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# Sovereign Debt Crises and Vulture Hedge Funds: Issues and Policy Solutions

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# SOVEREIGN DEBT CRISES AND VULTURE HEDGE FUNDS: ISSUES AND POLICY SOLUTIONS

**Abstract:** Since the 1990s, "vulture" hedge funds have made fabulous returns by pursuing a controversial strategy: buying bonds issued by countries in or near default and then suing those countries for full repayment. Vulture funds' investments have resulted in chaotic, drawn-out default episodes and an enormous redistribution of wealth from developing countries to billionaire investors. Despite the real benefits vultures provide to the secondary market for sovereign debt, something must be done to dull their talons. Lamentably, however, no viable solution currently exists. This Note argues that a nonprofit fund designed to compete with vultures could at least mitigate harm to developing nations during the next wave of defaults.

## INTRODUCTION

At current interest rates, savings account holders will enjoy a thirty percent return on their initial deposit after fifteen years.[1] More adventurous investors who wade into the stock market can expect a handsome return of more than one hundred percent over that same period.[2] And for those intrepid souls who choose to litigate bond claims against poor, overly indebted sovereign nations, the rewards can be much, much richer.[3]

Take the hedge fund Elliott Capital (Elliott), which began buying Argentinian bonds in 2001.[4] Argentina's financial distress enabled Elliott to scoop these bonds up for pennies on the dollar.[5] Elliott then pursued full repayment

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[1] *9 Best Savings Accounts of April 2020*, NERDWALLET, https://www.nerdwallet.com/banking/best-savings-accounts [https://perma.cc/LX33-S92H]. The calculation above is based on a 1.7% interest rate compounding over fifteen years. *Id.*; *see Compound Interest Calculator*, MONEYCHIMP, http://www.moneychimp.com/calculator/compound_interest_calculator.htm [https://perma.cc/8MQV-A6G4] (calculating total return assuming one initial contribution and no withdrawals).

[2] *See* Roger Wohlner, *Average Stock Market Return*, WEALTHSIMPLE (Nov. 20, 2019), https://www.wealthsimple.com/en-us/learn/average-stock-market-return [https://perma.cc/Z5C2-9H9H] (calculating that the average annual return of the Dow Jones Industrial Index from 1897 to 2018 was 5.42%). A one-thousand-dollar investment returning 5.42% annually will grow to $2,208 in fifteen years. *Compound Interest Calculator*, *supra* note 1.

[3] Renae Merle, *How One Hedge Fund Made $2 Billion from Argentina's Economic Collapse*, WASH. POST (Mar. 29, 2016), https://www.washingtonpost.com/news/business/wp/2016/03/29/how-one-hedge-fund-made-2-billion-from-argentinas-economic-collapse/?noredirect=on&utm_term=.2374ebc896ec [https://perma.cc/ML8P-UJ7G].

[4] *Id.*

[5] *Id.* Elliott's final position, for which it paid $117 million, had a face value of over five times that amount. *Id.*

of the debt relentlessly, to the point where the fund convinced a court in Ghana to seize an Argentinian warship used to train naval cadets.[6] When Argentina finally agreed to settle for $2.4 billion in 2016, a year in which over twenty percent of Argentines lived in poverty, Elliott pocketed returns of over two-thousand percent.[7]

As one might expect, "vultures" like Elliott Capital do not enjoy popular support, despite providing a check on excessive sovereign borrowing as well as much-needed liquidity and information to the secondary market.[8] On the other hand, vultures' activity can hinder efficient sovereign restructuring, leading to prolonged periods of economic misery.[9] Still, since vultures began to circle in the 1990s, the international community has failed to find a way to capture their benefits while reining in their excesses.[10]

Sovereign debt levels have risen sharply in the decade following the Great Recession.[11] Debt issued by default-prone "frontier markets," or those that investors deem even riskier than emerging markets, recently surpassed its pre-financial crisis high.[12] Meanwhile, the coronavirus pandemic has tipped

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[6] Agustino Fontevecchia, *The Real Story of How a Hedge Fund Detained a Vessel in Ghana and Even Went for Argentina's Air Force One*, FORBES (Oct. 5, 2012), https://www.forbes.com/sites/afontevecchia/2012/10/05/the-real-story-behind-the-argentine-vessel-in-ghana-and-how-hedge-funds-tried-to-seize-the-presidential-plane/#422e59fc25aa [https://perma.cc/5JSL-FNEF].

[7] Luca Di Fabio, *Economic Development in Argentina and Its Effect on Poverty*, BORGEN PROJECT (May 17, 2018), https://borgenproject.org/economic-development-in-argentina-and-its-effect-on-poverty [https://perma.cc/KL3E-6SJM]; Merle, *supra* note 3. By contrast, buy-and-hold stock market investors would need to wait about 173 years to approach Elliott's gains. *See Compound Interest Calculator*, *supra* note 1. Elliot's aggression led Argentinian President Cristina Fernandez de Kirchner to label it and similar hedge funds "vultures" at a speech delivered to the United Nations (U.N.) General Assembly. Hugh Bronstein, *Argentina Calls Holdout Funds 'Terrorists,' Says Germany 'Hostile,'* REUTERS (Sept. 24, 2014), https://www.reuters.com/article/us-argentina-debt/argentina-calls-holdout-funds-terrorists-says-germany-hostile-idUSKCN0HJ1TM20140924 [https://perma.cc/GLQ6-QUGU].

[8] *See, e.g.*, David Dayen, *How Hedge Funds Are Pillaging Puerto Rico*, AM. PROSPECT (Dec. 11, 2015), https://prospect.org/article/how-hedge-funds-are-pillaging-puerto-rico [https://perma.cc/RV99-GCET] (noting that the Obama administration characterized Puerto Rico's battle with creditors as a "humanitarian crisis").

[9] *See* Merle, *supra* note 3 (describing Argentina's nearly two-decade long battle with vulture creditors).

[10] *See* A. Mechele Dickerson, *A Politically Viable Approach to Sovereign Debt Restructuring*, 53 EMORY L.J. 997, 998 (2004) (noting that despite several attempts in the twentieth century, the international community has failed to establish a sovereign bankruptcy program).

[11] *See* Marc Jones, *Government Debt Levels to Hit New Global High This Year—S&P*, REUTERS (Feb. 22, 2018), https://www.reuters.com/article/governments-debt-sp/government-debt-levels-to-hit-new-global-high-this-year-sp-idUSL8N1QC70R [https://perma.cc/7T7K-NBGD] (reporting that sovereign international debt had reached a record high for the third consecutive year).

[12] Steve Johnson, *Frontier Market at 15-Year High*, FIN. TIMES (Mar. 8, 2019), https://www.ft.com/content/106ff44a-402a-11e9-9bee-efab61506f44 [https://perma.cc/E4VQ-5EN7]. Debt owed by frontier markets, such as Pakistan, Nigeria, and Argentina, has increased by nearly thirty times since 2009. *Id.*

the global economy into recession.[13] Developing nations are in a precarious position, and cash-rich vultures will begin to circle overhead.[14] The need for an effective policy solution is urgent.[15]

Regrettably, however, the international community has failed to produce one.[16] Innovations in bond-drafting practices will not take effect for decades, and markets have been disappointingly slow to adopt them.[17] Calls for an international bankruptcy regime have failed to gain traction.[18] And anti-vulture fund legislation, which just a handful of nations have adopted, has the unfortunate effect of neutralizing the benefits that vultures provide.[19]

To avoid economic and humanitarian catastrophe in the wake of an imminent wave of sovereign default, developed nations must confront vultures head on.[20] The World Bank and International Monetary Fund (IMF) are already major direct creditors to the developing world.[21] The time has come for these in-

[13] Chris Isidore, *Coronavirus Has Plunged the World into a Recession, According to S&P*, CNN (Mar. 17, 2020), https://www.cnn.com/2020/03/17/economy/global-recession/index.html [https://perma.cc/B2CA-7R6K]. In addition to a mere "garden-variety recession," markets are grappling with the possibility of "several quarters of declining economic activity, a credit crisis or even a depression." Lewis Krauskopf, *'D' Word Rears Head as Coronavirus-Hit Markets Brace for Recession*, REUTERS (Mar. 17, 2020), https://www.reuters.com/article/uk-health-coronavirus-stocks-economy-usa/d-word-rears-head-as-coronavirus-hit-markets-brace-for-recession-idUSKBN2140IA [https://perma.cc/ZP97-ABEN].

[14] Klaus Willie et al., *Distressed-Debt Funds Take Breather Waiting for Next Crisis*, BLOOMBERG (Oct. 1, 2018), https://www.bloomberg.com/news/articles/2018-09-30/distressed-debt-funds-take-a-breather-waiting-for-next-crisis [https://perma.cc/AW4R-UKVM]. According to one hedge fund manager, "next year is going to be good for distressed debt in emerging markets and Europe." *Id.* That next crisis has arrived: "the recent implosion in global financial markets . . . sparked by the coronavirus outbreak" has brought emerging market debt "closer to 'vulture' territory." Agustino Fontevecchia, *Argentine Bonds Slide Toward 'Vulture' Territory*, FORBES (Mar. 17, 2020), https://www.forbes.com/sites/afontevecchia/2020/03/17/argentine-bonds-slide-toward-vulture-territory/#16d276df114a [https://perma.cc/25YY-NFKB].

[15] *See* Jones, *supra* note 11 (reporting that global sovereign debt levels reached an all-time high in 2018).

[16] *See* Dickerson, *supra* note 10, at 998 (bemoaning the lack of an international bankruptcy system after several failed attempts to establish one).

[17] *See* Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299, 319–21 (2005) (discussing the market's reluctance to deviate from boilerplate language in sovereign bonds).

[18] Dickerson, *supra* note 10, at 998.

[19] *Id.*; *see* Lucas Wozny, Note, *National Anti-Vulture Funds Legislation: Belgium's Turn*, 2017 COLUM. BUS. L. REV. 697, 712–14 (describing the negative impact of anti-vulture legislation on the secondary market for distressed sovereign debt).

[20] *See* Dayen, *supra* note 8 (detailing the dire economic and humanitarian situation in Puerto Rico in throes of its debt crisis).

[21] *See IMF Conditionality*, INT'L MONETARY FUND (Mar. 30, 2020), https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/28/IMF-Conditionality [https://perma.cc/9HYS-PM74] (describing the International Monetary Fund's (IMF) lending to credit-strapped nations); *What Is IDA?*, INT'L DEV. ASS'N, http://ida.worldbank.org/about/what-is-ida [https://perma.cc/F7UK-QV2H] (noting that IDA is "one of the largest sources of assistance for the world's poorest 76 countries" that "provides grants to countries at risk of debt distress").

stitutions to enter the secondary market and begin buying distressed sovereign debt.[22]

Part I of this Note provides an overview of sovereign debt crises, describing their history, causes, and consequences.[23] Part I then examines the vulture hedge funds and their role in sovereign debt restructuring.[24] Part II discusses various policies designed to mitigate the damage done by vultures in sovereign default scenarios.[25] Part III argues that none of those proposals is adequate to both address the problems caused by holdout litigation and preserve the benefits that vulture funds provide.[26] Part III then recommends a novel, market-based approach under which institutional lenders form funds to compete with vultures.[27]

## I. SOVEREIGN DEBT AND VULTURE FUNDS

Section A of this Part reviews the mechanics of sovereign default, including its causes and consequences.[28] It then provides a brief historical overview of sovereign default, culminating in the sovereign default landscape of today.[29] Section B covers vulture funds that invest in the distressed debt securities of struggling companies and nation-states.[30] The discussion includes the history and development of vulture funds, their methods, and the impact of their activities in the sovereign debt market.[31]

### *A. Sovereign Debt Crises*

Sovereign nations finance their activities by issuing fixed-income debt securities that pay regular interest payments and return the investor's initial investment upon maturity.[32] Episodes of sovereign default—when debtor na-

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[22] *See infra* notes 285–316 and accompanying text.
[23] *See infra* notes 32–113 and accompanying text.
[24] *See infra* notes 114–171 and accompanying text.
[25] *See infra* notes 172–284 and accompanying text.
[26] *See infra* notes 285–297 and accompanying text.
[27] *See infra* notes 298–316 and accompanying text.
[28] *See infra* notes 32–72 and accompanying text.
[29] *See infra* notes 73–113 and accompanying text.
[30] *See infra* notes 114–171 and accompanying text.
[31] *See infra* notes 114–171 and accompanying text.
[32] Lee C. Buchheit & G. Mitu Gulati, *Responsible Sovereign Lending and Borrowing*, 73 LAW & CONTEMP. PROBS. 63, 65 (2010); Stephen Kim Park & Tim R Samples, *Towards Sovereign Equity*, 21 STAN. J.L. BUS. & FIN. 240, 242 (2016). Government budget deficits and debt loads have ballooned in the twenty-first century. Rich Miller, *U.S. Budget Deficit*, BLOOMBERG (Dec. 19, 2018), https://www.bloomberg.com/quicktake/deficit-disconnect [https://perma.cc/FW4R-73VX]. In the United States, for example, both reached record highs in 2018—the deficit hit nearly eight hundred billion dollars and the national debt reached nearly twenty-two trillion dollars. Lydia DePillis, *US National Debt Rises $2 Trillion Under Trump*, CNN (Jan. 4, 2019), https://www.cnn.com/2019/01/03/politics/trump-us-national-debt/index.html [https://perma.cc/MX94-6MHH]; Miller, *supra*. The U.S. government's response to the coronavirus outbreak will only add to these numbers. Jon Hilsenrath,

tions fail to make payments according to the terms of debt contracts—have occurred regularly throughout history.[33] The following Section covers the circumstances surrounding sovereign default, the history of such defaults, and issues presented by the current sovereign restructuring framework.[34]

### 1. Causes and Effects

Researchers have identified a number of interrelated economic and political risk factors that may contribute to sovereign default.[35] Perhaps the simplest explanation for why sovereign governments default is economic malaise.[36] Sixty-two percent of sovereign defaults since the year 1800 have coincided with a sharp decline in economic output, and in severe downturns, the probability of sovereign defaults doubles.[37] The story is not so simple, however, as struggling countries have often avoided default whereas flourishing ones have not.[38]

Other factors may include the cost of borrowing, swings in trade balances, currency devaluation, banking crises, and political tumult.[39] Since the latter half of the twentieth century, U.S. monetary policy has largely determined the borrowing costs of developing nations.[40] As U.S. interest rates rise, so too do

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*Coronavirus Pandemic to Test Limits of How Much Debt U.S. Can Bear*, WALL ST. J. (Mar. 18, 2020), https://www.wsj.com/articles/u-s-deficit-set-to-soar-as-government-responds-to-coronavirus-11584568685 [https://perma.cc/H2HR-V5PP] (projecting record-high deficit levels following the outbreak).

[33] *See* Ricardo Correa & Horacio Sapriza, *Sovereign Debt Crises* 3, 5 (Bd. of Governors of the Fed. Reserve Sys., International Finance Discussion Paper No. 1104, 2014), https://www.federalreserve.gov/pubs/ifdp/2014/1104/ifdp1104.pdf [https://perma.cc/XPS4-2ETC] (describing the mechanics of sovereign default episodes and noting that they have been "recurrent events" throughout history). Sovereigns need not repudiate debt entirely to default. *Id.* at 5. Also, credit rating agencies consider any debt renegotiation that eases a sovereign's debt burden to be a technical default episode. *Id.*

[34] *See infra* notes 35–171 and accompanying text.

[35] *See* Correa & Sapriza, *supra* note 33, at 6–7 (discussing the myriad causes of sovereign default).

[36] Michael Tomz & Mark Wright, *Do Countries Default in "Bad Times"?*, 5 J. EUR. ECON. ASS'N 352, 352–54 (2007).

[37] *Id.* at 355–56. "Severe" downturns are those where economic activity contracts by more than seven percent below long-term trend growth. *Id.* at 355.

[38] *Id.* at 353. Contrary to what an armchair economist might expect, an empirical study conducted by Michael Tomz and Mark Wright detected a "surprisingly weak" relationship between reduced output and default. *Id.* The picture is probably more complex; a complete account of default likely requires greater detail on the performance of individual sectors of the sovereign's economy, the sovereign's economic performance relative to that of other nations, and the interplay between economic and political factors. *Id.* at 358–59.

[39] Correa & Sapriza, *supra* note 33, at 6–7. These factors may operate independently or in tandem to create a negative "feedback loop." *Id.* at 4.

[40] Vivek B. Arora & Martin Cerisola, *How Does U.S. Monetary Policy Influence Sovereign Spreads in Emerging Markets?*, 48 IMF STAFF PAPERS 474, 490, 493 (2001).

spreads between developing nations' sovereign debt and U.S. treasuries.[41] The increased borrowing cost thus elevates default risk for sovereigns with vulnerable economies.[42]

Emerging economies are also particularly sensitive to "terms of trade" shocks, which are changes in the ratio of their export prices to import prices.[43] Trade shocks are especially devastating for economies whose health is overly dependent on the exportation of a small number of commodities.[44]

Swings in the value of local currency also present risk of default.[45] The risk is particularly acute where the sovereign must make debt service payments in another currency such as U.S. dollars.[46] Devaluation of the local currency can make such payments more burdensome.[47]

Banking crises can also precipitate sovereign defaults, typically through one of two avenues: government involvement in the financial sector and the economic ramifications of weakened banks.[48] Default risk increases where governments act as a backstop to struggling banks by guaranteeing their debts or bailing them out of insolvency.[49] Banking crises can also result in currency

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[41] *Id.* at 475.

[42] *Id.*; Justin Lahart, *The Fed Won't Save Emerging Markets*, WALL ST. J. (Sept. 13, 2018), https://www.wsj.com/articles/the-fed-wont-save-emerging-markets-1536859244 [https://perma.cc/R3BM-FCUQ]. In the future, the Federal Reserve's fiscal tightening and interest rate normalization campaigns may ultimately result in default for several struggling emerging economies. *See* Lahart, *supra* (discussing the Fed's 2018 plan to raise interest rates and its probable effects on emerging markets).

[43] Christian Broda, *Terms of Trade and Exchange Rate Regimes in Developing Countries*, 63 J. INT'L ECON. 31, 32 (2002); Enrique Mendoza, *The Terms of Trade, the Real Exchange Rate, and Economic Fluctuations*, 36 INT'L ECON. REV. 101, 134 (1995).

[44] Gabriel Cuadra & Horacio Sapriza, *Sovereign Default, Terms of Trade and Interest Rates in Emerging Markets* 1 (Banco de México, Working Paper No. 2006-01, 2006), https://www.banxico.org.mx/publications-and-press/banco-de-mexico-working-papers/%7B2426947A-D772-E109-C1D1-722EB39B6BAC%7D.pdf [https://perma.cc/G7FD-QZLK]. For example, oil constitutes ninety six percent of Venezuela's total exports. *Venezuela Exports*, TRADING ECON., https://tradingeconomics.com/venezuela/exports [https://perma.cc/HQ26-763S]. Not coincidentally, Venezuela has the dubious honor of most defaults—ten—since 1800. *Usual Suspects*, THE ECONOMIST (July 31, 2014), https://www.economist.com/graphic-detail/2014/07/31/usual-suspects [https://perma.cc/KP9F-X5J5]. Ecuador is currently tied for the lead. *Id.*

[45] Correa & Sapriza, *supra* note 33, at 7.

[46] *Id.*

[47] *Id.*

[48] Carmen M. Reinhart & Kenneth S. Rogoff, *From Financial Crash to Debt Crisis*, 101 AM. ECON. REV. 1676, 1701 (2011); Correa & Sapriza, *supra* note 33, at 8. In some cases, sovereign debt issues can precede bank crises; in practice, it is difficult to determine the direction of causation. Reinhart & Rogoff, *supra*, at 1698.

[49] Correa & Sapriza, *supra* note 33, at 9–10. Because they create uncertainty and drive sovereigns deeper into debt, bailouts increase sovereign borrowing costs, and rising bond yields reduce the prices of outstanding sovereign debt, of which domestic banks tend to hold a large portion. *See id.* (noting that a "bailout of the banking sector lowers government debt prices, and further deterioration of the balance sheets of those banks holding public debt" can lead a country to default); *see also* Eduardo Borensztein & Ugo Panizza, *The Costs of Sovereign Default* 4, 17 (Int'l Monetary Fund, Working

panics or induce economic downturns.[50] A floundering financial sector can staunch the flow of credit through an economy, creating a domino effect of higher borrowing costs, reduced economic activity, lower tax receipts, and increased public sector spending.[51]

Finally, political events may also play a role.[52] Shifts in leadership can result in policy changes, reduced confidence, and elevated borrowing costs, thereby increasing default risk.[53]

The consequences of sovereign defaults can be severe, although empirical evidence suggests that they do not last long.[54] First, defaults are accompanied by a decrease in Gross Domestic Product (GDP) of between 0.5% and 2%, with an average of 1.2% per year spent in default.[55] Default may also negatively affect a debtor sovereign's standing in the community of nations.[56] Reputational costs can impair a debtor nation's ability to access capital markets, or at the very least raise that nation's cost of borrowing temporarily.[57]

In addition, default can result in exclusion from international trade.[58] Such exclusion may take the form of official trade sanctions like embargoes or may occur as a result of increased credit costs for firms in the debtor nation.[59] Additionally, because sovereign debt is often held by residents of the issuing nation, default can impose costs to the domestic economy through the financial system.[60] In particular, local banks that hold sovereign debt experience heavy

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Paper No. 08/238, 2008), https://www.imf.org/external/pubs/ft/wp/2008/wp08238.pdf [https://perma.cc/ZV8B-MP6Q] (noting that "domestic residents tend to account for a sizeable portion of the holdings, perhaps a majority" of sovereign debt). Bailouts may therefore have the unintended effect of further weakening wobbly banks' balance sheets and prolonging crises. Borensztein & Panizza, *supra*, at 18.

[50] Correa & Sapriza, *supra* note 33, at 8.

[51] *Id.* at 8–10.

[52] *Id.*; *see also* Juan Carlos Hatchondo et al., *Heterogeneous Borrowers in Quantitative Models of Sovereign Default* 2–4 (Fed. Reserve Bank of Richmond, Working Paper No. 07–01R, 2007), https://www.richmondfed.org/-/media/richmondfedorg/publications/research/working_papers/2007/pdf/wp07-1r.pdf [https://perma.cc/9WCN-W6WY] (using a predictive model to determine the impact of political change on sovereign default risk).

[53] *See* Hatchondo et al., *supra* note 52, at 2 (analyzing the effects of regime change on sovereign bond prices in Brazil and Ecuador).

[54] Borensztein & Panizza, *supra* note 49, at 22. Empirical studies have not shown detrimental economic effects more than two years post-default. *Id.* at 23. Indeed, even serial defaulters seem to enjoy relatively unfettered access to international capital. Carmen M. Reinhart et al., *Debt Intolerance*, BROOKINGS PAPERS ON ECON. ACTIVITY, no. 1, 2003, at 4. Creditor- or debtor-imposed limits on borrowing by default-prone sovereigns may help to break the painful cycle of default. *Id.* at 5.

[55] Borensztein & Panizza, *supra* note 49, at 8.

[56] *Id.* at 14.

[57] *Id.* "Reputation of sovereign borrowers that fall in default, as measured by credit ratings and spreads, is tainted but only for a short time." *Id.* at 22.

[58] *See id.* at 14–16 (discussing research that shows "a decline in bilateral trade" following default).

[59] *Id.* at 15.

[60] *Id.* at 17–19.

losses as a result of default, which may impact their willingness or ability to lend.[61] The downstream effects of restricted lending can be severe.[62]

Finally, default often comes at a cost to political leaders, including risk of unpopularity or even ouster.[63] The historical record suggests that chief executives of defaulting democratic governments face a fifty percent chance of removal from office following default.[64] Defaulting dictatorships, on the other hand, tend to cast the blame on economic ministers, who face an even greater probability of removal.[65] These risks can incentivize leaders to borrow responsibly and minimize default risk.[66] On the other hand, political risks may drive leaders of overly indebted nations to temporize, which can exacerbate the economic effects of an eventual default.[67] For example, an extended period of potential default can create uncertainty, erode confidence, and lead to higher interest rates.[68] Notwithstanding the strong incentives for nations to avoid these costs, however, defaults have been a recurring theme throughout history.[69]

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[61] *See id.* at 18 (noting that the causal nexus between banking crises and sovereign defaults is difficult to untangle).

[62] *See id.* (observing that "when domestic banks hold large amounts of government debt, the domestic financial sector may be put under significant stress by the default").

[63] *Id.* at 20.

[64] *Id.* at 21. When democracies meet their debt obligations, chief executives' chances of removal are less than twenty-five percent. *Id.* at 22. Default can lead to revolution as well, particularly when resulting from a severe economic downturn. Antonis Adam & Konstas Karanatsis, *Sovereign Defaults and Political Regime Transitions* 20–21 (Univ. of Ioannina, MPRA Paper No. 69062, 2016), https://mpra.ub.uni-muenchen.de/69062/1/MPRA_paper_69062.pdf [https://perma.cc/S6VQ-8BQJ]. For example, a sharp contraction in Ecuador's economy in 1998 and subsequent default in 1999 led to a successful coup in 2000. *Id.*

[65] Borensztein & Panizza, *supra* note 49, at 22, 40. These figures suggest that dictatorships may need additional disincentives to default. *See id.* at 22 (finding that dictators typically hold economic ministers accountable for default). Economic officials are not safe in democracies, either, as default on bonds by any type of government doubles the risk of removal. *Id.* In normal periods, that risk is around twenty percent. *Id.*

[66] *Id.* at 20.

[67] *Id.* Failed default-avoidance tactics pose potentially grievous economic risks. *Id.* Ineffectual "belt-tightening" austerity measures can induce or compound economic recession. *Id.*; *see* Dickerson, *supra* note 10, at 1006 (noting that "sovereigns . . . often wait too long to initiate a debt restructuring, thus increasing . . . the costs associated with the delayed attempt to renegotiate the debt"). The government of Lebanon, which defaulted in March 2020, opted for swift default following an economic crisis and has thus far rejected IMF assistance contingent on "austerity measures like tax hikes and cuts in subsidies." Timour Azhari, *Lebanon Will Default on Its Debt for the First Time Ever*, ALJAZEERA (Mar. 7, 2020), https://www.aljazeera.com/ajimpact/lebanon-default-debt-time-200307182500108.html [https://perma.cc/C4BZ-48T7]. A Lebanese economic analyst called the government's decision the "least worst option available." *Id.*

[68] Borensztein & Panizza, *supra* note 49, at 20.

[69] *See* FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 6–9 (2007) (providing detailed historical data on sovereign defaults); *see also* Dickerson, *supra* note 10, at 1006–07 (noting that sovereigns' fears of economic repercussions, elevated borrowing costs, and uncertainty regarding the success of a restructuring contribute to an overall reluctance to default).

One reason for the phenomenon's stubborn persistence is that default begets future default.[70] Nations with certain institutional shortcomings appear to be more susceptible to default over time, and default itself may have the effect of deepening those deficiencies.[71] Such "serial defaulters" thus present a perpetual default risk despite significantly lower GDP-to-debt ratios than more developed countries.[72]

2. History

The earliest default on record occurred in Greece in the fourth century.[73] Defaults continued through the centuries, but became more common in the nineteenth and twentieth centuries as nation-states and international capital markets matured.[74] Since the start of the eighteenth century, there have been roughly two-hundred and fifty sovereign defaults; of these, Latin American governments are responsible for a large majority.[75]

Sovereign debt in the twentieth century came primarily in the form of syndicate bank loans, which groups of large international banks lent to debtor nations.[76] Defaulting nations coordinated debt restructurings through deals with both the "London Club," an informal group of commercial lending institutions, and the "Paris Club," a group of industrialized creditor nations and

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[70] Reinhart et al., *supra* note 54, at 1–2.

[71] *Id.* Specifically, default-prone countries have underdeveloped financial systems. *Id.* at 1. Default can impede further development, increasing the risk of future default. *Id.* Thus, past default is a reasonably reliable indicator of future default. *Id.* at 3.

[72] *Id.* at 1. For "debt intolerant" nations, default risk rears its head when their indebtedness stretches beyond fifteen to twenty percent of Gross National Product (GNP). *Id.* Conversely, developed nations appear capable of carrying debt loads over twice the size of their economic output without an appreciable increase in default risk. *See* Robin Harding, *The Fears About Japan's Debt Are Overblown*, FIN. TIMES (Sept. 5, 2017), https://www.ft.com/content/e26d36e6-918b-11e7-a9e6-11d2f0ebb7f0 [https://perma.cc/4S8N-JS2J] (discussing Japan's ability to carry a debt load well over two hundred percent of its GDP).

[73] STURZENEGGER & ZETTELMEYER, *supra* note 69, at 3. Greece has defaulted an additional five times in the modern era, most recently in 1932. Investopedia, *Debt Defaults Have Greek History*, FORBES (Sept. 28, 2011), https://www.forbes.com/sites/investor/2011/09/28/debt-defaults-have-greek-history/#98bc00f4f2f7 [https://perma.cc/2V2E-84AF].

[74] STURZENEGGER & ZETTELMEYER, *supra* note 69, at 3–9. Pre-nineteenth century governments typically dealt with unsustainable debt burdens through currency debasement instead of formal debt restructuring. *Id.* at 3.

[75] *Usual Suspects*, *supra* note 44. Of the top ten repeat offenders, nine are Latin American countries. *Id.* Ecuador and Venezuela lead the pack with ten each, and Uruguay, Costa Rica, Brazil, and Chile all have defaulted nine times. *Id.* Argentina, Peru, and Mexico have each defaulted eight times. *Id.*

[76] Park & Samples, *supra* note 32, at 250.

lenders such as the World Bank and IMF.[77] The latter has reached 433 restructuring agreements since its inception in 1956.[78]

In the late 1980s, however, the sovereign debt landscape changed fundamentally.[79] A tidal wave of defaults dramatically increased borrowing costs for Latin American countries, causing a spiral of rising debt service costs, economic contraction, and political unrest.[80] In response to the crisis, U.S. Treasury Secretary Nicholas Brady introduced a novel solution—conversion of privately issued sovereign loans into so-called "Brady Bonds" that could be traded on the secondary market.[81] Since then, bond issuance has become emerging nations' favored means of raising capital.[82]

Today, government debt has risen to historic heights.[83] Since the financial crisis of 2008, governments have drastically increased the ratio of their outstanding debt to GDP in an effort to spur economic growth through spending programs.[84] Prior to the coronavirus outbreak, outstanding government debt had reached seventy-two trillion dollars.[85]

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[77] Alon Seveg, *When Countries Go Bust: Proposals for Debtor and Creditor Resolution*, 3 ASPER REV. INT'L BUS. & TRADE L. 25, 40, 42 (2003). Whereas the Paris Club is a formal entity akin to the IMF or World Bank, the London Club simply refers to a rotating cast of syndicated lenders. *Id.*

[78] *Key Numbers*, CLUB DE PARIS, http://www.clubdeparis.org/en/communications/page/key-numbers [https://perma.cc/JHG2-W8UQ].

[79] Seveg, *supra* note 77, at 41–42.

[80] Ross. P. Buckley, *The Facilitation of the Brady Plan*, FORDHAM INT'L L.J. 1802, 1803 (1998); Borensztein & Panizza, *supra* note 49, at 7.

[81] Buckley, *supra* note 80, at 1804. "One could say the development of the secondary market turned the debt crisis from an unmitigated, into a mitigated, disaster." *Id.* at 1889. In the 1980s, poor debtor nations borrowed from concentrated groups of commercial lenders. *Id.* at 1803–04. Although this lending paradigm lacked the collective action problems of the Brady Bond system, it tended to strangle poor countries' access to capital. *Id.* At creditors' behest, struggling countries enacted austerity programs to meet debt service payments or qualify for bridge funding; these programs stifled growth, making repayment even less likely. *Id.* Ultimately, some creditors simply stopped lending. *Id.*

[82] *Id.* at 1888; Cuadra & Sapriza, *supra* note 44, at 3. From 1989 to 1999, outstanding Latin American sovereign bond indebtedness grew from one billion dollars to over two hundred billion dollars. Cuadra & Sapriza, *supra* note 44, at 3.

[83] Spriha Srivastava, *Global Debt Surged to a Record $250 Trillion in the First Half of 2019, Led by the US and China*, CNBC (Nov. 15, 2019), https://www.cnbc.com/2019/11/15/global-debt-surged-to-a-record-250-trillion-in-the-first-half-of-2019-led-by-the-us-and-china.html [https://perma.cc/JQC4-246G]. In the wake of coronavirus-induced financial panic, "more cases of sovereign and corporate debt distress" await "a world economy awash in debt." Hung Tran, *Coronavirus and Debt: A Toxic Mix*, FIN. TIMES (Mar. 10, 2020), https://www.ft.com/content/0cc94fb6-8b35-427d-9f98-dc727303ebbf [https://perma.cc/LRY7-ZHEP].

[84] Mike Bird, *Few Warning Signs on Sovereign Debt*, WALL ST. J. (Dec. 30, 2018), https://www.wsj.com/articles/few-warning-signs-on-sovereign-debt-11546007401 [https://perma.cc/YT9L-MJNP].

[85] Tran, *supra* note 83. This astronomical figure will only increase as governments and central banks scramble to stave off recession. *See* Jason Lemon, *National Debt Could Surpass $25 Trillion with Coronavirus Spending*, NEWSWEEK (Mar. 23, 2020), https://www.newsweek.com/national-debt-could-surpass-25-trillion-amid-spending-combat-coronavirus-1493758 [https://perma.cc/FV4W-UL4K] (covering the dramatic expansion in U.S. government spending since the outbreak).

Emerging markets have increased their indebtedness relative to GDP by over forty percent over the past decade.[86] Although economists generally believe that large, industrialized economies can sustain large debt-to-GDP ratios without heightening their default risk, less developed countries remain in a precarious position.[87] Further, surges in public debt are historically correlated with a higher incidence of default.[88] And as recent history has indicated, sovereign default risk can rattle financial markets to their core, potentially posing systemic risks to the global financial system.[89]

### 3. Sovereign Debt Restructuring in the Brady Bond Era

Despite mounting indebtedness and the potentially severe costs of default, there is currently no clean sovereign restructuring mechanism.[90] Moreover, the rise of Brady Bonds has led to a wide dispersion of creditors.[91] Under the pre-1980s regime, creditors were few in number and generally aligned in their interests.[92] Today, however, sovereign bondholders are scattered across the globe; for example, Argentina's 2001 default implicated nearly half a million creditors.[93] Diverse creditors may have misaligned incentives following a de-

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[86] Ira Iosebashvili, *Rising Emerging-Market Debt Sparks Anxiety*, WALL ST. J. (Dec. 31, 2018), https://www.wsj.com/articles/rising-emerging-market-debt-sparks-anxiety-11546261200 [https://perma.cc/72J4-PM35]; Jonathan Wheatley, *Emerging Markets Under Pressure as Debt Mounts*, FIN. TIMES (Mar. 6, 2018), https://www.ft.com/content/c6df7af2-1c9f-11e8-956a-43db76e69936 [https://perma.cc/SMA4-JS3K].

[87] Paul Wallace, *$100 Billion of Debt from Emerging-Market Nations Is Now Distressed*, BLOOMBERG (Mar. 19, 2020), https://www.bloomberg.com/news/articles/2020-03-19/the-emerging-market-distressed-debt-club-is-getting-very-crowded [https://perma.cc/AK2P-K77X]; *see* Wheatley, *supra* note 86 (noting that some economists were wary of these rising debt levels prior to the coronavirus pandemic).

[88] Reinhart & Rogoff, *supra* note 48, at 1701.

[89] Roman Kräussl et al., *The European Sovereign Debt Crisis: What Have We Learned?* 3 (Ctr. for Fin. Studies, Working Paper No. 567, 2017), https://www.econstor.eu/bitstream/10419/149623/1/87785405X.pdf [https://perma.cc/FG3K-WXYB]. Economists worry that the so-called "PIIGS," Portugal, Ireland, Italy, Greece, and Spain, whose sluggish economies make sustaining their massive debt burdens a significant challenge, could "bring down the European Union." Mark Koba, *PIIGS: CNBC Explains*, CNBC (Aug. 11, 2011), https://www.cnbc.com/id/44058478 [https://perma.cc/V8PP-EQV3]. The coronavirus has hit Italy particularly hard; an Italian default would pose a "high-impact risk to the global economy and an existential threat to the eurozone." Tran, *supra* note 83.

[90] Hagan, *supra* note 17, at 301–02.

[91] Park & Samples, *supra* note 32, at 250. Whereas sovereign creditors were formerly small groups of commercial lenders, they now consist of market actors who buy sovereign-issued bonds on the secondary market. *Id.*

[92] Seveg, *supra* note 77, at 41–42. Lenders, usually members of the Paris and London Clubs, had typically made long-term investments in debtor nations. *Id.* at 43. Delays in restructuring have injurious effects on defaulting sovereigns, and hence also on their large creditors. *Id.*

[93] Park & Samples, *supra* note 32, at 251. Adding to the complexity of the situation in Argentina, these hundreds of thousands of creditors held 152 flavors of debt securities. *Id.* These creditors might have included "large commercial banks, smaller commercial banks, local banks, investment banks, insurance companies, pension funds, mutual funds, retail funds, hedge funds, nonfinancial companies,

fault.[94] This situation has created a chaotic, unpredictable restructuring regime that presents several intractable issues.[95]

First, absence of a dependable restructuring framework may give rise to moral hazard.[96] Moral hazard refers to situations in which one party to a transaction behaves recklessly because it knows the other party bears the risk of that behavior.[97] In the sovereign debt context, restructuring distressed bonds owed to thousands of dispersed creditors presents obvious logistical difficulties. And where the debtor nation is "too big to fail," institutions like the IMF may extend bailout loans, which are often contingent on the debtor implementing structural economic reforms.[98] Such well-intentioned bailout packages, however, create incentives for debtor nations to ignore both default risk and structural reform.[99] And the dispersion of creditors beyond the debtor nation's borders may contribute even further to moral hazard, as the financial health of a foreign creditor will likely have little impact on the debtor nation's economic outlook.[100] Creditors' incentives are likewise distorted; IMF backstop loans may embolden them to both issue risky loans and oppose restructuring agreements.[101]

Second, the Brady Bond era has also created liquidity and informational issues on the secondary market for distressed sovereign debt.[102] When bond prices fall rapidly, creditors who lack the resources to enforce the sovereign

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and retail investors." Jill. E. Fisch & Caroline M. Gentile, *Vultures of Vanguards? The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1070 (2004).

[94] *See* William W. Bratton, *Sovereign Debt Restructuring and the Best Interest of Creditors*, 57 VAND. L. REV. 4, 20–22 (2004) (explaining the negative effects of the increasing fragmentation of sovereign creditors); Fisch & Gentile, *supra* note 93, at 1074–75 (highlighting the diversity of interests of sovereign creditors in the Brady bond era). For example, investors may have different investment horizons and/or cost bases. Fisch & Gentile, *supra* note 93, at 1075–76. Long-term investors and those with relatively low-cost bases may be more willing to grant a sovereign favorable restructuring terms. *Id.* On the other hand, those seeking a quick profit or who bought in at or near face value will prefer immediate full repayment. *Id.*

[95] Park & Samples, *supra* note 32, at 252–54.

[96] *Id.*

[97] *Moral Hazard*, FIN. TIMES (Apr. 26, 2010), https://www.ft.com/content/1a7ed6da-513d-11df-aceb-00144feab49a [https://perma.cc/E7D7-FKPK].

[98] Wozny, *supra* note 19, at 717.

[99] *See* JOANNA DREGER, COLL. OF EUR., WHY IS SOVEREIGN DEBT RESTRUCTURING A CHALLENGE? THE CASE OF GREECE 7–8 (2012), https://www.coleurope.eu/system/files_force/research-paper/beep24.pdf?download=1 [https://perma.cc/B5RW-S2EQ] (discussing how sovereigns expecting bailout funds anticipate "a relatively easy restructuring process," thus "lower[ing] incentives to enact reforms necessary to regain the ability to pay its debt"); Dickerson, *supra* note 10, at 1011 (noting that the prospect of IMF backstop funding may lead "sovereigns to make risky borrowing decisions," and that bailouts may protect "sovereigns from the costs of . . . imprudent borrowing").

[100] *See* Borensztein & Panizza, *supra* note 49, at 17–18 (noting that defaulting nations suffer more grievous economic consequences when the majority of their creditors are domestic).

[101] Dickerson, *supra* note 10, at 1010.

[102] Wozny, *supra* note 19, at 715–17.

debtor's obligations in court may suffer a complete loss on their investment.[103] In addition, creditors may have difficulty gathering information on a debtor sovereign's financial health and borrowing capacity prior to investing, and sovereigns may have incentives to exaggerate economic output in order to reduce borrowing costs.[104] These issues may reinforce one another, as difficulty in gathering accurate information might reduce the pool of potential investors, thus raising the risk of total loss for bondholders who cannot litigate their claims.[105] This in turn contributes to the risk of moral hazard, as default and subsequent total loss by creditors represents a windfall to the defaulting sovereign.[106]

Third, the Brady Bond era has ushered in severe collective action problems.[107] Thousands of investors with distinct interests, investment horizons, and levels of sophistication may hold a distressed sovereign bond.[108] In the past, coordination between industrialized creditor nations, lending institutions, and developing debtor nations was relatively predictable and streamlined, and the parties involved generally had an interest in the continued economic growth of the sovereign.[109]

Although these familiar groups still play a significant role in sovereign restructurings, the atomization of creditors has made unanimous agreement among them difficult.[110] This situation may induce some individual creditors who might otherwise agree to participate in a restructuring to "free ride" on the efforts of others and await a more lucrative deal.[111] In essence, individual creditors have incentives to hold out and sue for full repayment rather than settling for a reduced return in a restructuring.[112] These holdouts have significant lev-

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[103] *Id.* at 711; Felix Salmon, *In Defense of Vulture Funds*, FELIX SALMON (Feb. 27, 2007), https://www.felixsalmon.com/2007/02/in-defense-of-vulture-funds/ [https://perma.cc/BG93-V8D4].

[104] Park & Samples, *supra* note 32, at 273. This issue is particularly salient in the context of GDP-linked equity securities, which some commentators have proposed as an alternative source of capital for emerging countries. *Id.* Several countries, including Argentina, Ukraine, and Greece, have issued such securities, although their effectiveness in reducing sovereign debt crises has not yet been determined. *Id.* at 273–74.

[105] Wozny, *supra* note 19, at 711.

[106] *Id.*; *see* Salmon, *supra* note 103 (discussing a hypothetical default scenario where there are no distressed debt investors).

[107] Seveg, *supra* note 77, at 46; *see* JOHN NOLAN, FIN. POLICY FORUM, EMERGING MARKET DEBT & VULTURE HEDGE FUNDS: FREE-RIDERSHIP, LEGAL & MARKET REMEDIES (2001), http://www.financialpolicy.org/DSCNolan.htm [https://perma.cc/28K6-6FJ3] (offering a detailed overview of the collective action issues that have arisen since the implementation of the Brady plan in the 1980s).

[108] *See* Fisch & Gentile, *supra* note 93, at 1074–76.

[109] *Id.* at 1070–73. Dispersion of creditors opens a chasm between creditors' individual interests and the socially optimal outcome of an efficient restructuring. *Id.* That many creditors are not actually lenders and have merely purchased sovereign debt on the secondary market only widens the gap, as they lack incentives to provide interim financing. *Id.*

[110] *Id.*

[111] NOLAN, *supra* note 107.

[112] *Id.*; Seveg, *supra* note 77, at 46–47.

erage over the defaulter, as disorderly and protracted restructurings place significant economic stress on debtor nations, and holdout litigation itself is expensive and time-consuming.[113]

## *B. Vulture Funds*

The rogue holdout creditors mentioned in the previous Section are commonly referred to as "vultures."[114] The following Section describes the activities of vulture funds, their history, and their impact on sovereign debt restructuring since the 1980s.[115]

### 1. What Are Vulture Funds?

American bankruptcy investing came of age in the wake of the Great Depression.[116] Early distressed debt investors profited through a form of arbitrage on the value of companies' assets and the depressed prices of their securities; after restructuring, those prices often converged.[117]

The seminal event in modern activist vulture investing was the 1970 bankruptcy of the Penn Central Railroad.[118] At the time, Penn Central's bankruptcy was one of the largest and most complex in history, involving a tangled web of assets, mortgages, and bond issues.[119] The fantastic returns earned by proto-vultures and the speed with which they generated them induced more

[113] Wozny, *supra* note 19, at 716–17; *see* Alexandra Stevenson, *How Argentina Settled a Billion-Dollar Debt Dispute with Hedge Funds*, N.Y. TIMES (Apr. 25, 2016), https://www.nytimes.com/2016/04/25/business/dealbook/how-argentina-settled-a-billion-dollar-debt-dispute-with-hedge-funds.html [https://perma.cc/YR5S-VGPE] (describing Argentina's fifteen-year battle with its relentlessly litigious creditors).

[114] *See* Katherine Burton & Katia Porzecanski, *Vulture Investing*, BLOOMBERG (May 31, 2017), https://www.bloomberg.com/quicktake/vulture-investing [https://perma.cc/N53G-XLK5].

[115] *See infra* notes 116–171 and accompanying text.

[116] HILARY ROSENBERG, THE VULTURE INVESTORS 8 (1st ed. 1990). Still, investing in distressed assets is an activity with ancient roots. *See* 3 PLUTARCH, THE PARALLEL LIVES 318 (Loeb Classical Library 1916). Marcus Licinius Crassus, who for a time ruled Rome as *triumvir* alongside Julius Caesar and Pompey, amassed great wealth by buying burning buildings. *Id.* at 318, 356. Because Crassus obtained these buildings "at a trifling price owing to . . . fear and uncertainty," he eventually came to dominate the Roman real estate market. *Id.* at 318. Vulture tactics also seem to have been fairly common in early nineteenth-century America, a period of burgeoning entrepreneurship and concomitant business failure. Edward J. Balleisen, *Vulture Capitalism in Antebellum America: The 1841 Federal Bankruptcy Act and the Exploitation of Financial Distress*, 70 BUS. HIST. REV. 473, 474–76 (1996).

[117] ROSENBERG, *supra* note 116, at 8; James Chen, *Arbitrage*, INVESTOPEDIA (Feb. 1, 2020), https://www.investopedia.com/terms/a/arbitrage.asp [https://perma.cc/6BZT-UCRT] (defining arbitrage as "the purchase and sale of an asset in order to profit from a difference in the asset's price between markets").

[118] ROSENBERG, *supra* note 116, at 11.

[119] *Id.*

players to get in on the distressed debt action.[120] In addition, an overhaul of the bankruptcy code in 1978 streamlined the process, allowing companies and creditors more maneuverability before and during restructuring.[121] The industry has grown exponentially since.[122] In 1990, distressed debt funds held less than one billion dollars under management; private distressed debt funds today hold hundreds of billions.[123]

Vulture funds typically buy struggling companies' debt at a steep discount from issue price.[124] Traditional, passive distressed debt investors try to identify distressed companies with a solid core business or valuable assets; they then buy and hold the debt for several years in a bet that the company will return to profitability after weathering their present inability to meet debt service payments.[125] These vultures hope to receive the remainder of debt payments, sell the debt at a price closer to fair value, or perhaps exchange the debt for equity.[126]

Modern vulture funds often take a more activist approach.[127] They may try to acquire a stake large enough to win some control over the restructuring process.[128] A one-third share of outstanding debt, for example, is enough to block a restructuring agreement, as approval requires a two-thirds supermajority of creditors.[129] Vultures may also try to influence the process by holding positions on creditors' committees or leveraging their bankruptcy expertise

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[120] *Id.* at 11, 13. Investor Martin Whitman earned a five hundred percent return in just a single year. *Id.* Others with slightly longer investment horizons gained up to ten times the amount of their initial outlay. *Id.*

[121] *Id.* at 15. Prior to 1978, bankrupt companies were required to cede management of the company to a trustee. *Id.* Additionally, restructuring agreements needed the unanimous approval of creditors. *Id.* The 1978 changes, which added Chapter 11 to the Bankruptcy Code, allowed management to continue in their capacity through the bankruptcy and for agreements to pass with approval of just a majority of creditors. *Id.*

[122] *See* THOMAS DELLA CASA ET AL., MAN INVS., HEDGE FUND INVESTING IN DISTRESSED SECURITIES: CAPTURING THE UNIQUE VALUE CREATED BY CORPORATE AND ECONOMIC TURNAROUNDS 11 (2008), http://www.opalesque.com/files/ManDistressed_investing_Final.pdf [https://perma.cc/TH2X-VATW] (describing the explosive growth in distressed debt funds' assets under management since the 1990s).

[123] *Id.*; Rob Kozlowski, *Private Debt AUM Hits $667 Billion in 2017*, PENSIONS & INV. (Aug. 6, 2018), https://www.pionline.com/article/20180806/ONLINE/180809887/private-debt-aum-hits-667-billion-in-2017 [https://perma.cc/FE4X-NR8X].

[124] ROSENBERG, *supra* note 116, at 22; *see* Burton & Porzecanski, *supra* note 114 (providing history, definitions, and a concise summary of vulture investor activity in both the corporate and sovereign debt arenas).

[125] ROSENBERG, *supra* note 116, at 15, 25–26. Hilary Rosenberg analogizes these vultures to "migratory birds" that "fly in" for good opportunities and move on when the weather begins to turn cold. *Id.*

[126] *Id.*

[127] *Id.* at 15, 25. In contrast to "migratory birds," Rosenberg likens activist vultures to "nest builders; these investors typically have a longer investment horizon and take part in strategic decision making." *Id.*

[128] *Id.* at 19.

[129] *Id.*

and industry contacts.[130] Some vultures may make significant equity investments in distressed companies as well; these funds may then hire new management or use their own expertise to guide the company through the restructuring process.[131] Others may even use their power as a dominant creditor to force the debtor company through a Chapter 11 bankruptcy in lieu of informal renegotiation with creditors.[132] In sum, activist vultures play a significant role in determining how a distressed company will accommodate its creditors.[133]

Students of the industry have not yet determined whether vultures' impact is a salutary one.[134] In certain cases, vultures may hinder efficient restructuring, as bondholders who bought in at different prices have conflicting incentives in a restructuring agreement.[135] Nevertheless, vultures play an important role in providing liquidity on the secondary market and working capital to distressed companies.[136] In addition, vultures' incentives are frequently aligned with those of the company—each hopes to speed up the restructuring process in order to make the company profitable again.[137]

### 2. Sovereign Vulture Funds

In the 1990s, vulture investors branched out from private debt into sovereign liabilities.[138] The following Section outlines how vulture funds profit from

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[130] *Id.* at 19, 27.

[131] *Id.* at 19–20, 26.

[132] *Id.*

[133] *Id.* at 22.

[134] *See* Michelle M. Harner, *Trends in Distressed Debt Investing: An Empirical Study of Investors' Objectives*, 16 ABI L. REV. 69, 70–71 (2008) (declaring that "the precise impact and future implications of the involvement of distressed debt investors . . . are difficult to determine").

[135] ROSENBERG, *supra* note 116, at 20. For example, investors who bought at a steep discount may be willing to settle for less than a full return, unlike those who bought in at or near full face value. *Id.*

[136] Harner, *supra* note 134, at 71; *see* Paul M. Goldschmidt, *More Phoenix Than Vulture: The Case for Distressed Investor Presence in the Bankruptcy Reorganization Process*, 2005 COLUM. BUS. L. REV. 191, 259 (arguing that "distressed debt investors can add new, positive energy to the restructuring process"); *see also* Edith Hotchkiss & Robert M. Mooradian, *Vulture Investors and the Market for Control of Distressed Firms*, 43 J. FIN. ECON. 401, 404 (1997) (finding that "post-restructuring performance . . . associated with vulture . . . purchases suggest that vultures' poor public image is not justified by empirical evidence").

[137] ROSENBERG, *supra* note 116, at 20. Still, the degree of alignment will depend on the vulture's investment horizon; those who do not care to remain invested in the debtor company until it regains financial stability will seek the maximum return on their investment before the debtor is prepared to provide it. Harner, *supra* note 134, at 107. This may in certain cases force potentially viable companies into liquidation. *See id.*

[138] Saskia Sassen, *A Short History of Vultures*, FOREIGN POL'Y (Aug. 3, 2014), https://foreignpolicy.com/2014/08/03/a-short-history-of-vultures/ [https://perma.cc/S69A-BBAQ]. Elliot Associates L.P.'s pioneering fifty-seven-million-dollar lawsuit against Panama in New York State court ushered in the era of sovereign debt vultures. *Id.*

these investments.[139] This Section goes on to discuss vulture funds' success in alleviating the issues of moral hazard, secondary market liquidity and information-gathering, and collective action that have plagued the post-Brady Bond era.[140]

Vultures take a strikingly different approach in the sovereign context than they do in corporate restructurings.[141] As in the corporate context, vultures buy up the debt of distressed sovereigns on the secondary market at bargain prices.[142] Instead of working with the sovereign to guide it back to profitability, however, vultures seek repayment of principal through litigation.[143] Vultures typically seek to enforce sovereign debt obligations through the attachment of assets, although they have employed other sophisticated strategies in recent years.[144] These efforts are as controversial as they have been lucrative.[145] In some instances, vulture suits have sparked international outrage.[146]

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[139] *See infra* notes 141–146 and accompanying text.

[140] *See infra* notes 147–171 and accompanying text.

[141] *See* Sassen, *supra* note 138 (providing a general overview of how vulture funds profit from their investments in distressed sovereign debt).

[142] *Id.*; *see* ROSENBERG, *supra* note 116, at 22 (discussing vulture funds' investment tactics in the corporate debt context).

[143] *See, e.g.*, Elliott Assocs., L.P. v. Republic of Pan., 975 F. Supp. 332, 334 (S.D.N.Y. 1997) (awarding summary judgment to vulture fund Elliot Associates in its action for recovery of the full face value of the $28.7 million in Panamanian bonds, plus interest and fees, that it had bought at a steep discount on the secondary market).

[144] Tim R. Samples, *Rogue Trends in Sovereign Debt: Argentina, Vulture Funds, and* Pari Passu *Under New York Law*, 35 NW. J. INT'L L. & BUS. 49, 58, 61 (2014). For example, vultures have successfully argued for enforcement of *pari passu* clauses in sovereign debt contracts. *Id.* at 58. In the domestic context, these clauses simply place unsecured creditors on a level playing field in bankruptcy. *Id.* But courts have interpreted *pari passu* clauses contained in sovereign bond contracts to require debtors to make regular payments to all bondholders, whether they have agreed to restructuring or are holding out for a richer reward. *Id.* In *Elliot v. Peru*, Elliot Associates asserted its position at the vanguard of sovereign debt recovery litigation. *Id.* There, a Belgian court enjoined Peru from making payments only to those who had agreed to a restructuring plan. *Id.* Peru was then forced to settle quickly with Elliot in order to avoid default, awarding the latter a return of four hundred percent. *Id.*

[145] *See* Park & Samples, *supra* note 32, at 254 (discussing how "profiting at the expense of poor countries with vulnerable citizens makes the sovereign debt vulture industry a lightning rod for criticism"); Samples, *supra* note 144, at 59–60 (noting that vulture funds' detractors "rang[e] from United Nations officials and IMF economists to religious charities").

[146] Samples, *supra* note 144, at 59–60 (listing critics of vulture funds); *see, e.g.*, Joyce Fegan, *Protests as Family Farm Put up for Sale by Vulture Fund*, IRISH EXAMINER (Sept. 15, 2018), https://www.irishexaminer.com/breakingnews/ireland/protests-as-family-farm-put-up-for-sale-by-vulture-fund-869139.html [https://perma.cc/X229-HYBJ] (describing the public outcry after a hedge fund foreclosed on a family-owned Irish farm); Martin Guzman & Joseph E. Stiglitz, *How Hedge Funds Held Argentina for Ransom*, N.Y. TIMES (Apr. 1, 2016), https://www.nytimes.com/2016/04/01/opinion/how-hedge-funds-held-argentina-for-ransom.html [https://perma.cc/5XXS-CX28] (criticizing vulture funds' tactics in seeking repayment on Argentinian debt); *'Stop Vulture Funds': Puerto Rico Students Protest Austerity*, TELESUR (May 4, 2017), https://www.telesurenglish.net/news/Stop-Vulture-Funds-Puerto-Rico-Students-Protest-Austerity-20170504-0040.html [https://perma.cc/B93Z-GQYU] (reporting on a national anti-vulture fund protest led by students at the University of Puerto Rico).

Vulture funds have a mixed record on the issues that have arisen in the lawless post-Brady sovereign restructuring landscape.[147] Perhaps the most compelling rationale for the continued existence of vulture funds is their deterrent effect against sovereign moral hazard.[148] Without the looming threat of litigation, it is not clear that sovereigns, particularly dictators, have adequate incentives to avoid default.[149] The economic repercussions from default are short-lived, and dictators typically respond to defaults by simply removing their economic ministers.[150]

Vulture funds also fill a valuable role as providers of liquidity and information.[151] Where repayment of sovereign debt is uncertain and bondholders lack the resources or wherewithal to litigate their claims, vultures may represent bondholders' only option for exiting their investment and avoiding a potentially crippling loss.[152] In addition, vultures are a reliable source of information to investors of all stripes.[153] Smaller creditors likely do not have the resources to conduct their own research of a sovereign's financial health prior to making an investment, and sovereigns have strong incentives to exaggerate economic growth and financial stability.[154] After investing, smaller creditors have virtually no incentive to gather information, as they are unlikely to be able to litigate their claims should the sovereign default.[155] Vultures, on the other hand, have abundant resources, institutional expertise, and risk total loss if their efforts in court do not succeed.[156] Vultures' presence or absence from a given market therefore sends a powerful signal to other investors.[157] And for larger, institutional investors, vulture activity provides crucial pricing infor-

[147] *See* Park & Samples, *supra* note 32, at 253–54 (addressing the problems created by "the so-called vultures of sovereign debt," described as "maligned actors in sovereign finance"); Wozny, *supra* note 19, at 705–14 (describing the myriad benefits provided by vulture investors).

[148] *See* Fisch & Gentile, *supra* note 93, at 1049–51 (discussing the role of creditor-initiated litigation as a "check on the possibility of opportunistic default, which in turn facilitates the functioning of the international capital markets").

[149] *See id.* (noting that the threat of litigation may deter "rogue sovereigns"); Borensztein & Panizza, *supra* note 49, at 22 (noting that the most common result of default by a dictatorship is removal of economic ministers).

[150] Borensztein & Panizza, *supra* note 49, at 22, 40 tbl.12.

[151] Fisch & Gentile, *supra* note 93, at 1100.

[152] *Id.* at 1100–01.

[153] *Id.*

[154] Wozny, *supra* note 19 at 712–13; Salmon, *supra* note 103.

[155] Wozny, *supra* note 19, at 712–13.

[156] Samples, *supra* note 144, at 60; Wozny, *supra* note 19, at 712–13.

[157] *See* Fernando Barciela, *Vulture Funds Leave Spain in Search of Fresh Game*, THE CORNER (Aug. 17, 2016), http://thecorner.eu/spain-economy/vulture-funds-leave-spain-in-search-of-fresh-game/57062/ [https://perma.cc/K35E-X4QS] (noting that vultures' flight from the Spanish debt market signified a reduced default risk).

mation that allows them to mark their holdings to market.[158] Vultures have also exposed sovereign abuses of international debt-relief efforts.[159]

Despite their positive attributes, vultures have undeniably aggravated the collective action problems rooted in the atomization of sovereign creditors.[160] Holdout litigation, vultures' primary tactic in the sovereign context, is a major obstacle to an efficient restructuring.[161] Because these lawsuits threaten to extend periods of economic uncertainty, sovereigns have good reasons to settle with vultures quickly.[162] Other creditors may in turn hold out and seek full repayment for themselves.[163] Further, a court's ruling in a vulture suit could alter or potentially invalidate the terms of a broader restructuring agreement.[164] And unlike the creditors of the pre-Brady era, vultures have no interest in the economic health of the debtor nation.[165] The holdout conundrum also raises the risk of moral hazard, as sovereigns facing expensive holdout litigation have reduced incentives to implement economic reforms upon which restructuring deals are conditioned.[166]

These issues are magnified where vulture holdouts are "empty creditors" and own credit default swaps on the very debt they seek to enforce.[167] Similar to insurance contracts, these instruments pay out upon default by the sovereign.[168] In this scenario, vultures have little incentive to engage in restructuring plans that will avoid default and therefore fail to trigger payment on the swap.[169]

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[158] Fisch & Gentile, *supra* note 93, at 1051.

[159] Wozny, *supra* note 19, at 713; Tony Allen-Mills, *Hedge Funds Lift the Lid on African Deception*, ALEXANDER'S GAS & OIL CONNECTIONS (June 15, 2008), http://www.gasandoil.com/news/africa/67c4ba36f57496c01738bf41816f68e6 [https://perma.cc/7YUE-ACC2] (describing how Elliot Associates' private investigators uncovered staggering fraud and corruption at the highest levels of government in the Democratic Republic of Congo).

[160] *See* Park & Samples, *supra* note 32, at 254 (discussing how "relatively small numbers of creditors that choose not to participate in insolvency negotiations can pose serious problems for sovereign restructurings, even when a vast majority of creditors agree to participate").

[161] Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253, 253–54 (2003).

[162] *See* Wozny, *supra* note 19, at 715 (describing how holdout vulture funds can "disrupt the restructuring and prevent the sovereign state from accessing international capital markets to obtain the financing necessary for development").

[163] *Id.*

[164] *See* Fisch & Gentile, *supra* note 93, at 1051 (noting that "litigation may . . . operate as a check on the terms of a proposed restructuring, giving a creditor recourse against a restructuring that provides insufficient value to creditors or that unduly favors some creditors over others").

[165] Buckley, *supra* note 80, at 1888.

[166] DREGER, *supra* note 99, at 8–10.

[167] Patrick Bolton & Martin Oehmke, *Credit Default Swaps and the Empty Creditor Problem*, 24 REV. FIN. STUD. 2617, 2618 (2011). In essence, empty creditors hold default insurance on the very debt instruments they own. *Id.*

[168] *Id.*

[169] Yesha Yadav, *Empty Creditors and Sovereign Debt: What Now?*, 9 CAP. MKTS. L.J. 103, 113 (2014).

Finally, vultures may also seek to enforce a sovereign's "odious" debts, funds borrowed nominally for the state but actually diverted to the private use of government officials.[170] Such odious debts are likewise traded on the secondary market and are therefore potentially subject to holdout litigation.[171]

## II. POLICY PROPOSALS

The evidence suggests that sovereign debt crises are not going away any time soon.[172] Several international agencies have sounded the warning bell on rising levels of emerging market indebtedness, and the coronavirus pandemic likely marks the end of the long expansionary period following the Great Recession of 2008.[173] To make matters worse for emerging market debtors, the U.S. dollar has soared against other currencies in the wake of the outbreak-induced financial panic.[174] Despite this precarious situation, the collective action issues associated with securitized Brady Bonds have largely remained unaddressed since the 1990s.[175]

This Part analyzes three of the most prominent policy proposals to rectify this glaring market failure; namely, novel contractual provisions, the establishment of an international bankruptcy regime, and national anti-vulture fund legislation.[176] The Part provides an overview of each proposal, discusses their benefits and drawbacks in light of the issues discussed in Part I, and ultimately concludes that none is sufficient to provide the immediate relief that defaulting

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[170] Caroline M. Gentile, *The Market for Odious Debt: A Modern Legal History of Sovereign Debt*, 73 LAW & CONTEMP. PROBS. 151, 151 (2010).

[171] *See id.* at 151, 167–68 (discussing odious debt and vulture funds generally and noting that "holdout litigation . . . disrupts the restructuring process, causing delays and inflicting losses on the sovereign debtor and the other creditors").

[172] *See supra* notes 11–13 and accompanying text (noting that the combination of record sovereign debt levels and global recession has increased the risk of sovereign default).

[173] Phillip Inman, *World Economy at Risk of Another Financial Crash, Says IMF*, THE GUARDIAN (Oct. 3, 2018), https://www.theguardian.com/business/2018/oct/03/world-economy-at-risk-of-another-financial-crash-says-imf [https://perma.cc/VZ3M-YUMG]; Isidore, *supra* note 13. Global debt has surpassed the level reached prior to the 2008 financial crisis, approaching nearly two hundred trillion dollars in 2018. Inman, *supra*. Record-low interest rates following the crisis spurred this massive surge in borrowing. *Id.* In the past decade, sovereigns have increased their debt to GDP ratios by nearly twenty percent, and are piling on even more debt to mitigate the economic damage resulting from mass quarantine. *Id.*; Tran, *supra* note 83.

[174] Tanvir Gill, *The US Dollar Will Test 105 Against a Basket of Currencies in the Short Term, Analyst Says*, CNBC (Mar. 24, 2020), https://www.cnbc.com/2020/03/24/us-dollar-to-test-105-against-basket-of-currencies-says-analyst.html [https://perma.cc/W8WY-8UVZ]. Widespread asset liquidations have caused a global dollar shortage, and "the number one risk for world markets associated with dollar shortfall[] is a potential rise in defaults." *Id.*; *see* Correa & Sapriza, *supra* note 33, at 7 (examining the relationship between local currency devaluation and default risk).

[175] *See* Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 EMORY L.J. 929, 990 (2004) (noting that the international community has failed to implement a solution to vulture holdout litigation).

[176] *See infra* notes 179–259 and accompanying text.

nations so desperately need.[177] This Part then discusses the role of nonprofits when neither markets nor governments can offer a solution.[178]

### *A. Contractual Provisions*

Sovereign bond contracts typically contain boilerplate provisions found in corporate bonds.[179] Beginning in the 1990s, deep-pocketed vulture funds have employed crafty litigators to exploit contractual language and enforce payment on distressed debt, much to restructuring debtor nations' detriment.[180] Chief among these problematic provisions are *pari passu* and collective action clauses.[181]

Standard *pari passu* clauses place bondholders on an equal footing with other creditors such as owners of separately issued bonds or commercial syndicate lenders.[182] Such a clause might read something like the following: "These Notes rank, and will rank, equally (or *pari passu*) in right of payment with all other present and future unsecured and unsubordinated External Indebtedness of the Issuer."[183]

*Pari passu* clauses in corporate bonds are not controversial—they simply preserve the priority of senior debt in bankruptcy and place all unsecured creditors on a level playing field.[184] Courts interpreting a *pari passu* clause narrowly would find breach only where debtors attempt to use legal mechanisms to alter the pecking order of creditors.[185] In the sovereign context, however,

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[177] *See infra* notes 179–259 and accompanying text.

[178] *See infra* notes 260–284 and accompanying text.

[179] Choi & Gulati, *supra* note 175, at 990.

[180] *Id.* at 990–91. Elliot Capital Management pioneered this contractual approach in response to the complexity of attaching sovereign assets. G. Mitu Gulati & Kenneth N. Klee, *Sovereign Piracy*, 56 BUS. LAW. 635, 635 (2001). Typically, creditors can only attach assets "relating to the borrowing," which are typically stored within the debtor's borders. *Id.* at 635 n.4. Elliot's brilliant strategy in a 1995 suit against Peru was, in effect, to attach payments to other creditors who had accepted a restructuring plan by arguing for strict enforcement of their bonds' *pari passu* clause. *Id.* at 635–36.

[181] Choi & Gulati, *supra* note 175, at 933–34, 990–91.

[182] Rodrigo Olivares-Caminal, *The* Pari Passu *Clause in Sovereign Debt Instruments: Developments in Recent Litigation* 121 (Bank for Int'l Settlements, Paper No. 72, 2013), https://www.bis.org/publ/bppdf/bispap72u.pdf [https://perma.cc/YSS5-X3QH]. *Pari passu*'s literal Latin meaning is "with an equal step." *Pari* is the third-declension ablative form of *par*, *paris*, meaning equal; *passu* is the fourth-declension ablative of *passus*, meaning step. In English, the phrase is probably best translated as "proportionately." The author of this Note is a former high school Latin teacher, so citation to authority here would be superfluous. *See generally* Peter R. MacLeod, Note, *Latin in Legal Writing: An Inquiry into the Use of Latin in the Modern Legal World*, 39 B.C. L. REV. 235 (1998) (offering a "modern picture of how the legal community uses Latin and what Latin's current purpose is").

[183] Choi & Gulati, *supra* note 175, at 990.

[184] *Id.*

[185] ALLEN & OVERY, GLOB. LAW INTELLIGENCE UNIT, THE *PARI PASSU* CLAUSE AND THE ARGENTINE CASE 6–7 (2012), https://www.allenovery.com/germany/-/media/sharepoint/publications/sitecollectiondocuments/the20pari20passu20clause20and20the20argentine20case.pdf?la=en-gb&hash=535132436EDD502D32BC90B8C5D52E0D [https://perma.cc/DL8E-BHJS].

where there is no formal bankruptcy mechanism, the precise meaning of such clauses is not so clear.[186]

Preying on this ambiguity, enterprising vulture funds have turned this rarely used shield into a sharply whetted weapon of destruction.[187] In *NML Capital Ltd. v. Argentina*, the Second Circuit Court of Appeals adopted an expansive interpretation of *pari passu*.[188] Following a controversial 2000 Belgian high court decision, the Second Circuit interpreted the clause as restricting debtors in default from paying any creditor without making simultaneous *pro rata* payments to all others.[189] In essence, the ruling transformed *pari passu* ranking into *pari passu* payment.[190]

The court thus enjoined Argentina's payments to creditors who had agreed to a restructuring plan.[191] The Supreme Court's subsequent denial of cert placed the debtor nation in an intolerable bind, as paying vulture holdouts in addition to servicing the restructured debt would have thrown it right back into default.[192] Argentina was therefore forced to settle with the vultures, who then used their tremendous leverage to exact a king's ransom.[193]

Sadly, lawyers for sovereign debtors have been unable to articulate a coherent alternative account of the *pari passu* clause in the sovereign context; indeed, the original reason for including the clause in sovereign bonds may be lost to history.[194] And perhaps even more tragically, bonds issued since the ex-

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[186] *Id.*

[187] *See id.* at 4–6 (discussing vulture funds' litigation over *pari passu* clauses in sovereign bonds). One commentator has referred to the *pari passu* clause as the "most promising collection weapon to come along since nineteenth century gunboats." Anna Gelpern, *Courts and Sovereigns in the* Pari Passu *Goldmines*, 11 CAP. MKTS. L.J. 1, 4 (2016).

[188] ALLEN & OVERY, *supra* note 185, at 2. Under the narrow interpretation, *pari passu* is simply an assertion of bondholders' legal rank alongside fellow unsecured creditors instead of a requirement that all creditors receive *pro rata* payments. *Id.* Debtors' legal subordination of creditors, and hence breaches of the clause, hardly ever happen. *Id.*

[189] Gelpern, *supra* note 187, at 5. There, the Court of Appeals of Brussels enjoined Peru from making payments on restructured debt until it paid off holdout creditors. *Id.* Elliot Associates more than quintupled its initial eleven-million-dollar investment after Peru was forced to settle. *Id.*; Rodrigo Olivares-Caminal, *The* Pari Passu *Interpretation in the* Elliot *Case: A Brilliant Strategy but an Awful (Mid-Long Term) Outcome?*, 40 HOFSTRA L. REV. 39, 46 (2014).

[190] Gelpern, *supra* note 187, at 5.

[191] ALLEN & OVERY, *supra* note 185, at 5.

[192] John Muse-Fisher, Comment, *Starving the Vultures:* NML Capital v. Republic of Argentina *and Solutions to the Problem of Distressed Debt Funds*, 102 CALIF. L. REV. 1671, 1695 (2014).

[193] Hugh Bronstein & David Scigliuzzo, *Argentina Dubs Holdouts an 'International Mafia' as Deal Hopes Fade*, REUTERS (Aug. 14, 2014), http://www.reuters.com/article/2014/08/14/us-argentina-debt-idUSKBN0GE1FC20140814 [https://perma.cc/K829-ACMR]. In 2016, after years of negotiation, Argentina finally settled with holdouts for several billion dollars. Merle, *supra* note 3. The 2016 election of Mauricio Mauri as Argentina's president spurred the settlement after nearly a decade of bitter wrangling. Stevenson, *supra* note 113. Part of Mauri's platform was resolution of Argentina's lingering debt problems. *Id.*

[194] Choi & Gulati, *supra* note 175, at 991. Some commentators have argued that these clauses may just be a boilerplate vestige from corporate bond contracts. Stephen J. Lubben, *Possible Ripples*

pansive *pari passu* interpretation took root have continued to include such clauses.[195]

Yet another nettlesome boilerplate bond provision is the unanimous action clause (UAC).[196] Included in most sovereign bonds governed by New York law, UACs require all bondholders to ratify changes to bond terms.[197] Such clauses represent a major obstacle to efficient restructuring; even where ninety-nine percent of creditors approve of modifications to a repayment schedule, a single holdout can steer a sovereign towards default and exact a generous settlement.[198] The combination of UACs and *pari passu* clauses has proven to be a deadly cocktail.[199]

Fortunately, collective action clauses (CACs), which allow for amendment of bond terms with majority approval, have gradually become standard.[200] In 1996, the G-10 nations endorsed CACs as the best available defense against vulture predation.[201] Additionally, various official bodies have endorsed novel provisions for inclusion in sovereign bond contracts.[202] Perhaps most notably, the IMF published formal recommendations in 2014 for best practices in bond contract drafting.[203]

Although new drafting practices undeniably hold great promise, they alone will not protect vulnerable sovereigns in the next wave of defaults.[204]

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*from the Argentine Bond Litigation*, N.Y. TIMES (Dec. 13, 2012), https://dealbook.nytimes.com/2012/12/13/possible-ripple-effects-from-the-argentina-hedge-fund-court-fight [https://perma.cc/UE8T-CWG5]. Others posit that the phrase may be nothing more than an obscure Latin "credibility signal." Hayk Kupelyants, Pari Passu *Clauses: An Alternative Explanation*, OPINIOJURIS (May 5, 2014), http://opiniojuris.org/2014/05/08/pari-passu-clauses-alternative-interpretation/ [https://perma.cc/SK3E-HEY6].

[195] *See* Choi & Gulati, *supra* note 175, at 991 ("New contracts issued in the wake of the Brussels interpretation all contain the same *pari passu* language as before. And this is even though no one on the sovereign issuer side seemed to have a clear understanding of what value the clause provided.").

[196] *Id.* at 932.

[197] *Id.*

[198] *Id.*

[199] *See* Gelpern, *supra* note 187, at 4–5 (detailing Elliot's litigation against both Peru and Argentina).

[200] Hagan, *supra* note 17, at 319. Sean Hagan notes that this process of standardization took nearly a decade, and probably only took root because market participants feared more heavy-handed action from global authorities. *Id.* at 319–20.

[201] GROUP OF TEN, THE RESOLUTION OF SOVEREIGN LIQUIDITY CRISES 16–17 (1996), https://www.bis.org/publ/gten03.pdf [https://perma.cc/8KJC-M8Y4].

[202] *See, e.g.*, Louis Charbonneau, *U.N. Nations Approve Principles for Sovereign Debt Restructuring*, REUTERS (Sept. 10, 2015), https://www.reuters.com/article/us-un-sovereign-debt-idUSKCN0RA2KS20150910 [https://perma.cc/5HVF-827G] (discussing a U.N. resolution related to fixing sovereign restructuring issues).

[203] IMF, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, Staff Report, at 2–3 (Oct. 2014), https://www.imf.org/external/np/pp/eng/2014/090214.pdf [https://perma.cc/5V5B-SMQ4].

[204] *See* Fisch & Gentile, *supra* note 93, at 1110 (emphasizing that "participants in the sovereign debt market may have a strong preference for standard terms, not only across sovereign bonds issued by the same sovereign debtor but also across all sovereign bonds").

Some long-term sovereign bonds issued prior to the implementation of drafting reforms remain outstanding, and may for some time.[205] Further, a majority of outstanding sovereign debt is subject to New York state law and includes unanimous action clauses.[206] And the market's reluctance to adopt reforms means their effect may not be felt for a generation.[207]

Moreover, restructuring still promises to be a complex endeavor even with *pari passu*-less collective action clauses.[208] Sovereigns issue debt in different series and currencies.[209] Vultures can therefore still amass blocking positions, particularly in smaller issues, which in turn may affect the restructuring of other issues.[210]

### *B. International Bankruptcy*

Bankruptcy law in the United States has proven remarkably effective at preserving the economic viability of debtors while balancing the multifarious claims of creditors.[211] Indeed, some have credited Chapter 11 with powering the United States' economic engine through periods of turbulence.[212] In a typical business restructuring, an insolvent or barely solvent debtor files for relief

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[205] Anne O. Krueger (First Deputy Managing Director), IMF, *A New Approach to Sovereign Debt Restructuring*, at 31 (2002), https://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf [https://perma.cc/HAM8-TBXL]; *see* Gelpern, *supra* note 187, at 27 (noting that creditors have been reluctant to remove *pari passu* clauses, and that many prefer to "keep it just in case").

[206] Hagan, *supra* note 17, at 320. The contracts' choice of law provisions typically select New York law. *Id.*

[207] *See* Fisch & Gentile, *supra* note 93, at 1110 (discussing the popularity of conventional boilerplate in sovereign bond contracts); Hagan, *supra* note 17, at 319 (noting that the bond market has been slow to adopt collective action clauses).

[208] *See* Hagan, *supra* note 17, at 319–21 (discussing the weaknesses of purely contractual solutions to vulture holdout litigation).

[209] *Id.*

[210] *Id.* To illustrate, a holder of Bond A may opt to reject a restructuring plan if a vulture creditor with a blocking position in Bond B is likely to get a better deal by holding out. *Id.*; *see* Dickerson, *supra* note 10, at 1016 (describing the inadequacy of the collective action clause in curbing holdout litigation).

[211] Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 605 (2009). Elizabeth Warren and Jay Lawrence Westbrook note that despite much handwringing among academics, "Chapter 11 has been far more successful than supposed." *Id.*

[212] Kim Girard, *How Chapter 11 Saved the US Economy*, FORBES (Mar. 25, 2013), https://www.forbes.com/sites/hbsworkingknowledge/2013/03/25/how-chapter-11-saved-the-us-economy/#3e9143991520 [https://perma.cc/YL54-CFBN]. Despite a whopping $3.5 trillion worth of corporate debt near or in default following the 2008 crisis, Chapter 11 allowed many distressed companies, including Lehman Brothers, to reorganize in a relatively short period of time. *Id.* Unlike European restructuring regimes that prioritize liquidation and repayment of creditors, the U.S. system encourages rehabilitation; this feature may in part explain the outperformance of the U.S. economy since 2008. *Id.*

under Title 11 of the U.S. Code.[213] The court then imposes an "automatic stay" on creditors' right to repayment until the court certifies a debtor-submitted, creditor-approved restructuring plan.[214] Creditors who do not approve are at a minimum entitled to the amount they would receive under a Chapter 7 liquidation.[215] The system allows many companies experiencing temporary cash flow issues to emerge healthy and profitable.[216]

Beginning with Adam Smith in the eighteenth century, reformers have been calling for the implementation of such a system for sovereign debtors.[217] In 2001, the IMF put forth perhaps the most detailed proposal in history for an international bankruptcy regime.[218] Modeled closely after the U.S. bankruptcy system, the Sovereign Default Resolution Mechanism (SDRM) sought to impose order on the lawless frontier of sovereign debt restructuring.[219] Although a majority of IMF Executive Directors supported the SDRM at a preliminary stage, the United States, which holds veto power, ultimately torpedoed the plan.[220]

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[213] *Chapter 11 Bankruptcy: A Primer*, AM. B. ASS'N (July 31, 2011), https://www.americanbar.org/groups/gpsolo/publications/gp_solo/2011/july_august/chapter_11_bankruptcy_primer/ [https://perma.cc/PLZ7-CWNQ].

[214] *Id.*

[215] *Id.* Chapter 11 facilitates a firm's reorganization and continued existence post-bankruptcy. *Id.* Businesses utilize Chapter 7 to liquidate assets prior to termination. *Chapter 7—Bankruptcy Basics*, U.S. COURTS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics [https://perma.cc/ST4W-5F4Y].

[216] *See, e.g.*, Girard, *supra* note 212 (discussing the advantages of a robust bankruptcy system focused on debtor rehabilitation).

[217] ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS bk. V, ch. III (Edwin Cannan ed., 5th ed. 1904), https://www.econlib.org/library/Smith/smWN.html?chapter_num=37#book-reader [https://perma.cc/2EVZ-CVSH]. In Smith's own words:

> When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonourable to the debtor and least hurtful to the creditor. The honour of a state is surely very poorly provided for when, in order to cover the disgrace of a real bankruptcy, it has recourse to a juggling trick of this kind, so easily seen through, and at the same time so extremely pernicious.

*Id.*

[218] Hagan, *supra* note 17, at 300–01.

[219] *Id.*; *see* Park & Samples, *supra* note 32, at 242 (noting that "sovereign debt markets operate in a legal and regulatory void, largely free from direct regulatory or legal authority").

[220] Hagan, *supra* note 17, at 300–01. The United States probably pulled out of the Sovereign Default Resolution Mechanism (SDRM) for several reasons. *Id.* at 391–92. First, the market had begun to adopt the contractual reforms discussed previously in this Part. *Id.* Next, it appeared unlikely at the time that Congress would have approved of the SDRM. *Id.* The most cynical explanation, and perhaps most accurate, is that the financial industry lobbied strenuously against adoption of the proposal. *Id.*

The arguments in favor of an international bankruptcy regime are strong.[221] A binding, predictable mechanism for restructuring would effectively eliminate the collective action issues that have plagued the Brady Bond era.[222] For example, such a system could surmount the difficulties presented by collective action clauses by tallying all creditor votes on restructuring plans, not just those on a particular bond issue.[223] Moreover, bankruptcy could provide a forum for resolution of related disputes and promote greater transparency from defaulting debtors.[224]

Despite the prospective benefits of an international bankruptcy system, however, proposals to date have simply not been able to get off the ground.[225] Reformers have consistently floated the solution since the dawn of the Brady Bond.[226] Nearly thirty years and billions in vulture fund profits later, there is no momentum towards sovereign bankruptcy.[227] Although advocates should not give up the fight, the grim reality is that defaulting sovereigns need relief now.[228]

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[221] *See, e.g.*, Davy V.H. Nguyen, Note, *Towards a Sovereign Bankruptcy Regime*, 45 CORNELL INT'L L.J. 697, 715–16 (2012) (listing reasons why a sovereign restructuring system would likely be the best solution to collective action problems).

[222] *Id.*; *see* Dickerson, *supra* note 10, at 1023–24 (discussing the myriad potential benefits of a sovereign bankruptcy system); Patrick Bolton & Olivier Jeanne, *Structuring and Restructuring Sovereign Debt: The Role of a Bankruptcy Regime* 20 (Int'l Monetary Fund, Working Paper No. 07/192, 2007), https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Structuring-and-Restructuring-Sovereign-Debt-The-Role-of-a-Bankruptcy-Regime-21207 [https://perma.cc/M2RE-9K37] (arguing that a "bankruptcy regime for sovereigns could . . . mitigate . . . inefficiency by facilitating debt restructuring in a sovereign debt crisis").

[223] Hagan, *supra* note 17, at 336.

[224] *Id.* The SDRM proposal envisaged a body called the Dispute Resolution Forum (DRF) that would exercise sole jurisdiction over issues arising from the bankruptcy. *Id.* The DRF's powers would be similar to those of an Article III bankruptcy court hearing "core" proceedings in a bankruptcy case. 28 U.S.C. § 157(b)(1) (2018); Hagan, *supra* note 17, at 336. Whether the DRF's reach would have extended to "non-core" or "related to" proceedings are unclear. 28 U.S.C. § 1334; Hagan, *supra* note 17, at 336.

[225] Dickerson, *supra* note 10, at 998.

[226] *See* Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2281 (2000) (surveying sovereign bankruptcy proposals dating from the early 1990s).

[227] *See* Dickerson, *supra* note 10, at 998 (noting that the international community is "unwilling to embrace uniform sovereign debt restructuring legislation); Wheeler & Attaran, *supra* note 161, at 264 (describing the "fundamental political impediments related to national sovereignty" that have frustrated attempts to establish an international bankruptcy system).

[228] *See* Elaine Moore, *International Bankruptcy Law Back on Agenda*, FIN. TIMES (Oct. 29, 2014), https://www.ft.com/content/56622598-59fe-11e4-be86-00144feab7de [https://perma.cc/XQ2E-Q8XA] (reporting that despite 124 countries voting in the 2014 U.N. General Assembly to consider a "legal framework for restructuring the debt of bankruptcy sovereign debt that would go beyond the 'market-based' solution of new bond clauses . . . what comes next is unclear").

### *C. Anti-Vulture Legislation*

The outrage sparked by vultures' predatory tactics and the dearth of effective solutions have led to calls for anti-vulture legislation.[229] A handful of countries have such legislation on their books, including the United Kingdom (UK) and Belgium.[230]

The UK passed its anti-vulture law—the Debt Relief Act (DRA)—in 2010 following a high profile suit in which vultures sought to collect from Zambia and Liberia, two of the world's poorest countries.[231] The law's primary mechanism is a cap on sovereign creditor recovery.[232] The UK's law is rather limited in scope, however, as it only protects nations that the IMF has designated as "highly indebted poor countries" (HIPCs), or those who may soon qualify.[233] In addition, the law applies only to sovereign debt issued prior to the DRA's enactment.[234] Jersey and the Isle of Man, both British dependencies and noted international financial centers, followed Britain's lead in 2012 by passing virtually identical laws.[235]

Belgium's terse 2015 anti-vulture statute is probably the world's most comprehensive.[236] A single page in length, the law includes two main provi-

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[229] *See, e.g.*, Human Rights Council Res. 27/30, U.N. Doc. A/HRC/RES/27/30, at 2–3 (Oct. 3, 2014) (urging member nations to adopt anti-vulture legislation); *Stopping Vulture Funds Through National Anti-Vulture Laws*, BRETTON WOODS PROJECT (Oct. 6, 2016), https://www.brettonwoodsproject.org/2016/10/stopping-vulture-funds-national-anti-vulture-laws/ [https://perma.cc/8U4W-MGGA] (discussing legislative solutions to the vulture fund problem in order to raise awareness).

[230] Wozny, *supra* note 19, at 728. Certain of the Channel Islands and Australia have also enacted limited anti-vulture laws. *Id.*

[231] Muse-Fisher, *supra* note 192, at 1696.

[232] Debt Relief (Developing Countries) Act 2010, c. 22, § 3 (UK).

[233] *Id.* § 1. The statute applies only to "qualifying debt," which is defined as:

> [A] debt incurred before commencement that—(a) is public or publicly guaranteed, (b) is external, (c) is a debt of a country to which the Initiative [defined as the Heavily Indebted Poor Countries Initiative of the IMF and World Bank] applies or a potentially eligible Initiative country, and (d) in the case of a debt of a country to which the Initiative applies, is incurred before decision point is reached in respect of the country.

*Id.*

[234] *Id.*

[235] Wozny, *supra* note 19, at 731–32. A 2011 vulture lawsuit brought in Jersey against the Democratic Republic of Congo precipitated their passage. *Id.* The suit purposely sought to skirt Britain's anti-vulture law. Muse-Fisher, *supra* note 192, at 1697.

[236] *See* Loi relative à la lutte contre les activités des fonds vautours [Law Relating to the Fight Against the Activities of Vulture Funds], MONITEUR BELGE [M.B.], [Official Gazette of Belgium], Sept. 09, 2015, 57357 [hereinafter Belgium Anti-Vulture Funds Law] (restricting virtually all vulture fund activity, regardless of the debtor nation's wealth); JACQUES RICHELLE, STRELIA, BELGIAN 2015 ANTI-VULTURE FUNDS LAW 1–3 (2016), https://www.strelia.com/sites/strelia.com/files/strelia_-_belgian_2015_anti-vulture_funds_law.pdf [https://perma.cc/797S-9U6F] (providing an English-language overview of the Belgian statute and noting that it remains to be seen whether enforcement of the law could conflict with both international treaties and the law of the European Union); *see also* Wozny, *supra* note 19, at 737–39 (discussing differences between the United Kingdom's (UK) limited

sions.[237] First, it forbids creditors from attaching sovereign property, subject to some narrow exceptions.[238] Next, and most importantly, it eliminates recovery for creditors who pursue claims with what the law deems an "illegitimate advantage."[239] A two-part test determines whether a creditor is indeed pursuing such an illegitimate advantage.[240] The creditor's purchase price must first be significantly less than either the debt's face value or the amount the creditor seeks in repayment.[241] One or more of the following must then apply: the sovereign debtor is insolvent or nearly so; the creditor is incorporated in a qualified "tax haven;" the creditor regularly litigates such claims; the creditor held out in a restructuring; the creditor seeks to take advantage of the economically vulnerable sovereign; or satisfaction of the creditor's claims would adversely affect the budget and/or economy of the sovereign.[242] The Belgian Constitutional Court upheld the validity of this sweeping law in June 2018 following a challenge by NML Capital, a subsidiary of Elliott Capital Management.[243]

Such legislation has not yet found support in the United States, despite lawmakers' attempts in 2008 and 2009 to introduce anti-vulture bills.[244] Representative Maxine Waters' "Stop Very Unscrupulous Loan Transfers from Underprivileged Countries to Rich, Exploitive Funds Act" lands somewhere in between the relatively narrow DRA and the expansive Belgian law.[245] Waters' bill, which was referred to committees but has not yet been subject to vote, would effectively bar investment returns on distressed sovereign debt issued by poor countries.[246]

Anti-vulture fund legislation is an undeniably effective means of reducing creditors' incentives to hold out from restructuring and litigate their claims.[247]

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anti-vulture statute and Belgium's law, which applies to virtually any profit-seeking sovereign debt trading).

[237] Belgium Anti-Vulture Funds Law, *supra* note 236; Wozny, *supra* note 19, at 737–39.

[238] Wozny, *supra* note 19, at 737.

[239] Belgium Anti-Vulture Funds Law, *supra* note 236; Wozny, *supra* note 19, at 738.

[240] Belgium Anti-Vulture Funds Law, *supra* note 236.

[241] *Id.*; RICHELLE, *supra* note 236, at 1.

[242] RICHELLE, *supra* note 236, at 1.

[243] Antonio Gambini & Bodo Ellmers, *Debt Justice Prevails at the Belgian Constitutional Court: Vulture Funds Law Survives Challenge by NML Capital*, CADTM (June 6, 2018), http://www.cadtm.org/Debt-justice-prevails-at-the-Belgian-Constitutional-Court-Vulture-funds-law [https://perma.cc/Q73L-8GLD]. The court held the law to be "non-discriminatory, respectful of Belgium's EU and international commitments, and not in violation of any constitutional right." *Id.*

[244] Wozny, *supra* note 19, at 734.

[245] *See* H.R. 2932, 111th Cong. (2009). The bill would prevent "sovereign debt profiteering" against "qualified poor countries," a phrase to be defined by Treasury Department. *Id.* §§ 3, 6. Unlike the Debt Relief Act (DRA), Waters' bill contains no restrictions related to the timing of bond issuance. *See id.* (including no language with respect to bond issuance timing).

[246] *Id.* Specifically, the law would fine creditors' returns on poor countries' sovereign debt purchased at a price less than face value. *Id.*

[247] *See* Wozny, *supra* note 19, at 731–32 (noting that the DRA had the effect of forcing vultures to attempt to litigate claims in UK protectorates such as Jersey).

If adopted by a critical mass of developed creditor nations, they could reduce collective action issues and enable a more streamlined restructuring process.[248] As only a handful of creditor nations have adopted such laws, however, vulture fund activity is alive and well.[249]

Still, there are several reasons to be skeptical of such legislation, particularly of a comprehensive law like that of Belgium.[250] First, anti-vulture legislation may significantly erode the secondary market for sovereign debt.[251] Belgium's law, which caps creditor recovery at price paid, effectively extinguishes incentives to trade in distressed sovereign bonds, as no rational investor would incur transaction costs to acquire an asset that can never appreciate.[252] Because these laws do nothing to implement structural economic reforms in debtor countries, default risk remains.[253] Where default risk increases and bond prices fall in an illiquid market lacking opportunistic vulture funds, creditors may face large losses, or at least be forced into unfavorable restructuring deals.[254] Over time, these risks could chip away at sovereign bond subscription and lower developing nations' access to capital.[255] Even under anti-vulture laws less draconian than Belgium's, investors may shy away without adequate information on sovereign finances, especially considering the incentives for developing sovereigns to exaggerate their economic output.[256]

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[248] *See* Belgium Anti-Vulture Funds Law, *supra* note 236 (outlawing profitable holdout litigation).

[249] *See, e.g.*, Kate Aronoff, *Vulture Funds Stand to Make Millions in Wake of Hurricane Maria*, THE INTERCEPT (Sept. 28, 2018), https://theintercept.com/2018/09/28/puerto-rico-hurricane-maria-recovery-funds/ [https://perma.cc/78X7-6ACN] (detailing vulture funds' predatory tactics following Puerto Rico's recent debt crisis); Azhari, *supra* note 67 (reporting on Lebanon's March 2020 default and pointing out that "Lebanon can expect tough negotiations with creditors over rescheduling its debt, some of which has been bought at deep discounts by so-called 'vulture funds' that may seek to take the country to court to force it to repay the full face value").

[250] *See* Wozny, *supra* note 19, at 741–42. The limited scope of the UK's anti-vulture law could be an effective means of reducing predatory practice against the most vulnerable sovereigns. *Id.* That law, however, would not have protected a debtor like Argentina. Muse-Fisher, *supra* note 192, at 1696.

[251] Wozny, *supra* note 19, at 741.

[252] *Id.* Because the law caps recovery at purchase price, the only possible outcome for an investor is a loss when transaction costs are factored in. *Id.*

[253] *See* Belgium Anti-Vulture Funds Law, *supra* note 236 (containing no provision regarding structural economic reform in the debtor sovereign that the law is designed to protect).

[254] Wozny, *supra* note 19, at 711–12.

[255] *See* James Bai, *Stop Them Circling: Addressing Vulture Funds in Australian Law*, 35 SYDNEY L. REV. 703, 728–29 (2013) (warning against solutions that could "raise significant barriers for lending in the worldwide sovereign debt market, gradually driving interest rates to higher levels that would force riskier sovereign debtors (like HIPCs) out of borrowing entirely").

[256] *See* Wozny, *supra* note 19, at 712–14 (discussing how vulture activity provides information to investors); *see also* Park & Samples, *supra* note 32, at 273 (highlighting developing nations' incentive to overestimate GDP in order to reduce borrowing costs).

Anti-vulture laws might also exacerbate moral hazard for debtor nations, particularly dictatorships prone to incurring "odious" debt.[257] Without the looming threat of litigation to enforce bond claims, sovereigns may be tempted to over-borrow, default, and restructure on favorable terms.[258] Over time, such behaviors are likely to increase borrowing costs, as well as risk of future default.[259]

### *D. Market Failure and Nonprofits*

"Market failure" occurs when market participants' rational pursuit of self-interest leads to socially undesirable outcomes.[260] One prominent example is a market's inability to limit "negative externalities," or costs that profit-seeking market actors impose upon innocent third parties.[261] For example, a factory emitting noxious pollutants imposes externalities on its neighbors in the form of higher health care costs.[262]

Government regulation often acts to mitigate negative externalities.[263] In the above example, a government might penalize a factory whose emissions cause harm.[264] But regulatory measures themselves often fail.[265] Regulations may be ineffective or give rise to unintended consequences, particularly in complex markets like the financial or health care markets.[266] In addition, regulations themselves impose compliance costs that may exceed the original cost

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[257] Wozny, *supra* note 19, at 712–14.

[258] *See id.* at 709–10 (detailing the problem of moral hazard in the sovereign default context).

[259] Bai, *supra* note 255, at 729.

[260] Jim Chappelow, *Market Failure*, INVESTOPEDIA (Apr. 7, 2020), https://www.investopedia.com/terms/m/marketfailure.asp [https://perma.cc/S8FB-KDFV] (defining "market failure" as a situation in which "the individual incentives for rational behavior do not lead to rational outcomes for the group").

[261] Tyler Cowen, *Public Goods and Externalities*, CONCISE ENCYCLOPEDIA OF ECON., http://www.econlib.org/library/Enc1/PublicGoodsandExternalities.html [https://perma.cc/NG7T-K3NK].

[262] *Id.*

[263] Steven L. Schwarcz, *Regulating Shadows: Financial Regulation and Responsibility Failure*, 19 WASH. & LEE L. REV. 1781, 1787 (2013). Where externalities cause markets to fail, government intervention often takes the form of cost-shifting from innocent third parties to the responsible party. *Id.* at 1793. Such interventions increase economic efficiency, as the externalities no longer affect third parties' behavior. *Id.*

[264] *Id.*

[265] *See* HOWARD BEALES ET AL., REGULATORY TRANSPARENCY PROJECT, GOVERNMENT REGULATION: THE GOOD, THE BAD, & THE UGLY 10 (2017), https://regproject.org/wp-content/uploads/RTP-Regulatory-Process-Working-Group-Paper.pdf [https://perma.cc/PCN7-4KHD] (noting that although "regulation is an essential tool for achieving broad public goals . . . poorly designed regulations can do more harm than good").

[266] *See Over-Regulated America*, THE ECONOMIST (Feb. 18, 2012), https://www.economist.com/leaders/2012/02/18/over-regulated-america [https://perma.cc/PRZ2-E8SN] (lamenting the inscrutability, inefficiency, and dubious efficacy of the Affordable Care and Dodd-Frank Acts). *See generally* DAREN BAKST ET AL., THE HERITAGE FOUND., BIG GOVERNMENT POLICIES THAT HURT THE POOR AND HOW TO ADDRESS THEM (2017), https://www.heritage.org/sites/default/files/2017-04/SR176.pdf [https://perma.cc/V9MV-MY9G] (exploring the unintended negative consequences of government regulation on America's poorest citizens).

of the externality.[267] Finally, although regulatory agencies in the United States are somewhat insulated from the political process, there is undoubtedly a political dimension to government rulemaking; in certain cases, there may simply not be sufficient political will to tackle a given problem.[268]

Where neither markets nor governments are equipped to solidify a failing market, nonprofit organizations often step into the breach.[269] Today, there are well over one million nonprofits registered in the United States, and it is estimated that their activities constitute five percent of U.S. GDP.[270] Data suggests that certain nonprofits are highly effective in carrying out their stated missions.[271] The historical record shows that almost all social movements in American history spawned from the nonprofit sector.[272]

The role of nonprofits in failed healthcare markets furnishes a useful example.[273] Of the thirty-three wealthiest nations in the world, twenty-four have some form of government-provided healthcare.[274] In the United States, which has not yet ceded control of the healthcare market to the government, nonprofits play an essential role.[275] Nonprofit hospitals, for example, treat indigent patients.[276] Were these patients unable to obtain free services on the open mar-

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[267] *See* William Dunkelberg, *The Insidious Cost of Regulation*, FORBES (Apr. 4, 2017), https://www.forbes.com/sites/williamdunkelberg/2017/04/04/the-insidious-cost-of-regulation/#33bcb0865c7b [https://perma.cc/HC4Q-8G5Z] (highlighting the astronomical costs imposed by government regulation and decrying the lack of rigorous cost-benefit analysis prior to implementation).

[268] Roger Noll, *The Political Foundations of Regulatory Policy*, 139 J. INSTITUTIONAL & THEORETICAL ECON. 377, 378 (1993); Sara Bodnar, *Does the Administrative State Threaten U.S. Democracy?*, REG. REV. (Oct. 19, 2017), https://www.theregreview.org/2017/10/19/bodnar-administrative-state-threaten-democracy/ [https://perma.cc/7L46-Y2QP].

[269] Avner Ben-Ner, *Who Benefits from the Nonprofit Sector? Reforming Law and Public Policy Towards Nonprofit Organizations*, 104 YALE L.J. 731, 734 (1994) (book review). In the United States, a nonprofit is a tax-exempt business pursuing some public good. *What Is a "Nonprofit"?*, NAT'L COUNCIL NONPROFITS, https://www.councilofnonprofits.org/what-is-a-nonprofit [https://perma.cc/GG9Z-MLHP].

[270] BRIAN MCKEEVER, URBAN INSTITUTE, THE NONPROFIT SECTOR IN BRIEF 2015: PUBLIC CHARITIES, GIVING, AND VOLUNTEERING 1 (2015), https://www.urban.org/sites/default/files/publication/72536/2000497-The-Nonprofit-Sector-in-Brief-2015-Public-Charities-Giving-and-Volunteering.pdf [https://perma.cc/A92X-DA7W].

[271] Lester M. Salamon et al., *The Nonprofit Sector: For What and For Whom?* 1, 19 (Johns Hopkins Comparative Nonprofit Sector Project, Working Paper No. 37, 2000). Ninety percent of nonprofit service providers perform at a level designated as "medium to high." *Id.*

[272] Lester M. Salamon, *The Rise of the Nonprofit Sector*, 73 FOREIGN AFF. 109, 109–10 (1994).

[273] *See* Milton I. Roemer, *Market Failure and Health Care Policy*, 3 J. PUB. HEALTH POL'Y 419, 419 (1982) (noting that "in the provision of healthcare, free trade and competition have been particularly ineffective for allocation of resources").

[274] *List of Countries with Universal Healthcare*, TRUE COST (Jan. 21, 2013), https://truecostblog.com/2009/08/09/countries-with-universal-healthcare-by-date/ [https://perma.cc/937W-W4BQ]. Eight others have mandated health insurance coverage. *Id.*

[275] Mark Schlesinger & Bradford H. Gray, *How Nonprofits Matter in American Medicine, and What to Do About It*, 25 HEALTH AFF. 287, 288 (2006).

[276] SJ Benson, *The Many Market Failures of Health Care*, REAL PROGRESSIVES (Nov. 5, 2019), https://www.realprogressivesusa.com/news/featured/2018-11-05-market-failures-health-care [https://perma.cc/937W-W4BQ].

ket, public health would suffer; untreated patients might spread disease, put off treatment for early-stage illnesses, or neglect preventative care entirely.[277] Any of the foregoing outcomes would harm the indigent patient herself, as well as create a cascade of costs for other healthcare consumers.[278]

The IMF provides a nonprofit corrective to the failure of international capital markets.[279] By providing intermediate funding to countries in economic straits, the IMF works to contain potentially devastating externalities.[280] Profit-seeking actors are unlikely to extend credit to countries on the brink of disaster.[281] But these countries badly need access to cash in times of crisis to avoid sinking into depression and dragging their neighbors down along with them.[282] The IMF typically makes its loans conditional on the debtor nation implementing structural economic reforms designed to fix the issues that gave rise to the crisis in the first place.[283] The IMF's role can be likened to a nonprofit hospital treating a patient who is unable to pay; absence of a service-provider of last resort would have dire effects for both patients and their neighbors.[284]

## III. A NONPROFIT VULTURE FUND IS THE BEST AVAILABLE SOLUTION

The combination of record sovereign debt levels, global recession, and a soaring U.S. dollar are a recipe for widespread sovereign default.[285] The next decade is therefore likely to pose significant solvency challenges for overleveraged developing nations.[286]

The consequences of sovereign default episodes can be dire, particularly when such episodes are protracted.[287] The need for the international communi-

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[277] *Id.*

[278] *Id.*

[279] JAMES RAYMOND VREELAND, THE INTERNATIONAL MONETARY FUND: POLITICS OF CONDITIONAL LENDING 114 (2007).

[280] *Id.*

[281] *See* Buckley, *supra* note 80, at 1803–04 (describing the economic death spiral into which Mexico and other Latin American countries entered in the 1980s).

[282] *See* Borensztein & Panizza, *supra* note 49, at 7 (discussing the negative impact of Mexico's debt crisis on other emerging markets).

[283] *IMF Conditionality*, *supra* note 21.

[284] *See* Benson, *supra* note 276 (discussing health care nonprofits' role in remedying market failures).

[285] *See* Gill, *supra* note 174 (explaining the U.S. dollar's surge following the coronavirus-induced financial panic of March 2020); Isidore, *supra* note 13 (describing the global economic downturn following the coronavirus outbreak); Johnson, *supra* note 12 (reporting that sovereign debt levels in developing nations are at an all-time high).

[286] *See* Isidore, *supra* note 13 (noting that the coronavirus "has severely disrupted economic activity" and has "plunged the world's economy into a global recession"); *see also* Johnson, *supra* note 12 (suggesting that the vulnerability of heavily indebted developing economies may be "over the limits of sustainability").

[287] *See* Dickerson, *supra* note 10, at 1006 (noting that drawn-out debt crises impose more severe economic costs on debtor nations); Reinhart et al., *supra* note 54, at 1–2 (finding that default itself

ty to mitigate the damage from such episodes is urgent.[288] Aside from the obvious injustice of redirecting wealth from developing nations to hedge funds, vulture fund holdout litigation tends to prolong and complicate the sovereign restructuring process.[289]

Sadly, there is no effective solution at hand to deal with the inevitable next wave of defaults.[290] Bond drafting norms are powerless to alter the terms of most outstanding sovereign debt, and vulture funds have deep enough pockets to obtain blocking positions in individual bond issues and thereby mute the efficacy of majority action clauses.[291] Although an international bankruptcy regime would render these worries moot, the political will to establish one does not appear to exist.[292] In reaction to public outrage over outsized vulture fund returns made at the expense of defenseless sovereigns, some nations have enacted laws restricting vulture profiteering.[293] But these laws likely go too far in eliminating the liquidity, information, and moral hazard check provided by vultures.[294] Moreover, the long-term effect of such laws on developing nations' access to capital is unclear.[295]

Distressed sovereign debt in the Brady Bond era is a classic example of market failure.[296] Vulture funds' rational, court-sanctioned pursuit of profit has

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increases future default risk); Borensztein & Panizza, *supra* note 49, at 8 (showing that default episodes can reduce the defaulting sovereign's GDP by up to two percent).

[288] *See* Jose Antonio Ocampo, *Guest Post: The UN Takes the First Step to Debt Restructuring*, FIN. TIMES (Sept. 10, 2014), https://www.ft.com/content/53383c56-3e1b-3beb-ae04-5872abc8e299 [https://perma.cc/7YB4-QQF6] (highlighting the "systemic implications" of the current sovereign restructuring process).

[289] *See* Wheeler & Attaran, *supra* note 161, at 153–54 (discussing vulture holdout litigation generally); *see also* Merle, *supra* note 3 (chronicling Argentina's nearly two-decade struggle to resolve holdout litigation following a default episode).

[290] *See* Dickerson, *supra* note 10, at 998 (highlighting the lack of political support for an international sovereign debt restructuring system); Hagan, *supra* note 17, at 320 (emphasizing the limitations of a purely contractual approach to curbing vulture fund holdout litigation); Wozny, *supra* note 19, at 741 (discussing the tendency of anti-vulture fund laws to eliminate the substantial benefits those funds provide to the secondary market for sovereign debt).

[291] *See* Krueger, *supra* note 205, at 31 (noting that long-term sovereign bonds issued before recent improvements in bond drafting took root will not mature for several years); *see also* Hagan, *supra* note 17, at 320–21 (predicting that creditors' ability to obtain blocking positions in certain bond issues may render collective action clauses ineffectual).

[292] *See* Dickerson, *supra* note 10, at 998 (declaring the institution of an international bankruptcy regime an idea without political viability).

[293] *Compare* Debt Relief (Developing Countries) Act 2010, c. 22, § 3 (UK) (the UK's anti-vulture fund legislation), *with* Belgium Anti-Vulture Fund Law, *supra* note 236 (Belgium's significantly more restrictive law).

[294] *See* Wozny, *supra* note 19, at 741–42 (detailing the prospective market impact of anti-vulture fund legislation).

[295] *See id.* (noting that investors subject to anti-vulture laws may lack incentives to purchase sovereign debt).

[296] Chappelow, *supra* note 260 (defining "market failure" as a situation in which "the individual incentives for rational behavior do not lead to rational outcomes for the group").

led to disastrous results for the international community, and neither market-based nor government solutions are equal to the task of reducing the externalities wrought by holdout litigation.[297]

A benevolent, nonprofit distressed debt fund is the best and most readily available antidote to pernicious vulture activity.[298] In the absence of an effective market-based solution and enforceable government regulation, a nonprofit may be the only one left to fill the void.[299] Moreover, such a project is a natural fit within the burgeoning socially responsible investing movement.[300]

Such a fund is a superior solution to contractual fixes, an international bankruptcy system, or anti-vulture legislation.[301] First, a well-established international body such as the IMF could likely set up such a fund before any other available solutions could take effect, particularly since the IMF is already engaged in nonprofit, externality-mitigating work in the international capital markets.[302] Second, although the political will for an international bankruptcy regime is lacking, there is likely enough will for a stopgap measure such as a nonprofit fund.[303] Third, such a fund could at the very least curb vultures' excesses while preserving the benefits they provide.[304]

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[297] *See* Choi & Gulati, *supra* note 175, at 990 (concluding that there is insufficient political will to establish an international bankruptcy framework); Hagan, *supra* note 17, at 321–23 (noting the limitations of a purely contractual approach to sovereign restructuring reform); Merle, *supra* note 3 (discussing the economic impact of Argentina's fifteen-year battle with holdout creditors).

[298] *See* Ben-Ner, *supra* note 269, at 734 (describing nonprofits' traditional role as a stopgap in situations where neither government nor market-based solutions are available to rectify market failure).

[299] *Id.*

[300] *See* Adam Connaker & Saadia Madsjberg, *The State of Socially Responsible Investing*, HARV. BUS. REV. (Jan. 17, 2019), https://hbr.org/2019/01/the-state-of-socially-responsible-investing [https://perma.cc/PBV5-3PTC] (highlighting an $8.6 trillion increase in demand since 2010 for assets that meet certain environmental, social, and governance requirements); *see also* Todd Shriber, *Gender Equality ETF Still Going Strong*, BENZINGA (Mar. 8, 2019), https://www.benzinga.com/trading-ideas/long-ideas/19/03/13322495/gender-equality-etf-still-going-strong [https://perma.cc/9FNJ-RNF9] (commemorating the third anniversary of State Street Global Advisors' "SHE," an exchange-traded product tracking an index of public companies committed to gender equality).

[301] *See* Choi & Gulati, *supra* note 175, at 990 (remarking that there is no international consensus on the implementation of a sovereign bankruptcy system); Hagan, *supra* note 17, at 321–23 (discussing the need for reforms beyond improved contractual language in sovereign bond issues); Wozny, *supra* note 19, at 741–42 (detailing the potentially disastrous impact of anti-vulture legislation on the secondary market for sovereign debt).

[302] *See* VREELAND, *supra* note 279, at 114 (characterizing the IMF as a nonprofit market actor seeking to remedy market failure).

[303] Wheeler & Attaran, *supra* note 161, at 253; *see* Hagan, *supra* note 17, at 300–01 (reporting that "while support for the SDRM proposal was strong, it was not strong enough").

[304] *See* Park & Samples, *supra* note 32, at 253 (discussing the risks posed by "rogue" sovereign debtors with insufficient incentives to make good on loans).

The fund's charter could be modeled closely after the IMF's Articles of Agreement.[305] The charter's "Purposes" section might include a three-pronged mission of facilitating efficient sovereign restructurings, pursuing no more than modest returns on investment, and providing a check on sovereign moral hazard.[306]

The first two prongs would operate in tandem to enable the nonprofit to both outbid vultures for bonds at depressed prices and participate cooperatively in restructurings.[307] The fund could even buy bonds from vultures on the secondary market, allowing vultures to make a quick, if not quite so spectacular profit while avoiding prolonged litigation.[308] It might also consider simply subscribing to serial defaulters' new bond issues.[309]

In addition, the fund could offer incentives to market actors who, for example, sign a pledge not to engage in holdout litigation; for example, the fund might pledge to accept less favorable terms than other creditors.[310] By contributing to a robust secondary market, which sweeping anti-vulture legislation would eliminate entirely, a benevolent vulture fund would preserve investors' access to liquidity and information, and by extension sovereign debtors' access to capital.[311]

The fund could satisfy the third prong of its mission statement through the threat of holdout litigation.[312] The fund might first set forth certain "good standing" requirements for its debtors; these could include heightened disclosure obligations, debt limits, and structural economic reforms.[313] Upon default, sovereigns not in good standing would face holdout litigation, and perhaps even limits on bailout funds.[314] The prospect of litigation might encourage sovereigns to implement these reforms in good faith, thereby reducing the risks

[305] *See* Articles of Agreement of the IMF, Art. V (establishing limits on and conditions for the provision of IMF loans).

[306] *See id.* (setting out a mission statement upon which a nonprofit vulture fund might be based).

[307] *See* Wheeler & Attaran, *supra* note 161, at 253–54 (describing the problems caused when vulture funds purchase discounted sovereign debt and hold out for full repayment).

[308] *Id.*; Merle, *supra* note 3.

[309] *See* Reinhart et al., *supra* note 54, at 1–2 (finding that past defaults predict future ones).

[310] Wheeler & Attaran, *supra* note 161, at 253–54.

[311] Barciela, *supra* note 157 (noting that investors perceive vulture activity as a signal of heightened default risk).

[312] *See* Fisch & Gentile, *supra* note 93, at 1049–51 (describing the effects of opportunistic sovereign default on creditors).

[313] *See* Park & Samples, *supra* note 32, at 273 (noting that sovereigns have incentives to exaggerate their economic output to reduce borrowing costs); Reinhart et al., *supra* note 54, at 1–2 (finding that developing nations at risk of default tend to have structural economic deficiencies and excessive debt loads).

[314] *See* DREGER, *supra* note 99, at 7–8 (noting that bailout loans may disincentivize debtors from borrowing responsibly and enacting economic reforms); Fisch & Gentile, *supra* note 93, at 1049–51 (discussing holdout litigation's value as a bulwark against sovereign moral hazard).

of moral hazard and serial default.[315] The IMF's Articles of Agreement, which include limitations and conditions on its ability to lend, could once again provide a template for such provisions.[316]

## CONCLUSION

Rising sovereign debt levels and global recession will combine to create a fertile environment for sovereign default in the decade to come. Since the rise of securitized Brady Bonds in the 1990s, holdout litigation by vulture funds has delayed restructuring and resulted in massive transfers of wealth from poor developing countries to Western hedge funds. Despite spirited debate among academics and policymakers, no effective solution to this issue is ready for the coming wave of defaults. Proposed solutions will either not take effect quickly enough, are not politically viable, or will eliminate the real benefits that vulture funds provide to the secondary market. In the domestic context, nonprofit organizations routinely insert themselves into failed markets where market-based solutions or government regulatory action is ineffective. The community of developed nations should therefore form a nonprofit vulture fund to at least dampen the impact of vulture funds until a more thorough solution emerges.

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[315] *See* Dickerson, *supra* note 10, at 1010 (discussing how IMF bailouts "create[] a moral hazard risk by encouraging countries both to maintain domestic economic policies that are not fiscally sound and to borrow recklessly from private capital markets"); Reinhart et al., *supra* note 54, at 1–2 (noting that structural economic weaknesses and high debt loads predict sovereign default).

[316] Articles of Agreement of the IMF, Art. V (establishing limits on and conditions for the provision of IMF loans).