PUBLIC SYMBOL IN PRIVATE CONTRACT: A CASE STUDY

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ABSTRACT

This article revisits a recent shift in standard form sovereign bond contracts to promote collective action among creditors. Major press outlets welcomed the shift as a milestone in fighting financial crises that threatened the global economy. Officials said it was a triumph of market forces. We turned to it for insights into contract change and crisis management. This article is based on our work in the sovereign debt community, including over 100 interviews with investors, lawyers, economists, and government officials. Despite the publicity surrounding contract reform, in private few participants described the substantive change as an effective response to financial crises; many said it was simply unimportant. They explained their own participation in the shift as a mix of symbolic gesture and political maneuver, designed to achieve goals apart from solving the technical problems for which the new contract terms offered a fix.

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I. INTRODUCTION

In June 1997 a developing country defied convention. It issued New York law bonds that let 75 percent of the bondholders change key financial terms.[1] Until then, standard form New York law contracts required unanimous consent. But no one seemed to notice the innovation, and just about no one followed suit.

In February 2003 another developing country issued New York law bonds with a 75 percent amendment threshold.[2] This time, the world of international finance erupted in applause and criticism. Major press outlets, finance ministers, and senior executives publicly pondered the shift.[3] Other countries adopted similar provisions under the rubric of "Collective Action Clauses" or "CACs." Academic study of sovereign debt contracts took on new importance. This article is part of an effort to understand what happened and what it means.

Standard—or "boilerplate"—terms in complex financial contracts rarely change.[4] The prevalent theoretical explanation of boilerplate attributes its existence to learning and network effects and associated "switching costs."[5] This body of theory suggests that market participants attach value to contract terms either because they have been used in the past and are well known (learning effects), or are widely used now and/or are expected to be widely used in the future (network effects).[6] As a result, firms might adopt terms that are suboptimal on their own merits just because they are well understood or widely used. Switching may be costly for a single firm because it takes time and effort to produce a new term that works and to educate the target audience about its meaning. There is no guarantee that investors, analysts, and judges will interpret a new term in a way that is favorable to its original proponent or, as the example in our opening paragraphs illustrates, that others will adopt the term in the foreseeable future.

Boilerplate change is poorly understood because it happens so rarely, so slowly, and so quietly. Contract terms are not normally featured on the editorial pages of *The Wall Street Journal*, *The Economist*, or *The Financial Times*, let alone in academic articles in the fields of law, economics, or political science. Against this background, the dramatic and public shift in sovereign bond documentation beginning in 2003 offers a rare perspective on the contracting process and boilerplate change.

The CAC episode is unusual in another respect. World leaders generally do not know what boilerplate is, much less feature it in communiqués reserved for big-picture concerns such as global economic imbalances. Yet for nearly a decade CACs had a guaranteed spot in summit statements alongside financial stability and currency regimes.[7] Moreover, boilerplate theory does not usually contemplate a leading role for the public sector in promoting optimal private contract terms.[8] But in the case of Collective Action Clauses, governments not party to the contracts got credit for driving the shift.[9] Judging from recent policy initiatives, the apparent success of the CAC campaign may have spawned a new model of framing economic policy proposals in terms of private contract reform. The latest public-sector effort to promote GDP-indexed bonds cites the CAC experience as an inspiration, and even adopts some of the organizational features of the earlier initiative, such as the expert contract drafting group.[10]

For all its value as precedent, the public sector's role in the CAC episode remains unexplored. Proponents in the George W. Bush Administration called the shift "market-based" even as market commentary attributed it to government pressure.[11] On the other hand, neither the United States nor any other G-7 government appears to have issued direct threats or bribes—the traditional instruments of "hard power."[12] Financial industry regulators refused to mandate CACs or otherwise promote their inclusion; instead, pressure came in the form of exhortations by economic policy officials.[13] Did the "soft power"[14] of G-7 ideas convince developing countries of the inherent virtues of CACs? No emerging markets official would tell us that he or she participated in the CAC shift because the clauses could alter the course of a crisis. Even after moving to CACs, borrowers expressed skepticism about the extent of the holdout problem CACs would solve. Alternatively, scholars have suggested that G-7 governments engaged in informational "cueing" to help overcome network effects, a form of "soft" regulation.[15] Here too, no early mover admitted acting in expectation of a market-wide shift; few thought the G-7 capable of delivering such a shift and all worried that their country would pay a penalty for innovating.

A final lingering puzzle of the CAC episode is just how few private or public sector participants in it express strong feelings about the clauses as such. We spoke with dozens of actors whose websites and speeches proclaim the seminal importance of the CAC shift (usually as they claim paternity), yet in our interviews a scant few described the change itself as important in addressing the problems of sovereign debt restructuring or financial crises in the emerging markets. Many were unsure of how the new clauses would work in a crisis; most said they were probably good, none said they were clearly bad. More participants volunteered strong feelings about the process that led to the shift—praising cooperation, while at the same time grumbling about wasted time and official meddling. Was this another instance of wasted lawyering or runaway process?[16]

If true in part, this description is incomplete and not entirely fair. Most participants suggested that their efforts on

CACs had less to do with the clauses' literal purpose (facilitating future contract modification) than with their relative utility in advancing other goals, such as demonstrating commitment to a new crisis management strategy, currying political favor, or establishing reputations in the market. Some were successful in achieving these goals; others failed. Their collaboration produced a revealing study in the uses of contract form and ways of governance.

We depart from earlier quantitative and analytical studies of sovereign debt contracts[17] in favor of an interview-based approach. We have collected over 100 accounts of the CAC shift from market participants, officials, and others who took part in it, and have supplemented these with our own observations from the daily work of law firms and government offices, conferences and negotiations, press accounts, official documents, and of course the debt contracts themselves.[18]

Below we first review the sovereign debt context in the early 2000s, the contract provisions at the center of the study, and the process that led to the shift in 2003. Second, we recount alternative explanations for the shift that have been published to date. We then describe the findings from our interviews and conclude with implications for contract change, the uses of contract, and governance.

II. The Setting

A. Emerging Markets Sovereign Debt: Actors and Contracts

Our focus is on the external bonds of emerging markets governments, which traditionally has meant money borrowed from foreign residents in foreign currency under foreign law—for example, Mexico's dollar-denominated, New York law bonds marketed to U.S. residents.[19]

Although such bonds dominated foreign sovereign borrowing in the nineteenth century and into the 1930s, depression-era defaults shut down the market for over sixty years.[20] Sovereign borrowing came back in the 1970s in the form of bank loans. A wave of loan defaults in the 1980s triggered a new debt crisis, which stunted growth for a decade and threatened the health of major international banks. In the early 1990s, banks agreed to exchange bad loans for Brady Bonds, named after the U.S. Treasury Secretary who helped broker the solution.[21] Trading in the Brady Bonds paved the way for new issues. The emerging markets securities market was born.

The Economist defines emerging markets as developing countries, explained in turn as "[a] euphemism for the world's poor countries."[22] The term is also used occasionally to describe all countries with annual per capita income of below $10,725, classified as low- and middle-income by the World Bank.[23] This excludes high-income or "mature markets" issuers such as the United States and the other G-7 economies with well-established domestic financial systems, steady access to domestic and international investors, and the capacity to issue debt in their own currencies.[24] We prefer a narrower definition that reflects the fact that only a minority of all low- and middle-income countries have market access on any meaningful scale. J.P. Morgan's Emerging Markets Bond Index Global (EMBIG) includes U.S.-dollar-denominated debt instruments of governments and state-owned entities in thirty-three countries, for which dealers quote prices daily.[25] Market participants frequently use this index as a proxy to describe emerging markets external debt as an asset class. In the summer of 2003, as the market was shifting to CACs, EMBIG market capitalization was $224 billion.[26] Mexico, Brazil, Russia, and Turkey comprised over half this total (Argentina had been a big presence until its $100 billion default in 2001); a dozen countries accounted for nearly 90 percent. Over one-third of the debt in the index was investment grade.[27] Total external debt outstanding issued by EMBIG countries, including instruments denominated in Euro and others not included in the index was closer to $300 billion.[28] For comparison, foreign-currency debt issued by mature markets governments (such as New Zealand’s yen-denominated securities) was more than double the emerging markets total.[29] However, mature markets governments are often able to sell local-currency debt to foreign investors: at the end of January 2007, foreign residents held over $2 trillion in dollar-denominated U.S. Treasury securities.[30] Emerging markets debt is actively traded: a leading industry association reported annual trading volume at over $5.5 trillion in 2005, slightly below the historic high of $6 trillion reached in 1997.[31]

The number of people involved in emerging markets sovereign debt is small, partly due to the small number of large-volume issuers. Compared to thirty-three countries in the EMBIG, over 2500 companies are listed on the New York Stock Exchange alone.[32] Raising money abroad is most often the responsibility of a country’s finance ministry, occasionally of the central bank. Recently, stand-alone debt management offices have gained popularity. The core government team for a new issue is usually about half a dozen people.

When an emerging markets government wants to issue debt abroad, it hires an international investment bank to “manage” the offering to design and market the instruments, and, for underwritten deals, to commit to buy the debt. These “sell-side” institutions compete for mandates from governments; often two or more institutions are appointed “co-lead managers” for an issue.

Sell-side bankers refer to the issuing governments as their clients; their fees are a portion of the issue proceeds. About half a dozen investment banks dominate the scene, with another handful managing an occasional issue for a marginal sovereign. Sell-side banks have research departments that report regularly on the emerging markets. In theory, research and investment banking are separated by "Chinese walls."[33] When sell-side research analysts speak of clients, they refer to the investors, also known as the "buy-side."

There is no authoritative source of information on investors in emerging markets sovereign debt. Sell-side research departments occasionally survey their clients, and governments occasionally try to get a fix on their creditor base, but neither effort produces a comprehensive picture.[34] Less concentrated than the sell-side, the buy-side universe is still small: a few dozen funds hold most of the external debt issued by most emerging markets governments, except where domestic, expatriate, or retail investors are a significant presence. The funds are a mix of "dedicated" and "cross-over" institutions, active trading accounts, and "buy and hold" investors. Dedicated investors commit to put all or some of their money in risky emerging markets assets, such as a Latin America or Southeast Asia Fund.[35] Cross-over investors are generally more risk-averse, and are often regulated entities such as pension funds and insurance companies that may invest a portion of their portfolio in the emerging markets to boost returns when yields are low on mature markets assets.[36] Riskier debt attracts active traders that look for a quick profit in arbitraging price and interest rate differences worldwide.[37] Hedge funds are often associated with such investment strategies. Some buy-side outfits have their own research departments. Domestic residents and institutions in the issuing countries are an increasingly important investor category in some cases, as are retail investors (real people investing directly), especially for governments raising money in Europe and Japan.[38]

For most of the period we studied, seven trade associations catered to the investor community. Three focused on the emerging markets; the other four dealt overwhelmingly with mature markets securities.[39] All but one trade group claimed to represent both the buy-side and the sell-side; the Emerging Markets Creditors Association (EMCA) was established specifically to represent the buy-side.[40]

Lawyers in this practice mirror the market's concentration.[41] Half a dozen U.S. law firms, all but one headquartered in New York, document nearly all New York-law sovereign issues. A handful of London-based firms dominate the English-law sovereign market. Few of these firms have more than one or two partners specializing in sovereign debt.[42] The senior lawyers in this cohort tend to be veterans of the 1980s loan crisis; the younger ones spent their early days documenting new bond issues in the 1990s.

Sovereign bond documentation usually consists of a disclosure statement distributed to investors (and, in the case of a registered public offering, filed with securities regulators), a distribution agreement between the issuer and the managers, and a series of agreements, including the debt instrument itself, that govern the relationship between the sovereign debtor and its bondholders. Innovations such as shelf registration and medium-term note programs enable governments to establish a document umbrella that applies to a large portion of their issues and thereby to streamline documentation for any single borrowing. The key contracts are a product of issuer-manager negotiations with their respective lawyers. Buy-side investors generally do not see the disclosure statement until the marketing phase, with little room for detailed negotiation.[43] As a result, it is up to the managers and their lawyers to negotiate a document package they can sell. Structuring, negotiating, and selling a sovereign issue can take anywhere from a few days to several months; complex restructurings take longer.

Unlike other financial contracts, the sovereign lot has had trouble establishing its free market credentials.[44] When one of the parties is a government, power politics inevitably sway the invisible hand.[45] Governments enjoy special immunities,[46] and so might choose to walk away from foreign debts when it suits domestic political purposes. They have few credible ways to commit to pay or restructure, and have no sovereign bankruptcy regime to fill the gap. The resulting debt contracts are inevitably incomplete.[47] A sovereign debt crisis is often a political crisis with strategic implications beyond financial stability. From this perspective, it is unsurprising that governments occasionally take interest in one another's debt contracts.[48]

Before the trend toward restricting sovereign immunities took hold in the second half of the twentieth century,[49] foreign ministries were often the only channel for bondholders seeking redress.[50] But rich country governments did not always side with their constituents—bondholder concerns have had to compete with other parts of the foreign policy agenda. The U.S. and other G-7 governments were implicated in managing the 1980s Latin American debt crisis both because of the region's strategic significance and because sovereign defaults threatened the health of major U.S. banks.[51] The next generation of crises started with Mexico's near-default in 1994-1995, averted with the help of a $50 billion U.S.-led rescue package.[52] The crises culminated with Argentina's bond default in 2001, where foreign policy concerns were no less salient, even in the absence of bilateral financing.[53]

The wave of calamity that started with Mexico's "Tequila Crisis" in 1994 turned public attention to sovereign bond contracts.[54] It also prompted countless academic and policy projects to identify and reassess contract terms that could impact crisis management.[55] Amendment procedures quickly emerged as central among these terms.

B. Meet the Clauses

Contract terms are rarely named for social science theories. Collective Action Clauses are the exception. Collective action problems in economics and political science describe the circumstances where individuals acting rationally to maximize self-interest generate an outcome detrimental to their interests as a group.[56] Free-riding and the prisoner's dilemma are variants of the problem. Collective Action Clauses in sovereign debt contracts are provisions that address collective action problems that might arise among creditors, such as the incentives to rush for the exits (sell the debt), to rush to the courthouse, or to hold out and free-ride on a restructuring agreement.[57] Creditor coordination failures delay debt restructuring, ultimately reducing recovery for creditors as a group. All other things being equal, large groups lacking social cohesion are more prone to collective action problems. Hence the move from regulated bank syndicates to more dispersed bondholder constituencies was expected to cause disruption in sovereign debt management.[58]

Bankruptcy regimes address creditor collective action problems for corporate, individual, and municipal debtors—but not sovereigns. By the mid-1990s, a chorus of lawyers, officials, and academic economists anticipated a sovereign bond crisis and predicted chaos. Academics and economists in the "official sector" (here, the IMF and its dominant shareholders) framed the policy challenge in collective action terms.[59] The presumption that any attempt at bond restructuring would lead to systemic disruption was so strong in 1994 that few were willing to risk amending Mexico's domestic-law dollar-indexed *tesobonos*—the instruments at the center of the crisis—even if technically it could have been done by fiat.[60] Mexico's ties to the United States and other factors instead weighed in favor of a rescue loan.

Working groups of officials from systemically important economies assembled in the aftermath of crises in Mexico and throughout Asia considered and rejected sovereign bankruptcy as a political non-starter. Reports released in 1996 and 1998 advocated widespread adoption of contract terms—some old, some new—to improve creditor coordination and bind disruptive minorities.[61] In practice, these recommendations targeted New York Law bonds, which dominated the sovereign debt market.[62] Issuers and investors dismissed the prospect of coordination failures and rejected official intrusion in their contracts.[63] Contract reform initiative stayed with the academy and the official sector.[64] By 1998, the term "Collective Action Clauses" had come to describe the universe of terms they advocated.[65]

Lawyers seem like bit players in this story so far. But neither the officials nor the academics who advocated CACs had intuited the content of the clauses on their own. Trade journals and manuscripts circulating among practitioners by the mid-1990s identified four kinds of terms.[66] Most prominent were modification provisions that would allow a qualified majority of creditors (usually 75 percent in principal amount) to change payment terms over minority objections. These had been common in English and Japanese law bonds but were rare in New York and German law bonds. Second, a related set of terms would restrict an individual creditor's capacity to demand full repayment (accelerate) or to sue the debtor. Clauses that require creditors to share litigation proceeds with their comrades had been used in syndicated loans and were being proposed for bonds to dampen incentives to sue. Third, collective representation or engagement clauses would organize bondholders and channel their activities through a trustee or a creditor committee. Deputizing the trustee to accelerate, sue, and share the proceeds combines the representative function with the brake on individual enforcement described earlier. Finally, initiation clauses would help the debtor initiate a restructuring, and might sanction a payment suspension and a "cooling off" period.[67]

Mexico's SEC-registered twelve-year global note issue launched in February 2003 tipped the markets in the direction of CACs. Mexico's sole—momentous—innovation was in the modification provisions. Departing from the unanimity convention under New York law, the notes allowed amendment of financial terms by holders of 75 percent of outstanding principal. In a concession to creditors, Mexico raised the threshold for amending most other terms from 50 percent to 66 2/3 percent; several non-financial terms, including status and waiver of immunity, now required 75 percent.[68] Higher thresholds make it harder for the borrower in a debt exchange to get enough participating creditors voting to amend important non-financial terms of non-participating securities so as to make them worthless (a practice known as exit consents).

Trade association data suggest that since Mexico, more than two dozen countries—including Brazil, South Korea, Turkey, and South Africa—have issued bonds with majority modification provisions under New York law contracts, most using the 75 percent threshold for financial and key non-financial terms ("reserve matters").[69] A handful of countries have gone beyond majority amendment and adopted other innovations, but these have not caught on.

When we speak of the "CAC shift," we refer principally to the shift from unanimous to majority modification provisions in New York law bonds, which is virtually complete for new issues. By February 2006, the stock of bonds with CACs had grown to 60 percent of the total outstanding—up from 40 percent in just three years.[70]

As noted at the start, CACs were introduced twice over the past decade. Mexico's 2003 issue has attracted virtually all the commentary. But six years earlier, a group of less prominent issuers including Bulgaria, Kazakhstan, Egypt, Lebanon, and Qatar used majority modification clauses in their New York law bond issues aimed at the European market and exempt from SEC registration. These had little market impact, and attracted no official or academic attention until after Mexico in 2003. We focus on the shift that began in 2003, but discuss the earlier episode because the contrast is illuminating.

III. Official Stories and Published Explanations

The Mexico-led shift inspired a host of press releases, public statements, articles in the popular and trade press, and renewed academic activity on the subject of CACs. Most authors tried to explain why Mexico and others changed their contract forms. We found nine explanations, each stressing a different causal factor. In addition, we include an account of the "lost issues" six years before Mexico's. These public accounts served as background for our interviews.

A. Fear of SDRM

In this account, CACs prevail because they are the lesser of two evils. The IMF had proposed the Sovereign Debt Restructuring Mechanism (SDRM) as a quasi-statutory, treaty-based regime to deal with creditor coordination problems. Borrowers and private creditors rejected SDRM as an IMF power grab designed to encourage defaults and reduce demand for official money.[71] Before SDRM, neither sovereigns nor their creditors had shown enthusiasm for CACs.[72] With SDRM on the horizon, CACs began to look attractive.[73] Mexico and others then adopted CACs for fear that SDRM would prevail without an alternative method of dealing with sovereign insolvency.[74] A nuanced version of this story had Mexico adopting CACs to stop the talk of SDRM, which was harming the asset class regardless of the initiative's ultimate prospects.[75]

B. U.S. Pressure

Beginning in the fall of 2002 Bush Treasury officials appeared to make CACs a centerpiece of their strategy to eliminate public sector bailouts. Trade and financial press reported that Treasury arm-twisting caused Mexico and others to try CACs.[76] Others suggested that the shift came of a Treasury-sponsored change in U.S. law.[77] The leading advocate of CACs in the U.S. Government characterized the efforts as diplomacy and persuasion.[78] Some in the market pointed to Mexico's special relationship with the United States, and cited rumors of a quid pro quo.[79]

C. G-10 Expert Drafting Group

The working group of officials, convened by the G-10 governments,[80] commissioned "eminent lawyers" from relevant jurisdictions to draft model CACs. The group included partners from leading law firms representing both sovereigns and investment bankers, and had the imprimatur of the official sector.[81] One explanation of the group's role suggests that it served as a coordinating mechanism to overcome network effects, especially the fear that no one would follow the first mover in adopting CACs.[82]

D. Law Firms

Like the last explanation, this one credits the CAC shift to the party that helped overcome network effects. Choi and Gulati suggested that Cleary, Gottlieb, Steen & Hamilton, with its large stable of sovereign clients, had disproportionate influence in inducing the CAC shift.[83] For Choi and Gulati, the CAC shift had roots in Ecuador's aggressive new use of exit consents (advised by Cleary Gottlieb), which created uncertainty about the value of unanimity and opened a window for further innovation.[84] Cleary Gottlieb's own brochure takes credit for leading the CAC shift, among other innovations in the sovereign debt market.[85] The story is consistent with Kahan and Klausner's prediction that large volume intermediaries drive boilerplate change. Here the elite law firm caused the shift, motivated not only by the value of the new term to its clients, but also by the reputational value of being a market leader.[86]

The Choi-Gulati study ran into criticism from sovereign debt lawyers, who said it had missed the plot by giving all early-moving issuers equal weight and ignoring the special role Latin American issuers play in the New York market.[87] Had the authors understood this dynamic, they would have given more credit to two other law firms: Sullivan & Cromwell and Arnold & Porter.[88]

E. Lee Buchheit

One lawyer has been publicly associated with the CAC saga more than any other. He was among the first to urge the adoption of new contract terms to overcome collective action problems, and among the first to propose specific contract language in a popular trade journal. He was one of three New York lawyers on the G-10 drafting group and a senior partner at Cleary Gottlieb, the firm that represented both Mexico and Uruguay. An article in *Latin Finance* put all this together to credit Buchheit with CAC paternity.[89]

F. Big Institutional Investors

A front-page article in *The Wall Street Journal* claimed that big institutional investors—in particular, Mohamed El-Erian at Pimco—induced the shift to CACs.[90] Their willingness to buy a large share of Mexico’s first CAC issue and the advance assurance that they gave Mexico to that effect made the deal possible.

G. *Trade Associations*

This explanation credits the release of model “marketable” clauses by a group of seven leading creditors’ associations[91] with catalyzing the CAC shift. The so-called Gang of Seven clauses included an amendment threshold between 85 and 90 percent, an engagement clause, and other provisions that addressed creditor concerns with debtor misbehavior. *Euromoney* reasoned that the release of creditor consensus clauses signaled market acceptance of CACs in principle, and made their adoption in some form a foregone conclusion.[92]

H. *Pre-Emption*

This explanation goes specifically to Mexico’s motives.[93] Gelpern wrote that Mexico may have acted out of concern that less creditworthy countries under G-7 pressure would adopt creditor-sponsored CACs, and pay a premium to do so.[94] This would have created adverse precedent for Mexico to overcome. In a preemptive strike, Mexico adopted a 75 percent modification threshold and rejected most of the other proposed innovations.

I. Argentina

For nearly three years after its bond default, Argentina refused to enter into meaningful negotiations with its creditors and the IMF.[95] Many echoed the commentator who said that recognizing how little creditors could do to force sovereigns like Argentina to behave "led the private international financial community to become much more willing to endorse some official reforms to make sovereign debt rescheduling more orderly, most notably through the use of . . . (CACs) in new international bond issues."[96]

J. "Prehistoric" CACs and Inadvertence

We have found only one story about the use of CACs in New York law bonds before Mexico, which involved Bulgaria, Kazakhstan, Egypt, Lebanon and Qatar. Gugiatti and Richards, who studied these early issues to identify the effect of CACs on bond prices, report that not only did the market pay little attention, but that the borrowers seemed unaware, or at least indifferent, to the shift.[97] The study notes that each of these early issuances was documented by the London office of a New York Law firm.[98] The authors suggest that the innovation was "somewhat inadvertent"—a combination of the lawyers' comfort with New York law and their lack of familiarity with Euromarket boilerplate.[99] The firms were doing New York law deals, but cut and pasted contract terms from an English law form.[100]

IV. The Interviews

This section sets out accounts collected from over 100 participants in the CAC shift. Our contacts spoke to us in the expectation of confidential treatment; thus, we have coded the interviews to preserve anonymity. We proceed roughly in the order of the published explanations above, which together form the public story of the shift.

In gathering information for this article, we tried to be comprehensive first, by seeking out everyone directly involved in the CAC shift (about 200 people), and second, by soliciting different perspective on the same events—for example, interviewing issuers, underwriters, investors, and lawyers on both sides in the early CAC deals. Based on the interviews and our experience with this community since the early 1990s, we believe that we contacted over half of all direct participants in the shift. We obtained multiple accounts of every incident we describe, have shared drafts of this article with many of our interviewees, and have reflected their comments. This approach also addressed fading memories and hindsight bias, though both remain important concerns. We eschewed statistical survey tactics in favor of free-form interviews that allowed our contacts to frame their accounts in their own terms[101] and produced nuance lacking in prior studies, including our own.[102]

A. SDRM: The Phantom Menace

The majority of our contacts connected the CAC shift with SDRM. Only three said that the CAC shift might have happened without the threat of SDRM; we return to their views later in the article. Most market participants offered one of two versions of the explanation. In the first version, the official sector wanted to foist a statutory regime on the market, but backed down in the face of market resistance, settling for CACs as "second best." According to one investor, "There were enough parties of interest in the world of finance [opposing SDRM] that political forces in Washington stood down. The White House listened to this, [and thought] 'maybe we were making too many enemies, [maybe] we need a second best.' CACs were that second best."[103]

In the second market view, more common among those familiar with public sector efforts to promote CACs in the 1990s, officials announced SDRM out of frustration with the market's failure to adopt CACs or any other fix to the collective action problem that governments foresaw and markets dismissed.[104] SDRM was the nuclear fix, a way to ensure that the "[p]rivate sector would pay attention finally to what government thinks."[105]

Our interviews and correspondence confirm that industry representatives had tried more than once to trade their acceptance of CACs for the official sector's commitment to "drop" SDRM,[106] which implies that they had thought such a bargain to be within the power of their official interlocutors. A dozen or so contacts described a particularly contentious gathering of investors, emerging markets and G-7 officials hosted by the U.S. Treasury in late September 2002 on the margins of the World Bank-IMF Annual Meetings. The parties reportedly tried to reach consensus on CACs, but failed to do so because the United States would not take SDRM off the table.[107] One participant described the meeting as a "debacle"; at one point Mexico's Finance Minister Francisco Gil Diaz "got up and said, 'Forget it, we are never doing CACs!'"—a gesture the Minister reprised at international gatherings in the run up to February 2003.[108]

Did the G-7 and the IMF truly aim for a statutory regime, settling for CACs as the face-saving fallback? Or was SDRM a ploy to induce a market fix to collective action problems after nearly a decade of market resistance to official pleas? And were the G-7 deliberately driving a hard bargain, holding SDRM over the markets to secure unconditional surrender on CACs? Interviews with officials suggest a different story, and raise the possibility that SDRM itself came of a loss of control by the United States and coordination failure among the G-7.

Most accounts of the IMF's initiative[109] start with Argentina. In August 2001, that country secured its last IMF loan before defaulting on nearly $100 billion in foreign bonds.[110] The Bush Treasury, eager to distance itself from Clinton-era bailouts,[111] was searching for a way to inject market discipline in the Argentine package. Inspired by the financial engineering of the Brady Plan and by faith in market ingenuity, the Treasury team pressed the IMF to set aside $3 billion out of $23 billion for a "market-based," "voluntary" restructuring operation.[112] It soon became clear that restructuring $100 billion with $3 billion would take more magic than engineering.[113] But some of the early design meetings introduced Paul O'Neill, the eccentric first Treasury Secretary of the second Bush Administration, to negative pledge constraints in sovereign debt contracts.[114] O'Neill did not take well the prospect that a contract clause might interfere with debt restructuring for an insolvent sovereign, and in September 2001, he publicly called for a sovereign bankruptcy mechanism.[115]

Days earlier, O'Neill had hosted a private breakfast for Horst Koehler, the Managing Director of the IMF, and Anne Krueger, his newly-appointed First Deputy.[116] Several senior staff were in attendance. One participant told us that at breakfast, O'Neill "waxed poetically" about international bankruptcy.[117] Another reported O'Neill saying something like, "We need an international bankruptcy court . . . and do it by December."[118] The IMF had explored sovereign bankruptcy several times in the preceding decade, each time without an action mandate from its major shareholders. For the IMF officials at the Treasury breakfast, O'Neill's call signaled an institutional boost. Elated, "Horst and Anne sort of floated out of the place."[119]

In contrast, O'Neill's deputies took his words as rhetorical gloss. The Secretary had identified a problem—inflexible debt contracts—and commissioned a solution. Statutory sovereign bankruptcy was a solution, but one that was costly (at a minimum, requiring Congressional approval) and more importantly, too dirigiste for most of the Bush team's free market sensibilities. One team member, a lawyer, suggested that bankruptcy functions could be synthetically replicated in a contract. Conversations with staff and outside experts (mostly academic economists) unearthed the earlier CAC initiatives, going back to 1995. Officials became convinced that “[n]ot only was it possible, it was smarter to do it [contractually].”[120] But by then, the IMF machine was in full gear designing the statutory framework.

Some participants in the August breakfast say they saw right away that O’Neill’s deputies and Krueger took him completely differently. But Treasury officials, still completing transition to the new Administration, thought they had time to bring Fund management “back on the reservation.”[121] They miscalculated. Krueger gave her first speech launching SDRM in November 2001.[122] IMF had sent an advance copy to the Treasury but heard nothing back.[123] Krueger may have assumed she had what “clearance” she needed; Treasury officials assumed more substantive consultations would ensue.

Market reaction to Krueger’s speech was scathing. One New York lawyer recalled that the speech “scared the Bejesus out of” some business contacts, saying, “It’s VIII(ii)(b) again, but much, much worse!”—referring to an earlier official attempt to sanction nonpayment under Article VIII(ii)(b) of the IMF Articles of Agreement (Charter).[124] A buy-side money manager summarized market concerns as two-fold: discomfort with, first, “institutionalizing a process by which your contracts would be trumped,” and, second, having that process run by an institution like the IMF, controlled by the G-7, and exposed to their shifting policy priorities.[125] Many others suspected Fund motives and accused it of a conflict of interests: the IMF is often the largest creditor of a sovereign in distress.

Once the idea was out, it proved hard to squash. O'Neill had no problem with CACs, but refused to allow his deputies to end the statutory experiment. A celebrated industry captain before his Treasury stint, he fancied the idea of different groups competing to design solutions to his problem.[126] Competition began to resemble confrontation the following spring when Krueger and John Taylor, Treasury Under Secretary for International Affairs, both spoke at a conference on sovereign debt restructuring at the Institute for International Economics, a Washington think tank.[127] Krueger delivered a modified version of the first SDRM proposal, scaling down the IMF's role.[128] Taylor endorsed CACs in a speech that was read as dismissing SDRM as a matter for academic speculation.[129] Those involved in preparing the speech say that Taylor never intended to slight Krueger, a former Stanford colleague, and certainly did not mean "academic" in a pejorative sense. The following account is typical:

> He was asked to speak at a conference, he had views to share. Fairly sure he was not doing it to be Machiavellian. He was being an academic. She thought that the U.S. was supporting her. There was pressure

> after for John not to be in Anne’s face . . . she was "slightly" upset.[130]

Taylor considered Krueger a friend; he also knew that she was revising the original design—perhaps he had expected their approaches to converge.[131] In retrospect, it is hard to see how a U.S. proposal with no role for the Fund could escape being perceived as threatening. In any event, the press reported the speeches as open conflict between the IMF and its largest shareholder.[132] The signal this sent may have trumped the substance of either initiative. Dispatched to control the damage, Taylor’s new deputy, Randal Quarles, told the press that the United States was for a two-track approach, where the Fund and the G-7 would explore both CACs and SDRM.[133]

Krueger had some support inside the Bush White House. The nature and depth of this support is unclear. Taylor recounts in his book being called to the White House to manage the press flap.[134] Krueger was friendly with National Security Adviser Condoleezza Rice (Krueger, Rice and Taylor all had taught at Stanford in the same period). When Krueger and Rice occasionally dined together, Krueger would mention the SDRM, and Rice would respond with encouragement.[135] But senior White House staff apparently considered and rejected the idea of elevating either SDRM or CACs beyond the Treasury.[136] A Treasury official characterized White House interest as “discomfort with the press playing up the conflict between Treasury and IMF . . . . It was an arcane issue at the White House . . . ."[137]

National Economic Adviser Larry Lindsey and CEA Chairman Glenn Hubbard were among the few White House officials to weigh in on the debate, generally in line with the contractual approach.[138] Hubbard even gave a keynote speech at an IMF conference on SDRM, held on January 22, 2003. He proposed a mix of contractual innovation and a voluntary dispute resolution mechanism that echoed some features of the SDRM, combined with restructuring incentives and tighter conditions on IMF lending.[139] Even though in substance Hubbard's idea was much closer to Taylor's than to Krueger's, his rhetoric was telling—he called CACs a "Treasury proposal," as if to distance the rest of the Administration from the controversy.[140] Some Treasury officials saw Hubbard's "third way" as a worrisome diversion.[141] But for IMF staff the speech sounded the death knell for SDRM—they had assumed that the White House was with Krueger.[142] Hours later, things got surreal as Quarles delivered another ritual endorsement of the two tracks, promoting the clauses but encouraging the IMF to keep refining their SDRM proposal.[143] That afternoon, an IMF staffer complained privately to one of us that he wished the United States would just end the charade and put his colleagues out of their misery.

Active controversy around SDRM and CACs lasted for about a year-and-a-half after Krueger’s first speech. Some senior U.S. and IMF officials suggested quietly it was a no-win battle, and tried to distance themselves from both sides to the extent possible.[144] Their reasons were some combination of believing that neither initiative was likely to succeed, and that CACs were inadequate, while SDRM was ill thought-out. Some said that at the Fund, Krueger “owned” the initiative so completely that it left little room for others of her stature.[145] “It was going to be her legacy,” and was her battle to fight.[146] On the other hand, our contacts often pointed to a small cohort of “true believers” in SDRM, comprised of Krueger and several senior IMF staff, sustained in their design work by encouragement from O’Neill, the desire to boost the role of the IMF, at least acquiescence from the White House, and importantly, by support from European capitals.

By the end of the 1990s, European officials had come to lead the opposition to outsize IMF packages. Germany’s insistence on hard lending limits typified this view, as did a joint paper by the Bank of England and the Bank of Canada, advocating debt standstills and lending limits.[147] Unlike the newly minted Bush appointees, many European representatives in the CAC-SDRM debate were veterans of the “private sector involvement” wars of the late 1990s.[148] Wary of discretion, which had let the United States steamroll over their objections, and weary of the old CAC initiatives that looked in retrospect like a fig-leaf for U.S.-led bailouts, the Europeans wanted firm crisis management rules.[149] SDRM was their chance, thanks to the space created by O'Neill.[150] Europe's over-representation on the IMF Board made its support impossible to ignore, even if the United States alone could have blocked the supermajority vote to amend the Charter.[151]

With the United States tied to the parallel tracks for as long as O'Neill was in office, the most vocal resistance to SDRM in the IMF Board came from large emerging market issuers, notably Mexico and Brazil.[152] One official called the SDRM the "wrong idea at the wrong time," noting flatly that if it had prevailed, his country would have lost all market access.[153] In private, borrowers also worried about losing access to IMF funds; some raised the IMF's conflict of interest.[154] In public, they framed their resistance in the language of large-volume market issuers, as in this example: "From the point of view of [this issuer], all discussions of default, possibility of making default easier, were not genial. . . . Our scenario is not default."[155]

Mexico's CAC issue came two months after O'Neill's stormy departure from office in December 2002.[156] It is hard to speculate whether either event alone was sufficient to shelve SDRM. The IMF conference where Hubbard and Quarles appeared to speak at cross-purposes came between O’Neill’s resignation and the appointment of his successor, John Snow, and may have been a symptom of the interregnum. (Mexico’s spokesman at the conference reiterated his country’s opposition to both tracks, suggesting that finance leaders should better focus on building hospitals, not morgues.) Our interviews tie O’Neill’s departure, SDRM, and Mexico’s issue together. This statement by a U.S. official is unusual for bringing broader geo-strategic issues to bear on the CAC-SDRM debate:

> Of course, now we had an alternative. We could see the alternative happening, it is easier to say we do not have to talk about [SDRM] anymore. Maybe it is easier for the U.S. not to support SDRM. Period. Certainly O’Neill had to be gone . . . . With O’Neill’s departure, . . . [the U.S.] could say to the MD, the U.S. will never support this, and you need our vote. At about the same time, there was a big blowup at the UN about Iraq—after that, it became clear the UN process was failing, falling apart . . . . With those U.S.-European battles, it made no sense to have battles [at the IMF] for no good reason. When Koehler said the U.S. is against, it’s over . . . . Koehler was never a true believer . . . .[157]

O’Neill’s initial set-up of a competition between IMF staff and his own framed the episode. Taylor put it diplomatically, "The existence of an alternative proposal advocated by the IMF (and in particular by my colleague Anne Krueger) also had bearing on our financial diplomacy plan."[158] Another U.S. official recalled O'Neill saying, "If SDRM solves it, good; if your way solves it, good. Read my lips—I want the problem solved. Don't swat Anne down. I'm behind Anne and you will get in line."[159] Admitting that O'Neill's directive put his deputies in an awkward position, the same official said, "In the end, I think it was a good thing from the point of view of process that we didn't swat down the SDRM . . . . [W]ith O'Neill out of the building, the heart of Treasury support [was gone]. Mexico moved; others moved . . . We said all along, 'may the best process win,' and it did."[160] Yet other officials said that keeping SDRM alive may have done more harm than good:

> Some people feel [that SDRM was a] forcing factor. I am not sure. Private sector was so alarmed, it ran the risk of scaring [them] away from the whole deal. Did not make much difference. The underlying story is O'Neill versus Snow. O'Neill wanted to have it [SDRM] out there. Snow was very comfortable about [ending] SDRM. The whole thing changed.[161]

The irony of the episode is that SDRM's ultimate chances of being implemented had always been slim to none. The IMF Charter is an international treaty; amending the Charter requires an affirmative vote of 85% of its Board. At about 17%, the United States alone could block the initiative, playing the holdout. Amendment also requires approval by member states, which for the United States would implicate the U.S. Congress.[162] The leading policy officials in the Bush Administration came to office skeptical of the role of the international financial institutions and the way in which the Clinton Administration had used them to battle international crises. Before his appointment, Taylor had even suggested abolishing the IMF (he later distanced himself from the statement).[163] The idea that this Administration would spend political capital to expand IMF power at the expense of private contracts, and that Congress would blithely go along, verges on inconceivable.[164] One European official involved in early CAC efforts offered a broader view:

> I always thought SDRM was dead in the water, because countries just do not cede sovereignty. The Rey Report said as much. It was a waste of the Fund’s time, [of] anyone’s time. It was not a credible alternative.[165]

Other contacts, including investors and emerging markets officials who worked hard to defeat the proposal, said they had always assumed SDRM would die—eventually.[166] As some of the later accounts suggest, eventually may not have been soon enough.

In sum, if the SDRM initiative had a role in the CAC shift—

and our interviews suggest that it did—then this may be the ultimate story of inadvertence. The political transition in the United States and the Argentine crisis, bound up in this story, are the salient distinguishing features between the successful shift in 2003 and the failed campaign for CACs in the late 1990s. A brand new, enterprising U.S. Treasury Secretary, unaware of the old CAC initiatives, got peeved at the negative pledge clause in Argentina's bonds, and unleashed a statutory alternative that made CACs seem handsome by comparison. O'Neill's intervention empowered IMF management (led by another new Bush appointee) and long-time European advocates of rule-based crisis resolution, but also energized his own deputies to work hard to preempt them. The White House allowed the space for competition by deeming the controversy too technical and insignificant to intervene. The entire kerfuffle lasted long enough either to convince the markets of the merits of the contractual solution, or to create enough uncertainty about the outcome to make it worth debtors' and creditors' while to preempt the debate.

B. Invisible Hands

Bush Administration officials came up with CACs in the fall of 2001, knowing little or nothing about the prior life of the initiative in the 1990s. One official implicated in the clauses' comeback described a tinge of awkwardness when learning he had re-invented the CAC wheel: "It's round, it rolls, look what I've discovered!"[167] A staffer privy to both iterations of the CAC campaign was more charitable: "There was a lot of pressure for a radical alternative, and to his credit, John [Taylor] did not yield to the pressure, but dusted off the CACs."[168] The subtlety was lost on some market observers:

> I did not pay much attention to the early rounds; it did not make sense to. We thought it would go away. And for a period it seemed they [CACs] vanished . . . and then they reemerged. I try to stay away from Washington, I am not a lobbyist. Here, Washington lobbied us, invaded . . . . I thought they were on a tear to fix . . . but fix the wrong thing. Boy they sure got CACs. Now you can bind 25 percent.[169]

In this and other accounts, market-based change came courtesy of successive Washington invasions. This explanation raises more questions. If U.S. pressure catalyzed the CAC shift in 2003, what were the ingredients of the winning strategy? Why did U.S. advocacy fail the first time around in the 1990s? Did the early efforts contribute to its eventual success?

Even though it involved only domestic law bonds, Mexico's 1994 crisis solidified public consensus that the era of bond crises had arrived, and would be worse than the 1980s loan crisis.[170] Experts pointed out that foreign bank loan restructuring took a decade, and both the instruments and the creditors were fewer and more flexible in the 1980s.[171] By the mid-1990s, emerging market sovereign bonds had acquired a reputation as a sacred asset class, partly because they seemed technically difficult to restructure, but also partly because of their association with the moral commitment the official sector had made in sponsoring the Brady Plan.[172] The Bradies were meant to be inflexible so as to instill fear of default into the hearts of wayward debtors. One provision in the bonds turned out in retrospect to be near-comical bluster—a promise that they would never be restructured. Starting in 1995, academic and trade journals began publishing lawyers' bond restructuring proposals; even more ideas circulated informally.[173]

On the official side, concern about bond restructuring went hand-in-hand with concern about mega-bailouts: many in the finance circles fumed at the $50 billion Mexico package.[174]

Central banks took the lead in preventing a recurrence. A series of central bank deputies' meetings beginning in February 1995 produced a G-10 working party under the leadership of Jean-Jacques Rey, the Belgian central bank deputy chosen, in the words of one participant, "because he was neutral—not American but not crazy Bundesbank—no bailouts."[175] But the Rey group's mandate was "a reaction to what [the United States] did, [the thinking being that] there has got to be a better way of handling sovereign liquidity crises."[176] The fruits of the group's work, known informally as the Rey Report, came out in May 1996. It considered and rejected statutory sovereign bankruptcy as neither feasible nor appropriate and proposed a "market-led process to develop for inclusion in sovereign debt instruments contractual provisions that facilitate consultation and cooperation" between debtors and creditors, as well as among creditors.[177] This specifically included majority modification to improve restructuring predictability.[178]

It is not clear how the contract proposal made its way into the report. Some later commentators credit a volume edited by economists Barry Eichengreen and Richard Portes, commissioned by the British Treasury and the Bank of England in connection with their work in the Rey group.[179] But some of the authors and working party members describe the bond clause proposals as "already out there" and part of the crisis management discussion.[180] Veterans of the 1980s crisis who participated in the Rey effort said that the lengthy, costly and traumatic restructuring delays they attributed to high-majority and unanimity requirements in loan contracts played a role in framing their concerns.[181] Some private practitioners had expressed similar worries several years before the 1994 Tequila Crisis.[182]

In market surveys commissioned for the Rey Report, investors dismissed the contract proposal:

> Market participants opposed any attempt to change the present structure of bond contracts. The general view among the respondents was that bonds represent a simple promise by the borrower to pay, and their attractiveness as an investment vehicle reflects their character as easily transferable, unencumbered and difficult-to-restructure securities.[183]

To be fair, investors also dismissed sovereign bankruptcy and bondholder committees—they pretty much wanted to be left alone. We were privy to similar outreach efforts several years later, which elicited roughly the same market response.

Nevertheless the clause proposal, initially mocked as “a tinny deliverable,”[184] survived for almost five years. After the Rey Report, clauses reappeared in a report on crisis resolution by the G-22[185] in the aftermath of the Asian financial crisis, and as part of the International Financial Architecture Initiative in 1999. One staffer suggested this resilience was due to a combination of intellectual appeal and bureaucratic convenience:

> [CACs offered a] very elegant, simple theoretical framing. It worked in the economics world. Collective action problems are a well-accepted category that a legal problem falls into—a well-accepted model of market failures . . . . Government is only involved if there is a market failure. It is easy to show market failure here. . . .Very powerful framing overlapped with the concern in the legal world whether document standards in New York law Brady bonds made sense—set up in a way [where] exit [equals] no more restructuring—that made it harder down the line. This simple accepted model of potential problem that worked both in legal and economic world—there was an element of truth to the arguments—got elevated and expanded into a notion that because CACs are not there, there is no market solution, [and] the only option is a bailout. Somehow it went from “absence of CACs makes restructuring harder than it should be” to “there will always be bailouts.”
>
> . . . .

> . . . Jeff Sachs was pushing international bankruptcy,[186] [and it] seemed too far. Traded securities . . . difficult to restructure [means a] bailout next time—the Mexico problem—not tenable. As [is] always the case, you put the unattractive options as the first bullet and the third, everyone picks the option in the middle. The option in the middle was to do something that makes tradable bonds easier to restructure.[187]

The intellectual appeal story is plausible because of the large number of academic economists involved in CAC policies over time. Lawrence Summers and John Taylor are the best-known of the lot, but the economics PhDs involved over time and at the highest levels numbered in the dozens. It helps explain the search for market failures and the willingness to commission academic studies in support of the effort.

The bureaucratic story requires elaboration. The officials who discussed the topic with us made clear that their advocacy of CACs related to a bigger policy objective. If Mexico-style bailouts were no more, bond restructuring was inevitable. In the late 1990s, CACs became part of the effort to signal that the official sector would not stand in the way of sovereign bond restructuring, and in some cases may even demand it. The implications of that judgment translated into two big policy shifts in the late 1990s under the rubric of “private sector involvement in crisis management,” or “PSI”.[188] First, the Paris Club of government-to-government creditors would condition its relief on the debtor’s commitment to seek private bond restructuring terms comparable to the official concessions.[189] Second, the IMF would extend to bonds its willingness to finance countries while they are in default on private debt.[190] Several participants said that at the time, CACs ended up on the “laundry list” of things to be for in operationalizing PSI.[191] Despite three years of market resistance beginning with the Rey Report investor surveys, the clauses still had an inoffensive, vaguely market-friendly ring to the official ear.

But in the late 1990s, CACs remained an adjunct initiative. A former Clinton White House official suggested that Treasury Secretaries Robert Rubin and Lawrence Summers never seemed eager to push hard on the CAC front.[192] Staffers observed that Rubin and Summers had expressed their respective reservations differently:

> Larry was worried that it would make us look feckless. We publicized it a certain amount, but how they structure contracts is not our business. If this is our primary recommendation and they do not do anything about it, we look feckless.
>
> Rubin was happy to have us talk about it, but

> would not have supported drafting model clauses. [He said] "These guys have a problem coming down the pike. [They will have to] restructure bonds—if they can't do it, this is when it will happen. This will not be solved until they believe it is a problem, and when they do, then they will solve it better than we ever had."[193]

The delicate state of the global economy weighed heavily against regulation or even heavy pressure on market participants: "Although we believed that CACs would not in any basic sense change the situation, [they were a] highly charged symbolic political thing since the Rey Report."[194] Moving precipitously might "screw up fragile equilibrium."[195] Mulling CACs' eventual success, another participant in the Clinton-era debates admitted being torn between feeling "sheepish—they made it happen when we could have done it in 1999-2000—and what I used to think then, which is that . . . in the hierarchy of priorities . . . it was not number one, number two, or number three."[196]

The overall tone of the PSI effort of the 1990s was more burden-sharing than privatization. CACs were part—even if the mildest part—of a policy package that signaled "we want banks to take a hit."[197] The official sector was not about to get out of the crisis management business; rather, private creditors that got a subsidy post-Mexico would now be asked to pay their way. In the late 1990s, the official sector was united around bond comparability and lending into arrears on bonded debt. These were measures that governments could and did implement on their own, with minimal cooperation from the private sector. Once they did, officials could wait and see how bond restructurings might pan out. Within two years, Pakistan, Ukraine, and Ecuador had secured high participation rates in distressed bond exchanges without significant litigation.[198] Ecuador was especially influential because it restructured New York law Brady bonds without CACs, thanks in part to another market-generated contractual innovation—exit consents.[199]

The context had changed by the time CACs reemerged in 2002, several years after the Paris Club and IMF policies had been implemented. IMF packages were getting even larger under the new U.S. Administration, which had made opposition to bailouts a plank of its foreign economic policy.[200] The new U.S. leadership framed this opposition as leaving the market to its own devices—getting the public sector out of crisis management, rather than making the private sector pay.[201] On the other hand, for many European officials SDRM seemed like a natural next step in escalating the PSI debate.

The free-market contingent at the U.S. Treasury needed an alternative that promised to reduce bailouts, empower market forces, and look credible enough to preempt SDRM. CACs—long rejected by Wall Street—were arguably the worst candidate. On the other hand, once SDRM was out of the box the time constraint was real, especially if one believed as some did that the debate itself was harmful to the markets. No other palatable alternative had materialized. Republican officials may have found philosophical appeal in a fix that literally "came from the markets" in the form of standard English law contracts, and bonus bureaucratic appeal in a fix that looked familiar and essentially harmless to the finance officials in the major industrial countries and even some emerging markets countries that had to buy into CACs to make the shift happen. Within two years, CACs went from being a symbol of "bail-ins" to being a symbol of market-friendly reasonableness.[202]

Taylor noted the early history of CACs in his public statements and private outreach.[203] Several officials specifically credited the education efforts of the 1990s with the initiative's quick progress in the 2000s, speculating that if CACs had first sprung up on the eve of Argentina's default, they would have taken another decade to adopt.[204] Most of our interviews with investors and emerging markets officials suggest little knowledge of the history. Some of this may be due to personnel changes. One executive prominent in the 2003 shift speculated that he was too junior to have been included in the

CAC conversations of the 1990s.[205] (A Washington team met with the head of his operation in 1999.) Another investor privy to both iterations of the initiative described a subliminal learning process: “People were worn out, but also knew that the public sector lived for that stuff and would never wear out.”[206] In retrospect, early advocacy increased the volume and sharpened the focus of CAC information in the public domain; the drumbeat also raised awareness of bond contracts among some creditors and helped frame the mandate for groups like EMCA, discussed below.

For European officials, the life of CACs between 1995 and 2003 looked more like a continuous effort,[207] even if it proceeded in fits and starts and in distinct phases:

> As for the two iterations, there are clear distinctions. I do not think they are completely and absolutely distinct—they [led] into one another. Excuse the analogy, it is like the process of labor—one contraction leading into another. But they were significantly different.
>
> . . . .
>
> People who think of success or failure in the international domain bring up the idea of a hegemon. The fact that the U.S. was behind this was necessary but wasn’t sufficient. The U.S. was certainly behind the first phase as well.[208]

This official divided the policy push into three phases—the 1995-96 Rey Report, which was essentially a G-10 only exercise, outreach notwithstanding; the 1998 G-22 report on crisis resolution, authored by a group of officials from major industrial and emerging market economies in equal numbers; and the “Taylor-Quarles” phase, which mobilized an even broader range of actors, including lawyers and diverse members of the investor community.[209] Another European described a more diffuse process:

> I do not particularly subscribe to [the] ‘individuals make a difference’ school of thought. If the Rey Report had not been written, if Eichengreen-Portes hadn’t produced the report, if O’Neill hadn’t encouraged Krueger to give her SDRM speech—the Quarles working group, Taylor’s advocacy, Buchheit’s advocacy (and these people were important advocates)—would have taken place in a vacuum.[210]

On balance, even if market outreach had limited visible effect, it seems fair to trace the education and buy-in process among officials to 1995, and for a small but important subset, even further back to the restructurings of the late 1980s. There is some irony to the fact that CACs’ most important and powerful proponents in the official sector—Deputy-level Bush Treasury officials—were also the last to arrive on the scene. It helped that their career staff were familiar with the clauses, and that their principal international interlocutors knew about them and were open to them. The accretion of press and academic studies that made CACs look harmless at worst, and often helpful, boosted the officials' rhetorical arsenal and increased their comfort with advocating new terms.[211]

The way in which the new team pursued CACs is instructive. As Under Secretary for International Affairs, John Taylor was head of Treasury's international division; Quarles was his deputy. They oversaw an organization of roughly 150 staff, organized into functional and geographic offices.[212] Functional offices are responsible for policies that span geographic regions, such as international debt, development, trade, investment, terrorist finance, and U.S. participation in multilateral institutions. "Country" offices are responsible for policy with respect to specific countries and regions, and generally maintain staff-level communications with other finance ministries and central banks. The functional office responsible for U.S. policy in the IMF and the G-7 process had the "lead" in staffing the CAC initiative, with input from in-house lawyers and the office of the U.S. representative at the IMF.[213]

Between Krueger's first speech in November 2001 and the summer of 2002, the lead office collected research on the clauses, and consulted with academics, some emerging markets issuers, and selected market participants (mostly trade groups and researchers at large investment banks). Early efforts focused on including CAC advocacy in important policy signaling documents, such as G-7 communiqués, speeches and other public statements by senior U.S. officials, meetings with foreign counterparts, and market outreach.[214] This was similar to the late 1990s tactics.

In April 2002, the G-7 Finance Ministers and Central Bank Governors adopted an Action Plan to strengthen crisis prevention and resolution.[215] G-7 ministers' meetings usually yield statements and communiqués, broader-brush documents meant to signal economic trends and policy intentions. An Action Plan, however, signaled urgency and specificity—an emphasis on results reflecting the public style of the new U.S. team. "Contingency clauses" were the first item in the plan, followed by limits on IMF lending, greater transparency in official decision-making, and further work on SDRM (which "would take time").[216] The one-page plan described the clauses in detail, tracking Taylor's speech a few weeks earlier. CACs had appeared in G-7 statements in the 1990s, but their prominence in this "action" document meant a promotion.

One official described the plan as a U.S.-British compromise to diffuse European support for SDRM and present a united G-7 front for CACs. Shortly after giving the speech that launched the CAC campaign, Taylor traveled to Russia. On the way back, he stopped for a G-7 meeting in London. There, Taylor and his U.K. counterpart Gus O'Donnell agreed to frame CACs as a predicate for limiting IMF lending in crisis—a policy long advocated by the Europeans.[217] For the Clinton Treasury, CACs were marginal and strict limits were unacceptable (and in any event not credible); for their successors, both CACs and limits sent a message against bailouts. Concerned that the other G-7 members would see any U.S-British deal as suspect, Taylor and O'Donnell asked the Canadian deputy to present what became the Action Plan.[218]

Everyone reports that Treasury's CAC strategy shifted either in the summer of 2002, or following the disastrous meeting with issuers and investors in September.[219] Staff in "country" offices were charged with learning the issuance pipeline for their region in the last quarter of 2002 and early 2003, working with in-house lawyers and using informal market contacts. The lead functional office put together a composite log and coordinated an intensified outreach plan with calls from Taylor, Quarles, and other officials to finance ministers, deputies, and debt managers in the issuing countries. With issuers' permission, U.S. officials and staff also contacted the lawyers and investment bankers involved.

Our official sector contacts stressed that there was no “arm-twisting”: no threats were made, and no rewards were promised. Taylor and others have described “an exercise in persuasion;”[220] the briefings and reports we have seen do nothing to refute this characterization. It is difficult to ascertain how the conversations were perceived on the other end. While none of our investor and emerging markets contacts would admit to having their own arms twisted, many seemed certain that twisting was going on elsewhere. U.S. officials and staff involved in the calls describe the response as mixed: some ministers knew nothing of the clauses; others said they had heard issuing with CACs would be costly. Everyone was polite, but no one volunteered. Smaller, shakier issuers said they could not afford to jeopardize their market access; others said they had no plans to default, did not need new clauses, and would not risk paying a penalty for no good reason.[221] The outreach log from January 2003 records “broadly supportive” and “maybe next time” sentiment. Issuers pointed to the bankers, bankers pointed to the issuers, everyone pointed to the investors. One U.S. official painted this picture:

> Don’t think any of them saw it as in their own interest. Lawyers—why should they change? They have a template, they are making good money. Countries risk the yield going up. Imagine a finance minister [who is] responsible for spreads going higher. Investment

community saw it as taking power away from them.[222]

Against this background, broadening investor outreach was a key aspect of the new strategy. As noted, in the first half of 2002 officials were in frequent contact with trade associations and sell-side research analysts. The buy-side was usually represented in these discussions by members of EMCA, a group that emerged out of Ecuador’s Brady default in 1999.[223] EMCA had been vocal in opposing any contract change that would diminish investor protections.[224] By the end of 2002, U.S. officials engaged with a broader cross-section of the buy-side, including large investors who reached out to the Treasury and tried to distance themselves from EMCA positions.[225] On the sell-side, the team shifted focus from research to bankers “actually doing deals”:

> [A]fter we really got down into the dirt [in late 2002], making calls to the debt managers in the countries and to the real live investment bankers actually doing the deals, these people knew very little about the whole CAC debate. It was quite astonishing. The people doing the deals hadn’t been going to the conferences, could have cared less, hadn’t heard much from the conference goers, and didn’t know much at all. They just knew how to generate fees. So, the private sector talking heads

weren’t worth much.[226]

By late 2002, outreach to issuers suggested that no single country was willing to go first. As an alternative, the U.S. Treasury and its allies in the investor community tried to get a group of highly rated issuers, potentially including Mexico, Korea, Poland, and South Africa, to announce together their intention to issue with CACs. The announcement would not be linked to any particular issue that might fail. To set the stage, they planned a meeting with the target issuers in late February, a week or so before John Snow’s first G-7 Finance Ministerial. The objective was to have large investors reassure the countries that they were willing to buy their debt with CACs and did not expect to charge a penalty.

At the last minute Mexico canceled. It later turned out that Mexican officials were meeting with their bankers and lawyers to plan for the country’s first CAC issue. By many accounts, U.S. officials found out about the issue shortly before the launch. According to Mexican officials, the Finance Minister broke the news casually at the end of a lunch with the new Treasury Secretary.[227] One senior U.S. official describes intense coordination leading up to the launch, where Treasury pledged and delivered a public statement of support and procured similar backing from the G-7; others suggest this was a compressed process following Mexico’s surprise revelation—the difference may be a matter of emphasis.[228] Within days of Mexico's announcement, at Snow's first G-7 meeting, the United States signaled the end of the two tracks. SDRM was officially shelved in April.[229]

Just as SDRM was identified with Anne Krueger, in 2002-2003 many saw CACs as John Taylor's initiative. Observers familiar with early CAC efforts said Taylor's voluntary contractual initiative was doomed on arrival. Comments from the audience at his April 2002 speech predicted nothing would happen without a government mandate; hallway chatter bordered on disparaging—but Taylor seemed undaunted.[230] In less than a year, he proved them all wrong. For a non-lawyer, Taylor had an impressive grasp of how key clauses worked; he missed no opportunity to raise CACs in speeches and testimony, and asked for frequent progress reports on the initiative. He was invested in the targeted, intensive outreach. Contacts at all levels described encounters where Taylor—a mild-mannered man—showed visible frustration with the slow progress to CACs, most notably in late 2002. One person remembered getting a call about CACs while Christmas shopping at Target, in which Taylor said, "Nothing is happening, we need to do something!"[231] Another only tangentially involved with CACs recalled Taylor's reaction to a CAC-less bond issued without Treasury's knowledge—"There is no excuse, we should be calling everyone!"[232]

Some suggest CACs made sense as a defensive move on Taylor's part: "[T]he principal aim was to stop SDRM and his mad boss."[233] Yet among all U.S. participants in the CAC episode, only academic economists (of which he is one) expressed Taylor's level of enthusiasm for the clauses' substantive value and their potential importance in crisis. Taylor's website puts CACs among his most important accomplishments at the Treasury, under the headline, "Essential Reform of the International Financial System: Collective Action Clauses," and alongside Iraq's reconstruction, terrorist financing, and China's exchange rate.[234] In speeches, he has credited the success of the CAC effort partly to the post-9/11 spirit of international cooperation. We have no way of knowing whether this conviction was genuine; if it were, we can only speculate on the reasons. But we cannot help wondering whether a cooler, more pragmatic approach to CAC advocacy in 2002 might have failed as its predecessors did in the late 1990s: "History needs a midwife in this situation. John was the midwife."[235]

C. Ritual Experts

Several published accounts of the CAC shift focus on the role of experts, especially of lawyers and economists, in educating the officialdom and the markets. Interviews suggest that shift participants used expertise in unexpected ways.

We have noted the impetus economic theory gave to the clause initiative by framing the bondholder collective action problem and the holdout dilemma.[236] Two other instances of expert deployment stand out in the CAC campaign. The first is the eminent lawyers’ team commissioned to draft model clauses under the auspices of a G-10 working group chaired by Quarles. The second is the econometric studies that asked whether investors demand a higher price for bonds with CACs than for those without.

In June 2002, shortly after the release of the G-7 Action Plan, the G-10 established a working group of officials to infuse more content in the CAC exhortations.[237] Quarles was in the chair.[238] We have no evidence that the group was intended as a “counter-design” project to balance the IMF’s work on SDRM; however, in retrospect it appears to have played some such function. The group’s product, released in three months, contained two parts: an official report recommending clauses for inclusion principally in New York law bonds, and a set of model clauses drafted by an advisory group of “eminent lawyers” who represented sovereign debtors and creditors in jurisdictions where most external sovereign debt is issued (England, Germany, Japan and New York).[239] The effect was to produce a tangible alternative to SDRM and the industry clauses released four months later, an alternative that had “intellectual heft”[240] and appeared to come pre-endorsed by major countries and law firms in the sovereign market.

Quarles’ role in the enterprise was critical. Before joining the Bush II Administration, he was a partner at Davis, Polk & Wardwell in New York;[241] he had also held a domestic finance appointment in the Bush I Treasury.[242] In his new government stint he soon gained a reputation as an engaged listener, a quick thinker, and a dynamic interlocutor even among those who disagreed with him. One sell-side banker who met Quarles several times described him as “one that looked like a dyed-in-the-wool Republican,” and in the same breath recalled being “pleasantly surprised” with his willingness to listen and delve into substance.[243]

Some said the drafting effort was Quarles’ idea; others saw his leadership as a U.S. effort to control G-10 mission creep. Belgian officials were especially keen to use the CAC campaign to bolster the role of the G-10, a forum where Belgium and other “small Europeans” not part of the G-7 play an important role. Even some European participants in the working group described it in part as a Belgian play for relevance.[244] We heard this sentiment from a senior U.S. official:

> I was so glad that Randy chaired it. . . . After the G-7 supported [clauses], the G-10 decided this would

> be something to do. It is a group always looking for something to do.[245]

Taylor was not at the meeting that sanctioned the working group, and though he went along with it, he was never comfortable with officials prescribing contract text to the market.[246] He had a point: even as the group's report put distance between its own recommendations and the eminent lawyers' model clauses, and even as insiders all attested to Quarles' scrupulous enforcement of that distance in the process, virtually all our market contacts perceived the model as the official position on the merits. This was especially significant with respect to the 75 percent amendment threshold for "reserve matters" (key financial and legal terms): "Randy was not shy about 75 percent. The report said certain countries, certain profiles, certain problems . . . [but] 75 percent is the mandated number."[247]

Other G-10 recommendations for New York law bonds included trustees or permanent bondholder representatives, elected bondholder representatives to negotiate in restructuring (engagement), brakes on acceleration and litigation, and additional disclosure by the issuer.[248]

The extent to which the G-10 effort helped convince some of the early movers is a matter of debate. One "eminent lawyer" who was also involved in an early CAC issue suggested that "[t]he G-

10 report gave enough legitimacy to the use of the clause" for issuers to experiment.[249] A U.S. official said that the G-10 template added to Mexico's comfort.[250] But some Mexican officials expressed concern at the proliferation of drafting and discussion fora: "Discussions at IIF, G-10, U.S. government—process not leading anywhere. It was seen as [re]opening every single item in the contract."[251] Soon U.S. officials found themselves reassuring issuers that the G-10 would not make a fuss if they went ahead with clauses different from the template.[252]

By late 2002 to early 2003, some in the United States began to worry that G-10 had started a "runaway process," with other groups threatening to form on the heels of the Quarles-led effort.[253] European support for a code of conduct for sovereign debt management[254] and renewed efforts to include CACs in the debt issued by EU member states were threatening to dilute the focus on a core set of clauses and a core group of issuers.[255]

Mexico soon made the concerns moot. At the IMF conference on SDRM in January 2003, even as Mexican officials delivered the customary public nays, they let their U.S. counterparts know that they had commissioned a set of clauses from Cleary Gottlieb, and were willing to use them if the conditions were right.[256] Price penalty remained the biggest concern.

The question of whether investors would charge more for

CACs had haunted the clause enterprise from the start. It had several iterations. The first often came out in "market outreach": when told about CACs, investors who had not heard of them said flatly that "orderly" restructuring meant easier restructuring, and that they wanted more money for any clause that made debt easier to restructure. This was true even for investors who held billions of dollars in English law CAC bonds. A charitable interpretation of this reaction has CACs as a sign. A country switching to CACs (unlike the country that has them as a matter of course in its English-law contracts) revealed that it was thinking about default. This meant that it was more likely to default, and possibly—depending on how the clauses actually worked in crisis (which no one knew or wanted to spend time figuring out)—suggested lower recovery in a restructuring.[257] Some investors described the buy-side response as reflexive:

> CACs' utility is next to nothing. Guys do not read prospecti—is that the proper plural?—until next to default. Guys like me will ask for five extra basis points even if it is not worth it, something to hang our hat on.[258]

Economists in the academy and in the government might have had a reflexive reaction of a different sort. If indeed there was a bondholder collective action problem, and if CACs helped solve it, then somehow it must surface in the bond price. One possible effect might even be beneficial to the issuer—if CACs reduced deadweight loss to the bondholders from a prolonged, messy restructuring, then an average bondholder that wanted to get a deal done quickly might forego a few basis points for the sake of a smoother process. On the other hand, to the extent the country had to convince fewer creditors to accept its restructuring proposal, it might offer a worse deal to the marginal bondholder[259] —a price penalty would be in order.

One senior government economist described a search for pricing studies at the time of the Rey Report in 1995-1996; to his surprise, the search came up dry.[260] In the next few years, a number of studies appeared, many associated with the official sector (the Bank of England, the IMF, the Australian Central Bank).[261] The studies disagreed vigorously on methodology; debates continue to this day. Moreover, market assessment of CACs—and their pricing—may well change if and when they are used to restructure debt on a significant scale. But even the most pessimistic among the early studies predicted only a minimal price penalty, and only for some sovereigns. A study by Eichengreen and Mody suggested that while borrowing costs might rise slightly for poor credits, they could go down for highly rated countries that used CACs because markets did not expect them to engage in opportunistic defaults and would value the flexibility that CACs could offer.[262] The implicit message was that the CAC initiative would best be led by a country with a high credit rating. Early in 2003, Mexico fit the bill.

Several of our official sector contacts—all economists—said that the pricing studies increased their comfort level with promoting CACs.[263] But none recalled differences among the studies; the shared view that any penalty would be small was enough. One U.S. official not normally prone to post-modern musings implied that the studies' value was in large part rhetorical: "We always cited Barry [Eichengreen]'s work. Of course, econometrics can never prove beyond shadow of a doubt . . . . I used it in advocacy [to] neutralize the bad stuff [they were] hearing. . . . If I were [an emerging markets debt manager], I would still be awfully worried."[264]

The "bad stuff" came mostly from investors, often mediated through investment bankers. Many investors were also trained as economists. Some buy-side players dismissed the pricing studies:

> Academic studies on pricing were useless as they always are. [They] grossly misunderstand how investors behave, investor sophistication. The data sets they use would make [a quantitative analyst] cringe.[265]

Investment bankers were more muted, but kept coming back to marketing concerns:

> They [emerging markets clients] were petrified. Very

> hard to imagine how [CACs would result in] terms that were better for them, and very easy to imagine how [it could be] worse. The official sector was winking and nodding that they would indemnify, but it is not clear how they could have done it.[266]

Even as U.S. officials consistently reported that their Mexican counterparts worried about the price penalty above all, a senior debt manager recalled that the Mexican team paid little attention to the academic pricing studies.[267] This did not mean that issuers did not care about pricing, simply that their thinking about price was influenced by factors other than academic studies.

A sell-side banker explained that by 2003 investors analyzed Mexico much as they did a high-grade U.S. corporate issuer, focusing on discounted cashflows rather than the probability of default.[268] Nevertheless, Mexican officials and their bankers worked hard to make any potential price effects untestable. On the one hand, the first CAC bond had to be far enough away from the most liquid issues on Mexico's yield curve, so that it could not be compared directly. On the other hand, it could not be so far off as to risk being illiquid, with CACs getting the blame. The result was a success by all accounts. The most critical analyst report suggested less than a twenty-five basis point penalty.[269] Others came in lower; Mexico and its advisers maintain it paid none.[270] Months after the first issue, traders in the secondary market no longer asked whether the bonds they got had CACs; bankers filling their orders no longer volunteered.[271]

In sum, the experts' role in the CAC campaign was hardly straightforward. In the case of the G-10 working group and its "eminent lawyers," the principal benefit of the technical work was not optimal contract language, but a process that created the appearance of consensus and legitimacy for some set of CACs. The G-10 report also created a straw man, a presumption, and a yardstick by which subsequent model and actual clauses could be measured. This role is distinct from the one Ahdieh described when he credited the G-10 with helping overcome network effects: no issuer or investor told us that the model clauses put them at ease or signaled a market-wide shift following the model.[272] On the other hand, by opening half a dozen contract terms to negotiation, the G-10 process may have increased uncertainty and created the impetus for Mexico to preempt further experimentation. Like the model clauses, the academic pricing studies responded to demand from the official sector. They added to the comfort level among CAC advocates, and may have helped diffuse demands for a CAC subsidy. But for much of the CAC campaign, the studies fed into a rhetorical loop, a ritual retort to ritual investor threats about a default scenario that for issuers and investors alike remained imponderable and unpondered.

D. Product Design

Our contacts consistently said that the lawyers did *not* push Mexico to adopt CACs in February 2003. Neither Cleary Gottlieb (representing Mexico) nor Sullivan & Cromwell (representing the lead managers) took a firm position on the merits before Mexico made up its mind. What role did the lawyers play in this shift? We asked this question of every contact that had knowledge of the transaction—lawyers, bankers, investors, and officials. Most said that Mexico's lawyers were wary of changing the standard documentation. Mexican finance officials took the early legal memos to suggest that "with all the legal architecture, CACs did not add much or take away much. No value added."[273] The decision to shift was made at the Mexican finance ministry, with the approval of the minister himself.[274] Consultations with Cleary Gottlieb were important, but not decisive. Once Mexican officials made the decision, they approached Cleary Gottlieb, J.P. Morgan, and Goldman Sachs to execute it.[275] Sullivan & Cromwell collaborated in the draft.

Our impressions contradict both the Choi-Gulati studies and the original Kahan-Klausner framing that focused on high-volume intermediaries. Underlying both sets of studies is an image of lawyers and bankers who design a fix to multiple clients' problem, with the incentive to diffuse their invention in the market. But accounts of the process leading up to Mexico's issue suggest that virtually no one involved saw the holdout problem as either problematic for Mexico or in need of an imminent fix. With or without CACs, "deals got done" is the phrase we heard often from the lawyers. The problem on which lawyers and clients appeared to agree was a proliferation of official initiatives. That required a different fix. This observation from a banker involved in the deal is typical:

> In [the lawyer's] mind, CACs were in because my client wants it, Treasury wants it. If [they are] truly effective fifteen years from now, my client does not care because they do not plan to default.[276]

While they did not drive the decision to shift, the lawyers helped determine the precise form of the new clauses and how the shift was executed. Lawyers and clients described the process in similar terms. First, Mexican officials commissioned an analytical memo that fed into the decision. A month or so later, the clients decided to move, called the lawyers down to Mexico City, and asked them to draft the contracts. The deep relationship between Mexican finance officials and their lawyers, going back to the early 1980s, helped expand the lawyers' role.

The form of Mexico's CACs was born of a team effort. The fact that most deal protagonists knew one another from prior transactions (unsurprising given the small community) surely helped. Clients and lawyers alike sought to keep innovation to a minimum for fear that the market's tolerance for change was limited. The end result was a version of the G-10 majority amendment provisions using the 75 percent threshold, modified to be more consistent with standard form documentation for U.S. issuances. Mexico passed on the other G-10 recommendations, such as a trustee. A lawyer involved in the deal observed that an 85-90 percent amendment threshold would have made investment bankers' lives easier, but would have set disastrous precedent for Mexico.[277] Lawyers said they knew the English law convention (75 percent of a quorum) and had done corporate restructurings using English law amendment provisions. We got the strong sense that going above 75 percent of outstanding principal in New York law bonds would have been a sign of weakness, at least for a strong credit like Mexico—it enhanced neither the issuer's nor the lawyer's reputation. Mexico's position was that amendment thresholds were irrelevant to its credit analysis. Moving away from the G-10 and closer to the industry-backed levels would have contradicted this view and betrayed concern with market reception of the issue. Market chatter in response to Brazil's use of 85 percent two months later confirms this.[278] Looking back, none of the investment bankers involved in Mexico's first issue complained to us about 75 percent.[279] On the other hand, one banker recalled inserting a provision that made certain kinds of exit consents more difficult to obtain; after Mexico's contracts became market standard, he expressed regret at not pressing for a wider range of similar protections.[280]

Lawyers also argued against elaborate investor consultations before bringing the first issue to market. They and others worried that instead of allaying investor jitters about CACs, the meetings would dilute the contract language against Mexico's interests:

> When the U.S. Government was talking to everyone . . . arranging meetings between the country and buy-side, we said, "Nonsense!" . . . Immediately after launching the deal, discussions with [buy-side were] tense: "We want this, we want that . . . ." They were offended they didn't get to design the product. In the end, they bought the deal.[281]

Less than two months after the Mexican prototype hit the markets, Brazil and Uruguay were offering new variations on CACs. Brazil's clauses were more conservative, limited to majority amendment and raising the voting threshold to 85 percent from Mexico's 75 percent. Uruguay's clauses were more aggressive. They included the 75 percent amendment threshold plus aggregated voting across bond issues, made possible because Uruguay exchanged its entire debt stock. Uruguay used a trust structure instead of a fiscal agency agreement, which brought collective representation and litigation-retardant benefits. It added other bondholder protections at the investors' request.

Some contacts suggested that this diversity reflected competition among law firms and lawyers eager to define the new standard and boost their own reputation. Arnold & Porter represented Brazil, Cleary Gottlieb represented Uruguay, Sullivan & Cromwell represented Brazil's investment banks, and Shearman & Sterling represented the bankers for Uruguay. All four firms are major players in the sovereign market.

Those involved in the deals did not report a story of competition either among the individual lawyers or their firms. Lawyers in the same firm did not always agree on the form that CACs should take. Mexico and Uruguay both used Cleary Gottlieb, but adopted different modification provisions. Both Brazil and Mexico had Sullivan & Cromwell representing the lead managers, but used different voting thresholds for their early CACs.

The differences over what form CACs should take appear to have broken down between those lawyers who described CACs primarily as a response to official pressure, and those who looked to CACs to solve the holdout problem. This is not to say the first group did not understand CACs, but that they conceived of their own mandate differently. Lawyers advising early CAC movers often saw themselves as part of a team that engineered a deal with high participation and no price penalty, which in turn would help establish the viability of CACs as a concept, subject to later technical revision (one lawyer even told the press that his client might revise its CACs as market standards evolve).[282] The clauses had to work and be a net improvement for their clients, but above all they had to sell and sell quickly—hence this group was inclined to minimalism. One lawyer summed up the enthusiasm this way: “We all think having CACs will be better than not . . . . Not only are they a good idea, but not particularly intellectually challenging.”[283]

On the other hand, those who drafted CACs to address a holdout problem tended to advocate the more aggressive clause forms. Buchheit at Cleary Gottlieb stands out for having advocated clauses to battle holdouts even before the Rey Report.[284] In a 2007 article, he attributed the CAC shift to investor frustration with losing money to holdouts and Argentina’s protracted restructuring[285] (no investor was willing to make the link in our interviews). Unlike most sovereign debt lawyers whose work includes a mix of new issuance and restructuring, Buchheit’s sovereign practice is almost all restructuring. An elegant and prolific writer, he had published many articles on CACs before the Mexico shift. The first of these appeared in 1991, on the heels of some particularly contentious renegotiations of syndicated bank loans where individual banks had held the rest hostage.[286] In 1998-1999, he published a series of columns in the leading trade publication proposing specific CACs for bonds,[287] and more articles elsewhere discussing ways of addressing the holdout problem.[288] He became something of a public intellectual on sovereign debt matters, frequently called upon by the official sector (for the G-10 “eminent lawyers” group, among other efforts), but also a deeply polarizing figure among some creditors for his aggressive representation of distressed countries.

Despite his public association with CACs, Buchheit appears to have played a small role in Mexico’s decision and the execution of its first CAC issue. But many point to Buchheit’s instrumental role in designing Uruguay’s CACs in April 2003, which went beyond Mexico’s surgical response to official initiatives.

Uruguay’s documentation, including a trust structure and aggregated voting across different issues, became the model for Argentina and the Dominican Republic, represented by other lawyers at Cleary Gottlieb, as well as Iraq, a Buchheit client—all comprehensive debt restructurings. Argentina added a twist by introducing a trust indenture that covered both New York and

English law bonds. Recently Grenada (another Buchheit client) used the trust structure and eliminated a bondholder’s individual right to sue for missed payments.[289] To the extent U.S. pressure for CACs played a role in these cases, it did not seek to go beyond the Mexican model.

Uruguay and even more so Grenada were smaller and less sophisticated issuers than Mexico, Brazil, or Argentina. Smaller issuers were more likely to look to their lawyers for substantive strategic decisions, which in turn may have given more of an opening to an entrepreneur like Buchheit. His history with CACs and the earlier initiatives may have prompted him to respond to official pressure in ways different from other lawyers. Taylor’s philosophical discomfort with endorsing specific clauses made minimalism the natural response for those who worried about government pressure more than they did about holdouts, it also offered two good reasons for Mexico’s preemption strategy.[290] For those like Buchheit who worried about holdouts, official advocacy offered a window of opportunity to fix the problem; the others’ minimalist tendencies worked to narrow that window.

In the Buchheit story, a market actor convinced of a market failure did play a key role in producing a set of clauses which address that failure. It was not the role reported in the published stories, which focused on Mexico’s CAC move. Instead, Buchheit's role as innovator emerged in the window created by the Mexico shift; his clients' contracts were greeted with only a fraction of the fanfare that accompanied the first issue.

E. Great Men and Little Funds

"Market resistance" is the standard explanation for the eight-year lag between the Rey Report and February 2003. In contractual boilerplate studies—assuming CACs were optimal for the parties—it evokes network effects and switching costs. We used our interviews to try to unpack the forces behind investor resistance to CACs.

Interviews and official records suggest that large sell-side investment banks acknowledged the theoretical value of CACs in principle, but rebuffed official requests to intervene with their sovereign clients. A banker ultimately involved in an early CAC issue put it this way: "Treasury would call and we would say that we are not an arm of the U.S. Government, we work for the issuers."[291] He might have advocated for CACs if he could have assured an issuer that a new legal term would save it even one basis point, but a cost savings seemed improbable.[292] An official outreach log entry for this firm reads, "Will not raise CACs with issuers."[293] Once issuers made up their minds to move, the bankers—much like the lawyers—were instrumental in designing the early issues and setting the market standard.

In contrast to the Klausner-Kahan study where end investors are diffuse and invisible, the buy-side was prominent throughout the CAC episode. But the buy-side came in several varieties. EMCA got the most attention and stirred up the greatest passions. It was staffed by investors with busy day jobs. Many of its leaders joined up in reaction to what they saw as sell-side fecklessness, official venality, and issuer treachery in Ecuador and Argentina.[294] But they also expressed higher motives, such as improving the asset class or bridging the intractable information gaps that plagued emerging markets sovereign debt:

> Market people thought the government people were morons. Government people said, "why are you buying this stuff, you know what it is . . . ." Markets see [the IMF] as the transfer agent for their money to developing countries. Developing countries see it as the paymaster that makes sure that creditors get paid. Both cannot be right.[295]

Publicly, EMCA styled itself as the voice of the bondholder grassroots, and had initially distanced itself from the older, more professionalized trade groups with significant sell-side membership and roots in the 1980s debt crisis. EMCA's penchant for public purity positioned it as the enemy of both SDRM and CACs. But the group was the first on the investor side to propose a package of clauses that included majority amendment. EMCA’s “Model Covenants for New Sovereign Debt Issues” circulated informally as early as May 2002, four months before the G-10 clauses and eight months before the consensus clauses later endorsed by seven market associations including EMCA itself.[296]

Like the official initiatives to promote creditor collective action, EMCA clauses technically removed the unanimity constraint. In hindsight, market contacts point to these clauses as evidence that investors had always accepted CACs in principle. But EMCA’s effort addressed fundamentally different problems—issuer misbehavior (hidden action) and sovereign immunity. One member said that EMCA clauses came about after investors “saw Argentina acting the way it did” in late 2001 to early 2002.[297] Drafted by a lawyer who had successfully sued several emerging markets governments, the clauses proposed to facilitate injunctive relief, waive central bank immunities, and expand the universe of assets and protections available to creditors.[298] The amendment threshold was 95 percent for an expanded list of reserve matters including key financial terms, 75 percent for most other terms, and 100 percent for the amendment provisions themselves.

EMCA said that it took the official sector at its word—if Treasury wanted a market fix for financial crises, and granted its decision to go about the fix by altering private contracts, we, the market, would organize to claim the terms we really want. In effect, these investors tried to use the official initiative, including Taylor’s reluctance to be prescriptive, as a vehicle to revisit some of the contractual battles that led to EMCA’s birth. Their clause package would help defeat exit consents and enshrine a broad interpretation of the *pari passu* clause to facilitate debt enforcement.[299] CAC advocates outside the bondholder community saw a Trojan horse, and the package went nowhere.

EMCA’s effectiveness and power base were not clear. On the one hand, its leaders had access to high level U.S. officials, and EMCA’s public reactions to events of concern for its membership (such as sovereign defaults and G-7 policy turns) were quick and forceful. On the other hand, EMCA’s ability to hold its own base together and speak for the emerging markets buy-side community were patently limited. Mexico’s CAC issue and Argentina’s restructuring both occasioned indignant EMCA press releases, but drew participants from its membership.[300] EMCA’s limited influence on the contractual front had a structural reason. We noted previously that buy-side investors do not normally negotiate sovereign bond contracts; the sell-side does it for them. Issuer’s and underwriter’s counsel do the drafting. Investors can and do make their views known to issuers and the sell side—hence, the expanded list of reserve matters in Mexico and the virtual disappearance of aggressive exit consents after Ecuador—but typically, to buy or not to buy is the only decision the buy-side makes, sometimes with the help of in-house lawyers, but often without. Some lawyers for major issuers told us they simply had no occasion to interact with the buy-side. EMCA leaders understood this predicament and saw the campaign for CACs as an opening for more direct input into contract terms. But Taylor's refusal to be prescriptive cut both ways—he would not protest Brazil's 85 percent threshold, nor would he carry the water for EMCA on *pari passu*.

Several of our public and private sector contacts said that by the fall of 2002, some large emerging markets investors were dissociating themselves from the EMCA leadership position, which they characterized as too vocal, inflexible, and "legalistic" (they attributed the latter to the presence of lawyers-turned-fund-managers on EMCA's board). As one investor put it,

> We invest based on economic fundamentals. Legal minutia is not what we do. . . . These legal provisions—we are money managers—do we read them? . . . [W]e are supposed to be smart enough, invest in a liquid market—if there is a debt crisis, you are not supposed to have the debt! . . . SDRM was ridiculous. . . . Everyone agreed that CACs are a decent step

> forward. Once they are introduced, [we'll] see how the market reacts . . . if anyone cares.[301]

A more complex explanation for the buy-side split has to do with the evolution of emerging markets debt as an asset class. Ten years after the Brady Plan, crossover investors came to hold substantial stocks of emerging markets debt, usually the better rated credits. Contract and regulation often bar these investors from holding assets below a specified rating threshold. The fact that emerging markets ratings were more volatile than their U.S. corporate counterparts created unexpected problems for crossover investors. One prominent emerging markets specialist on the buy side recalled a downgrade of Peru in the wake of successful holdout litigation.[302] Crossover fund managers in his company had to sell Peruvian debt quickly, even though nothing had changed about the country's fundamentals. After the incident, he had trouble convincing colleagues to invest in emerging markets debt, even where it was cheap compared to similarly rated U.S. corporate securities. The experience in turn convinced him that if the emerging markets were to mature as an asset class, something had to be done to neutralize the holdouts and make recovery values more predictable.[303] CACs looked like a reasonable something. However, sympathetic investors exposed to both dedicated and crossover perspectives now found themselves at odds with longstanding EMCA positions and dedicated investors intractably opposed to any weakening of creditor rights.

Late in 2002, several executives responsible for large emerging markets funds contacted the official sector and offered help with getting a country to adopt CACs. They proposed a meeting to reassure high-quality issuers of their willingness to buy CAC bonds; as noted earlier, the meeting was scheduled but Mexico backed out.

When Mexico launched its first CAC bond, EMCA was furious. The following view, emailed the day after the deal closed, is indicative:

> First, the procedure made the whole deal feel like a jam-job. EMCA had draft covenants on the table for nearly two years. We were not even consulted before this deal was put on the table. Kind of pathetic. After years of Buchheit et al complaining that the buy-side cannot organize itself, when we finally do organize, the issuers and allied officials ignore us. This does not engender good will on the part of the market. (That, of course, is probably not on the officials' agenda anyway.) . . . [M]ost dedicated EM investors believe that the UST and Cleary were behind much of this deal. As a technical matter it was not so much elegant as clever/sneaky to bring the first CACs . . . in Mexico. Crossover investors are a big part of

> the Mex investor base, so there was no need to force these bonds onto the dedicated EM investors who are the key buyers of the lower grade EM credits. . . . The 75% threshold is a joke. EMCA and EMTA said as much. The trigger level leaves the clause open to easy abuse by distressed sovereigns. It is unlikely to be an issue in Mex, since the probability of default is so low for this credit. . . . The trigger level is the key to making CACs effective vs a joke. And what happened to all of the other covenants that the buy-side asked for? The negotiations over bond docs have been a joke—nothing has started.[304]

Many contacts told us of a contentious conference call organized by the lead managers, Goldman Sachs and JP Morgan, shortly after the launch. Most of the sentiment was along the lines of the preceding quote. One of the larger investors "piped up and lauded the Mexicans on taking an important step forward and asserted that if people were so skeptical of the issuers' motives maybe they should be investing in another asset class . . . but he was a lone positive voice."[305] One sell-side banker said in retrospect that the conference call represented "95 percent of the noise [that] occurred" in response to CACs.[306] Many said to us that EMCA activists represented a small fringe of the investor community. But even if that were true, at the time the deal managers could ill afford to dismiss them—"We have five major institutional investors . . . saying 'if you buy this, you destroy the asset class.' . . . They are thought leaders."[307]

One thought leader who got credit for the CAC shift from the press and government officials was Pimco's Mohamed El-Erian. El-Erian was among the largest investors in emerging markets assets, a former IMF staffer, and one of EMCA's founding board members (he resigned after 2001).[308] He spoke publicly on policy issues relevant to the asset class, and for many was taking on the role of a buy-side "senior statesman."[309] Multiple contacts told us that he engaged with the official sector in the winter leading up to the CAC shift, and had offered to work with major issuers to help broker the shift. But just as many contacts said he was unhappy at not being consulted ahead of time about Mexico's issue and did not buy it for reasons that had to do with some combination of money and principle.[310]

EMCA was one of three market associations active in the CAC episode in the United States. The Washington-based Institute of International Finance and New York-based EMTA (formerly the Emerging Markets Traders Association) both engaged regularly with officials throughout the private sector involvement campaign of the 1990s, and especially in the CAC-SDRM debate. IIF was founded early in the 1980s debt crisis, with a membership comprising leading commercial banks that were also the dominant creditors to troubled sovereigns.[311] It was later expanded to include investment banks. In addition to serving as an industry forum for major financial institutions and a liason with the official sector, IIF periodically publishes economic and market research. EMTA started in the early 1990s as LDC Debt Traders Association, with a mission to facilitate trading in the Brady bonds and later all emerging markets debt.[312] Its membership overlaps with IIF's, but EMTA focuses more on improving trading practices and market and legal infrastructure, and serves as the authoritative clearing house for information in these areas. A former Bush I Treasury official is the head of IIF; EMTA's head is a former Shearman & Sterling partner who was active in the Brady restructurings. The two organizations aspire to represent both sell-side and buy-side investors; they are often seen as closer to the sell-side, an impression reinforced with EMCA's appearance on the scene.

IIF leadership was in frequent contact with Taylor and his colleagues from the earliest days of the CAC initiative. Charles Dallara, the head of IIF, took the lead as a liason between the interested industry associations and the U.S. Treasury; the focus was on defeating SDRM. Senior Treasury officials valued IIF's early support for the contractual approach, but worried that the group did not have a way to operationalize the support quickly: “Charles’s initial reaction was positive. But it wasn’t, ‘We’re doing it’—not operational.”[313] Some at IIF saw Treasury’s campaign as too public and adversarial—the problem was not CACs themselves, but the public sector cramming them down on the market, in 2002 just as much as in 1996:

> [I] believe from the bottom of my heart, if G7, Treasury, IMF—anyone—had serious discussions about CACs on a voluntary basis, [we] could have had CACs in bonds four years [earlier].[314]

Treasury’s outreach to individual issuers and institutions, which Taylor considered key to the ultimate success of the CAC shift, was counterproductive in this view. In an individual capacity, each market participant was bound to “talk their book”[315]—hence some of the more vituperative responses to early official overtures. The function of a trade association like IIF was to act in the collective interest of the market, to bring out the inner statesman in the financier.[316]

But in 2002 Treasury was in a hurry. Whether IIF could have delivered CACs in the relevant time frame is subject to debate. Buy-side and sell-side investors involved in early CAC issues dismiss IIF efforts as irrelevant. Then again, most of the deal participants were mid-level executives. IIF tended to work through “senior statesmen” at the higher rungs of major global institutions. Most of them knew one another from having worked together on the loan restructurings of the 1980s, a time when the informal norms of this small community of elite bankers, lawyers, and government officials ruled the roost. Skeptics dismissed the “great men” approach as a relic of the 1980s that could not deliver in the diffuse, diverse world of the capital markets.[317] But surely support at the top could not hurt.

While IIF appeared to lead negotiations with the official sector, EMTA played a central role in the last key design exercise leading up to Mexico’s issue. Following EMCA’s clause proposal and the formation of the G-10 working group, the onus was on the industry mainstream to produce a set of terms that stood a realistic chance of being adopted. The goal was partly to preempt SDRM, but also to address the one problem around which there was consensus among market participants—the problem of “the rogue debtor.”[318] EMTA, EMCA, IIF, the London-based IPMA, and three broader securities industry groups released the “marketable clauses” package on January 31, 2003, together with an early version of the code of conduct for sovereign restructurings.[319] These clauses were a far cry from EMCA’s, but shared the same essential impetus—creditors would yield on majority amendment for key financial terms (this time at 85 percent of the outstanding principal provided 10 percent did not object), in exchange for more robust investor protections, disclosure and safeguards against the use of exit consents.[320]

The process of building consensus among the “Gang of Seven” trade associations took time; their clauses were the last to arrive on the scene. But their release did signal a turning point; by early February 2003, every market constituency as well as the government of every major financial center was on record supporting clauses in some form—the question was which form would prevail.

Yet again, industry endorsement of CACs was hardly on the merits, as a robust solution to a real collective action problem. Years later, one of the leaders of the “marketable” drafting effort called the entire CAC episode “make-work.” He speculated that successful holdout litigation against Peru in 1996 had galvanized official efforts to solve a holdout problem that was not really there:

> Suing a sovereign is so damn hard—being a holdout is hard, not smart. . . . [The] official sector was offended by what happened to Peru—someone bought low and shook down Peru. . . . It offended [their] sense of fairness in the financial system. I was pretty offended while the Brady deal was going on, but not when [the holdout] collected. Peru was flush. It paid when it did not hurt to pay.[321]

A sell-side banker involved in an early CAC deal said he “suspected that Taylor was smart enough to realize that whether [issuers] include or exclude CACs meant not a hill of beans—which turned out to be the case. I thought it was entirely political.”[322] And a buy-side money manager summarized the general sentiment this way:

> Conceptually it is hard to argue against CACs if they are written well. [CACs] removed the very small probability that holdouts would stop [a country from conducting a generalized restructuring]. The issue is nonsense, but CACs, if properly drawn, would [be] the appropriate theoretical response. If you think that holdouts are a small problem, [the amendment threshold] should be above 90 percent. If you are of the other view, they should be as low as possible. This begs the question whether the public sector was concerned with a smooth and efficient workout, or with their capital being trapped. . . . [CACs are a] potentially reasonable theoretical answer to a remote but plausible theoretical problem. Get into compound complex sentence that the average investor group does not worry about.[323]

F. The Ultimate Market Story

It is worthwhile at this point to pull together the different interview strands that address Mexico's motives for moving first. SDRM was malingering at the IMF, the U.S. Treasury had lobbied Mexico for months, and drafting efforts were proliferating. These factors weighed against what seemed like unwavering resistance at the highest levels in the Mexican government.

The core Mexican team responsible for making the decision consisted of three officials led by the Finance Minister. The Minister went so far as to write a scathing thirteen-page letter to O'Neill in November 2002, expressing his intractable opposition to both CACs and SDRM.[324] What changed minds so drastically that (apparently, on a weekend) Mexican officials called their lawyers down to Mexico City to implement CACs?

We heard two explanations. Market participants, both lawyers and bankers, told of a rumor that some small country was going to launch an offering using industry-sponsored clauses with a high amendment threshold. Such unfavorable CACs risked becoming market standard if Mexico did not preempt this unnamed country. Others focused on Mexico's leading role in opposing

SDRM. A trade press account of the CAC shift suggested that taking SDRM off the table was the quid pro quo that Mexico extracted out of the United States.[325]

Both stories are problematic, even though we heard them from multiple sources. Not one of our contacts had a clue as to the identity of the country in the small country-bad clauses rumor, raising the possibility that it was just a rumor. In public and in private, Mexican officials expressed only a general desire to preempt bad precedent, and only a general concern about proliferating public and private initiatives that threatened to destabilize the boilerplate. Bankers and lawyers involved in the deal echoed the sentiment.

As for fear of SDRM and the quid-pro-quo theory, it rings only partly true. It is unlikely that a U.S. Treasury under John Snow would have continued the two-track charade much beyond the spring of 2003. Hubbard’s keynote at the IMF conference on January 22 signaled to a spectrum of interested parties that White House support was not there. On the other hand, even after Mexico’s debut, a market-wide shift looked far from certain.[326] Mexico’s issue was a hopeful sign and a new argument for the contract contingent, but not mission accomplished. And in any event, even wholesale adoption of CACs was never an adequate substitute for statute in the SDRM camp. Almost two years and two dozen CAC issues since Mexico, one U.S. contact speculated that if a vote were held on the day of our interview, a majority of the IMF Board would have supported SDRM.[327]

So what moved Mexico? Mexican officials tell the ultimate market story—an issuer with significant market power that perceived a threat to this power from a mix of official meddling and bondholder activism: "For us, the issue was our role as issuer. We were concerned about the state of discussion on the markets. . . . What generated the change? We didn't like the fact of being pushed around by international initiative where our fate was not very clear."[328]

This is not so much a story of Mexico eager to get the best possible clauses into its debt, or of Mexico worried that SDRM would come to pass, but of Mexico worried that talk of SDRM—*and* clauses—would not stop. The talk got everyone thinking about default (the morgues), threatened to create uncertainty in the markets about G-7 and IMF behavior in crisis, and to increase the cost of capital for the very countries supposed to benefit from the initiatives.

We have no way of knowing whether the story of market and political leadership that we read in the press and heard from Mexican officials in fact reflects their true motives for using CACs. Virtually all the lawyers, bankers, and investors involved in the first CAC deal, as well as the G-7 officials who lobbied Mexico, stress reputational factors and U.S. pressure and de-emphasize the CACs’ substantive value. The limited scope of Mexico’s CACs supports the point.

To the extent Mexico wanted to use the CAC incident to create a perception of autonomy and leadership, it was wildly successful. A European official put it this way:

> Mexico may have been ahead of the curve. . . . They not only earned the respect of the official sector (that didn’t mean anything to the Mexicans), they showed the markets that they were ahead of the markets. . . . They are too intelligent, too sophisticated to have believed SDRM was a realistic possibility.[329]

Market participants and officials alike offered effusive comments about the Mexican debt managers’ intelligence, sophistication, financial acumen, and investor relations style. Mexico, they said, was not like any other emerging markets issuer. Observers spoke of a “revolutionary experience,” a “transformation of mentality between 1994 and 2000,” of getting “out of the victim mentality” that plagues the emerging markets.[330] Mexican officials “may have been the only example of adult behavior in the whole [crowd]”:

> [Mexico’s Deputy Secretary of Finance Agustín] Carstens had been Mexican ED [Board representative] at IMF. He was always very open minded and into

> modernizing the IMF. He was ok on transparency, etc., which put him in contrast with many of his EM colleagues on the Board. In FinMin, he worked a lot with markets. I actually think Agustin was being internationalist minded at the time and believed that he thought Mexico should be internationalist to show that it was playing a greater role as a responsible player on the global scene. He and Alonso Garcia should be mega-stars of [the] article.[331]

While Mexico's circumstances and leadership indeed stood out at the time, many of our contacts also noted that the shift conceived in the turmoil of the 1990s finally happened under unusually benevolent market conditions, when interest rates in mature market economies were at all-time lows and investors flocked to emerging market debt.[332] Mexican debt was investment grade, and attracted growing numbers of crossover investors. The government had pre-financed for the year, and did not need the money from the CAC issue (it used the proceeds to retire more costly Brady bonds). It was difficult to envisage a better time.[333] But the experiment was not riskless:

> At the time, Mexico could issue $1 billion on a day's notice; everyone knew our contracts. [Issuing with CACs] disturbed it a little bit without an immediate benefit for Mexico. . . . Push [to] strengthen

> international financial system. . . . Instead of opening the book in the morning and closing six hours later oversubscribed, three days working the phones. Some committed clients surprised, some sensed betrayal [because Mexico had] not consulted them.[334]

A Mexican official who played a key role in the move described CACs as beneficial, but suggested that their principal benefit in 2003 was to let business people return to business:

> Both debtors and creditors like having a set of contracts, and proceed to issue. Impractical to make the issue of contracts . . . . [Settling procedural terms] allows us to focus on the substantive issues of the transaction—issues, rights, options. This is what the market participants want.[335]

In this framing, which we also heard from other emerging markets contacts, government debt managers are first and foremost market participants whose goal is to minimize borrowing costs. We got the distinct sense that when these officials spoke of a disequilibrium that prompted the CAC shift, they referred to the flurry of public sector crisis resolution initiatives, not holdout problems. For them, public good and international prestige came by way of being market actors *par excellence*.[336]

G. At the Tipping Point

Mexico’s sound economy and sterling reputation made it the perfect first mover in February 2003. These same qualities gave skeptics the perfect excuse to dismiss it as precedent. Mexico was not like the rest of the emerging markets; maybe its CAC issue should be viewed much as the G-7 countries’ attempts to “lead by example,” putting clauses in their own foreign-currency debt—a face-saving, but irrelevant, gesture.[337]

The next two countries to launch CAC issues were Brazil and Uruguay, both in April 2003. Unlike Mexico, neither Brazil nor Uruguay had been doing quite so well. Brazil had been out of the international markets for over a year. It had just elected a leftist government, prompting questions about its economic policy course. Uruguay had suffered from Argentina’s financial crisis, including a massive bank run that only stopped with the help of an IMF package that amounted to $500 for each Uruguayan.[338] If Brazil and Uruguay could use CACs, even hardened skeptics would have to concede that the shift was on its way.

We heard two kinds of explanations for Brazil’s and Uruguay’s moves. The first attributed them to competition among lawyers and law firms to set the market standard for CAC issues. As discussed earlier, we found no evidence of such competition. The second explanation brought back U.S. pressure as the dominant factor. As with Mexico, the pressure was there, but the way in which it worked, and the extent to which it was effective, were context-specific.

In early 2003, Brazil was the IMF's largest debtor, and was about to draw more funds and extend its repayment period before the year's end.[339] It could ill-afford a public spat with official creditors. But Brazil was also among the largest emerging markets issuers in the world: it accounted for about one-fifth of the index, with Mexico and Russia as its nearest competitors.[340] A Brazilian official involved in the CAC decision explained:

> In the short-term, Brazil faced incredibly hard times in the market. . . . Everything could be used against us. We had to preserve [a] relationship with bondholders at any cost.[341]

The leading business daily in Brazil called CACs "default clauses" (*cláusulas de calote*) in reports that blamed the United States for foisting them onto issuers to put investors on guard and save IMF bailout money. Brazilian officials took great pains to show they were in the driver's seat.[342] This is in further contrast to Mexico, where emotions seemed to run lower in brief reports citing government releases and the foreign press, all praising Mexico's market leadership.[343] To our knowledge, in neither country did the press debate the merits of majority amendment provisions, notwithstanding robust coverage of the Argentine default and general sensitivity to debt issues. Both SDRM and CACs appeared as foreign political artifacts, with limited resonance for domestic audiences.

With Mexico, Brazil led the opposition to SDRM in the IMF Board. Brazilian officials said that initially they did not see much light between CACs and SDRM—both gravely threatened the country’s fragile market access. But faced with a combination of SDRM’s resilience and a growing sense of market acceptance for some form of CACs, they came to describe clauses as a “good compromise,”[344] “reasonable, not disruptive,”[345] and ultimately, a “Pareto improvement”.[346]

Two factors affected the timing of Brazil’s first CAC issue. First, unlike Mexico, Brazil needed the money and so had to launch in favorable market conditions for its own sake, if not for the CAC cause. Second, Mexico had to go first. We believe that had Brazil returned to market in January instead of April, its CACs would have had to wait. Mexico’s first move established the presumption that CACs carried no penalty; Brazil tested that presumption. Mexican and Brazilian finance officials knew one another and had discussed CACs and SDRM; however, we have no evidence that they coordinated their respective CAC debuts.

Our Brazilian contacts described their first CAC issue as “part of a very clear indication on many fronts of where we stood.”[347] Brazil stood in a delicate spot. After the election, it desperately needed to reassure investors of its free-market credentials—”evolutionary, rather than revolutionary; that was our sound byte”[348]—which made any discussion of potential default anathema. According to trade press, Brazil “absolutely had to have a hugely successful deal to mark its reintroduction to the capital markets.”[349] On the other hand, if Brazil saw itself ultimately as part of the Mexico cohort, issuing with CACs was not all bad: “We wanted to do it, it was time to do it.”[350] Brazil needed G-7 support to continue drawing exceptional sums from the IMF at a very delicate time for its economy and political system. In a more subtle sense, Brazil needed to signal to the markets that the United States and the G-7 would stand by it in the event things took a turn for the worse.

The resulting compromise, a majority amendment clause with an 85 percent threshold—in contrast to Mexico’s 75 percent—is easy to explain in this context, even as it drew criticism in the sovereign debt world.[351] Conspiracy theorists blamed Brazil’s lawyers and investment bankers; Brazilian officials insisted to us that the decision was their own. Critics said that the 85 percent threshold signaled both that Brazil was a weaker credit, and that the threshold itself made a difference.[352] This went against much of what Mexico had tried to accomplish in designing its first move.

But Mexico's offer was structured specifically to launch CACs; launching CACs was at best a third-tier objective for Brazil. And Brazil was spectacularly successful in meeting its first-tier objective—the issue was oversubscribed, with an order book total of over $7 billion for a $1 billion offer, spread among 430 accounts.[353] Brazil has since shifted its amendment threshold to 75 percent, in line with Mexico's, validating it as the new market standard. In retrospect, its officials described the episode as "technical progress";[354] some went out of their way to praise Taylor's reasonableness and sensitivity.[355]

CACs were not foremost on the minds of Uruguayan officials facing default on a debt stock of over $5 billion. But in an odd way, legal provisions became entangled with the business and policy aspects of the debt exchange: "We did not like to default on debt. Did not know about CACs, SDRM. But by chance immersed into a very sharp debate among lawyers, U.S. Treasury, IMF—something we realized months later—trying to solve fundamental problems."[356]

The debate in Uruguay's case had to do with its IMF package and the terms of its debt restructuring. Uruguayan officials prized the country's reputation as a reliable borrower; it did not have its neighbors' history of defaults. Because much of its debt was held domestically, they also worried that a default or deep debt reduction would spur another bank run.[357] But the official sector was ill-disposed to finance another bailout of private creditors. Some Uruguayans suspected that theirs was becoming a test case for a new regime that would lead into SDRM.[358] More likely IMF was reeling from Argentina's default and accusations that the Fund had financed unsustainable policies and last-ditch debt exchanges that increased Argentina's unsustainable debt.[359] IMF staff and some market participants grumbled that Uruguay's proposed restructuring terms were too rich—a mere extension of maturities—and would leave its debt levels dangerously high, guaranteeing another restructuring shortly.[360]

Against this background, Uruguay was probably the only one of the early movers that had approached CACs recognizing that they might be used in the foreseeable future—even granting the team's conviction that its proposed financial path was sustainable. Uruguayan officials report that they had decided to use CACs in late January, a month before Mexico's issue. Even though Cleary Gottlieb represented both Mexico and Uruguay, the bankers and their lawyers were all different, and we found no evidence that the documentation work on the two issues was coordinated in any meaningful way. Everyone involved in Uruguay's issue said that Mexico's success made it easier to sell Uruguay's more radical clause package. But at least one lawyer speculated that Uruguay would have tried CACs even if Mexico had not gone first, piggybacking on the G-10 recommendations.[361] A G-7 official was more blunt: “Do you really think that Urugay would, in coming to us to support big IMF money and an Exchange Stab[ilization] Fund loan, have not had CACs in their exchange?”[362]

Uruguay’s deal was intensively marketed, and made specific accommodations in response to investor requests, which generated good will. The team did not have to worry about a CAC price penalty, since in a restructuring the price is set in the offer. Participation was the only open variable. Uruguay’s exchange closed with over 90 percent participation; the holdouts were later paid off. So far, Uruguay has not needed to restructure again.

Uruguay is also the only case we know where the participants produced a pro forma calculation after the exchange to see how having CACs in the old bonds might have changed the results.[363] The exercise suggests that CACs operating issue by issue (such as those included in new Mexican and Brazilian bonds) would have increased participation by a few percentage points each. The big jump came with aggregation across issues, which added up to ten percentage points depending on the voting threshold. Of course such a calculation cannot reveal how investor behavior would change, if at all, with the advance knowledge that their bonds could be amended.

Countries such as Argentina and the Dominican Republic that have restructured since Uruguay have built on its model, including aggregation. An Argentine official said that by the time his government announced it would use CACs, they had become market standard—a non-issue. He even recalled proposing to lower the amendment threshold below 75 percent; he was outvoted.[364]

Once Mexico, Brazil, and Uruguay shifted, the floodgates opened. We spoke with some of the officials, lawyers, and bankers involved with the shifts for ten sovereigns that followed the first three movers: South Africa, South Korea, Turkey, Italy, Panama, Venezuela, Chile, Belize, Argentina, and the Dominican Republic. None of them reported any drama in the country's shift to CACs. There simply was no story to tell.

This is not to say that issuers would have shifted to CACs simply because Mexico, Brazil, and Uruguay had done so. U.S. Treasury officials and staff kept working the phones for months after Mexico, and CACs remained a talking point at official meetings. Market contacts even reported that the effort escalated after Mexico. From the public sector, we did not get a sense of escalation, but rather of continued pressure and a desire to maintain momentum behind "the market solution." Officials reported that later in 2003, South Africa went so far as to issue in London, in Euros, under New York law as a favor to the United States—quite a change from earlier the same year when, according to outreach records, South Africa had declined to join the first movers' group.[365] Treasury advocacy gave the impetus, but the experiences of Mexico, Brazil, and Uruguay gave sovereigns and their advisers confidence that CACs would not raise borrowing costs.

Again, almost none of the professionals involved in the post-Uruguay issues mentioned the need to solve the holdout problem as the motive for the shift. The impetus came from the U.S. Treasury, transmitted through government-to-government channels. Long-term considerations of what contract clauses would facilitate orderly debt restructuring did not merit discussion, either at the level of individual lawyers/bankers or at the level of their firms.

We remained puzzled at the speed with which the shift occurred following the move by the first handful of sovereigns. Our contacts pointed to market education. Even if all the official drumbeat and private commentary between 1996 and 2003 was not enough to overcome the first mover problem, once that problem was solved education kicked in. Beginning in the mid-1990s, the market learned the value of CACs; it was now ready to use them. In response, we suggested that it was improbable that the most sophisticated players in the international financial markets needed seven years to learn that supermajority provisions could neutralize holdouts. Moreover, market participants continued to disagree about the holdout problem long after shifting to CACs. If education was the answer, it begged more questions—what exactly did market participants think they needed to know before they could use CACs? And how did they come upon the missing information? The next set of explanations came in two versions: economist and lawyer.

The economist version of the story from both bankers and officials boiled down to one factor—price. Economists in the public and private sector disagreed on the existence of a holdout problem in need of a solution, but they agreed that for the CAC shift to happen, participants needed a better sense of the cost to sovereigns of switching to CACs in their New York law bonds. For debt managers and their bankers to be comfortable with a switch, they needed assurances that the penalty would be minimal. If academic pricing studies helped frame official advocacy,[366] then investor behavior and market research in Mexico, Brazil, and Uruguay showed in the market's own terms that price penalty worries were a red herring—at least when market conditions were sweet.

For the lawyers, the key issue was not pricing, but the cost of deleting a protection that had been in New York law sovereign bonds as far back as anyone could remember. Every one of the clauses in a standard form document is there for some historical reason, leading lawyers explained. Some major event temporarily altered the balance between debtor and creditor or among creditors. New clauses arose as responses to such events.[367] When someone proposes to alter a clause, lawyers want to know why it had been included in the first place, and what protection would be lost by removing it. That loss often cannot be discerned just by reading the text of the clause.

Quarles addressed this concern with his intervention at the IMF conference in January 2003.[368] Quarles' former firm, Davis Polk, had played a leading role in the era of railroad bankruptcies and equity receiverships (roughly between 1880 and 1930). Collusion among large creditors and large equity interests in the big workouts of that era threatened to squeeze out minority creditors. The response culminated in the creation of a corporate bankruptcy system where workouts would be supervised by a federal judge. So as to protect minority creditors outside bankruptcy, publicly issued corporate bonds in the United States had to mandate unanimous approval for any changes to key payment terms.[369] Quarles knew this history and was able to explain the origins of unanimity in the move to statutory corporate bankruptcy. The existence of a bankruptcy system where holdout problems would be settled meant that outside of bankruptcy, creditors could live with unanimity. The United Kingdom saw no similar statutory reform, which is why

English law corporate bonds kept majority amendment. Quarles' speech reassured some U.S. lawyers that there was no hidden danger in switching to CACs.[370] In addition, this history—which Quarles and Buchheit told in parallel—helped reassure officials that the unanimity requirement for corporate bonds did not reflect a broader public policy against CACs in the United States.[371]

Even as he reendorsed the two-track approach, Quarles' history lesson neatly reinforced the CACs-SDRM opposition. It implied that CACs made the most sense in the absence of a bankruptcy system. Statutory sovereign bankruptcy was just what the market wanted to avoid.

H. The Meaning of Argentina

No public or private account of the CAC shift passes without mention of Argentina and its 2001 sovereign bond default —the largest in history. None of the big crises until then had featured foreign sovereign bonds, which had been the overwhelming focus of reform efforts: Mexico's and Russia's were about domestic debt, Thailand's, Korea's and Indonesia's about bank and corporate debt.[372] Ecuador, Pakistan, and Ukraine had foreign bond crises, but were just too small to occasion the cataclysm. Their bond restructurings went quickly; Ukraine even used the CACs already in its English law bonds, but Pakistan did not, and Ecuador could not because it had none, with no apparent difference in outcome among the three.[373] Argentina was just the sort of crisis experts had prophesied—hundreds of thousands of creditors, and 150 different bond issues in six different currencies and eight different jurisdictions. It took Argentina three years to launch a foreign bond exchange, which has left over $20 billion in holdouts and has been plagued by dozens of lawsuits.[374] The crisis shocked and shamed the system and got everyone, notably Paul O'Neill,[375] energized to do something about it.

Would Argentina have panned out differently if its New York law bonds had CACs? No one told us that it would have. Argentina's reluctance to restructure before default had little to do with its debt contracts and everything to do with its domestic politics and its currency regime.[376] The delay in launching a restructuring after default and the hostile tone of the operation, again, were a function of politics at the highest levels and appear to have been perceived as such by investors.

What of the litigation? Argentina's debt swap was held up for over two months thanks to a lawsuit attempting to attach defaulted bonds tendered by participating holders. The delay cut deeply into some traders' profits. But it had precisely the opposite impact on participating holders from what theory predicted: instead of demanding their bonds back and holding out for more, the creditors who had already tendered wanted the restructuring to go on as soon as possible, even if—especially if—the litigants got paid in full. One of EMCA's last public acts was filing an amicus brief in the holdout lawsuit, asking the Second Circuit to make sure that Argentina consummated the restructuring regardless of the holdout settlement.[377] The holdouts lost and Argentina went forward with one of the most aggressive debt reduction deals in memory.

Would CACs have made no difference? Pro forma calculations in the aftermath of Uruguay's exchange suggest that if Argentina had used aggregated majority amendment provisions, at least the passive holdout number might have been much smaller than $20 billion. Defaulted debt still outstanding is a contingent liability for the government that could one day constrain its external financial activities. On the other hand, even if most of the $20 billion in holdouts went away under a hypothetical aggregation scenario, those determined to litigate would have had little trouble buying up a small debt issue at pennies on the dollar and forcing it out of the exchange.

In sum, Argentina's crisis motivated everyone in the sovereign debt world to redouble efforts to improve crisis resolution. But remedies differed depending on the proponents' diagnosies of the problem that Argentina revealed. The prospect of another IMF bailout prompted the U.S. Treasury Secretary to commission a fix to overcome inflexible debt contracts and the ensuing competition between SDRM and CACs. Default drove industry groups to put proposals on the table designed to address hidden action, or bad faith on the part of the sovereign debtor. But no one suggested to us that the prevailing fix—CACs—would have produced a substantially quicker and smoother restructuring, with less suffering or smaller losses for anyone involved.

I. The 1997-2001 Shift in England: Inadvertence or Market Response?

Mexico's shift in February 2003 is often described as the first sovereign CAC issue under New York law. Two researchers from the Central Bank of Australia, Mark Gugiatti and Anthony Richards, showed that this was inaccurate. Mexico was the first of the large sovereign issuers to use CACs in a public offering registered with the SEC. But between 1997 and 2001, five smaller sovereign issuers—Lebanon, Egypt, Qatar, Bulgaria, and Kazakhstan—used CACs in New York law bonds issued privately in the U.K.[378]

What caused their departure from convention? Gugiatti and Richards suggested that New York lawyers in London had mechanically copied English law forms, changing only the governing law clause.[379] This view was based on Bank of England inquiries with several of the law firms involved, which reported form copying combined with an apparent lack of awareness on the part of the lawyers of the novelty in their approach.[380]

Form copying is standard contract drafting practice; it can be mechanical or deliberate. We spoke to many of the lawyers and bankers involved with these early CAC deals. Not surprisingly, the lawyers maintained that they were fully aware of the difference between New York and U.K.-style amendment language, and used the U.K. form deliberately. But some went further, describing negotiations to keep the language from their clients' English law bonds because it was advantageous, even though they were concerned about penalties for departing from the New York unanimity standard. Lawyers told us that the investment bankers for Kazakhstan investigated whether majority amendment provisions would carry a price penalty, decided that they would not, and the deal went ahead.

Ten years later, the banker who reportedly led the effort had no recollection of the clause, but speculated that deal managers in London may have used New York law to appeal to U.S. investors, and may have acted under a mandate from the U.S. headquarters to use a specific New York law firm to document the deal.[381] A different banker at the same institution, who was later involved in Mexico’s CAC debut, remembered learning about the early clauses shortly before February 2003; he even recounted a rumor that Mohamed El Erian had helped convince Egypt to use CACs shortly after Kazakhstan.[382]

As it turned out, the broader market did not pay the slightest attention to Kazakhstan’s or Egypt’s innovations, or to those of Bulgaria, Lebanon, and Qatar that followed. Neither Clinton nor Bush II Treasury officials recalled hearing about these early CACs before 2003.

Some of the lawyers who worked on these deals tell a version of the story more directly related to solving the holdout problem. Several had worked on the Brady restructurings in the 1980s and 1990s and had witnessed the holdout problem firsthand in cases such as Poland, which involved bank loans. Others had worked on the more recent Ukrainian restructuring, which used English-style CACs in a successful exchange. Both groups had a strong substantive preference for the English law form.

In sum, the inadvertent form-copying story does not hold up—at least some lawyers had debated the amendment provisions and knew full well they were deviating from convention, even if they might have been unaware of the official sector’s support for CACs.

Richards and Gugiatti found the five pre-Mexico CAC issues in a limited data search. Our interviews raise the possibility that there may be others. One lawyer told us that Argentina tried to include English-style majority amendment provisions in its first SEC-registered offering in 1993, much like Kazakhstan, based simply on the fact that it had the language in its English law debt.[383] Lead managers from Merrill Lynch reportedly refused.[384] But there may have been other, lower profile issuers that asked and faced little resistance.

V. Conclusions

Public explanations of the rapid market-wide shift in sovereign bond amendment provisions reflect a traditional understanding of contracts. In the official accounts of the CAC episode, contract terms matter because they regulate the actions of contract parties: they facilitate or impede debt workouts, motivate decisions to pay, default or restructure, and serve as a vehicle for contingency planning and risk allocation between the sovereign and its bondholders. Against this background and absent statutory bankruptcy, the sovereign might seek lower amendment thresholds to facilitate restructuring; bondholders would seek higher thresholds to control “rogue” borrowers, but not so high as to invite holdouts and deadweight losses. A reasonably high majority amendment clause seems desirable and attainable from this perspective.

Why did it take so long to break the unanimity habit in New York? Literature on boilerplate would point to learning and network externalities. These in turn underlie many of the public explanations for the shift: governments, investors, lawyers, official and private groups variously get credit for helping market participants overcome switching costs associated with learning and network effects.[385]

Collective action problems and switching costs also help justify government involvement. SDRM makes sense both as an alternative means of promoting collective action, and as a stick to push the markets to switch to CACs—a way of altering the calculus for switching costs.

But the view of contracts we got in most of our interviews differed from the one that underpins all of these explanations. Despite the apparent risks of holdouts under unanimity, and the equally apparent merits of majority amendment as a fix, participants in the CAC shift consistently refused to cite these as motivating factors for their efforts. Early movers asserted that amendment terms had no bearing on a sovereign's decision to default or restructure, were routinely ignored by investors buying sovereign bonds, and while potentially helpful at the margins, may not function as expected in crisis. Whether or not this is the case, the interviews give us no basis to conclude that shift participants saw CACs as a meaningful improvement in their contracts, and therefore provide no basis to assess the learning and network explanations.

Instead, the participants' attitude to contracts echoes Stewart Macaulay's classic 1963 study of Wisconsin manufacturers.[386] Macaulay found that contracts often played a bit part in the business relationships they purported to govern.[387] This conclusion was at odds with the prevailing contracts literature, which was built on the presumption that contracts mattered in a very literal sense for their technical function.

Macaulay's findings raised three kinds of questions for contracts scholarship. First, how should courts interpret terms deliberately left vague by the parties? Second, if contracts (or, for that matter, the law) did not govern business relationships, what did? Third, why would anyone spend time and money on contract terms that were, in the parties' own words, beside the point?

Answers to the first two questions are the subject of a distinguished literature.[388] The third question has drawn increasing attention from scholars.[389] While our project did not start out trying to answer the third question, our findings point in its direction. We studied sophisticated market actors who deliberately changed their contracts in an apparent attempt at contingency planning. But most of them told us that they were not worried about the contingency the new terms addressed, and insisted that these terms were at best marginally useful in managing risks associated with default. They said they adopted the terms in their private contracts primarily to send a public message to non-parties—other governments, international institutions, and the broader markets—in the hope of getting political, reputational, and economic benefits.

Law scholars and economists have written about the use of contracts to send messages. In 1941, Lon Fuller described what he called a “channeling function” of the contract form.[390] Parties write their contracts, he says, not only to serve as evidence in court or to constrain one another’s commercial behavior, but also to communicate something about their relationship to the outside world.[391] More recently, Mark Suchman proposed the notion of “contract as artifact,” where contractual devices serve not only as a technical fix but also as a symbol and gesture directed at non-parties.[392] Contract theorists in economics have described instances where the contract form itself serves as a signal, conveying information to would-be parties.[393]

The function of CACs and of the contract form more broadly that emerges from our interviews is clearly related to the functions described in these strands of the contracts literature. But it is not an easy fit. For example, our interviewees frequently described their use, non-use, support of, or opposition to CACs as “signaling”.[394] Yet CACs look ineffective as a traditional signaling device—a way to tell good borrowers apart from bad ones.[395] After Mexico, Brazil, and Uruguay moved, adopting CACs in New York became effectively costless for sovereigns regardless of their credit rating. The precise formulation of an issuer’s CACs, including the voting threshold, also seemed to lose significance as a means of conveying the likelihood of default or restructuring.[396]

In our contacts’ accounts of the CAC shift, “signaling” (in the broader sense of using contract terms to communicate) was often done by and directed at non-parties--people and institutions outside the contract. The same contract form was used to send different messages depending on who was communicating and to whom; it became a medium of communication.

For example, CACs may have communicated both Mexico’s status as a market leader and the Bush Administration’s desire to stop bailouts. At some point between 1996 and 2005, CACs in New York-law bonds went from standing for economic weakness, reduced willingness to pay, and official coercion of private creditors, to being a sign of strength, of market and political leadership, and market-friendly policies—an oddity in contracts literature.

Our interviews also raise new questions about the role of governments in the incident. Much of the credit for the CAC shift goes to newly appointed U.S. officials anxious to distance themselves (at least symbolically) from their predecessors' crisis management strategy. They invested unprecedented time, prestige, and intellectual resources in promoting an increasingly familiar and inoffensive contract term under historically favorable market conditions. The campaign proceeded in tandem with a statutory alternative, which came to look viable almost accidentally, thanks to the intervention of a maverick U.S. Treasury Secretary. The official sector encouraged drafting efforts and pricing studies whose principal value appears to have been rhetorical and political. The G-10-sponsored drafting group in particular implicated leading private sector lawyers in the official effort, spurred competition with trade associations seeking a different market standard,[397] and ultimately created an implicit benchmark for countries' clauses.

For issuers and bondholders alike, all this activity did not reduce, but exacerbated uncertainty about future crisis management. It also destabilized sovereign bond boilerplate, opening a wide range of previously settled contract terms to variation. Mexican debt managers described this as a threat; Buchheit saw an opportunity.

The pattern of official activity does not look like regulation, even of the soft "cueing" variety. Despite persistent misperceptions to the contrary,[398] the U.S. Government did not displace private contracting in the CAC episode, as it had in the Trust Indenture Act's unanimity requirement for U.S. corporate bonds. Officials' adoption of private contract terms as a symbol of their free market agenda, and especially their deep involvement in drafting and negotiating substantive content, resemble the behavior of a party.

This observation is consistent with Bulow and Rogoff's view of sovereign debt as a three-party relationship. Creditor country taxpayers have a vested interest in the resolution of sovereign debt crises (for example, to maintain mutually beneficial trade), and are willing to make side payments to debtors and creditors to make the deal happen.[399] Taking Bush II Treasury officials at their word, they saw themselves as unwitting third parties to sovereign bond contracts, committed to provide financing in the event the parties failed to restructure in crisis. The CAC initiative was presented as a way push the private sector to write the official sector out of the boilerplate, eliminating or reducing the scope for a contingent bailout. According to Taylor, "*a rules-based reform of the IMF was inseparably linked to a reform of the process for sovereign debt restructuring*."[400] The strategy would work only if CACs in fact facilitated restructuring without official intervention.

But no one knows for sure how CACs will work in the next crisis. At this writing, one small issuer, Belize (a Buchheit client), has used New York law CACs to restructure a bond. The transaction concluded without incident—as did most of the CAC-less restructurings before it.[401] Just about everyone we interviewed agreed that in the next big crisis, CACs might help on the margins, but will not change the policy response or the economic outcome. Perhaps the next crisis will have nothing to do with New York law bonds. Do Ghanaian law bonds have CACs?[402]

ENDNOTES

*Rutgers University School of Law-Newark and Duke University School of Law, respectively. For comments, we owe thanks to Scott Baker, Patrick Bolton, William W. Bratton, Philip G. Cerny, Stephen Choi, Giselle Datz, Kevin Davis, Adam Feibelman, Eric Helleiner, Claire Hill, Melissa Jacoby, William Klein, Kimberly Krawiec, Stuart Macaulay, Richard Portes, John Pottow, Anthony Richards, Annelise Riles, Kenneth Rogoff, Felix Salmon, Brad Setser, Shari Spiegel, Lawrence H. Summers, Daniel K. Tarullo, George Triantis, Edwin M. Truman, Matthew R. Tubin, Mark Weidemeier, Brittany Wilcox, participants in this symposium, the faculty colloquium at Rutgers-Newark, the 2006 Annual Meeting of the Canadian Law and Economics Association, the 2007 Stanford/Yale Junior Faculty Forum, the 2007 CSGR Summer Research Conference at the University of Warwick, and the 2007 Annual Meeting of the Law and Society Association. Special thanks to Nancy Staudt for providing the initial impetus, to Robert E. Scott for motivating our theoretical search, and to John Conley for guidance at every stage of this project. Professor Gelpern thanks the Dean’s Fund at Rutgers—Newark for financial support. Most important, thanks to all our “informants,” many of whom also commented on drafts of the article. They made this project possible.

1. *See* Republic of Kazakhstan, Offering Circular, $350 Million, 8.375 Percent Notes Due 2002 (issued Oct. 1, 1997) (on file with authors).

2. *See* United Mex. States, Pricing Supplement and Prospectus, $1 Billion (Feb. 2003) (on file with authors).

3. *See, e.g.*, Statement of G-7 Finance Ministers and Central Bank Governors (April 12, 2006), http://www.g8.fr/evian/english/navigation/news/previous_news/ministerial_meetings_communiques/statement_of_g-7_finance_ministers_and_central_bank_governors.html. *See also infra* Part III. An April 25, 2006, Westlaw search in the ALLNEWS database for articles discussing "Collective Action Clauses" in the sovereign debt context yielded over 400 hits, including many references to official statements.

4. *See* Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261 (1985); Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or "The Economics of Boilerplate")*, 83 VA. L. REV. 713 (1997).

5. *See* Kahan & Klausner, *supra* note 4, at 719-30.

6. *See id*. at 719-28.

7. *E.g.*, Press Release, White House, U.S. Actions at the G-8 Summit (June 2, 2003), *available at* http://www.whitehouse.gov/news/releases/2003/06/20030602-10.html; Press Release, Can. Dep't of Fin., G-7 Finance Ministers Adopt Financial Crises Action Plan (Apr. 20, 2002), *available at* http://www.fin.gc.ca/news02/02-034e.html; Dehli Communique, G-20 Finance Ministers' and Central Bank Governors' Meeting (Nov. 23, 2002), *available at* http://www.g20.org/documents/communiques/2002_india.pdf.

8. It does not preclude a role for the public sector either. In their study, Kahan and Klausner advocate private standard-setting bodies for contracts on the model of the existing standard-setting bodies for industrial products, some of which are state-run. *See* Kahan & Klausner, *supra* note 4, at 761-65.

9. *See infra* Part III.A-C.

10. *See* Int'l Monetary Fund, G-24 Seminar on GDP-Indexed Bonds (Apr. 21, 2006), http://www.imf.org/external/mmedia/view.asp?eventid=577 (webcast).

11. *See infra* Part III.B.

12. One way of exerting economic power is through loan

conditionality of the International Monetary Fund (IMF), trade, or other agreement links. *See e.g.* Jeffrey Sachs, *Conditionality, Debt Relief, and the Developing Country Debt Crisis* (Nat'l Bureau of Econ. Research, Working Paper 2644, 1988), *available at* http://www.nber.org/papers/W2644.

13. *See, e.g.*, Barry Eichengreen, *Restructuring Sovereign Debt*, 17 J. ECON. PERSP. 75 (2003).

14. The term describes "the ability to get what you want by attracting and persuading others to adopt your goals. It differs from hard power, the ability to use the carrots and sticks of economic and military might to make others follow your will." Joseph S. Nye, Jr., *Propaganda Isn't the Way: Soft Power*, INT'L HERALD TRIB., Jan. 10, 2003, at 6.

15. Robert B. Ahdieh, *Between Mandate and Market: Contract Transition in the Shadow of the International Order*, 53 EMORY L.J. 691, 735 (2004) ("cueing" may include a signal that the term will be widely used).

16. *See* ANNELISE RILES, THE NETWORK INSIDE OUT 171-78 (2000) (women's issues "networkers" working for the sake of the Network and its paraphernalia, with the effect of shutting out politics and the women in whose name the networking takes place); Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary*

Study, 28 AM. SOC. REV. 55 (1963) (contracts play a marginal role in the business relationships of Wisconsin manufacturers).

17. *See, e.g.*, Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 EMORY L.J. 929 (2004).

18. Our approach to and use of interviews is similar to that in John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 6-12 (2005) (describing "business ethnography"), and that of Dezalay and Garth (which they describe as "reflexive sociology"). *See* YVES DEZALAY & BRYANT G. GARTH, THE INTERNATIONALIZATION OF PALACE WARS: LAWYERS, ECONOMISTS, AND THE CONTEST TO TRANSFORM LATIN AMERICAN STATES (2002). Earlier work using similar approaches includes Macaulay, *supra* note 16 and ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES, 291-2 (1991) (describing interview-based research in a small community).

19. The distinction is important because during the period we study, governments began to shift away from such borrowing into local currency, often governed by domestic law. BIS Quarterly Review at 45-63 (Sep. 2003), *available at* www.bis.org and INT'L MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT: MARKET DEVELOPMENTS AND ISSUES, ch. 3 (Apr. 2006) [hereinafter GLOBAL FINANCIAL

STABILITY REPORT]. As countries remove restrictions on capital flows, the link among currency, governing law, and residence of the holder has weakened. While economists usually focus on currency and residence of the holder, for purposes of this project we are only concerned with governing law. See Anna Gelpern & Brad Setser, *Domestic and External Debt: The Doomed Quest for Equal Treatment*, 35 GEO. J. INT'L L. 795, 795–96 (2004), for a discussion of the definitions of domestic and external debt used by lawyers and economists.

20. For a summary, see Rory Macmillan, *Towards a Sovereign Debt Work-out System*, 16 NW. J. INT'L L. & BUS. 57, 80–84 (1995).

21. For a summary, see Nancy Birdsall and John Williamson, Delivering on Debt Relief: From IMF Gold to a New Aid Architecture at 14-15 (2002).

22. Economist.com, Economics A-Z, http://www.economist.com/research/Economics/alphabetic.cfm?LETTER=E (follow "Emerging Markets" hyperlink; then follow "Developing Countries" hyperlink) (last visited Mar. 19, 2007). *See generally* Ashoka Mody, *What Is an Emerging Market*? 35 GEO. J. INT'L L. 641 (2004) (providing a systematic overview of the defining characteristics of emerging markets).

23. The World Bank, Country Classification (2007) www.worldbank.org/datastatistics (follow “Country Classification” hyperlink) (“Economies are divided according to 2005 GNI per capita, calculated using the World Bank Atlas method. The groups are: low income, $875 or less; lower middle income, $876 - $3,465; upper middle income, $3,466 - $10,725; and high income, $10,726 or more.”)

24. *Id.*

25. Gloria M. Kim, J.P. Morgan Securities Inc., EMBI Global and EMBI Global Diversified: Rules and Methodology (Dec. 2004) (on file with authors). In mid-2003, the largest countries in the EMBI Global were Brazil, Mexico and Russia. Jonathan Bayliss, J.P. Morgan Securities Inc., Emerging Markets as an Asset Class (Sep. 2003) (on file with authors). Other countries frequently included are Argentina, Bulgaria, Chile, China, Colombia, Cote d’Ivoire, the Dominican Republic, Ecuador, Egypt, El Salvador, Hungary, Indonesia, Lebanon, Malaysia, Morocco, Nigeria, Pakistan, Panama, Peru, the Philippines, Poland, Serbia, South Africa, South Korea, Tunisia, Turkey, Ukraine, Uruguay, Venezuela, and Vietnam. The older EMBI+ index includes fewer countries, has higher liquidity requirements than EMBI Global, and excludes certain debt of parastatals and local

governments. EMBI Global Diversified includes the same countries as EMBIG, but caps the weighting of the largest issuers within the index. Kim, *supra.*

26. Bayliss, *supra* note 27.

27. Id.

28. Id.

29. Authors' estimate based on BIS Quarterly Review, *supra* note 19 at 27 and Joint BIS-IMF-OECD-WB External Debt Database, *available at* http://devdata.worldbank.org/sdmx/jedh/jedh_dbase.html.

30. U.S. DEP'T OF THE TREASURY AND FED. RESERVE BD., MAJOR FOREIGN HOLDERS OF TREASURY SECURITIES (Mar. 15, 2006) *available at* http://www.treas.gov/tic/mfh.txt.

31. Soon after reaching the 1997 high, the volume fell sharply with the wave of international financial crises. The new total represents a strong recovery. EMTA, EM Background: History and Development, http://www.emta.org/emarkets/ (last visited Jun. 19, 2007).

32. NYSE Group, Inc., Listed Companies, http://www.nyse.com/about/listed/1170350259411.html (Dec. 31, 2006).

33. For a skeptical account of the separation between

research and investment banking in emerging markets finance, see PAUL BLUSTEIN, AND THE MONEY KEPT ROLLING IN (AND OUT): WALL STREET, THE IMF, AND THE BANKRUPTING OF ARGENTINA 61-71 (2005).

34. *See* GLOBAL FINANCIAL STABILITY REPORT, *supra* note 19, at 95; Jennie Byun & William Oswald, J.P. Morgan Securities Inc., Emerging Markets External Debt as an Asset Class (Apr. 26, 2006), at 34-35 (on file with authors).

35. The IMF estimated that between 30 and 40 percent of the funds invested in the emerging markets in 2001 came from dedicated investors. INT'L MONETARY FUND, INVOLVING THE PRIVATE SECTOR IN THE RESOLUTION OF FINANCIAL CRISES: RESTRUCTURING INTERNATIONAL SOVEREIGN BONDS 16 n.14 (Jan. 24, 2001), *available at* http://www.imf.org/external/pubs/ft/series/03/ips.pdf. Cross-over investors were becoming more significant in 2003. BIS Quarterly Review, *supra* note 19 at 47. Investors usually measure their performance relative to an index such as EMBI+ or EMBIG. Id. at 47-48 and INT'L MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT: MARKET DEVELOPMENTS AND ISSUES 36 n.4 (Dec. 2002) *available at* http://www.imf.org/external/pubs/ft/gfsr/2002/04/pdf/chp3.pdf. See BLUSTEIN, *supra* note 33, at 70-73, on the paradoxes of index investing.

36. BIS Quarterly Review, *supra* note 19. Until recently,

returns on emerging and mature markets assets rarely correlated. *See* GLOBAL FINANCIAL STABILITY REPORT, *supra* note 19, at 92.

37. Active traders and speculative investors can be especially important in the run-up to, or after, the default. They buy distressed debt at a discount and they often agree to harsh restructuring terms because they hope to reap large profits relative to the low purchase price. Commentator often conflated distressed debt buyers and holdout litigants, even though the two business models are different. *See* Anna Gelpern, *After Argentina* 7-8 (Inst. for Int'l Econ., Policy Brief No. PB05-02, 2005), *available at* www.iie.com/publications/pb/pb05-2.pdf.

38. *See id.* For example, German and Italian retail investors held a significant portion of Argentina's debt at the time of its default in 2001. *Id*. at 3. On the rise of domestic investors, *see* BIS Quarterly Review *supra* note 19 at 45.

39. The three focusing on emerging markets were the Emerging Markets Creditors Association (EMCA) (www.emcreditors.com), EMTA (formerly the Emerging Markets Traders Association) (www.emta.org), and the Institute of International Finance (IIF) (www.iif.com). The four dealing primarily with mature markets securities were the Securities

Industry Association (SIA), the Bond Market Association (BMA), the International Primary Market Association (IPMA) and the International Securities Market Association (ISMA). SIA and BMA have since merged to become The Securities Industry and Financial Markets Association (SIFMA) (www.sifma.org); IPMA and ISMA became the International Capital Market Association (ICMA) (www.icma-group.org).

40. See www.emcreditors.com.

41. Compare Dezalay and Garth's description of the small and tightly linked international arbitration community, YVES DEZALEY & BRYANT G. GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER 10 (1996).

42. Cleary Gottlieb is an exception. *See* Choi & Gulati, *supra* note 17, at 950.

43. Not one investor reported reading the underlying contracts.

44. For a summary of economic literature on sovereign debt, see Federico Sturzenegger and Jeromin Zettelmeyer, Debt Defaults and Lessons from a Decade of Crises at 31-54(2006). On why sovereigns repay their debts, see Jeremy Bulow & Kenneth Rogoff, *Sovereign Debt: Is to Forgive to Forget?*, 79 AM. ECON. REV. 43, 46-47 (1989) (discussing the enforcement model); Harold

L. Cole et al., *Default, Settlement, and Signalling [sic]: Lending Resumption in a Reputational Model of Sovereign Debt*, 36 INT'L ECON. REV. 365, 367-68 (1995) (discussing the reputational model); Jonathan Eaton & Mark Gersovitz, *Debt with Potential Repudiation: Theoretical and Empirical Analysis*, 48 REV. ECON. STUD. 289, 289-90 (1981) (similar discussion).

45. *See* Louis A. Pérez, Jr. & Deborah M. Weissman, *Public Power and Private Purpose: Odious Debt and the Political Economy of Hegemony*, __ N.C. J. INT'L L. & COM. REG. __, [7–23] (forthcoming 2007) for a historical overview of government-sponsored private lending to Latin American sovereigns.

46. *See, e.g.*, Republic of Argentina v. Weltover, 504 U.S. 607 (1992); Georges R. Delaume, *The Foreign Sovereign Immunities Act and Public Debt Litigation: Some Fifteen Years Later*, 88 AM. J. INT'L L. 257 (1994).

47. *See* Patrick Bolton & Olivier Jeanne, Sovereign Debt Structuring and Restructuring: An Incomplete Contracts Approach (2002) (unpublished manuscript, on file with authors).

48. *See* Miles Kahler, Politics and International Debt: Explaining the Crisis, in Miles Kahler, ed., The Politics of International Debt at 16-22 (1986). For a more recent overview of official actors involved in sovereign debt restructuring, see

LEX RIEFFEL, RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD HOC MACHINERY 24–45 (2003); Lee C. Buchheit, *The Role of the Official Sector in Sovereign Debt Workouts*, 6 CHI. J. INT'L L. 333 (2005).

55. *See supra* note 51.

50. *See, e.g.*, Macmillan, *supra* note 20, at 80-84.

51. *See* Ross P. Buckley, *The Facilitation of the Brady Plan: Emerging Markets Debt Trading from 1989 to 1993*, 21 FORDHAM INT'L. L.J. 1802, 1802-15 (1998).

52. *See* MEXICO 1994: ANATOMY OF AN EMERGING MARKET CRASH (Moises Naim & Sebastian Edwards eds. 1997).

53. *See* Eric Helleiner, *The Strange Story of Bush and the Argentine Debt Crisis*, 26 THIRD WORLD Q. 951, 965 (2005).

54. While many of the crises (including Mexico's) did not involve foreign sovereign bonds, these were seen as a key source of vulnerability. *See* Edwin M. Truman, *Debt Restructuring: Evolution or Revolution?*, 1 BROOKINGS PAPERS ON ECON. ACTIVITY (2002); NOURIEL ROUBINI & BRAD SETSER, BAILOUTS OR BAIL-INS? RESPONDING TO FINANCIAL CRISES IN EMERGING ECONOMIES, ch. 8 (2004).

55. *See, e.g.*, Liz Dixon & David Wall, *Collective Action Problems and Collective Action Clauses*, FIN. STABILITY REV. 142 (2000); Mark Gugiatti & Anthony Richards, *Do Collective Action Clauses Influence Bond Yields? New Evidence from Emerging*

Markets, 6 INT'L FIN. 415 (2003); Mark Gugiatti & Anthony Richards, *The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers*, 35 GEO. J. INT'L L. 815 (2004); Torbjörn Becker et al., *Bond Restructuring and Moral Hazard: Are Collective Action Clauses Costly?* (Int'l Monetary Fund, Working Paper WP/01/92, 2001), *available at* http://www.imf.org/external/pubs/ft/wp/2001/wp0192.pdf; Barry Eichengreen & Ashoka Mody, *Would Collective Action Clauses Raise Borrowing Costs?* (Nat'l Bureau of Econ. Research Working Paper No. 7458, 2000), *available at* http://papers.ssrn.com/sob3/papers.cfm?abstract_id=630737.

56. *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (2d ed. 1971).

57. *See* Eichengreen, *supra* note 13, at 81-82; *see also* THOMAS JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 11-14 (1986).

58. The description is stylized. Some syndicates include hundreds of banks, while some bond issues are closely held.

59. *See, e.g.*, BARRY EICHENGREEN, ET AL., CRISIS? WHAT CRISIS? ORDERLY WORKOUTS FOR SOVEREIGN DEBTORS (1995) (a volume commissioned by the Bank of England as part of its work on the Rey Report); GROUP OF TEN, THE RESOLUTION OF SOVEREIGN LIQUIDITY CRISES: A REPORT TO THE MINISTERS AND GOVERNORS PREPARED UNDER THE AUSPICES OF THE DEPUTIES (1996)

[hereinafter REY REPORT], *available at* http://www.bis.org/publ/gten03.pdf.

60. An op-ed in *The Financial Times* reflected the prevailing sentiment: “As the Mexican crisis showed, the world financial system desperately needs a mechanism to draw bondholders together to renegotiate foreign government debt.” Rory Macmillan, *Personal View: New Lease of Life for Bondholder Councils*, THE FIN. TIMES (London), Aug. 15, 1995, at 11. In fact, the Mexican crisis showed little, since the rescue package preempted bondholder mischief by paying them off. *See infra* note 197 and accompanying text.

61. *See* REPORT OF THE WORKING GROUP ON INTERNATIONAL FINANCIAL CRISES (1998) [hereinafter G-22 REPORT], *available at* http://www.bis.org/publ/othp01d.pdf; REY REPORT, *supra* note 59.

62. New York law bonds accounted for about 80 percent of all emerging markets paper in 2002. *See* INT’L MONETARY FUND (Dec. 2002), *supra* note 35, at 44.

63. *See infra* note 190 and accompanying text.

64. Clauses had a handful of early prominent supporters in the market; these were the exception. *See, e.g.*, Lee C. Buchheit, *The Collective Representation Clause*, 17 INT’L FIN. L. REV. 9 (Sep. 1998); Ed Bartholomew, Ernest Stern & Angela Liuzzi,

Two-step Sovereign Debt Restructuring: A Market-based Approach in a World without International Bankruptcy Law (2002), http://www.iiiglobal.org/topics.soveriegn/Two_Step_Sovereign_Bartholomew.pdf.

65. The term “collective action clauses” appears to have been used for the first time in the G-22 REPORT. *See supra* note 61.

73. For a summary of the provisions that had attracted official attention in the late 1990s, see Lee C. Buchheit, *Sovereign Debtors and Their Bondholders,* UNITAR Training Programmes on Foreign Economic Relations Document No. 1, at 19-22 (2000), *available at* http://www.unitar.org/fer/sovereign.pdf and Anna Gelpern, *For Richer, For Poorer: Sovereign Debt Contracts in Crisis*, 1 J. Int’l Banking Reg. 20, at 27-29 (Jan. 2000).

67. Elements of earlier proposals came together as the initiation clause in John Taylor’s April 2002 speech. *See infra* note 140.

68. For one of the many official sector announcements of Mexico’s 2003 shift, see International Monetary Fund, IMF Continues Discussion on Collective Action Clauses in Sovereign Bond Contracts (Apr. 18, 2003),

http://www.imf.org/external/np/sec/pn/2003/pn0353.htm.

69. EMTA, Sovereign Bond Documentation Charts, http://www.emta.org/ndevelop/emsovbonddoccharts.htm (last visited March 19, 2007). Several countries started with 85 percent and switched to 75 percent in subsequent issues. *See id*.

70. INT'L MONETARY FUND, REPORT OF THE MANAGING DIRECTOR TO THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE ON THE IMF'S POLICY AGENDA 8 n.9 (Apr. 20, 2006), *available at* http://www.imf.org/external/np/pp/eng/2006/042006.pdf. The total includes all international bonds, not just ones governed by New York law. Most of the outstanding bonds without CACs were issued before 2003.

71. *See* Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299 (2005). *The Economist* explained the CAC shift this way in May 2003: "Why have borrowers changed their minds? One reason is fear. Once the SDRM was mooted—a far worse idea than collective-action clauses in borrowers' eyes—the thought that it might be put into effect focused minds on the search for a market-based alternative." *Dealing With Default*, ECONOMIST, May 8, 2003, at 63.
Paul Blustein's book on Argentina's crisis concludes:

The triumph of CACs over the SDRM offered some depressing insights into the difficulty of making headway on international financial reforms. The idea of introducing the clauses had been proposed years earlier and had stalled amid opposition from Wall Street; only when the more radical SDRM reared its head did private financiers come around to backing CACs as the lesser evil.

BLUSTEIN, *supra* note 33, at 230. *See also A Better Way to Go Bust*, ECONOMIST, Feb. 1, 2003, at 64; Melvyn Westlake, *Battle of the Heavyweights*, EMERGING MARKETS, Sept. 27, 2002, at 16.

72. *See* Hagan, *supra* note 71, at 319-20.

73. "Developing countries are issuing new bonds that should make it easier to clear up or head off defaults." *Dealing with Default*, *supra* note 71, at 63. *See also* DEUTSCHE BANK EMERGING MARKETS DAILY 8 (Feb. 26, 2003) (on file with authors).

74. *See* Hagan, *supra* note 71, at 320 (citing Adam Lerrick & Allan H. Meltzer, *Sovereign Default: The Private Sector Can Resolve Bankruptcy Without a Formal Court*, Q. INT'L ECON. REP., Apr. 2002, at 2: "With bailouts ruled out, the private sector is confronted with a choice: accept regulation or find its own solution to make restructuring work."); *see also* Barry Eichengreen et al., *Crisis Resolution: Next Steps* (Int'l

Monetary Fund, Working Paper No. WP/03/196, 2003) (noting that the IIF's embrace of Collective Action Clauses would never have happened in the absence of the SDRM initiative), *available at* http:// www.imf.org/external/pubs/ft/wp/2003/wp03196.pdf.

75. ROUBINI & SETSER, *supra* note 54, at 313.

76. *See Dealing With Default*, *supra* note 71, at 63 ("American pressure also played a part: the Treasury made no secret of its preference for the new clauses."). For more recent accounts, see BLUSTEIN, *supra* note 33, at 230 ("Eventually, with U.S. clout working its usual magic, CACs won endorsement from the G-7 and the IMF's policy-setting committee of member-country finance ministers, and several emerging-market countries began issuing bonds with the clauses in 2003."); and David Skeel, *Why Contracts are Saving Sovereign Bankruptcy*, INT'L FIN. L. REV., Mar. 2006, at 24-32 ("With some serious arm-twisting by the US Treasury, Mexico broke the logjam in 2003 . . . .").

77. *See* Alan Beattie, *'Vulture Funds' Circle but Debtors Remain a Moving Target*, FIN. TIMES (London), Feb. 19, 2007, at 15.

78. JOHN B. TAYLOR, GLOBAL FINANCIAL WARRIORS: THE UNTOLD STORY OF INTERNATIONAL FINANCE IN THE POST-9/11 WORLD (2007) at 124-125

79. *See* Felix Salmon, *Blazing a Trail Down Mexico Way*, EUROMONEY, Apr. 2003, at 124; *see also* John Authers, *Mexico Sends*

Signal with Bond Clauses, FIN. TIMES (London), Feb. 26, 2003, at 31 ("'. . . Mexico is building up a war-chest of favours to the US Treasury, which it's going to claim . . . in the future,' said Walter Molano . . . . 'This deal is going to be an orchestrated success, because there's an enormous amount of political reputation riding on this, specifically for the US Treasury.'"); Fernando J. Losada, *Mexico: Going Nowhere Fast*, ABN-AMRO EMERGING MARKETS FORTNIGHTLY, Mar. 5, 2003, at 31 ("The authorities in Mexico were apparently persuaded by the US Treasury and some leading Wall Street bankers to attempt to issue such a bond."); Matthieu Wirz, *Mexico Introduces CACs to Rocky Reception*, INT'L FIN. REV., Mar. 1, 2003, at 71 ("Bankers and investors point to the heavy hand of the US Treasury and recognition of the inevitability of CAC implementation to explain the decision.").

80. The Group of Ten (G-10) comprises eleven economies with significant financial sectors (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States), coordinated at the Bank for International Settlements in Basel. Central Banks play a bigger role in the G-10 than in other similar fora, such as the G-7. *See* Federal Reserve Bank of New York, Bank for

International Settlements, http://www.newyorkfed.org/aboutthefed/fedpoint/fed22.htm (last visited Mar. 19, 2007).

81. *See* Part IV.C *infra*.

82. *See* Robert B. Ahdieh, *The Role of Groups in Norm Transformation: A Dramatic Sketch, in Three Parts*, 6 CHI. J. INT'L L. 231, 240-41, 245-46 (2005) (on the G-10 experts and other groups, some formed in response to the specter of SDRM); Choi & Gulati, *supra* note 17, at 970; *see also* Elmar B. Koch, *Collective Action Clauses: The Way Forward*, 35 GEO. J. INT'L L. 665 (2004) (noting the report of G-10 working group provided the necessary guidelines or framework for the market to formulate their clauses). Also noting the role of the G-10 drafting committee as a key element in the progress towards CACs, see JOHN DRAGE & CATHERINE HOVAGUIMIAN, BANK OF ENG., COLLECTIVE ACTION CLAUSES: AN ANALYSIS OF PROVISIONS INCLUDED IN RECENT SOVEREIGN BOND ISSUES 2-3 (2004), *available at* http://www.bankofengland.co.uk/publications/fsr/2000/fsr17art9.pdf; and Pierre Francois-Weber, *Sovereign Debt (re)Structuring: Where Do We Stand?* FIN. STABILITY REV. (Banque DeFrance), Nov. 2005, at 105 (noting that the "spread of collective action clauses (CAC) follow[ed] the Quarles Report by the Group of

10”), *available at* http://www.banque-france.fr/gb/publications/telechar/rsf/2005/etud5_1105.pdf.

83. *See* Choi & Gulati, Innovation, *supra* note 17, at 975-76.

84. *Id*. at 934, 936, 944-47.

85. *See* Cleary Gottlieb Firm Brochure Overleaf, http://cgsh.com/files/tbl_s5102SiteFileUpload/File5788/4/Cleary_Gottlieb_Firm_Brochure.pdf (“2003: The firm helps pioneer the use of collective action clauses (CACs) in sovereign debt offerings.”) (last visited Mar. 19, 2007).

86. An April 30, 2006, visit to the Cleary Gottlieb website revealed several references to the firm’s role in helping Mexico develop these clauses for the market. *See, e.g.*, News Release, Cleary Gottlieb, Mexican Bond Issuance (Apr. 11, 2003) (on file with authors).

87. See the responses of Sergio Galvis and Lee Buchheit at Stephen J. Choi & Mitu Gulati, *The Evolution of Boilerplate Contracts: Evidence from the Sovereign Debt Market* 45 (Buchheit), 49 (Galvis) (N.Y. Univ. Sch. of Law Law & Econ. Research Paper Series, No. 05-17; Georgetown Univ. Law Ctr. Bus., Econ. and Regulatory Policy, No. 800264, 2005), *available at*

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=800264#PaperDownload (free login and download required).

88. Sullivan & Cromwell's website features their role in the CAC shift:

> We played an integral part in the debate about the development of collective action clauses, which represent a market-based response to the hold-out problem that arises when debt becomes distressed. Collective action clauses were first used by United Mexican States in its successful February 2003 bond offering, where we represented the underwriters.

Sullivan & Cromwell LLP, First Use of Collective Action Clauses (2003), http://www.sullcrom.com/practice/servicedetail.aspx?firmService=21&pdText=PDInfoText3& pdname=LR021969) (last visited Mar. 19, 2007). The Arnold & Porter analogue is at Arnold & Porter LLP, Firm Advises Brazil on Innovative $1 Billion Global Bond Issue (May 2003), http://www.arnoldporter.com/case.cfm?publication_ID=743.

89. In an article on twenty innovators who had helped transform the Latin American financial markets, *LatinFinance* listed Mexico's adoption of CACs among Buchheit's

accomplishments. *Breaking the Mold*, LATINFINANCE, Dec. 2005, at 23-24.

90. Craig Karmin, *Power Player: A Fund Chief Flexes Muscles When Countries Need a Loan*, WALL ST. J., Oct. 26, 2004, at A1. *Cf*. Felix Salmon, *The Emerging Markets Heavyweight*, EUROMONEY, Sept. 2003, at 44 (describing El-Erian's influence in the emerging markets securities world).

91. See *supra* note 44 for the list of associations.

92. *See* Salmon, *supra* note 79, at 125-128.

93. *See Dealing With Default*, *supra* note 71, at 63 ("[S]elf-interest led Mexico to go first. It hoped that by starting the ball rolling it would brand collective-action clauses as a sign of good credit, rather than of weakness."); *see also* Gelpern, *supra* note 37, at 6; Salmon, *supra* note 79, at 128.

94. Anna Gelpern, *How Collective Action Is Changing Sovereign Debt*, INT'L FIN. L. REV., May 2003, at 20-21. Mexican officials "denied any link between the US and Mexico's use of CACs, but frankly admitted the advantage of setting a standard" before the clauses became more widely used. Wirz, *supra* note 90, at 71.

95. *See* Arturo C. Porzecanski, *From Rogue Creditors to

Rogue Debtors: Implications of Argentina's Default, 6 CHI. J. INT'L L. 311 (2005); Helleiner, *supra* note 53.

96. Helleiner, *supra* note 53, at 965. *Cf*. Ernesto Zedillo, *Argentina or the "Principles"?* FORBES, May 23, 2005, www.forbes.com/global/2005/0523/012_print.html ("Argentina's financial collapse was the impetus for serious discussions on how to improve the system.") and Lee C. Buchheit, *Supermajority Control Wins Out*, INT'L FIN. L. REV., Apr. 2007, at 2 ("[T]he fresh memory of a major sovereign debt restructuring dragging on year after exasperating year may have convinced some holders that speed in the workout process – even at the cost of some intercreditor bruising – was worth it.")

97. *See* Gugiatti & Richards, *supra* note 55; *See also* Anthony Richards & Mark Gugiatti, *Do Collective Action Clauses Influence Bond Yields? New Evidence from Emerging Markets*, 6 INT'L FIN. 415, 421 & n.12 (2003) (reporting indifference to CACs among legal advisers in these deals). Robert Gray, a senior official with ICMA, confirms the Richards and Gugiatti observations and further suggests that their finding of lawyer indifference to the early changes also extended to the issuers, underwriters, and investors involved in those initial deals. *See* Robert Gray, *Collective Action Clauses: Theory and Practice*, 35

GEO. J. INT'L L. 693, 703 (2004).

98. Gugiatti & Richards, *supra* note 55, at 815.

99. *Id.* at 826.

100. *Id*.

101. See DEZALAY & GARTH, *supra* note 41, at 17, on the value of encouraging interviewees to present their own picture of the relevant legal field: "[I]t serves to identify what they seek to appear to be and what they reject, thereby serving to define the principles of opposition that structure the field and shape change over time."

102. The use of free-form interviews and withholding attribution in the text leaves us open to criticism because, among other reasons, such a study may be difficult to replicate. *See generally*, Lee Epstein & Gary King, *Exchange: Empirical Research and the Goals of Legal Scholarship: The Rules of Inference*, 69 U. CHI. L. REV. 1, 38-45 (2002). Our response is twofold: First, we spoke with a large portion—potentially over half—of all participants in a small universe. Even with a smaller sample, a later study should be able to replicate our findings. Second, we simply saw no other way to learn and tell what we thought was an important story. *E.g.* Stewart Macaulay, *Contracts, New Legal Realism, and Improving the Navigation of*

The Yellow Submarine, 80 TUL. L. REV. 1161, 1185 & n.99 (2006); *cf.* ELLICKSON, *supra* note 18.

103. Telephone Interview (July 1, 2006) [hereinafter Interview 070206] (the transcripts of all interviews are on file with the authors).

104. *See* Hagan, *supra* note 71, at 302.

105. Interview (Nov. 17, 2005) [hereinafter Interview 111705].

106. *See, e.g.*, Letter to Paul H. O'Neill from the heads of EMTA, IIF, IPMA, BMA, SIA, ISMA, and EMCA (Dec. 6, 2002) (on file with authors):

> We believe that a market-based approach to strengthening crisis management holds the only promise for success. Consequently, we have taken the lead in developing marketable collective action clauses (CACs) that could command the support of both investors and issuers. Regrettably, that effort was set back by the "two-track" approach reinforced in September, an approach which was seen by a number of investors as well as issuers as signaling that a sovereign debt restructuring mechanism (SDRM) could override what is achieved through CACs.

107. *See, e.g.*, Interview (Sept. 27, 2005, and Mar. 5, 2006) [hereinafter Interview 092705]; Interview (Oct. 6, 2005, and Dec. 9, 2005) [hereinafter Interview 100605]; TAYLOR, *supra* note 89 at 122-124; Paul H. O'Neill, U.S. Treasury Sec'y, Keynote Address to the Institute of International Finance (Sept. 28, 2002), *available at* http://www.treasury.gov/press/releases/po3077.htm (where O'Neill refers to the meeting several days earlier but commits to pursue both CACs and SDRM).

108. Interview 100605, supra note 107.

109. The intellectual history of sovereign bankruptcy precedes SDRM, tracing at least as far back as Adam Smith. *See* Kenneth Rogoff & Jeromin Zettelmeyer, *Early Ideas on Sovereign Bankruptcy: A Survey* 3 n.5 (Int'l Monetary Fund Working Paper, No. WP/02/57, 2002), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=879533.

110. MICHAEL MUSSA, ARGENTINA AND THE FUND: FROM TRIUMPH TO TRAGEDY (2002) (criticizing IMF disbursements in the run up to default); BLUSTEIN, *supra* note 37 at 135-157, TAYLOR, *supra* note 89 at 86-88.

111. *See, e.g.*, John B. Taylor, *Loan Rangers*, WALL ST. J., Apr. 19, 2006, at A12 (defining his legacy as putting a brake on the IMF bailouts of the 1990s); Press Release, John B. Taylor,

Office of Pub. Affairs, U.S. Treasury, The Bush Administration's Reform Agenda At the Bretton Woods Institutions: A Progress Report and Next Steps, Testimony Before the Committee on Banking, Housing, and Urban Affairs, United States Senate (May 19, 2004), *available at* http://www.treasury.gov/press/releases/js1662.htm (describing post-Mexico packages of the 1990s as an example of short-term tactics that risked distorting market incentives) [hereinafter Taylor Progress Report].

112. Interview (Dec. 14, 2005) [hereinafter Interview 121405B]; BLUSTEIN, *supra* note 33 at 152-153; TAYLOR, *supra* note 89 at 87-88; International Monetary Fund, Transcript of a Press Briefing by Thomas Dawson, Director, External Relations Department (Aug. 30, 2001), *available at* http://www.imf.org/external/np/tr/2001/tr010830.htm (last visited Jun. 27, 2007).

124. Eichengreen implies that collective action problems were responsible for the failure to deploy the $3 billion in a preemptive restructuring. Eichengreen, *supra* note 13 at 82. The officials or investment bankers who participated in the discussions said that the $3 billion mandate did not reflect financial realities; none reported coordination problems. *See*

e.g., *supra* note 123 and Interview (Jan. 31, 2006) [hereinafter Interview 013106]. In retrospect, Taylor describes the value of $3 billion as "strongly signaling that this was in fact the final augmentation." TAYLOR, *supra* note 89 at 88

114. A standard negative pledge clause restricts the borrower's capacity to pledge collateral to secure future debts. Most private lenders to sovereigns, as well as the World Bank, require negative pledge commitments.

115. "We need an agreement on an international bankruptcy law, so that we can work with governments that in effect need to go through a Chapter 11 reorganization instead of socializing the cost of bad decisions." *The Condition of the Financial Markets and Regulatory Responses Following the September 11 Terrorist Attacks:* Hearing Before the Committee on Banking, Housing, and Urban Affairs, 107th Cong. 33 (2001) (statement of Paul O'Neill, Secretary, United States Department of the Treasury).

116. The IMF's first deputy is traditionally nominated by the United States. Krueger, a prominent economist, was a Bush White House choice. For the announcement of her appointment, *see* Stanford Report, Economics Professor Anne Krueger Named to Key Job at IMF (June 8, 2001), http://news-

service.stanford.edu/news/2001/june13/krueger-613.html

117. Interview (Dec. 16, 2005) [hereinafter Interview 121605].

118. Interview 121405B, *supra* note 124.

119. *Id*.

120. *Id*.

121. *Id*.

122. *See* Anne Krueger, First Deputy Managing Dir., Int'l Monetary Fund, International Financial Architecture for 2002: New Approach to Sovereign Debt Restructuring, Speech at the National Economists' Club Annual Members' Dinner (Nov 26, 2001), *available at* http://www.imf.org/external/np/speeches/2001/112601.htm.

123. Interview 121405B, *supra* note 124.

124. Interview (Dec. 13, 2005) [hereinafter Interview] 121305B. *See* Daniel K. Tarullo, *Rules, Discretion, and Authority in International Financial Reform*, 4 J. INT'L ECON. L. 613, 674 (2001).

125. Interview 070206, *supra* note 103. Many in the market never bought into the IMF's efforts to distance itself from the actual management of the restructuring process—no technical changes could convince the skeptics that SDRM was anything other

than a power grab by the IMF.

126. Interview 121405B, *supra* note 118. In the fall of 2002, O'Neill publicly called for a competition of ideas:

> Simply put, our goal is to change the way that debt is restructured, not to tie ourselves to one approach or another. If there were a third approach to consider, we would welcome that opportunity as well. Don't throw stones at our best efforts to fix this system—throw ideas. The competition of ideas will ensure that we develop the most sensible system to bring predictability to sovereign debt restructuring. We will explore every option, every means to our goal, assess its flaws and strengths, and modify it accordingly.

O'Neill, *supra* note 107.

133. The institute has since been renamed Peter G. Peterson Institute for International Economics (www.petersoninstitute.org).

128. Anne O. Krueger, First Deputy Managing Dir., Int'l Monetary Fund, New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking, Speech at the Conference on "Sovereign Debt Workouts: Hopes and Hazards," Institute for

International Economics (Apr. 1, 2002), *available at* http://www.iie.com/publications/papers/paper.cfm?ResearchID=454. *See also* Paul Blustein, *IMF Scales Down 'Bankruptcy' Plan*, The WASH. POST, Apr. 2, 2002, at E1.

129. John B. Taylor, Under Sec'y of Trasury for Int'l Affairs, Sovereign Debt Restructuring: A US Perspective, Speech at the Conference on "Sovereign Debt Workouts: Hopes and Hazards," Institute for International Economics (Apr. 2, 2002), *available at* http://www.iie.com/publications/papers/paper.cfm?ResearchID=455. For press reactions, see *infra* notes 143 and 144.

130. Interview (Dec. 13, 2005) [hereinafter Interview 121305.

131. Telephone Interview (June 15, 2006) [hereinafter Interview 061506]; TAYLOR, *supra* note 78 at 117.

132. *See, e.g.*, Alan Beattie & Raymond Colitt, *US Scorns IMF Plan for Bankrupt Governments: Proposals to Help Countries in Crisis Sort Out Their Debts without Fear of Litigation Have Met a Cool Response*, FIN. TIMES (London), Apr. 6, 2002, at 7; Paul Blustein, *IMF Crisis Plan Torpedoed: Treasury Official Rejects Proposal a Day After It Is Advanced*, WASH. POST, Apr. 3, 2002, at E1; *Sovereign Bankruptcies*, THE ECONOMIST, Apr. 6, 2002, at 98.

TAYLOR, *supra* note 78 at 116-117, summarizes the press reactions.

133. *See, e.g.*, Paul Blustein, *IMF Reform Plan Makes Comeback: U.S. Eases Stand on 'Bankruptcy' Idea*, WASH. POST, Apr. 9, 2002, at E4; O'Neill Says US View on IMF Debt Restructuring Plan Misinterpreted, AFX EUROPEAN FOCUS, Apr. 9, 2002.

134. TAYLOR, *supra* note 78, at 118.

135. *See* Interview (Mar. 23, 2006) [hereinafter Interview 032306]; Interview 121405B, *supra* note 118. Some Administration insiders suggested to us that Rice was merely being polite without delving into the initiative's substance.

136. Interview (Dec. 20, 2005) [hereinafter Interview 122005].

137. Interview 061506, *supra* note 131.

138. *See id.*; TAYLOR, *supra* note 89 at 119; R. Glenn Hubbard, Chairman, Council of Econ. Advisors, Enhancing Sovereign Debt Restructuring, Remarks at the Conference on the Sovereign Debt Restructuring Mechanism, International Monetary Fund (Jan. 22, 2003), *available at* http://www0.gsb.columbia.edu/faculty/ghubbard/speeches/1.22.03.pdf [hereinafter Hubbard, Jan. 22, 2003, Remarks]. Hubbard delivered nearly identical remarks several months earlier at the American Enterprise Institute. *See* R. Glenn Hubbard, Chairman,

Council of Econ. Advisors, Enhancing Sovereign Debt Restructuring, Remarks at the American Enterprise Institute Conference on the IMF's Sovereign Debt Proposal (Oct. 7, 2002), *available at* http://www.whitehouse.gov/cea/EnhancingSovereignDebtRestructuringAEIOct72002.pdf.

139. Hubbard, Jan. 22, 2003, Remarks, *supra* note 138.

140. *Id*.

141. Interview 061506, *supra* note 142.

142. Hubbard's audience was likely unprepared to parse yet another proposal; the big question on everyone's mind was whether the White House was with the SDRM or against it. There is some evidence that Hubbard did indeed intend his speech as a signal against the SDRM. One guest at a conference luncheon recalls Hubbard asking privately, "Was I clear enough?," a question that confirmed the impression around the table that the speech sought to end the IMF experiment. Interview (May 25, 2006) [hereinafter Interview 052506]. On the other hand, it is not clear that White House officials cared much one way or another about the substance; they just wanted the controversy to end. A prominent academic heading an advisory body, Hubbard may have been testing out yet another theoretical construct that

could simultaneously help solve the restructuring problem and end the Treasury-IMF contest.

143. For a discussion of the impact of Quarles' remarks on the lawyers in the audience, see *infra* Part IV.G.

144. *See* Interview (Dec. 12, 2005) [hereinafter Interview 121205]; Interview (Dec. 20, 2005) [hereinafter Interview 122005].

145. Interview 052506, *supra* note 142. A long-time observer of sovereign debt restructuring interpreted Krueger's ownership as the first sign of doom: "When this came out [as] the Anne Krueger proposal—not IMF, not Koehler—[it was the] first clue to me that it was dead on arrival." Interview (June 6, 2006) [hereinafter Interview 060606].

146. Interview 052506, *supra* note 142.

147. *See* PAUL BLUSTEIN, THE CHASTENING: INSIDE THE CRISIS THAT ROCKED THE GLOBAL FINANCIAL SYSTEM AND HUMBLED THE IMF 170-74 (2001); TAYLOR, *supra* note 89 at 107; Andy Haldane & Mark Kruger, The Resolution of International Financial Crises: Private Finance and Public Funds (Nov. 2001) (unpublished paper of the Bank of England and Bank of Canada) http://www.bankofengland.co.uk/publications/other/financialstability/boeandboc.pdf. This staff paper came with the explicit

endorsement of the heads of their respective central banks. *See* Haldane & Kruger, *supra*, at 2. As the authors note, the paper circulated widely in the official finance circles before being publicly released. *Id.* at 1.

148. ROUBINI & SETSER, *supra* note 54, at 2-3, 6 and note 7. *See* Telephone Interview (Feb. 17, 2006) [hereinafter Interview 021706]. Blustein describes private sector involvement, a term that emerged in the context of the 1990s crises and the accompanying IMF packages, as "a code phrase for inducing banks and investors to accept part of the burden for resolving a crisis by reducing or stretching out their claims." BLUSTEIN, *supra* note 147, at 174.

149. *See generally* Tarullo, *supra* note 124. Tarullo contrasts the European position with the strongest proposal for a rule based system by Meltzer and others; he does not dwell on the disagreements between the Clinton Administration and its European allies. *Id.* at 641. European officials were not against CACs (in fact, most came across to us as both supportive and optimistic about their value), but were merely skeptical of their capacity to reduce bailouts. *See, e.g.*, Telephone Interview (Sept. 11, 2006) [hereinafter Interview 091106].

150. *See* Brad Setser, The Political Economy of SDRM (Jan.

8, 2005) (unpublished draft, on file with authors).

151. *See, e.g.*, Edwin M. Truman, *Rearranging IMF Chairs and Shares: The Sine Qua Non of IMF Reform*, *in* REFORMING THE IMF FOR THE 21ST CENTURY 203 (Edwin M. Truman, ed. 2006) (proposing a consolidated European seat); *see also* Lorenzo Bini Smaghi, *IMF Governance and the Political Economy of a Consolidated European Seat*, *in* REFORMING THE IMF FOR THE 21ST CENTURY, *supra* at 233-55 (explaining the paradox of Europe's nominal over-representation against the lack of coordination among European chairs in the IMF); Ngaire Woods, *Unelected Government: Making the IMF and the World Bank More Accountable*, 21 BROOKINGS REV. 9 (2003) *available at* http://www.brookings.edu/press/review/spring2003/woods.htm (criticizing constituency representation).

152. Because Mexico was part of the Spanish constituency, it could only voice its objections intermittently, when it sat in the constituency chair. *See* Interview 121305B, *supra* note 130; Interview (Dec. 12, 2005) [hereinafter Interview 121205]; Interview (June 16, 2006) [hereinafter Interview 061606]; E-mail to G. Mitu Gulati (July 24, 2006) [hereinafter Interview 072406].

153. Telephone Interview (Aug. 4, 2006) [hereinafter Interview 080406].

154. *See* Interview 121205, *supra* note 152.

155. Interview 061606, *supra* note 152. Interview 121205 illustrates a similar sentiment: both CACs and SDRM raised concerns with signaling default; to some, SDRM raised them more starkly.

156. On O'Neill's resignation, see RON SUSKIND, THE PRICE OF LOYALTY: GEORGE W. BUSH, THE WHITE HOUSE, AND THE EDUCATION OF PAUL O'NEILL (2004); and also Interview 121605, *supra* note 117.

157. Interview 121305B, *supra* note 124. *See also, e.g.*, Interview 121605, *supra* note 117, Interview 121305, *supra* note 130.

158. John B. Taylor, Essential Reform of the International Financial System: Collective Action Clauses, http://www.stanford.edu/~johntayl/Essential%20Reform%20of%20the%20International%20Financial%20System,%20CACs.htm (last visited Mar. 19, 2007).

159. Interview 121405B, *supra* note 118.

160. *Id*.

161. Interview 061506, *supra* note 131.

162. *See* Articles of Agreement of the International Monetary Fund, July 22, 1944, 60 Stat. 1401, 2 U.N.T.S. 39, as amended through June 28, 1990, Article XVIII, *available at*

www.imf.org/external/pubs/ft/aa.aa.pdf; Bretton Woods Agreements Act, 22 U.S.C. § 286c (2000).

163. *See Uncommon Knowledge: Adios IMF? International Monetary Fund* (Hoover Institution video filmed Dec. 15, 1998), *available at* http://www.uncommonknowledge.org/99winter/320.html.

164. *See, e.g.*, Interview 060606, *supra* note 145.

165. Interview 021706, *supra* note 148.

166. *See, e.g.*, Interview 121205, *supra* note 152; Interview 060606, *supra* note 145. The incentive to claim foresight ex-post is obvious. But we heard similar sentiment from scores of officials, investors, and observers long before SDRM was shelved.

167. Interview 121405B, *supra* note 118.

168. Interview 121305, *supra* note 130.

169. Interview 111705, *supra* note 105.

170. *See supra* notes 69–71 and accompanying text.

171. The Brady bonds, which were the predominant model for emerging markets sovereign bond contracts, had not been designed as "market instruments but rather [as] crisis instruments created specifically by the creditor banks as a prerequisite for agreeing to significant debt and debt service reduction." James Hurlock & Troy Alexander, *The Fire Next Time: The Dangers in the*

Next Debt Crisis, 15 INT'L FIN. L. REV. 14 (1996).

172. *See* REY REPORT, *supra* note 59; Vincent Truglia et al., *Sovereign Risk: Bank Deposits vs. Bonds*, MOODY'S INVESTOR SERV. SPECIAL COMMENT, Oct. 1995 (surveying recent history of selective sovereign default and implications for different instruments); Azmat Zuberi & David Roberts, *Preferred Creditors and the Sovereign Ceiling*, DUFF & PHELPS CREDIT RATING CO., Mar. 19, 1996.

173. *See, e.g.*, Hurlock & Alexander, *supra* note 171; Symposium, *The New Latin American Debt Regime*, 16 NW. J. INT'L L. & BUS. 5 (1995); J.B. Hurlock, Sovereign Bankruptcies: Countries Cannot Always Pay (1995) (unpublished manuscript, White & Case, cited in Barry Eichengreen & Richard Portes, *Crisis? What Crisis? Orderly Workouts for Sovereign Debtors* in Eichengreen et al., *supra* note 66 at 65); James B. Hurlock, *A Chapter 9 Process for the Global Financial System?* (May 17, 1995) (unpublished manuscript, White & Case, on file with authors) [herinafter, Hurlock, *Chapter 9*]. According to Hurlock, "Several tactics were tried during the [1980s] Debt Crisis to curb the power of the unanimity provisions. The first, and most obvious, was to amend the provisions over time as debt fatigue began to overcome the restructuring participants …" Id. at 12.

174. BLUSTEIN, *supra* note 147, at 172.

175. Interview (Oct. 7, 2005) [hereinafter Interview 100705].

176. *Id*.

177. REY REPORT, *supra* note 59, at 1.

178. *Id*. at 16-17.

179. EICHENGREEN, ET AL., *supra* note 59.

180. *See* Interview 100705, *supra* note 175; Interview 021706, *supra* note 148; Interview (Jan. 3, 2006) [hereinafter Interview 010306]; Interview (Aug. 17, 2006) [hereinafter Interview 081706].

181. *E.g.*, Interview 092705, *supra* note 107. Buchheit and Hurlock each reported collective action problems in earlier loan restructurings, and blamed holdouts for the lengthy and costly workouts. Lee C. Buchheit, *Making Amends for Amendments*, 10 INT'L FIN. L. REV. 11 (1991); Hurlock, *Chapter 9*, *supra* note 186 at 2 and 12 (citing Poland's experience and proposals to reduce amendment thresholds).

182. Buchheit, *supra* note 194.

183. REY REPORT, *supra* note 59, at 31.

184. Interview 092705, *supra* note 107.

185. The group included the G-7 and Argentina, Australia, Brazil, China, Hong Kong, India, Indonesia, Malaysia, Mexico,

Poland, Russia, Singapore, South Africa, South Korea and Thailand.

186. *See* Jeffrey D. Sachs, Do We Need an International Lender of the Last Resort, Frank D. Graham Lecture, Princeton University (Apr. 20, 1995), *available at* http://www.earthinstitute.columbia.edu/about/director/pubs/intllr.pdf. For a more recent iteration, see Jeffrey D. Sachs, *The Roadblock to a Sovereign Bankruptcy Law*, 23 CATO J. 73 (2003), *available at* http://www.cato.org/pubs/journal/cj23n1/cj23n1-8.pdf.

187. Interview (Nov. 22, 2005). This statement sets out for CACs the classic ingredients for dissemination of policy ideas.

188. *See supra* note 148 and accompanying text.

189. *See* Jeffrey Keegan, *Growing Chorus of Regulators Want Sovereign Bondholders to Share the Pain*, INV. DEALER’S DIG., May 3, 1999, at 16; Kristin Lindow et al., *Pakistan’s Paris Club Agreement Implies New Official Strategy Regarding Seniority of Sovereign Eurobonds*, MOODY’S INVESTORS SERV. GLOBAL CREDIT RES., Mar. 1999, at 3. Bank loans had been subject to “comparability” since the 1970s.

190. Before 1989, the IMF refused to finance countries in arrears to private creditors. This empowered the creditors to

hold up both their own as well as the IMF's financing. As bank restructurings progressed, the Fund changed its policy to allow lending where the country was still in default on its loans, provided the country was complying with its policy program. With qualifications, the policy expanded to cover default on bonded debt in the late 1990s. INT'L MONETARY FUND, FUND POLICY ON LENDING INTO ARREARS TO PRIVATE CREDITORS: FURTHER CONSIDERATIONS OF THE GOOD FAITH CRITERION 3-9 (July 30, 2002), *available at* http://www.imf.org/external/pubs/ft/privcred/073002.pdf.

191. Interview (Sept. 9 and 13, 2005) [hereinafter Interview 091305]. *See also* Interview 092705, *supra* note 107.

192. Interview 010306, *supra* note 180.

193. Interview 091305, *supra* note 191.

194. Interview 010306, *supra* note 180.

195. *Id.* For a sense of the international economic environment and public perceptions of the role of the U.S. economic policy team, see Joshua Cooper Ramo, *The Three Marketeers*, TIME, Feb. 15, 1999, at 34, *available at* http://www.time.com/time/asia/asia/magazine/1999/990215/cover1.html.

196. Interview (October 21, 2005).

197. Interview 010306, *supra* note 180.

198. *See, e.g.*, Interview 091106, *supra* note 149, suggesting that the Paris Club was reasonably satisfied with the market's "practical, technical" response to bond comparability.

199. *See* Lee C. Buchheit, *How Ecuador Escaped the Brady Bond Trap*, 19 INT'L FIN. L. REV. 17 (2000); Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, UCLA L. REV. 59, 83-84 (2000).

200. ROUBINI & SETSER, *supra* note 54, at 8-9; Tarullo, *supra* note 124, at 650–51, 660.

201. Taylor contrasted the Bush Administration's approach to that of their predecessors: "They tended to be government-focused rather than market-focused, emphasizing large loans by the official sector and later government-induced bail-ins by the private sector." Taylor Progress Report, *supra* note 111. Whether this market focus went beyond rhetoric and the extent to which it made for sound policy is much debated. *See, e.g.*, ROUBINI & SETSER, *supra* note 54 at 8-9 and 368-369.

202. Interview 010306, *supra* note 180.

203. Taylor, *supra* note 158.

204. *See, e.g.*, Interview 092705, *supra* note 180.

205. Telephone Interview (Mar. 3, 2006) [hereinafter Interview 030306].

206. Interview 070206, *supra* note 103.

207. *See* Interview 021706, *supra* note 148; Interview 091106, *supra* note 149; Telephone Interview (July 10, 2006) [hereinafter Interview 071006].

208. Interview 021706, *supra* note 148.

209. *Id.*

210. Interview 071006, *supra* note 207.

211. *See* Interview 100705, *supra* note 180; Interview 061506, *supra* note 131.

212. U.S. Treasury, Organization Chart (Dec. 20, 2005), http://www.treas.gov/organization/org-chart-122005.pdf.

213. *E.g.*, Interview 100605, *supra* note 118. [EDS: you have it tagged as 113], Interview 061506, *supra* note 142 [tagged as 135].

214. Id.

215. Press Release, G-7 Fin. Ministers and Cent. Bank Governors, Action Plan (Apr. 20, 2002), *available at* http://www.treasury.gov/press/releases/po3015.htm. See BLUSTEIN, *supra* note 147, at 34-36, for a discussion on the role of the G-7 Finance Ministers' meetings and G-7 Deputies' channels in international economic policy.

216. Press Release, *supra* note 215.

217. TAYLOR, *supra* note 89 at 119-120. The Clinton Treasury had a powerful ally in U.S. Federal Reserve Board Chairman Alan Greenspan. Greenspan, Rubin, and Summers were loath to tie their own hands, and in any event had viewed hard IMF lending limits as not credible. Taylor suggested that CACs gave lending limits credibility in Greenspan’s eyes. TAYLOR, *supra* note 89 at 120 Others who knew Greenspan speculated that he went along with the deal because the new limits were still plenty flexible, while the clauses did no harm. Interview 100705, *supra* note 180.

218. TAYLOR, *supra* note 89 at 120. Canada chaired the G-7 process that year. The Canadian finance ministry welcomed the new approach as reflecting ideas Canada had been pressing for years to reform international financial architecture. A chronology accompanying the Canadian press release dates the architecture reform effort to the start of Mexico’s Tequila Crisis in December 1994, and features Canada’s advocacy of CACs and its own CAC issue in 2000. Press Release, G-7 Fin. Ministers, Can. Dep’t of Fin., Adopt Financial Crises Action Plan (Apr. 20, 2002), *available at* http://www.fin.gc.ca/news02/02-034e.html.

219. *See supra* note 119_ and accompanying text.

220. Taylor, *supra* note 158.

221. *See* Interview 061506, *supra* note 131; Interview 121305B, *supra* note 124.

222. Interview 061506, *supra* note 131.

223. We discuss EMCA's role in detail in Section IV(v) below. Background on EMCA is available at http://www.emcreditors.com/about.html (last visited Mar. 19, 2007).

224. For the EMCA's response to Mexico's February 2003 issuance with CACs, see Press Release, Emerging Mkts. Creditors Ass'n (Feb. 26, 2003), *available at* http://www.emcreditors.com/pdf/EMCA_Press%20Release_2_26_03.pdf.

225. *See* Interview 100605, *supra* note 107; Interview 030306, *supra* note 205.

226. Interview 121605, *supra* note 117.

227. Interview 121205, *supra* note 152.

228. Interview 061606, *supra* note 152; Interview 121605, *supra* note 117. While the precise form and timing of the issue appear to have been a surprise, Taylor's book and file memos indicate that Mexican officials told their U.S. counterparts that they were ready to move in principle as early as January. TAYLOR, *supra* note 89 at 127-128; *See also* Press Release, Office of Pub. Affairs, U.S. Treasury, U.S. Treasury Statement

Regarding Decision by Mexico to Issue Bonds with Collective Action Clauses (Feb. 24, 2003), *available at* http://www.treasury.gov/press/releases/200322418171120575.htm.

229. Press Release, Office of Pub. Affairs, G-7 Action Plan Implementation, April 2003 (Apr. 12, 2003), *available at* http://www.treasury.gov/press/releases/200341213252315778.htm.

230. Interview 010306, *supra* note 180.

231. Interview 121605, *supra* note 117.

232. Interview (Dec. 14, 2005) [hereinafter Interview 121405].

233. Interview 010306, *supra* note 180. *See also* TAYLOR, *supra* note 78 [89], at 116.

234. *John B. Taylor, Policies in International Finance* 2001-2005, http://www.stanford.edu/~johntayl/policiesinternationalFinance.htm (last visited Mar. 19, 2007).

235. Interview (Sept. 27, 2005) [hereinafter Interview 092705B].

236. *See supra* notes 61, 204, 211.

237. GROUP OF TEN, REPORT OF THE G-10 WORKING GROUP ON CONTRACTUAL CLAUSES (Sept. 26, 2002), *available at* http://www.bis.org/publ/gten08.pdf.

238. *Id.* at 8.

239. *Id.* at 1-2.

240. Interview 121605, *supra* note 117.

241. To our knowledge, his practice did not include sovereign debt.

242. The White House, Resources for the President's Team, http://www.whitehouse.gov/results/leadership/bio_360.html (last visited Mar. 19, 2007).

243. Interview (June 7, 2006) [hereinafter Interview 060706B].

244. Interview 021706, *supra* note 148.

245. Interview 061506, *supra* note 131. Considering the history of the Rey Report, the suggestion that the G-10 came to CACs late was not entirely fair.

246. *See* Interview (Sept. 2, 2005); Interview 061506, *supra* note 131.

247. Interview 111705, *supra* note 105. The G-10 Report specifically cautioned against thresholds above 75 percent. GROUP OF TEN, *supra* note 237, at 5. The fact that official pronouncements on IMF lending to Argentina hinged on participation levels in the bond exchange, and that Argentina's exchange in the spring of 2005 secured 76 percent bondholder

participation, no doubt colored market thinking.

248. GROUP OF TEN, *supra* note 237.

249. Interview (Sep. 22, 2005 [hereinafter Interview 092205]; follow-up e-mail to Anna Gelpern, July 21, 2006).

250. Interview 121405B, *supra* note 118.

251. Interview 121205, *supra* note 152.

252. Interview 061506, *supra* note 131; Interview 121605 *supra* note 117.

253.

254. BANQUE DE FR. STAFF, TOWARDS A CODE OF GOOD CONDUCT ON SOVEREIGN DEBT RE-NEGOTIATION (Jan. 2003), *available at* http://www.fesur.org.uy/publicaciones/Trichet-proposal.rtf. This proposal was incorporated in the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging markets. The Principles were released jointly by the IIF, IPMA, and several key emerging markets issuers in the fall of 2004. *See* Press Release, Sovereign Issuers of Int'l bonds, the Inst. of Int'l Fin., and the Int'l Primary Mkt. Assoc., Key Principles Agreed To Strengthen Emerging Markets Finance (Nov. 22, 2004), *available at* http://www.ipma.org.uk/pdfs/221104%20Principles%20Pressrrelease.PDF.

255. We discuss the impact of G-7 and other mature markets issuers including CACs in their debt in Part IV.C and Part IV.G_ below.

256. Interview 100605, *supra* note 107.

257. Interview 060706B, *supra* note 243.

258. Interview (June 7, 2006) [hereinafter Interview 060706]. This comports with the view that contractual "deviance" alone may carry a penalty, in Omri Ben-Shahar and John A.E. Pottow, *On the Stickiness of Default Rules*, 33 FLA. ST. U. L. REV. 651 (2006).

259. *See* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1, 56-61 (2004) (citing Patrick Bolton & David S. Scharfstein, *Optimal Debt Structure and the Number of Creditors*, 104 J. POL. ECON 1 (1996)).

260. Interview 100706, *supra* note 175.

261. *See supra* note 62 (citing studies by Eichengreen & Mody, Becker, Richards & Thaicharoen, and Gugiatti & Richards); *see also* K. Tsatsaronis, *The Effect of Collective Action Clauses on Foreign Sovereign Bond Yields*, BIS Q. REV., INT'L BANKING & FIN. MKT. DEV. 1999, at 22-23.

262. Barry Eichengreen & Ashoka Mody, *Would Collective

Action Clauses Raise Borrowing Costs? (Nat'l Bureau of Econ. Research, Working Paper No. 7458, 2000), *available at* http://www.nber.org/papers/w7458.pdf.

263. *See, e.g.*, Interview 061506, *supra* note 131.

264. *Id*.

265. Interview 030306, *supra* note 205.

266. Interview 060706B, *supra* note 243.

267. Interview (Dec. 12, 2005) [hereinafter Interview 121205].

268. Interview 060706B, *supra* note 243.

269. Losada, *supra* note 79, at 31.

270. *See, e.g.*, Salmon, *supra* note 90; Alonso Cervera, *Mexico*, EMERGING MKTS. ECON. DAILY, CREDIT SUISSE FIRST BOSTON, Feb. 27, 2003, at 7; Interview 121205, *supra* note 152; Interview 060706B, *supra* note 243. Early reports and interviews attributed the lack of a price penalty to Mexico's creditworthiness and the remoteness of default.

271. Interview 091305, *supra* note 191.

272. *See* Ahdieh, *supra* note 93. We exclude statements from lawyers and officials who participated in the G-10 effort.

273. Interview 121205, *supra* note 152.

274. *Id.*

275. *Id.*

276. Interview 060706B, *supra* note 243.

277. Telephone Interview (Mar. 1, 2006) [hereinafter Interview 030106].

278. *See infra* note 367 and accompanying text.

279. Interview 013106, *supra* note 124; Interview 060706, *supra* note 271.

280. Interview 013106, *supra* note 124. The provision elevated events of default to the level of a reserved matter requiring a 75 percent vote to amend (instead of two-thirds), but only if amended in conjunction with an exchange offer. *See* United Mex. States, *supra* note 2, at 8.

281. Interview 030106, *supra* note 277. Cleary Gottlieb does not appear to have issued a press release in connection with Mexico's first CAC offering in February 2003. Firm announcements began claiming credit for CACs in early April, with an offering by Mexico's state-owned oil company Pemex one week before the Government's second CAC issue in New York. Pemex issued under English law for the sole purpose of promoting the clauses; they have continued into 2005. News Release, Cleary Gottlieb, Pemex in €750 Million Note Offering (Apr. 4, 2003) (on file with authors) and News release, *supra* note 97. A search

for “collective action clause” on www.cgsh.com (last visited Jun. 27, 2007) yields press releases for CAC offerings by South Korea and the Dominican Republic in 2005.

282. Salmon, *infra* note 349.

283. Interview (May 25, 2006) [hereinafter Interview 052506D].

284. *See Breaking the Mold*, *supra* note 89 and Buchheit, *supra* note 194.

285. Buchheit, *supra* note 103.

286. Buchheit, *supra* note 182 [194].

287. *See* Buchheit, *supra* note 71, Lee C. Buchheit, *Majority Action Clauses May Help Resolve Debt Crises*, 17 Int’l Fin. L. Rev. 17 (Jul. 1998), and Lee C. Buchheit, *Changing Bond Documentation: The Sharing Clause*, 17 Int’l Fin. L. Rev. 9 (Aug. 1998).

288. *E.g.,* Buchheit, *supra* note 78 and Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317 (2003).

289. Lee C. Buchheit & Elizabeth Karpinski, *Grenada’s Innovations*, 21 J. Int’l Banking Reg. 227 (2006). Before Grenada, actions for accelerated claims had to be brought through the trustee, but individual suits for missed payments

could be brought individually. The effect of Grenada's innovation was to eliminate another weapon in the holdout creditors' arsenal.

290. Mexico could be as minimalist as it pleased, while preempting another country's egregious minimalism.

291. Interview 013106, *supra* note 124.

292. *Id*. *See also* Interview 060706, *supra* note 271. This does not mean that the institution was renouncing its "network coordinating" responsibilities in general. Since CACs were expected to carry a penalty, and since there was no agreement among market participants on the grounds for such a penalty, the optimal standard was unclear and the need for standardization not obvious.

293. CACs: Country/Firm Outreach Overview As of January 28, 2002 [sic] (Jan. 28, 2003) (on file with authors).

294. *E.g.*, www.emcreditors.org, Interview 060706, *supra* note 271.

295. Id.

296. EMCA, MODEL COVENANTS FOR NEW SOVEREIGN DEBT ISSUES (May 3, 2002), *available at* http://www.emcreditors.com/pdf/model_convenants.pdf.

297. Interview 120905, *supra* note 267.

298. EMCA, *supra* note 296.

299. Id. EMCA was established in part to protest Buchheit's aggressive use of exit consents on behalf of Ecuador. Investors who later became part of EMCA's leadership also protested Ecuador's attempt to restructure its Brady bonds while sparing its Eurobonds; they claimed that the treatment of secured bondholders violated Ecuador's *pari passu*, or equal treatment undertaking (most considered this to be a misapprehension of the clause). *Ecuador: A Case for Comparability?*, EMERGING MKTS. DEBT REP., Mar. 29, 1999, at 13; Felix Salmon, *The Buy Side Starts to Bite Back*, EUROMONEY, Apr. 2001, at 46. *See also* Lee Buchheit & Jeremiah Pam, *The Hunt for* Pari Passu, RESTRUCTURING NEWS L. (Cleary Gottleib, New York, N.Y.), Aug. 2004, at 6 (addressing the controversy over the *pari passu* clause).

300. Some EMCA leaders said the bondholders participated in these deals because they were clueless, sleepy, docile sheep—"the only one less equipped than the public sector was the private sector." Interview 070206, *supra* note 103. Some members offered another reason for the difficulty of coordinating even a small group of investors. At least when it comes to litigation and possibly other forms of aggressive enforcement, money

managers must get permission to proceed from the account holders. Few are willing to undertake this additional level of coordination. Hedge funds and proprietary traders do not have this problem. Telephone Interview (Dec. 9, 2005).

301. Interview 030306, *supra* note 205.

302. Telephone Interview (Dec. 27, 2006).

303. *Id*.

304. Email to Anna Gelpern (Mar. 4, 2003) (on file with authors).

305. Email to Anna Gelpern (Feb. 24, 2003) (on file with authors).

306. Interview 013106, *supra* note 124.

307. Interview 060706B, *supra* note 243.

308. *Compare* EMCA, About EMCA: Directors 2001, www.emcreditors.com/list_directors_2001.html, *and* EMCA, About EMCA: Directors 2002, www.emcreditors.com/list_directors_2002.html. *See also* Salmon, *infra* note 349.

309. Salmon, *supra* note 101.

310. *See e.g.*, TAYLOR, *supra* note 89 at 128-129. After Brazil, El-Erian wrongly predicted that lower credit issuers would stay with higher amendment thresholds. *See* Salmon, *infra*

note 349.

311. The Institute of International Finance, Inc., About IIF, http://www.iif.com/about/ (last visited Mar. 19, 2007).

312. EMTA, Mission and Origins, http://www.emta.org/about/ (last visited Mar. 19, 2007).

313. Interview 061506, *supra* note 131.

314. Interview 060606, *supra* note 146.

315. *Id.*

316. *Id.*

317. *See, e.g.*, Interview 052506D, *supra* note 283; Interview 013106, *supra* note 124; Interview 030306, *supra* note 205.

318. Porzecanski, *supra* note 95.

319. EMCA, EMTA, IIF, IPMA, ISMA, SIA AND TBMA, Model COLLECTIVE ACTION CLAUSES FOR SOVEREIGN BONDS (Jan. 31, 2003), *available at* www.emta.org/ndevelop/Final_merged.pdf.

320. *Id*. at 13.

321. Interview 111705, *supra* note 105.

322. Interview 060706B, *supra* note 243.

323. Interview 070206, *supra* note 103.

324. *See* Interview 100605, *supra* note 107; Interview 121405B, *supra* note 118.

325. Salmon, *supra* note 90. Like Salmon, we found no evidence of other tradeoffs, for example, on immigration or trade policy. The fact that the White House was uninterested in CACs makes these kinds of tradeoffs unlikely.

326. See *infra* Part IV.G for efforts to maintain momentum for the contract shift after Mexico's initial issue.

327. Interview 121305, *supra* note 130. The figure of 70 percent was widely circulating in late 2002 to early 2003. Interview 013106, *supra* note 124.

328. Interview 121205, *supra* note 267.

329. Interview 021706, *supra* note 148.

330. Interview 060606, *supra* note 146.

331. Interview 121605, *supra* note 117. Carstens holds a PhD in Economics from The University of Chicago, and is the Finance Minister of Mexico at the time of this writing. ED stands for Executive Director.

332. A biweekly sell-side research note a few weeks before Mexico's launch described the market conditions:

> EM debt has soared in recent days in moderate volume, allowing the asset class to deliver a year-to-date return in excess of 2%. The rally in the US Treasury market, where 10-year yields have dropped from 4.20%

> two weeks ago to below 4.00% at present, is creating a hothouse effect for investors in EM bonds. Portfolio managers in the US and Europe continue to receive inflows of funds looking to be invested in EM bonds.

ABN-AMRO, EMERGING MKTS. FORTNIGHTLY, Feb. 9, 2005, at 1. *See, e.g.* Interview 060706, *supra* note 243; Interview 070206, *supra* note 103; Email to G. Mitu Gulati (July 7, 2006).

333. *See, e.g.*, Interview 030106, *supra* note 277.

334. Interview 121205, *supra* note 267. *See infra* note __ for more on the investor reaction. Note this official's use of "clients" to denote investors in his country's debt.

335. Interview 121205, *supra* note 267.

336. Here it is useful to contrast Mexican and U.S. accounts of the months leading up to the first CAC issue. Mexican officials and their advisers stress the fact that the decision was made independently and all but sprung on the U.S. Treasury, even as they expressed gratitude for U.S. and G-7 support. U.S. officials emphasize long-term, painstaking coordination. *See supra* note 241 and accompanying text.

337. Press Release, Can. Dep't of Fin., *supra* note 7. The Honourable Paul Martin, Min. of Fin. for Can., Statement Prepared for the International Monetary and Financial Committee,

Prague, Czech Republic (Sept. 24, 2000), *available at* http://www.fin.gc.ca/news00/00-072e.html; Mervyn King, Deputy Governor of the Bank of Eng., The International Financial System: A New Partnership, 20th Anniversary of the Indian Council for Research on International Economic Relations (2001), *available at* http://www.bankofengland.co.uk/publications/speeches/2001/speech138.htm (describing initiatives by Canada and the United Kingdom to lead by example by including CACs in their foreign-currency debt). Emerging markets officials and investors uniformly dismissed such efforts as irrelevant. A European official described the principal value of leading by example as rhetorical: "It helped rhetorically in the debate—took away a cheap short argument. If I were an [EM] issuer, I would not be interested in what zero-risk countries are doing." Interview 071006, *supra* note 207. But one lawyer involved in debt offerings for a G-7 issuer recalled Quarles appealing to the government to use CACs—which the lawyer apparently considered irrelevant in view of the country's credit quality—"as some kind of post-9/11 unity thing". Interview (April 17, 2007).

338. Felix Salmon, *Uruguay's Elegant Transformation*, EUROMONEY, Feb. 2004, at 86.

339. INT'L MONETARY FUND, FINANCIAL STATEMENTS 18 (April 30, 2003), *available at* http://www.imf.org/external/pubs/ft/quart/2003fy/043003.pdf.

340. *See supra* note 27 and accompanying text.

341. Interview 080406, *supra* note 153.

353. *See e.g.*, *Cláusula de calote adotada pelo Brasil foi sugestão dos EUA*, Folha de São Paulo, Apr. 29, 2003, *available at* http://www1.folha.uol.com.br/folha/dinheiro/ult91u66455.shtml (last visited Jun. 22, 2007); Leonardo Souza, *Brasil deverá adotar a "cláusula de calote" para fazer novas emissões*, Folha de São Paulo, Apr. 12, 2003, *available at* http://www1.folha.uol.com.br/fsp/indices/inde12042003.htm (citing Economy Minister Antonio Palocci's insistence that he raised CACs of his own accord in a meeting with Treasury Secretary Snow and Fed Chairman Greenspan). We are grateful to Giselle Datz for these and other Brazilian press materials and for the translations from the Portuguese.

359. For example, Mexico's CAC debute merited only a squib in a leading newspaper, which noted that issuing with CACs put Mexico in the company of mature markets issuers such as the United Kingdom and Italy. *Nombres, Nombres y... Nombres/ Acelerará fuerte en México GE Capital Bank y va por dls. mil 400*

millones de cartera para el 2005 in La Reforma, Feb. 27, 2003, *available at* www.reforma.com

344. Interview 080406, *supra* note 153.

345. Interview 061606, *supra* note 152.

346. Interview 080406, *supra* note 153.

347. Interview 061606, *supra* note 152.

348. Interview 080406, *supra* note 153.

349. Felix Salmon, *Brazil Goes Off On a CACs Tangent*, EUROMONEY, June 2003, at 156.

350. Interview 080406, *supra* note 153.

351. *See* Salmon, *supra* note 349.

352. Interview 060706B, *supra* note 243.

353. Salmon, *supra* note 349.

354. Interview 080406, *supra* note 153.

355. Interview 061606, *supra* note 152.

356. Interview 122005, *supra* note 171.

357. Salmon, *supra* note 338.

358. "Ex-post we realized that IMF was trying to force us to go to SDRM approach." Interview 122005B, *supra* note 171.

359. *See generally* Mussa, *supra* note 121; Republic of Arg., Prospectus Supplement and Prospectus (filed pursuant to Rule 424(b)(5)), at 165-66 (Jan. 10, 2004) (describing a pre-default

debt exchange that increased the net present value of Argentina's debt by $9.5 billion), http://www.sec.gov/Archives/edgar/data/914021/000095012305000302/y04567e424b5.htm#214.

360. Salmon, *supra* note 338; Interview *supra* note 143; Interview 013106, *supra* note 124.

361. Interview 092205, *supra* note 262.

362. Interview 121605, *supra* note 117.

363. Buchheit & Pam, *supra* note 299. As part of its comprehensive restructuring, Uruguay amended several small Japanese bonds using CACs already in its Japanese law contracts.

364. Interview 121305, *supra* note 130. One of the lawyers involved in Argentina's exchange said that CACs were "a foregone conclusion." Interview 052506D, *supra* note 283.

365. Interview 121405B, *supra* note 118; Interview 121605, *supra* note 156; Salmon, *supra* note 349.

366. *See e.g., supra* note 277 and accompanying text.

367. *See* LEE C. BUCHHEIT, HOW TO NEGOTIATE EUROCURRENCY LOAN AGREEMENTS, ch. 2 (2d ed. 2000) (describing loan contract terms as akin to the "scars on an aging prizefighter," each scar telling an old battle story).

368. *See supra* note 154 and accompanying text.

369. Trust Indenture Act of 1939, 15 U.S.C. 77aaa et seq.

370. Academics knew this history well. *See* DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (2001); David A. Skeel, Jr., *Can Majority Action Provisions Do It All?*, 51 EMORY L.J. 417 (2003); Tarullo, *supra* note 124, at 670-71. Buchheit had also published an article on the topic. *See* Buchheit & Gulati, *supra* note 302.

380. At roughly the same time, similar public policy concerns were raised in both Japan and Germany with regards to CACs in sovereign bonds governed by their laws. See Takehiro Nobumori, Aspects of Collective Will of Bondholders Under Japanese Law, 35 Geo. J. Int'l L. 755, 773-75 & n.22 (2004).

372. *E.g.* Truman, *supra* note 61.

373. Dixon & Wall, *supra* note 55, at 142, 150-51.

374. For an original analysis of Argentina litigation, see Marcus Miller & Dania Thomas, Sovereign Debt Restructuring: The Judge, the Vultures, and Creditor Rights (May 2006) (on file with authors).

375. *Supra* notes 123-126 and accompanying text.

376. *See, e.g.*, BLUSTEIN, *supra* note 33; Brad Setser & Anna Gelpern, *Pathways Through Financial Crisis: Argentina*, 12 GLOBAL GOVERNANCE 465 (2006).

377. Brief of the Emerging Markets Creditors Ass’n as Amicus Curiae, NML Capital, Ltd., v. Rep. of Arg., No. 05-1543-CV(L) (2d Cir. Apr. 20, 2005).

378. Gugiatti & Richards, *supra* note 62.

379. Id.

380. Interview 121306B, *supra* note 124.

381. Email to Anna Gelpern (May 3, 2007) [Interview 050307].

382. Interview 013106, *supra* note 124.

383. Interview 052506D, *supra* note 283.

384. Id.

402. Taylor was among those who suggested literally compensating countries for switching. Taylor, *supra* note 140.

386. Macaulay, *supra* note 16.

387. *Id.* at 57-67.

388. See, e.g., Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981) for a classic treatment of the first question. Macaulay’s own study focused on answering the second question. Although it addresses statutes and ordinances more than contracts, Ellickson’s research on economic relations among cattle ranchers offers critical insights into the second question. Ellickson, *supra*

note 18.

389. Mark C. Suchman, *The Contract as Social Artifact*, 37 L. & SOC'Y REV. 91 (2003), offers the broadest theoretical framework for answering the third question. The literature on the "boilerplate" phenomenon (see Scott & Goetz and Klausner & Kahan, *supra* note 4, Ben-Shahar & Pottow, *supra* note 271) addresses one aspect of the question—why parties fail to reform suboptimal terms. Few legal studies offer an affirmative case for including contract terms for reasons other than their mechanical function. *But see, e.g.*, Claire A. Hill, *A Comment on Language and Norms in Complex Business Contracting*, 77 CHI.-KENT L. REV. 29, 56 (2001) (suggesting that the signaling value of contract terms may be distinct from their mechanical function).

390. Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 801-03 (1941).

391. *Id*.

392. Suchman, *supra* note 389, at 108-15. *See also* Hill, *supra* note 389, at 56.

393. *See, e.g.*, Philippe Aghion & Patrick Bolton, *Contracts as a Barrier to Entry*, 77 AM. ECON. REV. 388 (1987), for a domestic commercial example; Joseph Stiglitz, unpublished manuscript on file with authors (2007), for a related argument

in the sovereign context; *see generally* PATRICK BOLTON & MATHIAS DEWATRIPONT, CONTRACT THEORY 100-27 (2005).

XXX. Participants used similar language in public statements. For example, Taylor observed, "…I did look for opportunities to take some immediate actions that would signal change, in particular, that we wanted to move in the direction of 'rules' or 'limits' [on official lending] …" Taylor, *supra* note 89 at 108. Mexican officials said the CAC move was meant "'to send a signal' to the markets, and that … there was almost no chance of a debt restructuring within the next 12 years." Authers, *supra* note 90.

411. A. Michael Spence, *Job Market Signaling*, 87 Quarterly J. of Econ. 355 (1973) (describing a mechanism by which good employees can distinguish themselves from bad ones by acquiring costly but otherwise useless education).

412. For example, lawyers for a leading trade association observed that their contract analysis product was most interesting to to academics; members paid little attention. Interview (Jun. 4, 2007) [Interview 060407].

414. Creditors sought to control debtor moral hazard, pointing to Argentina as the "rogue debtor". Porzecanski, *supra* note 106. For the role of associations in producing

boilerplate, *see* Kevin E. Davis, *The Role of Nonprofits in the Production of Boilerplate* 104 Mich. L. Rev. 1075 (2006).

398. *See, e.g.*, Beattie, *supra* note 77.

399. Jeremy Bulow & Kenneth Rogoff, *Multilateral Negotiations for Rescheduling Developing Country Debt: A Bargaining-Theoretic Framework*, 35 IMF STAFF PAPERS 644 (1988). For an alternative view of three-party sovereign debt negotiations, see Sachs, *supra* note 12. Similarly, a U.S. cabinet official we interviewed referred to the public sector's predicament as "the realtor squeeze" – an analogy to real estate brokers who sacrifice part of their commission to close home sale. Interview (Dec. 19, 2006) [Interview 121906].

XXX. TAYLOR, *supra* note 89, at 110 (emphasis in the original).

417. *See generally*, Sturzenegger & Zettelmeyer, *supra* note 49.

402. Kathryn Wells, *Sovereigns Look Abroad: G8 Debt Relief Package Will Not Constrain Issuance Plans*, EUROMONEY, Aug. 9, 2006, at 54.