

# Necessity and Feasibility of a Standstill Rule for Sovereign Debt Workouts

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## A. Summary

This study explores the feasibility of an incremental approach to the formation of a sovereign debt workout mechanism, using the example of a standstill rule. In the first part, the study argues that there is a need for the establishment of a standstill rule applicable during sovereign debt workouts (B.). After defining standstill and reconsidering its economic value (B.I.), the study revisits the reasons why it was excluded from past proposals for a statutory insolvency regime for sovereign debtors (B.II.). Today, these reasons have at least partly lost their pertinence, and new reasons for standstill have emerged (B.III.). Available alternatives are insufficient (B.IV.). One should, however, pay close attention to the drawbacks of a standstill rule, such as its

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potential impact on the general cost of debt, the availability of interim financing, debtor moral hazard, and the unresolved question of its duration (B.V.).

The second part explores ways how such a standstill rule could be established (C.). The best available option seems to rely on the emergence of a general principle of law as part of an incremental approach (C.I.). This is a source of law which necessitates reconstructive efforts on the part of legal scholarship (C.II.). Guided by the normative premise that debt restructurings are collaborative exercises of public authority by an international community of states, it appears plausible to reconstruct a standstill rule as an emerging general principle of law (C.III.). However, the operationalization of this nascent principle requires further specification, which might require a political process leading to the adoption of soft law or other resolutions (C.IV.).

## **B. The Case for a Standstill Rule for Sovereign Debt Workouts**

### **I. Definition and Economic Rationale**

Almost all domestic bankruptcy codes impose a standstill on creditors' claims with the initiation of insolvency proceedings.<sup>1</sup> Standstill usually consists of two elements:

- 1) A stay on litigation or enforcement actions initiated by creditors;
- 2) A cessation of payments by the debtor to its creditors.

Standstill may be automatic or require the approval of a court; cessation of payments may be optional or obligatory, depending on the jurisdiction and type of proceedings initiated (reorganization or liquidation). The purpose of standstill is to ensure the orderly progress and conclusion of the insolvency proceedings, whether through the restructuring or liquidation of the debtor, and to secure the equality of the creditors in that process by prohibiting unjustified payments to parts of the creditors and preventing them from running to the courts.<sup>2</sup> Standstill thus has advantages for both the debtor and its creditors. Standstill might in theory create moral hazard on the part of the creditor, but this is usually contained by the requirement of appointing an administrator or trustee who manages or oversees the insolvent debtor during the restructuring.

### **II. Past Debates: The Removal of a Standstill Rule from the SDRM Proposal**

Whether standstill would be a meaningful element of a debt workout mechanism for sovereign debtors became the object of an intense debate in the discussions about the establishment of a Sovereign Debt Restructuring Mechanism (SDRM) as part of the

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<sup>1</sup> Examples: §§ 362 and 365, USC Title 11; §§ 89 and 103, German Code on Insolvency Proceedings; Art. L611-4, L621-40 (stay) and L621-24 (cessation of payments), French Commercial Code; Art. 42 and 53, Japanese Bankruptcy Act; Art. 6, 49, 115 et seq., Brazilian Bankruptcy Code.

<sup>2</sup> A. Krueger, A New Approach To Sovereign Debt Restructuring (2002) 11.

International Monetary Fund (IMF) in 2002 and 2003. In this debate, as summarized in two IMF policy papers,<sup>3</sup> consensus emerged among IMF board members that the inclusion of a standstill rule in the proposed SDRM would be of limited advantage and involve a number of risks. In particular, it was held that:

- it would be in the interest of the debtor state to continue meeting its payment obligations at least partly in order to not disrupt the provision of interim financing while negotiating a restructuring agreement with its creditors. This would avoid serious spillover effects for other parts of the economy. A cessation of payments might, however, be advisable for debt which is selected for restructuring, or for debt owned by non-cooperative creditors;
- pre-restructuring litigation was very rare and did not constitute a significant risk. It was anticipated that this would probably have changed with the introduction of the SDRM: The prospect of a non-consensual reduction of the nominal value of their claims might incentivize creditors to litigate earlier. However, as enforcement is difficult and time-consuming, creditors would only have small chances to collect on a judgment before a restructuring agreement would be reached and become binding on all creditors by virtue of the SDRM regime;
- in order to mitigate remaining risks, the imposition of a selective stay might be advisable. However, since states are not subject to administration or liquidation, respect for creditor equality would require making such stay conditional upon the consent of the majority of the affected creditors.

This generally skeptical view as to the value of standstill was seconded by some voices in the literature. It was pointed out that giving the IMF a role in the imposition of non-automatic standstill might give the Fund the opportunity to impose conditionalities that might put the balance of interests to be achieved by the SDRM at risk.<sup>4</sup> Others, however, pointed out that the selective stay suggested by the IMF would be insufficient.<sup>5</sup>

The SDRM never saw the light of the day, and the IMF does not plan to retry establishing one in the near future.<sup>6</sup> At the time, it was agreed that contractual clauses should suffice

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<sup>3</sup> IMF, *The Design of the Sovereign Debt Restructuring Mechanism—Further Considerations*, 27 November 2002; IMF, *Proposed Features of a Sovereign Debt Restructuring Mechanism*, 12 February 2003.

<sup>4</sup> N. Roubini and B. Setser, “Improving the Sovereign Debt Restructuring Process: Problems in Restructuring, Proposed Solutions, and a Roadmap for Reform” (2003), 12; at 15, they ultimately leave the question of the value of standstill open.

<sup>5</sup> P. Bolton and D.A. Skeel, “Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?”, 53 *Emory Law Journal* (2004) 763, 780ff.; from the earlier literature: B. Eichengreen and R. Portes, *Crisis? What Crisis? Orderly Workouts for Sovereign Debtors* (1995) 36. Comprehensive review of the earlier literature in K. Rogoff and J. Zettelmeyer, “Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976–2001”, IMF Staff Papers No. 49 (2002).

<sup>6</sup> Cf. the absence of a recommendation to that effect in IMF, *Sovereign Debt Restructuring – Recent Developments and Implications for the Fund’s Legal and Policy Framework*, 26 April 2013.

to overcome collective action problems in sovereign insolvencies.<sup>7</sup> The experience with collective action clauses since that time as well as recent developments relating to the enforcement of claims against sovereign debtors call for a reconsideration of the merits of a standstill rule.

### **III. Developments Calling for the Inclusion of a Standstill Rule**

#### **1. The Insufficiency of Collective Action Clauses**

For a long time, collective action clauses (CAC) have been a common feature of sovereign bonds issued under English law. They have become increasingly popular with bonds issued under New York law since 2003. Collective action clauses in bonds issued under German law were put on a solid legal basis in 2009, although their inclusion was considered to be legally possible even before that.<sup>8</sup> The term “collective action clauses” comprises a number of different contractual clauses aiming at overcoming collective action problems in case of sovereign defaults. Two of them are of particular significance for the question whether there is a need for a standstill rule: Modification clauses (or majority restructuring clauses) allow changes to the payment terms by majority vote (usually 75% or 85%); and acceleration clauses (or majority enforcement clauses) require usually the consent of at least 25% of the bondholders in order to declare principal and outstanding interest on a bond immediately due and payable in case of a (partial) default.<sup>9</sup> Taken together, these two types of CACs might in theory prevent individual creditors from enforcing their original claims to the detriment of other creditors, whether before or after the conclusion of a restructuring agreement. This would obliterate the need for a standstill rule.

However, experience shows that the operation of CACs does not live up to these expectations. Since the voting thresholds only apply to all bonds of one particular issue, large “vulture funds” are in a position to acquire a blocking minority and to obstruct the restructuring.<sup>10</sup> While the majority of restructurings still remained unaffected by litigation, litigation played a quantitatively relevant and costly obstacle to other restructurings.<sup>11</sup> In case of the 2012 Greek debt restructuring (Private Sector Involvement –PSI), 36 bonds selected for the restructuring included CACs, but only 17 of them were

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<sup>7</sup> For many: R. Quarles, “Herding Cats: Collective-Action Clauses in Sovereign Debt - The Genesis of the Project to Change the Market Practice in 2001 through 2003”, 73 *Law and Contemporary Problems* (2010) 29-38.

<sup>8</sup> Gesetz über Schuldverschreibungen aus Gesamtimmissionen, 31 July 2009, BGBl. I (2009) 2512; on the previous legal situation see Bundesministerium der Finanzen, “Statement by the German Federal Government on the admissibility of including collective action clauses in foreign sovereign bond issues subject to German law”, 14 January 2000.

<sup>9</sup> Y. Liu, “Collective Action Clauses in International Sovereign Bonds” (2002), 3ff.; M. Bradley and M. Gulati, “Collective Action Clauses for the Eurozone. An Empirical Analysis” (2012), 10.

<sup>10</sup> For many: K.P. Gallagher, “The New Vulture Culture: Sovereign Debt Restructuring and Trade and Investment Treaties”, *IDEA Working Paper 02/2011*, 12.

<sup>11</sup> J. Schumacher, C. Trebesch and H. Enderlein, “Sovereign Defaults in Court: The Rise of Creditor Litigation”, 21 June 2013, 11ff.

restructured successfully by making use of CACs.<sup>12</sup> The number of litigated restructurings and the sums claimed have been on the rise for the last decade;<sup>13</sup> ironically the period which saw the widespread introduction of CACs precisely in order to prevent litigation. Also, the IMF finds negotiations with creditor committees to be increasingly difficult due to their dispersed nature and diverging interests, which vary with the price the creditor has paid for a debt instrument.<sup>14</sup>

In light of this, it should not come as a surprise that pre-restructuring litigation still does not play a significant practical role, despite the fact that many bonds now contain modification clauses. Should creditors develop an interest in pre-restructuring litigation, it might emerge that acceleration clauses are no waterproof remedy: certain bonds issued under US law preserve the right of individual bondholders to accelerate their claims in case of default and only prevent the acceleration of all bonds of the issue.<sup>15</sup>

Aggregation clauses are intended as a means to improve the shortcomings of issue-specific modification clauses. They stipulate that a modification of payment terms is possible if the holders of a majority of all outstanding bond series (e.g. 85%) as well as the holders of a smaller majority of the individual bond issue (e.g. 66%) agree.<sup>16</sup> Aggregation clauses thus raise the bar for holdout creditors. However, the bar might still not be high enough to prevent holdouts effectively, especially for bond series with a small volume. In addition, aggregation clauses have only been introduced in a few states, and it would take a long time until they become part of a significant part of worldwide outstanding sovereign debt.<sup>17</sup> One idea to make them more effective would be to remove the voting threshold for each bond issue and allow modification if an aggregate threshold is met. However, in some legal orders this might collide with the securities regulation or rules on unfair contract terms, since it would expose the holders of one particular bond to the majority vote of holders of other bonds with entirely different maturities, due dates, interest rates, etc.

With restructurings being much more difficult to impose on non-cooperative creditors than previously thought, the experience with CACs eliminates at least to some extent one of the principal reasons for the removal of a standstill rule from the 2003 draft for the SDRM. There is therefore a need for a standstill rule, which would apply in principle as long as the restructuring has not been completed, i.e. during the pre-agreement and post-agreement periods. It does not have to be automatic or bar litigation *per se* as long as it bars enforcement.

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<sup>12</sup> IMF (note 6) 28.

<sup>13</sup> Schumacher et al. (note 11) 12. This finding partly contradicts R. Bi, M. Chamon and J. Zettelmeyer, “The Problem that Wasn’t: Coordination Failures in Sovereign Debt Restructurings”, *IMF Working Paper No. 11/265*. It uses a broader dataset than the authors of the latter paper.

<sup>14</sup> IMF (note 6) 36.

<sup>15</sup> Liu (note 9) 11.

<sup>16</sup> For examples, see: Cleary Gottlieb Steen & Hamilton, “Collective Action Clauses Against Aggregation Mechanisms” (2011).

<sup>17</sup> IMF (note 6) 29.

## 2. Developments in Enforcement Litigation: The *Pari Passu* Clause

Another recent development calling for the reconsideration of the value of standstill relates to the dispute about the interpretation of the *pari passu* clause. Those clauses are included in the contractual terms of most sovereign bonds. They might read as follows:

The Notes rank, and will rank, *pari passu* in right of payment with all other present and future unsecured and unsubordinated External Indebtedness of the Issuer.<sup>18</sup>

In a corporate context, the clause means that the debt will rank equally with other unsecured debt in case of liquidation.<sup>19</sup> In the context of sovereign debt, its meaning is disputed. According to the traditional understanding, it has a rather narrow meaning, addressing only the issue of *legal* priority, preventing the debtor from legally subordinating the bonds in question to other debt. More recent is a wider interpretation of the clause. It originates in the case *Elliot Associates v. Peru*, in which the Brussels Court of Appeals decided that it gave a right to ratable payments. Accordingly, holdout creditors were entitled to intercept payments to creditors who had exchanged their bonds.<sup>20</sup>

For the purposes of this study, the origin and meaning of the clause as well as its change over time do not require closer analysis.<sup>21</sup> What matters is that courts in the United States recently seem to move towards the wider interpretation. The Federal District Court for the Southern District of New York adopted this view in the case *NML v. Argentina*.<sup>22</sup> The Court of Appeals for the Second Circuit will soon render its decision on appeal against the latest orders of the District Court in that case, but it has already affirmed the “ratable payment” interpretation in an earlier decision on appeal.<sup>23</sup>

Should the “ratable payment” interpretation be approved, the consequences might be dramatic. Fiscal agency agreements involve many U.S. institutions in the processing of payments to cooperative bondholders. Those proceeds might become subject to attachments by holdout creditors. Past experience tells that comparable landmark judgments trigger new waives of holdout litigation.<sup>24</sup> The outcome of this case might therefore invalidate the argument that standstill is unnecessary because enforcement is difficult. This would strongly call for the introduction of a standstill rule applicable

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<sup>18</sup> Quoted after L.C. Buchheit and J.S. Pam, “The *Pari Passu* Clause in Sovereign Debt Instruments”, 53 *Emory Law Journal* (2004) 869, 871.

<sup>19</sup> M. Weidemaier, R. Scott and M. Gulati, “Origin Myths, Contracts, and the Hunt for *Pari Passu*”, *UNC Legal Studies Research Paper No. 1633439* (2011) 4.

<sup>20</sup> Brussels Court of Appeal, 8th Chamber, *Elliot Associates v. Peru*, Register No. 2000/QR/92, 26 September 2000.

<sup>21</sup> For these questions see Weidemaier et al. (note 19); Buchheit and Pam (note 18).

<sup>22</sup> United States District Court, Southern District of New York, *NML Capital v. Argentina*, 08 Civ. 6978 (TGP) et al., Order of 21 November 2012.

<sup>23</sup> 2nd Circuit, *NML Capital et al. v. Argentina*, 12-105(L) et al., 26 October 2012. The text of the clause at stake in this case is reproduced on pages 4-5.

<sup>24</sup> Schumacher et al. (note 11) 20.

during both pre-agreement and post-agreement periods up until the conclusion of the restructuring. Standstill would not have to be automatic.

#### **IV. Alternatives to Standstill?**

At the moment, no explicit standstill rule exists in international treaties or in the legal framework of international organizations. Nevertheless, some existing procedural or substantive provisions and concepts might at least partially serve the same ends and prevent holdout litigation.

##### **1. Sovereign Immunities**

In principle, sovereign immunities could serve the same purpose as a standstill rule.<sup>25</sup> However, sovereign debt instruments are nowadays regularly considered *acta iure gestionis*. Under public international law, states may therefore not invoke jurisdictional immunity in order to stop holdout litigation.<sup>26</sup> Domestic courts usually interpret the legal provisions on sovereign immunities applicable in their jurisdiction in the same way and do not grant immunity as a defense against such suits.<sup>27</sup> On top of that, the standard terms of sovereign debt instruments routinely contain waivers of immunity.

The question remaining is that of the extent of enforcement immunity, i.e. which assets of the debtor state enjoy immunity against attachment or other enforcement action. In this respect, the wording of waivers differs, and so does their interpretation from one court to another. While U.S. courts exempted central bank assets from enforcement, the High Court of Ghana held that the broad terms of the waiver also subject navy ships to enforcement action. Since these disputes revolve around questions of *domestic* law, agreement among courts of various jurisdictions is unlikely to emerge. Immunities therefore cannot replace a standstill rule.

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<sup>25</sup> Comprehensively: A. Gelpern, “Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt”, 121 *The Yale Law Journal* (2012) 888, 898ff.

<sup>26</sup> Cf. Art. 2(1)(c)(ii), UN Convention on Jurisdictional Immunities of States and Their Property.

<sup>27</sup> E.g. United States Supreme Court, *Argentina v. Weltover*, 504 U.S. 607 (1992); United Kingdom Supreme Court, *NML Capital Ltd. v. Argentina*, [2011] UKSC 31, para. 20 (Lord Phillips). An exception is the 2005 decision of the Corte di Costituzionale in yet another case involving Argentina. However, in substance, it deals rather with necessity and the Italian act of state doctrine than with immunities. See Corte di Cassazione - Sezioni Unite Civile, Ordinanza del 27 maggio 2005, n. 11225. For further cases see X. Yang, *State Immunity in International Law* (2012) 79ff.

## 2. Necessity as a Defense

States regularly invoke necessity as a defense in cases against holdout creditors before international courts and tribunals since the *Serbian Loans* case,<sup>28</sup> as well as before domestic courts.<sup>29</sup> However, necessity as a defense is unsatisfactory as a replacement for a standstill rule for several reasons. First, a defaulting state may not invoke necessity if it has contributed to the state of necessity.<sup>30</sup> This requirement has limited the ability of defaulting states to use this defense effectively, since a sovereign default is typically the result of multiple causes, including the economic policies of the defaulting government.<sup>31</sup> Second, the legal consequences of invoking necessity do not correspond to the policy objectives of sovereign debt restructurings. Necessity only entitles a state to a temporary stay of proceedings, which ceases as soon as the economic or financial situation improves. This does not necessarily coincide with the successful completion of a debt restructuring. Also, a state might have to pay damages to its creditors for the delay.<sup>32</sup> Third, the invocation of necessity is detrimental to creditor rights and interests, for it may also be invoked in case of unilateral haircuts where it might be difficult to establish whether the state has done the utmost to find a consensual solution.

## 3. Exchange Restrictions

Debevoise proposed considering sovereign debt contracts as exchange contracts according to Art. VIII(2)(b) of the IMF Articles of Agreements, which would enable the debtor state to prevent their enforcement in other jurisdictions by imposing export regulations.<sup>33</sup> So far, courts in the United States, the United Kingdom, and Germany, amongst others, have not followed this view, arguing that the term “exchange contracts” did not include sovereign debt instruments.<sup>34</sup>

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<sup>28</sup> PCIJ, Case Concerning the Payment of Various Serbian Loans Issued in France (*France v. Serbia*), PCIJ Rep (1929) Series A No. 20.

<sup>29</sup> E.g. German Federal Constitutional Court, Cases 2 BvM 1-5/03, 1, 2/06, decision of 8 May 2007, BVerfGE 118, 124.

<sup>30</sup> Cf. Art. 25(2)(b), Articles on State Responsibility; ICJ, *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)* (Merits), ICJ Rep (1997) 7, 46.

<sup>31</sup> For a critique of the ICSID awards on necessity cf. S. Schill, “International Investment Law and the Host State’s Power to Handle Economic Crises”, 24 *Journal of International Arbitration* (2007) 265-286; C. Binder, “Changed Circumstances in Investment Law: Interfaces between the Law of Treaties and the Law of State Responsibility with a Special Focus on the Argentine Crisis”, in C. Binder *et al.* (eds), *International Investment Law for the 21<sup>st</sup> Century* (2009) 608-630ff.; M. Waibel, “Two Worlds of Necessity in ICSID Arbitration: *CMS* and *LG&E*”, 20 *Leiden Journal of Int’l Law* (2007) 637-648.

<sup>32</sup> Waibel (note 31).

<sup>33</sup> W. Debevoise, “Exchange Controls and External Indebtedness: A Modest Proposal for a Deferral Mechanism Employing the Bretton Woods Concept”, 7 *Houston Journal of International Law* (1984) 157-68; see also Rogoff & Zettelmeyer (note 5) 479-80.

<sup>34</sup> C. Tietje, *Die Argentinien-Krise aus rechtlicher Sicht: Staatsanleihen und Staateninsolvenz* (2005) 10-11.



The IMF might change this interpretation by issuing an interpretative declaration to that effect.<sup>35</sup> This interpretative declaration might bend the meaning of the terms of that article to the extreme so that it is not certain whether domestic courts would follow it. It is also unlikely to happen. Before issuing such a declaration, the IMF might consider it necessary to legislate more extensively on sovereign defaults in order to prevent giving worldwide effect to unilateral debt repudiation undertaken in bad faith. This might require an amendment of the Articles of Agreement that would amount to the establishment of an SDRM.

## **V. Potential Drawbacks: Financing Costs, Interim Financing, Moral Hazard, Duration of Standstill**

Even though there are pertinent reasons for the introduction of a standstill rule at present, such a rule might entail certain financial risks which need to be addressed. First, the introduction of a standstill rule might increase the general **cost of borrowing** for sovereigns. It has been shown that contractual provisions have an impact on pricing, at least if investors have the choice between different bonds of the same sovereign.<sup>36</sup> But investors would not have a choice between bonds subject to standstill and bonds not subject to it. The rule would apply across the board to all sovereign debt. The question is therefore only whether a standstill rule might incentivize more risk-averse investors to opt for safer investments, such as sovereign debt from states with better credit ratings and credit histories, or other asset types. This might reduce the availability of capital and increase the price of sovereign debt. However, recent data show that most holdout creditors are vulture funds and that litigation from retail investors is practically inexistent.<sup>37</sup> Therefore, the introduction of a standstill rule barring litigation or enforcement should in theory not have a significant impact upon the market for sovereign debt of non-defaulting states.

Further, a standstill rule must not compromise the ability of a state to obtain **interim financing** (debtor-in-possession financing) during the restructuring. Obtaining interim financing is one of the central challenges to any debt restructuring.<sup>38</sup> Should interim financing be subject to standstill, potential lenders, including multinational and bilateral ones, might not be willing to extend the required credits. In fact, it has been a requirement for IMF lending that there are no arrears to a state's bilateral and multilateral creditors – while there might be arrears to its private creditors.<sup>39</sup> Any standstill rule should therefore

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<sup>35</sup> Eichengreen and Portes (note 5) 38.

<sup>36</sup> S.J. Choi, M. Gulati and E.A. Posner, "Pricing Terms in Sovereign Debt Contracts: A Greek Case Study with Implications for the European Crisis Resolution Mechanism", *John M. Olin Law & Economics Working Paper No. 541* (2011).

<sup>37</sup> Schumacher et al. (note 11).

<sup>38</sup> Krueger (note 2) 11.

<sup>39</sup> International Monetary Fund, *IMF Policy on Lending into Arrears to Private Creditors* (1999).

exempt credits provided as interim financing, at least optionally.<sup>40</sup> This would not only help attract bilateral and multilateral interim financing, but also to regain market access.<sup>41</sup>

Such an exemption might cause problems with the *pari passu* clause. Under the wider interpretation of this clause, private creditors whose payments are suspended or whose claims are stayed might consider it a violation of their contractual rights if the claims of bilateral or multilateral creditors providing interim financing are not subjected to such stay.<sup>42</sup> It is unclear how courts would deal with such a kind of formalized discrimination among creditors, however justified it may be economically. In the worst case, and depending on the legal nature of any standstill rule, they might hold the standstill rule to be inapplicable because it violates creditor equality. One might overcome any problems by making standstill dependent on the affirmative vote of the majority of affected creditors, as it had been envisaged for the SDRM by some voices.<sup>43</sup> However, such a voting requirement would most certainly display the same loopholes as other majority voting clauses, including aggregation clauses. It would therefore be important to design any standstill rule in a way that ensures it will take precedence over *pari passu* and other potentially conflicting contractual obligations. This could be achieved through contractual stipulations which grant standstill priority over *pari passu*, or by choosing a legal basis for standstill which prevails over contractual provisions.

Another problem to be addressed is the risk that a standstill rule might create **moral hazard** on the part of the debtor state. However, research shows that states tend to initiate a debt restructuring rather too late than too early, given the political costs associated with it and the fear of contagion.<sup>44</sup> The need to ensure interim financing and the conditionalities associated with it might suffice to contain moral hazard.<sup>45</sup>

A further legal problem which might arise in case a standstill rule sees the light of the day concerns its **duration** and generally the question what should happen with the claims of holdout creditors, especially after a restructuring agreement has been implemented by most of the other creditors. Past debates about standstill understood standstill as part of an obligatory, potentially treaty-based restructuring mechanism and did not further elaborate on this point. This study does not take it as a given that such a mechanism will ever be established. In this case, standstill would cause a situation where the ownership of a claim does not involve any longer the ability of its owner to collect on the claim or to enforce it. It is unclear to what extent domestic or international courts would be willing to accept such a situation. In that respect, the decision of the Frankfurt Court of Appeals from June 2006 might serve as a warning, in which the court decided that Argentina

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<sup>40</sup> S.L. Schwarcz, "Sovereign Debt Restructuring Options: An Analytical Comparison", 2 *Harvard Business Law Review* (2012) 95, 112ff.

<sup>41</sup> Whether debtors should resume debt service to private creditors is the subject of a dispute between the IMF and the Institute of International Finance, cf. IMF (note 6) 40 (para. 61).

<sup>42</sup> Cases of inter-creditor discrimination are frequent, cf. IMF (note 6) 27-8.

<sup>43</sup> *Supra*, B.I.

<sup>44</sup> C. Trebesch, "Delays in Sovereign Debt Restructuring. Should we really blame the creditors?" (2008); IMF (note 6) 15ff.

<sup>45</sup> For a more sophisticated rejection of the moral hazard argument see Rogoff and Zettelmeyer (note 5) 496ff.

could not invoke the defense of necessity (not standstill) any more – without paying sufficient attention to the collective action problem ensuing from holdout litigation.<sup>46</sup> If a standstill rule exists, it might therefore be worthwhile considering the resumption of debt service to holdout creditors after the vast majority of creditors have implemented the restructuring agreement, treating holdouts as if they had accepted the restructuring agreement. This would be in line with the “ratable payment” criterion.<sup>47</sup>

## **C. Standstill As a General Principle of Law: The Incremental Approach**

### **I. General Considerations: General Principles of Law as the Most Realistic Option**

The second part of this study looks into ways for establishing a standstill rule for sovereign defaults which do not include the adoption of a binding international treaty. Although this would probably be the most effective and legally sound solution, for the time being, the political momentum necessary for such a step might not be available. The adoption of a treaty might also have institutional implications which would require difficult negotiations.

A further consideration concerns the legal nature of any standstill rule. In order to effectively bar litigation before domestic or international courts, the rule needs to be binding. Consequently, the adoption of a soft law declaration or any document of mere political or aspirational character would alone be insufficient. Although contractual clauses would meet the requirement of bindingness, the flaws and loopholes of majority enforcement clauses (acceleration clauses) analyzed above render this option ultimately insufficient, although it might supplement other options.<sup>48</sup> To implement standstill in a decentralized fashion through domestic law would require legislation in nearly all states.<sup>49</sup> This might not be easier to achieve than the ratification of an international treaty.

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<sup>46</sup> Oberlandesgericht Frankfurt, 8th Civil Senate, case 8 U 107/03, judgment of 13 June 2006, marginal no. 42ff. Cf., by contrast, the judgment of the Argentinean Federal Administrative Tribunal in *Randado, Aldo Diego c. PEN*, JNFed. Cont. Adm. Nro. 1, 12 October 2006, which held that the cessation of payments and exchange offer had been justified by the emergency of the economic situation, that the economic situation had improved due to the sacrifices made by the cooperative bondholders, and that the holdout creditors who chose not to participate in the exchange should not benefit from their sacrifice.

<sup>47</sup> Cf. *NML Capital v. Argentina* (note 23).

<sup>48</sup> Cf. B.III.1.

<sup>49</sup> Cf., however, J. Bulow, “First World Governments and Third World Debt”, *Brookings Papers on Economic Activity* 1 (2002) 229, 230. He argues that it would be sufficient if the US and the UK and probably some other important economies repeal the exception from jurisdictional immunity for foreign debt instruments and the possibility to waive such immunity. This raises many questions. Such a broad repeal of immunities would go far beyond what is needed in order to prevent holdout litigation. It might therefore be unconstitutional in some jurisdictions. Also, jurisdictional clauses in debt instruments might quickly adjust and evade to jurisdictions where immunity for debt instruments continues to be denied or may still be waived. “Jurisdictional havens” might thus emerge. Judgments obtained there might have to be recognized in other jurisdictions due to mutual recognition agreements. – These arguments apply both to

Also, domestic legislation might give rise to diverging interpretations and would not oblige international courts and tribunals. Customary international law would apply directly to international courts and indirectly to domestic courts, by engaging the responsibility of the state. However, customary international law requires – custom, i.e. more or less consistent state practice supported by *opinio iuris*. The spread of holdout litigation shows that no customary standstill rule exists at present<sup>50</sup> – even though case law sometimes recognizes the public policy interests militating in favor of such a rule.<sup>51</sup>

This leaves one option to be explored in further detail, namely the incremental approach. It relies on a variety of legal sources and bases which might complement approaches based on other legal sources such as CACs and changes in domestic legislation. Pursuant to this approach, it might be possible to reconstruct a standstill rule as a general principle of law in accordance with Art. 38(1)(c) of the Statute of the International Court of Justice. The following section discusses the nature of general principles of law as well as the methodology required for their reconstructive establishment (II.), while the subsequent sections discuss the prospects of standstill becoming recognized as such a principle (III. and IV.).

## II. The Nature and Reconstruction of General Principles

### 1. General Principles of Law as a Source of International Law

General principles of law are a proper source of international law.<sup>52</sup> They have been recognized at least since the adoption of the ICJ Statute. Before, their legal status had been heavily disputed,<sup>53</sup> although arbitral tribunals had frequently used them.<sup>54</sup> They are usually extrapolated from domestic legal orders by means of analogical and comparative reasoning.<sup>55</sup> According to Pellet,<sup>56</sup> a general principle is:

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domestic rules on immunities as suggested by Bulow, but the risk of evasive behavior would be the same in case of domestic standstill rules.

<sup>50</sup> Acts of the judiciary might contribute to the formation of customary law, see only PCIJ, *Lotus (France v. Turkey)*, PCJ Rep Series A No. 10 (1927) 28.

<sup>51</sup> See *infra* C.III.2.

<sup>52</sup> This is why Koskenniemi designates them as “normative” general principles, see M. Koskenniemi, “General Principles: Reflexions on Constructivist Thinking in International Law” in M Koskenniemi (ed.), *Sources of International Law* (2000) 360-402, 364-5.

<sup>53</sup> A. Verdross, “Les principes généraux de droit dans le système des sources du droit international public” in Université de Genève, Faculté de Droit (ed.), *Recueil d'études de droit international en hommage à Paul Guggenheim* (1968) 521-530, 521f.

<sup>54</sup> A. Pellet, “Article 38”, in A. Zimmermann et al. (eds), *The Statute of the International Court of Justice* (2006) marginal no. 247; V.D. Degan, “General Principles of Law”, 3 *Finnish Yearbook of International Law* (1992) 1, 22ff.

<sup>55</sup> H. Lauterpacht, *Private Law Sources and Analogies of International Law* (1977) 67ff. – From this type of general principle of law, one needs to distinguish general principles of international law, cf. G. Gaja, “General Principles”, in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law* (2007) marginal no. 17ff. The latter have no relevance for this study.

- *an unwritten legal rule of wide-ranging character.* This requirement does not put principles on a par with moral rules. Rather, they are just another form of legal rules, although of a more abstract and general character.<sup>57</sup> They usually express the ratio of more specific rules and serve as guidelines for their interpretation and application.<sup>58</sup> But it is also possible to base an argument about the legality of a certain act on its conformity with a specific general principle.
- *recognized in the municipal laws of States.* Most legal orders should be familiar with a principle considered to be a general principle, but not necessarily all.<sup>59</sup>
- *transposable at the international level.* This requires the principle to be of a somewhat abstract character. Principles which are contingent upon the existence of specific institutions which only exist on the domestic level may not be considered general principles.<sup>60</sup> For example, basic parliamentary practices, even though in use in all democratically elected parliaments, may hardly become general principles, because they might be inapplicable on the international level. A further indicator for the existence of a general principle of law is the fact that it is applicable both in public law and private law contexts. But this criterion should not be overstretched since the distinction between public and private law as well as its significance varies from one legal order to another.

Pellet reports that general principles originally had the purpose of avoiding a *non-liquet*.<sup>61</sup> However, a non-liquet is more easily avoided by default rules, and the *Lotus* judgment established the default rule that “[r]estrictions upon the independence of States cannot therefore be presumed.”<sup>62</sup> Therefore, general principles of law rather seem to serve international courts to avoid judgments that would contradict basic principles of justice, only because the state practice necessary for the establishment of a customary rule cannot be proven. General principles thus presuppose the view that there is a universal international legal order which exceeds the sum of the manifestations of the will of its member states and comprises fundamental ideas of justice.<sup>63</sup> However, one should not equal general principles with natural law, since they require a basis in the practice of domestic legal systems.

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<sup>56</sup> Note 54, marginal no. 249.

<sup>57</sup> On the theoretical debate surrounding the distinction between rules and principles see R. Dworkin, *Taking Rights Seriously* (1977) 22; J. Habermas, *Faktizität und Geltung* (1992) 255, 309-17.

<sup>58</sup> R. Kolb, “General Principles of Procedural Law”, in A. Zimmermann et al. (eds), *The Statute of the International Court of Justice* (2006) 793, marginal no. 2.

<sup>59</sup> According to Gaja (note 55) marginal no. 16, the International Court of Justice is reluctant to recognize general principles when it would require controversial discussions of comparative law.

<sup>60</sup> V.D. Degan, *Sources of International Law* (1997) 103.

<sup>61</sup> Note 54, marginal no. 245.

<sup>62</sup> Note 50, 18.

<sup>63</sup> R. Kolb, *La bonne foi en droit international public* (2000) 24-5, 45ff.; Degan (note 54) 58ff.

A matter of positive international law, states need to comply with general principles. Some constitutions incorporate general principles into the domestic legal order, either directly by cross-referencing,<sup>64</sup> or indirectly, e.g. by way of the idea of comity.<sup>65</sup>

## 2. The Reconstruction of General Principles and the Role of Legal Scholarship

General principles thus result from a constructive endeavor, in which principles of domestic legal orders are extrapolated to the international level. This raises questions about the “authorship” of general principles, and in particular about the role of legal scholarship in their construction.

According to a traditional view in legal theory, the making and the interpretation of the law can be, and should be, strictly separated. The interpretation of the law in legal scholarship is merely a cognitive exercise. This view found a vocal expression in the pure theory of law of Hans Kelsen.<sup>66</sup> Also, Article 38(1)(d) of the ICJ Statute stipulates that legal scholarship does not constitute a source of law proper, but is confined to the “determination” of rules of law. Some consider scholarship therefore as “documentary evidence” for the existence of international law and deny it has a role in law-making.<sup>67</sup>

However, the evolution of our understanding of language brought about by what is commonly referred to as the “linguistic turn” leads to a collapse of the strict separation between law-making and interpretation. Accordingly, the meaning of legal rules is not only indeterminate, but also context-sensitive to the extent that it only emerges in the practice of their interpretation and application. Each interpretation of the law is thus tantamount with its further development.<sup>68</sup> In other words, the conceptual work of legal scholarship always contributes to the further development of the law. This is especially acute in international law, a relatively young and developing field of law characterized by decentralized institutions, cases and practice.<sup>69</sup> International legal scholarship therefore necessarily involves a good dose of political considerations.<sup>70</sup>

Certainly, this has exposed legal scholarship to the critique of scholars in the tradition of legal realism. Koskenniemi discovered a habit of pseudo-objective reasoning in international legal scholarship (and international law), which did not recognize the role of political preferences.<sup>71</sup> Jaye Ellis criticizes international legal scholarship for its selective

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<sup>64</sup> E.g. Art. 25 of the German Basic Law.

<sup>65</sup> C. Wheeler and A. Attaran, “Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation”, 39 *Stanford Journal of International Law* (2003) 253.

<sup>66</sup> H. Kelsen, *The Pure Theory of Law* (1967) 355.

<sup>67</sup> Pellet (note 54) marginal no. 299.

<sup>68</sup> Seminal on the concept of language advocated by the linguistic turn: L. Wittgenstein, *Philosophische Untersuchungen*, 16th edn (2004), 262 (sec. 43). On the significance of the linguistic turn for international law, see J. d’Aspremont, *Formalism and the Sources of International Law* (2011) 196ff.

<sup>69</sup> A. Peters, “Realizing Utopia as a Scholarly Endeavour”, 24 *European Journal of International Law* (2013) 533, 537; F. Tesón, “The Role of Academics in the Legal System: International Law”, in P. Cane and M. Tushnet, *Oxford Handbook of Legal Studies* (2003) 941.

<sup>70</sup> A. Cassese, *Five Masters of International Law* (2011) 259; Tesón (note 69) 946.

<sup>71</sup> M. Koskenniemi, *From Apology to Utopia. The Structure of International Legal Argument* (2005) 218ff.

use of comparative law in the formation of general principles.<sup>72</sup> However, this critique does not render legal scholarship illegitimate. It should only compel legal scholars to reflect on the normative premises of their arguments.<sup>73</sup> They should be aware that scholarly efforts, like the establishment of general principles, are reconstructive processes which require dialectical reasoning including both positive analyses of the domestic legal situation in comparative perspective, and normative reasoning on the premises of such principles, i.e. on the rationale underlying the domestic law analogy.<sup>74</sup>

There are two limits to the reconstructive efforts of legal scholarship. First, in their role as scholars, lawyers may not engage in formal law-making processes.<sup>75</sup> They belong to the realm of politics, and to the extent that lawyers engage in such processes, their proposals are only expert opinions and require political affirmation by adequate procedures in competent bodies and organizations. Of course, the line between reconstruction and law-making might be thin at times. In the perspective of discourse theory, it seems appropriate to draw the line in accordance with the style of reasoning, with the way in which an argument is made: as long as scholars, bearing in mind the above-mentioned requirement to be frank about their normative premises, *argue* that a certain rule exists, they are on safe ground and only exposed to reasoned criticism that their argument is wrong. As soon as they *argue* that a rule does not exist yet but should exist, they are engaging in law-making.<sup>76</sup> The second limit concerns the normative premises of dialectical reconstructions of legal rules, including general principles. Legal scholars are not free to use whatever normative premise they wish. Rather, they have to tie their normative premises to the existing legal framework. In that sense, their task is a reconstructive one. This is what separates the idea of legal positivism so firmly immersed in international legal thought from natural law.<sup>77</sup>

### **III. The Reconstruction of Standstill as a General Principle of Law**

#### **1. Normative Premise: Sovereign Debt Workouts as Exercises of Public Authority**

In light of the preceding section, this section elaborates on the normative premises of a standstill rule for sovereign debt workouts as a general principle of law. The rationale of a standstill rule is based on an understanding of sovereign debt workouts as exercises of

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<sup>72</sup> J. Ellis, “General Principles and Comparative Law”, 22 *European Journal of International Law* (2011) 949.

<sup>73</sup> Cassese (note 70) 259.

<sup>74</sup> This has been termed doctrinal constructivism, see generally A. von Bogdandy, “The Past and Promise of Doctrinal Constructivism: A Strategy for Responding to the Challenges Facing Constitutional Scholarship in Europe”, 7 *International Journal of Constitutional Law* (2009) 364; emphasizing the significance of both positive and normative reasoning in an international law context: Peters (note 69) 549-50.

<sup>75</sup> Peters (note 69) 539.

<sup>76</sup> Habermas (note 57) 146-7, 397.

<sup>77</sup> For anecdotal evidence of the positivist mindset of international lawyers, see Cassese (note 70) 255.

public authority. This implies a paradigm change from a private law to a public law approach to sovereign debt restructurings.

For much of the history of the last two centuries, sovereign debt workouts were considered as a matter to be decided only between the debtor and its creditors by consensus.<sup>78</sup> The parties only pursue their own interests in such a horizontally structured arrangement, not the interests of any group or community. Since about the late 1980s, the way in which sovereign debt workouts are conducted has changed in some important ways into the direction of a public law paradigm.<sup>79</sup> Debt workouts nowadays comprise many elements which are meant to protect the interests of the international community of states, as well as of citizens, not only of creditors and debtors. Institutionally, debt workouts began to take place in a closely coordinated network of international actors involving the IMF, the Paris Club and the London Club, as well as other venues for private creditors.<sup>80</sup> In substance, the workouts facilitated by this arrangement are intended to pursue interests which serve the common good, and not only private interests of the parties involved. Manifestations of this are the IMF's lending into arrears policy; the granting of debt relief by the Paris Club since the introduction of the Toronto terms in 1988; the Brady Bond exchanges; the Heavily Indebted Poor Countries Initiative; or the Monterrey Consensus.<sup>81</sup> The global financial meltdown has intensified the focus on public interest, as is evidenced by the recalibration of the Fund's lending programs, as well as by efforts geared also towards prevention such as the IMF's fiscal monitor or the UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing. Certainly, not every element and not every trend in sovereign debt workouts fit into this picture. But the broad direction seems clear.

Whether these efforts were or are actually successful and promoted the common good is a completely different question. What matters is that the actors involved in these efforts considered their actions in that way, focusing on debt sustainability as a being in the public interest, and not just on a narrow view of borrowers' or lenders' interests. The new

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<sup>78</sup> H. Feldmann, *Internationale Umschuldungen im 19. und 20. Jahrhundert* (1991) 20ff., 317ff.

<sup>79</sup> On the public law paradigm in global governance, see generally B. Kingsbury, N. Krisch and R. Stewart, "The Emergence of Global Administrative Law", 68 *Law and Contemporary Problems* (2005) 15; B. Kingsbury & M. Donaldson, "From Bilateralism to Publicness in International Law", in U. Fastenrath et al. (eds), *From Bilateralism to Community Interest (Festschrift Simma)* (2011) 79; A. von Bogdandy, P. Dann and M. Goldmann, "Developing the Publicness of Public International Law: Towards a Legal Framework for Global Governance Activities", 9 *German Law Journal* (2008) 1375; J. Klabbers, A. Peters and G. Ulfstein (eds), *The Constitutionalization of International Law* (2009); in the context of sovereign debt workouts, see R. Howse, "Concluding Remarks in the Light of International Law", in C. Esposito, J.P. Bohoslavsky, and Y. Li (eds), *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (2013) 385-389; O. Lienau, *Rethinking Sovereign Debt: Debt and Reputation in the Twentieth Century* (forthcoming 2013); A. von Bogdandy and M. Goldmann, "Sovereign Debt Restructurings as Exercises of International Public Authority: Towards a Decentralized Sovereign Insolvency Law", in C. Esposito, J.P. Bohoslavsky, and Y. Li (eds), *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (2013) 39-70.

<sup>80</sup> The recent IMF paper provides ample illustration of this, see note 6.

<sup>81</sup> Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002 (UN Doc. A/CONF.198/11, chapter 1, resolution 1, annex).



bilateral lenders which reject the Paris Club might not necessarily disagree with this approach, but with the way the institution is organized.

This paradigm change has normative implications. Above all, it imposes the need for sovereign debt workouts to justify their authority and to acquire legitimacy. This has been elaborated by the scholarship on global administrative law, international public authority, or the constitutionalization of international law.<sup>82</sup> Underlying these implications is a conviction that international institutions pursue public interests which ultimately derive from the people they serve.<sup>83</sup> For the present purposes, these implications do not need to be elaborated in full. What matters is that the extrapolation of a standstill rule as a general principle would support the public interests pursued by sovereign debt workouts. It would bolster their effectiveness and shield them against creditors refusing to accept the public interests involved.

## 2. Positive Analysis: Standstill as an Emerging General Principle

It can be argued that a general principle of law is emerging according to which the negotiation or implementation of a sovereign debt workout entails a standstill on creditors' claims.<sup>84</sup> In addition, one might also consider such a standstill rule as a concretization of good faith as an established general principle of law.<sup>85</sup> The precise qualification depends on whether one prefers deductive or inductive modes of reasoning. Inductively, the case for standstill as a general principle is rather strong. In practically all domestic jurisdictions, bankruptcy filings of private entities trigger a stay on enforcement actions.<sup>86</sup> Although domestic law might vary in some details from one legal order to the other, in particular as some jurisdictions require prior court approvals, on an abstract level there is a high degree of convergence: authoritative, centralized insolvency proceedings bar individual enforcement against the creditor in default.<sup>87</sup>

This rule originating in private sector insolvencies is increasingly applied to defaults in the public sector. First, domestic legislation in some jurisdictions provides for some form of stay in case of defaulting public entities. Under Chapter 9 of title 11 of the US Code, automatic stay is applicable in bankruptcy procedures against municipalities.<sup>88</sup> Other states that have enacted bankruptcy legislation for sub-national entities include Brazil,

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<sup>82</sup> See note 79.

<sup>83</sup> R.G. Teitel, *Humanity's Law* (2011); A. Peters, "Humanity as the A and  $\Omega$  of Sovereignty", 20 *European Journal of International Law* (2009) 513.

<sup>84</sup> In this sense R. Dolzer, "Staatliche Zahlungsunfähigkeit: Zum Begriff und zu den Rechtsfolgen im Völkerrecht", in J. Jekewitz *et al.* (eds), *Festschrift Partsch* (1989) 531, 546-7.

<sup>85</sup> On good faith as a general principle cf. Kolb (note 63).

<sup>86</sup> International Law Association, "State insolvency: options for the way forward", Report for the Hague Conference (2010), 23; C.G. Paulus, "A Statutory Procedure for Restructuring Debts of Sovereign States" (2003) 49 *Recht der Internationalen Wirtschaft* (2003) 401, 404; M. Waibel, "Opening Pandora's Box: Sovereign Bonds in International Arbitration" 101 *American Journal of Int'l Law* (2007) 711, 750.

<sup>87</sup> See note 1; this has been recognized by international tribunals, cf. ICSID, *Noble Ventures Inc. v. Romania*, case ARB/01/11.

<sup>88</sup> 11 U.S.C., §§ 901(a), 362.

Bulgaria, Hungary, Romania, and South Africa. It routinely includes some form of stay on enforcement.<sup>89</sup> Even in the absence of formal bankruptcy proceedings, there is legislation in some legal orders recognizing that creditors may not obtain and enforce judgments for the full amount of their debt against insolvent sovereign debtors. After the Second World War, Germany passed legislation which annulled, with few exceptions, all domestic government debt of the Reich, thereby mooting ongoing and future enforcement action.<sup>90</sup> The 2010 United Kingdom Debt Relief (Developing Countries) Act reduces claims of private creditors against countries participating in the HIPC proportionate to the relief granted to them under the initiative. Although the legislation in Germany and the UK technically does not impose stays, it serves the identical purpose, namely ensuring the orderly resolution of debt crises through international negotiations while preserving the equality of creditors.

Second, state practice and some case law show the application of stays of proceedings in case of private creditor holdout litigation during sovereign debt workouts. An early example is a 1962 judgment of the German Federal Constitutional Court concerning Germany's post-war default, in which it recognized that sovereign defaults justified highly intrusive measures including the legislative cancellation of debt without compensation because of the high significance of the state for politics and the economy in general and the ensuing impossibility to liquidate all of the state's assets.<sup>91</sup> In 1985, the Supreme Court of New York recognized the principle that proceedings should be stayed during a workout in a suit against Venezuela, basing it on the duty of the plaintiff to respect creditor solidarity.<sup>92</sup> Another line of reasoning originates in the first decision in *Allied Bank Int. vs. Banco Credito Agricola de Cartago*. In 1984, the US Federal Court of Appeals for the Second Circuit ruled against a holdout creditor since Costa Rica seemed to be negotiating in good faith at the time. When the restructuring later amounted to a rather unilateral suspension of payments, the first ruling was reversed.<sup>93</sup> A more recent example for this line of reasoning is provided by the 2005 summary order rendered by the same court in *EM Ltd. v. Argentina* and *NML Capital v. Argentina*. Although this order formally lacks precedential value, it has been widely cited for the remarkable considerations of the judge, who decided that "the District Court acted well within its authority to vacate the remedies in order to avoid a substantial risk to the successful conclusion of the debt restructuring. That restructuring is obviously of critical importance to the economic health of a nation."<sup>94</sup> At around the same time, the Italian Corte di Cassazione recognized that the need to safeguard essential public interests and human rights justified extending immunity over Argentina's emergency laws, even though it had waived its immunity for the bonds in dispute. The underlying rationale is the same, even though the court presents it as a combination of arguments relating to necessity and

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<sup>89</sup> M. Waibel and L. Liu, "Subnational Insolvency: Cross-Country Experiences and Lessons", *World Bank Policy Research Working Paper No. 4496* (2008), 26.

<sup>90</sup> § 1(1), Allgemeines Kriegsfolgensgesetz, 5 November 1957, BGBl. III, No. 653-1.

<sup>91</sup> Case 1 BvR 987/58, Judgment of 14 November 1962, BVerfGE 15, 126, 140-144.

<sup>92</sup> Supreme Court of New York, *Crédit français S.A. v. Sociedad financiera de Comercio*, 490 N.Y.S.2d 670 (1985); Dolzer (note 84) 539.

<sup>93</sup> Case 83-7714, 18 March 1985, 757 F.2d 516; cf. Rogoff & Zettelmeyer (note 5) 475.

<sup>94</sup> *EM Ltd. V. Argentina; NML Capital v. Argentina*, 05-1525-cv, Summary Order, 13 May 2005.

immunity.<sup>95</sup> The 2011 judgment of the US Court of Appeals for the Second Circuit in *CVI v. Argentina* seems to endorse its earlier line of reasoning, although only indirectly.<sup>96</sup> In this case, the Court upheld the attachments received by CVI on Argentina's reversionary interest in collateral pledged for Brady bonds (i.e. when exchanging Brady bonds, Argentina would receive the pledged collateral, which CVI would then have "confiscated" pursuant to the attachment orders). However, the Court based its decision primarily on the argument that the attachments concerned only a relatively small sum (USD 100m), while the volumes of the planned restructuring and thus of the expected reversionary interest were much larger. Therefore, the Court concluded that the attachment would not obstruct Argentina's finances. If one reverses this argument, attachments could principally be vacated in case they obstruct a sovereign debt workout.<sup>97</sup> In the pending case *NML v. Argentina*, the same court upheld the District Court's injunction obliging Argentina to make ratable payments, but not without emphasizing that this did not threaten the implementation of Argentina's restructuring plan and would not trigger a new financial and economic crisis.<sup>98</sup>

Certainly, the mentioned cases represent only part of the entire picture. Judges at the US Federal Court for the Southern District of New York rendered dozens of judgments in favor of vulture funds attempting to reclaim the nominal amount of their debt against Argentina in which they did not recognize that Argentina had a legitimate interest to have the proceedings stayed until the conclusion of its restructuring.<sup>99</sup> Other particularly infamous decisions include the Belgian decision in *Elliot Associates v. Peru*.<sup>100</sup> But there seems to be some development. In *Pravin Banker v. Banco Popular del Peru*, the defaulting state attempted to reach a negotiated exchange of defaulted debt into Brady bonds. The US Federal Court of Appeals for the Second Circuit only declined to stay proceedings as a matter of comity because the US government considered participation in a Brady plan restructuring as a strictly voluntary matter.<sup>101</sup> By contrast, the amicus brief submitted by the US government in the *NML v. Argentina* case decided in October

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<sup>95</sup> See note 27; see also Waibel (note 86) 757.

<sup>96</sup> *Capital Ventures International v. Republic of Argentina*, 10-4520-cv et al., 20 July 2011, 652 F.3d 266.

<sup>97</sup> See also the decision of the 2nd Circuit in *Capital Ventures International v. Argentina*, 05-2591-cv, 23 March 2006, 443 F.3d 214, 217, regarding the risk that the order of attachment might create "confusion" among the creditors participating in the exchange offer (obiter dictum): "[W]e can conceive, perhaps, of a situation in which an order of attachment might be against the public interest for some reason not addressed in the CPLR (statute)."

<sup>98</sup> *NML Capital et al. v. Argentina*, 12-105(L), 26 October 2012, 26.

<sup>99</sup> E.g. *EM Ltd. v. Argentina*, 03-Civ-2507(TPG), opinion on motions for attachment and restraints, 7 April 2010; see also the impressive list of judgments against Argentina in a restraining order of 15 January 2010 in the case *Aurelius Capital Partners et al. v. Argentina*, 07-Civ-2715(TPG), totalling more than \$500m. But see also in this as well as 11 other cases the order of the same court of 28 March 2012 lifting an earlier restraining order concerning funds of the Argentinean central bank held at the Federal Reserve Bank of New York in order to enforce judgments of a total worth of over \$2.2bn (*EM Ltd. v. Argentina*, 865 F.Supp.2d 415).

<sup>100</sup> See note 20.

<sup>101</sup> Case 96-7183, 25 March 1997, 109 F.3d 850, 855; see also U. Panizza, F. Sturzenegger and J. Zettelmeyer, "The Economics and Law of Sovereign Debt and Default", 47 *Journal of Economic Literature* (2009) 651, 659.

2012,<sup>102</sup> while formally insisting that debt workouts had to be voluntary, stressed that this should not allow individual creditors to thwart an entire workout.<sup>103</sup>

For the above reasons, it seems possible to identify a – normatively well-founded – conviction across legal orders that both private and sovereign debt workouts must not be jeopardized by holdout litigation or arbitration. All requirements for the emergence of a general principle of law are met.<sup>104</sup>

#### IV. Specifying the Standstill Rule: Options

Nevertheless, such an emerging general principle is only what its name says – *general*. In order to become fully operational, it would have to be more specific in a number of respects:

- What triggers should apply? Would the mere unilateral claim of the debtor state or the unilateral suspension of payments be sufficient to trigger standstill automatically? Or should international organizations or other fora be given a role in the decision about the imposition of standstill? The latter would deserve particular consideration should the standstill be optional.
- What exceptions should apply? Especially, how should creditors providing interim financing be treated? This raises the question of the creditor “seating chart”.<sup>105</sup>
- How long should standstill remain in place, and what conditions would apply in order to lift it? E.g., would standstill be lifted if it turns out that the debtor acts in bad faith? Who should make the decision?

In accordance with what has been said about the nature of general principles,<sup>106</sup> it might be impossible to extrapolate a standstill rule featuring this level of detail from comparative law. Those questions should therefore better be treated in a soft law instrument or a code of conduct, which would have to seek political endorsement.

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<sup>102</sup> Note 98.

<sup>103</sup> Brief for the United States of America as Amicus Curiae in Support of Reversal, case 12-105-cv(L), 4 April 2012, <<http://blogs.reuters.com/felix-salmon/files/2012/04/US-Br.pdf>> access on 14 December 2012.

<sup>104</sup> In the taxonomy proposed in M. Goldmann, “On the Comparative Foundations of Principles in International Law: The Move towards Rules and Transparency in Fiscal Policy as Examples”, in C. Esposito, J.P. Bohoslavsky, and Y. Li (eds), *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (forthcoming 2013), this principle would be characterized as a guiding principle about to mature to a general principle, if not as an existing general principle.

<sup>105</sup> A. Gelper, “Building a Better Seating Chart for Sovereign Restructurings”, 53 *Emory Law Journal* (2006) 1119.

<sup>106</sup> Above C.II.1.

## **D. Recommendation**

It is therefore recommended that the Working Group debate the plausibility of the reconstruction of standstill as a general principle of law and the feasibility of a proposal for a soft law instrument or code of conduct supplementing this rule with the level of detail necessary for it to become fully operational.