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ISSN 1749-8279

World Economy & Finance
Research Programme

Working Paper Series

WEF 0017

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March 2007

World Economy & Finance Research Programme
▪ Birkbeck, University of London ▪ Malet Street ▪ London ▪ WC1E 7HX ▪

Good faith in sovereign debt restructuring: the evolution of an open norm in 'localised' contexts?*

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March 2007

Abstract

Since the Argentine debt crisis in 2001 (and the settlement of 2005) the influence and credibility of the official sector especially the IMF is at a historical low. It is in this context that changes in sovereign bond contracts, for instance, the widespread adoption of collective action clauses raise questions about future debt restructurings. Market participants, especially creditors overwhelmingly believe that contract modification is important but only 'at the margins'. If contractual change is marginal, what then are the mechanisms that will ensure fair and orderly debt workouts?

In the absence of a global, multilateral, regulatory framework for sovereign debt restructuring, our examination of changes in the period leading up to the Argentine settlement and after, reveals that market participants may instead be relying on good faith to do the job with the court recognising similar expectations. Good faith, though entrenched as a legal norm in several domestic jurisdictions, such as Germany and the U.S., is a relative newcomer to sovereign debt workouts. This evolving norm is not institutionally embedded and unlike the domestically entrenched version, is not a legal rule with specific requirements that needs to be fulfilled. We conclude by showing that good faith is an open norm 'localised' *inter alia* in formal and informal contexts in which market participants interact with each other and therefore conceptually similar to *Treu und Glauben* as recognised in section 242 BGB.

Keywords: Sovereign debt, good faith, open norm, localised context

Word Count: 6241

*__Acknowledgements__: We are grateful for comments by Sayantan Ghosal, Chris Hughes and Marcus Miller. The first author acknowledges financial support from CSGR, University of Warwick. The second author acknowledges financial support from the ESRC Research Programme 'World Economy and Finance' (RES-165-25-0006) and the administrative support of the Department of Economics, University of Warwick. The usual disclaimer applies.

> The collapse of the Argentine economy, which commenced a couple of weeks after the withdrawal of the IMF mission in early December 2001, was one of the most spectacular in modern history…National output shrank 11 per cent in 2002, leaving one quarter of the workforce unemployed and a majority of the population below the poverty line, even as prices soared for basic food items such as bread, noodles, and sugar.
>
> (Blustein 2005, p.1,2),

The final settlement that followed in 2005 was similarly spectacular: out of a total outstanding debt of $81.8 billion, 76% of Argentina's creditors suffered a 66.3 % 'haircut'. A majority of creditors received only 35 cents for every dollar they lent Argentina, a minority who refused to participate in the settlement got nothing at all and still await a resolution of their claims in the courts.

The Argentine settlement

Restructured debt	$81.8bn
Number of Bonds	152
Legal Jurisdictions Involved	8
'Haircut' in Discount Bond	66.3%
Acceptance	76%

Source: Porzecanski (2005)

The extent of the haircut and the percentage of creditors who accepted the settlement distinguish the Argentine case from other sovereign debt restructurings. In Ecuador (2000), for instance, the total amount of debt was $6.8 billion dollars and 97% of its creditors suffered a 40% haircut. Similarly, out of a total debt of $31.8 billion dollars, the Russians imposed a haircut of 37.5% with a participation rate of 98%. In the crises

suffered by Ecuador (2000), Ukraine (1998-2000) and Uruguay (2003), the total outstanding debt was less than $10 billion dollars. In the restructurings that followed, there were no haircuts and participation rates were above 90 % (Porzecanski 2005). Though it is clear that the haircut and the low participation rate of creditors in the Argentine is markedly different from earlier restructurings, there appears to be no clear understanding in the literature of why this was the case.

Commentators generally agree that the Argentine crisis was imminent following the governments wholesale adoption of the 'Washington Consensus' during the 1990's: 'eradication of inflation, the privatization of industry, the deregulation of the economy and the removal of trade barriers' (Blustein 2005, p 4).[1] Others argue that the courts played a significantly different role in Argentina when compared with other debt settlements (Miller & Thomas 2007). It is not surprising, therefore that there is very little agreement on what framework can prevent crises of this magnitude to occur in the future and to ensure fair and orderly settlements, if they do.

According to Paul Blustein, the IMF and global financial markets were complicit in the Argentine crisis, though this may not be true of the settlement. Historically, sovereigns have been forced to concede to the claims of minority creditors refusing to participate in debt restructuring. These holdouts or opportunistic creditors have successfully used the courts to delay settlements and obtain 100 per cent of their claims. Initially, this appeared to be the trend in the case of Argentine sovereign debt litigation, where Argentina had to deal with repeated attempts by holdouts to stymie any settlement with the majority.

[1] See Appendix for details of the events that led to the Argentine crisis in 2001.

However, the settlement proves otherwise: by offering to settle a majority of its debt, the debtor appears to have been in a better bargaining position than private creditors. Thus there appear to be different factors, such as the credibility and reputation of the IMF and informal, market-driven, governance structures that may play a significant role in future settlements.

The inadequate appreciation of these factors underlie the failure of Anne Krueger's framework: the sovereign debt restructuring mechanism (SDRM) modelled on Chapter 11, U.S. corporate bankruptcy proceedings (Krueger 2002a, b). The SDRM as an official sector initiative is premised on a view that any possible market-driven solution would fail to ensure orderly and fair settlements instead of one that recognises the necessity of both.

In any event, Krueger's announcement divided discussions on the appropriate regulatory framework into two camps: one that favoured a market-driven framework through the modification of contract terms and the other that favoured an official sector interventionist framework like the SDRM. The latter was eventually rejected by market participants who finally settled on contract modification through the widespread adoption of collective action clauses (CACs) in sovereign debt issued under U.S. law.[2] These bonds are discussed in more detail later in this paper.

In a recent paper, Anna Gelpern and Mitu Gulati (2007) set out the views of market participants on the change to CACs. The conclusions were surprising: CACs were viewed

[2] By 2005 almost 100% of new international bond issues had CACs and around half of the outstanding debt has CACS (Hellenier 2006, IM 2005).

as being important but only at the margins. This view is in direct contrast with those that viewed CACs as the best tool to achieve the aim of fair and orderly debt settlements (Taylor 2002). So if CAC's are at best marginally important, in what other ways can this aim be achieved?

To answer this question, we reveal the discourse amongst market participants on good faith. We specifically assess whether the Argentine case is really a 'tipping point' event in the life cycle of an evolving global norm (Finnemore & Sikkink 2005). In the absence of a specific official sector description of good faith or a multilateral, regulatory framework to enforce a notion of good faith in sovereign debt, it is unclear how this notion evolves and the contexts that sustain it.

Section one situates the widespread adoption of CACs in a larger socio-economic and political context. This is followed by specifying how market participants choose to modify their behaviour in 'localised' contexts and thereby comply with notion of good faith. Section three discusses how the U.S. courts involved in sovereign debt litigation have historically expected market participants to change their behaviour to comply with what we believe to be an evolving good faith requirement. Section four describes the process by which an open norm evolves in 'localised' contexts. This is followed by our conclusions.

The adoption of CACs in the context of wider socio-economic and political change

In this section, we situate the widespread adoption of CACs in a wider socio-economic and political context to clarify the factors that can influence the aim of achieving fairer and orderly settlements in the future. We begin by describing sovereign bond documentation. We then go on to discuss the following changes. The diminishing role of the official sector specifically the IMF, the formation of regional political alliances, recent attempts by influential private creditors to organise around a set of rules outside existing official, organisational, structures, the changing nature of judicial intervention, and the phenomenon of low Argentine spreads despite its refusal to deal with existing holdouts.

Sovereign bond contracts are characterised by collective decision-making provisions, which vary according to the contractual terms (Buchheit & Gulati 2002). At the time of the crises, the Argentine bond contracts, issued under U.S. law required unanimity. Consequently, variations in the payment terms and the date of payment could be undertaken only with the unanimous consent of all the bondholders in the series. In contrast, the non-financial terms in the debt instruments could be varied by a supermajority of bondholders. Variations of this kind do not require the consent of all the bondholders. However once these are accepted by the required super majority of bondholders, they are binding on all holders regardless of whether an individual holder voted for the change.

Prior to Argentina settlement in March 2005, its debt instruments were distinguishable from instruments with CACs that characterise both corporate and sovereign bonds governed by English law. The latter permit changes to the payment terms of a bond with the consent of persons representing 75% (by amount) of the bonds voting at a bondholder's meeting that meets certain quorum requirements (Dixon & Wall 2000). The required supermajority varies with different issues. CACs are typically not found in debt instruments governed by U.S. law. According to some views, creditors using bonds issued under U.S. law have traditionally been wary of CACs and have preferred unanimous consent to vary the financial terms of debt instruments (Dixon & Wall 2000). However, this has changed with Mexico's and Argentina's recent issue of debt instruments with CACs. The widespread adoption of CACs though the market-driven approach raises issues of creditor co-ordination, aggregation, debtor moral hazard etc that in the absence of any official-sector involvement require an examination of market norms and institutions which will ensure compliance and more significantly avoid or minimize the effects of events such as those apparent in the Argentine crisis.

The diminishing role of the IMF can be traced to the period that preceded the debt crisis in 2001. According to Blustein (2005 p.5), the 'IMF … overlooked Argentina vulnerabilities but even when the Fund tried to sound alarms, the markets optimism rendered the Funds concerns irrelevant.' By all accounts, the conduct of the IMF at this time raises concerns about its credibility in future debt settlements. There is also the issue of a conflict of interest between the role of the IMF as a creditor and as a significant player in facilitating debt settlements (Dhillon et al 2006).The IMF's role and influence

in sovereign debt settlements is further reduced by events after the crises. Argentina has since repaid its entire debt owed to the IMF (Mander 2007). These changes are significant especially with the widespread adoption of CACs as it reveals 'the absence of a binding link between private renegotiation and multilateral instruments for policy monitoring…[which] considerably reduces the leverage of the Fund on the overall [restructuring] process.' (Sgard 2005, p.1)

The decreasing influence of the IMF can also be traced to the development of a regional political nexus between Argentina and Venezuela. In a recent development, Hugo Chávez, the President of Venezuela lent Argentina 3 billion dollars (Economist 2006). This developing political alliance combined with the diminishing influence of the IMF increases Argentina's bargaining position as a future debtor in sovereign debt settlements.

Another significant development introduced by Jean-Claude Trichet, President of the European Central Bank[3] on behalf of private creditors is contained in the document entitled 'Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets' (the creditor-initiated code of conduct) (IIF 2005). According to some accounts, this code represents an unprecedented instance of a creditor-initiated strategy that aims to achieve orderly and fair sovereign debt settlements (Helleiner 2006). Since its release in November 2004, the creditor-initiated code of conduct has been acknowledged by emerging markets like Brazil, Korea, Mexico and Turkey[4], and has received the support of the G-20, the G7 and the Paris Club. This initiative has also received support from

[3] See also Helleiner (2006).
[4] Argentina has refused to accept this code of conduct.

other creditor organisations like International Capital Markets Association (ICMA) and the IMF management. This creditor-initiated code describes conduct that will fulfil expectations of what amounts to good faith in the process of sovereign debt restructuring.

Since a majority of the international bonds issued by Argentina are governed by U.S. law and there is no supranational statute or court governing sovereign borrowing, the Southern District Court of New York (SDNY), the lowest state court in New York, has preliminary jurisdiction to deal with all legal matters that arise between Argentina and its creditors. A recent analysis of Argentine debt litigation reveals the process of 'judge-mediated debt restructuring': a form of judicial intervention influenced by the good faith attempts by a debtor to restructure a majority of its debt (Miller and Thomas, 2007). The authors claim that in the period leading to the swap, the U.S. courts played an unprecedented role in promoting the swap by engaging the debtor and aggregating the claims of diverse creditors.

Finally, the premiums on Argentine debt have been low (Chung 2007). These low sovereign spreads reflect the indifference of global capital markets to its steadfast refusal to settle outstanding creditor claims.

This section articulates the changes that form the context in which the widespread adoption of CACs has taken place so far. This context is characterised by distinct and sometime unprecedented political and socio-economic changes. The next section specifies the localised contexts in which this new paradigm is articulated and in which a discourse of good faith can be situated.

Good faith: ‘ localised’ contexts and compliance

This section describes the localised contexts in which market participants choose to modify their behaviour and thereby comply with a notion of good faith.

During the Argentine debt restructuring process creditors expressed their concerns about the debtors conduct and justified their expectations on the ground of good faith. In the period leading up to the settlement in 2005, the limits of good faith was raised by creditors in the statement issued by the Argentine Bond Restructuring Agency which stated that ‘Every month that Argentina delays its restructuring, it saves $700 million in accumulating interest. Since the default in December 2001, this adds up to more than $ 20 billion. Instead of relying upon exhortation and a vague and subjective standard of “good faith”, the IMF should create automatic financial incentives that encourage governments to restructure defaulted foreign debt without delay.’ (Lerrick 2004) In the same period, this norm was again more positively endorsed by the Global Committee of Argentine Bondholders (GCAB) who represented holders of over 39 billion dollars in debt. This included more than 500,000 retail investors and more than 100 institutions, banks, partnerships and committees (GCAB 2004). This reveals that creditors expect the debtor to act in a particular way and that this expectation is justified on the grounds of good faith.

As discussed earlier, the most recent and (probably the most significant) use of the notion of good faith was in the creditor-initiated code of conduct. This code of conduct

articulates a well-defined process for restructuring negotiations and aims ‘at restoring macroeconomic stability and market access on a timely basis.’ Principle no 3 specifies ‘Good Faith Actions’ as set out below:

> Voluntary, good faith process. When a restructuring becomes inevitable, debtors and creditors should engage in a restructuring process that is voluntary and based on good faith. Such a process is based on sound policies that seek to establish conditions for renewed market access on a timely basis, viable macroeconomic growth, and balance of payments sustainability in the medium term. Debtors and creditors agree that timely good faith negotiations are the preferred course of action toward these goals, potentially limiting litigation risk. They should cooperate in order to identify the best means for placing the country on a sustainable balance of payments path while also preserving and protecting asset values during the restructuring process. In this context, debtors and creditors strongly encourage the IMF to implement fully its policies for lending into arrears to private creditors where IMF programs are in place, including the criteria for good faith negotiations. Sanctity of contracts. Subject to their voluntary amendment, contractual rights must remain fully enforceable to ensure the integrity of the negotiating and restructuring process. Formation of creditor committees and specification of debtor and creditor actions during restructuring. Debtors should resume, to the extent feasible, partial debt service as a sign of good faith and resume full payment of principal and interest as conditions allow.

Unlike the earlier references by creditors to good faith during the Argentine restructuring process, that expect the debtor to act in a particular way, the code sets up a context in which the conduct of creditors and debtors will be expected to comply with good faith in any future restructuring process.

The issue of good faith was also raised by Argentine in its prospectus supplement as follows (Ministry of Economy 2005, p.15):

> Other than conditioning funding on the Government making progress in the restructuring of its debt obligations, the IMF does not play any official role in this restructuring process. The IMF has a policy of lending to creditors in arrears only if such creditors engage to the extent possible, in good faith negotiations to restructure nonperforming obligations. No objective measures exist for evaluating whether such negotiations are feasible or whether they are being conducted in good faith. The Government believes that it has met the criteria of good faith through its dialogue with its creditors since it defaulted on its debt. Nevertheless, we can offer no assurance that the IMF will apply a similar standard of good faith, or that the IMF will not rely on additional or other factors in measuring the Government's progress in restructuring its obligations

This reference to good faith in the Argentine prospectus refers to its own conduct (its fulfilment of its debt obligations as far as a majority of its creditors are concerned) and the conduct of the IMF, another market player in the context of the ongoing settlement.

Finally, in April 2002, in response to the question whether the IMF would take any action against a country breaking the [SDRM] rules the then director of the IMF Anne Krueger stated that the answer would 'raise real questions as to whether the debtor was negotiating in good faith with its creditors' (Krueger 2002b).

Later that year, the IMF Board discussed the 'Good Faith Criterion' *Under the Funding Policy on Lending into Arrears to Private Creditors* (IMF 2002). This policy allows 'fund lending into sovereign arrear to external private creditors…in circumstances in which:… and (ii) the member is pursuing appropriate policies and is making a good faith

effort to reach a collaborative agreement with its creditors.' There is therefore clear evidence that the official sector also recognises good faith as a prescriptive norm.

This section reveals that good faith is not recognised as a legal rule nor do market participants expect the norm to be enforced on them at the time of the restructuring. However, it is clear that market participants in 'localised' transactional contexts justify their expectations of changes in the behaviour of other market participants by reference to a notion of good faith. The following section examines how courts involved in sovereign debt litigation articulate the expectations of market participants in relation to good faith.

Good faith and the U.S. courts: setting the historical context

This section examines the reliance by the U.S. courts on good faith to justify judicial expectations of contractual behaviour in the context of sovereign debt litigation.

The *CIBC Bank* litigation is one of the earliest cases in which the notion of good faith was discussed by the courts, albeit not very positively. This case became relevant in a context of increasing creditor power and in the absence of alternate, formal debt resolution mechanisms, when sovereign debtors attempted to block holdout litigation with carefully drafted loan agreements. In the litigation by CIBC Bank, on behalf of the Dart family (a vulture fund), against Banco Central de Brasil.[5] Brazil negotiated the Multi-Year Deposit Facility Agreement (the 'MYDFA') as part of the restructuring of its

[5] *CIBC Bank and Trust Co (Cayman)Ltd v. Banco Central do Brasil* 886 F.Supp.1105 (S.D.N.Y.1995)

debt in the 1980's.[6] The MYDFA provided among its terms that MYDFA debt could be accelerated upon the event of default only if more than 50% of the creditors, calculated by amount of debt holdings, voted to accelerate.[7] Just a year after the MYDFA was executed Brazil failed to meet its obligations and sought to restructure the MYDFA debt pursuant to the Brady Plan. The Dart family refused to go along with the new restructuring and instead filed suit seeking both to obtain the accrued and unpaid interest on their approximately $1.4 billion of MYDFA debt and to accelerate the entire principal.[8]

CIBC Bank's effort to accelerate was blocked by Brazil's careful approach to the new restructuring. In connection with the 1992 restructuring Brazilian officials ordered Banco de Brasil, a Brazilian commercial bank majority owned (51 %) by the Brazilian treasury to retain $1.6 billion of MYDFA debt rather than converting all of its holdings pursuant to the restructuring. By retaining a majority of the outstanding MYDFA debt Banco de Brasil was able to prevent CIBC from obtaining a majority vote in favour of accelerating the debt.

In the litigation that followed, although the court rejected Banco Central's defences and upheld Brazil's move to block acceleration of the debt. The court observed that the plain terms of the contract required a majority vote to accelerate and that CIBC did not hold a majority of the outstanding debt.[9] Moreover, the court refused to imply an obligation of good faith and fair dealing on Brazil in order to invalidate Banco de Brasil's actions to

[6] *Id.* at 1107
[7] *Id.*
[8] *Id.*
[9] *Id*. at 1113

block the acceleration.[10] Significantly, the court observed that the implied terms sought by CIBC would have the effect of impairing the rights of the parties and the ability of debtors and creditors 'to order their relationships through contractual debt agreements.'[11] Indeed the court expressly acknowledged that the provisions allowed Banco de Brasil to retain and vote its share of the MYDFA debt to hinder other creditors attempting to accelerate that debt.[12]The court's ruling permitted the litigation seeking accrued and unpaid interest to proceed but barred acceleration of the debt. This effectively reduced CIBC's claimed damages from more than $1.4 billion to only $60 million. In this case, it is clear that in the absence of any clear malfeasance on the part of the debtor, the court would refuse to imply a notion of breach of good faith.

In contrast with earlier sovereign debt litigation, the Argentine cases explicitly allow for debt restructuring to proceed on the ground that the debtor is engaged in good faith attempts to restructure its debt and make a satisfactory offer to a majority of its creditors [NML Capital Ltd v. The Republic of Argentina (13 March 2005)]. This represents a clear departure from precedents that predominantly protect the rights of creditors even if these were clearly opportunistic and would, if allowed stymie imminent swaps (Miller & Thomas 2007).

In the Argentine case, after the swap settled and a majority accepted a reduced return on their debt, Argentina has continually refused to concede to the outstanding claims of the minority holdouts for a 100 per cent pay out. This refusal has not resulted in high

[10] *Id.* at 1115
[11] *Id*. at 1116
[12] *Id.*

sovereign spreads (see discussion above), despite predictions to the contrary (Porzecanski 2005). High sovereign spreads represent market sanctions against 'rogue' debtors, that is, debtors who fail to fulfil their debt obligations. The absence of market sanctions also indicates a correspondence between the judicial notion of good faith and one that is accepted by market participants. The section 'Voluntary, Good faith Process' of the IIF code of conduct for instance,(see above) states that '[d]ebtors should resume, to the extent feasible, partial debt service as a sign of good faith and resume full payment of principal and interest as conditions allow.'

A historical examination of good faith in the context of CACs in domestic litigation reveals no clarity in the judicial notion of good faith though there are identifiable rules that can be shown to guide judicial discretion in this regard. Good faith for instance, is an embedded legal norm in the U.S. as articulated in the *Restatement (Second) of Contracts* (1981). Therefore, a black letter approach would view all contracts as being subject to an implied covenant of good faith and fair dealing. In this jurisdiction, 'good faith is a backstop duty intended to protect parties who do not have specific contract provisions to protect them' (Bratton & Gulati 2003, p.65). Though, this good faith duty may be entrenched it has not been applied so broadly to corporate bond contracts in general (Bratton & Gulati 2003, p.66) and arguably not at all in sovereign debt litigation. To support the argument that the actions of a debtor reflect a judicially recognised notion of good faith, one that is distinct from that set out in the *Restatement* one must first draw a distinction between different kinds of contracts and transactional contexts (More discussion on this distinction in the next section).

Sovereign debt contracts are commercial contracts and courts would therefore be wary of implying a good faith requirement 'ex post [as this] would be to frustrate their intent and add uncertainty' (Bratton & Gulati 2003, p.65). However, in the context of other commercial contracts this has not stopped the courts from standing 'for the proposition that where a majoritarian modification occurs in a distress situation, includes an equal payout to all the creditors, and involves no side deal between the majority and the debtor, there occurs no violation of duties to the minority.' (Bratton and Gulati 2003, p.68) This reasoning matches the one taken by Judge Griesa in his affirmation that Argentina is involved in good faith negotiations with its creditors to resolve its debt crisis and therefore this must not be interfered with by opportunistic holdout claims of the majority.[13] The analysis of sovereign debt litigation in this section when compared with normal commercial cases reveals that the courts recognise the expectations that market participants have and that these are justifiable because of good faith.

Good faith in sovereign debt: the evolution of an open norm in 'localised' contexts

Good faith has been widely used in legal domestic jurisdictions especially the US, Germany and France. The identifying character of good faith is that the notion must be examined in its broader social context, to identify the cultural explanations of its meaning. Two distinctions can be made in relation to good faith: one based on the domestic legal jurisdiction in which the norm is found and the other on the transactional

[13] Though this is not as far as Bratton and Gulati may be willing to go on account of the view that 'syndicated loan disputes do not translate easily to the context of a large sovereign bond issue.'

context in which the notion is used. This section explores this distinction to specify a description of good faith conduct relevant in the context of a sovereign debt restructuring process.

Good faith in domestic jurisdictions

It is often not possible to apply any one notion of good faith in all domestic jurisdictions. English law does not recognise a notion of good faith[14] comparable with the notion adopted and institutionally entrenched in Germany and as discussed earlier in U.S. law. (Teubner 1998, Brownsword et al 1999). In German civil law, the notion of good faith is closely allied to the indigenous notion of *Treu und Glauben* (literally: fidelity and faith) which eventually finds its way into section 242 BGB (Zimmerman & Whittaker 2000). Section 242 BGB 'specifies the way in which contractual performance has to be rendered and it gives rise to a host of ancillary, or supplementary duties that may arise under a contract: duties of information, documentation, co-operation, protection, disclosure etc. These duties can also apply in the pre-contractual situation and they may extend after the contract has been performed' (Zimmerman & Whittaker 2000, p. 24).

Different notions of good faith are also used depending on the transactional context. Thus in the literature a distinction is commonly made between commercial and consumer contracts (Wightman 1999). It follows from this distinction that an enforceable or normative notion of good faith is applied to consumer contracts while arms length transactions are viewed as being regulated by a contextual notion of good faith. On

[14] Though it is arguably the case that English law does recognise some notion of good faith

account of the welfare implications associated with consumer contracts, courts will use the norm to impose terms on parties *ex post*.

A contextual notion of good faith is one where the courts recognise the tacit understandings between the parties at the time the contract is formed and leave the parties to negotiate contractual outcomes accordingly. The recognition that parties negotiating at arms length are sophisticated enough to arrive at outcomes consistent with the tacit understandings specific to their 'localised' contracting contexts respects autonomy and choice. The recognition of contextual good faith requires an interpretation that is not confined to the four corners of the contract in dispute. The contracting terms are important but only at the margins (Wightman 1999).

Following from the nuanced descriptions of good faith in domestic jurisdictions, we can conclude that good faith in sovereign debt is not a legal transplant nor can it be described as a normative or enforceable legal rule. Good faith as the term has been used by market participants in the context of sovereign debt is an open norm. The content of the norm good faith cannot be established in an abstract manner but takes shape only by the way in which it is applied.[15]

Conclusions

This paper examined and analysed the changes in sovereign bond contracts, for instance, the widespread adoption of collective action clauses. These contract modifications were

[15] This is similar to the notion of *Treu und Glauben* in German law and section 242 BGB.

examined in the context of socio-economic and political changes that have taken place since the Argentine debt crisis in 2001 (and the settlement of 2005). Despite being touted as the panacea of all the ills that have plagued sovereign debt restructuring in the past, market participants, especially creditors overwhelmingly believe that contract modification is important but only 'at the margins'. This paper set out to examine the mechanisms that will ensure fair and orderly debt workouts.

In the absence of a global, multilateral, regulatory framework for sovereign debt restructuring and the market rejection of the SDRM our examination of changes in the period leading up to the Argentine settlement and after, reveals that market participants rely on a contextual notion of good faith to do the job. This view is reflected in the judicial recognition of good faith.

Good faith in sovereign debt restructuring is an evolving open norm recognised in the localised contexts in which market participants interact. This evolving norm is not institutionally embedded and unlike the domestically entrenched version, is not a legal rule with specific requirements that needs to be fulfilled. In the context of its application in sovereign debt restructuring so far, good faith is conceptually similar to *Treu und Glauben* and section 242 BGB as recognised in German civil law. On the basis of our analysis we can say that the Argentine case does represent a 'tipping point' event in the life cycle of an evolving global norm (Finnemore & Sikkink 2005). This is borne out by the ongoing orderly restructuring of Belize's debt, which in the process has become the 'first country in more that seventy years to use a [CAC]… to restructure a sovereign bond governed by New York law' (Beales & Chung 2007).

In the absence of a possible future shift to a normative and therefore enforceable notion of good faith, this paper has not examined whether market participants will comply with good faith or whether a contextual form of good faith can limit moral hazard. This paper has also not explored whether good faith can stem the desire for opportunistic gains that vulture funds have had in the past and which may still stymie debt restructuring in the future. We have also not engaged in a comparative analysis of other 'tipping point' events in other norm cascades in a global context.

This paper establishes that norms evolve in the localised, transactional contexts in which market participants interact. This allows for an appreciation of these contexts and signals a shift from a regulatory paradigm based on the enforcement of contractual terms negotiated at the time bonds are purchased, to one that allows the tacit understandings of the parties at the time at which bonds are restructured to influence the financial terms of the settlement.

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