it to be binding to all creditors or bondholders, two (2) requirements should be fulfilled.[117] There is as well a requirement that a minimum percentage of 66.7% of the bonds of a particular issuance agree to a proposed modification of payment terms and also an overall agreement among the bondholders aggregated across all of the issuance of the sovereign.

Collective action Clauses mitigate the problem of renegotiation as long as a successful vote in accordance with the terms of the clause is positively correlated with the bad State of the world, but it may not be.[118]

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[114] Supra note 97
[115]Supra note 91
[116] ibid
[117] ibid
[118] Eric A. Posner Stephen J. Choi G. Mitu Gulati, Political Risk and Sovereign Debt Contracts, (Coase-Sandor Working Paper Series in Law and Economics), university of Chicago Law School, 2011

Moreover, to ensure that the voting threshold is neither too high nor too low and that it scope is neither too broad nor too narrow is the most difficult task when designing a CAC. A sovereign debt contract may contain only CAC, only a non-payment CAC or both. An excessively broad CAC may allow the issuer to compel creditors to approve a sub-optimal restructuring, but a CAC that is too narrow will prevent optimal restructuring or at least an increase in transaction costs.[119]

Although CACs mitigate the problem of renegotiation, they have disadvantages. On a general perspective, they are like national systems of bankruptcy but have disadvantage as they do not bind creditors across bond issues.

To understand the puzzle, suppose that a given country X issue bonds worth of $5 billion in 2008 and then issue $ 5 billion worth of additional bonds in 2013. After few years later it becomes clear that the country X cannot pay the all amount of $10 billion debt. In this case Each group of creditors may think that it will be paid in full if the other group of creditors undergoes a restructuring. The two groups of creditors end up voting against the restructuring under its CAC. As the number of credit groups increases, this problem may become insoluble. [120]

However, countries have tried to solve issues by aggregation clauses, to allow restructuring when each class of creditors gives some degree of approval and both categories of creditors give some level of approval.

On contract some version of *Pari Passu* clause, arguably require all creditors to be treated in same way, also address this problem. We will discuss these articles in the next section with the supporting case of NML Capital v. Argentina.

IV.4.2 *Pari Passu* Clauses

As reiterated above the provision of *pari passu* bars the sovereign from passing legislation to lower the legal rank of a creditor vis-à-vis some future creditor, it is seeking

[119]Supra note 118.
[120] Ibid

to borrow from. In that case, the issuer shall be constrained from acting in a manner that, violating the negative pledge clause in terms of granting a formal security interests, which does alter the legal rank of the debt.[121]

A *pari passu* clause included in a sovereign bond contract, it generally indicates that bonds rank equally with each other and with other unsecured obligations of the issuer. It can be defined as "equal among equals". And that bondholders are in the same rank as other unsecured creditors.[122]

However the meaning of the clause makes it possible and clear to maintain that it comprises two elements including an internal element, meant that the obligations will have an equal rank between them; and an external element, which is meant that , the bonds is ranked equally with other unsecured debt, present or future of the issuer.[123]

On the above note, referring to the Argentina case in NML Capital Litigation, the first issue was of over interpretation of the pari passu clause, and the meaning of equal treatment provision. Beforehand, it was appropriate to understand the genesis of pari passu clause and equal treatment provision as well as their rationale in sovereign debt contracts before discussing about their interpretation.

When a private institution issues bonds, the issuer presents to its potential investors how risky will it be while there is a probability that the issuer will default on its promise to pay the bond later. Moreover, there is a possibility in the corporate context that the value of the firm's debt obligations will surpass the value of its current assets or assets it can generate in the foreseeable future. A corporation or firm is in such situation, the borrower and its assets can be liquidated through bankruptcy.[124]

To do so, borrower's assets are converted into cash at liquidation, that cash is in return distributed to creditors and lenders have long recognized that the priority for cash disbursements in liquidation is important and that's why in the event of liquidation, the

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[121] Rodrigo Olivares-Caminal, The pari passu clause in sovereign debt instruments: developments in recent litigation, available at https://www.bis.org/publ/bppdf/bispap72u.pdf, accessed on 08/11/2019
[122] Ibid.
[123] Ibid
[124] Marija Dutcik, Variations on pari passu in international loans, may 2016 found at https://www.researchgate.net/publication/315767487 accessed on 10/11/2019

pari passu clause evolved as a mechanism to ensure that creditors are treated equally and are paid on a *pro rata basis.* The big utility of pari passu clause is especially discovered when the corporation has the ability to issue new debt with different contractual terms. The *pari passu* clause ensure that no new debt would be given priority over more senior debt, and vice versa, between the borrower and other creditors.[125]

The main purpose of these clauses is to substitute inexistent insolvency laws at the international level with consistent laws by offering "equity among creditors" a social norm inherited from almost all national legal cultures.[126]

The pari passu clause as applied in Argentina sovereign bonds litigation, provided that "*the Securities will constitute direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank pari passu and without any preference among themselves and the payment obligation of the Republic under the securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness*".[127] This second sentence is referred to as the "Equal Treatment Provision".[128]

In the interpretation of judge Griesa, making payments under the Exchange bonds while refusing to pay amounts that continue to be outstanding under the FAA Bonds constitutes a breach of pari passu clause.[129]

However, on the other hand, the US Court of Appeal interpreted it in the sense that the real dispute was over what constitutes subordination under the pari passu clause and concluded that in pairing the two sentences of its pari passu clause, the FAA manifested an intention to protect bondholders from more than just formal subordination. The court opined that the pari passu clause in its first sentence prohibits Argentina, from formally subordinating the bonds by issuing superior debt whereas the second sentence

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[125] Supra note 124
[126] Ibid
[127] Pari passu clause as applied in NML Capital Ltd V.Argentina, found at https://www.financierworldwide.com/the-pari-passu-clause-as-applied-in-argentina-sovereign-bonds-litigation#.XcWB-6-xXIU, accessed on 08/11/2019.
[128] ibid
[129] Ibid.

prohibits Argentina from paying on other bonds without paying on the FAA Bonds. In sum, Court meant that , the two sentences of the Pari Passu Clause protect against different forms of discrimination.[130]

The interpretation of pari passu clause in the sovereign debt contract draws this study to deal with strategies and procedures to debt restructuring mechanism in the next section.

IV.5 Sovereign Debt Restructuring Mechanism (SDRM)

This section shall attempt to discuss the role of International Monetary Fund in restructuring debt of sovereign State.

IV.5.1 The role of IMF in SDRM

The objective of a SDRM is to facilitate the orderly, predictable and rapid restructuring of unsustainable sovereign debt, while protecting the value of assets and the rights of creditors. The most controversial solution to the sovereign debt problem has been proposed by Anne Krueger.[131]

One of the proposals from Anne was to avail a formal insolvency framework for sovereign debtors at the international level as it is domestically, given proves that domestic bankruptcy courts provided a convenient and effective tool to solve the collective action problem for private, or domestic workouts [132]

However, a detailed proposal for how a system would operate, A. Krueger made as well a generalized assessment concerning the problem with sovereign debt, such as the collective action problem and the risk of opportunistic holdouts.[133]

[130] Supra note 121 .
[131] Anne Krueger was both former chief economist and Deputy Managing Director at the IMF
[132]Supra note 27
[133] ibid.

Her proposal was that IMF could lend its strong institutional support for countries struggling to restructure effectively their debt obligations by noting that it should undertake substantial monitoring efforts on countries that are within the IMF's assistance program and are in danger of default.[134]

A. Krueger argues that these monitoring efforts are indispensable to ensure that a defaulting sovereign does not engage in opportunistic fiscal policy. The IMF's unique position would allow the institution to alleviate the burden on individual creditors to monitor a defaulting sovereign's actions.

According to her, future Sovereign Debt Restructuring Mechanism would be constructed on goals including "*Preventing holdout creditors from disrupting good-faith negotiations, providing creditors with a guarantee that the debtor country will act responsibly during the "stand still" period, providing financial support and guarantees to private lenders who will need additional incentive to cooperate with and make loans to a defaulting sovereign, and binding minority creditors to a restructuring agreement once it has been agreed to by a large enough majority".*[135]

Likewise, Krueger hoped that such a system would rarely be utilized, but would rather provide a predictable and well-developed operation, such that debtors and investors would be able to reach a mutually beneficial solution by negotiating" in the shadow of the law.[136]

Some believe that a SDRM would afford creditors more rights and bridge the disparity in bargaining leverage between sovereigns and their lenders.[137]

Furthermore, some have been quick to defend against proposals made about SDRM, arguing that the implementation of such a program shall undergo too many challenges and inherent flaws to be sorted out .[138]

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[134] Supra note 27
[135]ibid.
[136] ibid
[137] Buchheit, Lee C. (2005), The Role of the Official Sector in Sovereign Debt Workouts, Chicago Journal of International law: Vol 6: No 1, article 19.
[138]Alexis Reiffel (2003), Restructuring Sovereign Debt: The Case for Ad Hoc Machinery (Brookings Institution Press 2003), See Generally Ch. 11

The first concern is that sovereigns are unwilling to cede control over a work out process to any third party and will continue to refuse to renounce complete autonomy in absence of a better incentive to do so.[139]

Others allegedly argue that an IMF controlled system would limit the bargaining power of creditors and would be an efficient medium through which the geopolitical wishes of the G7 government could be imposed on private sector lenders."[140]

However, as D.I K. Tarullo points out that, the above leverage affects both sides of the creditor- debtor equation as the ability to impose an economic standstill upon a sovereign would give IMF substantial leverage over creditors, but also significant power over the autonomy of sovereigns.[141]

More to the above in criticizing IMF controlled system, C. Boeri, has found problems with the IMF's SDRM even more numerous and have identified problems with the IMF's statutory approach. The applicability of that approach to debt already incurred under different terms should be retroactive and the costs of administration and enforcement may exceed the benefits. There is also a risk of confusion over the IMF's role in the world order as a lender of last resort, not a sovereign debt manager.[142]

Finally, some have pointed to successes" of cases like Argentina, to illustrate that "borrowers and lenders can work out bond defaults on their own.[143]"

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[139] Dickerson, A. Mechele, "A Politically Viable Approach to Sovereign Debt Restructuring" (2004). Faculty Publications. 828. Available at https://scholarship.law.wm.edu/facpubs/828

[140] supra note 74,

[141] Daniel K. Tarullo, Neither Order nor Chaos: The Legal Structure of Sovereign Debt Workouts, 53 EMORY L. J. 657, 676 (2004)

[142] Boeri, Celeste (2003),How to Solve Argentina's Debt Crisis: Will the IMF's Plan Work? Chicago Journal of International law: Vol4: No 1, Article 18.
Available at https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1207&context=cjil

[143] Lee C. Buchheit, Sovereign Debt Restructurings: The Legal Context, in SOVEREIGN RISK: A WORLD WITHOUT RISK-FREE ASSETS? BIS Papers No. 72 107, 110 (July 2013)

In this regard, B. Park discussed the description of sovereign debt problems above and the ongoing struggle between Argentina and its creditors where by sovereign bond contracts created unique legal problems for bondholders, issuers, and courts, especially when a sovereign becomes insolvent given that there is no international workout mechanism through which the sovereign's debt can be efficiently restructured. He pointed out that an Argentinian default (repudiation) is the socially optimal response to the *NML Capital* decision and will lend the most stability to the sovereign debt market.[144]

B. Park further asserted that International legal scholars remain uncertain whether such judgments on sovereign debts are enforceable against a sovereign State.[145]

However the Supreme Court of the United States brought an answer to the issue in the context that it has accepted a petition for certiorari regarding enforceability issues and is considering a petition for the underlying question of holdout creditors' rights and though scholars and politicians had proposed solutions to the sovereign debt dilemma, none of the proposed solutions provided an adequate remedy to the problem enhanced as drawn clearer by the above Supreme Court.[146]

IV.5.2 Applying IMF's SDRM to Developing Countries

M. Miriungi, pointed out that international organizations such as the IMF may provide assistance in the form of aid to such struggling States to overcome debt crises, but it is not infrequent that such aid comes with conditionalities.[147]

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[144] Park, Brian, "SOLVING THE SOVEREIGN DEBT CONUNDRUM: NML CAPITAL V. ARGENTINA: A LAW AND ECONOMICS PERSPECTIVE" (2014) available at https://pdfs.semanticscholar.org/d58f/218410aed721173ef60754c2a1417bda8de7.pdf

[145] ibid

[146] Supra note 142.

[147] Miriuki Muriung (2016)i, Towards a legal framework on sovereign debt restructuring: a developing countries' perspective, available at http://erepository.uonbi.ac.ke/bitstream/handle/11295/100281/Muriungi%20Muriuki_Towards%20a%20Legal%20Framework%20on%20Sovereign%20Debt%20Restructuring%20a%20Developing%20Countries%E2%80%99%20Perspective.pdf?sequence=1&isAllo, accessed on 08/11/2019

The author also argues that those conditionalities might present other eventual consequences that may not bode well for the country in resolving the debt crisis and that from another perspective, a nation faced with debt crisis might benefit as the crisis might force such a country to implement the needed economic reforms geared towards improving its financial position.[148]

Another drawback with the IMF‘s SDRM proposal particularly with respect to developing countries is the huge role that was to be played by the IMF itself.[149]

As stated above, the IMF would still retain the powers to determine the debt sustainability of a country and this would have a bearing on the approval or disapproval of the debt restructuring plan. Further, the IMF would continue availing funds in form of bailouts or loans to countries afflicted by a debt crisis.[150]

In addition, the IMF would still house the dispute resolution body to be formed under the SDRM. The huge role played by the IMF in this whole proposal would be unsettling and inappropriate for developing countries. This is because the IMF decision making organs and voting power is skewed in favor of creditor countries. The possibilities of fairness in such a mechanism would be remote particularly for developing nations which constitute the majority debtors, especially with the exclusion of official bilateral lending from the SDRM. [151]

Moreover, given that the IMF is also a large lender to most developing nations; it is not far-fetched to argue that it would be self-interested in having its loans repaid, to the detriment of debtor countries.

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[148] Supra note 147

[149]Ugo Panizza, Do We Need a Mechanism for Solving Sovereign Debt Crises? A Rule-Based Discussion‘ (2013)

[150]International Monetary Fund (IMF), ‗Proposed Features Of A Sovereign Debt Restructuring Mechanism‘ (2003),available at http:www.imf.org/external/np/pdr/sdrm/2003/021203.pdf

[151]Hal S Scott, ‗A Bankruptcy Procedure for Sovereign Debtors?‘ (2003) 37 Int‘l Law 103, 126.

IV.5.3 Syndication and Third-Party Guarantee

Creditors are usually offered protection in the context of sovereign debt through Syndication or third-party guarantee and the functionality of this system, third parties like IMF or another sovereign could play the role of an insurer of an issuing country's sovereign debt.

Mostly such above practice would have the effect of reducing the interest rate demanded by investors and increasing the security of their loan. Another party in the event of default, would be ties to the investment, providing an alternate source for investment recovery.[152]

To some extent, a process like this already exists in practice. Often, the IMF provides financial assistance to struggling sovereigns for the avoidance of default.[153]

One of the strategies used by IMF in assisting sovereign is to make temporary, interest free loans to countries in financial distress and also lend needed liquidity through stand-By Arrangements in which the IMF plays the role of the guarantor of loans made to the country in distress.

In exchange for such assistance, the IMF imposes on the distressed sovereign Certain market-based regulations. On international scale, the IMF acts similarly to the US Federal Deposit Insurance Corporation (FDIC) to regulates and stabilize investments. However, IMF alone cannot secure the entire sovereign debt system, and this is illustrated by IMF's refusal to continue support Argentina in its darkest situation in December 2001.[154]

Sovereign that behave according to IMF's market based rules get its support in the event of distress. However, many sovereigns do not abide by market –based standards and such conduct has often led them to the default in the first place. IMF provides a

[152] Supra note 121
[153]The Role of the IMF in Argentina, 1991-2001
[154] ibid

helpful form of investment protection but at a limited degree because once default has occurred, the IMF cease to be useful as a source of investment recovery.[155]

Moreover, in 2018, investment began to dry up in Argentina, whereby the Government accepted a record $57 billion loan from the International Monetary Fund (IMF) to keep fiscal cuts relatively low and a year markets have responded badly and as a consequence investors continue to pull their money through the, freefall against the dollar currency rate exchange.[156]

Argentina has experienced many cycles of boom and bust up in the sense that swings have been exacerbated by a reliance on exporting commodities, which prices fluctuated drastically, and a recurring willingness to run up large debts to pay for social programs whereby some experts argue that this cycle has a Museum of Foreign Debt.[157]

It is admitted that Argentine's express contempt for international lenders such as the IMF, which often imposes spending cuts and other measures as part of its bailout programs and the last loan deal the IMF reached with Argentina before 2018's coincided with the country's deepest-ever recession and Argentines blame the IMF for precipitating their country's worst recent economic crisis.[158]

IV.5.4 The approach of model law to the restructuring of sovereign debt

Unresolved sovereign debt issues and disruptive disputes hurt debtor countries, their citizens and creditors. Although Investors and countries design sovereign debt contracts that have terms mitigating both enforcement and renegotiation issues, the existing "contractual" approach to sovereign debt restructuring, including the use of so-called collective action clauses, is insufficient to address the problem and the political

[155] Supra note 153
[156] Andrew Chatzky, Argentina's Default Risk: What to Know, 23/09/2019 Available at https://www.cfr.org/in-brief/argentinas-default-risk-what-know. accessed on 19/11/2019
[157] Supra note 153
[158] ibid

economy of concluding Treaties makes it unlikely that a multilateral "statutory" approach will be successful in the near future. Reason why there is a need of a more effective and realistic approach to the enforcement of sovereign debt contracts.[159]
According to Steven L. Schwarz, a model law approach to achieve a more resolution on legal political and economic framework feasible without excluding other parallel approach should be put in place.

The research went on to say that a model law approach which is a suggested legislation for national government to consider enacting as internal law in their jurisdiction would build an incremental step towards developing norms for a sovereign debt restructuring legal framework that goes beyond mere contracting. [160]

For enforceability purpose, each government opting for a legal approach should take steps necessary to make the law effective in its jurisdiction and it is also recommended for each government enacting a model law, to enact the same legislative text to facilitate cross border legal comparability.[161]

According to the Model Law approach as proposed by Schwarcz, there would be a supervisory authority but which would only be limited to ministerial actions.[162] This would obviate the need for a formal supervisory authority since disputes would be resolved through binding arbitration. This would help deal with the problem of institutional bias that would otherwise ensue, were a dispute resolution body to be set up under the auspices of any of the international organizations. Indeed, Schwarcz cites this as an important advantage of the model law over a convention, which normally requires a formal supervisory body.

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[159] Steven L Schwarcz, ‗Sovereign Debt Restructuring: A Model-Law Approach' (2016) available at https://www.uncitral.org/pdf/english/congress/Papers_for_Programme/133-SCHWARCZ-A_Model-law_Approach_to_Sovereign_Debt_Restructuring.pdf
[160] Supra note 153
[161] ibid
[162] ibid

Schwarcz predicates the feasibility of his model law on the fact that most sovereign bond contracts at present are governed by either New York law or English law save to the extent where such contracts are governed by the law of the sovereign debtor.[163]
As such, so his argument goes, if a nation such as the United States or the United Kingdom or a state such as the New York state were to enact a law based on the model law; that alone would suffice.[164] This is because either of the national jurisdictions is likely to refrain from preempting such a law since the same would force a sovereign debtor to issue its debts governed by the other nation's law. This would significantly reduce the preemptive nation 's law in the world of international finance.

At once, one sees the difficulties with this model as proposed by Schwarz. It cannot be assumed that only two nations 'laws will continue to dominate the majority of sovereign debt contracts. Some sovereign debtors may choose to issue bonds in their own local laws, especially so as to guard against foreign currency fluctuations, or even as a matter of principle or pride. It further cannot be assumed that any of the nations whose law dominates sovereign bond contracts, will always be bothered about a relegation of its law in the world of international finance, as to prevent it from preempting such a model law

Another important feature of Schwarz's proposed model law is the concept of retroactivity, whereby he proposes that the model law would operate backwards as to cover existing debt contracts. He argues for the retroactivity of the model law making the case that it is not proscribed under international law as long as it is not arbitrary or discriminatory in nature.[165] He also takes comfort in the fact that nothing in the English law appears to prohibit the retroactivity of laws, though he notes the difficulty in the United States. Such a retroactive application of the model law as to cover extant debts is sure to face legal challenge in the courts.

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[163] Schwarcz bases his proposal on the arguments by Setser that most of the sovereign bond contracts are governed by either English law or New York law, and to a limited extent, by Japanese law. See Brad Setser, IPD Task Force on Sovereign Debt brief, ‗The Political Economy of the SDRM' (2008), 1-2
Available at: <http://www.cfr.org/content/publications/attachments/Setser_IPD_ Debt_SDRM.pdf>
[164] Supra note 159
[165] ibid

However, the greatest weakness with the Model Law lies in its non-binding nature. Of course, Schwarz anticipates this and in its stead, proffers the argument that a non-binding instrument like a Model Law may be more appealing to nations especially during its experimentation stages, owing to its relaxed nature.[166] He argues that the less formalistic nature of enacting a Model Law as contrasted to a treaty, helps foster open communication and may thus lead to increased success of such a law. However, as noted by Schwarz, model laws may be denounced or amended unilaterally by a nation without causing an infraction of international law. This means that even if a model law were to be developed, a nation may choose to refuse to follow through on its commitments, especially given the international politics that dominate the world of finance. The reduced certainty, (as contrasted with a convention or a treaty), significantly militate on the effectiveness of a model law.

This chapter has scrutinized a number of mechanisms that can overcome the collective action problems. Possible remedies have been analyzed such as terms of optimal sovereign debt contract, the application of IMF's SDRM to developing countries. Syndication and Third-Party Guarantees are other possible means by which creditors could be afforded protection in the context of sovereign debt.

However, we noted that all mechanisms in place hardly take into account the interests of developing countries while they constitute a big portion of debtors. Consequently, there is a need of developing and adopting a sovereign debt restructuring framework that takes into consideration the interests of developing economies for them to get out of the sovereign debt crisis

[166] Supra note 159

V. CONCLUSION AND RECOMMENDATIONS

During this study, our findings have revealed that the absence of international bankruptcy law and procedures hinder the enforcement of sovereign contracts and may in some circumstances prevent investors (creditors) to lend money to sovereign borrowers to avoid the risk of not being reimbursed and the legal recourse is not always certain.

Over past centuries, sovereign states have largely been spared from prosecution and creditors had no credible legal remedy in case of default. However, from 1970's, there has been a lot of progress. The law has changed, allowing creditors to sue foreign governments in national courts and to enforce money judgments through seizure and liquidation of some government assets[167] without being limited by the sovereign immunity.

Despite the progress reached with regards to the enforcement of sovereign debt, the role of contract in that enforcement was not enough emphasized. This study has highlighted the role of contracts in the enforcement of sovereign debts.

The assumption that contracts are inappropriate to sovereign debt markets is founded on the belief that creditors cannot easily obtain and enforce judgements against sovereign sovereigns. As explained however, States can make promises in the bond agreement that expand the right of creditors. As the issuance of bonds has become a more attractive and utilized way used by countries to raise funds, many sovereign bonds contain detailed provisions specifying where the sovereign can be sued and which assets may be seized to enforce a judgement. These include waivers of immunity from jurisdiction, waivers of immunity from execution and a series of contractual clauses, such as conditions facilitating the service of the trial to pave the way for the court. These enforcement enhancing clauses can and do vary in scope. A sovereign can honor his promise of repayment by consenting to lift immunity from execution even

[167] M. Weidemaier, Sovereign Immunity and Sovereign Debt, 2014 U. ILL. L. REV. 67 (2014)

with respect to his diplomatic assets abroad.[168] As explained in the last chapter about remedies to the enforcement of sovereign debt contracts and reiterated in this conclusion, the first optimal contract shall take into account issues of implementation, renegotiation, creditors vs creditors conflict as well as sovereign risk taking.

Most of sovereign contracts are model contracts and parties do not pay attention to their clauses while some key clauses are not well drafted especially those related to enforcement and restructuring. Enforcement and restructuring clauses in sovereign debt contract are very sensitive as long as they govern the enforceability of the contract in case of default. Therefore, those clauses catering for renegotiation and governing law issues should be deeply assessed with wisdom of both contracting parties (borrowers and creditors) with the purpose of attaining the objective they have contracted for.

Collective action clauses providing for restructuring in case of default shall be well outlined in the sovereign debt contract so that they can successfully be implemented without giving rise to irreversible financial distress of contracting parties.

An effective way of ensuring a faster and more orderly restructuring is to clearly define the restructuring procedures at the first issue of the bond. The inclusion of the terms of a restructuring in the bond agreement can help mitigate the problems of collective action that lead to losses by forcing creditors to a common and well-defined restructuring process.

Believing in market solutions, our point of view echoes the position adopted by the US Treasury Department. For the latter, encouraging creditors and debtors to revise or rewrite the way bonds were drafted in order to improve the terms under which countries borrowed money would be a solution. According to the Treasury Department, the primary problem with sovereign debt restructuring is the lack of process to restructure debt.[169]

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[168] The UK SIA section 13(3)

[169] JONATHAN SEDLAK, Statutory reform or contractual solution?, University of Pennsylvania law review, vol 152

The most concern attached to restructuring is the uncertainty surrounding it. In the absence of a process in place, investors are unable to appropriately asses the cost of default and without this information, not only bond prices are imprecise, but great uncertainty arises when a country has unmanageable debts.[170]

As stated earlier, if debtors and creditors are encouraged to include in their sovereign debt contracts clauses defining clearly restructuring process, uncertainty will be reduced and market will operate more efficiently with fewer defaults, which means that contracts could be a solution to the sovereign debt restructuring and therefore reduce considerably defaults.

However, there are supporters of a global sovereign debt restructuring legal framework. For them, problems associated with sovereign debt restructuring such as the problem of non-participating creditors as well as the inability to aggregate all of sovereign 's creditors and bind them along with the sovereign to a common restructuring agreement could not be addressed by a contractual provision on collective action clause. That's why in their point of view, a global sovereign debt restructuring legal framework should be envisaged for a more effective and realistic approach of sovereign debt contracts enforcement.

In light of the foregoing, we would recommend a statutory sovereign debt restructuring framework in the form of a convention or a treaty that should be under the auspices of the United Nations. The reason for housing the convention under the United Nations is because the body is composed of virtually all countries of the world in addition to having more neutrality than other bodies such as the IMF. In additional we would prefer a convention or a treaty as opposed to a model law due to its binding nature.

[170] Supra note 149

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