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Bringing Rule of Law and Fairness to the Dysfunctional World of Sovereign Debt: A Role for Canada?

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Bringing Rule of Law and Fairness to the Dysfunctional World of Sovereign Debt: A Role for Canada?

Abstract

Restructuring sovereign debt has long proved challenging: There is no formal regime for sovereign insolvencies similar to those that that govern domestic bankruptcy and insolvency and attempts to create one by international treaty have been met with political resistance. Currently, sovereign debt restructuring is governed by the debt contracts themselves along with the background law in the jurisdiction in which the debt is issued. Sovereign immunity also protects most state assets from seizure. These ad hoc restructuring processes are plagued by unpredictability, however, and there are incentives for individual creditors to "hold out," demanding full repayment of their claims and thereby undermining a necessary restructuring. Judicial decisions in recent years regarding debt governed by New York law have only strengthened the hand of these holdout creditors. While modifications to standard terms in sovereign debt contracts can go some way towards improving the current situation, this paper proposes that a superior option is the adoption of a Model Law on sovereign debt restructuring by at least one appropriate jurisdiction. Under the Model Law approach, sovereigns could issue debt in a jurisdiction that has enacted a law providing for a fair, orderly, and predictable restructuring in the event that a sovereign's debt becomes unsustainable. Due to its well-developed financial markets and reputation for the rule of law, this paper argues that Ontario, supported by Canada, would be an appropriate jurisdiction to enact such a law. This article further argues that a collaborative legislative approach between Ontario and federal Parliament would best ensure the constitutional validity, and therefore stability, of this novel and innovative proposed regime.

Keywords

Debts, Public--Law and legislation; Debt relief; International finance--Law and legislation

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Bringing Rule of Law and Fairness to the Dysfunctional World of Sovereign Debt: A Role for Canada?

MAZIAR PEIHANI AND MARK JEWETT*

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Restructuring sovereign debt has long proved challenging: There is no formal regime for sovereign insolvencies similar to those that that govern domestic bankruptcy and insolvency and attempts to create one by international treaty have been met with political resistance. Currently, sovereign debt restructuring is governed by the debt contracts themselves along with the background law in the jurisdiction in which the debt is issued. Sovereign immunity also protects most state assets from seizure. These ad hoc restructuring processes are plagued by unpredictability, however, and there are incentives for individual creditors to "hold out," demanding full repayment of their claims and thereby undermining a necessary restructuring. Judicial decisions in recent years regarding debt governed by New York law have only strengthened the hand of these holdout creditors. While modifications to standard terms in sovereign debt contracts can go some way towards improving the current situation, this paper proposes that a superior option is the adoption of a Model Law on sovereign debt restructuring by at least one appropriate jurisdiction. Under the Model Law approach, sovereigns could issue debt in a jurisdiction that has enacted a law providing for a fair, orderly, and predictable restructuring in the event that a sovereign's debt becomes unsustainable. Due to its well-developed financial markets and reputation for the rule of law, this paper argues that Ontario, supported by Canada, would be an appropriate jurisdiction to enact such a law. This article further argues that a collaborative legislative approach between Ontario and federal Parliament would best ensure the constitutional validity, and therefore stability, of this novel and innovative proposed regime.

IN RECENT DECADES, SOVEREIGN DEBT CRISES—most recently in Greece and Argentina, and now in Venezuela—have spurred both controversy and interest. The world of sovereign debt is deeply dysfunctional. Countries in unsustainable financial situations may be unable to pay, but there is no systematic way to resolve their positions. The result is seemingly endless litigation, with most creditors ready to agree to an equitable resolution while a few holdout creditors are able to manipulate the system to obtain an unfair advantage.

Sovereign insolvencies differ from domestic insolvencies in that the latter are almost universally regulated by legislation; when an individual or company faces an inability to pay its debts, statutes across jurisdictions regulate the behaviour of both the debtor and the debtor's creditors. Statutes typically provide a framework for negotiating a compromise on unsustainable debt, and as a last resort allow for the winding up of a corporation or a bankruptcy and fresh start for individual debtors. No comparable regime exists for sovereigns; sovereigns cannot declare bankruptcy, as there is no regime in which they may do so, and thus are incapable of ever obtaining the legalized fresh start that follows bankruptcy for individual debtors.[1] There is furthermore no existing formalized regime under which sovereigns and their creditors can negotiate restructuring agreements. All that is available to sovereigns at present is the option to negotiate with their creditors

1. For obvious reasons, sovereigns cannot be liquidated and wound up like corporations.

individually[2] and the ability to rely upon the institution of sovereign immunity, which protects state assets from seizure when and if they default on their loans. The status quo, however, allows for opportunistic behaviour by holdout creditors who refuse to restructure their claims and then seek to benefit from other creditors' concessions by demanding the payment of their own claims in full.

The recent Argentinian sovereign debt crisis dramatically illustrates the dysfunctional nature of the current sovereign restructuring problem. While the vast majority of Argentina's creditors accepted a compromise, a few—primarily hedge funds specializing in the trade of distressed debt on secondary markets—did not. The course of litigation in American courts, ending with a refusal of the US Supreme Court to hear an appeal from New York Federal Court decisions, was a significant win for the holdout creditors.[3] Those rulings, discussed in greater detail below, found that Argentina was in violation of the *pari passu* (equal ranking) clause in its US dollar-denominated bonds that were governed by New York law, and banned the sovereign from making payments on its restructured bonds unless it paid holdout creditors in full.[4] This ruling relied on a novel interpretation of the *pari passu* clause, which historically had been understood to prohibit legal subordination of claims but not to require ratable payments, and also took the unusual step of issuing injunctive relief against third parties.[5]

The effect of the legal action and the combined rulings meant that Argentina lost a long legal battle of more than a decade and was forced to pay the holdout creditors 2.426 billion USD. This protracted and dramatic ordeal demonstrated how a small group of creditors can successfully extract preferential treatment and cause severe disruption for everyone else—other creditors as well as the sovereign debtor. Most commentators regard this development as decisively tilting the delicate balance between debtors and creditors, giving individual creditors

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2. Anna Gelpern notes, however, that in practice, this informal restructuring process "is dominated by a small group of repeat players" who form a "tight community with considerable norm-generating capacity," and that a degree of coordination therefore occurs even in the absence of a formalized regime. See Anna Gelpern, "A Skeptic's Case for Sovereign Bankruptcy" (2013) 50 Hous L Rev 1095 at 1106.
3. *Republic of Argentina v NML Capital, Ltd*, 573 US 134 (2014); *NML Capital, Ltd v Republic of Argentina*, 727 F (3d) 230 (2d Cir 2013); *NML Capital, Ltd v Republic of Argentina*, 699 F (3d) 246 (2d Cir 2012) [*NML Capital v Argentina,* 2012].
4. *Ibid*.
5. For a discussion of the novelty of the injunctive remedy given in this case, see Mark C. Weidemaier & Anna Gelpern, "Injunctions in Sovereign Debt Litigation" (2014) 31:1 Yale J on Reg 189.

incentives to refuse restructuring agreements and thereby making mutually beneficial settlements harder to achieve.[6]

Attempts to remedy the dysfunctional status quo have thus far generally fallen within two broad approaches: (1) the proposal of a treaty on sovereign debt restructuring, or the "treaty approach," and (2) the insertion of certain contractual provisions into the debt instruments themselves, known as the "contractual approach."

The first approach is an attempt to replicate some features of domestic bankruptcy and insolvency legislation for sovereigns via an international treaty. However, the prospects for establishing such a regime are bleak. The only fully thought-through true sovereign bankruptcy regime initiative, the Sovereign Debt Restructuring Mechanism (SDRM) proposed by the International Monetary Fund (IMF) in the early 2000s,[7] remains politically infeasible.

Meanwhile, the contractual approach has had limited success. Contractual reforms have included clarifying *pari passu* repayment terms in order to avoid the outcome seen in the Argentina litigation and, perhaps most importantly, the insertion of collective action clauses (CACs) that seek to limit holdout behaviour by aggregating creditors' restructuring decisions in supermajority voting provisions. While these reforms are welcome, they have thus far been less than fully successful. Currently, a substantial stock of sovereign bonds lacks robust aggregate voting mechanisms, and not all new sovereign bond issuances contain the enhanced contractual provisions designed to prevent holdout litigation.

Moreover, the contractual approach has inherent limitations that prevent it from providing a complete resolution to the problem of sovereign debt. For instance, CACs only apply to bonds, and cannot apply to syndicated or bilateral loans, meaning the threat of holdout creditors will continue in sovereign debt restructuring even as CACs become increasingly widely adopted. Illustratively,

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6. See *e.g.* Martin Guzman & Joseph E Stiglitz, "How Hedge Funds Held Argentina for Ransom," *New York Times* (1 April 2016), online: <www.nytimes.com/2016/04/01/opinion/how-hedge-funds-held-argentina-for-ransom.html> [perma.cc/VN4C-VSFZ]; Jack Jrada, "Closing the Book on Argentina's Sovereign Debt Default: The Second Circuit's Decision and its Ramifications for Sovereign Debt Restructuring in the Eurozone" (2013) 32 Rev Banking & Fin L 222 at 222, 232; Brett Neve, "*NML Capital, Ltd. v. Republic of Argentina:* An Alternative to the Inadequate Remedies under the Foreign Sovereign Immunities Act" (2014) 39 NCJ Intl L & Com Reg 631 at 657–60.

7. See International Monetary Fund, *Report of the Managing Director to the International Monetary and Financial Committee on a Statutory Sovereign Debt Restructuring Mechanism* (Washington, DC: IMF, 8 April 2003). For a detailed legal analysis of the SDRM proposal, see Sean Hagan, "Designing a Legal Framework to Restructure Sovereign Debt" (2005) 36 Geo J Intl L 299 at 33590.

CACs did not operate to prevent holdout creditors from building blocking positions in the recent Greek debt crisis despite their existence in most Greek debt instruments.[8] Additionally, the interpretation of *pari passu* clauses across jurisdictions remains inconsistent and unclear, even though new modified clauses help address this uncertainty.

The two dominant approaches under consideration therefore, each in their own way, appear inadequate to resolving the problem of sovereign debt.[9] However, between these two approaches there lies a third option: A Sovereign Debt Restructuring Model Law ("Model Law") adopted by a legislature in at least one jurisdiction designed to facilitate a rapid, orderly, and collaborative debt restructuring agreement between a sovereign debtor and its creditors. The Model Law approach shares similar objectives with the IMF's proposed SDRM but proposes to achieve it by means of national or subnational legislation that sovereigns and their creditors can contractually opt into, rather than by means of a binding international agreement. This paper argues that the Model Law approach retains the primary advantages of both the treaty and contractual approaches, without being hindered by some of their principal limitations. This article further suggests that the Province of Ontario, supported by the government of Canada, is well-positioned to take the lead in adopting this approach. Not only would Ontario demonstrate leadership in resolving a pressing international issue and enhance the rule of law and fairness in sovereign debt restructurings, adopting the

8. See Part II, below, for a discussion.
9. Regarding the dominance of these two approaches, the International Law Association (ILA) has been studying the problem of sovereign debt since 2007, and has focused primarily on the treaty approach and the contractual approach as the two available solutions. For instance, in 2014 the ILA's Sovereign Bankruptcy Study Group held a moot court to debate these two approaches. See Sovereign Insolvency Study Group, "State Insolvency: Options for the Way Forward" (Paper delivered at the International Law Association Conference at The Hague, August 2010), (2010) 74 Intl L Assoc Reports Conferences 978; See also "Study Groups," online: International Law Association <www.ila-hq.org/index.php/study-groups> [perma.cc/3V2M-9DAG].

Model Law would also lead to local benefits by significantly advancing Toronto's position as a world-class financial jurisdiction.[10]

The article proceeds as follows. First, the article considers the negative consequences of the absence of a legal framework to deal with unsustainable sovereign debt. It revisits historically significant episodes, such as the Greek and Argentinian debt crises, in which a small group of creditors successfully insisted on preferential treatment and managed to disproportionately benefit from the entire restructuring process. Similar circumstances appear to be developing in Venezuela, with even more catastrophic consequences. Such holdout actions not only have haunted sovereign borrowers and nations reeling under economic and social crises but have also undermined the collective economic interests of creditors. The article then provides a historical survey of past attempts to create a formal restructuring framework at the international level. These attempts range as far back as a Mexican proposal to the Pan American Conference in 1933, through to the IMF-sponsored SDRM proposal in the early 2000s, and more recent attempts in 2014–2015 in the UN General Assembly to move towards a multilateral legal framework for sovereign debt restructuring. The article illustrates how all these proposals seeking to create an international treaty or organization to deal with sovereign debt failed to generate sufficient support and hence could not move forward. The article then demonstrates that the current contractual approach to managing sovereign debt has not sufficiently resolved the issue and is unlikely to do so in the future due to inherent limitations of this approach.

The last part of the article focuses on the Model Law as an alternative reform initiative that could more effectively address the current sovereign debt impasse. The fact that the Model Law can become law and operate with only one jurisdiction adopting it—provided that it is the right jurisdiction—would make it far less prone to failure than other reform initiatives that have relied on concerted multilateral action. Model laws have brought about incremental reform in other areas of law, such as international commercial arbitration and

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10. The meaning of the rule of law in the context of sovereign debt restructurings is contested. See Oonagh E. Fitzgerald, "The Pursuit of Global Rule of Law for Sovereign Debt Restructurings," Commentary (10 March 2015), online: Centre for International Governance Innovation <www.cigionline.org/publications/pursuit-global-rule-law-sovereign-debt-restructuring> [perma.cc/5HAV-X94P]. While some are of the view that the rule of law requires debtor countries to pay all debts in full, we note that no domestic insolvency regime requires this of debtors, however strong the rule of law may be in that jurisdiction. Instead, we prefer the alternative view discussed by Fitzgerald that ties the concept of the rule of law to the clarity and public availability of rules surrounding sovereign debt restructuring (*ibid* at 2).

cross-border insolvency, which proved contentious for many years. The article argues that Canada, and the Province of Ontario in particular, is well-placed to take the lead with this initiative, and addresses various constitutional and other issues that may arise with respect to the adoption of the Model Law in Canada. The article closes with a review of previous reform initiatives in sovereign debt and the valuable lessons they can offer on how to succeed with the Model Law.

I. SOVEREIGN DEBT CRISES, HOLDOUTS, AND DISORDERLY OUTCOMES

Although the Argentinian and Greek debt crises are the most recent examples, a number of other costly and destabilizing sovereign crises serve as a forceful reminder that the international community lacks a framework for resolving sovereign debt in a timely and orderly fashion. *Allied Bank International v Banco Credito Agricola de Cartago* is one of the earliest cases that highlighted the flaws of the existing regime.[11] In 1981, Costa Rica had suspended payment to a 39-member bank syndicate. A restructuring agreement had been reached with all creditors except one, Fidelity Union Trust of New Jersey, which sued through its agent, the Allied Bank. The US Second Circuit initially upheld a district court ruling in favour of Costa Rica that had held:

> Costa Rica's prohibition of payments of its external debt is analogous to the reorganization of a business pursuant to Chapter 11 of our Bankruptcy Code… Costa Rica's prohibition of payment of debt was not a repudiation of the debt but rather was merely a deferral of payments while it attempted in good faith to renegotiate its obligations.[12]

However, upon learning that the US government was opposed to the restructuring deal, the Second Circuit reversed itself, arguing that while the parties could negotiate the terms of payment, "the underlying obligations to pay nevertheless remain valid and enforceable."[13] As commentators noted at the time, the *Allied Bank* ruling made it clear that US-style Chapter 11 protections were

11. *Allied Bank International v Banco Credito Agricola de Cartago*, 566 F Supp 1440 (SDNY 1983).
12. *Allied Bank International v Banco Credito Agricola de Cartago,* 733 F (2d) 23 at 26 (2d Cir 1984).
13. *Allied Bank International v Banco Credito Agricola de Cartago*, 757 F (2d) 516 at 519 (2d Cir 1984) [*Allied Bank*].

not available to sovereigns.[14] As a result, individual creditors could demand full payment of their claims, even though such holding out would further injure the financial performance of the debtor sovereign and the collective economic interest of creditors.[15]

The holdout problem resurfaced forcefully in the recent Greek debt crisis. The Greek 2012 debt exchange represented the largest debt restructuring in the history of sovereign defaults. The program amounted to a €200 billion debt exchange and €30 billion debt buyback, allowing for €106 billion in debt relief—an equivalent of 55 per cent of Greek GDP.[16] While the restructuring of Greek law-governed bonds was executed relatively quickly and smoothly because of the retroactive insertion of CACs, the restructuring of foreign law-governed bonds proved to be a daunting challenge.[17] Despite the inclusion of CACs in these bonds, holdouts managed to build blocking positions in more than half the series, which led to a large failure of the restructuring vote. Private creditors holding €6.4 billion (about C$10 billion today) in face value refused to exchange the old bonds for the new ones and have since been paid their full claims on schedule.[18]

The Argentinian debt crisis, as discussed above, provided another clear illustration of the dysfunctional nature of the restructuring problem. In June 2014, the US Supreme Court refused to hear Argentina's appeal from the New York court decisions in *Argentina v NML Capital, Ltd*, thereby letting the lower courts' rulings in favour of the holdout creditors stand. The District Court held that the *pari passu* clause prevented Argentina from making payments on restructured bonds so long as payments due under bonds held by holdouts

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14. Sidney Dell, "Crisis Management and the International Debt Problem" (1985) 40 Intl J 655 at 668; Jeffrey D Sachs, "Managing the LDC Debt Crisis" [1986] Brookings Papers on Econ Activity 397 at 418.
15. Sachs, *supra* note 14 at 418.
16. Miranda Xafa, "Sovereign Debt Crisis Management: Lessons from the 2012 Greek Debt Restructuring" (2014) Centre for International Governance Innovation Papers Series No 33 at 5, online: <https://www.cigionline.org/publications/sovereign-debt-crisis-management-lessons-2012-greek-debt-restructuring>. See also Miranda Xafa, "Greece: Playing with Matches in the Ammunition Warehouse" (2017) Centre for International Governance Innovation Policy Brief No 100, online: <https://www.cigionline.org/publications/greece-playing-matches-ammunition-warehouse>.
17. US, *Lessons from the IMF Bailout of Greece, Hearing Before the Subcommittee on Monetary Policy and Trade of the Committee on Financial Services, US House of Representatives*, 115th Cong (2017) at 22 [Gelpern, *Testimony before the US House of Representatives*]; Anna Gelpern, "Sovereign Debt: Now What?" (2016) 41 Yale J Intl L Online Special Edition 45 at 79.
18. Gelpern, *Testimony before the US House of Representatives*, *supra* note 17 at 23; Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, "The Greek Debt Restructuring: An Autopsy" (2013) 28 Econ Pol'y 513 at 527.

remained outstanding.[19] Based on this unusual interpretation, which was upheld by the Second Circuit, the district court issued an injunction that not only forbade Argentina from paying the exchange bondholders, but also threatened to sanction financial market utilities, trustees, and everyone else who acted "in active concert or participation" with the Republic. As a result, payment intermediaries that feared being held in contempt of the court refused to process payments under the exchange bonds. The injunction even applied to entities such as Euroclear that were in foreign jurisdictions and governed by foreign law.[20] Cut off from the global financial system and unable to raise money on bond markets, the newly-elected government of Mauricio Macri decided to end the holdout saga. On 22 April 2016, NML received a payment of US$2.426 billion. The payment meant that NML, which had paid only 28 cents a dollar for the bonds, or US$177 million in total, made a 1270 per cent return on its investment. This outcome provides a remarkable demonstration of how a small group of creditors can extract preferential treatment at the expense of all other stakeholders and even third parties.

The disorder of the status quo arguably has adverse consequences not only for the domestic economies of indebted sovereigns but for the global economy more broadly. In the economies of borrowing governments, defaults and restructuring processes plagued by delays and uncertainty can lead to significant economic and social dislocation, which can then have spillover effects into integrated economies. Furthermore, unsustainable sovereign debt may pose a systemic risk to the international financial system.[21] In addition, creditors as a whole are likely prejudiced by the current regime, and economists have suggested that improved governance of debt restructuring could lead to a net improvement to the aggregated economic outcomes of all parties.[22]

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19. *NML Capital v Argentina*, 2012, *supra* note 3 at 257-61.
20. For further discussion of these injunctions, see Weidemaier & Gelpern, *supra* note 5.
21. See Jay L Westbrook, "Sovereign Debt and Exclusions from Insolvency Proceedings" in Christoph G Paulus, ed, *A Debt Restructuring Mechanism for Sovereigns: Do we need a Legal Procedure?* (Oxford: Hart, 2014) 251 at 251. Lloyd Blankfein, the former CEO of Goldman Sachs, has also commented that, in recent years, sovereign debt has become a major source of global financial uncertainty. See Sridhar Natarajan, "Blankfein Sees Italy Turmoil as Biggest Sovereign Debt Threat," *Bloomberg* (19 June 2018), online: <www.bloomberg.com/news/articles/2018-06-19/blankfein-sees-italy-turmoil-as-biggest-sovereign-debt-threat>.
22. See Joseph E Stiglitz et al, *Frameworks for Sovereign Debt Restructuring: IPD-CIGI-CGEG Policy Brief* (New York: Columbia University, School of International and Public Affairs & Centre for International Governance Innovation, 2014) at para 3, online: < http://policydialogue.org/files/publications/IPD-CIGI-CGEG_Report_-_FSDR_Conference_R.pdf>.

As discussed above, there have been several attempts to improve upon the current approach to sovereign debt. The following section will outline attempts to address the deficiencies of the current system through a formalized, treaty-based approach.

II. THE LONG QUEST FOR A FORMAL SOVEREIGN DEBT RESTRUCTURING MECHANISM

The quest for a formal mechanism for sovereign debt restructuring at the international level dates back at least to a Pan American Conference in December 1933, when Mexico's foreign minister José Manuel Puig called for a public international organization to take care of debt negotiations and arrangements.[23] Puig's proposal was meant to strengthen the bargaining position of the debtor countries vis-à-vis private creditors who had organized themselves into powerful Banker Committees.[24] However, the proposal failed to generate sufficient support. Other Latin American countries argued that the creation of such an international organization would send a negative signal to foreign investors. The United States also refused to support the proposal because it did not want to be involved in any discussions regarding private investors' claims.[25]

The next noteworthy attempt came during the Bretton Woods negotiations in the late 1940s. The initial blueprints of the IMF provided that member states could not default on external loans without the approval of the Fund.[26] This provision was intended to empower the Fund to engage in compulsory arbitration in debt negotiations.[27] Similarly, the initial charter of the International Bank for Reconstruction and Development (IBRD) prohibited the Bank from lending to countries that had defaulted on foreign loans except when a debt workout was approved by a Bank's special committee appointed for this purpose.[28] These

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23. See Eric Helleiner, "The Mystery of the Missing Sovereign Debt Restructuring Mechanism" (2008) 27 Contributions to Pol Econ 91 at 95.
24. *Ibid* at 9596; Skylar Brooks & Domenico Lombardi, "Governing Sovereign Debt Restructuring Through Regulatory Standards" (2016) 6 J Globalization & Dev 287 at 290.
25. See Helleiner, *supra* note 23 at 97.
26. The document can be found in J Keith Horsefield, *The International Monetary Fund 1945-1965: Twenty Years of International Monetary Cooperation*, vol 3 (Washington, DC: IMF, 1969) at 44, 71.
27. *Ibid* at 71.
28. See *Suggested Outline of a Bank for Reconstruction and Development of the United and Associated States*, art B.4, quoted in Robert W Oliver, *International Economic Co-operation and the World Bank* (New York: HM Publishers, 1975) at 292.

provisions were never incorporated into the Articles of Agreement of the IMF or the IBRD. There was a concern that Latin American countries would find the provisions offensive and would not be willing to support institutions that would likely refuse to lend them money. At the same time, others thought that such provisions would substantially tilt the balance in favour of debtors and give them too much power in debt negotiations.[29]

Sovereign debt was initially largely absent from political circles in the post-war decades due to limited international lending to developing countries.[30] This situation changed dramatically following the oil shock of 1973, when many developing countries borrowed heavily from international banks. By the late 1970s, it was clear that the loans were unsustainable, and that there was a need for debt restructuring.[31] In 1978, the United Nations Conference on Trade and Development (UNCTAD) put forward the idea of a more institutionalized restructuring mechanism. The G77 picked up and expanded on this idea and proposed an international debt commission that would examine debt and development issues and facilitate restructuring by mediating between debtors and creditors.[32] The proposal was ultimately dropped because of opposition by Western governments and banks that feared it could encourage more applications for debt relief and shift the terms of bargaining in favour of sovereign debtors.[33]

While arguments for a more formal restructuring mechanism continued in the 1980s and 1990s, they received little official interest.[34] It was not until the early 2000s that the issue was put back on the official agenda. In a November 2001 speech, Anne Kruger, the IMF Deputy Managing Director, put forward an ambitious proposal for a formalized sovereign debt restructuring mechanism that came to be known as the SDRM.[35] The SDRM's objective was to "provide

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29. Helleiner, *supra* note 23 at 102-103; Oliver, *supra* note 28 at 143-44, 375.
30. Kenneth Rogoff & Jeromin Zettelmeyer, "Bankruptcy Procedures for Sovereigns: A History of Ideas, 19762001" (2002) 49 IMF Staff Papers 470 at 471.
31. Kathryn C Lavelle, "Sovereign Debt Restructuring: Alliances Crossing the Financial Services Industry, States, and Nongovernmental Organizations" in Tony Porter & Karsten Ronit, eds, *The Challenges of Global Business Authority: Democratic Renewal, Stalemate, or Decay?* (Albany: State University of New York Press, 2010) 257 at 261; Helleiner, *supra* note 23 at 104.
32. *Ibid* at 262; Lex Rieffel, *Restructuring Sovereign Debt: The Case for Ad Hoc Machinery* (Washington: Brookings Institution Press, 2003) at 144-45.
33. See Susanne Soederberg, "The Transnational Debt Architecture and Emerging Markets: The Politics of Paradoxes and Punishment" (2005) 26 Third World Q 927 at 935.
34. See Rogoff & Zettelmeyer, *supra* note 30 at 483.
35. See Anne Krueger, "A New Approach to Sovereign Debt Restructuring" (26 November 2001), online: International Monetary Fund <www.imf.org/en/News/Articles/2015/09/28/04/53/sp112601> [perma.cc/H72J-J27D].

a framework that strengthens incentives for a sovereign and its creditors to reach a rapid and collaborative agreement on a restructuring of unsustainable debt."[36] It sought to improve collective action among creditors by establishing a legal framework that would empower a supermajority of creditors to make critical decisions binding on all creditors.[37] A key component of the SDRM was a "Dispute Resolution Forum" (DRF) tasked with facilitating and monitoring the restructuring as well as resolving disputes between the sovereign debtor and creditors.[38] The DRF could also impose a stay on all enforcement actions against the debtor while restructuring was taking place.[39] The IMF would finance the DRF and select its members, but the DRF would operate independently from the Fund.[40] The SDRM and the DRF would be established by amending the IMF Articles of Agreement, which would require approval of three-fifths of the members. Once approved, all members would be bound by the new provisions.[41]

The SDRM initially gained support from Western governments, including the US, UK, Canada, and Switzerland, but it soon became evident that success would be difficult to achieve.[42] Emerging market borrowers, such as Mexico and Brazil, argued that the initiative would increase their borrowing costs. They were nervous that private investors would perceive the mechanism as an inducement to default and therefore make capital more expensive.[43] Some expressed concerns about the IMF's conflict of interest, finding it hard to see the Fund as an independent observer when it had exposure to debtors itself.[44] The proposal also encountered strong opposition from the private sector community, which saw the proposal as encouraging more restructuring, in turn reducing private capital flows.[45] Finally, the last blow came from the US government shifting its

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36. See International Monetary Fund, *Report of the Managing Director to the International Monetary and Financial Committee on a Statutory Sovereign Debt Restructuring Mechanism: Proposed Features of a Sovereign Debt Restructuring Mechanism* (Washington, DC: 8 April 2003) art 1, online: <www.imf.org/external/np/omd/2003/040803.htm> [perma.cc/59QB-YWCM].
37. *Ibid*, art 11.
38. *Ibid*, art 13.
39. *Ibid*, art 7(c).
40. *Ibid*, art 13 (i-ii).
41. *Ibid*, art 14.
42. See Anna Gelpern & Mitu Gulati, "How CACs Became Boilerplate, or, the Politics of Contract Change" (2004) Initiative for Policy Dialogue Working Paper, online: <academiccommons.columbia.edu/catalog/ac:126625> [perma.cc/4LP8-26XP] at 5-16.
43. *Ibid* at 16; Helleiner, *supra* note 23 at 110.
44. See Gelpern & Gulati, *supra* note 42 at 16; Lavelle, *supra* note 31 at 269; Westbrook, *supra* note 21 at 256.
45. See Lavelle, *supra* note 31 at 269.

support from the SDRM to a market-based, contractual approach.[46] The SDRM initiative was eventually put in abeyance in 2003.[47]

The idea of a formal debt restructuring mechanism returned to policy circles in the aftermath of the Argentinian and Greek debt crises. In September 2014, the United Nations General Assembly (UNGA) adopted a resolution calling for the "establishment of a multilateral legal framework for sovereign debt restructuring processes."[48] The UNGA followed up with another resolution in December 2014, establishing an Ad Hoc Committee on Sovereign Debt Restructuring Processes. The Ad Hoc Committee held a number of meetings in 2015 that led to agreement on adherence to a number of principles, such as legitimacy, good faith, impartiality, and fairness, in sovereign debt restructurings.[49] These principles, which came to be known as the "Basic Principles on Sovereign Debt Restructuring Processes," were endorsed by a General Assembly Resolution in 2015.[50] While the aforementioned UN resolutions were adopted by large majorities, developed economies, including the US, UK, Japan, and the EU, either voted against them or abstained.[51] These jurisdictions, along with the IMF and the World Bank, did not attend the Ad Hoc Committee's meetings and explicitly refused to engage in any intergovernmental negotiations.[52] As a result,

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46. The G-7 Action Plan in 2002 supported "a market-oriented approach to the sovereign debt restructuring process in which new contingency clauses would be incorporated into debt contracts." Canada chaired the G-7 process that year and it was the actually Canadian deputy who presented G-7's work on CACs. See Statement of G-7 Finance Ministers and Central Bank Governors, Washington, DC (20 April 2002) online: G8 Research Group <www.g8.utoronto.ca/finance/fm022004.htm#action> [perma.cc/32ML-UD9F]; Gelpern & Gualti, *supra* note 42 at 26, n 143.
47. François Gianviti et al, *A European Mechanism for Sovereign Debt Crisis Resolution: A Proposal* (Brussels: Bruegel, 9 November 2010) at 19; Lavelle, *supra* note 31 at 270.
48. *Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes*, GA Res A/RES/68/304, UNGA, 68th Sess, A/RES/68/304 (2014).
49. United Nations Ad hoc Committee on Sovereign Debt Structuring Processes, *Committee Report Second Part: Chairperson Summary*, UNCTAD 3rd Working Sess (2015).
50. *Basic Principles on Sovereign Debt Restructuring Processes*, GA Res 69/319, UNGA, 69th Sess, A/RES/69/319, (2015).
51. The US, UK, Japan, Germany, Canada voted against both Resolution 68/304, "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes," and Resolution 69/319, "Basic Principles on Sovereign Debt Restructuring Processes." For the voting records of these resolutions, see General Assembly of the United Nations, "Voting Records" (last visited 10 September 2017), online: <www.un.org/en/ga/documents/voting.asp> [perma.cc/GEL3-T6TG].
52. See Charles W Mooney Jr, "A Framework for a Formal Sovereign Debt Restructuring Mechanism: The KISS Principle (Keep It Simple, Stupid) and Other Guiding Principles" (2015) 37 Mich J Intl L 57 at 66, n 36.

the UN's initiative, which marked the latest official attempt to create a binding multilateral legal framework for sovereign debt restructuring processes, has not yielded any meaningful progress.

III. THE CURRENT CONTRACTUAL APPROACH

The preferred approach of creditors and developed country governments to-date has been to regulate sovereign debt restructuring through contractual mechanisms. The primary contractual tool to regulate restructurings is the collective action clause (CAC), which binds all creditors to the will of a super-majority. This feature attempts to address the problem of holdout creditors and simulates the majority voting provisions found in domestic restructuring regimes. However, the traditional CAC only allowed for voting within a single series of bonds, thereby addressing the collective action problem only within a relatively small group. Therefore under these initial aggregation mechanisms, holdout creditors would not have great difficulty in defeating the restructuring process overall.

The unsettling consequences of the Argentinian litigation led the International Capital Markets Association (ICMA), a trade association for participants in global capital markets, to release a new set of model provisions to be included in sovereign bond contracts. These provisions contain enhanced CACs—sometimes referred to as CACs 2.0, or second-generation CACs—that allow for the aggregation of a sovereign's bond debt beyond a single series. Under these provisions, a sovereign may still choose to restructure a single series, but may also aggregate across series under either a two-limb or single-limb voting procedure. The three restructuring options that ICMA's model CAC provisions offer a sovereign issuer are as follows:

> Modification of a single series of bonds, as before, with a requirement that three-quarters of a series agree to the restructuring;
>
> Modification of multiple series of bonds, with the requirement that the restructuring be approved half of each series polled, and two-thirds of all outstanding debt polled (two-limb voting); and
>
> Modification of multiple series of bonds, with one aggregated vote amongst all bondholders, with a requirement that three-quarters of total bonds approve the restructuring.[53]

53. ICMA, "Standard Aggregated Collective Action Clauses ("CACS") for the Terms and Conditions of Sovereign Notes" (August 2014) online: <www.icmagroup.org/assets/documents/Resources/ICMA-Standard-CACs-August-2014.pdf> [perma.cc/T3DB-CM9T].

Following their introduction, CACs 2.0 were endorsed by the IMF Executive Board and the G20 Finance Ministers and Central Banks Governors.[54] In November 2014, Mexico made the first public offering with the new clauses under New York law, selling US$2 billion in 10-year bonds. A significant point about the Mexican issuance is that it contradicted the speculation that markets would demand a greater interest rate for the inclusion of CACs. In fact, the 2014 issuance locked in the lowest interest rates in Mexican history and CACs 2.0 had no impact on the bonds' pricing whatsoever.[55] Since then there has been a substantial uptake of CACs 2.0 in new bonds issuances without any observable impact on bonds' pricing.[56]

The model ICMA provisions also contain a new standard *pari passu* clause, drafted to clarify the meaning of *pari passu* and avoid the difficulties that Argentina faced in the New York courts. Most importantly, the new provision clarifies that it does not prevent a sovereign issuer from paying one creditor without at the same time paying all others, following the traditional meaning of *pari passu* that it is only the bonds and not their payments that rank equally.[57]

Despite being a positive step forward, as discussed above these contractual reforms have so far been unable to provide a complete solution to the sovereign restructuring problem. As of October 2016, a substantial stock of outstanding sovereign bonds—worth US$846 billion—lacks robust aggregate voting mechanisms. It is also likely that not all new sovereign bond issuances will contain enhanced contractual provisions.[58] For example, 74 out of 228 bond issuances made from October 2014 to October 2016, representing US$68 billion, lacked enhanced contractual provisions.[59] The most recent IMF survey in 2017 indicated

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54. See International Monetary Fund, Press Release, No 14/466, "Communiqué of the Thirtieth Meeting of the International Monetary and Financial Committee, Chaired by Mr. Tharman Shanmugaratnam, Deputy Prime Minister of Singapore and Minister for Finance, October 11, 2014" (11 October 2014), online: <www.imf.org/en/News/Articles/2015/09/14/01/49/pr14466> [perma.cc/U7V8-BGJD]; Munk School of Global Affairs & Public Policy, "G20 Leaders' Communiqué" (16 November 2014), online: G20 Information Centre <www.g20.utoronto.ca/2014/2014-1116-communique.html> [perma.cc/HUT8-7MM3].
55. Mark Sobel, "Strengthening Collective Action Clauses: Catalysing Change—The Back Story" (2016) 11 Capital Markets LJ 3 at 10.
56. International Monetary Fund, *Second Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts* (IMF, December 2016) at 6 [IMF, "Second Progress Report"].
57. ICMA, "Standard Pari Passu provision For the Terms and Conditions of Sovereign Notes" (August 2014) online: <www.icmagroup.org/assets/documents/Resources/ICMA-Standard-Pari-Passu-Provision-August-2014.pdf> [perma.cc/QVN8-XFZE].
58. See IMF, "Second Progress Report," *supra* note 56 at 3, 6-7.
59. *Ibid* at 3.

that the new bonds issued under New York law by Lebanon, Korea, Philippines, as well as new bonds issued under English law by Azerbaijan, Hungary, Malaysia, and Poland did not include enhanced CACs.[60]

Moreover, even the enhanced aggregate voting mechanisms suffer from important limitations, such as the fact that they only apply to bonds and exclude other important forms of sovereign debt, such as syndicated or bilateral loans.[61] Accordingly, due both to the inability of CACs to bind all of a sovereign's creditors and the absence of CACs in a substantial portion of existing sovereign bonds, the risk of disruptive holdout litigation continues to overhang sovereign debt.

At the time of writing, for example, holdouts present an imminent danger in the case of Venezuela, a country engulfed in an economic crisis and in default on virtually all its external debt.[62] It is clear that the Republic cannot continue servicing its debt and a restructuring of some form will be inevitable. Restructuring Venezuela's debt, however, will likely be challenging with respect to bonds issued by the PDVSA, the Venezuelan national oil company. Standing at about US$25 billion, the PDVSA bonds are governed by New York law and lack any contractual clauses that would permit a super-majority of creditors to

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60. International Monetary Fund, *Third Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts* (Washington, DC: 15 December 2017) at 3.
61. Peterson Institute for International Economics, *Sovereign Damage Control*, by Anna Gelpern, Policy Brief 13-12 (May 2013) at 13, online: <piie.com/publications/policy-briefs/sovereign-damage-control?ResearchID=2395> [perma.cc/8SJ3-PJZC].
62. The magnitude of the Venezuelan economic and social crisis could be better understood by looking at some of the recent forecasts. The Venezuela Congress reported that the inflation reached an annual 83,000 per cent in July 2018. Economists in Caracas have forecasted an inflation of 300,000 to 400,000 per cent for the year and the IMF even goes further to suggest that the country is heading for 1,000,000 per cent inflation. According to the UN, 2.3 million, 7 per cent of the entire population, have left Venezuela since 2015. For further information, see Gideon Long "Venezuelans left reeling by dollar shortages and hyper-inflation," *Financial Times* (24 August 2018), online: <www.ft.com/content/2506f266-a72b-11e8-8ecf-a7ae1beff35b> [perma.cc/H7KC-8EL2]; Alejandro Werner, "Outlook for the Americas: A Tougher Recovery" (23 July 2018), online (blog): *IMFBlog* <blogs.imf.org/2018/07/23/outlook-for-the-americas-a-tougher-recovery> perma.cc/9548-3HFZ]; Gideon Long "Hollowed-out Venezuela counts the cost of crisis," *Financial Times* (4 September 2018) online: <www.ft.com/content/55bd21a8-b02e-11e8-8d14-6f049d06439c> [perma.cc/P3NV-MSUJ]. On Venezuela's default, see Edward White & Hudson Lockett "S&P Says Venezuela is in default on sovereign debt," *Financial Times* (14 November 2017) online: <www.ft.com/content/88bc3246-c8f4-11e7-ab18-7a9fb7d6163e> [perma.cc/K8JD-YSCW]; Lee C Buchheit & G Mitu Gulati, "Sovereign Debt Restructuring and US Executive Power" (2018) 14 Capital Markets LJ 114 at 127.

approve a restructuring binding on all creditors.[63] Similar to most other bonds issued under foreign law in international markets, the PDVSA bonds have waived sovereign immunity and some of them even contain the same *pari passu* clause that was used by the holdouts in *Argentina v NML Capital*.[64] Inspired by the recent Argentinian saga, it can be expected that holdouts will intervene and seek to interfere with any restructuring attempts. They can sue the PDVSA in foreign courts, obtaining judgements to seize Venezuelan oil shipments and intercept international payments.[65] Any of these actions could have devastating consequences for the Venezuelan economy, which derives 95 per cent of its international revenue from the sale of oil.[66]

IV. A MORE REALISTIC REFORM ALTERNATIVE: SOVEREIGN DEBT RESTRUCTURING MODEL LAW

A. ADVANTAGES OF A MODEL LAW APPROACH

This article has thus far argued that the treaty approach to improving sovereign debt restructuring is politically infeasible, and that the contractual approach is insufficient. This section of the article suggests a third alternative, namely restructuring legislation adopted by a jurisdiction under whose laws a sovereign could issue its debt. This has been called the "Model Law" approach, and was originally suggested by Professor Steven L. Schwartz of Duke University's School

63. Lee C Buchheit & G Mitu Gulati, "How to Restructure Venezuelan Debt (¿Cómo restructurar la deuda venezolana?) (Duke Law School Public Law & Legal Theory Series No 2017-52, 2017), online: <papers.ssrn.com/sol3/papers.cfm?abstract_id=3006680> [perma.cc/U4CS-5NMW] at 3, 6; Clifford Krauss, "Venezuela Staves Off Default, but Low Oil Prices Pose a Threat," *New York Times* (12 April 2017), online: <www.nytimes.com/2017/04/12/business/venezuela-oil-debt-payment.html> [perma.cc/Y72E-T6WL].
64. W Mark, C Weidemaier & Matt Gauthier, "Venezuela as a Case Study in (Limited) Sovereign Liability" (2017) 12 Capital Markets LJ 215 at 215-16. For a discussion of the proceedings in *Argentina v NML Capital*, see Parts I & II, above.
65. In fact, Bloomberg recently reported that three hedge funds holding about 15 per cent of the outstanding of Venezuela's 2034 bonds (US$1.5 billion) have hired the same law firm which represented Aurelius Capital Management in the Argentina litigation to explore legal enforcement options. The group has the minimum threshold to block any key modifications, and therefore restructuring, of the bond contracts. See, for further information, Katia Porzecanski, "New Venezuela Creditor Group Emerges to Tackle Defaulted Debt," *Bloomberg* (31 May 2018) online: Bloomberg <www.bloomberg.com/news/articles/2018-05-31/new-venezuela-creditors-group-emerges-to-tackle-defaulted-debt>.
66. Jim Wyss et al, "Threat of U.S. oil sanctions on Venezuela sparks fears of economic 'collapse'" *Miami Herald* (18 July 2017) online: <www.miamiherald.com/news/nation-world/world/americas/venezuela/article162281848.html>.

of Law in 2015.[67] Despite the name given to this approach, we note at the outset that the proposed Model Law differs from other existing model laws in that the coordination of countries' domestic legal regimes is not its principal objective.[68] Instead, the purpose of the Model Law is to allow sovereigns to "opt-in" to a legislative restructuring regime by issuing their debt under the laws of a single enacting jurisdiction; while enactment of the law by multiple jurisdictions may lead to further benefits, duplication is not necessary for the sovereign debt restructuring Model Law to have efficacy.

The proposed Model Law is therefore a sort of hybrid between a formal, treaty-based regime and the existing contractual approach. Like with a treaty, the rules governing the restructuring would be publicly available and based in law, rather than in the parties' contracts: The Model Law would allow the rules of a potential restructuring to be known by all affected parties in advance, thereby enhancing the rule of law surrounding sovereign debt restructuring. The Model Law, however, has significantly greater political feasibility than an international treaty; while sovereign issuers and their creditors would need to select the law of the enacting jurisdiction to govern their debt contracts, this option becomes available to them as soon as even one country enacts the Model Law as domestic legislation.

The Model Law approach also preserves the freedom of contract that exists in the current contractual approach to sovereign debt restructuring. The Model Law would not be imposed upon a government or its creditors. Instead, the main basis for the application of the Model Law would be contractual, by means of the parties' choice of law clause. Sovereigns and their creditors would effectively choose to be governed by the Model Law by selecting the law of the enacting

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67. Steven L Schwarcz, "Sovereign Debt Restructuring: A Model-Law Approach" (2015) 6 J Globalization & Dev 343 at 380-81; Steven L Schwarcz, "A Model-Law Approach to Restructuring Unsustainable Sovereign Debt" (21 August 2015), online (pdf): Centre for International Governance Innovation <www.cigionline.org/sites/default/files/documents/PB%20no.64%20Updated_1.pdf> [perma.cc/S7TZ-43XE]. The full text of the Sovereign Debt Restructuring Model Law can be found in the appendix of both documents and has been also annexed, with the author's permission, to this article [*Sovereign Debt Restructuring Model Law*].

68. For examples of model laws in which uniformity is a primary objective, consider the Uniform Commercial Code (UCC (1995)), and the UNICITRAL Model Law on International Commercial Arbitration. See United Nations Commission of International Trade Law, *Status of UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006* (Vienna, 2008), online: <www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998_Ebook.pdf> [perma.cc/D7V3-SPLM].

jurisdiction to govern the contract.[69] A corollary of this, however, is that the Model Law approach would share a limitation of the contractual approach in that it would depend on the will of the parties to choose to be governed by the enacting jurisdiction, just as the contractual approach depends on the parties to include aggregation clauses and well-defined terms.

However, we suggest that the Model Law approach offers benefits over and above the contractual approach. The Model Law does not only allow for enhanced aggregation of bond debt, similar to the second generation of CACs, but it may also allow other types of debt to be included in a restructuring process.[70] The Model Law also contains provision for a neutral supervisory authority to oversee and provide structure to the process, as well as an arbitration mechanism to settle any disputes that arise between the parties.[71] Importantly, therefore, even if voting is not aggregated across types of debt (which may prove to be a difficult feat) under the Model Law, the centralized and supervised forum provided for by the Model Law would enhance communication, transparency, and fairness among all affected parties. Given the uncertainty and unpredictability of the status quo, the possibility of strengthening the global rule of law surrounding sovereign debt restructuring may be one of the greatest advantages of the Model Law approach.

An additional benefit of the Model Law is the availability of emergency liquidity that would rank ahead of other claims.[72] Obtaining new sources of funding has always been a major difficulty for distressed sovereigns, particularly because new lenders are reluctant to lend money in the absence of gaining priority for the repayment claim.[73] The Model Law addresses this problem by granting priority to new lenders over existing creditors, provided that existing creditors have notice and the opportunity to block the lending if the loan is too large or the terms are inappropriate.[74]

Due to its form as domestic legislation, the Model Law also allows for continued experimentation and incrementalism; changing the procedure to

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69. One alternative version of the Model Law requires parties to not only select the law of the enacting jurisdiction to govern their contract, but also to expressly choose to be governed by the Model Law. See the alternative formulation in *Sovereign Debt Restructuring Model Law*, *supra* note 67, art 1(1)(a).
70. A restructuring plan will become effective and binding if it is approved by creditors holding two-thirds in value and more than half in number of a class of claims concerned. See *ibid*, art 7(2).
71. *Ibid*, arts 2, 3, 10.
72. *Ibid*, c IV.
73. See generally Stiglitz, *supra* note 22 at paras 8-10.
74. *Sovereign Debt Restructuring Model Law*, *supra* note 67, arts 8-9.

reflect lessons learned would require legislative amendment in one jurisdiction, rather than simultaneously amending many debt contracts. However, the ease with which the restructuring process could be changed by the enacting jurisdiction would require market participants—both the sovereign issuer along with creditors—to have significant faith in the neutrality and fairness of the enacting jurisdiction. An appropriate enacting jurisdiction is therefore crucial to the success of the Model Law.

The first jurisdiction to enact the law would also likely realize significant benefits within its borders, which would serve as a sort of remuneration for its role in creating the global public interest benefits that would result from the Model Law. The following section will outline benefits that would likely accrue to the first jurisdiction to adopt the legislation, and will recommend the Province of Ontario, with support from the federal Canadian government, as an appropriate jurisdiction to lead this innovative approach to sovereign debt restructuring.

B. THE MODEL LAW AS A LEADERSHIP OPPORTUNITY FOR ONTARIO

The first jurisdiction to enact the Model Law has the potential to receive significant advantages in its capacity as a first mover on this initiative; moreover, it is likely that the Model Law would not entail any adverse consequences for the adopting jurisdiction.[75] The advantages associated with being the first jurisdiction to adopt the Model Law would arise primarily through the growth of that jurisdiction's financial and legal sectors. The Model Law would create business opportunities for local financial institutions to act as intermediaries in sovereign debt transactions, and for law firms of the enacting jurisdiction to advise on debt

75. At a roundtable conference sponsored by CIGI on 28 February 2017, two potential areas of concern were identified regarding the proposed Model Law: reputational concerns around being associated with sovereign defaults, and any impact of the Model Law on the status of the province's debt. However, our view is that no problems will arise related to either of these issues. Just as New York and England are not blamed when a sovereign defaults on loans governed by their law, there is no reason to believe that Ontario would be blamed should a sovereign default on, or require the restructuring of, a bond issued under Ontario law. Conversely, our view is that Ontario could enjoy enhanced international stature by virtue of its leadership in offering a solution to this important global problem. Furthermore, the enactment of the Model Law would not add to the province's financial burden and could be drafted so as to exclude Ontario's debt, if desired. See Maziar Peihani & Kim Jensen, "The Model Law Approach: How Ontario Could Lead the World in Providing Certainty and Fairness in Sovereign Debt Restructuring" (28 February 2017), online: Centre for International Governance Innovation <www.cigionline.org/sites/default/files/documents/2017%20SDR%20Round%20Table%20Report%20WEB.pdf> [perma.cc/JPC2-GQB3] at 3.

contracts. Furthermore, it is common practice for parties to a sovereign debt contract to submit to the jurisdiction of the courts in the same jurisdiction of the law governing the contract. English and New York courts, for example, are the two primary forums for sovereign debt disputes given that most foreign sovereign bonds are also governed by English or New York law. Similarly, depending on the institutions selected by the Model Law, domestic entities could be designated to supervise the restructuring process, and local arbitrators and courts could be designated to hear disputes arising under the Model Law.

The first jurisdiction to enact the law could also see a rise in its international reputation due to its leadership in resolving an important global issue. As discussed above, there is widespread international support for improved mechanisms to govern the restructuring of sovereign debt, as illustrated by the passing of two UN General Assembly resolutions in 2014.[76] The opposition to a treaty by some developed countries would likely not carry over to the Model Law approach, given that the latter retains freedom of contract for both issuers and their creditors. Instead, the first jurisdiction to enact the law would likely be seen as offering an innovative and creative solution to a global problem that, prior to its leadership, had long proved intractable.

However, a caveat to the above is that these benefits will only be realized if the enacting jurisdiction is trusted by market participants; sovereign issuers and their creditors must be willing to have their debt contracts be governed by the law of the enacting jurisdiction in order for the Model Law to take practical effect. This requires the jurisdiction that enacts the law to have an international reputation for political stability and rule of law. Furthermore, given the reliance of the sovereign debt market on existing financial infrastructure, the ideal jurisdiction would have an established financial sector that could support expansion into the market for sovereign debt. Finally, because most existing foreign-law governed sovereign debt is issued under either New York or English law, many of the Model Law's proponents believe that a successful Model Law State would most likely be a common law jurisdiction, in order to facilitate easier integration with existing capital markets and legal systems in London and New York.

We suggest that, on all criteria, the province of Ontario is well placed to take the lead as the first mover in adopting the Model Law. Ontario is of course a common law jurisdiction. Already, federal and Ontario bonds are predominantly issued under Ontario law (and the laws of Canada as applicable in Ontario) and benefit

76. See Part II, above, for a discussion of the UN General Assembly resolutions.

from the legal infrastructure available in the province.[77] An Ontario-adopted Model Law that strikes the right balance between the interests of creditors and debtors would make Ontario attractive to foreign issuers as well. Developing economies would find it particularly attractive to issue debt in Toronto and to choose Ontario law to govern their contracts. Both New York and London came to dominate the sovereign debt business not only because of their deep capital markets but also through offering their laws to govern foreign sovereign debt contracts. Both jurisdictions facilitated the issuance of foreign bonds by allowing sovereigns to choose New York or English laws to govern their transactions, even when the bonds were actually listed elsewhere.[78] Historically, sovereign issuers have been ready to accept the legal system of a foreign jurisdiction to govern their contracts and hear their disputes if that foreign jurisdiction enjoys a reputation for fairness and independence.[79]

In addition to its attractiveness to sovereign borrowers, Ontario law would be an appealing choice to foreign investors who are often reluctant to buy debt governed by the issuer's domestic law. These investors fear that the sovereign debtor could unilaterally change its law to discharge its obligations and defeat their legitimate contractual expectations. Such concerns do not apply if Ontario law governs, given both Canada and Ontario's reputations for rule of law, an independent and fair judiciary, and legal safeguards to protect creditors' reasonable expectations.

Ontario is also well positioned to take the lead on the Model Law initiative due to Toronto's position as a global financial centre and the principal financial centre within Canada. Moreover, the adoption of the Model Law is well aligned with the Ontario government priority to advance the success of the financial

77. See *e.g.* Department of Finance Canada, "Legal Terms and Conditions for Government of Canada Domestic Debt Securities" (last modified 30 March 2015), online: <www.fin.gc.ca/invest/dds-tmi-eng.asp> [perma.cc/R2PK-8HJR].

78. See Dilip Ratha, Supriyo De & Sergio Kurlat, "Does Governing Law Affect Bond Spreads?" (2016) World Bank Development Economics Global Indicators Group Policy Research Working Paper No WPS7863, online: World Bank <documents.worldbank.org/curated/en/903341476714665225/Does-governing-law-affect-bond-spreads> [perma.cc/V9AE-2ANU] at 3.

79. See Elisabeth de Fontenay, Josefin Meyer & Mitu Gulati, "The Sovereign Debt Listing Puzzle" (2016) Duke Law School Public Law & Legal Theory Working Paper No 2017-4 1 at 6-7, online: <papers.ssrn.com/sol3/papers.cfm?abstract_id=2853917> [perma.cc/5HMZ-P3NP].

services industry and increase jobs and investments in the sector.[80] Toronto is home to many leading banks, insurers, securities dealers, and pension funds, and continuously ranks as one of the best financial centres in the world.[81] Furthermore, Toronto is an excellent investment destination for major international financial institutions. In 2015, it ranked fifth among North American cities for inward foreign direct investment (FDI) in financial services, accounting for US$95.5 million investment.[82] In terms of outward FDI, Toronto ranks second only to New York, accounting for more than one billion US dollars.[83] Moreover, Canadian capital markets raised C$382 billion during 2015 and the TMX Group's market capitalization stood at C$2.8 trillion as of the end of March 2017.[84] Adding to Ontario's tool kit of finance-related services a facility to resolve sovereign debt would strengthen the province's standing in a competitive but changing global marketplace.

The uncertainty created by Brexit and the Trump Administration's criticism of the global trading system has implications for financial markets around the world, and may create opportunities to shift the trade winds of global finance. Ontario's reputation for political stability and rule of law and its excellent financial infrastructure provide the province with an opportunity to lead the world in the development of international norms and advance its own competitive position through the adoption of the Model Law. While there may be authority for Ontario to pursue this initiative independently under the division of powers in Canada's constitution, given the novelty of the proposed regime and the paramount need for legal stability, our view is that a collaborative approach between the Ontario and the federal government is the superior course of action.

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80. See generally Ministry of Finance, *Jobs for Today and Tomorrow 2016 Ontario Budget*, by The Honourable Charles Sousa at 3-56, online: <www.fin.gov.on.ca/en/budget/ontariobudgets/2016/papers_all.pdf> [perma.cc/3S9D-P26W].
81. See Silvia Pavoni, "Brexit-Bound London Stays Top of IFC Tree Rankings," *The Banker* (September 2017), online: <tfi.ca/policy-research/international-financial-centres-rankings> [perma.cc/P3S4-A6AS].
82. See Silvia Pavoni "New York Leads, Toronto Gains," *The Banker* (1 December 2015), online: <www.thebanker.com/Banker-Data/International-Financial-Centres/New-York-leads-Toronto-gains> [perma.cc/6FDJ-FXA9].
83. *Ibid*.
84. See "Dealmakers 2016," *Financial Post* (28 January 2016), online: <business.financialpost.com/investing/outlook-2016/dealmakers-2016-click-here-for-all-our-data> [perma.cc/HG3K-KAQR]; "TMX Group Equity Financing Statistics - March 2017," *Canada NewsWire* (7 April 2017), online: <web.tmxmoney.com/article.php?newsid=7604795236533080&qm_symbol=X> [perma.cc/3QMW-CBN7].

The issue of the constitutional authority to enact the Model Law is discussed in the following section.

C. CONSTITUTIONAL CONSIDERATIONS

Because Canada is a federation with legislative power allocated between the federal and provincial legislatures, any serious consideration of a Model Law to be adopted by Ontario must include a consideration of constitutional jurisdiction to make such an enactment. Could Ontario unilaterally enact a Model Law? Or would such a provision require coordinated legislation between Ontario and the Parliament of Canada? The answers to these questions are rooted in the division of powers set out in the *Constitution Act, 1867*, and the potential overlap between separate heads of power. Of particular relevance are section 91(21), which grants the federal government exclusive jurisdiction over "Bankruptcy and Insolvency," and section 92(13), which gives the provinces similar jurisdiction over "Property and Civil Rights in the Province," also referred to as "civil law."[85] The constitutional question is usually framed as "What is the legislation in 'pith and substance'?"

I. BANKRUPTCY AND INSOLVENCY

The Model Law shares features with laws whose pith and substance has been found to be bankruptcy and insolvency. The *Companies' Creditors Arrangements Act* (*CCAA*) is federal legislation allowing debtor companies with claims of at least C$5 million to make court-sanctioned compromises or arrangements with their creditors.[86] Despite that it did not deal directly with matters of bankruptcy, the Supreme Court of Canada held that the first enactment of this legislation in 1933 was a valid exercise of Parliament's power in bankruptcy and insolvency.[87] Shortly thereafter, similar federal legislation targeting farmers, *The Farmers' Creditors Arrangements Act*, *1934* was also upheld as pertaining to bankruptcy and insolvency.[88]

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85. *Constitution Act*, *1867* (UK), 30 & 31 Vict, c 3 (UK), ss 91(21), 92(13), reprinted in RSC 1985, Appendix II, No 5.
86. *Companies' Creditors Arrangements Act*, RSC 1985, c C-36.
87. *Reference Re Constitutional Validity of the Companies Creditors Arrangement Act (Dom)*, [1934] SCR 659 [*Reference Re Companies' Creditors Arrangement Act, 1933*].
88. *British Columbia (AG) v Canada (AG)*, [1936] SCR 384, (*sub nom Reference Re Farmers' Creditors Arrangement Act, 1934*), aff'd *British Columbia (AG) v Canada (AG)* (1937), 1 DLR 695, (*sub nom Reference Re Farmers' Creditors Arrangements Act, 1934*) (PC) [*Reference Re Farmers' Creditors Arrangement Act, 1934*].

By contrast, several provincial attempts to regulate debtor-creditor relationships in the context of the debtor's financial distress have been found *ultra vires* the provincial legislature's jurisdiction in property and civil rights. Some statutes purporting to adjust interest rates on certain types and classes of debts were held to infringe on Parliament's exclusive legislative powers in matters of interest, granted under section 91(19) of the *Constitution Act, 1867*.[89] Alberta's *Debt Adjustment Act* of 1937 is of greater relevance to the Model Law.[90] This statute was enacted during the depression and empowered an administrative body to, among other things, impose a debt composition on creditors.[91] Despite the fact that the *Act* was not formally predicated on the insolvency of the debtor,[92] it was nevertheless struck down as a law relating in "pith and substance" to bankruptcy and insolvency.[93]

In our view, however, there is a compelling argument that the proposed Model Law would be best characterized as a law in relation to property and civil rights, despite its apparent similarity to other laws that have been found to relate to bankruptcy and insolvency. As discussed above, the sovereign is only subject to the law of the jurisdiction that enacts the Model Law by its own contractual choice. Surely, the federal grant of power in bankruptcy and insolvency was never intended to regulate the debt contracts of a financially distressed foreign state,

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89. See *Credit foncier franco-canadien v Ross* (1937), 3 DLR 365 (ABCA); *Saskatchewan (AG) v Canada (AG)* (1949), 2 DLR 145 (PC). A subsequent case, however, narrowly defined interest to require the essential characteristic of day-to-day accrual. See *Ontario (AG) v Barfried Ltd*, [1963] SCR 570. A later case then upheld legislation relating to interest as a valid exercise of Parliament's powers under s 91(19) despite that it did not that did not deal with the day-to-day accrual of interest. See *Tomell Investments Ltd v East Marstock Ltd*, [1978] 1 SCR 974.
90. *The Debt Adjustment Act, 1937*, SA 1937, c 9, as amended by SA 1941, c 42.
91. *Alberta (AG) v Canada (AG)* (1943), 2 DLR 1 (*sub nom Reference Re Debt Adjustment Act, 1937*) (PC) [*Reference Re Debt Adjustment Act, 1937*] at 1213.
92. See Peter Hogg, *Constitutional Law of Canada* (Toronto: Thomson Reuters, 2018) (loose-leaf updated 2018, release 1), ch 25 at 7; For a general discussion on federal and provincial powers regarding debt restructuring, bankruptcy, and insolvency, see ch 25.
93. *Reference Re Debt Adjustment Act, 1937*, *supra* note 91. Locke J has stated his opinion that, had a similar Debt Adjustment Act been challenged in Saskatchewan, it would have been struck down for the same reasons as the *Alberta Debt Adjustment Act, 1937*. See *Canadian Bankers' Association v Saskatchewan (AG) (1955)*, [1956] SCR 31 at 41. However, a statute suspending a creditor's right to bring an action to recover a loan during a notice period that provides a last opportunity for the debtor to repay is a valid exercise of property and civil rights in the province. See *Bank of Montreal v Hall*, [1990] 1 SCR 121.

and to remove this from the provinces' more general power in property and civil rights in the case that a sovereign chooses to issue its debt under a province's law.[94]

More fundamentally, however, we submit that the regulation of sovereign debt contracts does not fall within federal power in bankruptcy and insolvency due to a sovereign's inability to become bankrupt. As discussed above, no bankruptcy regime exists for sovereigns, and the Model Law is not purporting to create one. While laws pertaining to "insolvency" outside the context of bankruptcy, such as the *CCAA*, have been held *intra vires* the federal Parliament, all such laws addressed entities that have the capacity to become bankrupt under Canadian law.

Numerous cases have explicitly held that the prevention of bankruptcy was a feature of valid federal insolvency legislation. Justice Cannon in the *Reference Re Companies' Creditors Arrangements Act, 1933*, writes:

> If the proceedings under this new Act of 1933 are not, strictly speaking, "bankruptcy" proceedings, because they had not for object the sale and division of the assets of the debtor, they may, however, be considered as "insolvency proceedings" *with the object of preventing a declaration of bankruptcy and sale of these assets*.[95]

In the subsequent *Reference Re Farmers' Creditors Arrangement Act, 1934*, Lord Thankerton for the Judicial Committee of the Privy Council cited this earlier *Reference*, stating: "it cannot be maintained that legislative provision as to compositions, *by which bankruptcy is avoided*, but which assumes insolvency, is not properly within the sphere of bankruptcy legislation."[96] The prevention of bankruptcy has furthermore been held to be an objective of the *CCAA* in subsequent judicial decisions.[97]

Further support for our view that the Model Law may not properly be "insolvency" legislation within the meaning of Canadian constitutional law can be found in the definition of insolvency used by the courts. In *Reference*

94. We further note that dispute resolution mechanisms would be expressly selected in the Model Law, which would supersede background domestic dispute resolution procedures. See *supra* note 67, art 10.
95. *Reference Re Companies' Creditors Arrangement Act, 1933*, *supra* note 87 at 664 [emphasis added].
96. *Reference Re Farmers' Creditors Arrangement Act, 1934*, *supra* note 88 at 701 [emphasis added].
97. See John D Honsberger & Vern DaRe, *Debt Restructuring: Principles and Practice* (Toronto: Canada Law Book, 1990) (loose-leaf updated 2009, release 29) at s 9:02. "Mr. Justice Urquhart of the Supreme Court of Ontario in three separate decisions rendered between 1939 and 1944 said that the object of the Act was to keep a company in business despite insolvency which distinguishes the Act from winding-up or bankruptcy proceedings" (footnotes omitted).

Re Farmers' Creditors Arrangements Act, 1934, Lord Thankerton, writing for the Privy Council, stated:

> In a general sense, insolvency means inability to meet one's debts or obligations; in a technical sense, it means the condition or standard of inability to meet debts or obligations, upon the occurrence of which statutory law enables a creditor to intervene, with the assistance of the Court, to stop individual action by creditors and to secure administration of the debtor's assets in the general interest of creditors.[98]

The implication of this statement is that insolvency, "in a technical sense," is an act of bankruptcy, the commission of which enables creditors to commence bankruptcy proceedings. This is stated explicitly by Justice Rand in *Canadian Bankers Association v Saskatchewan (AG)*: "The usual mark of insolvency is the inability to meet obligations as they mature; *it constitutes an act of bankruptcy* and furnishes ground for proceeding against the debtor under the Bankruptcy Act."[99]

We suggest that, because sovereigns are not liable to become bankrupt under Canadian law, a sovereign's inability to pay its debts would not constitute "insolvency" in the legal sense, and thus any provincial laws allowing for the restructuring of sovereign debt may be properly considered to be outside the federal government's exclusive competence in matters of bankruptcy and insolvency.

Further support for our position can be found in the reasons for which matters of bankruptcy are typically assigned to the national government in federal jurisdictions. Peter Hogg notes that, along with Canada, both the United States and Australia assign competence in bankruptcy matters to their federal governments.[100] He writes:

> These grants of power recognize that debtors may move from one province to another, and may have property and creditors in more than one province. A national body of law is required to ensure that all of a debtor's property is available to satisfy the debtor's debts, that all creditors are fairly treated, and that all are bound by any arrangements for the settlement of the debtor's debts.[101]

When no bankruptcy can arise, however, the location of a debtor's assets is irrelevant; and while the sovereign availing itself of the Model Law may indeed

98. *Reference Re Farmers' Creditors Arrangement Act, 1934, supra* note 88 at 700.
99. *Canadian Bankers' Associations*, *supra* note 93 at 46 [emphasis added].
100. Hogg, *supra* note 92, ch 25 at 1.
101. *Ibid*.

have debts not governed by the law of an enacting province, this would similarly be the case if the law were enacted at the federal level.[102]

II. TERRITORIAL LIMITATION CONTAINED IN SECTION 92(13)

In our view, therefore, the federal grant of power in bankruptcy and insolvency would not necessarily defeat a province's attempt to enact the Model Law. The territorial limitation contained in the wording of section 92(13), however, could pose another potential obstacle to the validity of the Model Law. Indeed, at least one provincial attempt to regulate debtor-creditor relationships was defeated on the basis that affected creditors resided outside the province.[103]

The judicial interpretation of the territorial limitation contained in section 92(13) has evolved throughout Canada's constitutional history. While some early cases held that even incidental extra-territorial effects of a law would render it *ultra vires* the enacting province, another line of cases held that such incidental effects would not violate the territorial limitation so long as the pith and substance of the law related to matters within provincial competence. In 1984, in *Reference Re Upper Churchill Water Rights Reversion Act*, the Supreme Court confirmed the second line of cases: It was held that incidental effects on extra-provincial rights would not render a law *ultra vires* whose pith and substance related to matters within provincial legislative competence.[104] In that case, however, the Court found the pith and substance of the impugned law to be the expropriation of contractual rights located outside of the Province of Newfoundland, thus rendering the enactment *ultra vires* the province's powers under section 92(13).[105]

Following *Reference Re Upper Churchill Water Rights Reversion Act*, any incidental effects under the Model Law outside of the Province of Ontario should not undermine its constitutional validity. It remains to be considered, however, how a Court would situate the primary territorial effects of the Model Law. In *Reference Re Upper Churchill Water Rights Reversion Act*, the Court found that the pith and substance of the law was the expropriation of contractual rights.[106] The court situated these intangible contractual rights by following the general rule

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102. Justice Beetz made a similar statement on the purpose of the federal grant of power to regulate bankruptcy and insolvency stating that: "The main purpose was to give to Parliament exclusive jurisdiction over the establishment by statute of a particular system regulating the distribution of a debtor's assets." See *Robinson v Countrywide Factors Ltd*, [1978] 1 SCR 753 at 804-805.
103. See *Credit foncier franco-canadien*, *supra* note 89.
104. *Reference Re Upper Churchill Water Rights Reversion Act*, [1984] 1 SCR 297 at 332.
105. *Ibid* at 335.
106. *Ibid*.

under private international law that such rights are situated in the jurisdiction in which action may be brought.[107] In this case, it had been expressly stated in the contract that disputes would be heard in the Province of Quebec.[108] Given that the object of the law was determined to be the expropriation of contractual rights that the Court located outside of the Province of Newfoundland, the law was found to be *ultra vires* Newfoundland's constitutional jurisdiction over property and civil rights in the province.

Following this analysis, the object of a Model Law enacted by the Province of Ontario should be found to be territorially situated within the province. The debt contracts being regulated by the Model Law would have necessarily selected the law of Ontario to govern their contracts. Given that common law courts have jurisdiction to hear disputes regarding a contract governed by the law of that jurisdiction,[109] *Reference Re Upper Churchill Water Rights Reversion Act* suggests that a province seeking to enact the Model Law will not likely be hindered by the territorial limitation contained in section 92(13).[110] Furthermore, as suggested above, it is common for contracts to include forum selection clauses in favour of the jurisdiction whose law governs the contract, and it is possible that many of the debt contracts that would be affected by the Model Law would have selected the Province of Ontario to hear disputes arising under the contracts. Following *Reference Re Upper Churchill Water Rights Reversion Act*, such clauses could further strengthen the argument for the territorial validity of the Model Law. However, some commentators have noted that both the identification of a law's pith and substance and the situation of intangible rights can be subject to significant discretion.[111] For this reason, it is difficult to predict with any degree of certainty how these points would be judicially decided in a novel situation.

III. A COMBINED AND COOPERATIVE APPROACH

In our discussion of the constitutional characterization of the Model Law thus far, we have suggested that it is likely Ontario could validly enact such a law: As stated, our view is that neither the federal grant of power in bankruptcy and insolvency nor the territorial limitation contained in section 92(13) of the *Constitution Act, 1867* would necessarily defeat a province's attempt to enact the Model Law.

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107. *Ibid* at 334.
108. *Ibid* at 306.
109. Janet Walker, *Canadian Conflict of Laws*, 6th ed (Markham, Ontario: LexisNexis Canada, 2005) (loose-leaf updated 2018), ch 11, s 11.6.
110. See generally *Reference Re Upper Churchill Water Rights Reversion Act, supra* note 104.
111. See Ruth E Sullivan, "Interpreting the Territorial Limitations on the Provinces" (1985) 7 SCLR 511 at 540-43.

It is readily apparent, however, that the project contemplated by the Model Law is unique. Domestic legislation whose primary purpose is to offer a restructuring regime to foreign sovereigns surely pushes the boundaries of all current precedents in Canadian constitutional law. Enacting the Model Law would thus necessarily be breaking new ground in constitutional jurisprudence and would correspondingly involve some degree of legal uncertainty.

The underlying objective of the Model Law, however, is to provide greater certainty and predictability in sovereign debt markets; a law enacted by the Province of Ontario that may be susceptible to constitutional challenge would therefore not be useful in serving its fundamental purpose. For this reason, despite our view that Ontario arguably has constitutional authority to enact the law independently, our strong recommendation is for both the federal Parliament and the Ontario legislature to pass complementary legislation enacting the Model Law.

The precise nature of this collaboration would depend on the final form that the law takes. The Model Law drafted by Professor Steven Schwartz offers an excellent template, but will require elaboration prior to enactment, particularly in a federation such as Canada in which powers are divided between levels of government. For instance, the draft law does not pre-select either the Supervisory Authority that will oversee the restructuring process or the body that would arbitrate disputes arising under the Model Law. Moreover, as discussed in this section, legislative power in Canada for various matters relevant to the Model Law—such as interest, insolvency, and property and civil rights—is variously assigned to the provinces and federal Parliament. While this section has discussed the characterization of the Model Law's pith and substance at a broad level, a definitive analysis of the Model Law's constitutional validity would necessarily depend on the exact text of the proposed law. Finally, we note that the federal-provincial collaboration may take various forms: The two laws could "mirror" one another as exact duplicates—a technique sometimes used to immunize legislation against constitutional challenge—or "dove-tail," with each level of government passing those portions of the law within its legislative competence.[112]

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112. See *e.g. Canada-Newfoundland and Labrador Atlantic Accord Implementation Act*, SC 1987, c 3; *Canada-Newfoundland and Labrador Atlantic Accord Implementation Newfoundland and Labrador Act*, RSNL 1990, c C-2 (showing an example of mirror legislation regarding the management of petroleum resources in the Gulf of St Lawrence); See generally Cooperative Capital Markets Regulatory System, "Backgrounder: Agreed Elements of a Cooperative Capital Markets Regulatory System" (19 September 2013) online: <ccmr-ocrmc.ca/wp-content/uploads/2014/04/CCMRWebSept19BkgrderAIPPDF.pdf>; "Cooperative Capital Markets Regulatory System Governance and Legislative Framework" (31 October 2014) online: <ccmr-ocrmc.ca/wp-content/uploads/Oct_31-Commentary-English.pdf> (showing an example of dove-tailing legislation).

Our recommendation for a collaborative approach is consistent with the principle of cooperative federalism, which has been embraced as the "dominant tide" of modern federalism by the Supreme Court of Canada. In *Reference Re Securities Act*, the Court noted that:

> The Judicial Committee of the Privy Council … tended to favour an exclusive powers approach … The Supreme Court of Canada, as final arbiter of Constitutional disputes since 1949, moved toward a more flexible view of federalism that accommodates overlapping jurisdiction and encourages intergovernmental cooperation—an approach that can be described as the "dominant tide" of modern federalism.[113]

The benefits of federal-provincial cooperation in matters of or surrounding insolvency are well-established. When the Bill to enact the first *Companies' Creditors Arrangements Act, 1933* was given its second reading in the Senate, Senator Meighen remarked that:

> The law now submitted to us could be made vastly more effective if it were not for the federal system. As it is, the best result can be obtained only by the passage by our legislatures of such co-operative measures as will enable civil rights, and companies within their purview, to be interfered with for the general advantage.[114]

Insolvency—in its general meaning, and not the technical meaning described above—has been recognized by the courts as an area in which both federal and provincial legislative power can concurrently operate. In *Robinson v Countrywide Factors*, Justice Beetz observed that the risk a debtor may be unable to repay its debts underlies those parts of the common law that relate to "mortgage, pledge, pawning, suretyship and the securing of debts generally," but that laws regulating such matters do not cease to be laws in relation to property and civil rights.[115] Justice Beetz continued:

> When the exclusive power to make laws in relation to bankruptcy and insolvency was bestowed upon Parliament, it was not intended to remove from the general legal systems which regulated property and civil rights a cardinal concept essential to the coherence of those systems … . However, given the nature of general legal systems, the primary jurisdiction of Parliament cannot easily be exercised together with its incidental powers without some degree of overlap in which case federal law prevails. On the other hand, *provincial jurisdiction over property and civil rights should not be measured by the ultimate reach of federal power over bankruptcy and insolvency*.[116]

113. *Reference Re Securities Act*, 2011 SCC 66 at paras 56-57.
114. "Bill 77, an Act to facilitate Compromises and Arrangements between Companies and their Creditors," 2nd reading, *Senate Debates*, 17th Parl, 4th Sess, Vol 1 (10 May 1933) at 474 (Hon Arthur Meighen).
115. *Robinson v Countrywide Factors*, *supra* note 102 at 804.
116. *Ibid* at 804-805 [emphasis added].

As the above quotation suggests, federal and provincial law already closely interact in matters of insolvency generally. One may usefully consider the various Personal Property Security Acts (PPSAs) enacted by Canadian common law provinces.[117] These statutes require creditors to register any security they hold in order to perfect their claim thereon. Creditors who fail to perfect their claim will see their rights subordinated to other creditors who registered and perfected their interests, and in particular, to the rights of a trustee in bankruptcy. As a result, some have argued that PPSAs are *ultra vires* or are in conflict with federal legislation because they alter the rights of certain creditors in bankruptcy proceedings.[118]

Such an interpretation has yet to be followed by the courts, likely due to the nature of PPSAs.[119] PPSAs are *intra vires* provincial legislatures because they make reference to, but do not interfere with, bankruptcy trustees while pursuing the legitimate provincial legislative goal of governing the rights of secured creditors.[120]

V. CATALYZING CHANGE: DRAWING LESSONS FROM PREVIOUS REFORMS

The Model Law draws upon the reform experience in other areas of law that had long been proven intractable. A leading example is the UNCITRAL Model Law on International Commercial Arbitration, which became a major success due to its informal character and incremental approach to reform. It is worth noting that Canada was the first country to adopt the UNCITRAL Model Law and has played a key role in its development and judicial interpretation. The Canadian provinces played an important role and were unanimous in supporting its implementation. Today, the UNCITRAL Model Law has been adopted by 111 jurisdictions.[121]

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117. For instance, *Personal Property Security Act*, RSO 1990, c P10; *Personal Property Security Act*, SNS 1995-96, c 13; *Personal Property Security Act*, RSBC 1996, c 359.
118. Arthur Peltomaa, “Constitutional Validity of Provincial Legislation Subordinating Unperfected Security Interests to Trustee in Bankruptcy” (1982) 42 CBR (NS) 104.
119. Andrew J Roman & Jasmine Sweatman, “The Conflict Between Provincial Property Security Acts and the Federal Bankruptcy Act: The War is Over” (1992) 71 Can Bar Rev 77 at 100.
120. Similarly, the Supreme Court settled the question of the validity of provincial acts regarding fraudulent preferences by allowing provincial laws to have effect unless rendered inoperative by conflicting federal bankruptcy law. See *Robinson v Countrywide Factors*, *supra* note 102. This case is discussed further in Hogg, *supra* note 92, at ch 25 at 8.
121. See “Status UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006,” online: <www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html> [perma.cc/VT83-8UD6].

The experience with reform efforts in improving sovereign debt management to-date also offers valuable lessons on how to succeed with the Model Law. As discussed, in light of the existing political constraints on creating a treaty-based regime such as the SDRM, recent reforms to improve sovereign debt restructuring have mainly focused on market-based and contractual approaches. A notable example of such reforms is provided by the second-generation CACs and the new standard *pari passu* clauses that were introduced by the International Capital Market Association following difficulties in resolving claims in Argentina and Greece's debt restructuring due to holdout creditors.[122]

In spite of limitations that were reviewed previously, the CAC reform process offers important lessons for the Model Law initiative. First, it suggests that the robust aggregation mechanisms of the Model Law, which also address the *pari passu* issue, are unlikely to affect the bonds' pricing. As discussed above, the 2014 Mexican issuance that included the second-generation CACs saw the lowest interest rates in Mexican history, and the subsequent uptake of these clauses by other issuers also showed no effect on pricing.[123] The Model Law can be an even more attractive option than CACs 2.0 as it includes provisions on the supervision of the restructuring process and the settlement of disputes through arbitration. Such provisions provide creditors with greater confidence that their legal rights will be reasonably protected in the governing forum and that they will receive a fair remedy in case of default or disputes.

Second, the CACs reform highlights the importance of signaling and issuing the bonds in good times. That is to say, if a sovereign issuer is in sound financial condition and there are no looming questions about its debt sustainability, issuing debt under Ontario law should not send any negative signal to markets. The final lesson is on the importance of outreach and building alliances to overcome collective action problems. The Mexican issuance with the enhanced CACs helped policy makers overcome their first mover challenge and provided the markets with the essential confidence to take up the enhanced clauses in new bonds. Given that Canada is politically stable and has a sound reputation for the rule of law and an independent judiciary, it should be possible to convince a sovereign borrower with sustainable debt dynamics to issue debt under Ontario law. The first issuance will then pave the way for the greater uptake of Ontario law in future sovereign debt issuances.

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122. See Part III, above, for a discussion of these clauses.
123. *Ibid*.

VI. CONCLUSION

The search for a binding sovereign debt restructuring mechanism has been ongoing for a very long time. As this article shows, since the 1930s, various attempts have been made to establish a statutory restructuring mechanism, the most notable of which was the IMF's SDRM, which has now been abandoned, or left in limbo. In the absence of an international restructuring mechanism, collective action clauses remain an imperfect attempt to resolve sovereign debt issues. While the enhanced CACs are a promising step in the right direction, they are still far from a reliable and complete approach to addressing sovereign debt issues.

Although previous attempts aimed at establishing a statutory debt restructuring mechanism recognized the inadequacy of the contractual approach, they failed to generate sufficient support because they had to rely on concerted multilateral action. The Model Law reform initiative can offer the predictability and effectiveness of a statutory approach without foundering on the obstacles that frustrated previous reforms. Once the Model Law is adopted in one jurisdiction, it may be adopted by other national and subnational jurisdictions and spread its appeal and application without having to rely on treaties or binding international agreements.

Historically, parties to sovereign debt transactions favoured New York and England given their well-developed body of commercial law and their judicial systems' impartiality in resolving disputes. However, the recent Argentinian saga has casted a shadow over the legitimacy of the New York courts and their impartiality resolving sovereign debt disputes. Further, the chaos and uncertainty caused by Brexit challenges London's dominance as a global financial hub. Together, these factors create opportunities for other financial centers, such as Toronto which are politically stable and can provide the essential impartiality and business certainty that sophisticated commercial parties seek in their international transactions. Therefore, the time seems ripe for Canada to step up and promote its own distinct position in international finance.

As this article argues, the Model Law provides a unique leadership opportunity for Ontario, enabling the province to establish an orderly sovereign debt resolution regime under the rule of law. Ontario's neutrality and strong reputation for the rule of law and financial stability would support creditors' confidence and reasonable expectations. Particularly, if collaborative legislation is pursued with the federal government, there should be no constitutional obstacle to the Province of Ontario's adoption of the Model Law. By its adoption, significant benefits would accrue to debtor states and creditors, and Ontario could further

develop its capacities as a world-class financial jurisdiction. Both Ontario and the deeply dysfunctional sovereign debt world would benefit from the introduction and adoption of the Model Law.

VII. ANNEX: SOVEREIGN DEBT RESTRUCTURING MODEL LAW[124]

PREAMBLE

The Purpose of this Law is to provide effective mechanisms for restructuring unsustainable sovereign debt so as to reduce (a) the social costs of sovereign debt crises, (b) systemic risk to the financial system, (c) creditor uncertainty, and (d) the need for sovereign debt bailouts, which are costly and create moral hazard.

CHAPTER I: SCOPE, AND USE OF TERMS

Article 1: Scope

1. This Law applies where, by contract or otherwise, (a) the law of [this jurisdiction] governs [*alternative*: this Law is specifically stated to govern] the debtor-creditor relationship between a State and its creditors and (b) the application of this Law is invoked in accordance with Chapter II.
2. [*This provision is optional*] Where this Law applies, it shall operate retroactively and, without limiting the foregoing, shall override any contractual provisions that are inconsistent with the provisions of this Law.

Article 2: Use of Terms

For purposes of this Law:

1. "creditor" means a person or entity that has a claim against a State;
2. "claim" means a payment claim against a State for monies borrowed or for the State's guarantee of, or other contingent obligation on, monies borrowed; and the term "monies borrowed" shall include the following, whether or not it represents the borrowing of money per se: monies owing under bonds, debentures, notes, or similar instruments; monies owing for the deferred purchase price of property or services, other than trade accounts payable arising in the ordinary course of business; monies owing on capitalized lease obligations; monies owing on or with respect to letters of credit, bankers' acceptances, or other extensions of credit; and monies owing on money-market instruments or instruments used to finance trade;
3. "Plan" means a debt restructuring plan contemplated by Chapter III;

124. See *Sovereign Debt Restructuring Model Law*, *supra* note 67 (incorporated here with Professor Schwarcz's permission).

4. "State" means a sovereign nation;
5. "Supervisory Authority" means [name of neutral international organization].

CHAPTER II: INVOKING THE LAW'S APPLICATION

Article 3: Petition for Relief, and Recognition

1. A State may invoke application of this Law by filing a voluntary petition for relief with the Supervisory Authority.
2. Such petition shall certify that the State (a) seeks relief under this Law, and has not previously sought relief under this Law (or under any other law that is substantially in the form of this Law) during the past [ten] years, (b) needs relief under this Law to restructure claims that, absent such relief, would constitute unsustainable debt of the State, (c) agrees to restructure those claims in accordance with this Law, (d) agrees to all other terms, conditions, and provisions of this Law, and (e) has duly enacted any national law needed to effectuate these agreements. If requested by the Supervisory Authority, such petition shall also attach documents and legal opinions evidencing compliance with clause (e).
3. Immediately after such a petition for relief has been filed, and so long as such filing has not been dismissed by the Supervisory Authority [or this jurisdiction] for lack of good faith, the terms, conditions, and provisions of this Law shall (a) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of [this jurisdiction]; (b) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of another jurisdiction that has enacted law substantially in the form of this Law; and (c) be recognized in, and by, all other jurisdictions that have enacted law substantially in the form of this Law.

Article 4: Notification of Creditors

1. Within 30 days after filing its petition for relief, the State shall notify all of its known creditors of its intention to negotiate a Plan under this Law.
2. The Supervisory Authority shall prepare and maintain a current list of creditors of the State and verify claims for purposes of supervising voting under this Law.

CHAPTER III: VOTING ON A DEBT RESTRUCTURING PLAN

Article 5: Submission of Plan

1. The State may submit a Plan to its creditors at any time, and may submit alternative Plans from time to time.
2. No other person or entity may submit a Plan.

Article 6: Contents of Plan

A Plan shall

1. designate classes of claims in accordance with Article 7(3);
2. specify the proposed treatment of each class of claims;
3. provide the same treatment for each claim of a particular class, unless the holder of a claim agrees to a less favorable treatment;
4. disclose any claims not included in the Plan's classes of claims;
5. provide adequate means for the Plan's implementation including, with respect to any claims, curing or waiving any defaults or changing the maturity dates, principal amount, interest rate, or other terms or cancelling or modifying any liens or encumbrances; and
6. certify that, if the Plan becomes effective and binding on the State and its creditors under Article 7(1), the State's debt will become sustainable.

Article 7: Voting on the Plan

1. A Plan shall become effective and binding on the State and its creditors when it has been submitted by the State and agreed to by each class of such creditors' claims designated in the Plan under Article 6(1). Thereupon, the State shall be discharged from all claims included in those classes of claims, except as provided in the Plan.
2. A class of claims has agreed to a Plan if creditors holding at least [two-thirds] in amount and more than [one-half] in number of the claims of such class [voting on such Plan] [entitled to vote on such Plan] agree to the Plan.
3. Each class of claims shall consist of claims against the State that are pari passu in priority, provided that (a) *pari passu* claims need not all be included in the same class, (b) claims of governmental or multi-governmental entities each shall be classed separately, and (c) claims that are governed by this Law or the law of another jurisdiction that is substantially in the form of this Law shall not be classed with other claims.

I. CHAPTER IV: FINANCING THE RESTRUCTURING

Article 8: Terms of Lending

1. Subject to Article 8(3), the State shall have the right to borrow money on such terms and conditions as it deems appropriate.
2. The State shall notify all of its known creditors of its intention to borrow under Article 8(1), the terms and conditions of the borrowing, and the proposed use of the loan proceeds. Such notice shall also direct those creditors to respond to the Supervisory Authority within 30 days as to whether they approve or disapprove of such loan.
3. Any such loan must be approved by creditors holding at least two-thirds in amount of the claims of creditors responding to the Supervisory Authority within that 30-day period.
4. In order for the priority of repayment (and corresponding subordination) under Article 9 to be effective, any such loan must additionally be approved by creditors holding at least two-thirds in principal amount of the "covered" claims of creditors responding to the Supervisory Authority within that 30-day period. Claims shall be deemed to be "covered" if they are governed by this Law or by the law of another jurisdiction that is substantially in the form of this Law.

Article 9: Priority of Repayment

1. The State shall repay loans approved under Article 8 prior to paying any other claims.
2. The claims of creditors of the State are subordinated to the extent needed to effectuate the priority payment under this Article 9. Such claims are not subordinated for any other purpose.
3. The priority of repayment (and corresponding subordination) under this Article 9 is expressly subject to the approval by creditors under Article 8(4).

CHAPTER V: ADJUDICATION OF DISPUTES

Article 10: Arbitration

1. All disputes arising under this Law shall be resolved by binding arbitration before a panel of three arbitrators.
2. The arbitration shall be governed by [generally accepted international arbitration rules of (name of neutral international arbitration body)] [the rules of the International Centre for Settlement of Investment Disputes/ International Centre for Dispute Resolution/ International

Chamber of Commerce International Court of Arbitration/ specify other international arbitration organization].

3. Notwithstanding Article 10(2), if all the parties to an arbitration contractually agree that such arbitration shall be governed by other rules, it shall be so governed. Such agreement may be made before or after the dispute arises.
4. The State shall pay all costs, fees, and expenses of the arbitrations.

CHAPTER VI: OPT IN

Article 11: Opting in to this Law

1. Any creditors of the State whose claims are not otherwise governed by this Law may contractually opt in to this Law's terms, conditions, and provisions.
2. The terms, conditions, and provisions of this Law shall apply to the debtor-creditor relationship between the State and creditors opting in under Article 11(1) as if such relationship were governed by the law of [this jurisdiction] under Article 3(3).