SOVEREIGN DEBT RESTRUCTURING: ACTIVE NEW YORK ASSEMBLY BILL PROVIDING FOR A NEW COMPREHENSIVE SOVEREIGN DEBT RESTRUCTURING MECHANISM AND A LIMIT ON RECOVERIES ON SOVEREIGN DEBT

In our client briefing of May 2023 we referred to three active bills in the New York Assembly which, if enacted, would have had a material impact on the process of sovereign debt restructuring and the market for sovereign emerging market debt generally. Those three bills lapsed in the last session of the New York Assembly.

An amended version of one of those bills has now effectively become active again in the current session of the New York Assembly. This is Assembly Bill A2970A which was amended and recommitted to the Ways and Means Committee on March 6, 2024 and is the same as Senate Bill S5542A which was amended and recommitted to the Banking Committee on Feb 28, 2024. A copy of the Senate Bill is annexed to this client briefing.

Senate Bill S5542A is given the short title of 'the sovereign debt stability act' and we refer to it as the Sovereign Debt Stability Bill in this client briefing.

The Sovereign Debt Stability Bill essentially combines the key ingredients of previous New York Assembly Bills designed effectively: (i) to impose a comprehensive sovereign debt restructuring mechanism (through Assembly Bill A2102A dated January 2023 and Senate Bill S5542 dated March 8, 2023); and (ii) to limit recoveries on sovereign claims to those which would have been applicable if they had been held by the US itself and those claims were the subject of one or more international initiatives in respect of the sovereign debt of an affected country (through Assembly Bill A2970 dated February 1, 2023 and Senate Bill S4747 dated February 14, 2023).

Whilst in separate form, we reviewed the earlier versions of the draft Bills on these topics in our May 2023 client briefing. In the May 2023 client briefing we also reviewed Assembly Bill A5290 dated March 7, 2023 and Senate Bill S5623 dated March 9, 2023 which were designed to alter New York State law on champerty in respect of sovereign claims and impose a duty on the holder of the New York law governed instruments to participate in a qualified restructuring affecting that instrument (being, broadly, a modification of the payment terms of some or all of the unsecured debt instruments issued by a foreign state where (i) the IMF has made an assessment of unsustainability within the prior twelve months; and (ii) the modification is accepted by the holders of not less than two-thirds in amount and more than one-half in number of the debt instruments affected by the modification (excluding, for voting purposes, any 'self held' instruments)).

Overview – The Sovereign Debt Stability Bill would Create a New Approach to Sovereign Debt Restructuring through a New Article 8 of the New York Banking Law

By way of executive summary, if the Sovereign Debt Stability Bill is enacted, new Article 8 of the New York Banking Law would enable a country facing financial difficulties (referred to as a 'debtor state' in the Bill) which believed it had unsustainable debts to file a petition with the State of New York. Article 8 describes the required process, certifications and notifications to creditors. It contemplates that a plan for restructuring would be submitted by the country which designated different classes of claims. Majority voting would apply to each class and so, effectively, majority payment terms amendments would be retroactively introduced into debt contracts. Once a plan was approved by all classes, the plan would become effective at which point contractual rights to payment would effectively be replaced by those specified in the plan. New money would be capable of being raised through majority voting and would be legally senior to other claims.

Where Article 8 is invoked, most fundamentally, the effect would be retroactively to alter existing New York law contractual rights in relation to sovereign claims governed by New York law.

By incorporating the key provisions previously contained in Assembly Bill A2970 and Senate Bill S4747, the Sovereign Debt Stability Bill also allows a debtor state to elect to limit recoveries on sovereign debt claims to those which would have been applicable if those debt claims had been held by the US itself and those debt claims were the subject of an international initiative in respect of the sovereign debt of the debtor state.

Background and Description in Outline of the Existing Position

There is no insolvency or bankruptcy regime applicable to sovereign debtors under which an orderly reorganisation of the financial claims of a sovereign debtor can be achieved and, in essence, that is one key part of what the Sovereign Debt Stability Bill seeks to achieve.

Whilst the topic has been discussed and proposals have in the past been made, there has never been any such insolvency or bankruptcy regime for sovereign debtors and so, not surprisingly, mechanisms have developed and evolved over time to seek to ensure that the payment terms of sovereign debt can be revisited in practice when that is necessary.

Given the breadth of its roles with respect to its member states (comprising almost all countries), the International Monetary Fund (‘IMF’) has been significantly involved in this field, including through its lending policies (including its lending into arrears policies), monitoring the effectiveness of applicable mechanisms and making recommendations for improvement.

There is much in the statement of legislative intent in section 220 of the Sovereign Debt Stability Bill with which most practitioners in the sovereign debt restructuring field would broadly agree, namely that: debt distress, debt crises, and disorderly default can be associated with unacceptable human suffering and economic decline; there should be support for orderly, collaborative and effective international sovereign debt relief for countries with unsustainable levels of debt; when it is not perceived as equitable or legitimate by stakeholders in borrowing and lending countries, debt restructuring can be ineffective and not necessarily lead to sustainable outcomes; and fair burden sharing among public and private creditors is essential to the legitimacy and effectiveness of debt relief initiatives. However, the Sovereign Debt Stability Bill is likely to give rise to many questions among many practitioners in this field and the linked field of voluntary new debt raisings by emerging market sovereigns, as described below and in our client briefing of May 2023, as relevant.

Main Points of Principle on the Sovereign Debt Stability Bill

At Variance with the Existing International Financial Architecture: In a nutshell, the existing approach to the restructuring of sovereign debt relies on practices, policies and initiatives of key players, including the IMF, the Paris Club and the G20, supplemented by the adoption of contractual enhancements by private sector investors. This existing approach has to date been evolutionary in nature in the sense that it responds to challenges as they arise. Recent innovations include the IMF's 2021 General SDR allocation, the Debt Service Suspension Initiative ('DSSI') and the Common Framework for debt treatments beyond the DSSI (the 'Common Framework') in response to the Covid-19 pandemic and the creation of the Global Sovereign Debt Roundtable. Innovations in contractual provisions in respect of private sector claims have typically involved the Institute of International Finance ('IIF') (not least as the secretariat of the IIF Principles for Stable Capital Flows and Fair Debt Restructuring) and the International Capital Market Association ('ICMA') and the result has in recent years included the development of template: enhanced aggregated collective action clauses ('CACs') for inclusion in sovereign bonds; a new pari passu provision which clarifies that the rateable payment interpretation of the pari passu clause does not apply, for inclusion in sovereign bonds and loans, and; majority voting provisions ('MVPs') for inclusion in sovereign loans; as well as work in the area of catastrophe resilient debt clauses ('CRDCs') to provide protection for sovereign debtors exposed to the risks of natural disasters and/or pandemics; and the publication of the IIF's Voluntary Principles for Debt Transparency and the implementation thereof with the OECD as information repository. It is unclear how the Sovereign Debt Stability Bill will fit with these existing practices, policies and initiatives (which are loosely referred to as the 'Existing International Financial Architecture') and, given the significance of New York law and the New York courts in the field of existing private sector emerging market sovereign debt claims, the impact of enactment of the Sovereign Debt Stability Bill could be profound.

Limited Consultation with Stakeholders: If enacted the Sovereign Debt Stability Bill would have a very significant impact on the incentives associated with, and the process of dealing with, sovereign debt restructurings. A consultation process allows both a technical review and the evaluation of potential unintended consequences to be undertaken. Under the Existing International Financial Architecture it has become customary for there to be market consultations with varying degrees of formality in respect of proposed significant initiatives in the field of sovereign debt restructurings. Valuable insights are typically obtained including, for example, any pricing implications for new debt raisings following a new policy initiative, which would potentially affect the debt sustainability of debtor countries through increased debt servicing costs or loss of market access more rapidly than might otherwise have been the case. In this context the potential impact on the trading of existing sovereign debt would also typically be considered. Further, credit rating agency implications and the risk of accelerated sell offs have also been taken into consideration in developing policy in this area. Useful insights into likely moves away from the use of New York Law and the New York Courts would also be valuable. Some mapping of the sequencing between the processes included in the Sovereign Debt Stability Bill and the role of the IMF and the Paris Club as well as the Common Framework and their respective norms and practices would assist understanding among stakeholders.

Retroactive Impact and US Policy Implications: The Sovereign Debt Stability Bill, if enacted and applicable, will vary existing contractual rights if a debtor state with unsustainable debt files a petition with the State of New York. Sovereign debtors issuing under New York law, creditors and other market participants will want to understand the constitutional underpinnings of the legislation. Also, historically in broad terms, the US Federal Government position, where the debts owed by foreign sovereigns are unsustainable, has been to promote voluntary creditor participation through negotiation and both sovereign debtors and creditors will expect negotiations to continue to be at the heart of sovereign debt restructurings. The Sovereign Debt Stability Bill may also have implications for US foreign relations.

The Sovereign Debtor's Plan vs the IMF's Debt Sustainability Analysis ('DSA'): Under the Existing International Financial Architecture, the IMF's DSA is the key ingredient around which debt relief negotiations occur, where the sovereign debtor has an applicable IMF-supported Program. As a petition from a sovereign debtor under the Sovereign Debt Stability Bill requires the sovereign debtor to certify that it is cooperating with the IMF to devise an effective, efficient, timely and fair path back to sustainability, for these purposes we take that as being the functional equivalent of requiring that the sovereign debtor has such an applicable IMF-supported Program. However, it is the sovereign debtor's plan which triggers the voting procedures under the Sovereign Debt Stability Bill, rather than the IMF's DSA. This is likely to materially affect one key element of the balance of incentives effectively associated with the Existing International Financial Architecture.

Preferred Creditor Status Built into the IMF's DSA: Under the Existing International Financial Architecture, certain types of creditor enjoy Preferred Creditor Status ('PCS') which in essence means that the burden of payment adjustment in respect of the claims of a sovereign debtor does not fall on the claims owed by that sovereign debtor to those institutions enjoying PCS. The IMF and the World Bank enjoy PCS, as do many multilateral development banks, such as in Inter-American Development Bank, the Asian Development Bank and the African Development Bank. The US is a significant shareholder in all of those institutions. The pricing and other terms of the loans made to members by these institutions are made on the assumption that PCS will be respected. The credit ratings of debt instruments issued to fund the operations of these institutions similarly assume that PCS will be respected. PCS is currently built into the IMF's DSA. The sovereign debtor's plan will not necessarily include PCS and the potential ramifications in the areas of: (i) the pricing and other terms of the loans made by institutions currently enjoying PCS to sovereign debtors, (ii) the robustness of the balance sheets of these institutions, and (iii) the credit ratings of the debt raisings by these institutions could be negative for the shareholders in these institutions and sovereign borrowers.

Other Typically Excluded Debt Claims: Generally, the payment terms of short term trade debt tend not to be revisited and this is effectively excluded from the scope of the restructuring in the Sovereign Debt Stability Bill. However, there are other typical exclusions (such as secured debts) which are not built into the Sovereign Debt Stability Bill. In practice these other exclusions are adopted for good commercial reasons (e.g. to keep certain types of debt finance flowing). Typically, in practice, the majority of the burden of payment adjustment falls on official sector debt and private sector debt which, in each case, does not fall within a generally excluded category (in other words, it is not short term and it is unsecured). The existing system is however sufficiently flexible to allow a case by case approach under which, in unusual circumstances, there may be deviations from these generally accepted norms.

The Potential for Multiple Debtor Elections*:* Under section 222 of the Sovereign Debt Stability Bill, the sovereign debtor now has considerable flexibility in respect of which debt claims are to be covered by the new restructuring mechanism (so called section 223 claims) on the one hand or to be covered by the limitation on recoveries by reference to the recovery level of the US itself (if it had held the debt claim) under an applicable international initiative (so called section 230 claims) on the other hand. For these purposes a distinction is drawn between debt claims which 'are governed by New York Law' (which is required for the purposes of section 223 claims) and those which 'are… enforced under New York law' (which is required for the purposes of section 230 claims). The sovereign debtor may change those choices once in the period before a plan becomes effective. More fundamentally (i) the sovereign debtor can decide which debt claims to include for these purposes (thereby allowing any debtor preferences to be pursued) and (ii) the distinction between governing law and enforcement under New York law may give rise to ambiguities in practice. Under the Existing International Financial Architecture, the evaluations associated with which debt claims to include are made under the aegis of the IMF and the so called 'debt perimeter' is selected after careful review of potential implications with the overall necessity of filling projected financing gaps in relevant Program years and so seeking to ensure overall debt sustainability.

Seniority of New Money vs PCS for IMF Lending: As mentioned in the Overview on page 2, under the Sovereign Debt Stability Bill, new money is to be legally senior to other claims. This is dealt with in sections 227 and 228 of the Sovereign Debt Stability Bill and is subject to a majority vote of creditors. It is difficult to reconcile the seniority of new money with PCS. As mentioned earlier (see "*Preferred Creditor Status built into the IMF's DSA*") there would be severe consequences associated with the loss of PCS for the institutions which currently enjoy it. The points made in that paragraph stem from the risk that the debtor state's plan is used instead of the IMF's DSA (in which in practice PCS is typically inherent). There is, however, a separate concern associated with IMF lending under the Existing International Financial Architecture and the contemplated legal seniority of new money under the Sovereign Debt Stability Bill. One of the key purposes of the IMF under its Articles is to lend to countries experiencing balance of payments problems and that stated purpose is expressly subject to adequate safeguards. In practice this IMF lending is often at the point where other stakeholders have stopped lending. In broad terms, to meet the adequate safeguards requirement the IMF itself needs to take steps designed to protect its lending. For the IMF and its members PCS is fundamentally important. It is a critical ingredient in the protection of IMF lending. A structure under which, through a general vote of creditors of a debtor state, new money advanced as part of the restructuring process from other lenders would be repaid 'prior to paying any other claims' under sub section 1 of section 228 of the Sovereign Debt Stability Bill would have a radical impact on the ability of the IMF to provide balance of payments support in accordance with its existing policies and practices.

Risk of Delays and Litigation Caused by Uncertainty: The Sovereign Debt Stability Bill would, most likely, have a major impact in the field of restructuring sovereign debt and would materially alter existing practices and incentives. It also leaves many important questions of detail unanswered, not least as to the role and scope of any appointed independent monitor, referee or special master, which could potentially lead to market uncertainty and unintended consequences for debtor states as well as other relevant stakeholders. One almost inevitable consequence, particularly if the Bill is enacted without taking into account feedback resulting from a well-run and comprehensive consultation process, could be an increase in delays and/or litigation.

Other Technical Drafting points: Our May 2023 client briefing covers other technical drafting points under the headings of Comprehensive Approach to Sovereign Debt Restructuring through New Article 7 of the New York Banking Law – Assembly Bill A2102A (starting on page 6 thereof) and Limit on Recovery on Sovereign Claims (starting on page 14 thereof). Note in the previous iteration, Article 7 rather than Article 8 of the New York Banking Law was to be used to implement the new approach to sovereign debt restructuring.

For a description of the approach to limiting recoveries by reference to the recovery level of the US itself (if it had held the debt claim) under an applicable international initiative please see our May 2023 client briefing under the heading Limit on Recovery on Sovereign Claims (starting on page 14 thereof).

Limitation on Recoveries under the UK Debt Relief (Developing Countries) Act 2010

Comparison with UK Statute: We also understand that decisions associated with seeking to promote the Sovereign Debt Stability Bill in the New York Assembly have been influenced in part by perceptions associated with the UK's Debt Relief (Developing Countries) Act 2010 (the 'UK HIPC Act'). It may therefore be helpful to set out a brief review of both the UK HIPC Act itself and the circumstances which gave rise to its enactment.

Overall Purpose of the UK HIPC Act: English law, like New York law, is widely used in the sovereign debt markets. The UK decided to legislate to assist only in the implementation of the heavily indebted poor country ('HIPC') initiative. It is therefore instructive to start with a review of the HIPC Initiative.

The HIPC Initiative and Loss of Preferred Creditor Status: The HIPC Initiative was launched by the World Bank and the International Monetary Fund in 1996 and was supplemented by two international agreements in 1999 and 2005. The 1999 Enhanced HIPC Initiative was designed to provide faster, deeper and broader debt relief, and required HIPCs to introduce measures designed to reduce poverty. The 2005 Multilateral Debt Relief Initiative was agreed at the G8 2005 Gleneagles summit and in broad terms provided for up to 100% cancellation of IMF, World Bank and African Development Bank claims for countries completing the HIPC Initiative. This is particularly noteworthy because these institutions enjoy PCS under the Existing International Financial Architecture.

Countries Benefitting from the HIPC Initiative: In a nutshell, the HIPC Initiative aimed to provide debt relief to a list of close to forty of the world's poorest countries. These countries had both high levels of poverty and unmanageable levels of debt. To be eligible, a HIPC country needed to demonstrate to the World Bank and the IMF that it had a poverty reduction plan and sound economic management policies so that savings from debt relief would be directed towards development and reducing poverty. When this point was reached (the Decision Point) the World Bank and the IMF agreed triggers with the country that the country had to meet in order to complete the HIPC Initiative and also to set a level of debt reduction (the Common Reduction Factor) required of all creditors in order to return that country's debts to a sustainable level.

Levels of Debt Relief: The Common Reduction Factor was applied on top of the traditional 67% debt relief considered necessary for HIPCs, and aggregate debt reduction in excess of 90% was usual. When a HIPC country had followed the poverty reduction plan for at least a year and met the reform triggers agreed with the IMF, typically it arrived at Completion Point. At Completion Point, all creditors, whether multilateral (such as the World Bank), bilateral (such as the governments constituting the permanent members of the Paris Club) or commercial were expected voluntarily to cancel their debt to the extent of the Common Reduction Factor in order to achieve debt sustainability for the HIPC. Many creditors, including commercial creditors, participated fully through, for example, the World Bank's Debt Reduction Facility, which funded (often with donor money) debt buy backs at very steep discounts to reflect the debt reduction required. Some multilateral and bilateral creditors went further by cancelling the entire amount of their HIPC debt.

So Why Did the UK Decide to Legislate?: Not all commercial creditors chose to participate in the HIPC Initiative. Some sought to claim the full amount of the debt or sell their claims to others. There were cases of non-participating commercial creditors pursuing their claims through litigation. The cases of Donegal v Zambia in 2007 and Hamsah Investments v Liberia in 2009, involved debt acquired for speculative purposes at a steep discount on the secondary markets. They caused alarm in the public sector because of their real and practical potential to limit the intended effects of the HIPC Initiative in reducing poverty in circumstances where effectively taxpayers/shareholders in developed economies had been exposed to losses through those institutions which enjoy PCS writing off their claims in order to assist in achieving poverty reduction in HIPC countries.

Objectives of the UK HIPC Act: In broad terms, the UK Government's objective was to ensure that funds given to HIPCs by multilateral or government entities through debt relief should not be diverted to litigating creditors instead of being used in the country's poverty reduction programme or to meet its development needs. In terms of specifics, the objective was to limit the recoveries that commercial creditors were able to make through litigation against HIPCs by not allowing commercial creditors to recover under UK law or in UK courts any proportion of their debt in excess of the sustainable level set by the HIPC Initiative. The UK Government also took the view that commercial creditors would be deterred from participating in the HIPC Initiative if non-participating creditors were able to profit through litigation.

Main Features of the UK HIPC Act: The debt affected by UK HIPC Act is only the debt eligible for relief under the HIPC Initiative. It is also limited to HIPC debt incurred prior to a HIPC's Decision Point and prior to the commencement of the UK HIPC Act. Any HIPC debt incurred between Decision Point and commencement is not covered. "Qualifying debt" is restricted only to a known and identifiable stock of historic debt. In practice the overwhelming majority of this debt had been in arrears for many years. Further, the UK HIPC Act had no meaningful impact in practice on the sovereign Eurobond market. We are aware of only one instance in which a HIPC had issued Eurobonds before the HIPC Decision Point. The country in question was Ivory Coast and the relevant bonds were Brady Bonds issued in 1998 as part of a broad debt reduction package for the country. The Brady Bonds were governed by New York law and, following Decision Point for the Ivory Coast in April 2010, were exchanged for new Eurobonds. There is no distinction in the UK HIPC Act between HIPC debt still held by the original creditor and HIPC debt that has been traded on the secondary markets. In addition to changing the terms of existing contracts by reducing the recoverable amount on due debts, the UK HIPC Act also applies the same reduction to qualifying debts on which judgment has been obtained but not yet enforced. In other words, past judgments and arbitral awards that have not yet been enforced will be retrospectively reduced on enforcement in the English courts.

Cross Border Elements: The UK HIPC Act naturally raises some cross border issues. Clause 3(8) of the Act provides that qualifying debt includes HIPC debt governed by foreign law as well as English law. However, the effect of this may be minimal as a claimant would, as a result, be unlikely to choose the English courts as the dispute forum of a foreign law HIPC debt claim. Further, the judgments that must be reduced under the UK HIPC Act upon enforcement are not just English judgments but also foreign judgments and arbitral awards. HM Treasury sought to justify extending the UK HIPC Act to the enforcement of foreign judgments and awards in the English courts on public policy grounds. The legislation provides that if the enforcement treaty between the UK and the relevant country requires enforcement in full, notwithstanding public policy grounds, then the foreign judgment or arbitral award will fall outside the UK HIPC Act.

Debtor Conduct Safeguard: To encourage HIPCs to settle claims on HIPC Initiative terms, the UK HIPC Act excludes from its application qualifying debt in respect of which a HIPC has not offered to compromise on HIPC Initiative terms before the "relevant time" after the commencement of "proceedings" by the creditor (clause 6) (except where the relevant time occurred prior to commencement of the legislation). "Proceedings" includes proceedings for the registration of a foreign judgment or arbitral award and for permission to enforce an arbitration award in the same manner as a court judgment; it does not include enforcement proceedings. "Relevant time" is the date of judgment or when the foreign judgment or arbitration award is registered or permission to enforce an arbitration award in the same manner as a court judgment is given. In addition, no HIPC can recover from a creditor an amount of qualifying debt already repaid by it (clause 8).

Duration, Process and Overall Summary: The UK HIPC Act is specific only: (i) to HIPCs (i.e. the world's poorest countries), (ii) a known and quantifiable stock of historic debt, and (iii) debts captured by the HIPC Initiative, which was a broadly based and supported international initiative under which institutions which enjoy PCS nevertheless significantly wrote down or wrote off their debt claims in order to support poverty reduction in the closed list of HIPCs. The UK HIPC Act limits recoveries to those available under the HIPC Initiative. The UK HIPC Act was the subject of consultation before enactment and was initially implemented for one year only to allow an assessment to be made as to any unwelcome unforeseen consequences before it was made permanent. Further, there was no meaningful impact of the HIPC Act on sovereign bond issuances in the international capital markets. It was therefore highly focussed and enacted in exceptional circumstances to seek to ensure that a once in a generation debt forgiveness process to assist in poverty reduction was not derailed.

If the G20 were to now feel that the Common Framework should benefit from a supporting statutory regime in multiple countries on a coordinated basis under which recoveries on sovereign debt claims were to be limited by reference to the Common Framework or similar international initiatives then the Global Sovereign Debt Roundtable among the G20 countries, the Paris Club, the IMF and the World Bank, among others, would be a natural forum for its evaluation and could assist in ensuring a coordinated approach.

We understand that certain members of the New York Assembly were keen to promote a new Bill relating to champerty so as to seek to close any perceived advantages for debtor states as between English law and New York Law in the area of champerty. We therefore set out below a brief review of English law champerty rules as they apply in the context of sovereign debt claims.

Champerty Under English Law

What is Champerty?: Under English law champerty is best understood by reference to the linked legal concept of maintenance. Maintenance occurs where a person, without just cause or excuse, supports litigation in which they have no legitimate interest. Champerty can be described as maintenance with the added factor of an entitlement to a share of the proceeds of that litigation. Laws under which champerty and maintenance were illegal have a long history and the rules relating to them have narrowed in scope over time. The remaining residual rules are now generally linked to attempting to limit the trafficking of litigation claims stemming from concerns associated with taking up excessive amounts of time in the courts and so can be best thought of as seeking to eliminate an abuse of process of the court.

Limiting the Impact of Champerty: Under English law there have been many steps taken over time which limit the relevance of maintenance and champerty in various areas of the law. For example, maintenance and champerty were previously torts and crimes but the Criminal Law Act 1967 abolished the torts and crimes of maintenance and champerty but preserved any rule or law under which a contract is contrary to public policy or illegal. Further, as the benefits of contingency fee structures in litigation in the English Courts became appreciated, legislation has been enacted which provides that, in most instances, such well structured arrangements are valid and enforceable, thus reflecting an evolution in public policy in this area.

Trading Sovereign Debt Claims and English Case Law: Under English law the trading of debt claims is regulated by statute. This extends to sovereign debt claims. There have been no statutory approaches under English law to limit champerty and maintenance in the field of the trading of debt claims generally, or sovereign debt claims in particular, and consequently there are no ‘safe harbours’ of the type set out in subdivision 2 of Section 489 of the New York Judiciary Law. However, the English law rules on champerty and maintenance in the context of the sale and purchase of sovereign debt were helpfully clarified in the Court of Appeal case of Camdex International Ltd v Bank of Zambia 1998. One key part of the judgment reads:

"*An assignment of debt is not invalid even if the necessity for litigation to recover it is contemplated. Provided that there is a bona fide debt, it does not become unassignable merely because the debtor chooses to dispute it. Suing on an assigned debt is not contrary to public policy even if the assignor retains an interest. What is contrary to public policy and ineffective is an agreement which has maintenance or champerty as its object; such a consequence will not be avoided by dressing up a transaction which has that character and intent as an assignment of a debt. But, because the assignment of a debt itself includes no element of maintenance and is sanctioned by statute, any objectionable element alleged to invalidate the assignment has to be proved independently and distinctly in the same way as any other alleged illegality has to be proved in relation to a contract which is on its face valid*".

The Practical Impact of the Residual Rules against Champerty and Maintenance in the Field of Sovereign Debt Claims: A simple purchase of sovereign debt claims without any other complexities (e.g. a distressed debt fund purchases sovereign debt at a steep discount for its own account) would almost certainly not be capable of being set aside in the English Courts on champerty or maintenance grounds. The only remaining circumstances in which maintenance or champerty has any relevance in this context would be where the sovereign debtor as plaintiff was able to prove that the purchase of the debt had maintenance or champerty as its object and the structuring of the transaction as a purchase of debt was designed to hide this purpose. The required fact pattern here would be highly unusual. At the very least it would need to include the involvement (and support in the litigation) of parties other than the creditor and the sovereign debtor and convincing evidence that the debt purchase was effectively a sham designed to disguise the intent of maintenance or champerty.

Key Conclusion: Simple purchases of sovereign debt claims, such as the deeply discounted purchase of sovereign debt by a distressed debt fund for its own account, would almost certainly not be capable of being set aside in the English Courts on champerty or maintenance grounds.

The Sovereign Debt Stability Bill does not seek to amend New York law on champerty. It remains to be seen if the previous Bills in the New York Legislature on champerty will be made active again in the same or an amended form.

We also understand that some New York policymakers are aware of the recent consideration of issues in the field of sovereign debt by a committee of the UK Parliament. Recent activity in this area is described below.

UK House of Commons International Development Committee Report on Debt Relief in Low-Income Countries and the UK Government's Response

Overall Context: In discussions associated with sovereign debt restructuring generally, the above UK House of Commons International Development Committee report published in March 2023 is noteworthy.

Similarly noteworthy is the UK Government's response to that report.

As will be seen, this UK Government response demonstrates no desire of the UK Government to legislate again in this area.

This report reviewed the broad area of international development for low-income countries and contained recommendations to government. Among the main recommendations made in the report was the following (note the reference below to the 'MDRI' is to the Multilateral Debt Relief Initiative introduced in 2005 which, broadly, resulted in the cancellation of up to 100% of the claims of the IMF, the International Development Association of the World Bank and the African Development Fund on countries that reached completion point under the enhanced Initiative for HIPC countries):

"The HIPC, the MDRI, the DSSI and the Common Framework were all undermined by the inability to compel or incentivise private creditors to participate. A legislative solution is required to enable the Common Framework to provide a meaningful way to address this. The UK Government's view on the relative merits of market-based solutions compared with legislative options is currently unclear. The UK Government should consult on the introduction of legislation to compel or incentivise participation of private creditors in the Common Framework, such as those proposed by the World Bank.

This should include proposals either:

a) to prevent low-income countries facing debt distress from being sued by private creditors for a sum greater than that those creditors would have received had they participated in the Common Framework; or

b) to make debt restructuring agreements binding for all private creditors, if the agreement is supported by at least two-thirds of private creditors. (Paragraph 62).

As New York and English law comprise the two major legal jurisdictions covering international debt agreements, the UK and New York have the potential to significantly improve private creditor participation in debt relief initiatives globally, particularly if these efforts are co-ordinated. We recommend that the UK Government engages in bilateral talks with New York law makers to explore the scope for co-operation in legislative approaches. (Paragraph 63)." [Recommendation 5].

The UK Government's response to Recommendation 5: The full response of the UK Government is set out below:

"***Reject***

There has been a significant increase in the volume of private sector lending to low-income countries in the last decade. The scale of privately held debt makes it clear that we need to address the role of private sector creditors, while we continue to make progress on other aspects of the debt agenda.

The Government is committed to ensuring that private sector creditors participate in debt restructurings on comparable terms. We have been working with the private sector on several areas of their participation in debt treatments, including under the Common Framework.

First, the UK, through HM Treasury, has ongoing engagement with private sector stakeholders, including through bilateral meetings, through representative institutions such as the Institute of International Finance (IIF) and ICMA, through regular engagements that take place between the Paris Club, of which we are a member, and the membership of the IIF, and now through the new Global Sovereign Debt Roundtable, to discuss debt issues including comparable treatment.

Second, the G20 and Paris Club have set out as a fundamental principle under the Common Framework that private creditors are expected to participate on at least as favourable terms as bilateral creditors. The UK has *repeatedly emphasised the importance of this principle and we are committed to making it work. The IMF and Paris Club Secretariat work with countries to engage with all their creditors, including those in the private sector, to seek such debt restructuring, and we welcome this. We note that private creditors agreed to a debt treatment for Chad, the first Common Framework debt treatment to conclude.*

Third, government has focussed on enhancing market-based (also known as contractual) solutions to private sector participation in debt restructurings. While the IMF noted in its 2020 report the architecture governing privately held debt has been working well in recent years, including with the wide adoption of enhanced Collective Action Clauses in sovereign bonds, which reduce creditor holdouts. The IMF also identified some areas for improvement. To make progress on addressing these areas, the UK established a Private Sector Working Group (PSWG) under its G7 Presidency in 2021 to explore improvements to the international architecture governing sovereign debt, specifically concerning how the private sector lends and restructures its debt. The group–which brought together a range of IFIs, private sector and academic stakeholders, official bilateral creditors, and borrowing countries–looked at one particular reform designed to enhance creditor participation and inter-creditor equity in debt restructurings - Majority Voting Provisions (MVPs) for syndicated lending contracts. MVPs allow a majority of creditors to bind a minority to the terms of a restructuring, thus reducing the power of holdout creditors, supporting orderly market functioning, and increasing the speed and efficiency of restructurings for debtor countries. As a result of the Group's work, specimen clauses have been published by major industry bodies and loan market associations. We are now working closely with the IMF and others to promote and ensure the wide take-up of these contractual innovations in new syndicated lending.

At this time, the government is focussed on the approach set out above rather than on a legislative approach, which would be complex and could have unintended consequences in terms of access to finance for developing countries."

Recommendation to Engage with New York Assembly Members: A further recommendation to the UK Government in the report is as follows:

We recommend that the UK Government engages in bilateral talks with New York law makers to explore the scope for co-operation in legislative approaches. [Recommendation 6].

The UK Government's response to Recommendation 6**:** The full response of the UK Government is set out below:

"***Reject***

The UK Government regularly engages the US Government on the full range of international debt issues, including on private sector participation in sovereign debt restructurings. As set out in the previous answers, the Government is currently focussed on ensuring CRDCs and MVPs are adopted in future lending contracts and continues to engage the US on this issue."

It therefore seems reasonable to conclude that any legislative steps taken by the New York Legislature in the sovereign debt field would not currently be matched by changes to English law.

Conclusion

We would anticipate that the overwhelming majority of the issues covered in this client briefing and our May 2023 client briefing, where relevant, would be raised for further discussion among relevant stakeholders following a broadly based and well run consultation process. Given the very significant impact in the area of incentives and the lack of clarity as to how the Sovereign Debt Stability Bill will sit with the Existing International Financial Architecture, such a consultation process would be most valuable.

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This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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STATE OF NEW YORK

5542--A

2023-2024 Regular Sessions

IN SENATE

March 8, 2023

Introduced by Sens. RIVERA, BRISPORT, CLEARE, COMRIE, GIANARIS, HOYLMAN-SIGAL, KRUEGER, MYRIE, RAMOS, SALAZAR, SANDERS -- read twice and ordered printed, and when printed to be committed to the Committee on Banks -- recommitted to the Committee on Banks in accordance with Senate Rule 6, sec. 8 -- committee discharged, bill amended, ordered reprinted as amended and recommitted to said committee

AN ACT to amend the debtor and creditor law, in relation to restructuring unsustainable sovereign and subnational debt

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Short title. This act shall be known and may be cited as the "sovereign debt stability act".

§ 2. The debtor and creditor law is amended by adding a new article 8 to read as follows:

ARTICLE 8

SOVEREIGN AND SUBNATIONAL DEBT

Section 220. Legislative intent.
221. Definitions.
222. Election to be covered by the provisions of this article.
223. Petition for relief; recognition.
224. Notification of creditors.
225. Debt reconciliation.
226. Submission, contents and voting on plan.
227. Financing the restructuring.
228. Priority of repayment.
229. Adjudication of disputes.
230. Recoverability of section 230 claims.
231. Application; opt in.
232. Severability.

§ 220. Legislative intent. The legislature finds that it is a long-standing policy of the United States and the state of New York, as the

EXPLANATION--Matter in italics (underscored) is new; matter in brackets [-] is old law to be omitted.

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world's leading financial center, to support orderly, collaborative and effective international sovereign debt relief for countries with unsustainable levels of debt. Debt distress, debt crises, and disorderly default are associated with unacceptable human suffering, economic decline, and financial market and payment systems disruption. Moreover, debt restructuring is ineffective and does not lead to sustainable outcomes when it is not perceived as equitable or legitimate by stakeholders in borrowing and lending countries. Additionally, public creditors are unlikely to participate in debt restructuring initiatives unless there is fair burden sharing among all public and private creditors, which is essential to the legitimacy and effectiveness of debt relief initiatives. Therefore, the legislature finds and declares that it shall be the policy of New York state to support international debt relief initiatives for countries to ensure that the cost of such debt relief is allocated in a fair and equitable manner, and that such costs do not fall disproportionately on the residents and taxpayers of New York state, and for other purposes. The purpose of this article is to provide effective mechanisms for restructuring sovereign and subnational debt so as to:

1. reduce the social costs of sovereign and subnational debt crises to residents of New York state;

2. reduce systemic risk to the financial system, a system that is concentrated in New York state;

3. reduce creditor uncertainty, including to the numerous holders of sovereign debt that are residents in New York state;

4. strengthen the role of New York state as a primary location for the issuing and trading of sovereign debt;

5. reduce the need for sovereign and subnational debt bailouts, which create moral hazard and are costly to residents of New York state;

6. otherwise protect economic activity within New York state's borders, by reducing the likelihood of a sovereign debt default which could adversely impact New York state's economy;

7. reduce, out of universal human rights and humanitarian imperatives, the social cost of unresolved sovereign debt crises imposed on the people of nations with unsustainable debt, especially the poorest among them, taking due account of creditor rights; and

8. enable debtor states to choose a debt restructuring option that appropriately suits its circumstances and needs.

§ 221. Definitions. For purposes of this article:

1. "creditor" means a person or entity that has a claim against a debtor state;

2. "claim" means a payment claim against a debtor state for monies borrowed or for the debtor state's guarantee of, or other contingent obligation on, monies borrowed; the term "monies borrowed" shall include the following, whether or not it represents the borrowing of money: monies owing under bonds; debentures; notes, or similar instruments of original maturity of at least one year; monies owing for the deferred purchase price of property or services, other than trade accounts payable arising in the ordinary course of government operations; monies owing on capitalized lease obligations; monies owing on or with respect to letters of credit, bankers' acceptances, or other extensions of credit of original maturity of at least one year;

3. "plan" means a debt restructuring plan pursuant to section two hundred twenty-six of this article;

4. "debtor state" means a sovereign nation; or unincorporated territory; or any subnational unit thereof, excluding any municipality whose adjustment or debts is governed by 11 U.S.C. 9;

5. "independent monitor" means an individual appointed by the governor, in consultation with the United States department of the treasury, acceptable to the sovereign debtor and to the holders, or their agents, of a majority of the obligations issued under New York law. The independent monitor is meant to facilitate and encourage an effective, prompt and fair agreement by the parties, as intended by this article. The debtor state shall pay the independent monitor's reasonable costs and expenses;

6. "international initiative" means any mechanism, framework or initiative in which the United States government and other sovereign states have engaged with international financial institutions and official and commercial creditors to advance the implementation and improvement of prompt and effective debt relief among eligible states, including but not limited to the Heavily Indebted Poor Countries Initiative of the International Monetary Fund and the World Bank, the Debt Service Suspension Initiative of the Group of 20, the Common Framework for Debt Treatments beyond the DSSI, also known as the "Common Framework", the Paris Club, and any successor or similar international mechanism, framework or initiatives;

7. "eligible claim" shall mean a claim as defined in subdivision two of this section and any judicial or other official domestic or foreign judgment with respect to such a claim against an eligible state participating in one or more of the international initiatives;

8. "eligible state" shall mean a sovereign state eligible to participate in one or more of the international initiatives;

9. "burden-sharing standards" shall mean standards set by the relevant international initiative or international initiatives for equitable burden-sharing among all creditors with material claims on each participating debtor without regard for their official, private, or hybrid status;

10. "section 223 claim" shall mean, as applicable, a claim with respect to which the debtor state has elected for its claims to be covered by section two hundred twenty-three through section two hundred twenty-nine of this article; and

11. "section 230 claim" shall mean an eligible claim with respect to which the debtor state issuing such claim has elected to be covered by section two hundred thirty of this article, and not to be covered by section two hundred twenty-three through section two hundred twenty-nine of this article inclusive.

§ 222. Election to be covered by the provisions of this article. 1. Any debtor state against which there are one or more claims governed by or enforced under New York law shall have the option to apply the provisions of this article to such claims by filing a notice thereof with the state of New York. In such notice, the debtor state shall choose whether those claims shall, to the extent governed by New York law, be covered as section 223 claims or, to the extent enforced under New York law, as section 230 claims. Within thirty days after giving such notice, the debtor state shall notify the holders of such claims and the state of New York of its choice. In the case of a choice to have those claims be covered as a section 223 claim, the debtor state shall also make the certifications specified in subdivision two of section two hundred twenty-three of this article. Any waiver of the provisions of this subdivision shall be ineffective.

2. A debtor state that makes a choice under subdivision one of this section shall have the right to change that choice once, at any time prior to a plan becoming effective and binding on the debtor state and its creditors, by notifying the state of New York and the holders of all claims affected by that choice.

§ 223. Petition for relief; recognition. 1. The notification under section two hundred twenty-two of this article that claims against a debtor state shall be covered as a section 223 claim shall constitute a voluntary petition for relief with the state of New York.

2. Such notice shall certify that the debtor state:

(a) seeks relief as a section 223 claim under this article, and has not previously sought relief under this article, or under any other law that is substantially in the form of this article, during the past five years;

(b) needs relief as a section 223 claim under this article to restructure claims that, absent such relief, would constitute unsustainable debt of the debtor state;

(c) agrees to restructure those claims in accordance with this section through section two hundred twenty-nine of this article;

(d) agrees to all other terms, conditions and provisions of this section through section two hundred twenty-nine of this article;

(e) has duly enacted any national or subnational law needed to effectuate these agreements. If requested by the independent monitor, such petition shall also attach documents and legal opinions evidencing compliance with this subdivision; and

(f) is cooperating with the International Monetary Fund to devise an effective, efficient, timely and fair path back to sustainability.

3. Immediately after such a petition for relief has been filed, and so long as such filing has not been dismissed by the independent monitor for lack of good faith or the debtor state has not changed its choice under subdivision two of section two hundred twenty-two of this article to have its claims covered by section two hundred thirty of this article, the terms, conditions, and provisions of this article shall:

(a) apply to the debtor-creditor relationship between the debtor state and its creditors to the extent such relationship is governed by the law of this jurisdiction;

(b) apply to the debtor-creditor relationship between the debtor state and its creditors to the extent such relationship is governed by the law of another jurisdiction that has enacted law substantially in the form of this article; and

(c) be recognized in, and by, all other jurisdictions that have enacted law substantially in the form of this article.

§ 224. Notification of creditors. 1. Within thirty days after filing its petition for relief, the debtor state shall notify all of its known creditors of its intention to negotiate a plan under section two hundred twenty-three through section two hundred twenty-nine of this article.

2. The independent monitor shall prepare and maintain a current list of creditors of the debtor state and verify claims for the purposes of supervising voting under section two hundred twenty-three through section two hundred twenty-nine of this article.

§ 225. Debt reconciliation. The creditor claims shall be reconciled against debtor records and any discrepancies shall be addressed between the parties.

§ 226. Submission, contents and voting on plan. 1. The debtor state may submit a plan to its creditors at any time, and may submit alternative plans from time to time.

2. No other person or entity may submit a plan on behalf of the debtor state.

3. A plan shall:

(a) designate classes of claims in accordance with subdivision six of this section;

(b) specify the proposed treatment of each class of claims;

(c) provide the same treatment for each claim of a particular class, unless the holder of a claim agrees to a less favorable treatment;

(d) disclose any claims not included in the plan's classes of claims;

(e) provide adequate means for the plan's implementation including, with respect to any claims, curing or waiving any defaults or changing the maturity dates, principal amount, interest rate, or other terms or canceling or modifying any liens or encumbrances; and

(f) certify that, if the plan becomes effective and binding on the debtor state and its creditors under subdivision four of this section, the debtor state's debt will become sustainable.

4. A plan shall become effective and binding on the debtor state and its creditors when it has been submitted by the debtor state and agreed to by each class of such creditors' claims designated in the plan under subdivision three of this section. Thereupon, the debtor state shall be discharged from all claims included in those classes of claims, except as provided in the plan.

5. A class of claims has agreed to a plan if creditors holding at least two-thirds in amount and more than one-half in number of the claims of such class voting on such plan agree to the plan, without counting claims owned by the debtor state or entities it controls.

6. Each class of claims shall consist of claims against the debtor state that are equal in priority, provided that:

(a) equal priority claims need not all be included in the same class;

(b) claims of governmental or multi-governmental entities holding claims each shall be classed separately;

(c) claims that are governed by this article or the law of another jurisdiction that is substantially in the form of this article shall not be classed with other claims; and

(d) the fact that a claim arises under, or is supported or evidenced by, a judicial or other official domestic or foreign judgment shall not in and of itself mean that such claim is not equal in priority to other claims.

§ 227. Financing the restructuring. 1. Subject to subdivision three of this section the debtor state shall have the right to borrow money on such terms and conditions as it deems appropriate.

2. The debtor state shall notify all of its known creditors of its intention to borrow under subdivision one of this section, the terms and conditions of the borrowing, and the proposed use of the loan proceeds. Such notice shall also direct those creditors to respond to the independent monitor within thirty days as to whether they approve or disapprove of such loan.

3. Any such loan shall be approved by creditors holding at least two-thirds in amount of the claims of creditors responding to the independent monitor within that thirty-day period.

4. In order for the priority of repayment, and corresponding subordination, under section two hundred twenty-eight of this article to be effective, any such loan shall additionally be approved by creditors holding at least two-thirds in principal amount of the covered claims of the creditors responding to the independent monitor within that thirty-day period. Claims shall be deemed to be covered if they are governed by

this article or by the law of another jurisdiction that is substantially in the form of this article.

§ 228. Priority of repayment. 1. The debtor state shall repay loans approved under section two hundred twenty-seven of this article prior to paying any other claims.

2. The claims of creditors of the debtor state are subordinated to the extent needed to effectuate the priority payment under this section. Such claims are not subordinated for any other purpose.

3. The priority of payment, and corresponding subordination, under this section is expressly subject to the approval by creditors under subdivision four of section two hundred twenty-seven of this article.

§ 229. Adjudication of disputes. The independent monitor may request that a court of competent jurisdiction appoint a referee or a special master to make recommendations to the court regarding the resolution of any disputes arising under a section 223 claim under this article.

§ 230. Recoverability of section 230 claims. Any section 230 claim incurred prior to the date of an eligible state's application to participate in one or more international initiatives shall only be recoverable:

1. to the extent that it comports with burden-sharing standards;

2. provided it meets robust disclosure standards, including intercreditor data sharing and a broad presumption in favor of public disclosure of material terms and conditions of such claims; and

3. only up to the proportion of the eligible claim that would have been recoverable by the United States federal government under the applicable international initiative if the United States federal government had been the creditor holding the eligible claim, and without regard to de minimis clauses.

§ 231. Application; opt in. 1. Where this article applies, it shall operate both retroactively and prospectively and, without limiting the foregoing, shall with respect to section 223 claims override any contractual provisions that are inconsistent with the provisions of this article. Notwithstanding the foregoing, the provisions of this article shall not operate retroactively as to debtor states that are not sovereign nations.

2. Any creditors of a debtor state whose claims are not otherwise governed by this article may contractually opt in to this article's terms, conditions, and provisions.

3. The terms, conditions, and provisions of this article shall apply to the debtor-creditor relationship between the debtor state and creditors opting in under subdivision two of this section as if such relationship were governed by the laws of New York state under subdivision three of section two hundred twenty-three of this article.

§ 232. Severability. If any provision of this article or its application to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of this article which can be given effect without the invalid provision or application, and to this end, the provisions of this article are severable. Without limiting the foregoing, a debtor state's choice to have claims covered as a section 223 claim shall be valid even if its choice to have claims covered as a section 230 claim of this article would be invalid, and vice versa.

§ 3. This act shall take effect immediately.