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W. Mark C. Weidemaier

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Abstract

This essay revisits the role of legal enforcement in sovereign debt markets. The conventional view, which has long held sway in the economic literature, is that the law of sovereign immunity denies creditors effective legal remedies when governments do not repay their debts. To many observers, weak legal enforcement is problematic, for effective legal remedies would facilitate credible repayment commitments and thereby increase access to credit. Though substantially correct, this perspective is also flawed. The assumption that creditors lack effective legal remedies implicitly treats sovereign immunity law as a set of mandatory rules. In fact, sovereign lenders can and do bargain for greater enforcement rights. When courts enforce these bargains—as they seem increasingly willing to do—legal remedies gain potency. Yet potent remedies need not improve the functioning of debt markets. Courts can create effective remedies against sovereign debtors only by imposing significant costs on third parties. Many loan debt contracts are drafted so as to maximize these externalities. The important question—given short shrift thus far—is whether the credibility-enhancing virtues of legal enforcement justify the costs.

INTRODUCTION

Does the threat of litigation in foreign courts make governments more likely to repay debts?[1] The standard answer—no—understands the law of foreign sovereign immunity as a nearly-insuperable barrier to legal enforcement. That body of law determines when courts and

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[1] Creditworthy governments with strong, independent legal institutions may require lenders to sue in domestic courts. Such governments, however, tend to borrow in their own currency and under their own law and thus have a variety of tools to avoid formal default.

other legal actors in a state may hear lawsuits and enforce judgments against foreign states and their instrumentalities. Codified in the United States and a few other jurisdictions, and established by case-law elsewhere, the law generally grants substantial immunity to foreign states. National courts may hear lawsuits that arise out of a foreign state's commercial but not "governmental" conduct, and a creditor who wins a judgment has only limited rights to enforce it through the seizure of sovereign assets. Because of these limitations, the sovereign debt literature generally discounts the relevance of legal enforcement (e.g., Panizza et al., 2009; Weidemaier and Gulati 2015).

Especially in the economics literature, standard accounts view the presumed absence of legal remedies as both a puzzle and a problem. It is a puzzle because lending markets cannot exist unless borrowers can credibly promise to repay. So why have lenders who apparently lack meaningful legal remedies nevertheless lent many trillions of dollars to foreign states? It is a problem because strong enforcement rights are associated with greater and cheaper access to credit (e.g., Shleifer 2003). If creditors had strong legal remedies, governments might be able to borrow more cheaply, investing loan proceeds in ways that (hopefully) promote economic growth and the welfare of citizens.

Although these are generally sound insights, my goal in this Essay is to qualify them in two respects. First, much of the sovereign debt literature is premised on a stylized view of foreign sovereign immunity law, one that implicitly treats that law as a set of mandatory rules determining the maximum rights available to creditors. In fact, the law of foreign sovereign immunity consists primarily of default rules, and research demonstrates that modern loan contracts endow creditors with much greater rights. For example, clauses in loan contracts authorize creditors to seize critical assets that government borrowers cannot easily shelter within their borders (e.g., diplomatic or

military assets) and to request injunctive relief blocking governments from paying creditors who participate in a debt restructuring. Sovereign debt litigation has become more frequent, fueled by the arrival of hedge funds that specialize in enforcing distressed government debt (Schumacher et al. 2014; Schumacher et al. 2015). National courts also seem increasingly willing to respect contract clauses that expand the rights available to creditors. Potentially, then, legal remedies can play a potent role in enforcing sovereign debt obligations.

The second qualification is that standard accounts emphasizing how strong legal remedies can expand access to credit overlook the substantial costs of legal enforcement. Courts can issue effective sanctions against foreign governments only by imposing significant costs on third parties. Some of these costs are the inevitable byproduct of legal remedies, as when a judgment creditor's attachment (i.e., seizure) of assets disrupts a commercial transaction between the government and a third party supplier. As I will explain, however, these costs are magnified when the judgment debtor is a foreign sovereign. In the context of a debt crisis, moreover, granting strong legal remedies to a creditor may increase the costs borne by official creditors. For example, the inability to restructure private debt claims may necessitate a larger bailout package. The important question—overlooked by the literature thus far—is whether the credibility-enhancing virtues of legal enforcement justify these costs.

A MODIFIED VIEW OF LEGAL ENFORCMENT

In prior eras of sovereign lending, disputes between bondholders and borrower governments rarely surfaced in national courts. Instead, a loan default prompted bilateral negotiations between the borrower government and its private bondholders. On rare occasions, rich country governments or multilateral institutions like the League of Nations played a role in resolving such disputes (e.g. Sgard 2004), but national courts were largely irrelevant. One reason

is that, until the 1970s, the law of sovereign immunity protected governments from suit in national courts (Weidemaier and Gulati, n.d.). Even today, when foreign governments no longer enjoy this traditional immunity, national courts are limited in their power to deploy coercive legal remedies against foreign governments.

The presumed irrelevance of legal enforcement frames a central puzzle in sovereign debt: Why do lenders expect repayment when they have few legal remedies (e.g. Panizza et al. 2009; Kolb 2011; Oosterlinck 2013; Puri 2016)? In earlier eras of lending, wealthy governments sometimes protected their citizens' foreign investments through military power or other coercive methods, including by taking physical control of ports and other revenue collection points (e.g., Mitchener and Weidenmier 2005; Rosenberg 2003). Governments rarely engage in such direct coercion today, so modern explanations emphasize other factors. These include the borrower's desire to maintain its reputation in capital markets (Tomz 2007; Cruces and Trebesch 2013), to avoid trade sanctions or other forms of retaliation (Bulow and Rogoff 1989), or to avoid the collateral economic costs of default, such as magnified output losses or a domestic banking crisis (Gennaioli et al. 2014; Panizza et al. 2009).

Each of these explanations takes the absence of legal enforcement as a given. Court judgments for money damages are enforced through asset seizure (e.g., FSIA § 1610), yet sovereign borrowers can keep assets safe within their borders, where local officials may block creditors from seizing them. Indeed, there are many examples of creditors trying unsuccessfully, often for years, to seize sovereign assets. The lesson many take from these episodes is that the threat of asset seizure "is not credible and therefore cannot motivate repayment" (Sinyagina-Woodruff 2003; Pitchford and Wright 2010).

However, this view of legal enforcement must be qualified. As explained below, the strength of a creditor's legal remedies against a foreign government depends on how broadly the creditor can interfere with the government's interactions with parties outside its borders. The law of foreign sovereign immunity protects sovereigns from a great deal of interference, but governments can waive much of this protection. Indeed, loan contracts often include "waiver" clauses that dramatically increase the government's exposure to creditor interference. Creditors cannot be certain that national legal authorities will enforce these clauses, but the trend is toward greater enforcement.

Legal Enforcement as Embargo

From the perspective of a sovereign debtor, the cost of a money judgment is not the loss of sovereign assets; it is the opportunity cost associated with the prevention of asset seizure and other forms of creditor interference (Weidemaier and Gelpern 2014). The sovereign debt literature recognizes these potential costs (e.g., Bulow and Rogoff 1989; Panizza et al. 2009) but generally views them as modest. However, even if that is the correct way to view the rights creditors enjoy (by default) under the law of foreign sovereign immunity, it may prove incorrect when creditors have contracted for greater rights.

A creditor's classic remedy is a money judgment enforced by the seizure and sale of the judgment debtor's assets. All judgment debtors can shelter some assets from creditors (e.g., Lopucki 1996), but foreign sovereigns receive special protection. As a general rule, creditors may seize sovereign assets when used for a commercial activity (FSIA § 1610; SIA § 13). This rule keeps property used for public or "governmental" purposes out of creditor reach. Nevertheless, many of the sovereign's assets remain exposed to its creditors. In the U.S. and U.K., for instance, the issuance of bonds is a commercial act, which means a creditor may try to seize the proceeds

of any new bond issue (Weltover v. Republic of Argentina, 504 U.S. 607 (1992); SIA § 13).[2] Likewise, a creditor may try to seize commercial goods purchased from U.S. or U.K. suppliers, or the funds owed to state-controlled enterprises that have sold goods in these markets. To avoid these outcomes, the sovereign must forego such transactions or conduct them in roundabout, expensive ways.[3] The practical effect of a money judgment, then, is a creditor-imposed embargo on the sovereign's commercial and financial transactions in any jurisdiction that will enforce the judgment (Weidemaier and Gelpern 2014). Some governments may be willing to bear these opportunity costs. After its 2001 default, for instance, Argentina was able to keep borrowing large sums in domestic capital markets (Panizza et al. 2009). Other sovereigns, however, may capitulate to creditors rather than endure long-term market exclusion.

Although a determined creditor can impede the sovereign's access to foreign capital and commercial markets, its rights are limited in important ways. Judgment creditors can seize assets belonging to or controlled by the sovereign but typically cannot prevent the sovereign from *transferring* assets to external creditors. That is because the sovereign can structure such transfers to occur within its borders; by the time the assets reach a foreign jurisdiction, they belong to the transferee and cannot be seized to satisfy a debt owed by the sovereign. Crucially, in a debt crisis, this means that a sovereign can credibly promise to keep paying any creditor who voluntarily agrees to reduce the amount of its claim. Post-default, for example, Argentina honored its

[2] Certain conditions must also be satisfied. The default rule is that a commercial asset (here, the proceeds of a new loan) must *also* have been "used for the commercial activity upon which the claim is based" (here, presumably, the initial loan). This "nexus" requirement disappears, however, when the sovereign has waived its immunity from execution or the creditor has obtained an arbitration award (FSIA § 1610(a)). This example assumes the sovereign has waived its execution immunity.

[3] For instance, the sovereign can buy and sell goods through a private enterprise that it surreptitiously controls, but this increases its costs and does not guarantee that foreign courts will treat the private enterprise as an entity distinct from the sovereign itself.

restructured debt by transferring money in Argentina to an indenture trustee, which then initiated a series of transfers resulting in payment to bondholders. Creditors will not agree to such a debt restructuring if they believe that non-participating holdouts will seize the payments.

Contract Determines the Scope of the Embargo

The discussion thus far has focused on the rights available to all creditors under the law of foreign sovereign immunity. The rules differ from jurisdiction to jurisdiction (e.g., Weidemaier and Gulati, n.d.), but, in the sovereign debt context, the differences are relatively slight in the jurisdictions that most interest creditors. Importantly, all of these rules can be modified by contract in ways that dramatically expand a creditor's ability to interfere with the sovereign's foreign transactions.

Take the rules governing execution immunity—i.e., the rules that prevent the seizure of sovereign assets to satisfy a creditor's money judgment. As noted, the law generally allows seizure only when the assets are used for a commercial activity in the jurisdiction. This rule is widely followed, including in important creditor jurisdictions like the United States (FSIA § 1610) and United Kingdom (SIA § 13). Some jurisdictions even insulate many commercial assets from seizure. For instance, the default rule under the Foreign Sovereign Immunities Act (FSIA) in the United States is that a creditor may seize commercial assets only when they are "used for the commercial activity" on which the creditor based its claim (FSIA § 1610(a)(2)). This "nexus" requirement is problematic when the creditor's claim arises from unpaid sovereign debt. Previously, for instance, I described how a judgment creditor could try to seize the proceeds of a new loan issued in the United States. Whether it will succeed under the FSIA's default rule depends on whether there is a sufficient nexus between the assets to be seized (the new loan proceeds) and the commercial act on which the creditor based its claim (taking out the old loan). That question

has no clear answer. Moreover, the nexus requirement will almost certainly prevent a creditor holding sovereign-debt-related claims from seizing commercial assets unrelated to borrowing money, such as contracts for the purchase or sale of commodities.

Thus, the default rules established by the FSIA let creditors with money judgments arising from unpaid sovereign debt interfere with only a small subset of the sovereign's foreign transactions. But these rules can be changed by contract (Panizza et al. 2009). If a creditor wants to eliminate the nexus requirement, it has at least two contractual tools available. First, it can insist that the sovereign include in the loan contract a clause waiving its execution immunity (FSIA § 1610(a)(2)). Second, it can insist that the contract include an arbitration clause (FSIA §1610(a)(6)).

The preceding example demonstrates how a creditor can eliminate the nexus requirement imposed by the FSIA. The result is to allow seizure of all assets used for a commercial activity in the United States. To my knowledge, however, every jurisdiction treats a foreign sovereign's *non*-commercial assets as immune from execution, at least presumptively. This means that sovereign immunity protects assets used for diplomatic, consular, military, and other governmental functions. To creditors, such assets are especially attractive targets. They are disproportionately valuable to the sovereign, relatively easy to find, and hard to shelter within the sovereign's own territory. In short, they are ideal sources of leverage for a creditor looking to get paid.

More controversially, the law in many jurisdictions—although not the United States[4]—apparently allows creditors to bargain for the right to seize non-commercial assets, potentially including even diplomatic and other highly sensitive assets. For example, the State Immunity Act 1978 (SIA) in the United Kingdom lets creditors seize assets (assuming certain conditions are

[4] The plain text of the FSIA, 28 U.S.C. § 1610(a), appears to limit execution to assets "used for a commercial activity in the United States."

satisfied) when the assets are used "for commercial purposes" or when the creditor has obtained "the written consent of the state concerned."[5] Likewise, the United Nations Convention on the Jurisdictional Immunities of States and their Property allows the seizure of non-commercial assets with a state's express consent, which can be provided ex ante in a written contract.[6] Increasingly, creditors are pressing courts to give effect to such clauses. As an example, loans made to Argentina before that country's 2001 default included a waiver of execution immunity extending "to the fullest extent permitted by the laws" of the jurisdiction in which creditor found Argentine assets (Fiscal Agency Agreement, A-18). On multiple occasions, creditors invoked this clause in an effort to seize property associated with Argentina's diplomatic functions in France.[7]

Clauses that waive execution immunity with regard to non-commercial assets give creditors potent new enforcement rights. The prevalence of such clauses in the existing debt stock is hard to estimate, because the answer depends on the relevant rules of contract interpretation, which are contested. For instance, although Argentina's waiver of sovereign immunity (quoted above) plainly seems to allow seizure of diplomatic assets when consistent with the law of the enforcing jurisdiction, at least one French court rejected this interpretation. According to that court, a waiver of sovereign immunity covers diplomatic assets only if it expressly refers to diplomatic property. But this ruling—however sensible and pragmatic—hardly follows as a matter of ordinary contract law, and indeed a later French case took the opposite view.[8]

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[5] SIA § 13. The state's consent "may be contained in a prior agreement."

[6] The Convention is not in force but, with twenty-eight signatories, provides some evidence of state practice with regard to execution immunity.

[7] Two notable cases include *Société NML Capital Ltd. v. Republique Argentine*, Cour de Cassation (1ère Chambre Civile), No. 09-72.057 (Sept. 28, 2011) and *Société NML Capital (Iles Caïmans) v. Etat d'Argentine, Cour de Cassation* (1ère Chambre Civile), No. 10-25.938, 11-10.450 and 11-13.323 (Mar. 28, 2013)).

[8] See cases cited note 7.

The broader point is that the loan contract determines the extent of a creditor's right to impede the sovereign's commercial, financial, and even diplomatic or military interactions abroad. In a dataset of sovereign bond contracts developed with colleagues at other institutions (e.g., Weidemaier et al. 2013; Choi et al. 2012), virtually all sovereign bonds issued in foreign markets include clauses waiving the issuing government's immunity from suit. Such clauses let bondholders file lawsuits and obtain judgments in courts of their choosing (subject to jurisdictional and other limitations imposed by the forum). The large majority of bond contracts also include clauses waiving the sovereign's execution immunity (Weidemaier 2014; Weidemaier and Gulati n.d.). Of the bonds that waive immunity from execution, only about half (53%) expressly *exclude* diplomatic assets, or assets used for "public" or "governmental" purposes, from the scope of the waiver. This means that nearly half of the bonds in the dataset could be interpreted to permit seizure of assets used for diplomatic functions, such as embassy bank accounts or even (in unusual cases) real property owned abroad.

Waivers of sovereign immunity are not the only contractual clauses that expand a creditor's right to impede the sovereign's foreign activities. Recall that a money judgment lets creditors seize foreign assets belonging to the sovereign but does not let them block the sovereign's transfer of assets to foreign creditors. Because of this, a sovereign can pay creditors who participate in a debt restructuring, while refusing to pay creditors that do not. Recent legal developments, however, suggest that loan contracts can prohibit such selective payments, at least if courts are willing to enforce the contract through injunctive relief. This implies that creditors can bargain ex ante for clauses that make it effectively impossible for the sovereign to restructure its debt.

The paradigmatic example of such a clause is the *pari passu* clause—familiar from litigation by distressed debt funds seeking to enforce unpaid bonds issued by Argentina (e.g., NML Capital

Ltd. v. Republic of Argentina, 699 F.3d 246 (2012)). As interpreted by federal courts in New York, the clause prevents the issuing government from paying any creditor without making an equivalent payment to equally-ranked creditors. This interpretation meant that Argentina could not make the periodic coupon payments due participants in its debt restructuring unless it also paid non-participants the full amount of their claims. The courts enforced this ruling through an injunction forbidding financial and other intermediaries from facilitating payment on the restructured bonds. In other words, the injunction accomplished what a money judgment does not: it prevented Argentina from transferring assets to creditors outside its borders (Weidemaier and Gelpern 2014). *Pari passu* clauses like that used by Argentina are relatively common. Some version of the clause appears in nearly every sovereign bond, and many use language functionally identical to that used by Argentina (e.g., Weidemaier et al. 2013).[9]

Courts as Gatekeepers: The Enforceability of Broad Waivers of Sovereign Immunity

From the preceding discussion, it should be clear that effective legal enforcement requires well-resourced creditor firms willing to make substantial investments in litigation. Holdouts have long been a feature of the sovereign debt markets. Many have been powerful and sophisticated creditors whose strategies would appear immediately familiar to modern observers (e.g., Flandreau 2013). Nevertheless, firms that specialize in litigation are a recent phenomenon (Schumacher et al. 2014). That fact complicates efforts to draw inferences about the relevance of legal enforcement to sovereign debt markets. It remains an open question whether such firms can make potent weapons out of the default rules of foreign sovereign immunity law.[10]

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[9] Recently, some governments have revised their contracts, or the associated disclosures to investors, to reduce the likelihood that courts will award Argentina-style injunctive relief (e.g., IMF 2015a).

[10] Viewed from this perspective, episodes in which a creditor engages in a prolonged but unsuccessful hunt for sovereign assets seem less like unfortunate gambles that "cannot motivate repayment" (Sinyagina-Woodruff 2003) and more like a repeat-player's investment in its reputation as a patient, determined litigant.

Whatever the answer to that question, modern loan contracts change these default rules in ways that significantly enhance creditor leverage. Courts are only beginning to grapple with the implications of such clauses. Broad waivers of execution immunity, expansive *pari passu* clauses, and other contractual protections cannot help creditors unless courts enforce them. Historically, courts have been reluctant to do so (Weidemaier and Gulati, n.d.). One reason is that courts cannot enforce their own judgments and must rely on other government officials to carry them out. Yet these officials have their own concerns, which may lead them to refuse their help (e.g., Delaume 1967, 205).[11] It is likely that judges recognize this dynamic and want neither to appear feckless by issuing unenforceable judgments nor to complicate matters for political actors.

However, courts are beginning to take a more muscular role in enforcing claims against foreign governments (e.g., Schumacher et al. 2014). In part, this is because contracts have evolved in ways that leave courts very little discretion to reject creditor arguments. For instance, recall that Argentina's waiver of sovereign immunity extended "to the fullest extent permitted by the law[.]" One French court, faced with prior law establishing that foreign governments could waive sovereign immunity, refused to interpret this language to permit seizure of diplomatic assets.[12] This basis for denying relief—already debatable as a matter of contract interpretation—only defers the important questions. As contracts incorporate clauses that more explicitly waive sovereign immunity and otherwise enhance creditor rights, courts will have to confront the merits of these clauses directly.[13]

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[11] These concerns include the desire to preserve diplomatic relations and a fear of retaliation: a state that allows the seizure of assets belonging to a foreign state may put its own foreign assets at risk.

[12] Société NML Capital Ltd. v. Republique Argentine, Cour de Cassation (1ère Chambre Civile), No. 09-72.057 (Sept. 28, 2011).

[13] For example: "The Issuer hereby irrevocably and unconditionally waives and agrees not to raise… any right to claim sovereign, diplomatic or other immunity from jurisdiction or execution and any similar defense, and irrevocably and unconditionally consents to the giving of any relief or the issue of any process, *including,*

ENFORCEMENT SPILLOVERS

As noted, many would view the development of robust legal remedies as a positive development for sovereign debt markets. Lending markets require commitment mechanisms; a would-be borrower that cannot credibly promise to repay cannot borrow at all. Legal remedies are one type of commitment mechanism (e.g., Williamson 1983). If courts will enforce them, contract clauses that increase the cost of default can "enrich both borrowers and lenders *ex ante*" (Chabot and Santarosa 2016) by reducing the cost of credit and enabling loans to borrowers who might otherwise prove too risky. This is as true for sovereign as for private borrowers—a point frequently made in the economic literature on sovereign debt (e.g., Chabot and Santarosa 2016; Pitchford and Wright 2010; Shleifer 2003).

Yet legal remedies also impose costs on parties outside the lending relationship. Although some of these costs are necessary byproducts of the legal system, they are magnified when a court tries to enforce a judgment arising from unpaid sovereign debt. Enforcement efforts can also undermine policies important to political actors in the court's home state and abroad. Finally, the favorable view that prevails in the economic literature assumes that legal remedies work by allocating costs between a borrower and its lenders. A loan default lets the borrower transfer to lenders some of the costs associated with its financial distress. Lenders with adequate legal remedies need not bear these costs. But it does not always follow that borrowers will bear them instead. To the contrary, some legal remedies may increase the need for official support in a financial crisis, thus transferring risk of default to other governments and their taxpayers. A full assessment of the virtues of legal enforcement must take these costs into account.

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without limitation, the making, enforcement or execution against any property whatsoever (irrespective of its use or intended use)…" (Republic of Estonia, Offering Circular for 5% Notes due 2007, at 9).

Enforcement Costs Attendant to Money Judgments

Despite changes in sovereign immunity law and in sovereign loan contracts, government borrowers remain relatively insulated from coercive legal enforcement. A creditor holding a money judgment probably cannot seize assets located within the sovereign's territory. Nor can a court compel a foreign government or its officials to honor an injunction or other order providing affirmative relief. Thus, remedies against sovereign governments operate primarily by disrupting relations with third parties (e.g., Weidemaier and Gelpern 2014). The effect of a money judgment, as explained previously, is to impair the sovereign's ability to borrow money and engage in commercial transactions with parties outside its borders.

A creditor-imposed embargo of this nature imposes substantial costs on third parties. To a degree, this is true of any effort to enforce any money judgment, even against private debtors. For example, counterparties involved in commercial transactions with a judgment debtor can find themselves swept up in a judgment creditor's efforts to find and levy on property belonging to the debtor. Yet the impact on third parties is magnified in sovereign debt cases in two related ways. First, legal sanctions cannot work effectively unless they impede the sovereign's access to global markets, yet national legal systems do not have uniform enforcement procedures or provide creditors with uniform enforcement rights. For a court bent on having the sovereign comply, this creates an incentive to craft a remedy with extra-territorial effect, thereby bypassing foreign laws and institutions that might otherwise undermine enforceability. Second, such remedies can have undesirable spillover effects by interfering with policies important to political actors and systemically-important third parties. Although cases not involving sovereign defendants can raise such concerns, they do not raise them as acutely. Some examples may help illustrate.

The mere entry of a judgment against a foreign government will unavoidably create diplomatic headaches for the court's home state. Attempts to enforce the judgment through the seizure of assets will create further headaches. To an extent, this is neither surprising nor troubling. The political actors who embraced the doctrine of restrictive immunity, which lets national courts hear lawsuits and enforce judgments against foreign governments (e.g., Verdier and Voeten 2015), surely had some sense of the potential consequences. Yet they probably did not anticipate modern developments, in which loan contracts routinely include clauses that cannot be enforced without significant damage to diplomatic relations.[14] I have already mentioned one example: clauses waiving immunity with regard to diplomatic or other sensitive assets (e.g., Commisions Import Export v. Republic of Congo 2015). Litigation over whether to enforce such clauses has significant implications for political officials in the court's home state (e.g., Couet 2015).

Efforts to enforce money judgments also can undermine policies important to other governments. As an example, consider a creditor's search for non-immune sovereign assets, which offers opportunities for what might be termed "discovery arbitrage." By this, I refer to a creditor's ability to exploit differences in the information-gathering procedural rules applicable in different jurisdictions. Assume that a court in jurisdiction A enters a money judgment against a foreign sovereign. The judgment will potentially impede the sovereign's access to A's commercial and capital markets by letting the creditor seize non-immune assets in the jurisdiction. However, officials in A cannot seize assets located outside their territory, which leaves the sovereign free to borrow money or engage in commerce in jurisdictions B, C, etc. To expand the judgment's impact, the creditor must ask legal actors in these jurisdictions to enforce it—i.e., to treat the judgment as

[14] In fact, early analyses of the restrictive immunity rule assumed that governments would not agree to waive immunity from seizure with regard to *any* assets, much less assets that served diplomatic or other sensitive functions (e.g., Harvard Research in International Law 1932, p. 707).

if it had been rendered by their own courts. Although the particulars of that process are not important here, it is frequently the case that creditors can enforce a court's judgment in multiple jurisdictions.

But of course, a creditor cannot enforce a judgment anywhere unless it knows where the sovereign's assets are located, and this requires access to information. Whether it can get this information depends on the relevant discovery rules. Some jurisdictions, such as the United States, authorize fairly sweeping discovery into the sovereign's commercial and other transactions. Others grant creditors much more limited discovery rights (e.g., Born and Rutledge 2011). Differences in discovery rules reflect different policy judgments about the value of transparency—in this case, the transparency required of foreign governments. Jurisdictions that limit discovery in the context of judgment enforcement have made a policy choice to limit transparency notwithstanding the interests of creditors. In these jurisdictions, there is nothing incongruous about a money judgment that cannot be enforced despite the presence of non-immune assets.

However, a determined creditor can render these policy choices irrelevant. It need only find a court with expansive discovery rules that is willing to give these rules extra-territorial effect. To simplify a complex area of law, the creditor must (i) identify entities with global reach and access to information about the sovereign and its assets (e.g., banks), (ii) persuade the court that such entities are subject to its jurisdiction, and (iii) demand information about the sovereign's assets, wherever located. A court that grants such a request effectively agrees to serve as a "discovery clearinghouse"—i.e., a one-stop forum in which creditors can obtain information about the sovereign's global assets, whether or not the court has the power to authorize seizure of those assets. Some U.S. courts have agreed to fulfill precisely this role (e.g., Republic of Argentina v. NML Capital Ltd. 2014; Vera v. Republic of Cuba 2015). In the process, they enable

litigants to circumvent the policy choices made by the jurisdictions where the sovereign's assets are located (e.g., Cross; 2014; Ishikawa 2015).

Costs Attendant to Injunctions

Efforts to enforce an injunction involve an even greater risk of undermining policy choices made by other governments. Again, the litigation against Argentina provides an example. The injunction there ordered the country to choose between defaulting on much of its public debt and paying holdout creditors in full. From the perspective of many governments and international financial institutions, the risk that one national court might enjoin a foreign government from servicing its debt to globally-dispersed investors undermines efforts to promote the orderly resolution of sovereign debt crises. For that reason, a number of foreign governments sought leave to participate as amici in the litigation in an unsuccessful effort to overturn the injunction (e.g., Gelpern 2014).

The litigation against Argentina also illustrates a broader problem associated with the enforcement of any injunction against a foreign government. A court that issues such an injunction cannot punish the sovereign directly for disregarding the order. Any hope of compliance depends on whether the court can credibly threaten third parties who might act as agent for the sovereign—or "in active concert or participation" with it—in a violation (Weidemaier and Gelpern 2014). But again, foreign governments can easily turn to other markets, carrying out transactions through third parties that are outside the court's jurisdiction and therefore beyond the reach of its contempt powers. In the Argentine case, defiance simply meant the country would have to route payments through non-U.S. financial intermediaries.

In practice, however, defiance proved much more complicated. Intent on forcing Argentina to comply, the court took an expansive view of its jurisdiction, expanding the injunction

to cover entities with tenuous connections to the United States. This necessarily undermined policies important to other governments. For instance, the court threatened Euroclear—a commercial bank and securities settlement system incorporated in Belgium and primarily regulated by Belgian law—with contempt sanctions if it processed payments in violation of the injunction (NML Capital Ltd. v. Argentina, Nov. 21, 2012).[15] The result flatly contradicted the law of Belgium, Euroclear's primary regulator.[16] From the court's perspective, however, the result was necessary, for the injunction would be "entirely for naught" if not given extraterritorial effect (NML Capital Ltd. v. Republic of Argentina, Nov. 21, 2014). This logic ultimately led the court to commandeer a large swath of the international financial architecture in its effort to bring Argentina to heel.

The Argentine case may be unusual, but it is an example of a more fundamental point. The impact of a court's order is limited by jurisdictional boundaries and by the fact that foreign governments are insulated from direct coercion. A court can accept this, or it can look for creative ways to limit the government's ability to circumvent or ignore its order. The latter course almost inevitably requires the court to disrupt transactions with third parties and to stretch jurisdictional boundaries (Weidemaier and Gelpern 2014).

Increasing the Need for Official Support in a Debt Crisis

Litigation against private debtors can involve costs analogous to those described above. Yet sovereign governments differ from private debtors, especially in cases arising out of public debt. Among other reasons, sovereigns more often transact with third parties that play a systemic

[15] Though Euroclear has some connections to the United States and (apparently) a representative office in New York, it is doubtful that these limited contacts were enough to subject it to the jurisdiction of U.S. courts.

[16] Belgian law explicitly forbids orders attaching or blocking cash settlement accounts (Weidemaier and Gelpern 2014).

role in the global economy (e.g., securities depositaries, clearinghouses, and other financial utilities), with institutions central to the resolution of financial crises (e.g., the IMF), and with other sovereigns (Gelpern 2013). A court bent on ensuring compliance may overly discount the impact of its orders on such actors and their policy objectives.

Litigation arising from a default on sovereign debt also poses unique risks. These include the risk that a government's inability to impose losses on private lenders will increase the demand for official sector resources in a debt crisis, or will otherwise distort the response by official actors. Consider a case in which the borrower has agreed to a robust *pari passu* clause that allows bondholders who reject a restructuring proposal to block payments to restructuring participants. The effect of such a clause is to make restructuring difficult or impossible (e.g., Wright 2011; Chabot and Santarosa 2016). Standard economic accounts presume that this will increase the cost of default to the borrower government, which will now have to impose additional losses on citizens in the form of higher taxes, lower growth, or other painful forms of economic adjustment (e.g., Chabot and Santarosa 2016). Though unpleasant for the borrower and its citizens in bad times, this is the cost of commitment.

But there is another, less charitable, way to view a contract that effectively precludes restructuring. Sovereigns encounter financial distress for many reasons, often outside the control of the borrower government. When this happens, resolution of the crisis requires intensely political decisions about how to allocate costs among the borrower's citizens (in the form of austerity policies), investors (through reprofiling or restructuring), and other governments and official funding sources. In many cases, fear of contagion or other factors will create pressure for official support. Given this dynamic, clauses that reduce the amount allocated to investors do not

only—or even necessarily—increase the borrower's share; they can also increase the share borne by official actors.

Consider the role of official lenders of last resort in a debt crisis. An example is IMF lending to governments that have lost capital market access and cannot meet their international payment obligations. IMF policy requires a debt restructuring or reprofiling (i.e., extension of loan maturities) if the government clearly cannot sustain its debt burden or if the IMF does not judge the burden as sustainable with high probability (IMF 2015b). The requirement serves the obvious purpose of ensuring that Fund resources do not simply go to satisfy debt obligations held by private investors, leaving the government's longer-term balance-of-payment problems unaddressed and potentially necessitating further rounds of official support.

If the government cannot impose losses on current holders of its debt, it may have to seek additional funds from official sources. In theory, official lenders could refuse, insisting that the borrower make up the difference by adopting harsher austerity measures. But concerns about economic and political contagion will often cloud these judgments. The Eurozone's massive 2010 bailout of Greece makes the point. As observers of the Greek rescue know, the bailout was motivated partly by the desire to *avoid* imposing losses on private investors, especially European banks with large holdings of Greek debt (e.g. Blustein 2015b). But the decision was also motivated by fear of the consequences of a potential Greek withdrawal from the common currency. Systemic concerns of this nature will often influence official lenders in deciding whether, and in what amount, to support a financially-distressed government. So will basic economic self-interest. To

the extent additional austerity measures will threaten a debtor's economic recovery, these measures may jeopardize repayment of any funds that official creditors have extended already.[17]

If legal remedies sometimes increase the official sector burden, then they are not merely tools that enable borrower commitment. They also transfer risk onto other governments, systemically-important global institutions, and ultimately global taxpayers. In some cases, these alternative risk-bearers may tacitly consent to such transfers of risk—for instance, a national government may prefer to mutualize the cost of another government's default when necessary to avoid strain on its banking system. But neither private investors nor government borrowers have any reason to take the interests of these third parties into account when structuring loan contracts. Investors do not care who bears the cost of default, so long as it is not them. Nor do governments have incentives to negotiate loan contracts that minimize the externalities of legal enforcement.

There is nothing novel or radical about recognizing that legal remedies can create negative externalities. In other lending contexts, this is taken as a given. For example, in comparison to any legal remedy available against a foreign government, the right of a residential mortgage lender to foreclose on a borrower's home is well-established and easily implemented. Yet even this right is not unfettered (e.g., Block-Lieb and Janger 2011; Jacoby 2008). Empirical research on the residential home mortgage market suggests that foreclosure imposes substantial costs on the community at large (e.g., Immergluck and Smith 2006; Center for Responsible Lending 2007), and these costs justify restrictions even on such a well-established right. It would be a mistake to embrace novel, relatively untested remedies against foreign governments without paying close attention to the costs such remedies entail.

[17] To be fair, official lenders do not always behave so rationally, as in the case of Greece, where harsh austerity may reduce the amounts ultimately recovered by European lenders.

This is just one example of a broader point. The restructuring of sovereign debt is an inherently multilateral exercise requiring information gathering (e.g., about the borrower's financial position), choices about restructuring policy (e.g., what conditions to impose on official lending), and enforcement of creditor rights (Sgard 2004). In prior eras of bond lending, these functions were relatively centralized (Sgard 2004). In the modern era, the separation of loan enforcement from restructuring policy decisions creates unavoidable tensions, which national courts may (or may not) prove adept at mitigating.

These tensions—and others like them—are at the heart of many contributions to this book. As examples, Carruthers and Lockwood (n.d.) explore how contracts and other legal (and economic) instruments influence the exercise of state sovereignty. Muir Watt (n.d., p. 35-37) identifies a disjuncture between modes of reasoning employed by national courts and those central to private international law. Buell (n.d.) explains institutional incentives that may lead to the extra-territorial assertion of jurisdiction by U.S. prosecutors. And Maillard (n.d.) notes that sanctions regimes tend to target financial intermediaries, using them as proxies in the effort to sanction a government's non-compliance with treaty obligations. Such examples illustrate the coordination problems inherent in a fragmented regime of global governance.

CONCLUSION

The conventional view that legal enforcement plays little role in the sovereign debt markets implicitly assumes that creditors cannot contract for potent rights enforceable by national courts. But this assumption is not required by the law of sovereign immunity, and it may prove empirically false. The more important question is whether courts *should* strive to create potent remedies. Effective legal remedies do not simply increase the sovereign borrower's share of the cost of default. Effective remedies complicate diplomatic relations for political actors in the forum,

threaten to undermine policy choices made by other governments, and can shift a greater proportion of the cost of default onto official lenders. If courts are to create a robust legal enforcement environment for claims against foreign sovereigns, they must decide whether these costs are justified.

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