

2003

The Feasibility of the IMF's Sovereign Debt Restructuring Mechanism: An Alternative Statutory Approach to Mollify American Reservations

Richard Euliss

Follow this and additional works at: <http://digitalcommons.wcl.american.edu/auilr>



Part of the [International Law Commons](#)

Recommended Citation

Euliss, Richard. "The Feasibility of the IMF's Sovereign Debt Restructuring Mechanism: An Alternative Statutory Approach to Mollify American Reservations." *American University International Law Review* 19, no. 1 (2003): 107-151.

This Article is brought to you for free and open access by the Washington College of Law Journals & Law Reviews at Digital Commons @ American University Washington College of Law. It has been accepted for inclusion in *American University International Law Review* by an authorized administrator of Digital Commons @ American University Washington College of Law. For more information, please contact fbrown@wcl.american.edu.

THE FEASIBILITY OF THE IMF'S SOVEREIGN DEBT RESTRUCTURING MECHANISM: AN ALTERNATIVE STATUTORY APPROACH TO MOLLIFY AMERICAN RESERVATIONS

RICHARD EULISS*

INTRODUCTION.....	108
I. BACKGROUND.....	114
A. ECONOMIC AND LEGAL CONSEQUENCES OF THE CURRENT INSTITUTIONAL VACUUM	115
B. THE IMF PROPOSAL EXPLAINED: COLLECTIVE ACTION CLAUSES ("CACs") AND THE SOVEREIGN DEBT RESTRUCTURING MECHANISM ("SDRM")	120
II. ANALYSIS	124
A. AMERICAN INFLEXIBILITY MAKES THE SDRM UNWORKABLE.....	125
B. SECTION 2(B) AS AN ALTERNATIVE APPROACH: THEORETICAL APPEAL AND THE PRACTICAL LIMITATIONS.....	128
1. <i>Article VIII, section 2(b) functioning as a stay on individual creditor claims</i>	129
2. <i>The narrow treatment of section 2(b) by the U.S. courts</i>	133
a. "Exchange Contracts"	134
b. Imposed "Consistently with this Agreement"	138
III. RECOMMENDATIONS	142
A. STATUTORY AMENDMENTS PROVIDE THE SOLUTION.....	143

* I would like to thank Professor Jerome Levinson for his invaluable insights on this topic; Professor Jeffrey S. Morton for truly inspiring my curiosity and for being such an exceptional mentor to so many students; my mother for her dedicated parenting and consistent encouragement; and the ILR staff for all of their efforts during the editing process of this Comment. Last, but certainly not least, thanks to Heidi for your unbridled support in everything I do—your active and caring participation in my life makes each success that much more gratifying.

B. SDRM'S OBJECTIVES ARE FULFILLED BY THE PROPOSED AMENDMENTS	148
CONCLUSION	150

INTRODUCTION

Currently, the international financial system lacks a structured framework through which countries can restructure their external debt.¹ In late 2001, the International Monetary Fund ("IMF" or "Fund") addressed this urgent need by proposing the formation of a formal international bankruptcy process.² As the IMF continues to refine the nuances of its proposal, the debate vigorously goes on as to the proper composition of a viable international bankruptcy scheme for IMF Members.³

Although the IMF proposal signaled a newfound urgency the sustainability of developing countries' external debt has been a salient issue on the international stage for some time.⁴ The issue gained prominence following the onset of the Organization of the Petroleum Exporting Countries ("OPEC") crisis, when the major private lending institutions found themselves inundated with an extraordinary amount

1. See International Monetary Fund, *Proposals for a Sovereign Debt Restructuring Mechanism (SDRM): A Factsheet* [hereinafter IMF Factsheet] (underscoring that the current international financial system lacks a strong legal framework for sovereign debt restructuring), at <http://www.imf.org/external/np/exr/facts/sdrm.htm> (last visited Sept. 23, 2003).

2. See Anne Krueger, International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring, Address Before the National Economists' Club Annual Members' Dinner (Nov. 26, 2001) (announcing that the staff and management of the IMF would like to create a process encouraging debtors and creditors to restructure unsustainable debt), at <http://www.imf.org/external/np/speeches/2001/112601.htm> (last visited Sept. 23, 2003).

3. See IMF Factsheet, *supra* note 1 (recognizing the lively debate surrounding the IMF proposal).

4. See JUDICIAL ENFORCEMENT OF INTERNATIONAL DEBT OBLIGATIONS ix (David M. Sassoos & Daniel D. Bradlow eds., 1987) (stating that the foreign debt crisis has been high on the international agenda for some time and will demand attention and careful analysis). The text further indicates that the crisis is unlikely to be resolved in the foreseeable future; in fact, it will likely deepen. *Id.*

of capital from the oil receipts of OPEC countries.⁵ Without enough outlets for this sudden supply of financial resources, the private lenders began offloading them on the developing countries in the form of syndicated bank loans,⁶ which later became known as “petrodollar recycling.”⁷ The sovereigns borrowed enthusiastically because these loans enabled them to avoid the austerity measures typically imposed on all official sector lending.⁸

Unfortunately, the zeal with which the creditors lent⁹—and for that matter, with which the debtors borrowed¹⁰—soon made it impossible

5. See DOMINICK SALVATORE, *INTERNATIONAL ECONOMICS* 455 (Leah Jewell ed., 1998) (recognizing the huge dollar deposits from petroleum-exporting countries arising from the manifold increases in the price of petroleum).

6. See *Elliott Ass'n. v. Banco De La Nacion*, 194 F.3d 363, 367 (2d Cir. 1999) (defining syndicated bank debt as debt syndicated by a lead bank, which maintains books and records for all holders).

7. See Jerome I. Levinson, *The International Financial System: A Flawed Architecture*, 23 *FLETCHER F. OF WORLD AFF.* 1, 2-3 (1999) (explaining that petrodollar recycling occurred when the Persian Gulf producers were unable to spend their oil revenues as fast as they were making them). Facing the dilemma of what to do with them, the producers ultimately decided to deposit the surpluses in the major multinational banks, who then, in turn, lent the money to other states in the form of loans. *Id.*

8. See ROBERT GILPIN, *THE POLITICAL ECONOMY OF INTERNATIONAL RELATIONS* 316 (1987) (noting that the lesser developed countries (“LDCs”) fortunate enough to be classified as creditworthy had at last found a way around the conditionality of the multilateral aid agencies); see also Levinson, *supra* note 7, at 4 (noting that the Newly Industrialized Countries (“NICs”) no longer had to rely upon the Bretton Woods institutions for loans, freeing them from IMF conditionality). Unfortunately, some of the IMF’s austerity measures have been partially blamed for exacerbating the very economic turmoil that prompted the borrower to turn to the IMF in the first place. See *Hearing on the State of the Argentine Econ. Crisis and the Role of the Int’l Monetary Fund Before the House Subcomm. on Int’l Monetary Policy and Trade Comm. on Fin. Services*, 2002 WL 25099845 (2002) (testimony of Mark Weisbrot, Center for Economic and Policy Research) [hereinafter *Hearing on Argentine Econ.*] (opining that the IMF contributed to the Argentine financial crisis through lending conditions that economists in the United States would never have recommended for their own economy during a recession).

9. See Lee C. Buchheit, *A Lawyer’s Perspective on the New International Financial Architecture*, 14 *J. INT’L BANKING L.* 225, 225 (1999) (explaining that the sudden influx of petrodollar deposits made re-lending those funds the financial imperative of the banks).

10. See *id.* at 226 (noting that the debt crisis had not curbed the appetite of emerging market borrowers for external financing, it only curbed the method and place in which that appetite would be satisfied).

for many countries to continue servicing their debt while maintaining even the most basic government services.¹¹ When debt burdens became truly unsustainable, and as a consequence, the debtor risked defaulting, the debtor and a creditor cartel commonly referred to as the "London Club"¹² entered into restructuring negotiations.¹³ Following a series of financial crises and bailouts,¹⁴ the United States unveiled the Brady Debt Relief Initiative, which effectively reduced

11. See Lawrence H. Summers, Former Treasury Secretary (July 12, 2000) (unpublished statement) (on file with the Department of the Treasury) (stating that for every dollar Honduras spends on health care, it sends four dollars to its creditors paying off old debts).

12. See Paul Williams & Jennifer Harris, *State Succession to Debts and Assets: The Modern Law and Policy*, 42 HARV. INT'L L.J. 355, 381 n.137 (2001) (explaining that the London Club is an informal organization of creditor banks organized when the creditor is unable to meet its obligations).

13. See J.D. Berchild, Jr. & J.J. Norton, *The Evolving United States Experience with Alternative Dispute Resolution Respecting Financial Institution Disputes*, in NON-JUDICIAL DISPUTE SETTLEMENT IN INTERNATIONAL FINANCIAL TRANSACTIONS 174, 183 (2000) (defining restructuring as an alternative way to resolve disputes arising from a financial instrument, where negotiations between the lender and borrower lead to both sides giving up something and gaining something). The authors refer to it as non-bankruptcy "reorganization." *Id.*

14. See *Argentina and the IMF Before the House Comm. on Fin. Structure, Subcomm. on Int'l Monetary Policy and Trade*, 2002 WL 25099844 (2002) (testimony of Allan H. Meltzer, Carnegie Mellon University) (recounting how the IMF made a five billion dollar advance to Argentina to prevent a banking and currency run); William Easterly, *The Failure of Development*, FIN. TIMES, July 4, 2001, at 13 (noting that sometimes aid lenders gave loans to enable old loans to be repaid). Bailouts are one of the main things the IMF hopes to avoid by implementing the SDRM. *Infra* note 53. Oftentimes, the loans have prompted the criticism that their primary function is to subsidize the poor decisions of investors who were already sufficiently compensated for their increased risk of investing in an emerging market by receiving higher interest rates. See Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 964 (2000) (noting that these loans are effectively subsidizing the defaulting states, as well as the defaulting states' creditors); see also Barry Eichengreen, *Bailing in the Private Sector: Burden Sharing in International Crisis Management*, 23-SPG FLETCHER F. WORLD AFF. 57, 57 (1999) (noting that in Mexico, South Korea, and Russia, official funds were used to repurchase and retire short-term debt that private investors were unwilling to hold, thereby shielding them from the consequences of their irresponsible lending decisions). Eichengreen further argues that this provides incentives to the private investor to engage in even less prudent lending, setting the stage for still larger crises and consequent bailouts. *Id.*

developing countries' debt burden.¹⁵ The success of the Brady Plan notwithstanding, external debt sustainability has remained a pressing concern,¹⁶ and because of a metamorphosis in the way capital is presently acquired, restructuring has become markedly more complicated.¹⁷

The peaceful resolution of the Cold War redirected the world's attention to issues of globalization and economic liberalization.¹⁸ This liberalization of the international capital markets gave the developing countries a renewed ability to raise fresh capital by issuing government bonds on the major bond markets in New York and London.¹⁹ Similar to the syndicated bank loans of the 1970's and

15. See *Elliott Ass'n. v. Banco De La Nacion*, 194 F.3d 363, 366 (2d Cir. 1999) (describing the Brady Plan as the U.S. Treasury urging of commercial lenders to forgive some of the debt owed by less developed countries, restructure what remained, and continue to grant those countries additional loans); see also Philip J. Power, *Sovereign Debt: The Rise of the Secondary Market and Its Implications for Future Restructurings*, 64 *FORDHAM L. REV.* 2701, 2720 (1996) (describing the Brady Plan as a new initiative designed to encourage banks to voluntarily reduce the debt burdens of developing countries). See generally Diego Aramburú, *Brady Plans for Commercial Bank Debt Relief*, in *GOVERNMENT RESPONSES TO THE LATIN AMERICAN DEBT PROBLEM* 159 (Robert Grosse, ed., 1995) (recounting how the U.S. Secretary of Treasury Nicholas Brady offered the U.S. government and official sector support in obtaining debt service relief from commercial bank creditors for those countries that successfully pursued comprehensive structural adjustment programs supported by the IMF and the World Bank). Aramburú further explains that the central feature of the Brady Plan was the menu of options, such as debt conversion bonds, front-loaded interest reduction bonds, and new money bonds. *Id.* at 160.

16. See Power, *supra* note 15, at 2701 (noting that the virtual disappearance of syndicated bank loans has not eradicated the challenges facing debtors, as Latin America's ratio of aggregate external debt earnings remains close to that prevailing at the onset of the debt crises).

17. See *id.* at 2702-03 (positing that the transformation of the creditor class from a relatively small number of private lending institutions to a large group of bondholders will likely render the complexity of any future sovereign debt restructuring far more significant than was previously the case).

18. See Aseem Prakash & Jeffrey Hart, *Introduction* to *RESPONDING TO GLOBALIZATION* 1, 9 (Aseem Prakash & Jeffrey Hart eds., 2000) (identifying the acceptance of free market principles as one of the most significant structural changes in the post-Cold War economy).

19. See WILLIAM R. CLINE, *INSTITUTE FOR INTERNATIONAL ECONOMICS*, *INTERNATIONAL DEBT REEXAMINED* 449-50 (1995) (explaining that most of the

1980's, the developing countries found this form of borrowing more attractive than that available from the IMF, which typically involved conditionality.²⁰

By switching to bonds, a country's creditors become less identifiable than the private lending institutions that make up the London Club cartel.²¹ The London Club consists of a small group of lenders with common interests, making loan restructuring with them inherently more manageable.²² Bondholders, on the other hand, are naturally a more diverse, amorphous²³ group with eclectic interests.²⁴ Still, if a debtor wishes to salvage its creditworthiness and secure fresh lending, it must reach an equitable arrangement with its

large troubled debtors of the 1980's have now reentered the international capital markets by floating government bonds).

20. See GILPIN, *supra* note 8, at 316 (detailing how absence of loan conditionality made private sources an attractive alternative to the IMF).

21. See Power, *supra* note 15, at 2702-03 (explaining that the increased number of creditors makes the restructuring process more complicated); see also Anne Krueger, Remarks at the Conference on "Sovereign Debt Workouts: Hopes and Hazards" at the Institute for International Economics (Apr. 1, 2002) [hereinafter Hopes and Hazards] (noting that the "move from commercial bank loans to bond issuance in the 1980s and 1990s has made creditor coordination much more cumbersome"), at <http://www.imf.org/external/np/speeches/2002/040102.htm> (last visited Sept. 23, 2003).

22. See Hopes and Hazards, *supra* note 21 (noting the lack of diversity of the syndicated lenders of the seventies and eighties compared with the body of modern day bondholders).

23. Because bonds are freely transferable on the secondary market, it is difficult for a sovereign to identify its creditor base at any one moment in time. See Power, *supra* note 15, at 2763 (demonstrating that the rise of the secondary market has made a sovereign's creditor base diverse and subject to change). Indeed, trading volume on the bonds may actually increase during a time of illiquidity, making it even more difficult to identify the holders. *Id.* at 2716. This type of market judgment often tempts the opportunistic investor to buy the bonds issued of an illiquid sovereign on the secondary market and then sue for full recovery. *Id.* If the secondary market price of a country's debt is substantially discounted to reflect default risk, at least some creditors may be able to obtain greater profits from a face value collection action than from a pre-default resale of their debt at the prevailing market price. *Id.* at 2764; see also discussion *infra* Part II.A (explaining how hold-out creditors make the restructuring process more difficult).

24. See Hopes and Hazards, *supra* note 21 (stating that bondholders comprise a much larger group than the private syndicated lenders).

bondholders.²⁵ One challenge, therefore, is to design a system that overcomes the many obstacles encountered when the creditors, with whom a debtor must negotiate, constitute such a diverse and numerically unwieldy group.²⁶

Creating this orderly restructuring process is vital to the health of the international economy.²⁷ If a country's external debt is not successfully restructured in a timely manner, both legal and economic consequences will make resolution of a liquidity crisis progressively more complex.²⁸ Thus, any proposal regarding the contemporary external debt problem, in order to be successful, must address both the legal²⁹ and the economic³⁰ realities caused by the current institutional vacuum.

While this Comment prescriptively considers the legal framework that would best constitute an international bankruptcy scheme, the

25. See Rory Macmillan, *Towards a Sovereign Debt Work-Out System*, 16 NW. J. INT'L L. & BUS. 57, 59 (1995) (noting that, after its financial crisis, the Mexican government was unable to return to the capital markets for six months). Macmillan further states that the IMF would probably make any official sector loan contingent upon some debt restructuring agreement between the debtor and its creditors. *Id.*

26. See discussion *infra* Part II.A (outlining the implications of the institutional vacuum).

27. See *infra* notes 56-57 (describing the economic impact of inaction in the face of a debt crisis).

28. See, e.g., *Weltover, Inc. v. Republic of Argentina*, 941 F.2d 145, 146-47 (2d Cir. 1991) (describing how creditors brought an action against Argentina for breach of obligations arising from debt instruments); *Lloyds Bank, PLC v. Republic of Ecuador*, 1998 WL 118170, at *1 (S.D.N.Y. 1998) (highlighting the cause of action to be various bondholders laying claim to debt agreements with Ecuador); *Elliott Ass'n. v. Banco De La Nacion*, 194 F.3d 363, 378 (2d Cir. 1999) (noting that the terms of the debt instrument called for application of New York law); *Weston Banking Corp. v. Turkiye Garanti Bankasi*, 442 N.E.2d 1195, 1197 (N.Y. 1982) (explaining that the terms of the note provide for the jurisdiction of New York courts); see also *infra* notes 56-57 and accompanying text (describing in detail the ramifications of inaction). See generally RAVI C. TENNEKON, *THE LAW & REGULATION OF INTERNATIONAL FINANCE* 193 (1991) (explaining that the source of a bondholder's legal rights is the bond contract, whose terms are enforceable in the appropriate jurisdiction). There are usually clauses providing that New York law will govern any disputes arising from the contract. *Id.*

29. See *infra* note 58 (citing a series of cases where private creditors seek specific performance of their bond contracts).

30. See discussion *infra* Part I.A (highlighting the relevant economic considerations).

proposed solution will necessarily be guided by relevant economic considerations.³¹ Part I discusses these legal and economic considerations, as well as the two-pronged IMF proposal, consisting of the Sovereign Debt Restructuring Mechanism ("SDRM") and Collective Action Clauses ("CACs").³² Part II argues that the SDRM is unnecessarily complicated and, in the absence of American acquiescence, overzealous.³³ Part II also introduces an alternative bankruptcy approach underpinned by Article VIII, section 2(b) ("section 2(b)") of the IMF's Articles of Agreement ("Agreement").³⁴ After surveying the benefits of using section 2(b), Part II then demonstrates that the provision suffers severely from narrow interpretation by the courts.³⁵ This narrow interpretation precludes the present form of section 2(b) from successfully functioning as the crux of an international bankruptcy scheme.³⁶ Finally, Part III posits that the IMF should adopt an alternative statutory approach.³⁷ This alternative involves amending section 2(b) of the IMF Agreement, as well as adding new provisions.³⁸ Doing so produces an effective legal framework through which a state can restructure its debt while simultaneously accounting for all of the IMF's objectives.³⁹

I. BACKGROUND

Presently there is no international institution that provides the procedures and protections analogous to those provided by Chapter

31. *Id.*

32. See discussion *infra* Part I.A-B (describing the relevant economic and legal concerns and discussing the attributes of the SDRM).

33. See discussion *infra* Part II.A (noting that the United States does not support the SDRM).

34. See discussion *infra* Part II.B.1 (discussing the possible use of Article VIII, section 2(b)).

35. See discussion *infra* Part II.B.2 (surveying negative American precedent).

36. See *id.* (arguing that the precedents are a significant obstacle).

37. See discussion *infra* Part III (outlining in detail an alternative statutory approach placing in the debtor the discretion to suspend debt payments in anticipation of restructuring negotiations).

38. See *id.* (proposing a new statutory approach).

39. See *id.* (describing an alternative statutory approach).

11 of the United States Bankruptcy Code.⁴⁰ The adverse implications of this institutional vacuum are considerable.⁴¹ Ameliorating these negative consequences would be the obvious goal of any proposed solution, and therefore, understanding them provides the necessary background to the various proposals considered in this Comment.

A. ECONOMIC AND LEGAL CONSEQUENCES OF THE CURRENT INSTITUTIONAL VACUUM

Debt officially becomes “unsustainable” when the debt-to-Gross Domestic Product (“GDP”) ratio rises incessantly.⁴² As this ratio continues to rise, the sovereign may seek more revenue for debt servicing by imposing higher taxes.⁴³ However, such a tax policy can

40. See Schwarcz, *supra* note 14, at 975-76 (explaining that Chapter 11 has traditionally advanced two goals: rehabilitating of viable debtors and ensuring equality of distribution of creditors); Steven L. Schwarcz, *Global Decentralization and the Subnational Debt Problem*, 51 DUKE L.J. 1179, 1192 (2002) (explaining how Chapter 11 principles allow for the freedom to agree on a reorganization plan). Further, a bankrupt’s choice to avail itself of these principles entitles it to protection from creditor claims pending a negotiated agreement. *Id.*; see also MICHAEL J. HERBERT, UNDERSTANDING BANKRUPTCY 105 (1995) (describing how filing for Chapter 11 affords the debtor protection by placing a stay on judicial and non-judicial proceedings). Chapter 11 reorganization is certainly the best analogy for sovereign debt restructuring since sovereign states are not subject to liquidation as is the case with other bankrupt entities, such as corporations. *Cf.* Schwarcz, *supra* note 14, at 977-78 (noting that the bankruptcy analogy applies only indirectly to sovereign debt restructuring since States are not liquidated and their assets redistributed).

41. See discussion *infra* Part I.A (considering the various implications of the institutional vacuum).

42. See Anne Krueger, Remarks at the Banco de Mexico’s Conference on “Macroeconomic Stability, Financial Markets and Economic Development” (Nov. 12, 2002) [hereinafter *Macroeconomic Stability*] (explaining that a debt is unsustainable when, under any realistic set of policies and circumstances that can be envisaged, the debt-to-GDP ratio rises without limit), at <http://www.imf.org/external/np/speeches/2002/111202.htm> (last visited Sept. 23, 2003).

43. See *id.* (explaining that in the face of unsustainable debt, a government may try to increase taxes).

stifle all prospects of economic growth,⁴⁴ and without economic growth there can be no long-term debt sustainability.⁴⁵

Further, because the debt is often denominated and payable in hard currency,⁴⁶ the sovereign must earmark much of its hard reserves for debt service.⁴⁷ During these shortages of hard currency, the domestic currency is exposed to speculative attacks⁴⁸ that can compromise its exchange rate, and consequently, increase the real value of any bonds denominated in, for example, U.S. dollars.⁴⁹ In other words, the devaluation of the local currency's value can cause a country's debt burden to double virtually overnight.⁵⁰

Restructuring becomes necessary when the sovereign can no longer sustain its debt.⁵¹ However, until recently little incentive existed for a

44. See *id.* (positing that such policies are growth-reducing, thereby increasing the degree to which the debt cannot be sustained). Thus, Krueger concludes that rising interests rates cause an increase in the interest cost of the debt itself. *Id.*

45. Cf. *Hearing on Argentine Econ.*, *supra* note 8 (declaring both that debt payment suspension would cause economic growth in Argentina with no affirmative action and that typical IMF-recommended adjustments would likely prolong the recession).

46. See HEATHER D. GIBSON, *INTERNATIONAL FINANCE: EXCHANGE RATES AND FINANCIAL FLOWS IN THE INTERNATIONAL SYSTEM* 221 (1996) (noting that the dollar is the major currency of denomination in the Eurobond market).

47. See Francois Gianviti, *Evolving Role and Challenges for the International Monetary Fund*, 35 INT'L LAW. 1371, 1374 (2001) (explaining that when a government has payments due on bonds denominated in hard currency, it cannot simply print local currency; thus, it must earn hard currency, during which time the debt cannot be serviced).

48. See Peter C. Y. Chow, *What We Have Learned from the Asian Financial Crisis*, in *WEATHERING THE STORM: TAIWAN, ITS NEIGHBORS, AND THE ASIAN FINANCIAL CRISIS* 191, 201 (Peter C. Y. Chow & Bates Gill eds., 2000) (positing that fluctuations in the exchange rate of the Japanese yen caused sudden and sizable flows of funds into and out of the region that were too large and too speedy to stop).

49. See *Welterover, Inc. v. Republic of Argentina*, 941 F.2d 145, 147 (2d Cir. 1991) (explaining that Argentina depends on its reserves of United States dollars and other internationally recognized currencies (*i.e.* hard currencies) to satisfy its foreign debt).

50. See Cline, *supra* note 19, at 9 (describing a situation where the increased value of the U.S. dollar caused a major rise in the nominal dollar stock of debt). Exchange rate volatility means initially serviceable debt can suddenly become unsustainable. *Id.*

51. See Power, *supra* note 15, at 2709 (noting that following the 1982 debt crisis there was no framework or precedent on which to rely, and in its absence, the

sovereign to engage in restructuring negotiations because the IMF often provided "bailout loans."⁵² The IMF has made it clear, however, that it no longer intends to provide these bailouts,⁵³ forcing the illiquid sovereign to choose between defaulting on its outstanding debt and ruining its creditworthiness, or participating in the restructuring process.⁵⁴ The current institutional vacuum, however, lacks a formal framework to make that process orderly.⁵⁵ As a

commercial lenders and debtors initiated informal negotiations to restructure the debt).

52. See *id.* at 2710 (explaining that the IMF and its largest contributors resolved the immediate crisis by providing a bridge loan, or a "bailout," to the debtor allowing it to continue service of its debt); see also Humberto Campodonico, *Peru's Efforts to Achieve Reinsertion in the International Financial System*, in GOVERNMENT RESPONSES TO THE LATIN AMERICAN DEBT PROBLEM 63, 71 (Robert Grosse ed., 1995) (noting that the purpose of bridge loans is to straighten out existing arrears); Eichengreen, *supra* note 14, at 57 (describing the common criticism that bailouts function to subsidize the poor decisions of investors).

53. See Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. REV. 59, 60 (2000) (stating that the IMF has made it clear to private holders of sovereign bonds that the official sector will not bail them out during any future sovereign debt workouts). But see Paul Blustein, *IMF Readying 'Transitional' Loan to Head Off Argentine Default*, WASH. POST, Jan. 14, 2003, at A07, (reporting that the IMF is considering granting Argentina a "transitional" loan, which is reportedly generating intense controversy because part of the IMF's motive is to stave off a threatened default), available at <http://www.washingtonpost.com/wp-dyn/articles/A51831-2003Jan13.html> (last visited Sept. 23, 2003). The regularity of IMF bailouts led to a "moral hazard," whereby the IMF inadvertently promoted irresponsible lending and borrowing because of an expectation by the parties that the IMF will provide similar bailouts in the future. See generally, Buchheit, *supra* note 9, at 228 (providing that a moral hazard exists when massive public sector bailouts encourage and reward reckless investment decisions by the creditors and unsound economic policies by the debtors). Buchheit further maintains that a moral hazard exists when massive public sector bailouts encourage and reward reckless investment decisions by the creditors and unsound economic policies by the debtors. *Id.* See generally Schwarcz, *supra* note 14, at 961-62 (positing that countries anticipating an IMF bailout might have less reason to take a prudent economic course, and lenders that anticipate being protected from default might have a greater tendency to take unwarranted financial risk). But cf. STEPHEN HAGGARD, THE POLITICAL ECONOMY OF THE ASIAN FINANCIAL CRISIS 6-7 (2000) (stating that moral hazards occur when liabilities have an implicit guarantee).

54. Cf. Buchheit, *supra* note 53, at 60 (noting that the IMF will no longer perform bailout loans).

55. See Power, *supra* note 15, at 1209 (taking note of the absence of a formal debt restructuring mechanism).

consequence, there is a great probability that investor panic will lead to a flurry of capital outflow,⁵⁶ or worse, economic contagion.⁵⁷

Economic factors, however, are not the only forces demonstrating the urgent need for an orderly restructuring process. Rather, the chaos following a sovereign default often causes bondholders—with whom the sovereign should ideally be negotiating for a mutually beneficial solution—to petition the New York courts for a judgment in their

56. Capital outflows occur when foreigners rush to exchange the local currency in which they are invested for their originally invested U.S. dollars. See ROY E. ALLEN, *FINANCIAL CRISES AND RECESSION IN THE GLOBAL ECONOMY* 79 (1999) (explaining how international holders of local currency “run” on that currency by demanding dollars in exchange for the local currency). Hence, “outflow” refers to U.S. dollars leaving the local economy. *Id.*; see also *supra* notes 47-50 and accompanying text (describing how foreign debt is often denominated in hard currency, and so when a sovereign is unable to service its debt, it must buttress those reserves). In fact, it has been noted that a loss of dollars is perhaps the worst possible event that may occur during liquidity crises, since it is usually a paucity of hard reserves that causes the crises in the first place. *Id.* Nevertheless, sudden increases in these outflows can devastate the local currency as well as the rest of the domestic economy. *Id.*; see also, e.g., Chow, *supra* note 48, at 199 (postulating that capital outflows stand out as one of the catalytic elements causing the Asian Financial Crisis); Nicholas D. Kristof & David Sanger, *How the United States Wooed Asia to Let Cash Flow In*, N.Y. TIMES, Feb. 16, 1999, at A1 (noting that liberal capital flows greatly contributed to the financial crisis in Thailand, which then spread throughout Asia, Russia, and finally Brazil).

57. Cf. Buchheit, *supra* note 9, at 225-29 (opining that to visit losses or even debt re-schedulings upon skittish bond investors flirts with contagion, the loss of private capital flows for indefinite periods, economic contraction in the debtor countries and disruptions to world trade, and financing relationships). Buchheit further explains that when contagion occurs, there seems to be something other than traditional market forces at work. *Id.* at 226. Often, investors will group together countries from a certain region and assume that political or economic turmoil in one naturally means turmoil in others. *Id.* Buchheit argues that bond investors are not good at discriminating between emerging markets, and thus, tend to retreat—causing contagion. *Id.* But cf. *Hearing on Argentine Econ.*, *supra* note 8 (implying that investors’ doubts concerning the possibly volatile Argentine peso were rational when one considers the 1994 Mexican peso crisis and the 1997 Asian economic crisis, as well as the 1998 Russian and the 1999 Brazilian currency devaluations). See generally HAGGARD, *supra* note 53, at 6-7 (explaining that when crises start in one country, there are a variety of channels through which they can be propagated to other countries, including fear of competitive devaluation or financial leakages). Haggard continues to argue that the financial meltdown in Thailand in 1997 “begat Indonesia and Malaysia; Taiwan’s devaluation begat market meltdown in Hong Kong in late October; and that meltdown begat South Korea, which resonated back through the Southeast Asian markets at the end of 1997.” *Id.*

favor.⁵⁸ This is made possible by choice-of-law clauses found in most bond contracts issued on the New York bond market.⁵⁹ These clauses vest jurisdiction in the New York courts for nearly all matters arising out of the bond contract.⁶⁰ Again, this flurry of litigation results from the institutional vacuum that could otherwise place a stay on all creditor-claims initiated against the debtor.⁶¹ If too many of these bondholders go to the courts, debt restructuring may no longer be practicable.⁶²

What is needed, then, is a structured and predictable method through which a debtor can secure a restructuring.⁶³ In order to be successful, the process first must have the confidence of the investors so that initiating restructuring negotiations does not perpetuate contagion effects.⁶⁴ Additionally, it must protect the debtor from individual creditor claims so that the debtor might effectively assess

58. See, e.g., *Welter, Inc. v. Republic of Argentina*, 941 F.2d 145 (2d Cir. 1991) (describing how creditors brought an action against Argentina for breach of obligations arising from debt instruments); *Lloyds Bank, PLC v. Republic of Ecuador*, 1998 WL 118170, at *1 (S.D.N.Y. 1998) (highlighting the cause of action as various bondholders laying claim to debt agreements with Ecuador). See generally *Elliott Ass'n. v. Banco De La Nacion*, 194 F.3d 363, 378 (2d Cir. 1999) (holding that by acquiring a debt instrument where the intent to litigate for enforcement is incidental or contingent, private bondholders shall be able to avail themselves of the New York courts).

59. See Buchheit & Gulati, *supra* note 53, at 59 (noting that New York law governed many of the government bonds issued on the international market).

60. See *id.* (examining the commonly invoked New York choice of law provision in bond contracts).

61. See HERBERT, *supra* note 40, at 105 (explaining that placing a stay on all creditor claims, as is commonly done in actual Chapter 11 reorganization, shields the debtor from those claims during the period of negotiation).

62. See MONTEK S. AHLUWALIA, *COMMONWEALTH SECRETARIAT, REFORMING THE GLOBAL FINANCIAL ARCHITECTURE* 48-49 (2000) (noting that when a country faces a liquidity crisis and is not given some temporary respite from these private actions, the debtor will have neither the time nor the resources to reach a voluntary agreement). Ahluwalia underscores the benefit a bankrupt entity enjoys by the imposition of a stay against all creditor claims in that the stay provides both the time and the resources needed to reach an agreement beneficial to creditor and debtor alike. *Id.*

63. See *supra* notes 56-57 and accompanying text (explaining the negative consequences resulting from the absence of a structured and predictable restructuring mechanism).

64. See *id.* (describing the contagion phenomenon in detail).

its financial situation and negotiate a mutually beneficial agreement between it and its entire creditor base.⁶⁵ Ideally, use of the process would become a matter of course so that investors would neither undermine the negotiations by bringing individual claims, nor would they allow a fear of economic catastrophe to become a self-fulfilling prophesy.⁶⁶ This result, among others, is exactly what the IMF purports its proposal will accomplish.⁶⁷

B. THE IMF PROPOSAL EXPLAINED: COLLECTIVE ACTION CLAUSES (“CACs”) AND THE SOVEREIGN DEBT RESTRUCTURING MECHANISM (“SDRM”)

In recent years, the restructuring problem has sparked an official response from both the IMF⁶⁸ and the U.S. Treasury Department.⁶⁹ The IMF advocates a two-pronged solution: first, a contractual approach whereby all new bond issues would carry with them CACs; and second, a statutory approach coined the SDRM, which would establish a separate entity to facilitate the restructuring process.⁷⁰

65. See *supra* notes 25, 58 and accompanying text (discussing the implications of failing to protect the debtor during negotiations).

66. See discussion *infra* Part III.A (explaining that an international bankruptcy framework can help in this regard by facilitating the negotiations and resolving the liquidity crisis sooner than was previously possible); see also *supra* note 56 (illustrating the phenomenon of capital flows by noting specifically that the less time the crisis remains unresolved, the less time there is available for investors to liquidate their investments in the debtor-nation).

67. See Macroeconomic Stability, *supra* note 42 (arguing that the SDRM would prevent capital outflow by providing a more orderly framework for restructuring, and underscoring that a government would be afforded protection from individual creditor claims).

68. See *infra* note 70 (quoting IMF policy towards the sovereign debt issue).

69. See *infra* note 77 (describing American policy regarding the sovereign debt issue).

70. See International Monetary Fund, *Public Information Notice: IMF Board Discusses Possible Features of a New Sovereign Debt Restructuring Mechanism* (stating that “[t]he Fund is considering two complementary approaches to creating a more orderly and predictable process for sovereign debt restructuring: (i) a contractual approach, in which debt restructurings would be facilitated by enhanced use of certain contractual provisions in sovereign debt contracts and (ii) the establishment of a universal statutory framework which would create a legal framework for collective decision making by debtors and a supermajority of creditors”), at <http://www.imf.org/external/np/sec/pn/2002/pn02106.htm> (last

CACs already appear in government bonds issued on the London market, but not in those issued in New York.⁷¹ As a consequence, any country wishing to restructure its debt issued on the New York bond market must first obtain the unanimous approval of all holders of that particular bond instrument.⁷² Assuming, *arguendo*, the good faith of all actors in this system, one can easily imagine the logistical and transactional difficulty in gaining the unanimous approval of so many private bondholders.⁷³ In practice, however, the debtor must also face the challenge of "holdout creditors," where, as a natural consequence of the unanimity requirement, recalcitrant creditors can coerce benefits greater than that to which they are equitably entitled.⁷⁴

However, the inclusion of CACs significantly lessens the problems of holdout creditors⁷⁵ and bondholder coordination.⁷⁶ CACs are

visited Sept. 23, 2003). The contractual side of the proposal is considered the more moderate of the two. *Id.*; see also Ralph C. Bryant, *Standards and Prudential Oversight for an Integrating World Financial System*, in *ESSAYS ON THE WORLD ECONOMY AND ITS FINANCIAL SYSTEM* 219, 262 (Brigitte Granville ed., 2000) (suggesting that the more modest steps suggested for more orderly ways of debt restructuring include majority-voting, collective-representation clauses in new bond contracts, and clauses requiring a certain percentage of bondholders to agree before legal action could be taken).

71. See John B. Taylor, Speech at the Conference "Sovereign Debt Restructuring: A United States Perspective" at the Institute for International Economics (Apr. 2, 2002) [hereinafter *A United States Perspective*] (noting that CACs currently appear in sovereign bonds issued under British law, but not in those issued under New York Law), at <http://www.iie.com/papers/taylor0402.htm> (last visited Sept. 23, 2003).

72. See Buchheit, *supra* note 9, at 228 (noting that bonds issued under American law require the unanimous consent of all bondholders before any changes to the bond's terms can be made).

73. See *id.* (explaining the unanimity requirement for bond restructures).

74. See, e.g., Schwarcz, *supra* note 14, at 961 (explaining that "in a sovereign debt restructuring context, any lender whose consent is needed for an overall settlement could hold out for a disproportionate share on the threat of preventing the settlement").

75. See Bryant, *supra* note 70, at 262 (stating that the goal of CACs is to prevent a few creditors from instigating legal actions or any other means of obstructing restructurings when such restructurings are in the interests of the debtor and the great majority of creditors); see also Eichengreen, *supra* note 14, at 63 (underscoring the incentive to purchase bonds from less patient investors and to threaten lawsuits designed to attach the debtor's assets). Eichengreen argues that the debtor, wishing to avoid expensive and embarrassing litigation, may feel compelled

simply clauses in the bond contract binding every holder of that bond issue to any decision made by a supermajority of all the holders.⁷⁷ Thus, if restructuring becomes necessary, so long as the debtor reaches an agreement with, for example, seventy percent of its holders, the agreement will bind all holders regardless of whether they voted in favor or against the terms.⁷⁸ Consequently, dissenting holders would be barred from bringing private actions for enforcement of their bond contracts in New York courts.⁷⁹ While this is the first of a two-pronged IMF strategy, the United States has not

to buy them out at full price so that they may be able to reach a settlement with more amenable bondholders. *Id.*

76. See *supra* notes 23-24 and accompanying text (addressing the difficulty in coordinating a restructuring negotiation with bondholders).

77. See R. Glenn Hubbard, Remarks at the Conference on the IMF's Sovereign Debt Proposal at the American Enterprise Institute (Oct. 7, 2002) (explaining that incorporating CACs would allow a supermajority of bondholders to agree to amendments to the payment terms of the bond, which would then become binding on other bondholders), at <http://www.whitehouse.gov/cea/EnhancingSovereignDebtRestructuringAEIOct72002.pdf> (last visited Sept. 23, 2003). It is fairly settled that inclusion of CACs will not raise borrowing costs. *Id.*; see also Eichengreen, *supra* note 14, at 63-64 (arguing that the relative ease of negotiating with CACs should help avoid a long deadlock and render the majority of investors better off). Accordingly, bond holders will not negatively react to the inclusion of these clauses. *Id.*

78. See Buchheit, *supra* note 9, at 228 (explaining that CACs permit amendments to bond contracts when there is the affirmative vote of a supermajority of the particular instrument's holders).

79. See Anne Krueger, Remarks at the Bretton Woods Committee Annual Meeting (June 6, 2002) [hereinafter Bretton Woods Committee] (positing that supermajority voting would afford the debtor legal protection from creditors during negotiations), at <http://www.imf.org.external/np/speeches/2002/060602.htm> (last visited Sept. 23, 2003). Krueger further indicates that bonds not containing CACs (issued on the New York market) allow private bondholders to seek enforcement of the bond contract in U.S. courts. *Id.*; see also *supra* note 28 and accompanying text (confirming the right of a bondholder to bring an individual action in New York courts to enforce the terms of the contract). Furthermore, the case law demonstrates that if the bond is sold on the secondary market, the purchaser, so long as he remains the rightful owner of the bond, henceforth holds all rights appertaining to a bond contract, including the right to sue in the New York courts for enforcement. *Id.*; cf. TENNEKOON, *supra* note 28, at 193 (observing that there is a direct legal nexus between each successive bondholder and the original issuer, and that that nexus transmits to each successive holder the rights and obligations contained in the bond instrument, as well as any restrictions and exemptions).

indicated a willingness to sanction anything beyond the inclusion of CACs in bond contracts.⁸⁰

The IMF, however, does not believe that CACs alone can provide a comprehensive solution because of several identified limitations.⁸¹ Instead, it advocates a legislative approach in addition to the contractual approach of CACs.⁸² As proposed, this SDRM would, similar to CACs, allow a supermajority of creditors to agree upon a resolution with the debtor and bind the remaining creditors in dissent.⁸³ According to the Fund, the SDRM would consist of an independent forum,⁸⁴ created through an amendment to the

80. See A United States Perspective, *supra* note 71 (describing the need for a proposal, and affirmatively supporting the use of CACs, but remaining silent as to the prudence of the IMF's SDRM); see also Hubbard, *supra* note 77 (advocating the use of CACs, but expressing American reservations about the SDRM). Hubbard posits that it would be a slow, difficult process, and underscores that its formation would require eighty-five percent of the membership vote. *Id.*; see also IMF, *World Bank Overhaul Before the J. Econ. Comm.*, 2002 WL 25099068 (2002) [hereinafter *World Bank Overhaul*] (testimony of John B. Taylor, United States Treasury for International Affairs) (calling for a decentralized approach to the sovereign debt problem and advocating the use of CACs).

81. See Hopes and Hazards, *supra* note 21 (noting that CACs only bind the holders of the particular bond issue in question). For example, their application is limited to the particular bond issue in which the clause actually appears. *Id.* Additionally, even if each CAC is drafted with the exact same phrasing, Krueger opines that they will inevitably be subject to differing interpretations depending on the jurisdiction in which it becomes relevant. *Id.* Lastly, and perhaps most importantly, Krueger notes that while CACs do offer an attractive long-term solution for future bond issues, there is no indication of how they can solve the problem of those bond issues currently outstanding that do not contain CACs. *Id.*

82. See Buchheit, *supra* note 9, at 228 (explaining that CACs permit amendments to bond contracts when there is the affirmative vote of a supermajority of the particular instrument's holders).

83. See Hopes and Hazards, *supra* note 21 (explaining that the SDRM would place the essential decision-making power in the debtor and a supermajority of creditors).

84. See Bretton Woods Committee, *supra* note 79 (discussing the SDRM's independence from the IMF).

Agreement, in which the restructuring would take place.⁸⁵ Any agreement certified by the forum would bind all Members.⁸⁶

In addition to establishing what is effectively a Chapter 11 bankruptcy forum, the IMF articulated three attributes of the proposed system. First, upon request, the debtor could secure a stay on all creditor claims.⁸⁷ Second, the creditors would have the power to extend the length of the stay in case extra time is needed to break an impasse.⁸⁸ Third, creditors would be encouraged to subordinate their outstanding claims to any new loans in order to encourage fresh lending.⁸⁹

Through this proposal, the IMF hopes to create a formal, predictable, and reliable method through which sovereign debtors can seek a restructuring.⁹⁰ If successful, this method should help to avert future debt crises.⁹¹ Because this proposal is still in its infancy, however, it remains unclear whether it is the best legal alternative or politically feasible.

II. ANALYSIS

This section argues that the SDRM cannot successfully provide a lasting solution to the external debt problem.⁹² Specifically, the

85. See Hopes and Hazards, *supra* note 21 (stating that the IMF could establish the SDRM by amending its Articles of Agreement, which would require acceptance by 3/5's of the IMF membership, carrying eighty-five percent of the total voting power).

86. See IMF, SOVEREIGN DEBT RESTRUCTURING MECHANISM—FURTHER CONSIDERATIONS 28 (August 14, 2002) [hereinafter FURTHER CONSIDERATIONS] (explaining that the forum's certifications would have a direct binding effect in all member countries), at <http://www.imf.org/external/np/pdr/sdrm/2002/081402.pdf> (last visited Sept. 23, 2003). This text indicates therefore that each Member's courts would have to comply with the certification and give it legal effect. *Id.*

87. See Hopes and Hazards, *supra* note 21 (noting an important attribute of the SDRM to be the sovereign's ability to secure a stay on creditor claims).

88. See *id.* (suggesting that the stay should be extendable).

89. See *id.* (noting the importance of securing fresh lending).

90. See *id.* (discussing the goal of the SDRM).

91. See generally *id.* (implying that the proposed system will limit the occurrence of future debt crises).

92. See Hubbard, *supra* note 77 (describing the United States' opposition to the SDRM).

SDRM suffers not from a lack of sound theory, but rather from flawed implementing procedure.⁹³ This section also considers the oft-proposed use of Article VIII, section 2(b) of the Agreement as a potential alternative for achieving orderly restructuring.⁹⁴ Finally, this section concludes by highlighting several important reasons why this attractive alternative, in its present form, also fails to produce a viable solution.⁹⁵

A. AMERICAN INFLEXIBILITY MAKES THE SDRM UNWORKABLE

The United States consistently has made clear its policy toward the formation of a Sovereign Chapter 11 framework.⁹⁶ Moreover, there is no indication that a policy shift is forthcoming.⁹⁷ Instead, the United States favors the exclusive use of CACs in bonds issued on the New York market and is opposed to the formation of a separate forum vested with the jurisdiction to facilitate the restructuring process and bind all Members of its certifications.⁹⁸

The lack of American acquiescence will prove fatal to the SDRM because its implementation requires an amendment to the IMF Agreement.⁹⁹ Article XXVIII of the Agreement outlines the procedure for an amendment's approval.¹⁰⁰ Specifically, three-fifths of the

93. See discussion *infra* Part II.A (arguing that the SDRM is substantively sound but suffers from procedural inadequacies).

94. See discussion *infra* Part II.B.1 (suggesting that section 2(b) could theoretically function as a bankruptcy mechanism).

95. See discussion *infra* Part II.B.2 (demonstrating that courts' interpretation of section 2(b) precludes it from effectively functioning as a bankruptcy process).

96. See Hubbard, *supra* note 77 (describing Washington's support for the principles underlying CACs, but also expressing American reservations about including the SDRM in any permanent international bankruptcy system).

97. See *supra* note 80 (listing statements in opposition to the SDRM). Not one of the United States' statements reviewed for this Comment implied a willingness to support the SDRM. *Id.*

98. See *id.* (advocating the use of CACs, but expressing the United States' reservations about the SDRM and suggesting that it would be a slow, difficult process).

99. See Hopes and Hazards, *supra* note 21 (stating that the SDRM would be achieved through an amendment to the Articles of Agreement).

100. See Articles of Agreement of the International Monetary Fund, July 22, 1944, art. XXVIII(a) [hereinafter Agreement] ("When three-fifths of the members,

membership, wielding eighty-five percent of the vote, must favor the amendment.¹⁰¹ Having the largest quota¹⁰² of all members of the Fund, the United States wields just over seventeen percent of the vote, giving it a *de facto* veto.¹⁰³ Thus, the biggest weakness of the SDRM lies not in its substantive attributes, but rather in the procedural protocol necessary to bring the concept into existence.¹⁰⁴ Curiously, the IMF has failed to address this most vital and conspicuous obstacle to its policy.¹⁰⁵

The United States has not thoroughly outlined the reasons for its opposition; therefore, explaining its position necessarily involves conjecture.¹⁰⁶ Perhaps the United States is uncomfortable with the

having eighty-five percent of the total voting power, have accepted the proposed amendment, the Fund shall certify the fact by a formal communication addressed to all members.”).

101. *Id.*

102. See Agreement, *supra* note 100, art. III, § 1 (defining a Member’s quota). “The subscription fee of each member shall be equal to its quota and shall be paid in full to the Fund at the appropriate depository.” *Id.* A Member’s quota is expressed in special drawing rights (“SDRs”). See *id.* (“Each member shall be assigned a quota expressed in special drawing rights.”). A Member’s amount of SDRs is extremely important because its voting power is directly dependent on its financial contribution to the Fund, as expressed in special drawing rights. See *id.*, art. XII, § 5(a) (“Each member shall have two hundred fifty votes plus one additional vote for each part of its quota equivalent to one hundred thousand special drawing rights.”).

103. See International Monetary Fund, *IMF Members’ Quotas and Voting Power, and IMF Governors* [hereinafter *Quotas and Voting Power*] (indicating that the United States has 37,149.3 million SDRs, comprising more than seventeen percent of the total institutional voting power), available at <http://www.imf.org/external/np/sec/memdir/members.htm> (last visited Sept. 23, 2003).

104. See *supra* notes 99-103 (demonstrating that the SDRM will likely fail because procedural protocol allows the United States to block its implementation).

105. See, e.g., Hopes and Hazards, *supra* note 21 (failing to discuss political realities necessary to bring the concept into existence); Bretton Woods Committee, *supra* note 79 (lacking any mention of political considerations).

106. See, e.g., A United States Perspective, *supra* note 71 (demonstrating how the United States has not explicitly explained its opposition to the SDRM); Hubbard, *supra* note 77 (expressing the lack of an articulated United States rationale for objecting to the SDRM).

binding nature of the forum's certifications.¹⁰⁷ As a related matter, it may fear the erosion of Members' jurisdiction by the forum.¹⁰⁸ Whatever the actual point of contention might be, speculation may prove moot because the international community must nevertheless formulate an orderly and predictable restructuring process that accounts for U.S. objections.¹⁰⁹ One common suggestion has been to use section 2(b) of the Agreement.¹¹⁰ However, the present form of section 2(b) precludes it from being the best possible alternative.¹¹¹

107. This proposition may be inferred from the fervent American support of CACs and its adversity towards the SDRM. *See supra* note 80 and accompanying text (citing various sources that express the United States' support for CACs and its disfavor for the SDRM). This U.S. distinction is especially curious because "majority control" is the central concept underlying both proposals. *Id.*; *see also* Hopes and Hazards, *supra* note 21 (explaining that both the SDRM and CACs would allow a majority of creditors to make an arrangement binding upon the minority in dissent). Thus, if trying to explain why the United States favors one proposal but not the other, one might search for latent distinctions between the two. In this case, CACs would still leave a role for the U.S. courts, where the SDRM's certifications are binding, and therefore, shielded from the United States court review. *Id.*; *see also* FURTHER CONSIDERATIONS, *supra* note 86 (stating that the forum's certifications would become binding on each member, and cannot, therefore, be challenged in the domestic courts of any member).

108. *Cf. A United States Perspective, supra* note 71 (noting that the IMF approach is more centralized than the United States' approach); *World Bank Overhaul supra* note 80 (calling for a decentralized contract-based approach). From these statements admonishing against centralized power in the forum, one might conclude that the United States is adverse to an accumulation of jurisdiction and power in the SDRM. *Id.*

109. *See* discussion, *supra* Part I.A (underscoring the importance of designing an international bankruptcy forum).

110. *See, e.g.,* Power, *supra* note 15, at 223-24 (describing how Article VIII, section 2(b) could be used as a means of making bond contracts unenforceable in foreign courts); Gianviti, *supra* note 47, at 1374-76 (explaining that many scholars have long advocated the use of Article VIII, section 2(b) as a bankruptcy mechanism); *see also* *Libra Bank Ltd. v. Banco Nacional De Costa Rica, S.A.*, 570 F. Supp. 870, 875 (S.D.N.Y. 1983) (analyzing the legality of a Costa Rican Regulation imposed pursuant to Article VIII, section 2(b), and noting that the purpose of said Regulation was to remedy its problems in servicing its external debt); *Weston Banking Corp. v. Turkiye Garanti Bankasi*, 442 N.E.2d 1195, 1200 (N.Y. 1982) (explaining that Turkey had previously imposed a similar section 2(b) Regulation to facilitate its restructuring).

111. *See* discussion *infra* Part II.B.2 (examining the obstacles of using section 2(b) as a restructuring-facilitator).

B. SECTION 2(B) AS AN ALTERNATIVE APPROACH: THEORETICAL APPEAL AND THE PRACTICAL LIMITATIONS

Proposals to use section 2(b) antedate the SDRM as a potential means for streamlining the restructuring process.¹¹² Theoretically speaking, merit exists in employing section 2(b) in this capacity.¹¹³ Realistically, however, narrow interpretations typically imposed by the U.S. courts compromise the viability of the section 2(b) approach.¹¹⁴ This narrow construction has lead many observers to abandon section 2(b) as a viable possibility.¹¹⁵ Yet, total abandonment may be premature.¹¹⁶ By making specific additions and amendments to the Agreement, the IMF may not only preserve section 2(b)'s positive attributes, but may also buttress its efficacy by ridding the provision of its shortcomings.¹¹⁷ At this point, it is necessary to consider both how section 2(b) might theoretically provide an attractive alternative to the SDRM, as well as how section 2(b)'s practical shortcomings have thus far precluded its use in this capacity.

112. See *supra*, note 110 (citing extensive sources that suggest the use of section 2(b) to streamline the restructuring process).

113. See Gianviti, *supra* note 47, at 1375-77 (demonstrating that Members can creatively use Article VIII, section 2(b) to achieve an effect tantamount to a bankruptcy stay, whereby all creditor claims are blocked because foreign courts are forced to give effect to the debtor's moratorium on debt payments); see also discussion *infra* Part II.B.1 (describing in more depth how section 2(b), in theory, could function as an international bankruptcy system).

114. See Werner Ebke, *Article VIII, Section 2(b), International Monetary Cooperation, and the Courts*, 23 INT'L LAW. 677, 682 (1989) (noting that courts, through their interpretations of section 2(b), have disregarded the objectives of the IMF); Gianviti, *supra* note 47, at 1375 (noting that courts in the United States have interpreted section 2(b) rather restrictively); cf. F. A. MANN, *THE LEGAL ASPECT OF MONEY* 379-80 (5th ed. 1992) (demonstrating how this narrow interpretation pervades English law as well). Mann notes an English Court of Appeals' narrow interpretation of important phrases within section 2(b). *Id.*

115. See Gianviti, *supra* note 47, at 1375 (noting that while there are still some who support the use of Article VIII, section 2(b) as a means to restructure sovereign debt, the recent emphasis has been on possible alternatives).

116. See *supra* note 110 and accompanying text (discussing the restructuring potential of section 2(b)).

117. See discussion *infra* Part III.A (arguing that section 2(b) can indeed be very useful if, and when, the IMF makes some necessary amendments).

1. *Article VIII, section 2(b) functioning as a stay on individual creditor claims.*

Theoretically, it is possible for section 2(b) to function as a bankruptcy stay on creditor claims.¹¹⁸ In exceptionally opaque language, section 2(b) of the Agreement provides, in relevant part:

[e]xchange contracts which involve the currency of any member and which are contrary to the exchange control regulation of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member.¹¹⁹

Although vague, one might infer from this language that the drafters sought to preserve within individual Members the qualified ability to impose exchange control regulations enforceable in any Member's courts.¹²⁰ This observation, however, fails to explain what it means when a country imposes "exchange control regulations" ("section 2(b) Regulations" or "Regulations").

The Agreement's drafters likely intended section 2(b) Regulations to give the sovereign the ability to buttress its currency's exchange rate by restricting the outflow of hard currency reserves.¹²¹ In

118. See Gianviti, *supra* note 47, at 1375-77 (demonstrating how a Member can use Article VIII, section 2(b) to achieve an effect tantamount to a bankruptcy stay).

119. Agreement, *supra* note 100, art. VIII, § 2(b).

120. See JOSEPH GOLD, IMF, INTERNATIONAL CAPITAL MOVEMENTS UNDER THE LAW OF THE INTERNATIONAL MONETARY FUND 30 (IMF Pamphlet Series No. 21, 1977) [hereinafter INTERNATIONAL CAPITAL MOVEMENTS] (explaining that original plans were achieved through Article VIII, section 2(b) to codify the obligation that Members cooperate and make each other's capital controls effective in their courts).

121. See *id.* at 30 (discussing that the Article VIII, section 2(b) allowed Members to impose capital restrictions). Although important at the time, Gold asserts that a sovereign's ability to control capital flows has become an even greater concern today than it was during the drafting of the Agreement. *Id.*; see also Chow, *supra* note 48, at 199 (postulating that capital outflows were a main contributor to the 1997 East Asian Financial Crisis). The imperativeness of having this ability derives from a direct correlation that often exists between the amounts of a nation's hard reserves on the one hand, and the exchange rate of its currency on the other. See GIORGIO RADAELLI, EXCHANGE RATE DETERMINATION AND CONTROL 92 (1995) (explaining that the short term impact of capital controls can help authorities battle currency turbulence and avoid speculative attacks); cf. PAUL KRUGMAN, INTRODUCTION TO CURRENCY CRISES 2 (Paul Krugman ed., 2000) (recognizing the widespread belief that a depletion of foreign exchange reserves forces a country's

contrast, the drafters probably did not envision section 2(b) as providing a method for Members to stay creditors' claims.¹²² Nevertheless, placing section 2(b) Regulations on bond payments could have an effect tantamount to a bankruptcy stay.¹²³

central bank to give up its defense on the value of the local currency). One can explain this phenomenon by simple supply and demand principles. Cf. DEREK H. ALDCROFT & MICHAEL J. OLIVER, EXCHANGE RATE REGIMES IN THE TWENTIETH CENTURY 41 (1998) (illustrating how loss of confidence in the local currency can lead to a rush to exchange it for a more stable currency, and implying that the increased demand on the foreign currency, and hence, the decreased supply of that currency, can lead to a devaluation of the local currency vis-à-vis the foreign currency). Therefore, Aldcroft and Oliver argue that by restricting the flow of those hard reserves, the regulating country can maintain its supply of reserves, which will then have a corresponding stabilization-effect on the exchange rate between the two currencies. *Id.*

122. See Beth A. Simmons, *Money and the Law: Why Comply with the Public International Law of Money?*, 25 YALE J. INT'L L. 323, 340 (2000) (explaining that the original purpose of section 2(b) was to protect the ability of governments to maintain approved restrictions). See generally *infra* note 128 (surveying the various purposes served by Article VIII, section 2(b) and not mentioning debt restructuring as one of them). The proposition that restructuring was not an original purpose of section 2(b) is buttressed by the fact that, according to the Vienna Convention, a treaty should be interpreted in light of its stated objectives. See Vienna Convention on the Law of Treaties Between States and International Organizations or Between International Organizations, Mar. 21, 1986, art. 31(1), 25 I.L.M. 543, 562 (stating that one shall interpret a treaty in light of its object and purpose). Doing so with the Articles of Agreement might lead one to conclude that the primary purpose of section 2(b) was to provide a means to respond to capital outflows. See generally Agreement, *supra* note 100, art. VIII, §2(b) (providing for the implementation of exchange control regulations). For example, article I(iii) cites as one goal of the Fund to avoid competitive devaluations among the Members. Agreement, *supra* note 100, art. I(iii). Using section 2(b) to respond to capital outflows can be a means toward that end. See *supra* note 121 (explaining how devaluations can result if a country is unable to implement the section 2(b) Regulations). Article I(v) describes another relevant goal of the IMF as providing an opportunity for members to correct maladjustments in their balance of payments. Agreement, *supra* note 100, art. I(v). It is most certain that section 2(b) Regulations on capital outflows can correct an imbalance of payments. See MANN, *supra* note 114, at 382 (noting the German interpretation that one purpose of section 2(b) was to prevent negative effects upon Members' balance of payments). Finally, nowhere in the Agreement is it a stated goal of the IMF to help facilitate debt restructuring. *Id.* See generally *infra* note 128 and accompanying text (surveying the various purposes served by Article VIII, section 2(b) and not mentioning debt restructuring as one of them).

123. See Gianviti, *supra* note 47, at 1375-77 (explaining that sovereigns can use section 2(b) Regulations on capital outflow as a means to enforce a debt payment moratorium).

For example, a country facing a liquidity crisis could protect any remaining liquidity by imposing a section 2(b) Regulation, thereby prohibiting the export of hard currency abroad.¹²⁴ Because the Regulation would necessarily suspend all bond payments, the terms of the contract would often place the sovereign in official default and trigger a cause of action for the creditors.¹²⁵ But because all Members are obliged to give extraterritorial effect to a properly-imposed section 2(b) Regulation, the creditor's cause of action will fail to mature, giving the parties time to engage in restructuring negotiations.¹²⁶ More specifically, section 2(b)'s text provides that if the Regulation is imposed consistent with the Agreement,¹²⁷ other Members are then obliged to respect the integrity of those Regulations and may not enforce in their courts any contracts contravening their spirit.¹²⁸

124. See *id.* (explaining that states become illiquid when they can no longer pay foreign debtors because their hard reserves need replenishing and suggesting that section 2(b) might be used to suspend enforcement of the bond contracts, thereby providing the sovereign with a reprieve). This section 2(b) regulatory power was originally vested in Members so they could prevent currency crises. See *supra* note 121 and accompanying text (highlighting that the original purpose of section 2(b) Regulations was to regulate capital flows, not facilitate the restructuring process). Now, however, it is suggested that those same regulations on the outflow of hard currency can help both to stabilize a country's liquidity while simultaneously precluding any individual actions to enforce the terms of the contract. *Id.*

125. Cf. TENNEKON, *supra* note 28, at 193 (observing that the bond is a source of rights and obligations between the parties).

126. See Gianviti, *supra* note 47, at 1375 (noting that section 2(b) could theoretically function as a stay on foreign creditor's actions and that such result would be achieved via a government-imposed moratorium on payments by resident debtors to their foreign creditors). See generally *supra* notes 121-124 and accompanying text (explaining that section 2(b) Regulations, if properly imposed, have extraterritorial effect, thereby precluding private creditors from exercising actions in domestic courts).

127. See *infra* notes 165-166 (noting that whether the sovereign actually imposed a given Regulation "consistent with the Agreement" has been a major source of controversy and has served as a means through which the U.S. courts have managed to limit their obligations arising under Article VIII, section 2(b)).

128. See *Unenforceability of Exchange Contracts: Fund's Interpretation of Article VIII, § 2(b) 446-4*, in *SELECTED DECISIONS AND SELECTED DOCUMENTS OF THE INTERNATIONAL MONETARY FUND*, 452-53 (1998) [hereinafter *Unenforceability of Exchange Contracts*]:

Using section 2(b) in this manner produces an effect tantamount to a stay on all creditor claims, thereby obviating the need for the SDRM's formal stay process.¹²⁹ Hypothetically, then, section 2(b) of the Agreement obligates the United States not to grant specific performance of a bond contract if doing so contravenes the properly-imposed Regulations of the debtor.¹³⁰ In other words, U.S. courts must give extraterritorial legal effect to those section 2(b) Regulations.¹³¹ The essence of the inquiry, then, becomes not whether the merits of the creditor's claim rightly entitle her to performance, but whether the comity principles¹³² of section 2(b) permit the court to entertain her claim in the first place.¹³³

The Board of Executive Directors of the [IMF] has interpreted . . . Article VIII, Section 2(b) . . . as follows:

Parties entering into exchange contracts involving the currency of any member of the Fund and contrary to the exchange control regulations of that member which are maintained or imposed consistently with the Fund Agreement will not receive the assistance of the judicial or administrative authorities of other members in obtaining the performance of the contracts or by awarding damages for their nonperformance.

An obvious result of the foregoing undertaking is that if a party to an exchange contract . . . seeks to enforce such a contract, the tribunal of the member country before which the proceedings are brought will not . . . refuse recognition of the exchange control regulations of the other members which are maintained or imposed consistently with the Fund Agreement.

available at <http://www.imf.org/external/pubs/ft/sd/index.asp?decision=446-4> (last visited Sept. 23, 2003).

129. See generally *Hopes and Hazards*, *supra* note 21 (describing a Member's ability to secure a stay on creditor claims as an important attribute of the SDRM). Using section 2(b) in this manner ensures a similar ability. See *Gianviti*, *supra* note 47, at 1375 (noting that section 2(b) could be used as a stay).

130. See *Unenforceability of Exchange Contracts*, *supra* note 128 (asserting that IMF members may not assist in contract enforcement where the contract was negotiated in contravention with exchange control regulations).

131. See *id.* (outlining IMF members' obligation to adhere to section 2(b) Regulations).

132. See *Power*, *supra* note 15, at 2738 (defining comity as "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation") (quoting *Hilton v. Guyot*, 159 U. S. 113, 164 (1895)).

133. See generally *Unenforceability of Exchange Contracts*, *supra* note 128 (clarifying that section 2(b) precludes courts from enforcing a contract that contravenes another Member's 2(b) Regulation).

Although 2(b)'s theoretical application is appealing, its realistic application is severely inhibited by practical limitations.¹³⁴ Oftentimes, when charged with the task of determining the scope of one's obligation under section 2(b), U.S. courts will construe it so narrowly that they eviscerate any responsibility that may otherwise have arisen from the provision.¹³⁵ As a result of the courts' disfavor of section 2(b) defenses,¹³⁶ it has fallen into disuse by sovereign defendants and, consequently, is in need of significant overhaul.¹³⁷ First, however, it is useful to consider how U.S. courts have construed section 2(b) so narrowly.¹³⁸

2. *The narrow treatment of section 2(b) by the U.S. courts*

A number of phrases embedded within the language of section 2(b) have provided fertile ground upon which to limit the provision's application. Two phrases—"exchange contracts" and "consistent with this agreement"—pose the greatest obstacles to section 2(b)'s use as a restructuring-facilitator¹³⁹

134. See Ebke, *supra* note 114, at 691 (noting that U.S. courts have construed section 2(b) almost to the point where the provision vanishes).

135. See discussion *infra* Part II.B.2 (analyzing precedent on courts' narrow construction of obligations under section 2(b)).

136. Cf. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 822 (1987) (suggesting that section 2(b) might be used as a defense); Ebke, *supra* note 114, at 701 (explaining that the courts of most IMF members are of the opinion that Article VIII, section 2(b) provides a defense); Werner Ebke, *Article VIII, Section 2(b) of the IMF Articles of Agreement and International Capital Transfers: Perspectives from the German Supreme Court*, 28 INT'L LAW. 761, 766 (1994) (noting that German courts have been more receptive of the Article VIII, section 2(b) "defense" when compared with other IMF members).

137. See, e.g., *Lloyds Bank, PLC v. Republic of Ecuador*, 1998 WL 118170 (S.D.N.Y. 1998) (demonstrating failure of Sovereign debtor to raise the defense); *Weltover, Inc. v. Republic of Argentina*, 941 F.2d 145, 146-47 (2d Cir. 1991) (exemplifying the scenario of a debtor deciding not to use the defense); *Elliott Ass'n. v. Banco De La Nacion*, 194 F.3d 363, 367 (2d Cir. 1999) (lacking a section 2(b) defense).

138. See Ebke, *supra* note 114, at 691 (noting that the U.S. courts have construed section 2(b) almost to the point where the provision vanishes).

139. Agreement, *supra* note 100, art. VIII, § 2(b).

a. "Exchange Contracts"

The inquiry of what precisely constitutes an "exchange contract"¹⁴⁰ for section 2(b) purposes probably has received more scholarly attention than any other phrase appearing in the provision.¹⁴¹ Because only those contracts that are deemed "exchange contracts" fall within the ambit of section 2(b),¹⁴² a court's interpretation of this term will necessarily place a concomitant limitation on section 2(b)'s scope as a whole. American and English interpretation¹⁴³ holds that "exchange contracts" are all those contracts that have "as their immediate objective the exchange of one currency for another."¹⁴⁴ As a consequence, regardless of whether a contract somehow affects a Member's own hard reserves, a Member should expect its section 2(b) Regulation to supercede only those contracts governing the direct exchange of one currency for another.¹⁴⁵ The courts make this limitation in spite of permissive language appearing elsewhere in the

140. See *id.* (codifying that "[e]xchange contracts which involve the currency of any member . . .").

141. See, e.g., 8 JOSEPH GOLD, IMF, THE CUBAN INSURANCE CASES AND THE ARTICLES OF THE FUND 25-27 (1966) [hereinafter CUBAN INSURANCE] (discussing the controversy over the exact meaning of "exchange contracts"); MANN, *supra* note 114, at 378-86 (providing an in-depth survey of the ambiguity surrounding the meaning of "exchange contracts"); Ebke, *supra* note 114, at 686-91 (surveying the various interpretations assigned to the phrase "exchange contracts").

142. See Agreement, *supra* note 100, art. VIII, § 2(b) ("[e]xchange contracts which involve the currency of any member . . .").

143. See MANN, *supra* note 114, at 379 (describing the English adoption of an interpretation of section 2(b) where the only contracts that would qualify are those that exchange one currency of one country for that of another); Gianviti, *supra* note 47, at 1375 (describing the American courts' interpretation of "exchange contract" to be those contracts intended for the exchange of currencies and opining that such narrow interpretation is caused by the provision's ambiguity); Ebke, *supra* note 114 (describing one of Judge Meyer's dissenting opinions, and noting that U.S. courts have not adopted his broad interpretation of the phrase "exchange contract").

144. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 822 (1987).

145. See discussion *supra* Part II.B.1 (explaining that section 2(b) Regulations can theoretically give the debtor the ability to impose debt payment moratoriums that other Members must grant legal effect to). Thus, the Regulation allows debtors to effectively to block the enforcement of a bond contract in foreign courts. *Id.*

Agreement that places sole discretion in Members to regulate all those transactions considered "capital movements."¹⁴⁶

Dallal v. Islamic Republic of Iran, argued before the Iran-United States Claims Tribunal, is demonstrative of this narrow construction of section 2(b).¹⁴⁷ In *Dallal*, the complainant purported to be the lawful holder of two checks drawn by International Bank of Iran, both payable to his New York bank account.¹⁴⁸ After the New York bank dishonored both checks,¹⁴⁹ the holder filed a complaint for the value of the checks plus interest.¹⁵⁰ In its defense, Iran argued that an official circular issued by its central bank prohibited the transfer abroad of foreign exchange.¹⁵¹ The tribunal easily concluded that because the true character of the transaction was simply to exchange rials (Iranian currency) for dollars, an "exchange contract" existed.¹⁵²

While most would agree that the checks in *Dallal* constitute "exchange contracts,"¹⁵³ compelling reasons exist not to limit the

146. See discussion *infra* Part II.B.2.b (explaining that Members have within their discretion the ability to regulate "capital movements" but they need IMF approval to regulate "current transactions"); see also Agreement, *supra* note 100, art. VIII, § 2(a) ("[N]o member shall, without the approval of the Fund, impose restrictions on the making of payments . . . for current international transactions."). "Members may exercise such controls as are necessary to regulate international capital movements . . ." *Id.* art. VI, § 3.

147. See *Dallal v. Islamic Republic of Iran*, 3 Iran-U.S.C.T.R. 10, 15-17 (Iran-U.S.Cl. Trib. 1983) (reasoning that an exchange of one currency for another is, in fact, an exchange contract).

148. See *id.* at 10-11 (recounting that Mr. Dallal became the lawful holder of two checks from the International Bank of Iran, which were both payable to his account at Chemical Bank New York).

149. See *id.* (noting that Mr. Dallal contended that the New York bank refused to honor both checks).

150. See *id.* (explaining that Mr. Dallal sought the face amount plus interest).

151. See *id.* at 11 (explaining that Iran referred the Tribunal to a Bank Markazi circular containing certain currency regulations that rendered payment on the checks in direct breach of same).

152. See *id.* at 15-17 (reasoning that if the true character of the transaction was simply to exchange rials for dollars and transfer the dollar amount to the United States—which is what occurred in this case—there is no doubt that the transaction was an exchange contract within the meaning of the IMF Agreement).

153. See *supra* notes 143-144 and accompanying text (illustrating that most legal sources concur that a contract providing for the exchange of two different currencies should be considered an "exchange contract" for section 2(b) purposes).

phrase's meaning to this one extreme. Article VI, section 3 clearly establishes that Members have sole discretion to impose section 2(b) Regulations on all "capital movement" transactions.¹⁵⁴ Consequently, other Members are generally obliged to give effect to all section 2(b) Regulations that restrict "capital movements."¹⁵⁵

By limiting the scope of "exchange contracts" to the facts in *Dallal*, courts are implying that Members do not have at their sole discretion the ability to regulate—and therefore "capital movements" do not include—any transaction that does not directly exchange currencies.¹⁵⁶ If the drafters intended to limit section 2(b)'s application to this narrow factual scenario, they might have more appropriately placed in Members the sole discretion to regulate "capital exchanges" in lieu of the seemingly broader phrase "capital movements."¹⁵⁷ Certainly there are "capital movements" that do not involve direct currency exchanges.¹⁵⁸

154. See discussion *infra* Part II.B.2.b (explaining that Members have within their discretion the ability to regulate "capital movements," but they need IMF approval to regulate "current transactions"); see also Agreement, *supra* note 100, arts. VIII, § 2(a) & VI, § 3 (outlining members' freedom to choose to impose section 2(b) Regulations); INTERNATIONAL CAPITAL MOVEMENTS, *supra* note 120, at 14 (noting that Members are free to control capital transfers).

155. See discussion *supra* Part II.B.1 (explaining that Members' courts are obligated to recognize any properly imposed section 2(b) Regulation).

156. See generally Agreement, *supra* note 100, art. VI, § 3 (illustrating that Members have within their sole discretion the ability to impose section 2(b) Regulations on "capital movements"). Because of this unqualified ability, the only reasonable inference from the courts strict interpretation of "exchange contracts" is that only direct currency exchanges will classify as "capital movements" in U.S. courts, otherwise the section 2(b) Regulation would be permissible. Cf. *Dallal*, 3 Iran-U.S.C.T.R. at 15-17 (stating that a simple exchange of rials for dollars demonstrates the meaning of "exchange contracts").

157. See Agreement, *supra* note 100, art. VI, § 3 (discussing Members' ability to use their discretion to exercise controls necessary to regulate international "capital movements"). Article VI, section 3 has a fundamental relationship with Article VIII, section 2(b), which requires that all Members' Regulations be imposed consistently with the Agreement. *Id.*; see also discussion *infra* Part II.B.2.b (explaining that a Member may regulate "capital movements" consistently with the Agreement in the absence of IMF approval but that no Member may regulate "current payments" consistently with the Agreement in the absence of IMF approval). Consistency with the Agreement notwithstanding, it is posited that instead of allowing for the regulation of "capital movements," if the Framers intended to limit the application of section 2(b) only to those contracts directly exchanging two currencies, such result could have been easily achieved by allowing

For example, a “capital movement” probably takes place whenever a sovereign issues a government bond denominated and payable in American dollars.¹⁵⁹ Even though two currencies are not directly exchanged for one another, it appears that capital has nevertheless “moved” from the country in which the investor resides towards the country floating the bond.¹⁶⁰ This form of “capital movement” makes it unreasonable to suppose that the drafters intended “exchange contracts” to comprise only the restricted group of transactions illustrated by *Dallal*.¹⁶¹ Certainly, it would be inconsistent with Article VI, section 3 to define “exchange contracts” in a way that divests Members of the discretion to impose 2(b) Regulations on “capital movements.”¹⁶²

If section 2(b) is ever going to form the crux of an international bankruptcy scheme, it is vital that “exchange contracts” be afforded broader interpretation so that bonds issued and payable in one

for regulation of “capital exchanges.” See generally discussion *infra* Part II.B.2.b (explaining that Members have the authority to regulate “capital movements”); see also Vienna Convention, *supra* note 122, art. 31(1) (“A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty . . .”).

158. Cf. REUVEN GLICK, ET AL., *Introduction to FINANCIAL CRISES IN EMERGING MARKETS* 28 (Reeuvén Glick et al. eds., 2001) (implying “Capital Movements” simply refers to the flow of capital resources in and out of an entity).

159. See RALPH H. FOLSOM & MICHAEL W. GORDON, *INTERNATIONAL BUSINESS TRANSACTIONS* 625 (1995) (noting that international bond transfers directly affect a state’s currency reserves).

160. Cf. *Weltover, Inc. v. Republic of Argentina*, 941 F.2d 145, 147 (2d Cir. 1991) (demonstrating the lending nature of bond instruments).

161. See GOLD, *supra* note 141, at 26-27 (arguing that exchange contracts exist even when two separate currencies are not directly exchanged for one another). According to Gold, the important inquiry is not the character of the transaction itself, but rather its ultimate effect. *Id.* Gold continues to note that classic exchange contracts (those exchanging one currency for another) have a practical effect on a Member’s hard currency reserves. *Id.* Because non-classic exchange contracts similarly affect a Member’s hard reserves, Gold posits they should appropriately be placed within the ambit of Article VIII, section 2(b). *Id.*

162. See Agreement, *supra* note 100, art. VI, § 3 (stipulating that IMF Members “may exercise such controls as are necessary to regulate international capital movements . . .”).

currency fall within its ambit.¹⁶³ Unfortunately, the current interpretation cripples section 2(b)'s debt restructuring potential.¹⁶⁴

b. Imposed "Consistently with this Agreement"

Another significant source of controversy concerns whether the sovereign imposed the section 2(b) Regulation consistent with its assumed obligations under the Agreement *in toto*.¹⁶⁵ The underlying inquiry is whether the Regulation required prior IMF approval; or alternatively, whether its imposition was in the sole discretion of the debtor.¹⁶⁶ According to the Agreement, if the Regulation restricts "current international transactions," then IMF approval is required.¹⁶⁷ If, however, it regulates international "capital movements," there is no need to seek prior IMF approval.¹⁶⁸

*Libra Bank Ltd. v. Banco Nacional De Costa Rica, S.A.*¹⁶⁹ illustrates how the nebulous distinction between "current transactions" and "capital movements" allowed an American court to

163. See FOLSOM & GORDON, *supra* note 159, at 625 (noting that the current state of the law precludes bonds from qualifying as "exchange contracts").

164. See *Dallal v. Islamic Republic of Iran*, 3 Iran-U.S.C.T.R. 10, at 15-17 (Iran-U.S.Cl. Trib. 1983) (reasoning that an exchange of one currency for another is, in fact, an exchange contract).

165. See Agreement, *supra* note 100, art. VIII, § 2(b) (providing for extraterritorial effect of a Member's regulation only if imposed "consistently with the Agreement").

166. See *id.* art. VIII, § 2(a) & art. VI, § 3 (illustrating that regulations of "capital movements" are in the sole discretion of the imposing Member, while regulations of "current transactions" require IMF approval in order to be consistent with the Agreement).

167. See *id.* art. VIII, § 2(a):

Subject to the provisions of Article VII, Section 3(b) and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.

168. See *id.* art. VI, § 3:

Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3(b) and in Article XIV, Section 2.

169. See *Libra Bank Ltd. v. Banco Nacional De Costa Rica, S.A.*, 570 F. Supp. 870, 875 (S.D.N.Y. 1983).

frustrate its obligations under section 2(b). In this case, Libra, an American Bank, made a \$40 million loan to Banco Nacional of Costa Rica.¹⁷⁰ After paying the first installment, Banco Nacional defaulted,¹⁷¹ placing the blame on a Ministry of Finance decree.¹⁷² The decree prohibited Banco Nacional from making principal or interest payments on foreign debt without the prior approval of the Central Bank.¹⁷³ The Court additionally found that Costa Rican officials imposed the decree to address its difficulty in servicing its foreign debt.¹⁷⁴ The Central Bank later denied Banco Nacional's request for hard currency to pay the second installment on Libra's loan.¹⁷⁵ When Libra filed suit, Banco Nacional argued, among other things, that the decree was a section 2(b) Regulation of international "capital movements," and therefore, the American court was obligated to recognize its legal effect.¹⁷⁶

Using an illustrative list found in Article XXX of the Agreement,¹⁷⁷ the Court reasoned that the Regulation was not consistent¹⁷⁸ with the

170. *See id.* at 874 (recounting that Libra Bank acted as an agent for sixteen banks in the making of a forty million dollar loan to Banco Nacional, a wholly owned Costa Rican bank).

171. *See id.* (explaining that after the first installment, Banco Nacional made no further payments).

172. *See id.* at 875 (noting that Banco Nacional alleged that a Central Bank resolution prevented it from honoring the loan agreement).

173. *See id.* at 874 (reciting Banco Nacional's allegation that Costa Rica's banking laws required the Central Bank's approval of all foreign exchange transactions).

174. *See Libra Bank Ltd.*, 570 F. Supp. at 870 (explaining that Costa Rica adopted the banking resolution in an effort to remedy its problems in servicing its external debts). This is a valuable "real world" example of how IMF Members might use section 2(b) Regulations during liquidity crises. *Id.*

175. *See id.* (explaining that the Central Bank denied Banco Nacional's requests for foreign currency in order to repay plaintiff's loans).

176. *See id.* at 897 (turning to the last defense by the defendant that the loan agreement is not consistent with Article VIII, section 2(b) of the Agreement because it required the circumvention of a properly-imposed Regulation).

177. *See Agreement, supra* note 100, art. XXX:

(d) Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:

all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;

IMF Agreement because it restricted "current transactions" rather than "capital movements."¹⁷⁹ Therefore, the Court reasoned, Costa Rica was obligated to secure prior approval from the IMF before implementing the section 2(b) Regulation.¹⁸⁰ Because Costa Rica failed to do so, the Court felt no obligation to recognize the Regulation's effect.¹⁸¹ Additionally, the Court treated section 2(b) as an affirmative defense, placing on the defendant the burden of proving whether it imposed the section 2(b) Regulation consistently with the Agreement.¹⁸²

The Court's underlying assumption was that a country can receive IMF approval only if it first petitions the Fund and imposes the Regulation after receiving affirmative, express approval.¹⁸³ This, however, is not the only possible interpretation of the Agreement. It

payments due as interest on loans and as net income from other investments;

payments of moderate amount for amortization of loans or for depreciation of direct investments; and moderate remittances for family living expenses.

178. Incidentally, demonstrating that a sovereign's regulation is designed to pursue the stated objectives of the Fund is not sufficient to prove that the regulation was "consistent" with the Agreement. *See Libra Bank Ltd.*, 570 F. Supp. at 901 (calling "bland" the assertion that merely fulfilling the purposes of the Agreement satisfies the consistency requirement).

179. *See id.* (holding that transactions of this type are appropriately classified as "current transactions"); *see also* Agreement, *supra* note 100, art. XXX (categorizing all payments due in connection with short-term banking and credit facilities as "current transactions"). Although this transaction was a "current transaction," and therefore requiring IMF approval, it does not necessarily follow that Costa Rica's failure to obtain express, prior approval is tantamount to a failure to secure satisfactory approval. *See Weston Banking Corp. v. Turkiye Garanti Bankasi*, 442 N.E.2d 1195, 1203-04 (N.Y. 1982) (arguing that the IMF's silence regarding Turkey's capital Regulations could easily be regarded as implied acquiescence or approval) (Meyer, J., dissenting).

180. *See Libra Bank Ltd.*, 570 F. Supp. at 901 (holding that Costa Rica's failure to secure IMF approval of the regulation rendered it inconsistent with the Agreement).

181. *See id.* (holding that because the Costa Rican government failed to secure IMF approval, section 2(b) did not apply, and consequently, U.S. courts were not obligated to recognize the Regulation).

182. *See id.* (holding that a "defendant who relies on Article VIII, Section 2(b) necessarily asserts that exchange controls are maintained or imposed consistently with the Articles, and he should have the burden of proving that this fact").

183. *See id.* (reasoning that Costa Rica imposed the Regulation inconsistent with the Agreement because it did so without IMF approval).

seems unreasonable that the drafters, having originally included section 2(b) in the Agreement as a response mechanism for monetary crises,¹⁸⁴ expected the sovereign first to traverse a potentially lethargic approval process before imposing emergency measures.¹⁸⁵ Early response is vital because the severity of economic crises tends to increase temporally.¹⁸⁶ Therefore, identifying section 2(b)'s purpose as a response mechanism for monetary crises reasonably leads to the inference that the absence of IMF objection should suffice as legal IMF approval.¹⁸⁷

184. See GOLD, *supra* note 120, at 30 (explaining that the purpose of Article VIII, section 2(b) is to place in Members the ability to respond to currency crises).

185. See Agreement *supra* note 100, art. VIII, § 2(a) (codifying that Members cannot impose regulations on current international transactions without IMF approval). By requiring IMF approval, this provision at first seems to limit the scope of section 2(b). *Id.* But the Agreement does not expressly require prior approval, nor does it define "approval." *Id.* Because the drafters included section 2(b) in the Agreement as a crisis response mechanism, it seems unreasonable to interpret Article VIII, section 2(a) to require the Member to engage the IMF in a prior, formal approval procedure. *Cf.* GOLD, *supra* note 120, at 30 (explaining that Article VIII, section 2(b) allowed members to impose capital restrictions); *infra* note 186 and accompanying text (describing in detail the consequences of government inaction in the face of a debt crisis).

186. See discussion *supra* Part I.A (describing the economic consequences of inaction by the government in the face of a debt servicing crisis). Furthermore, by requiring the sovereign to announce its need to impose these regulations so that they may secure a restructuring, the IMF would be inviting economic contagion. See *supra* notes 56-57 and accompanying text (describing the contagion phenomenon and illustrating how investor panic can act as a precursor to regional economic turmoil). If restructuring negotiations immediately occur with little or no interim period, there will be less uncertainty, and consequently, less risk of investor panic. *Id.*; see also Hopes and Hazards, *supra* note 21 (recognizing the potential danger during that period between the debtor's request for a stay and the point at which negotiations would begin, and stating that use of section 2(b) Regulations may form a necessary defense). Therefore, because a major goal of organized sovereign debt restructuring is to avoid exacerbating economic turmoil by providing a reliable and predictable process, the court's promulgation in *Libra* that a sovereign must first secure IMF approval before beginning the restructuring process cannot possibly be consistent with any discussion about an international bankruptcy scheme. *Id.*

187. See *Weston Banking Corp. v. Turkiye Garanti Bankasi*, 442 N.E.2d 1195, 1203-04 (N.Y. 1982) (arguing that the IMF's silence regarding Turkey's capital Regulations could easily be regarded as implied acquiescence or approval) (Meyer, J., dissenting). Meyer continues to note that the Fund had affirmatively announced its disapproval of a similar Czech Regulation. *Id.* Finally, Meyer concludes that the plaintiff had failed to present any evidence suggesting that the Regulation was inconsistent with the Agreement. *Id.* Because he found the paucity of plaintiff's

In the wake of *Libra*, however, it seems reasonably certain that U.S. courts will not classify as “capital movements” any section 2(b) Regulation intended to restrict payments on foreign debts.¹⁸⁸ Further, *Libra* held that Members can secure IMF approval for a proposed Regulation only through explicit, affirmative IMF acceptance.¹⁸⁹ Accordingly, in its present form, a sovereign can use section 2(b) both to regulate debt payments and stay claims only if it first manages to secure IMF approval.¹⁹⁰ However, such approval will not always be forthcoming, and if it is, it may nevertheless prove too late to quell the economic turmoil caused by inaction.¹⁹¹

III. RECOMMENDATIONS

Although the SDRM could effectively function as an international bankruptcy mechanism, the United States will likely block its implementation.¹⁹² It therefore becomes necessary to consider other ways to achieve similar objectives, while simultaneously gaining U.S. support.¹⁹³ In doing so, the basic attributes of section 2(b) seem very promising.¹⁹⁴ Like the SDRM, however, section 2(b) fails to provide

evidence dispositive, it impliedly follows that Meyer would not place the burden of proof on the defendant to establish that it imposed the regulation consistent with the Agreement. *Id.*

188. See *Libra*, 570 F. Supp. at 901 (holding that regulation of debt payments is not within Members’ sole discretion to regulate).

189. See *id.* (holding that Members may not regulate “current transactions” in the absence of express IMF approval).

190. See *id.* (holding that Costa Rica’s failure to secure IMF approval of the 2(b) Regulation rendered said Regulation inconsistent with the Agreement).

191. See *supra* notes 56-57 and accompanying text (detailing the consequences for failing to properly address a liquidity crisis).

192. See A United States Perspective, *supra* note 71 (failing to give the United States’ support for the IMF’s SDRM); see also Hubbard, *supra* note 77 (suggesting the SDRM would involve a slow, difficult process); Quotas and Voting Power, *supra* note 103 (demonstrating that the United States wields more than seventeen percent voting power).

193. See A United States Perspective, *supra* note 71 (recounting the United States’ policy towards sovereign debt restructuring and support for CACs).

194. See discussion *supra* Part II.B.1 (describing the potential use of article VIII, section 2(b) as the crux of an alternative international bankruptcy scheme).

an effective alternative, albeit for different reasons.¹⁹⁵ Nevertheless, section 2(b)'s obstacles may be overcome through simple textual amendments and additions to the Agreement as a whole.¹⁹⁶ The following suggested amendments offer an alternative approach that both addresses American reservations and functions similar to the SDRM and CACs.¹⁹⁷

A. STATUTORY AMENDMENTS PROVIDE THE SOLUTION

As a preliminary matter, the Members must amend the Agreement to vest in debtors the sole discretion to suspend temporarily their debt payments.¹⁹⁸ As discussed above, Members already have sole discretion to regulate "capital movements" but are required to obtain IMF approval for regulations of "current transactions."¹⁹⁹ Unfortunately, *Libra* demonstrates that loan payments are currently classified as "current transactions."²⁰⁰ In response to this negative precedent, the following language should be added to Article VIII, section 2(a):

Nothing in this Agreement shall be interpreted to divest any Member of the discretionary authority to impose temporary restrictions on debt

195. See discussion *supra* Part II.B.2 (recounting the interpretive limitations of article VIII, section 2(b) and demonstrating the crippling effect of these decisions).

196. See World Bank Overhaul, *supra* note 80 (calling for a decentralized approach to the sovereign debt problem).

197. See discussion *infra* Part III.A (suggesting ideal language to incorporate into amendments to the Agreement).

198. See Agreement, *supra* note 100, art. VI, § 3 (illustrating that Members have sole discretion to impose section 2(b) Regulations on "capital movements"). However, U.S. courts have too narrowly defined "capital movements" to include debt payment suspensions. See *Libra Bank Ltd. v. Banco Nacional De Costa Rica, S.A.*, 570 F. Supp. 870, 875 (S.D.N.Y. 1983) (holding that debt payment suspensions are appropriately classified as "current transactions," not "capital movements").

199. See Agreement, *supra* note 100, art. VI, § 3 (stating "[m]embers may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner . . . restrict[ing] payments for current transactions . . .").

200. See *Libra Bank Ltd.*, 570 F. Supp. at 901 (holding that loan payments are "current transactions"); Agreement, *supra* note 100, art. XXX (codifying that bond payments are properly classified as "current transactions").

payments,²⁰¹ as provided in Article VIII, section 2(b), if imposed in good faith and only for the purpose of external debt restructuring.²⁰²

This addition could allow a debtor to impose unilaterally a section 2(b) Regulation at the very moment it is no longer capable of servicing its debt.²⁰³ The section 2(b) Regulation would have an effect tantamount to a bankruptcy stay, thereby precluding the sovereign's creditors from enforcing a bond contract in any Member's court.²⁰⁴ The section 2(b) Regulation also will provide a period during which negotiations can take place,²⁰⁵ and because no prior IMF approval is

201. Without this clause, courts could preclude Members from temporarily suspending debt payments in anticipation of forthcoming restructuring negotiations. See *Libra Bank Ltd.*, 570 F. Supp. at 901 (holding that debt payment suspensions are appropriately classified as "current transactions").

202. This clause is included to prevent Members from abusing the authority to discontinue unilaterally its debt payments. See generally Agreement, *supra* note 100, art. VI, § 3 (illustrating that Members have within their sole discretion the ability to impose section 2(b) Regulations on "capital movements").

203. See Agreement, *supra* note 100, art. VI, § 3 (codifying that Members have sole discretion to regulate "capital movements," thereby making them enforceable in foreign courts). However, in its present form, Members could not use these section 2(b) Regulations on debt payments because they are not considered "capital movements." See *Libra Bank Ltd.*, 570 F. Supp. at 901 (holding that debt payments were "current transactions"). This proposed amendment dispenses with the "capital movement" versus "current transaction" distinction for restructuring purposes, thereby placing back in Members broad discretion to impose unilaterally a section 2(b) Regulation.

204. See Gianviti, *supra* note 47, at 1375-77 (demonstrating that Members can creatively employ Article VIII, section 2(b) to achieve an effect tantamount to a bankruptcy stay, whereby all creditor claims are blocked because foreign courts are forced to give effect to the debtor's moratorium on debt payments); cf. *Unenforceability of Exchange Contracts*, *supra* note 128, at 452-53 (demonstrating that a properly imposed section 2(b) Regulation has the force of law in all Members' courts).

205. See Hopes and Hazards, *supra* note 21 (emphasizing the importance of providing a stay on creditor claims during the negotiation process and how section 2(b) Regulations could be used to prevent capital flight). The IMF sought to achieve through the SDRM's stay a period during which a sovereign could negotiate without menacing private actions and without capital flight. *Id.*; see also Gianviti, *supra* note 47, at 1375-77 (illustrating how section 2(b) Regulations can be used to have the same effect as a bankruptcy stay).

needed, the unilateral Regulation will naturally expedite the initiation of a potentially protracted negotiation process.²⁰⁶

Yet, there is a countervailing concern that the IMF must also address. A safeguard must be in place to ensure that the sovereign can impose the section 2(b) Regulation only in good faith and only to the extent necessary for the purpose of reaching an agreement with its creditors.²⁰⁷ Therefore, although discretion should be placed in the debtor, it must be qualified.²⁰⁸ The best solution would allow the sovereign to impose unilaterally a preliminary section 2(b) Regulation and give the IMF ultimate authority to declare, based only on objective evidence, that the Regulation is an abuse of the Member's discretion.²⁰⁹ Members' courts should be under no obligation to give the Regulation extraterritorial effect if the IMF expresses its disapproval.²¹⁰ If, on the other hand, the IMF acquiesces, the

206. Cf. *Libra Bank Ltd.*, 570 F. Supp. at 901 (holding that a sovereign debtor would need IMF approval before it could impose a Regulation on debt payments). Because the proposed amendment will allow the debtor to impose the Regulation unilaterally without having to await formal approval, negotiations can commence sooner than would otherwise be the case. See discussion *supra* Part II.B.2.b (underscoring the economic and legal importance of swift response to a debt crisis).

207. See generally Agreement, *supra* note 100, art. VIII § 2(b) (illustrating how a legitimately implemented section 2(b) Regulation precludes enforcement in the courts of any member of a transaction whose terms require circumvention of the Regulation). Abuse is highly foreseeable given the broad discretion that this Comment's recommendation places in Members to impose unilaterally a section 2(b) Regulation; accordingly, it is something for which the system must account. Otherwise, Members could arbitrarily suspend debt payments and leave creditors with no way to seek redress.

208. See generally Gianviti, *supra* note 47, at 1375-77 (illustrating how Members would theoretically have the power to unilaterally stay all claims). Naturally, then, it would be best to place a check on that discretion to curtail the occurrence of gratuitous Regulations. *Id.*

209. See discussion *supra* Part II.B.2.b (arguing that the *Libra* Court made an unwarranted assumption that IMF approval can manifest itself only through an affirmative approval and alternatively positing that the absence of IMF objection should suffice); Gianviti, *supra* note 47, at 1375-77 (describing a potential application of section 2(b) that places sole discretion in Members to stay creditor claims); see also *supra* note 207-208 and accompanying text (describing the potential abuse when placing broad discretion in the Member); *supra* note 206 and accompanying text (noting the importance of responding quickly and decisively in the infant stages of a debt crisis).

210. See Agreement, *supra* note 100, art. VIII, § 2(a) (mandating the need for IMF approval for restrictions on current transactions).

Regulation's imposition would be considered consistent with the Agreement, and all Members' courts would then be obliged to dismiss without prejudice any individual claim for a period of, for example, six months.²¹¹ Additionally, IMF silence should sufficiently establish IMF acquiescence.²¹²

Bondholders should have the ability to vote for an extension of the section 2(b) Regulation if the parties cannot reach a mutually acceptable arrangement by the end of the six-month period.²¹³ If they choose not to extend its application, they are once again free to bring private, individual claims.²¹⁴ The creditors, although temporarily foregoing the right to enforce individually the terms of their contract with the sovereign, will be re-vested with that right if negotiations should reach an impasse.²¹⁵ This can all be accomplished by adding the following proposed language at the end of Article VIII, section 2(b):

In the event a Member contemplates such regulations for the purpose of restructuring external debt, it shall be sufficient that the IMF does not affirmatively disapprove of the regulation.²¹⁶ The IMF shall affirmatively

211. See *Unenforceability of Contracts*, *supra* note 128 (ruling that Members are prohibited from enforcing a contract whose performance contravenes the purpose of the 2(b) Regulation).

212. See *Weston Banking Corp. v. Turkiye Garanti Bankasi*, 442 N.E.2d 1195, 1203-04 (N.Y. 1982) (Meyer, J., dissenting) (arguing that the IMF's silence regarding Turkey's capital Regulations could easily be regarded as implied acquiescence or approval).

213. See *Hopes and Hazards*, *supra* note 21 (noting the ability of creditors to extend the length of the bankruptcy stay to be a central feature of the SDRM).

214. See *TENNEKON*, *supra* note 28, at 193 (explaining that the bond contract's terms serve as a source of rights upon which the creditor can sue the debtor for specific performance). However, a section 2(b) Regulation bars the enforcement of those rights. See discussion *supra* Part II.B.1 (explaining that a legitimately imposed section 2(b) Regulation has extraterritorial application, barring the enforcement of any legal instrument whose enforcement requires circumvention of the Regulation).

215. Cf. *TENNEKON*, *supra* note 28, at 193 (noting that the terms of the bond contract serve as a source of rights upon which a legal nexus is created between the creditor can sue the debtor for specific performance). Thus, an equitable system would certainly re-vest creditors with these rights. *Id.*

216. Compare *Libra Bank Ltd. v. Banco Nacional De Costa Rica, S.A.*, 570 F. Supp. 870, 875 (S.D.N.Y. 1983) (reasoning that Costa Rica imposed the relevant regulation inconsistent with the Agreement and without IMF approval) with *Weston*

express its disapproval only when it is objectively evident that the exchange regulation was not imposed solely for the good faith purpose of addressing a liquidity crisis.²¹⁷ In the absence of IMF disapproval, any regulation under this section shall have an extraterritorial effect for a period of six months, any extension of which is entirely within the discretion of the Member's creditors.²¹⁸

During the period of the Regulation's application, the debtor can begin restructuring negotiations with a group of creditor representatives, all of whom shall be elected according to terms specified in the particular bond contract.²¹⁹ Majority-action principles should guide the approval of the restructuring agreement so that if, for example, seventy-five percent of the holders vote in favor of the agreement, its terms will bind all those in dissent.²²⁰ In this respect, the proposed alternative mimics the effect of CACs.²²¹ This last objective would require an entirely new addition to the Agreement:

Banking, 442 N.E.2d at 1203-04 (Meyer, J., dissenting) (arguing that IMF silence regarding Turkey's capital Regulations could be interpreted as implied acquiescence or approval).

217. Functioning as yet another safeguard against potential abuse, this clause allows the IMF to affirmatively disapprove of the imposed regulation, but only when there is objective proof that something other than a need for restructuring motivated the Regulation's imposition. *Cf.* Agreement, *supra* note 100, art. VI, § 3 (illustrating that Members have within their sole discretion the ability to impose section 2(b) Regulations on "capital movements").

218. This clause ensures that the bondholders are not indefinitely denied their enforcement rights. *See* TENNEKON, *supra* note 28, at 193 (noting that the terms of the bond contract serve as a source of rights upon which the creditor can sue the debtor for specific performance).

219. This is an issue for the bond contract and, therefore, leaves the confines of this Comment.

220. *See* A United States Perspective, *supra* note 71 (recounting American support for the use of CACs and advocating the presence of a majority action clause). Use of a majority action clause attempts to secure American support by incorporating the essence of the American-favored collective-action clauses. *Id.* Also, it achieves the IMF-stated goal to form a bankruptcy mechanism that allows a majority of the creditors to conclude a legally binding agreement with the debtor. *See* Hopes and Hazards, *supra* note 21 (recounting the IMF proposal that the SDRM be premised on collective action principles).

221. *See* Hubbard, *supra* note 77 (explaining that the inclusion of CACs into bond contracts must allow "for aggregate collective action and representation against all instruments," as well as permit a supermajority of creditors to impose a restructuring agreement on all remaining creditors).

Consistent with Article VIII, section 2(b), if a Member imposes an exchange regulation to address a liquidity crisis, and during the application of that regulation the Member reaches an agreement with seventy-five percent of its creditors, said agreement shall thereafter bind all remaining creditors and shall enjoy extraterritorial enforcement in the courts of any Member.²²²

B. SDRM'S OBJECTIVES ARE FULFILLED BY THE PROPOSED AMENDMENTS

This proposed framework fulfills all the functions of an effective international bankruptcy system.²²³ First, the proposed framework provides the debtor with stay protection by imposing regulations on debt payments that Members' courts will not have the power to subvert.²²⁴ Second, it provides a period of reprieve during which a debtor and its creditors may reach a restructuring agreement.²²⁵ Third, the length of the stay is extendable.²²⁶ Fourth, the Member can implement the section 2(b) Regulation so as to guard against capital outflow, thus ensuring that skittish investors do not exacerbate the economic malaise.²²⁷ Fifth, and somewhat related, because there is no prior IMF approval required, the sovereign can impose the Regulation

222. This proposed provision embodies the initiative to garner the U.S. support by premising the proposal on majority action principals. *See generally id.* (expressing the U.S. support for CACs, which are based upon majority action, in the absence of a centralized forum).

223. *See generally* Hopes and Hazards, *supra* note 21 (detailing the major goals of the IMF's SDRM).

224. *See* Gianviti, *supra* note 47, at 1375 (explaining how the effect of a legitimately-imposed section 2(b) regulation is tantamount to a bankruptcy stay); *see also* discussion *supra* Part III.A (presenting possible amendments to the Agreement that would allow a debtor to successfully use section 2(b) Regulations as a stay mechanism).

225. *See* Hopes and Hazards, *supra* note 21 (explaining that the period during the stay's application provides a convenient opportunity for effective negotiation free from menacing creditor claims).

226. *See id.* (noting the SDRM's central feature as the ability of creditors to extend the length of the bankruptcy stay).

227. *See* GOLD, *supra* note 120, at 30 (noting that the purpose of section 2(b) Regulations was to place in the Member the ability to impose capital controls in response to exchange rate crises). This attribute is a mere byproduct of the original purpose of section 2(b) regulations. *Id.*

immediately, thereby protecting itself from speculative attacks on its currency by foreign investors.²²⁸ Sixth, the IMF will have the ability to block application if it determines the Regulation to be an abuse of the Member's discretion.²²⁹

Perhaps most importantly, such proposed changes to the Agreement are likely to win a favorable vote from the United States.²³⁰ Unlike the SDRM, the proposed alternative does not contemplate the formation of a centralized forum.²³¹ The United States has repeatedly expressed its contempt for establishing such an independent entity.²³² Furthermore, the process through which a restructuring agreement would be approved bears a striking resemblance to that of CACs,²³³ which, unlike the SDRM, have garnered American support.²³⁴ Lastly, this system does not require a permanent divestment of jurisdiction from Members' courts, because if the parties fail to reach an agreement, or if the IMF determines the Regulation to be an abuse of discretion, the creditors are once again free to bring private actions.²³⁵

228. See *supra* note 56 and accompanying text (describing the mechanics of investor speculation and its negative economic effects).

229. See Gianviti, *supra* note 47, at 1375-77 (noting that section 2(b) can be employed to give Members the unilateral capacity to stay all creditor claims). This attribute of the proposed framework is intended to curtail potential abuse of section 2(b) Regulations. *Id.*

230. See A United States Perspective, *supra* note 71 (expressing the United States' support for CACs' majority action principals of CACs).

231. See Hopes and Hazards, *supra* note 21 (emphasizing issues associated with the creation of an independent forum).

232. See Hubbard, *supra* note 77 (expressing American reluctance towards the creation of an independent bankruptcy forum).

233. See Buchheit, *supra* note 9, at 228 (positing that CACs would allow a supermajority of bondholders to agree to amendments on the payment terms of the bond, which would then become binding on other bondholders); see also *supra* note 221 and accompanying text (illustrating the symmetry between CACs and this Comment's proposed solution).

234. See A United States Perspective, *supra* note 71 (expressing the United States' support for the majority action principals of CACs).

235. Cf. TENNEKON, *supra* note 28, at 193 (noting that the terms of the bond contract serve as a source of rights upon which the creditor can sue the debtor).

CONCLUSION

The IMF has admirably endeavored to institutionalize the process of sovereign debt restructuring.²³⁶ Unfortunately, the United States has given every indication that its official support for the IMF plan is not forthcoming.²³⁷ Moreover, the United States enjoys the voting capacity to turn its official objection into an insurmountable obstacle.²³⁸ Under these circumstances, the SDRM will likely never become a physical reality.²³⁹ This does not mean, however, that the IMF's groundwork should be dismissed as naïve and idealistic.²⁴⁰ To the contrary, the international community must orchestrate a bold commitment to stabilize the restructuring process.²⁴¹ The consequences of procrastination have manifested themselves many times in the past and will most certainly continue to do so in the future.²⁴² In the modern interdependent economy, every state will have a vested stake in the outcome of future debt crises.²⁴³ Therefore, the search for an acceptable framework must continue.

The present form of section 2(b) is, upon first glance, an appealing alternative.²⁴⁴ Yet, U.S. courts have managed to cripple the

236. See Hopes and Hazards, *supra* note 21 (detailing and explaining the SDRM proposal in depth); see also Bretton Woods Committee, *supra* note 79 (outlining a proposed sovereign debt initiative).

237. See Hubbard, *supra* note 77 (expressing American reluctance towards the creation of an independent bankruptcy forum).

238. See Agreement, *supra* note 100, art. XXVIII (codifying that Amendments must receive the affirmative vote of eighty-five percent of the total voting power); see also Quotas and Voting Power, *supra* note 103 (demonstrating that the United States enjoys more than seventeen percent of IMF voting power).

239. See *supra* note 238 and accompanying text (asserting that the IMF cannot implement the SDRM without American support).

240. See generally Hopes and Hazards, *supra* note 21 (detailing the IMF plan).

241. See *supra* notes 56-57 and accompanying text (detailing the consequences of unregulated debt crises).

242. See *id.* (examining the ramifications of inaction during a debt crisis).

243. See *supra* note 57 (explaining the phenomenon of contagion, whereby the economic malaise of one country can easily spread to other countries).

244. See Gianviti, *supra* note 47, at 1375-77 (noting that Members have the ability to employ section 2(b) to give themselves the unilateral capacity to stay all creditor claims); see also discussion *supra* Part II.B.1 (explaining in depth the theoretical appeal of using Article VIII, section 2(b)).

provision's efficacy through narrow interpretations designed to retain as much jurisdiction as possible.²⁴⁵ These courts have failed to consider the long-term economic and legal consequences of their decisions.²⁴⁶ In response, the IMF Members must resolve themselves to amend their nearly sixty-year-old Agreement so that section 2(b) can function as the mainstay of an international bankruptcy scheme.²⁴⁷ Indeed, the IMF can breathe life into the now-impotent section 2(b) by embracing such an amendment process.²⁴⁸ By winning American support and by achieving the objectives of the SDRM, these changes constitute the best possible compromise.²⁴⁹

245. See, e.g., *Libra Bank Ltd. v. Banco Nacional De Costa Rica, S.A.*, 570 F. Supp. 870, 875 (S.D.N.Y. 1983) (restricting the use of section 2(b) Regulations).

246. See *supra* notes 56-57 (suggesting possible consequences of the courts' narrow interpretation of Article VIII, section 2(b)); see also discussion *supra* Part II.B.2.a-b (arguing that courts often fail to account for the international economic and international legal consequences of their decisions).

247. See discussion *supra* Part II.B.2 (arguing that section 2(b) cannot serve as an effective bankruptcy mechanism unless it undergoes significant change).

248. See discussion *supra* Part III (arguing that the amendment process can address section 2(b)'s present shortcomings).

249. See discussion *supra* Part III (arguing that this Comment's recommendation both accomplishes the IMF's goals and addresses American reservations).