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February 22, 1996

To: Members of the Executive Board

From: The Secretary

Subject: Note on "Legal Aspects of Standstills and Moratoria on Sovereign Debt Payments and their Effect on Actions by Creditors"

In May 1995, a "Note on an International Debt Adjustment Facility for Sovereign Debtors" (EBS/95/90, 5/26/95) was circulated to Executive Directors. That note, which examined some of the legal issues that would have to be resolved for achieving an orderly and comprehensive adjustment of a country's external debt, provided the basis for a Board seminar discussion on June 23, 1995. In the concluding remarks following this discussion, the Chairman referred to the parallel study being undertaken by the G-10, adding that such study could benefit further work in the Fund on this subject.

The G-10 Working Party on the Resolution of Sovereign Liquidity Crises requested the Fund's Legal Department to contribute a note on the legal aspects of standstills and moratoria on sovereign debt payments and their effect on actions by creditors for a meeting of the Working Party on November 28, 1995. A slightly revised version of this Note, with a few editorial changes and additional footnotes, was circulated to the Working Party on February 12, 1996. The text of the revised Note is attached for the information of Executive Directors.

With regard to the discussion in the attached Note of the possible use by the Fund of Article VIII, Section 2(b) of the Articles of Agreement to sanction moratoria by sovereign debtors, Executive Directors may wish to refer to the more detailed analysis of Article VIII, Section 2(b) contained in a 1988 paper on "Legal Effects of Approval or Nonapproval of Exchange Restrictions by the Fund" (EBS/88/13, 1/28/88) and to the minutes of the Executive Board seminars at which the paper was discussed--Seminar/88/5 and Seminar/88/6 (both on 6/3/88), and Seminar/88/7 (7/13/88).

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LEGAL ASPECTS OF STANDSTILLS AND MORATORIA ON SOVEREIGN DEBT PAYMENTS AND THEIR EFFECT ON ACTIONS BY CREDITORS

Staff Note

International Monetary Fund
Legal Department
February 20, 1996

This Note has been prepared by the Legal Department of the International Monetary Fund at the request of the G-10 Working Party on the Resolution of Sovereign Liquidity Crises. It does not purport in any way to reflect the views of the management or the Executive Directors of the Fund.

Contents

Legal Aspects of Standstills and Moratoria on Sovereign Debt Payments and Their Effect on Actions by Creditors

Introduction

The G-10 Working Party met in Basle on September 12, 1995 to study possible measures for "the orderly handling of sovereign liquidity crises." In connection with this ongoing study, the Legal Department of the International Monetary Fund has been requested to contribute a note examining the "legal aspects of a standstill on debt payments and of collective action by bondholders." This note would, in particular, examine legal means of preventing "free-rider" creditors from enforcing their claims against sovereign states pending an agreement on a debt restructuring. 1/ In order to achieve this result, particular consideration was to be given to the applicability of Article VIII, Section 2(b) of the Fund's Articles of Agreement.

Although the terms of reference for this note do not specifically mention external debt, it is understood that the note should focus on that aspect of sovereign debt. However, there is no agreed definition of external debt and there may be cases where domestic debt and external debt are closely linked and have similar economic effects (e.g., the Mexican Tesobonos). For instance, the same bond issue may be subscribed to by foreign and local residents and the same government may issue bonds denominated in local and foreign currencies. There are degrees in the "externality" of a debt, ranging from cases where all elements are "foreign" (governing law, jurisdiction, currency, creditors) to cases where most if not all elements are domestic, and these different elements may be relevant for different purposes. For purposes of this study, the external or domestic nature of the debt will be relevant only when enforcement is sought. The resolution of disputes relating to purely domestic debt is generally subject to domestic legal procedures, and does not raise issues pertaining to foreign sovereign immunities and "free-rider" creditors. Therefore, this note will focus on issues related to enforcement of claims against sovereign debtors and their assets in foreign courts.

The term "standstill" has several possible meanings. In the strict sense, it refers to an agreement between the debtor and its creditors to suspend both debt service payments by the borrower and legal actions by creditors while the debt is being restructured. In recent years, such stand-alone agreements have been rare. There have been instances, however, of de facto standstills pending restructuring of the relevant debt. In the case of the Paris Club, the conclusion of an Agreed Minute setting forth the

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1/ The term "restructuring" is used in this note to refer to both restructuring (broadly understood) and rescheduling (i.e., postponement of loan maturities), unless otherwise indicated.

framework for the restructuring of official credits and guarantees by individual creditors effectively operates as a de facto standstill until the restructuring agreements are executed. In the case of the London Club, the suspension of payments by a sovereign debtor, which is a unilateral moratorium imposed by the debtor, has generally been followed by an acquiescence of the commercial banks in those instances where the debtor demonstrates a good faith intention to negotiate a restructuring of the debt. This results in the establishment of a de facto standstill, similar to the Paris Club case, until a restructuring agreement is completed. Therefore, in terms of sequence, a moratorium will usually precede a de facto standstill, which itself will be followed by a restructuring. In the case of bondholders, there is no recent practice of standstills or moratoria, although there are a few examples of clauses in the terms and conditions of bonds providing for amendment of the payment terms by the bondholders representing a specified percentage of outstanding principal.

Restructuring agreements are legally not the same as standstills because they involve an amendment of the payment terms; nevertheless, they raise the same legal issues with respect to their negotiation, conclusion and enforcement, as well as the risks posed by "free-rider" creditors. Therefore, for the purpose of this note, reference to standstills will include restructuring agreements unless otherwise specified.

This note will examine:

- the existing law and practice on standstills, and the possibility of strengthening the existing legal framework for negotiating standstills with bondholders; and

- the existing law and practice on moratoria and the remedies available to creditors in cases of nonpayment of debt service obligations, and some possible options for strengthening the existing legal framework to prevent "free-rider" actions. Options examined include both how current legal protections afforded all defaulting debtors can be limited to those who take appropriate action to resolve the liquidity problem, as well as how additional protections can be extended to them. Among techniques for extending protections, this note examines the possible use of Article VIII, Section 2(b) of the Fund's Articles of Agreement.

Both with respect to standstills and moratoria, the note addresses the various issues and problems that would be faced in the establishment or implementation of any strengthened legal framework and the likelihood that these changes would be effective in restraining "free-rider" creditors from impeding an orderly resolution of sovereign debt problems through disruptive legal actions against sovereign states.

I. Standstills

A. Existing law and practice

A standstill is an agreement, either formal or informal, between a debtor and its creditors (or a category of creditors) providing for a suspension of debt service payments. The object of a standstill is to create a time period during which creditors agree not to press their claims, through formal legal process or otherwise, and during which (i) negotiations for a restructuring of debt can be undertaken and completed, usually in connection with the adoption of adjustment policies by the sovereign debtor, and (ii) there is no further strain on the debtor's finances caused by payments of interest and principal. Standstills would normally treat each creditor similarly.

Historically, standstills have been resorted to on several occasions. An early example of a standstill agreement is the German Municipal Debt Standstill Agreement of March 1932. This agreement covered the short-term debts owed to foreign creditors by German states (Länder) and corporations operating under public law. The standstill agreement provided, inter alia, that creditors would maintain or extend existing credits. 1/ The standstill agreement was extended annually until 1938. After World War II, Germany sought to repay these and other debts. The repayment of these debts was provided for in the Agreement on German External Debts (the London Accord), entered into by the Governments of Belgium, Canada, Ceylon, Denmark, France, Greece, Iran, Ireland, Italy, Liechtenstein, Luxembourg, Norway, Pakistan, Spain, Sweden, Switzerland, South Africa, the United Kingdom, the United States, Yugoslavia, and Germany on February 27, 1953. 2/

Standstills have also been negotiated with creditors represented by bondholders' committees. For example, in December 1932, the Romanian Government and representatives of various European bondholders' committees reached agreement on the terms and conditions of a standstill. 3/ Pursuant to this agreement, the representatives of the bondholders, who did not

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1/ See Harris, Germany's Foreign Indebtedness (1935), Appendix VI.

2/ The London Accord also covered the External (Dawes) Loan of 1924 and the International (Young) Loan of 1930, which involved debts of the federal government; however, these debts had not been the subject of standstill agreements.

3/ In the period preceding World War II, some debtor countries such as Romania were unable to convert their own currencies into the currency required to service a bond because of lack of foreign exchange. In this situation, a "transfer moratorium" was sometimes unilaterally imposed by the debtor country.

have the authority to bind the bondholders to an agreement, agreed to recommend approval of the standstill by the bondholders. 1/

The League of Nations Loans Committee also played a "good offices" role between bondholders and defaulting governments. For example, Hungary had initially approached the League of Nations requesting assistance in the issuance of bonds. The League of Nations Financial Committee determined the conditions of the loan, its amount, and the purposes to which the loan should be applied. The bonds were issued in 1924; however, they went into default during 1934-36. A resolution of this default was proposed by Hungary in 1937. The League of Nations Loans Committee conducted negotiations with Hungary. Following its work, this committee recommended to the bondholders that they accept the Hungarian proposal. 2/

In more recent times, informal mechanisms have been introduced for the restructuring of official debt and commercial bank loans.

The Paris Club first met in 1956 specifically to deal with Argentina's difficulties in servicing its debt to several European sovereign creditors. It has continued since that time as a forum for handling the restructuring of official bilateral credits and guarantees extended by OECD countries. For each sovereign borrower, the Paris Club agrees on a uniform formula for each creditor to renegotiate directly with the borrower. A fixed period (e.g., 12-18 months) is allowed for such renegotiation. While not constituting a formal, contractual standstill, it is generally understood that a creditor will not press its claims during this period. 3/ The borrower, in turn, gives the Paris Club creditors an undertaking that non-Paris Club creditors would receive comparable treatment. There have been several instances, however, where these arrangements have not materialized as expected. However, as a general matter, standstill arrangements are reached among most sovereign creditors through the Paris Club mechanism.

1/ See Borchard, State Insolvency and Foreign Bondholders, vol. 1 (repr. 1983), p. 131 n. 21. It was more typical for bondholders' committees, such as those formed in Belgium, France, and the United States, to seek repayment of defaulted bonds; they did not negotiate standstills or sanction moratoria.

2/ See Myers, "The League Loans," 60 Pol. Science Q. (1945), pp. 492, 506-510; see generally, Borchard, op. cit., at p. 131, n. 21 and pp. 214-16. By 1940, Hungary informed its creditors that it could no longer carry out the arrangement and separate arrangements were made with the creditors of each country.

3/ In most instances, a sovereign creditor would not institute legal process against a sovereign borrower. However, a sovereign creditor may press its claims in other ways, including through diplomatic means, by reducing or freezing bilateral assistance, or by imposing economic sanctions. It may also assign the loan to a third party, who might then take legal action.

The arrangements known as the London Club began in 1976, specifically to restructure Zaire's debt to commercial banks, and has continued since that time as a forum for handling the restructuring of loans made by commercial banks to sovereign debtors. Banks which participate in the London Club are represented by a "steering committee" or "advisory committee," typically consisting of no more than 15-20 banks, which deals directly with the sovereign borrower. During the period of negotiation, creditor banks refrain from commencing legal process against the defaulting sovereign. 1/ The negotiations between the sovereign debtor and the steering committee are completed when agreement is reached on a term sheet, which outlines the proposed restructuring terms. Syndicated loan agreements usually require the unanimous consent of creditor banks to change the payment terms; this consent has been impossible to achieve in some recent cases, as some banks were dissatisfied with the terms being offered. A few reluctant banks assigned their claims to other parties and actions were brought against the sovereign debtor.

Through participation in the London Club, standstill agreements were reached between creditor banks and Bolivia in 1980, the Philippines in 1983, Costa Rica in 1984, and Nigeria in 1986. In the case of the Philippines and Nigeria, the standstill applied only to repayments of principal. The duration of the formal standstill varied from 60 days (Costa Rica) to 120 days (Bolivia). In some of the cases, the standstills were extended.

Although the Paris and London Clubs do not always include all sovereign and private bank creditors, they provide largely effective fora for standstill negotiations with such creditors. Even before the creation of these fora, the relatively limited number of creditors made it possible to negotiate standstills among the majority of sovereign and private bank creditors. Moreover, Fund policies on arrears have strongly encouraged sovereign debtors to reach agreement with their official and commercial bank creditors.

In contrast, there is no organized forum for negotiations with bondholders; collective representation of and decision-making by bondholders has been made more difficult by their large number and wide dispersion, and by the proliferation of bearer bonds. However, there are terms and

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1/ A recent example of a standstill contractual term reads: "[E]ach Bank hereby agrees that from the effective date hereof through and including [date], such Bank will not (a) commence any legal action or proceeding to enforce payment of any principal, interest or other amount owing to it under any Agreement, (b) exercise any right of set-off or any similar right available to it under the Agreements or applicable law against any principal, interest or other amount owing to it under any Agreement, or (c) elect or vote in favor of or give notice of any acceleration of principal or other amounts owing to it under any Agreement...."

conditions in existing bond agreements that permit a limited form of organization of bondholders.

Currently, representative bond terms and conditions 1/ include a trust deed or indenture. The deed normally includes (i) the appointment of a trustee, who holds the legal title to the debt contract and who manages various aspects of the bond, including implementing certain decisions of bondholders, (ii) clauses providing for the calling of general meetings of bondholders, during which decisions can be made that alter the terms and conditions of the bond, and (iii) clauses stipulating the quorum required for adoption of changes to the terms and conditions of the bonds.

Some commentators have suggested that the trustee provided for in the trust deed or indenture could serve as agent of the bondholders with regard to negotiating a standstill. This is not currently the role of a trustee in bond deeds, and to create such a role would require a material change in the structure of such deeds. 2/ However, such a change may not be necessary to effect the desired results because, as noted earlier, representative bond deeds provide for the calling of a bondholders' meeting under certain circumstances. A meeting may be called either by the issuer or the trustee, and must be called by the trustee if investors holding a certain percentage of principal debt so request. Meetings, providing there is a quorum, can consider resolutions regarding various proposals, including a resolution amending the dates of payment of interest (i.e., a standstill). Representative bonds do not include a specific provision concerning the appointment of an agent for purposes of negotiating on behalf of the bondholders. However, bondholders can be represented at a meeting by their duly appointed agent or attorney.

Presumably, a standstill would be agreed to by bondholders only as part of either an overall bond restructuring, or of a general agreement that negotiations for a restructuring would be conducted in good faith. While other problems exist, the representative deed provisions regarding bondholders' meetings do not appear to be an impediment to reaching such an agreement. Under the trust deed, a bondholders' meeting could be called by the debtor for the purpose of requesting a standstill for a limited duration, during which good faith negotiations could be conducted; a resolution to that effect could be introduced at that time. A resolution could also be introduced selecting a group of bondholders to negotiate an

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1/ For purposes of preparing this note, the Legal Department has consulted with sovereign Eurobond underwriters and their counsel on the contents of typical terms and conditions, as well as reviewed a number of recent sovereign Eurobond offering circulars. The term "representative bond" refers to bonds identified through this process as broadly representative.

2/ The question of what role a trustee might play regarding the negotiation of a standstill is addressed in the BIS Questionnaire. Therefore, this issue is not addressed further here.

overall restructuring on behalf of all. It would also be possible for one or more bondholders to discuss restructuring informally with the sovereign debtor prior to the calling of such a meeting for purposes of drafting a preliminary agreement. Therefore, no material change would be necessary to such provisions.

Representative trust deeds require a quorum for meetings, which is expressed in terms of outstanding principal represented at the meeting, but quorums typically decrease over the course of one or two adjournments of meetings, to as little as 10 percent of outstanding principal. However, deeds also require different majorities for the amendment of different terms and conditions. With regard to changes in dates of interest payments, or any other significant change in the bond's terms and conditions, representative deeds require the consent of all bondholders, not only of those present and voting. Such unanimous consent terms virtually eliminate the ability to restrain "free-rider" bondholders.

While the representative trust deeds require unanimous consent, a few recent examples provide for majority, rather than unanimous, consent to change such terms and conditions. For example, a recent Argentine note set a quorum at an initial meeting of bondholders representing only 75 percent of principal and, at an adjourned meeting, those representing only 25 percent; in addition, a resolution is binding on all bondholders if carried by a simple majority of those present and voting, including a resolution to change any terms or conditions. 1/ This bond issue was fully subscribed. There are, however, currently no examples of bondholder meetings having been called under such quorum terms to consider a standstill or restructuring of bond terms and conditions. Also, because no meetings have yet been called, it is not yet known if it is practicable to collect enough bondholders to satisfy even a 25 percent quorum.

It has been suggested that, in order to preserve their access to bond markets, sovereign borrowers have generally protected bondholder interests and treated them preferentially over other creditors. However, it should also be noted that, while in the post-World War II period governments resorted largely to sovereign and private bank creditors, in recent years there has been a substantial increase in the use of bonds to raise foreign exchange capital. This suggests that, in the event of a liquidity or foreign exchange crisis in the future, it may be impossible to hold bond investors harmless. In these instances, it may be necessary to attempt to arrange a standstill with these creditors as well as those represented in the Paris and London Clubs.

1/ The terms and conditions of the note included New York choice of law and choice of forum clauses. Such provisions are generally upheld. See, for example, Aladdin Hotel Co. v. Bloom, 200 F.2d 627 (8th Cir. 1953) (extension of term of bond by specified majority upheld).

B. Strengthening the existing legal framework for negotiating standstills with bondholders

Some commentators have suggested that bondholders of sovereign debt could successfully be brought into standstill negotiations by creating a forum representing all or substantially all of these bondholders, and through which such negotiations could be conducted. A decision of a majority of these bondholders would have to be binding on all bondholders, eliminating the "free-rider" problem. Three techniques have been mentioned to implement these suggestions:

- encouraging issuers to include appropriate mechanisms in the terms and conditions of each sovereign bond issue;
- requiring the inclusion of such mechanisms by domestic law; and
- establishing bondholders' associations for sovereign bonds through domestic law.

1. Mechanisms under the terms and conditions of bonds

It has been suggested that terms and conditions of bonds provide for (i) the establishment of a bondholders' council (as a forum for negotiation) or the appointment of a bondholders' representative (to represent bondholders during negotiations); (ii) a procedure for bondholder registration (to identify those who have voting rights to approve a standstill negotiated by a representative); and (iii) the binding effect on all bondholders of a decision by a specified majority (to prevent "free-rider" dissenters).

As noted in Section A above, representative bond terms and conditions already have a procedure for calling bondholders' meetings. However, contacting bondholders for the purposes of calling meetings, or perhaps for selecting a group of bondholders to speak informally with a sovereign regarding standstill/restructuring may be difficult, especially because most of these bonds are in bearer, and not registered, form. Representative trust deeds do provide for notices of bondholders meetings to be published in a major newspaper of the jurisdiction where the bonds are to be listed (often Luxembourg) and the jurisdiction of choice of law and venue (often New York or London). Given the development of modern technology, the notice could be even more widely circulated, with little additional cost, on the Internet. The addition of such a new term to a trust deed could potentially increase the effectiveness of any notice without materially affecting the bonds' terms and conditions.

Also, as noted earlier, while representative bond terms require unanimity to effect a standstill or restructuring, there are a few examples of bonds providing for majority decisions binding dissenting investors. It cannot yet be concluded whether the majority rule provisions have had any adverse effect on the cost of capital, but these examples show the

possibility of including similar, or even more flexible, majority rule provisions in future bond issues. To the extent such a change made it appear more likely that a sovereign may default, it could raise the cost of borrowing. However, to the extent that it made a restructuring more orderly in the event of a default, it could reduce the cost of borrowing. The possibility of extending majority rule provisions in future bond issues could be explored with the relatively small number of major underwriters of such bond issues. An informal agreement reached with major underwriters might be more effective than other methods of promulgating "model" provisions. Also, if a large number of major underwriters agreed to include such terms, capital markets might react with greater acceptance.

2. Mechanisms under the domestic law of creditors' states

Many jurisdictions have legal rules that specifically provide for or otherwise regulate the organization of bondholders. These may include provisions for bondholder meetings and rules for binding dissenting bondholders through majority votes. These rules are of two types: (i) those that are based primarily in commercial law, which tend to apply to all resident commercial issuers of bonds, and (ii) those that are based primarily in securities law, which apply to bonds that are offered for public sale or market listing in the jurisdiction. The rules based in securities law are unlikely ever to apply to bonds not offered in the jurisdiction.

Currently, some jurisdictions such as the United States (State of New York) and the United Kingdom have specific provisions in their securities rules only for bonds offered or listed in their jurisdictions, while others, such as France and Germany do so through commercial laws which apply to local corporations. 1/ Current practice has been not to offer

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1/ For example, the United States Trust Indenture Act of 1939 provides for considerable regulation of a bond trust instrument, including (with certain limited exceptions) a rule that no bondholder may have a right to receive timely interest and principal impaired without his consent. 15 U.S.C. Section 77ppp. However, the Act only applies to securities offered in the United States, and bonds issued or guaranteed by a foreign government are specifically exempted. Ibid., Sections 77ccc and 77ddd(6). In the United Kingdom, rules concerning bond trust instruments are promulgated by the U.K. Stock Exchange and apply only to listed bonds. See Wood, Law and Practice of International Finance, vol. 2A (1990) Sections 9.12[5][b] and 9.13[2], pp. 9-124 and 9-149 to 9-150. In France, on the other hand, rules creating and regulating bondholder associations apply to all commercial companies with French head offices issuing bonds within France. Decree of 30 October 1935, Journal Officiel, 5 November 1935, corrected 7, 20, and 30 November 1935; Law No. 66-537 of 24 July 1966, Journal Officiel, 26 July and 19 October 1986. The German Law Concerning the Rights of Bondholders of 4 December 1899 makes provisions for bondholders' meetings in the case of most

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sovereign debt in New York or London, thereby obviating the application of securities laws in these jurisdictions. Because sovereign borrowers are not local corporations, they are not subject to rules governing those corporations.

It is highly unlikely that New York or the United Kingdom would enact laws requiring bondholder councils or majority voting in bonds that are not listed within their territories, or that France or Germany would extend their rules on corporations to sovereign borrowers. Moreover, representative bonds are often listed in Luxembourg, which is also unlikely to change its laws in a way which might adversely affect listings there. Therefore, there is little likelihood that a strategy of requiring specific terms and conditions through national laws would work.

3. Establishment of bondholder associations

Provisions have been made in the past under various domestic laws for the establishment of associations of foreign bond holders. 1/ These associations have played important roles in helping to organize bondholders, and to add prestige and diplomatic authority to negotiations with foreign sovereign debtors. However, they do not in any way affect the legal status of the terms and conditions of any bond, including the power to call bondholder meetings, or for a majority to bind a minority. Because, as discussed above, these are the principal problems, such associations are unlikely to add materially to any solutions. Until now, there has been no attempt by governments to confer upon these associations a power to consent to changes in the terms and conditions of bond issues on behalf of the bondholders.

1/ (...continued)
German commercial companies with German head offices. Reichsgesetzblatt S. 691, as amended by the law of 14 May 1914, the Ordinance of 24 September 1932, and the Laws of 20 July 1933, 25 June 1969, 2 March 1974, and 20 December 1993.

1/ See, e.g., United Kingdom, Corporation of Foreign Bondholders Act 1898, and France, Association Nationale des Porteurs Français de Valeurs Mobilières (established in 1898). The United States Congress has enacted a provision analogous to the U.K. law, the Corporation of Foreign Security Holders, 15 U.S.C. Sections 77bb et. seq. However, this provision can only take effect under presidential proclamation, and such proclamation has not been made.

C. Summary

Although the Paris and London Clubs do not always include all sovereign and commercial bank creditors respectively, they do provide largely effective fora for restructuring negotiations with such creditors. However, there is no such forum for bondholders. Because of the wide dispersion and variety of bondholders, the anonymity of holders of bearer bonds, and the general lack of procedure for a collective representation and decision-making process that binds dissenting bondholders, it would be rather difficult to secure an agreement with such creditors.

Current practice regarding bond terms and conditions provides possibilities for the calling of bondholder meetings, and for the negotiation of standstills. The advent of new technology may make such meetings and negotiations easier to effect. The main problem is that representative bond terms and conditions still require unanimity to adopt a standstill, making the elimination of "free-riders" virtually impossible, although there are some examples of bonds which allow for majority votes to bind dissenting bondholders. If capital markets can be convinced that such provisions will not increase the likelihood of default, or that in the event of default they will reduce transaction costs for a settlement, it may be possible to encourage new bond issues to include them. Consideration could be given to working with the major bond underwriters to design such provisions, and to reach general agreement to include them in future issues.

II. Moratoria

A moratorium is usually understood as a legislative or regulatory measure allowing debtors to postpone the discharge of their financial obligations. 1/ In the case of sovereign debtors, it refers to a decision by the sovereign debtor temporarily not to discharge its own debt; this decision may be formalized in a statute or regulation or remain informal and be evidenced by a de facto suspension of payments.

Sometimes the term moratorium is used -improperly- to designate a particular form of exchange control with a two-step process: (i) a prohibition of payments in foreign currencies and a requirement instead that they be replaced with payments in local currency, and (ii) a prohibition for the payees to convert all or part of the proceeds of such payments into foreign currencies. Usually, these laws provide that the payment in local currency will discharge the debtor, although the creditor has not received the amount of foreign currency stipulated in the contract. The combination of these measures constitutes an exchange restriction. 2/

A. Existing law and practice

In assessing the risk posed by "free-rider" creditors, it is important to bear in mind that strong protections are already afforded to all defaulting sovereign debtors, without in any way distinguishing between those sovereign debtors who are making a good faith effort to solve their liquidity problems and negotiate a restructuring, and those who are not.

This section will examine:

1/ This note does not deal with this type of moratorium.

2/ For instance, in June 1933, a "moratorium" law was promulgated in Germany. The law provided that interest and amortization payments owed to foreign creditors by German debtors, including those due under the debt obligations incurred by the German Government under the External (Dawes) Loan of 1924 and the International (Young) Loan of 1930, should be paid in German marks into a special account of the Konversionkasse, a corporation subject to the supervision of the Directorate of the central bank. In Re Helbert Wagg and Co. Ltd., 1956 Ch. 323, an English court held that, as the loan subject to the "moratorium" was governed by German law, the German law had to be recognized and the claim dismissed; see Wood, op. cit., vol. 2, Section 1.03[4], p. 1-20. Similar laws were adopted in other countries. In Mayer v. Hungarian Commercial Bank of Pest, 21 F. Supp. 144 (E.D.N.Y. 1937), the U.S. court dismissed a claim for payment of Hungarian municipal bonds, on the ground that the bonds were governed by Hungarian law and that a subsequent Hungarian law had been enacted prohibiting the payment abroad of such bonds (denominated in foreign currency).

- the legal issues raised by the imposition of moratoria on sovereign debt;

- the remedies that are available to creditors in the event of nonpayment of obligations following a moratorium; and

- methods of limiting current legal protections to those sovereign debtors who take appropriate steps to remedy their liquidity problem and negotiate in good faith with their creditors.

1. Moratoria on sovereign debtors' external debt

The following are some examples of moratoria on external debt:

• Mexico. In 1861, by request of the President, the Mexican legislature enacted a moratorium law. The moratorium law suspended for two years all public debt payments, including external debt payments owed to France, England, and Spain.

• Mexico. In August 1982, a moratorium on most principal payments due on Mexico's commercial bank debt was announced. Mexican Finance Minister Silva Herzog met with the countries' commercial bank creditors who agreed to a three-month standstill.

• South Africa. In September 1985, by presidential proclamation, the Government of South Africa instituted a four-month moratorium 1/ on principal repayments with respect to $14 billion of the country's $24 billion external debt, including debt obligations incurred or guaranteed by the Government. 2/

• Brazil. In February 1987, the President announced that the country would suspend interest payments on the $68 billion owed to commercial banks.

1/ In announcing this measure, the Minister of Finance referred to it as a "standstill." In subsequent Government statements, the measure was referred to as the "interim arrangements".

2/ The moratorium did not apply to repayments of public bonds issued for or on behalf of the South African public sector, debts to foreign governments or international financial institutions, or foreign debt commitments of the central bank, including gold swaps. The moratorium regulations provided for the establishment of special restricted accounts in South Africa into which South African debtors could make payments in local currency that would discharge their liabilities to the creditors. The Government assumed liability to the creditors in respect of money paid into these accounts.

• Côte d'Ivoire. In May 1987, the Government of Côte d'Ivoire declared a moratorium on debt service payments. The moratorium applied to debts owed both to bilateral creditors and commercial banks.

• Venezuela. In December 1988, the President of Venezuela announced that the country would stop repaying the principal on $20 billion of commercial bank debt from January 17, 1989. The moratorium excluded, among other things, principal repayments on government bonds issued abroad.

In the case of a moratorium on sovereign debt by legislative or executive action, a number of legal issues may arise.

First, irrespective of whether the loan agreement is governed by domestic or foreign law, the moratorium may violate the debtor's constitutional authority as there may be constitutional provisions which prohibit such action because of its confiscatory nature.

Second, where (as in most cases) the governing law is a foreign law (e.g., New York or English law), a foreign court is unlikely to recognize the moratorium as it has no legal basis in the lex contractus. 1/

Third, where the governing law is the law of the sovereign debtor, the view has been taken 2/ and endorsed by some courts, 3/ that, in the exercise of its legislative power, the sovereign debtor could enact laws amending its contractual obligations, including a suspension in the discharge of its financial obligations, but the opposite view has also been

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1/ In United States v. National City Bank of New York, 90 F. Supp. 448 (S.D.N.Y. 1950), the U.S. District Court held that Russian Treasury notes governed by New York law could not be repudiated by Russian law. Similar decisions have been taken in cases involving moratoria on private debt. In National Bank of Greece and Athens S.A. v. Metliss, 1958 A.C. 509, the English court held that the Greek bonds subject to a Greek moratorium law were governed by English law and, consequently, the moratorium was to be disregarded. Similarly, in Central Hanover Bank and Trust Co. v. Siemens and Halske A.G., 15 F. Supp. 927 (S.D.N.Y. 1936), the U.S. court held that bonds governed by New York law were insulated from a German law requiring that they be paid only in German scrip.

2/ Mann, "State Contracts and State Responsibility," 54 Am. J. Int'l L. (1960), pp. 572, 581-8.

3/ In French v. Banco Nacional de Cuba, 23 N.Y.2d 46 (1968), the New York Court of Appeals denied recovery on Cuban government certificates of indebtedness and initially payable in U.S. dollars, after a Cuban decree ordered their conversion into Cuban peso denominated certificates and prohibited the conversion of payment proceeds into foreign currency, on the ground that the certificates were governed by Cuban law. The Act of state doctrine was also invoked by the court.

presented, 1/ and the law is not settled. Moreover, the recognition of a country's power to amend its laws does not mean that they will necessarily be applied by a foreign court: they will not be applied if they violate the public policy ("ordre public") of the forum. 2/

2. Creditors' remedies

The existing law relating to the exercise of remedies by creditors against sovereign borrowers following a moratorium may be examined in terms of (i) the relevant contractual clauses of the loan agreements, and (ii) the enforcement of the creditors' claims through the judicial process, with particular reference to issues of jurisdiction and satisfaction of claims.

a. Contractual clauses

Loan agreements normally enumerate a comprehensive list of events known as "events of default" or "events of acceleration."

The "events of default" clause usually provides that, upon the occurrence and continuance of any such event, the lenders may exercise certain legal remedies against the borrower/issuer. These events may be grouped into two main categories: (i) actual breaches or defaults under the loan agreement, such as failure to pay sums when due, failure to comply with specific covenants and undertakings, or inaccuracy of a representation/warranty; and, (ii) anticipatory events of default, i.e., events that, in the opinion of the lenders, make it probable that the borrower's capacity to service the loan will be impaired, such as the occurrence of an "extraordinary situation", and cross-default and judgment clauses in relation to other external indebtedness of the borrower.

1/ Delaume, Legal Aspects of International Lending (1967), pp. 117-124. After the invalidation by Norway of a gold clause in Norwegian bonds held by French bondholders, France brought an action against Norway before the International Court of Justice, but the question was left unresolved: Case of Certain Norwegian Loans, I.C.J. Reports, 1957, p. 9.

2/ In the Messageries Maritimes case, the French Cour de cassation refused to apply a Canadian law of 1937 abrogating the gold value of the Canadian dollar to bonds issued by a French shipping company and payable in Canadian dollars in Canada or at their Dutch equivalent in The Netherlands: Cass. Jan. 1, 1950, D. 1951, p. 749, Rev. Crit. D.I.P. 1950, p. 609. It is not clear whether the decision was based on French public policy or -more probably- on a general rule that foreign laws restricting the freedom of parties with respect to currency clauses in international contracts will not be applied by French courts. In contrast, see In Re Helbert Wagg, cited above, and Mayer v. Hungarian Commercial Bank of Pest, also cited above, where foreign laws imposing a "moratorium" on nonsovereign debt, through a conversion into local currency and payment into local accounts, were applied without reference to the public policy of the forum.

The single most important "event of default", which appears in all loan agreements, is the failure of the borrower/issuer to pay principal or interest when due. Such failure is generally considered to be the clearest signal to the lenders that the prospect of repayment of the loan by the borrower is impaired. In the debt crisis scenario, the "failure to pay" event has assumed the greatest significance as it is invariably the first sign of a borrower's debt servicing difficulties arising from a liquidity squeeze. The other relevant "event of default" usually included in loan agreements is that the borrower has admitted in writing its inability to pay its debts as they come due or has declared a moratorium.

Upon the occurrence and continuance of an "event of default", the lenders are entitled, upon notice to the borrower, to terminate the commitment to lend (in the case of bank creditors) and/or accelerate the maturity of the loan (in the case both of bank creditors and bondholders).

In the case of loans by creditor banks, the provision for termination and acceleration usually states that, if any of the enumerated events of default occurs and continues for a specified period of time, 1/ then the banks may take action to terminate the lending commitment and accelerate the loan. The decision to terminate or accelerate may be taken either by the Agent or the syndicate as a whole. However, termination and acceleration are considered to be very drastic legal remedies and, as such, these decisions invariably require a decision of lenders holding a specified minimum percentage (typically 50 percent or 66-2/3 percent) of the total commitments or advances. In the case of bondholders, because the proceeds of the bonds are usually disbursed upfront in one lump-sum payment, the only remedy is acceleration. Bondholders holding a specified minimum percentage (typically 25 percent) of the total debt issue may declare the bonds immediately due and payable. 2/

The ultimate remedy for lenders in a situation of default by the borrower is to institute legal proceedings against the borrower. 3/ Under the terms of most agreements, any individual lender may institute legal proceedings in its own name against the borrower, although acceleration decisions normally require a collective decision by a specified majority (loans) or specified lower percentage (bonds) of the lenders, as noted earlier. This individual right to bring suits has been recognized in

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1/ The usual requirement is that the event of default must be "continuing" for a specified period (e.g., 90 days) at the time of the exercise of the right. If the event of default is cured before the banks actually exercise their rights, the lenders would no longer have the right to terminate or accelerate the loan.

2/ The low percentage (compared to syndicated loans) is due to the difficulties of obtaining a decision among widely dispersed and unorganized bondholders.

3/ Other remedies open to creditors include specific performance (which is rarely invoked) or set-off (which is often used by bank creditors).

numerous judicial decisions in the main lenders' jurisdictions, such as London and New York. 1/

The creditors' right to institute legal proceedings against sovereign borrowers is reinforced by the inclusion of consent to jurisdiction and waiver of immunities clauses in most loan agreements. Thus, sovereign borrowers irrevocably submit to the jurisdiction of the courts located in the principal lenders' country and accept the law of such country as the governing law. For example, in the case of loan agreements with the major Latin American countries where United States banks are the principal lenders, it is customary for the borrowers to submit to the jurisdiction of New York courts and to accept New York law as the governing law. 2/ Pursuant to such submission to jurisdiction, the borrower then designates an agent to receive service of summons, complaint or any other process in any legal action or proceeding that may be brought against the borrower. In addition, a sovereign borrower may also submit to the jurisdiction of specified foreign courts (e.g., London or Tokyo), including those of countries in which each of the lenders has its principal office, as well as its national courts.

A typical loan agreement also contains clauses (usually in the section "Representations and Warranties of the Borrower") under which the sovereign borrower represents and warrants that it is "subject to civil and commercial law with respect to its obligations" under the loan agreement and that such obligations "constitute private and commercial acts rather than public or governmental acts." These provisions are intended to preclude any defense of sovereign immunity that might otherwise be claimed by the sovereign borrower in respect of "public or governmental acts" of the sovereign.

By specifically consenting to the jurisdiction of the courts in the lenders' country, accepting its governing law, appointing an agent to receive legal process, and recognizing the commercial nature of the loan, the sovereign borrower waives any immunity from jurisdiction it might otherwise have invoked.

1/ See, e.g., Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985), cert. denied, 473 U.S. 943 (1985); Pravin Banker Assocs. v. Banco Popular del Peru, 93 Civ. 0094 (RWS), 1995 U.S. Dist. LEXIS 12377 (S.D.N.Y. 1995); CIBC Bank & Trust Co. Ltd. v. Banco Central do Brasil, 886 F. Supp. 1105 (S.D.N.Y. 1995); A.I. Credit Corp. v. Government of Jamaica, 666 F. Supp. 629 (S.D.N.Y. 1987); cf. Credit Francais Int'l v. Sociedad Financiera de Comercio, 490 N.Y.S.2d 670 (N.Y. Sup. Ct. 1985)(granting defendant's motion to dismiss because plaintiff, as an individual member of an international consortium of lending banks, was not a proper party and had no standing to sue individually).

2/ In certain cases (e.g., Brazil), due to constitutional restrictions, while the sovereign borrower may accept a foreign governing law, it may not submit to the jurisdiction of foreign courts and instead consents only to arbitration for the settlement of disputes.

In addition to submission to jurisdiction, loan agreements also normally include two related clauses. Under one, the sovereign borrower

> "agrees that a final judgment in any such action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by the law."

The other usual clause is an express waiver of immunities from execution. For instance, a clause waiving both immunity from jurisdiction and immunity from execution reads as follows:

> "To the extent that the Borrower has or hereafter may acquire any immunity from jurisdiction of any court or from any legal process (whether through service or notice, attachment prior to judgment, attachment in aid of execution, execution or otherwise) with respect to itself or its property, the Borrower thereby irrevocably waives such immunity in respect of its obligations under this agreement...."

Another key clause of syndicated loan agreements is the sharing clause. Under this clause, if any bank obtains payment with respect to principal of or interest on the loan owed to it that is proportionately greater than the payment obtained by any other bank with respect to such principal or interest, then the bank receiving such payment must share payment with all co-lenders under the agreement on a pro rata basis. This reflects a fundamental policy of creditors that, in the competition for the limited assets of an insolvent debtor, the creditors should be paid pari passu and that the debtor should not discriminate among its creditors. Preferential treatment of certain creditors is prevented by pooling all payments received into the hands of the agent bank which then distributes the proceeds to all lenders on a pro rata basis. 1/

In contrast to commercial bank loan agreements, the terms and conditions of bonds do not include sharing clauses. The reason may be that bondholders are not as well organized as syndicated banks. The absence of a sharing clause in bonds may provide a greater incentive to bondholders to sue because they do not have to share the proceeds of any judgment with other bondholders.

b. Enforcement of claims through judicial process

Moratoria are, by definition, actions by the debtor taken without the prior consent of at least some creditors. While a negotiated standstill may eventually be reached with many creditors, there may still be some left outside of the agreement. These "free-rider" creditors may elect to

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1/ Other relevant clauses in the loan agreement which give effect to the pari passu principle are the mandatory prepayment clause and the negative pledge clause.

challenge the moratorium, which they will characterize as a default on contractual obligations. By and large, sovereign creditors may challenge a moratorium by applying various types of pressure, political and otherwise, on the debtor to force it to pay. Private creditors, however, may only resort to legal process to press their claims. 1/ In the past, such suits have been brought by both private bank creditors and bondholders.

(i) Jurisdiction over sovereign debtors

Jurisdiction and sovereign immunities are determined by the laws of the country in which the action is brought against the debtor. Although residence of the debtor is generally recognized as the normal basis for exercising jurisdiction, most countries also recognize a number of other bases, 2/ including a specific consent of the parties to submit their dispute to a particular court. Moreover, an express consent to jurisdiction, when given by a sovereign debtor, constitutes a waiver of immunity from jurisdiction with respect to proceedings before the specified court.

As noted earlier, loan agreements and bond terms and conditions usually include consent to jurisdiction, choice of governing law and waivers of sovereign immunities from enforcement and execution of judgments. A review of cases indicates no instance where such contractual clauses were not upheld by the forum court. 3/ In those limited instances where there have been no such clauses, it would be possible for a foreign court, under its own laws, to assert jurisdiction and even to conclude that sovereign immunity from jurisdiction is not applicable. 4/

1/ They may also request the diplomatic protection of their governments, but there is no assurance that it will be granted.

2/ For instance, France will find personal jurisdiction based on the citizenship or residence of the plaintiff, while others, e.g., New York, will find jurisdiction based on the presence of a paying agent in the forum state: Republic of Argentina and Banco Central de la Republica Argentina v. Weltover, Inc., 504 U.S. 607 (1992).

3/ New York and London, which are the most common choices of law and venue in loan agreements, both have statutory provisions concerning waivers of sovereign immunity. The U.S. Foreign Sovereign Immunities Act states that once a foreign state waives immunity, it "has waived its immunity... notwithstanding any withdrawal of the waiver which the foreign state may purport to effect...." Foreign Sovereign Immunities Act ("FSIA"), 28 U.S.C. Section 1605(a)(1). The U.K. State Immunity Act ("SIA") has a similar provision: Section 2(1).

4/ Many, though not all, jurisdictions have accepted the legal doctrine that, when borrowing money, a state does not act in a sovereign capacity, but in a commercial one, and that, therefore, sovereign immunity does not apply. See, e.g., FSIA Section 1605(a)(2); Republic of Argentina v. Weltover, cited above; SIA Section 3.

(ii) Recognition and enforcement of foreign judgments

If the defendant sovereign has insufficient attachable assets in the forum where judgment was rendered, a creditor may begin proceedings in other jurisdictions where attachable assets may exist. The creditor will then have to begin the suit anew, unless he is able to obtain recognition and enforcement in the new forum of the earlier judgment. Except in those instances where there is more than one possible venue, the creditor will be forced to seek recognition of the earlier judgment.

Rules concerning the recognition of foreign judgments have a high degree of uniformity among most jurisdictions. Under the Uniform Foreign Money Judgments Recognition Act, which is currently in force in the State of New York, a foreign judgment may be recognized and enforced if it is final, conclusive, and enforceable where rendered, 1/ unless it satisfies one of the grounds for nonrecognition. 2/ A foreign judgment will not be recognized if the foreign proceedings were not fair and impartial and did not comport with due process of the law, or if the foreign court did not have personal jurisdiction over the judgment debtor. 3/ A court, in its discretion, may also not recognize the judgment if the foreign court did not have subject matter jurisdiction, the defendant received insufficient notice of the proceedings, the judgment was obtained by fraud, the underlying cause of action is repugnant to the public policy of the recognizing forum, the judgment conflicts with another final judgment, the proceeding in the foreign court was contrary to the parties' agreed upon method of dispute resolution, or the forum was seriously inconvenient. 4/

The European Communities Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters (the Brussels Convention), which governs recognition and enforcement of judgments among the member states of the European Union, has rules similar to the New York statute. A judgment which is final and enforceable and rendered in a Contracting State will be enforced in other states unless the court did not have jurisdiction under the Convention, 5/ the decision is contrary to the public policy of the

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1/ N.Y. Civ. Prac. L. & R. Section 5302 (McKinney's Consolidated Laws of New York 1978). The Act also applies to judgments that are pending or are subject to appeal. The recognizing court, however, may stay the proceedings until the appeal has been decided if the defendant satisfies the court that the appeal is pending or that he intends to appeal from the judgment. Ibid., at Section 5306.

2/ Ibid., Section 5303.

3/ Ibid., Section 5304(a).

4/ Ibid., Section 5304(b).

5/ Brussels Convention, art. 28.

recognizing country, 1/ the decision was given in default of appearance and the defendant was not given notice in sufficient time to enable him to defend, or if the judgment is not reconcilable with an earlier judgment of the recognizing State or with a recognizable judgment given in a noncontracting State. 2/

The rules of other important financial centers are similar. 3/

Therefore, as the conditions for recognition and enforcement are almost uniform and reflect generally accepted principles, there should be little difficulty in making an initial judgment enforceable in most other fora. However, the problems of executing that judgment are the same as they would be for the initial judgment.

(iii) Satisfaction of claims

As a general matter, assets of a state that are held within its own jurisdiction are protected against execution of judgment by domestic sovereign immunities. Therefore, judgments would generally have to be executed against assets held abroad.

There are three basic types of assets located within the territory of the forum that could be used to satisfy a judgment against a sovereign creditor. These include: (i) property owned directly by the sovereign; (ii) property of legal persons that are owned by the sovereign; and (iii) property of the sovereign's central bank.

- Property owned directly by the sovereign

A sovereign is likely to own property located in various foreign jurisdictions. This might include commercial bank accounts, buildings and other property for the use of diplomatic missions, and other assets. With the waivers generally found in loan agreements and bond terms and conditions, such property would be attachable unless the law of the forum state applies a specific exclusion. Often there are such exclusions. For example, regardless of waivers, the United States applies immunity to any property (i) used in connection with a military activity and of either a military character or under the control of a defense agency and (ii) immovable property used for a diplomatic or consular mission or as the

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1/ Ibid., art. 27(1). This condition is to be construed narrowly. Recognition of a foreign judgment may be denied on the ground of public policy only if recognition or enforcement would contravene fundamental moral or social principles of the recognizing forum.

2/ Ibid., art. 27(2),(3),(5).

3/ See, e.g., Japan, Code of Civil Procedure, art. 200.

residence of the chief of such a mission. 1/ Such immune property may constitute the majority of a defaulting sovereign's foreign assets.

Similar to the U.S. law, the U.K. law protects some property from attachment regardless of waivers, including the premises and physical property of diplomatic and consular missions, and the means of transport of the mission. 2/ It also appears that military property of a foreign state may be immune from attachment. 3/

French and German law would presumably protect certain assets of a foreign government from attachment either on the ground of their inviolability (diplomatic missions) or as part of the foreign government's public domain (e.g., military installations). 4/

There would generally appear to be little attachable property of worth held directly by the sovereign in foreign jurisdictions. Possible exceptions might include cases where title to an airline, ship, or other physical property were held directly by the sovereign, i.e., not through another legal person. Governments may also hold assets in foreign bank accounts.

- Property of separate legal persons that are owned by the sovereign

Generally, jurisdictions respect the separateness of different legal persons. Under this principle, the property of private or even public entities would not be attachable by a court for the satisfaction of claims on the sovereign debtor.

However, such a separation may be ignored in certain circumstances. For example, in the United States, a creditor may not generally execute judgment on assets of a separate legal person not a party to a sovereign

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1/ FSIA Sections 1610 (a)(4)(B) and 1611(b)(2). See Vienna Convention on Diplomatic Relations ("Vienna Convention"), art. 22(3); the United States is a party to the Convention.

2/ See SIA Section 16(1). The United Kingdom is a party to the Vienna Convention.

3/ Section 16(2) of the SIA states: "This Part of this Act does not apply to proceedings relating to anything done by or in relation to the armed forces of a State while present in the United Kingdom . . . ."

4/ This would generally include diplomatic missions, military property, etc.. See generally Crawford, "Execution of Judgments and Foreign Sovereign Immunity," 75 Am. J. Int'l L. (1981), pp. 820, 837-43; Delaume, Transnational Contracts: Applicable Law and Settlement of Disputes, vol. II (1990), Section 12.03.

default, even if the legal person is wholly owned by the sovereign. 1/ The "corporate veil" can be pierced, however, where "(i) the corporate entity is so extensively controlled by its owner that a relationship of principal and agent is created, or (ii) the separate corporate entity of a foreign instrumentality is abused to work fraud or injustice or to defeat overriding public policy." 2/ This has happened most rarely, and only under special circumstances. 3/ The United Kingdom has a similar rule. 4/

In France, although the law is not yet clearly settled, the cases show at least an unwillingness to authorize the seizure of other entities' assets when they are not fully owned by the sovereign debtor or when the sovereign debtor could have claimed immunity from jurisdiction for the relevant debt. 5/ In one case, where the creditors of one state-owned entity were seeking to attach assets of another entity owned by the same state, it was held that the attachment would only be possible if the creditors demonstrated that there was no separation of assets and liabilities between the two entities. 6/

- Property of the sovereign's central bank

Generally, a sovereign's central bank maintains foreign exchange accounts in major financial centers, such as New York, London, Frankfurt or Tokyo. However, a number of important obstacles prevent the attachment,

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1/ See Letelier v. Republic of Chile, 748 F.2d 790 (2d Cir. 1984); see also Hercaire Int'l, Inc. v. Argentina, 821 F.2d 559 (11th Cir. 1987) (assets of Argentina's wholly-owned national airline not subject to execution to satisfy a judgment against Argentina where the airline was neither a party to the suit nor was connected with the underlying transaction giving rise to the suit).

2/ Weisz, Schwarzkopf and Panitch, "Selected Issues in Sovereign Debt Litigation" in Latin American Sovereign Debt Management, ed. by Reisner, Cardenas and Mendes (1990) pp. 230, 267.

3/ See First National City Bank v. Banco Para El Comercio Exterior de Cuba, 426 U.S. 611 (1983). In this case, the Cuban bank counterclaimed against the American bank.

4/ See Wood, op. cit., vol. 2, Section 4.06[9], p. 4-34 to 4-35.

5/ In one case, attachment was not permitted on the ground that the public entity was owned not only by the sovereign, but also by foreign banks: Cass. July 21, 1987 Société Ltd. Benvenutti et Bonfant v. Banque Commerciale Congolaise, Clunet 1988, 108. In another case, attachment of a foreign state-owned entity's ship to collect a debt of the foreign state was not upheld on the ground that the foreign state could claim immunity of jurisdiction for the debt: Cass. February 4, 1986, General National Maritime Transport Company v. Soc. Marseille Fret, Rev. Crit. D.I.P. 1986, 718 and Clunet 1987, 121.

6/ Cass. Jul. 6, 1988, Clunet 1989, 376.

sequestration, or seizure of such assets in satisfaction of a judgment against the sovereign debtor.

As previously noted, while the terms and conditions of bank loan and representative bond agreements typically include waivers of sovereign immunity to personal jurisdiction, such waivers of immunity may not, and in most cases probably do not, apply to assets of the central bank. There are three reasons for this, and they are rooted in both the role of central banks in foreign borrowings and in specific statutory provisions or case law found in the most important financial centers.

First, in most cases, the central bank is a separate entity. Therefore, as any other public entity, it may invoke its separateness from the government against actions brought by the government's creditors. Moreover, when the law of the forum provides for immunities for central banks and their assets, it may claim the benefit of those immunities, even when the government has waived its own immunities, unless the law of the forum provides otherwise.

Second, before the debt crisis of the 1980s, sovereign borrowings were frequently effected through the sovereign's central bank or with its guarantee or participation. In these instances, a waiver of the central bank's immunities was often a condition for the loan. However, since the debt crisis, central banks of highly indebted countries have generally become more independent. While syndicated loans may still include the participation of central banks, bond offerings in recent years have generally not included the participation of central banks, or expressly stated that the waiver does not apply to central bank assets. 1/ This means that, in the terms and conditions of bonds issued over the past ten years or so, it is typical that no waiver of sovereign immunity has been given for central bank assets. Therefore, the lack of participation of central banks, or the exclusion of central bank assets from the coverage of sovereign immunity waivers, is likely to exclude central bank foreign exchange assets from the list of assets available to execute a judgment.

Third, two of the most important financial centers, the United States and the United Kingdom, have specific statutory provisions in their sovereign immunities laws that exclude central bank assets from attachment unless there is a waiver specifically applied to those assets. The Foreign Sovereign Immunities Act of the United States provides that central bank property "held for its own account" is immune from attachment and execution, unless the bank or its parent foreign government explicitly waives the central bank's immunity. 2/ According to the Departments of Justice and State, funds "held for [the central bank's] own account" are "funds used or

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1/ One exception to this rule is recent bond offerings by Venezuela.
2/ FSIA Section 1611(b)(1).

held in connection with central banking activities...." 1/ While an authoritative interpretation has yet to be rendered by a competent court, it has generally been presumed that this would include the country's general foreign exchange reserves; only such an interpretation would protect New York's position as a major repository of the foreign exchange assets of foreign central banks.

If the central bank's immunities are limited to funds held "for its own account," these immunities would apply to foreign exchange sold by the government to the central bank, but not necessarily to foreign exchange deposited by the government with the central bank and held by the central bank in its own accounts with foreign central or commercial banks. To support this conclusion, a recent decision of the U.S. Second Circuit Court of Appeals may be relevant. 2/ According to this decision, a sale of currency is a sale of "goods," even when the sale takes the form of a transfer to a bank account, and, if the transaction is not completed because of the other party's bankruptcy, the seller may claim restitution of the amount transferred as owner of the money rather than creditor of the defaulting party. Under this novel analysis, money held in a bank account constitutes an asset over which a person other than the bank may hold title. Although this decision is somewhat controversial given the fungible nature of money held in bank accounts, the argument could be made that the deposit made by the government is held on its behalf, as agent, by the central bank and, therefore, remains the government's property. A waiver of the government's immunities would then allow the creditors to attach that amount. However, there has been no judicial support so far for this conclusion.

The U.K. law specifically excludes all central bank assets from jurisdiction and execution in the absence of specific consent. 3/ While the wording in the U.K. law is somewhat unclear, and while the issue of government deposits with the central bank has apparently not yet been the subject of an authoritative court decision, it would also be likely that the interests of the forum state which have inspired its legislation would encourage courts to grant broad protection.

In France and Germany, there are no specific statutory exemptions for central bank assets. However, there are broad sovereign immunity protections. As a general matter, the assets of a central bank would appear to be immune providing that those assets were held for the exercise of a

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1/ Patrikis, "Immunity of Central Bank Assets Under U.S. Law" in Sovereign Lending: Managing Legal Risk, ed. by Michael Gruson & Ralph Reisner (1984), pp. 89, 96.

2/ In Re Koreag, Controle et Revision SA v. Refco F/X Associates, 961 F.2d 341 (2d Cir. 1992) (holding that a foreign exchange contract is a contract for the sale of goods under Article 2-102 of the New York Uniform Commercial Code.)

3/ See SIA Sections 14(4), 13(2) and (3).

"sovereign" function. 1/ It would appear that the holding of a country's foreign exchange reserves constituted such a function and, absent a waiver, these assets would be immune.

While the law regarding central bank assets may not be completely settled in France, Germany, or even other jurisdictions, the existence of New York and London as "safe havens" would suggest that, in the event that a jurisdiction adopted a more limited rule, central bank assets would move immediately to the safe havens, resulting in effective immunity from attachment and execution.

3. Assessment

In the case of bonds of recent issue, which are not guaranteed by central banks, there is little likelihood of creditors being able to attach sufficient assets to satisfy judgments against sovereign debtors. However, this does not mean that dissenting bondholders, who may have relatively small investments, may not be able to execute at least a substantial part of their judgments against sovereigns by attaching assets not protected by sovereign immunity.

The main feature of the present provisions on sovereign immunities is that protection for debtors extends to all, not just to those who have agreed to make a good faith effort to reach agreement with their creditors or otherwise resolve their liquidity problem. The question, therefore, is whether such protection should be limited to those debtors who are seeking to resolve the crisis appropriately. If it is decided to limit such protection, two immediate problems arise: (i) that of determining which debtors are taking appropriate action, and therefore from whom protection should be withdrawn, and (ii) the problem of designing effective methods of withdrawing such protection. Of course, once these questions are answered, the problem arises as to how the answers can be realistically and effectively implemented in a legally binding fashion.

The first problem raises difficult questions regarding both substance (e.g., the setting of standards for appropriate behavior, determining time limits during which protection would apply, etc.), and process (e.g., who would make such decisions, under what auspices they would be made, what would be the procedure for adoption, etc.). In order to avoid conflicting assessments by national authorities, it would be necessary to rely on the judgment of an international organization, even at the risk of accusations of political motivations.

With respect to the second problem, consideration could be given to amending domestic sovereign immunities laws in order to exclude sovereign debtors' assets and those of their public entities (including central banks)

1/ See the discussion in Delaume, Transnational Contracts, op. cit., ch. 12.

in cases where debtors do not act appropriately. This would require changes in existing law in those jurisdictions where central banks deposit foreign exchange, most importantly New York, the United Kingdom, Germany, France, and Japan. There would presumably be great incentive for a jurisdiction not to make such changes, in that they would adversely effect the jurisdiction's ability to retain central banking assets; this would reduce the jurisdiction's attraction as a financial center. 1/ Because legal changes would in most cases require legislative approval, any such change would appear particularly unlikely. Instead, consideration could be given to a contractual approach. For example, loan agreements could provide that, in case of default, the immunities of the sovereign debtor and its central bank will not be invoked unless a specified international organization has endorsed the default. Such a clause could reduce risk premia paid by sovereign debtors.

B. Strengthening the existing legal framework to prevent "free-rider" actions

As discussed in Section A above, it would appear that, while usually the clear majority of a sovereign debtor's foreign assets are protected from judicial process, not all assets are so protected. Therefore, additional protections could be envisaged for sovereign debtors while they are negotiating a restructuring agreement with their creditors. However, nearly identical problems arise in extending protections as in restricting them: that of determining which debtors are taking appropriate action and should be entitled to extended protection, and that of determining effective methods of extending protection. Of course, once solutions have been found, the problem arises as to how they can be realistically and effectively implemented in a legally binding fashion.

Section A above has already addressed the question of determining who, and under what criteria, debtors taking appropriate action might be distinguished from those which are not. Therefore, this section will examine how the existing protections afforded to those debtors could be strengthened. This could be done by (i) creating a mechanism for endorsement of moratoria by the Fund, (ii) interpreting Article VIII, Section 2(b) of the Fund's Articles to apply to certain moratoria, (iii) amending domestic laws to extend sovereign immunities in the case of certain moratoria, and (iv) adopting a new international agreement to effect a similar result.

1/ Legislative histories suggest that the central bank exceptions in the U.S. and U.K. laws are due directly to concerns over retaining the attractiveness of the jurisdictions as "financial centers."

1. Endorsement of a moratorium by the Fund

The approval of a stand-by or other arrangement by the Fund is in practice a condition for a Paris Club restructuring and the Fund's seal of approval (in the form of an arrangement or otherwise) is taken into account by creditor banks to reach a restructuring agreement with a sovereign debtor. By extension, it has been suggested that, when at least a large majority of creditor banks are prepared to agree to a restructuring agreement, an endorsement of the terms and conditions by the Fund should make the agreement binding on the reluctant creditors, thus avoiding the risk of individual actions that might lead to an unravelling of the tentative agreement.

The idea is interesting, but its implementation raises potentially insurmountable difficulties. Even assuming that the Fund were prepared to give its blessing to the terms and conditions of a restructuring agreement, and, by so doing, to alter the contractual rights of dissenting creditors, the Fund would have no authority under its present Articles of Agreement to impose its views. Such a power would have to be conferred upon the Fund either by an amendment of its Articles or by provisions in domestic laws that would be binding on the courts.

Perhaps this suggestion was inspired by the practice of U.S. courts, which defer to policy statements that have been made in certain cases by the federal government as an expression of its responsibilities in the conduct of U.S. foreign relations. 1/ However, experience shows that a statement of "Fund policy" is in no way comparable to a statement of U.S. policy in federal courts. For instance, in 1987, in A.I. Credit Corp. v. The Government of Jamaica, the U.S. District Court of the Southern District of New York had requested a statement of U.S. policy on the case. The statement was not made. Jamaica then turned to the Fund and obtained a letter, signed by a Fund official, stating: "On the basis of the information available to us, a judgment against a debtor country in this kind of case could create problems for the implementation of the international debt strategy that is supported by member governments of the International Monetary Fund." 2/ The Court mentioned that it had not received the communication of U.S. policy it had urged Jamaica to seek, quoted the Fund official's letter transmitted by Jamaica, and found for the plaintiff. In other words, recourse to the Fund's support did not help Jamaica.

Since then, there has been no attempt by the Fund to repeat this experience.

1/ See the statement of U.S. policy in Allied Bank Int'l, cited above.
2/ 666 F. Supp. 629, 633 n.5 (S.D.N.Y. 1987).

2. Interpretation of Article VIII, Section 2(b) of the Fund's Articles of Agreement

It has been suggested that Article VIII, Section 2(b) of the Fund's Articles of Agreement may provide authority to the Fund to effect a mandatory stay of certain enforcement actions against a defaulting sovereign debtor.

The first sentence of that provision reads:

> "Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member."

Under Article XXIX(a), "[A]ny question of interpretation of the provisions of this Agreement arising between any member and the Fund or between any members of the Fund shall be submitted to the Executive Board for its decision." Therefore, the Executive Board of the Fund has the power to adopt authoritative interpretations of the Articles. The only recourse against such decisions would be an appeal to the Board of Governors (Article XXIX(b)), whose decision would be final. There would be no recourse to a national or international court against a Fund interpretation of its Articles.

Accordingly, it is open to the Fund to interpret Article VIII, Section 2(b) and the Fund has already exercised that power (Decision no. 446-4, June 10, 1949). 1/

a. Meaning of interpretation

What is an interpretation of the Articles? One might think that an interpretation could take the form of a decision by the Fund that a particular situation meets the conditions required by Article VIII, Section 2(b), i.e., that the contract at hand is an "exchange contract which involves the currency of a member and is contrary to the exchange control regulations of that member maintained (or imposed) consistently with the Fund Agreement."

However, this type of decision would not be an interpretation of Article VIII, Section 2(b), but only a finding - based in part on factual considerations - that Article VIII, Section 2(b) is applicable.

As generally understood and confirmed by the practice of the Fund, an interpretation is an abstract statement of law, clarifying the meaning of a provision, and whose application to individual cases will require factual

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1/ Selected Decisions and Selected Documents of the International Monetary Fund, Twentieth Issue, p. 346.

findings. For instance, an interpretation by the Fund could state that loan agreements are exchange contracts when they involve payment to nonresidents or in foreign currency, but it would be the responsibility of the national courts to determine, as a matter of fact, whether a particular contract actually constitutes a loan agreement involving payments to a nonresident or in foreign currency. Therefore, an interpretation by the Fund could never give a complete assurance that the intended result would be achieved, because factual findings would remain a prerogative of national courts. However, there is at least one aspect where a finding by the Fund should be given special weight, namely, the finding that a particular exchange control regulation is consistent or inconsistent with the Fund's Articles, because this finding would be made by the Fund in the exercise of its jurisdiction under the Articles. 1/

b. Issues raised by an interpretation

Assuming that an interpretation of Article VIII, Section 2(b) is envisaged, three issues would have to be considered:

- the contents of the interpretation;
- its authority in national courts; and
- the weight given in national courts to the Fund's findings of consistency with the Articles.

(i) Contents of the interpretation

The interpretation would have to clarify various aspects of Article VIII, Section 2(b) on which conflicting views have been expressed. For instance, does the provision apply to exchange control regulations that are in force when the exchange contract is entered into or to those that are in force at the time of suit? When is a currency "involved" in an exchange contract: is it when it is the currency of payment or when the contract affects the member's balance of payments? In particular, two main difficulties would have to be resolved. First, the interpretation would have to clarify that a loan agreement is an exchange contract within the meaning of Article VIII, Section 2(b) if it provides for payment to nonresidents or in a foreign currency. Second, it would have to state that a moratorium imposed by a sovereign debtor in the performance of its own financial obligations is an exchange control regulation within the meaning of Article VIII, Section 2(b).

The first point would contradict the interpretation now prevailing in the courts of the United States and the United Kingdom.

1/ The GATT recognizes the authority of the Fund to make such findings: Article XV(2).

The second point would probably contradict the well-established position in the Fund that a default is not a restriction. 1/

Given the continuing difference of opinion on the meaning of "exchange contract" both among national courts of different countries and in doctrinal opinions, an interpretation by the Fund would be desirable. However, when such an interpretation was discussed in a Fund seminar in 1988, the conclusion was that the Fund should not try to impose its views on national courts in this matter. One of the arguments against adopting any interpretation was that, even if it were adopted, it would probably not be binding on the jurisdictions that have adopted a narrow interpretation (see below).

Whether a moratorium law can constitute an exchange control regulation is a totally different issue. Clearly, the Fund does not regard a sovereign debtor's default as an exchange restriction within the meaning of the Articles, because a restriction is imposed on another party, while a default is only a debtor's failure to discharge a financial obligation (either by lack of adequate resources or by a deliberate decision not to pay). Therefore, defaults on current payments are not regarded as inconsistent with Article VIII, Section 2(a) and are not subject to Fund approval. It may be noted in this respect that the White Plan for a Stabilization Fund of April 1942, which was one of the preparatory documents of the Bretton Woods Conference of 1944, included an obligation for members of the future Fund "[n]ot to permit any defaults on foreign obligations of the government or Central Bank without approval of the Fund." This provision later disappeared, while the proposed provision prohibiting restrictions and controls over foreign exchange transactions survived, after a number of amendments, to become Article VIII, Section 2(a). Accordingly, an extension of the Fund's jurisdiction to defaults as restrictions would not be possible.

While it is established that a default is not a restriction, the issue here is not whether a sovereign debtor's default would be regarded as a restriction but whether it could constitute an exchange control regulation. The concept of "exchange control" - which was associated with restrictions but as a separate concept in the White Plan - has never been defined by the Fund. In the practice of the Fund, exchange controls are understood as a broad concept not limited to, but including, restrictions. For instance, a verification procedure for authorizing current payments is an exchange control measure, not a restriction, but, if it gives rise to arrears, it constitutes a restriction. The reason is that exchange controls and restrictions share a common element: they are constraints imposed by a sovereign authority on persons or assets within its jurisdiction.

1/ Moreover, to the extent that the repayment of the loan would constitute a capital movement, the second point would contradict the position of German courts that capital movements are outside the scope of Article VIII, Section 2(b).

Therefore, in its descriptions of exchange controls, the Fund does not include sovereign debtors' defaults, because they are either involuntary or self-imposed measures. This would remain true even if the default was formally based on a legislative act prohibiting payments by the executive branch, because both the legislative and executive branches are organs of the debtor itself. In this respect, there is no substantive difference with a private corporate debtor which either does not have the resources to discharge its liabilities or whose organs decide to suspend its payments. This may have been the reason for the White Plan to make a distinction between "defaults" on the one hand and "restrictions and controls" on the other. Therefore, an objective interpretation of Article VIII, Section 2(b) would not support the conclusion that a sovereign debtor's default on its external debt constitutes an exchange control regulation.

Given this conclusion, would it still be possible to find ways to give effect under Article VIII, Section 2(b) to such a default? Two cases may be envisaged.

First Case: the sovereign debtor's liabilities are denominated (i.e., payable) in local currency. Then, a payment in local currency will discharge its obligations. Once the payment has been made, a prohibition to convert and transfer the proceeds of the payment would constitute an exchange restriction, not a default. If the payment was a current payment (amortization of loan), Fund approval would be required. If it constituted a capital movement (bullet payment), no approval would be required. Therefore, assuming Fund approval in the first hypothesis, Article VIII, Section 2(b) would apply. The only issue would be whether this provision also applies to capital movements; this point could be clarified in an interpretation.

Second Case: the sovereign debtor's liabilities are denominated (i.e., payable) in foreign exchange. If the contract is governed by the law of the debtor (which is rather unlikely), a possible solution would be to amend the law in order to provide that all payments shall be made in local currency. Then, once payment has been made, the same approach as in the first case can be used: prohibition to convert and transfer the proceeds. 1/ The problem here is whether all foreign courts would agree to apply the debtor's law modifying the currency of payment. If the contract is governed by a foreign law, a unilateral decision to

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1/ In French v. Banco Nacional de Cuba, 23 N.Y. 2d 46, (1968), the New York Court of Appeals denied recovery on Cuban government certificates of indebtedness and initially payable in U.S. dollars, after a Cuban decree ordered their conversion into Cuban peso denominated certificates and prohibited the conversion of payment proceeds into foreign currency, on the ground that the certificates were governed by Cuban law. The Act of state doctrine was also invoked by the court. See also the cases cited above on the German and Hungarian "moratorium" laws and their effects on the debts of nonsovereign debtors.

alter the substance of the sovereign debtor's obligation would probably not be recognized by a foreign court, unless perhaps the law is sufficiently general (applicable to the debts of all residents) to be regarded as nondiscriminatory and the foreign court is willing, as envisaged, for instance, in the Rome Convention of June 19, 1980, to give effect to the public policy of another state. 1/

In conclusion, it appears that, although an interpretation of Article VIII, Section 2(b) can be envisaged, it would raise very serious objections both from the standpoint of those who have applied a different interpretation (on the first point) and from the standpoint of an objective reading of the Articles (second point). Assuming that these obstacles are overcome, even more serious problems would have to be faced when implementing the interpretation.

(ii) Authority of the interpretation

There is no doubt that an interpretation of the Articles of Agreement by the Fund under Article XXIX is as binding on its members as the rule being interpreted, since it is declaratory of existing law. Nor is there any doubt that, when joining the Fund, each member has deposited "an instrument setting forth that it...has taken all steps necessary to enable it to carry out all of its obligations under this Agreement." (Article XXXI, Section 2(a)). Therefore, since Article VIII, Section 2(b) constitutes an obligation for each member to have its courts declare certain exchange contracts unenforceable, an interpretation by the Fund of this provisions would automatically or through some preestablished procedure become binding on the courts.

In a few countries, the existing legislation would seem to provide a procedure for the recognition of the Fund's interpretations. For instance, in the United Kingdom, an Order in Council may be adopted "for carrying into effect ... any of the provisions of the Fund Agreement as to the unenforceability of exchange contracts." 2/ On the basis of this provision, Article VIII, Section 2(b) was given the force of law in the United Kingdom by Order in Council, but the language seems broad enough to cover also interpretations of Article VIII, Section 2(b).

In other countries, there are no special rules, but there is a practice of either publishing official documents in a government publication or communicating official interpretations of international agreements through the foreign ministry to national courts. However, whether such a publication or communication would be sufficient to make a Fund interpretation binding on the courts remains to be seen. In those countries

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1/ Art. 7 of the Convention (in force since April 1, 1991), but this Article has not been introduced into the domestic legislation of all states that have ratified the Convention (e.g., Germany).

2/ Bretton Woods Agreements Act, 1945, Section 3(1).

where international law is part of the legal system, the courts could be expected to recognize the binding effect of a Fund interpretation. In those other countries where international law does not become the law of the land unless it is specifically enacted into law, an interpretation by the Fund might be regarded only as persuasive and subject to the court's final determination. For instance, in the United States, while the Federal Communications Commission has ruled that an authoritative interpretation by the Fund of Article IX, Section 7 was binding upon it, there has been no similar decision on Fund interpretations by state or federal courts. Although U.S. courts have in effect not contradicted Fund interpretations, they have not stated that these interpretations were binding upon them. 1/ We understand that in Canada an Act of Parliament would be required to make an interpretation binding on the courts. In this respect, it appears that countries that have adopted a dualist system, where international law has no direct effect on private litigation before their courts, will require particular measures to give effect to an interpretation by the Fund.

Therefore, even if an interpretation of Article VIII, Section 2(b) were adopted by the Fund, additional steps would still have to be taken to make it effective. In countries where parliamentary action is required, particularly those whose financial interests would likely be most affected, the interpretation may well remain ineffective.

(iii) Findings of consistency with the Articles

It would seem that the Fund is best qualified to determine whether a particular exchange control measure is consistent or inconsistent with the Articles, and experience shows that, when a national court consults the Fund on that issue, the Fund's advice is followed. However, as in the case of an interpretation, the reason may be simply that the Fund's opinion is persuasive rather than binding.

The issue of the persuasive or binding effects of a finding by the Fund was addressed by the American Law Institute in the Third Restatement of the Foreign Relations Laws of the United States (Section 822): "A statement by the Fund that a particular control is not maintained or imposed consistently with the Articles of Agreement is conclusive; a statement that the control is maintained or imposed consistently with the Articles of Agreement is entitled to great weight, but the court will make the final decision."

The position of the American Law Institute is rather characteristic of an unsympathetic view toward the application of Article VIII, Section 2(b) and, in that respect, reflects a more general attitude illustrated in U.S. courts by decisions such as the Zeevi case. 2/ Sir Joseph Gold assessed

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1/ See Gold, Interpretation by the Fund, IMF Pamphlet Series, No. 11, 1968, pp. 31-39.

2/ J. Zeevi and Sons, Ltd., et al., v. Grindlays Bank (Uganda) Ltd., 37 N.Y.2d 220, 333 N.E.2d 168 (N.Y. 1975), cert. denied, 423 U.S. 866 (1975).

the position of the Institute as follows: "The assumption continues to be that the advice of the Fund need not be sought in all cases. If the advice is sought, the distinction now is based on the content of the Fund's statement. If the Fund states that an exchange control regulation is not maintained or imposed consistently with the Articles, the statement is conclusive. If the Fund states that the regulation is consistent, the court may override this statement. No reason is given to defend the logic of this distinction. If there is logic in the distinction, it appears to be that under both propositions the plaintiff is favored. The interest of the foreign member is not decisive under the second proposition. The legal and practical objections to the court's authority to override the Fund's determinations, whether they are of consistency or of inconsistency, that have been advanced in the discussion of the topic in Draft No. 5 apply to Draft No. 6 as well. The courts are to administer the Articles; they may even decide that they do not approve a restriction that has been approved by the Fund. Perhaps the horrid dreams of Zeevi have frightened the drafters here too." 1/

As can be seen, the many roadblocks to using Article VIII, Section 2(b) through an interpretation in order to give effect to a moratorium are so substantial as to be probably overwhelming.

c. Selective application of the interpretation

An authoritative interpretation of Article VIII, Section 2(b) would strengthen the position of the debtor in that its exchange control regulations would be recognized in the courts of other countries when they are consistent with the Fund's Articles, but some may think that this protection is not always justified. There may be cases, for instance, where Fund approval is required to make the restriction consistent with the Articles. In those cases, it would be sufficient for the Fund to withhold approval in order to avoid making Article VIII, Section 2(b) applicable. In other cases, however, such as capital transfers, Fund approval is not required for the consistency of the restriction with the Articles because Article VI of the Fund Agreement allows members to impose such restrictions as they see fit. Therefore, an interpretation of Article VIII, Section 2(b) requiring the recognition of such restrictions could benefit sovereign debtors which are not even negotiating with their creditors.

In order to avoid such a result, various suggestions have been made. For example, it has been suggested that the interpretation would apply on a case by case basis, that is, only in those cases where the Fund would decide that it should apply. The obvious objection to this approach is that the Fund could not in good faith decide that what it regards as the correct interpretation of its Articles would not apply uniformly in all cases. Otherwise, the courts would probably conclude that the so-called interpretation did not constitute an interpretation within the meaning of

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1/ Gold, The Fund Agreement in the Courts, vol. III (1986), p. 710.

Article XXIX and would disregard it. Another suggestion was that, when the finding of consistency is made by the Fund for purposes of Article VIII, Section 2(b), the Fund could apply criteria other than those prescribed by the Articles. For example, the Fund could decide that a restriction on capital movements, which is authorized by Article VI, is or is not consistent with the Articles, depending on the circumstances, for the application of Article VIII, Section 2(b). The objection to this approach is that Article VIII, Section 2(b) refers explicitly to consistency of exchange control regulations "with the provisions of this Agreement." This can only mean that there is a single concept of consistency with the Articles, which determines both the legality of the measure under the provisions of the Articles and the applicability of Article VIII, Section 2(b).

Therefore, once an interpretation of Article VIII, Section 2(b) is adopted, it would not be possible to apply it selectively.

d. Conflicts with other treaties

The applicability of Article VIII, Section 2(b) cannot be considered in isolation, as if no other international agreement could affect the outcome of a dispute between a sovereign debtor and its creditors. Since accepting the obligations of the Fund's Articles, many Fund members have entered into other international agreements that tend to be more demanding than the Fund's Articles with respect to the liberalization of current payments or capital movements. Therefore, it is quite possible that a particular measure, which would be consistent with the Fund's Articles and give rise to the application of Article VIII, Section 2(b), could at the same time be inconsistent with another international agreement entered into subsequently by the state of the forum. In that case, assuming that the subsequent treaty is self-executing, it would prevail over Article VIII, Section 2(b) and prevent its application by the court. Consequently, as between parties to the treaty, the interpretation of Article VIII, Section 2(b) would have no practical effect. 1/

3. Amendment of the domestic sovereign immunities laws of creditors' states

As an alternative to changing contractual clauses in loan agreements or using Article VIII, Section 2(b) of the Fund's Articles of Agreement, it has been suggested that the application of certain bankruptcy law principles could largely avoid the risk of disruption caused by "free-rider" creditors without requiring an international bankruptcy code or institution. The essential procedure would be for certain key states (i.e., the jurisdictions

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1/ The treaty would not, however, affect the continued application of Article VIII, Section 2(b) in the parties' relations with other Fund members (see, e.g., Article 234 of the Treaty of Rome establishing the European Economic Community).

where the principal lenders are located, such as the United States and the United Kingdom) "to close their courts on a limited basis to creditors seeking to undermine a legitimate and fair restructuring process that has been endorsed by an overwhelming majority of similarly situated creditors." 1/

In the United States and the United Kingdom, it has been suggested, there is a legal framework for effecting such a change in the law. The U.S. Foreign Sovereign Immunities Act and the U.K. State Immunity Act already recognize that foreign states are subject to separate rules, both as to attachment and enforcement in aid of a judgment, and that certain assets of a sovereign and of its central bank are immune from seizure or attachment. Therefore, an amendment to these sovereign immunities laws could be adopted that would render a foreign state immune from suit or its property from attachment if, in the context of a sovereign debt workout, the litigating creditor were attempting to bring suit notwithstanding a restructuring plan that was being negotiated in good faith, or had been accepted by a supermajority of similarly situated creditors. 2/

There are two particular problems raised by this proposal:

The first is the problem of getting such an amendment to the law adopted in the key lenders' states. In principle, such an amendment might achieve the desired result if it is adopted in two or three of the key lenders' jurisdictions (e.g., the United States and the United Kingdom.) However, the subject of sovereign immunities, and the scope of their application in different types of situations, is extremely sensitive and could be politically controversial in many countries; and, as noted previously, countries have adopted varying legislative and judicial approaches to this question. Such an amendment process in most countries would, therefore, be subject to extensive and prolonged debate and may take several years to adopt. A major policy concern that is likely to influence this debate is whether it is appropriate or desirable to close a nation's courts to the resolution of what are considered to be legitimate commercial disputes. Such a change in law could potentially drive businesses away from that state or permit forum-shopping by creditors who may sue and obtain judgments in other more hospitable jurisdictions.

The second problem is what legal effect such an amended law would have on waiver of immunities clauses in loan agreements. Would the law have the effect of nullifying or temporarily suspending the application of such clauses? The whole idea behind waiver clauses, in the first place, is to get the sovereign borrowers to give up the sovereign immunities protection that they might otherwise enjoy under the law. Moreover, the principle that a sovereign may waive its immunities by contract is well-established in

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1/ Hurlock, "The Way Ahead for Sovereign Debt", 14 Int'l Fin. L. Rev. (1995), pp. 11, 12.
2/ Ibid.

international law and by many national sovereign immunities laws (e.g., in the United States and the United Kingdom).

To sum up, this approach is fraught with some fundamental problems that do not appear capable of resolution in the near term.

4. Adoption of a new international treaty

The final approach for dealing with the "free-rider" problem is to adopt a new international treaty, which would create treaty obligations that, either directly or through specific enactments, become part of the domestic law of participating states. The principal advantage of this approach is that the legal framework so established would apply to all creditors attempting to enforce their claims within the territories of any of the signatory states. Experience shows, however, that the adoption of a new treaty (especially on a subject as problematic as the present one) is likely to be a most time-consuming exercise and it is understood that this approach is, therefore, not favored by the G-10 Working Party.

C. Summary

The Fund's Articles of Agreement do not authorize the Fund to endorse moratoria and bind dissenting creditors, nor to approve those foreign decisions that permit a member to default on its loans. In the latter case, even if the Fund were to interpret its mandate to include defaults, it would still be confronted with the problem of limiting approval only to those restrictions made by creditors acting appropriately to resolve a liquidity crisis, which is clearly not authorized by the Articles. In any event, it is unlikely that courts in key jurisdictions would be automatically bound by an interpretation, as it is at least unclear whether these and other courts would be prepared to accept a finding by the Fund that a particular measure is consistent with the Fund's Articles. Finally, it is unlikely that key jurisdictions would adopt changes in their sovereign immunity laws to protect "appropriately acting" creditors.

Conclusion

This note was prepared in response to the specific terms of reference described in the Introduction. As such, it does not address other relevant issues that may need to be addressed in the resolution of sovereign liquidity crises. A central problem is the absence of a level playing field for debt restructuring negotiations between the different groups of creditors and sovereign debtors. This problem manifests itself in two principal ways.

First, the scope of information on sovereign debtors, their economies and their financial condition that is available to the Paris Club, the London Club and bondholders varies considerably. Official creditors, either

directly or through their participation in various international institutions, have better information than commercial bankers (who have some but not complete information) and bondholders (who have very little access to information). The Fund is promoting fuller and more complete disclosure to the public and, in particular, to the international financial community, of key economic and financial data by its member countries, but such disclosure is provided by members on a voluntary basis.

Second, in view of the unique status of each type of creditor and the quality of its relationship with the sovereign debtor, the bargaining strength of the three groups of creditors is markedly different. Official creditors through the Paris Club are in the strongest bargaining position because they are able to bring to bear, in a bilateral or multilateral context, political and diplomatic approaches to the resolution of sovereign liquidity problems. Their negotiations have also been facilitated by the Fund's policy not to extend financial assistance to any member country that remains in arrears to official creditors. Private creditors, on the other hand, do not have as much clout with sovereign borrowers who negotiate with them as adversaries, and the satisfactory conclusion of their negotiations is not a pre-condition for Fund assistance.