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Sovereign Debt Documentation: Unraveling the Pari Passu Mystery

Umakanth Varottil*

I. INTRODUCTION

A. Debt Restructuring; the Holdout Problem

When a debtor defaults on its payment obligations to creditors, a collective action problem generally results. The problem is accentuated when the debtor is confronted by a large group of creditors with differing interests. In such instances, a serious rift among the creditors often exists. One group of creditors, known as the participating creditors, tries to work with the debtor to reorganize its debts so the creditors can be confident about recovering at least a portion, if not all, of the debts owed to them by the debtor.¹ However, other creditors, known as holdouts or "vultures,"² generally believe they will have a better chance of receiving the entire payment due to them if they press for it instead of negotiating with the debtor.³ While participating creditors adopt a negotiation strategy and work with the debtor to

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3. See Coffee & Klein, supra note 2, at 1214. These creditors usually buy debts of issuers who are in financial distress, which they do so from other debt investors in the secondary market rather than in primary issuances. Id. Due to the deteriorating financial position of the issuers, holdout creditors are able to purchase the debts at a substantial discount to the issue price. Id. However, upon purchase of these debts, they acquire the right and entitlement to the full value of the debts (in the form of principal amounts and unpaid interest) against the issuer. Id. Holdouts therefore have necessary incentives to stay out of any debt restructuring to press for full payment or at least to demand a substantially better deal than what is being offered to the participating creditors in the hope of making a handsome profit in a relatively short time span. See id.
optimize their returns in the given circumstances, holdout creditors adopt a more aggressive strategy, staying outside any restructuring process, hoping to press their claims in court and force the debtor to pay the amounts due to them.\(^4\) Holdout creditors' efforts occasionally succeed.\(^5\)

This dynamic holds true even when the debtor is a sovereign.\(^6\) Restructuring sovereign debts is fraught with delicate imbalances which threaten successful workouts and turnarounds.\(^7\) In this situation, holdout creditors have resorted to clutching at every straw to tip the scales in their favor. One such straw is the ubiquitous *pari passu* clause, a standard term in most debtor-creditor agreements. *Pari passu*, a Latin phrase, means "in equal step" or "equally."\(^8\)

What is the relevance of the *pari passu* clause to holdout creditors? The answer is best examined in the context of a holdout episode that occurred in relation to debts owed by the Republic of Peru (Peru).

### B. The Elliott Case

Banco de la Nación (Nación), a Peruvian public sector bank, issued bonds in the international markets, guaranteed by Peru's government.\(^9\) Due to a default on the bonds, Peru was forced to negotiate a restructuring of the bonds with its creditors.\(^10\) Around the same time, Elliott Associates, L.P. (Elliott), a vulture fund, purchased bonds issued by Nación from certain bondholders.\(^11\) Like any vulture fund, Elliott refused to participate in the restructuring process.\(^12\) Consequently, Elliott adopted an aggressive litigation strategy, sued Nación

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4. Id.
5. A classic litigation strategy is one that was adopted by Elliott Associates, LP, a well-known vulture fund, against the Republic of Peru and Banco de la Nación, a Peruvian public sector bank. See infra Part I.B.
6. Matters get somewhat complicated in the case of a sovereign debtor due to the diverse nature of its creditors that may include banks, international financial institutions, official bilateral creditors, trade creditors and bondholders; add to that the absence of a bankruptcy or insolvency regime that governs delinquency of sovereigns. See Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1044 (2004).
7. Id. at 1070-71 (discussing the heterogeneity of interests among sovereign bond investors).
10. Id. at 334-35.
11. Id. at 332.
12. Id. at 335.
and Peru for full payment and obtained a judgment for over fifty-five million dollars in the district court for the Southern District of New York.\textsuperscript{13} Despite the favorable outcome, Elliott faced a problem common to sovereign creditors—the inability to enforce judgments in an effective manner. Sovereigns rarely have assets situated outside their jurisdiction, making it cumbersome for creditors to recover meaningful judgments.\textsuperscript{14} The \textit{pari passu} clause redeemed Elliott from this weak position.\textsuperscript{15}

Elliott knew Peru was prepared to pay participating creditors (to the exclusion of the holdouts) under its restructuring, which involved transferring funds from Peru to the Euroclear System in Belgium, which would in turn be paid over to the participating creditors.\textsuperscript{16} Elliott initiated an action in Belgium to enjoin the Euroclear System (acting through its operator and cash correspondent) from processing any payments received from Peru. Elliott adopted the position that the payments by Peru violated the equal treatment principle laid down in the \textit{pari passu} clause contained in the relevant agreements executed by Peru.\textsuperscript{17} An affidavit from Andreas Lowenfeld, a professor at the New York University School of Law, opined that under the \textit{pari passu} clause in the lending document, a debtor, including a sovereign, must pay all creditors ratably when it makes a payment to any of the creditors.\textsuperscript{18} On this basis, the \textit{pari passu} clause requires debtors to make payments to creditors on a proportionate basis; debtors cannot make

\begin{itemize}
\item \textsuperscript{15} Peru agreed to a \textit{pari passu} clause in its bond documentation that provided: "[t]he obligations of the Guarantor hereunder do rank and will rank at least \textit{pari passu} in priority of payment with all other External Indebtedness of the Guarantor, and interest thereon." William W. Bratton, \textit{Pari Passu and a Distressed Sovereign's Rational Choices}, 53 Emory L.J. 823, 824 (2004).
\item \textsuperscript{16} Id.
\item \textsuperscript{17} Id.
\item \textsuperscript{18} The \textit{Pari Passu Clause in Sovereign Debt Instruments}, supra note 8, at 878. Professor Lowenfeld stated in his affidavit:
\begin{quote}
I have no difficulty in understanding what the \textit{pari passu} clause means: it means what it says – a given debt will rank equally with other debt of the borrower, whether that borrower is an individual, a company or a sovereign state. A borrower from Tom, Dick, and Harry can't say "I will pay Tom and Dick in full, and if there is anything left over I'll pay Harry." If there is not enough money to go around, the borrower faced with a \textit{pari passu} provision must pay all three of them on the same basis . . . .
\end{quote}
\end{itemize}
payments to some creditors to the exclusion of others.\textsuperscript{19} Reversing the Commercial Court, the Belgian Court of Appeals accepted Elliott’s interpretation of the \textit{pari passu} clause and granted the \textit{ex parte} motion to block Peru’s payment on bonds to other creditors.\textsuperscript{20} Prevented from paying its creditors to make the restructuring successful, Peru found itself in a tactically disadvantageous position and settled with Elliott.\textsuperscript{21}

The court’s unconventional interpretation of the \textit{pari passu} clause surprised the sovereign debt market.\textsuperscript{22} Several commentators decried the Belgian court’s interpretation of the \textit{pari passu} clause.\textsuperscript{23} The success led other holdout creditors to invoke the \textit{pari passu} clause to prevent payments by sovereign debtors to participating creditors.\textsuperscript{24} Thus, the \textit{pari passu} clause became a powerful litigation strategy for holdout creditors to force sovereign debtors to make substantial payments to holdout creditors. The clause also became a significant impediment to the successful implementation of workouts between sovereign debtors and their creditors.

C. Elliott’s After-effects

Following the \textit{Elliott} judgment in 2000 (hereinafter \textit{Elliott}), practitioners anticipated reactive positioning from sovereign debtors as well as creditors to neutralize the effects of the \textit{pari passu} clause in light of the meaning provided by the Belgian court. Once the implications of the \textit{pari passu} clause were assimilated by the creditor community after \textit{Elliott}, sovereign debt documentation should have changed, particularly the \textit{pari passu} clause, to avoid the implications of the judgment. In other words, the creditor community and the lawyers representing

\textsuperscript{19} This is a somewhat radical interpretation as the expression “\textit{pari passu}” was conventionally understood to apply only to equality in “ranking” of a debt with other debts and not to the requirement that all debtors be paid at the same time, without one or more creditors being paid to the exclusion of others.

\textsuperscript{20} Bratton, \textit{supra} note 15, at 824. Elliott initially filed an \textit{ex parte} motion with the President of the Commercial Court in Brussels seeking to enjoin the Euroclear System from making payment to Peru’s creditors under the restructuring. \textit{The Pari Passu Clause in Sovereign Debt Instruments}, \textit{supra} note 8, at 877. However, as the Commercial Court denied the motion, Elliott preferred an \textit{ex parte} appeal to the Court of Appeals in Brussels. \textit{Id.}

\textsuperscript{21} \textit{Id.} at 879.

\textsuperscript{22} See infra Part II.

\textsuperscript{23} See generally \textit{The Pari Passu Clause in Sovereign Debt Instruments}, \textit{supra} note 8; Bratton, \textit{supra} note 15; \textit{Sovereign Piracy}, \textit{supra} note 14.

\textsuperscript{24} \textit{The Pari Passu Clause in Sovereign Debt Instruments}, \textit{supra} note 8, at 880-82. Although the use of the \textit{pari passu} clause by holdout creditors was not successful in all cases, they were at least able to force a settlement in some. \textit{See} Anna Gelpern, \textit{Building a Better Seating Chart}, 53 \textit{Emory L.J.} 1115, 1133-34 (2004) [hereinafter \textit{Building a Better Seating Chart}]; see also infra notes 61-64 and accompanying text.
them were expected to modify the pari passu clause to constrain the powers of maverick creditors (such as vulture funds) and prevent them from succeeding in holdout litigation under the Belgian court’s interpretation.

However, this anticipated drafting change never occurred. Empirical evidence reveals sovereign borrowers continue to operate with the identical pari passu clause used before Elliott, and failed to internalize the impact of the Belgian court’s interpretation.25 This poses an interesting question as to whether the continued use (“stickiness”) of the standard pari passu clause is the result of a conscious, deliberate choice by parties, inadvertence, or fear of changing boilerplate terms. This episode illustrates that stickiness in contracts following an unconventional interpretation typically occurs not only among parties whose bargaining powers are unequal,26 but also in contracts between sophisticated players (advised by specialists in established law firms and/or investment banks) whose bargaining powers are comparable.

Theories of standard contracts suggest boilerplate terms exist in contracts due to learning and network benefits, although such terms may have a value-reducing effect.27 The pari passu clause as a stan-


26. Contracts where the bargaining power of parties is unequal include (by way of illustration) those between employers and employees and between banks and retail loan borrowers. In such type of contracts, the terms are unilaterally set by one party and offered to the other party who is required to either accept the terms on an “as-is” basis or to reject the entire contract. David S. Schwartz, Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration, 1997 WIS. L. REV. 33, 56 (noting that such contracts, referred to as ‘adherent’ contracts “typically arise in a setting in which a class of stronger parties has systemically taken undue advantage of the adherent class, either through one-sided contract terms or through practices that cannot be altered by bargaining between the parties due to the disparities in power, knowledge, and interests”).

27. Marcel Kahan & Michael Klausner, Standardization and Innovation in Corporate Contracting (or “The Economics of Boilerplate”), 83 Va. L. Rev. 713, 718 (1997) (“The private benefits to a firm of adopting a standard contract term can be divided into two conceptual categories, each with different implications. One set of benefits, which we call “learning benefits,” arises when a firm adopts a contract term that has been commonly used in the past, regardless of whether other firms will continue using it in the future. A second set of benefits, which we call “network effects,” arises when a firm adopts a term that will be part of the firm’s contract at the same time that it is part of many other firms’ contracts, regardless of whether it has been commonly used in the past.”).
standard term validates these theories because "interpretive shocks" delivered by courts\(^{28}\) have failed to propel parties into action to alter this boilerplate term.\(^{29}\) Although Elliott caused considerable ambiguity as to the scope and extent of the pari passu clause, parties are reluctant to alter the clause for fear of exacerbating the ambiguity and confusion surrounding it.\(^{30}\)

This article builds upon the theories of boilerplate terms in contracts and the empirical evidence regarding use of the pari passu clause to proffer reasons due to which the clause may not have been altered despite interpretive shocks making it value-reducing to sovereign debtors and participating creditors. Several endogenous\(^{31}\) and exogenous\(^{32}\) reasons explain why boilerplate terms may be left untouched by contract drafters although logic and reasoning dictate they be altered to cushion interpretive shocks. Existing studies on boilerplate terms like the pari passu clause focus primarily on endogenous reasons for maintaining the status quo in boilerplate terms.\(^{33}\)

However, these studies did not look beyond empirical evidence for the rationale behind the pari passu clause and similar boilerplate terms' stickiness or at the exogenous factors playing a crucial role in the failure to change such boilerplate terms.\(^{34}\) This article fills this research gap by looking beyond empirical evidence and examining exogenous reasons for the continued use of the unchanged pari passu clause despite holdout creditors' successful use of the clause to chal-


\(^{29}\) See Innovation in Boilerplate Contracts, supra note 25, at 989-92 (use of the expression "interpretive shocks" in the context of the pari passu clause).

\(^{30}\) The Evolution of Boilerplate Contracts, supra note 25, at 12.

\(^{31}\) For purposes of this article, endogenous reasons or endogenous factors are those connected directly with the clause in question. For a discussion of endogenous factors affecting the pari passu clause in the context of sovereign debt restructuring, see infra Part IV.

\(^{32}\) Exogenous reasons or exogenous factors are those that are not connected with the clause in question. These may include other clauses or groups of clauses in the same contract of which the clause in question is a part, or may include factors such as bargaining power or negotiating leverage between parties, market conditions or other factors that may have an impact on the manner in which parties are likely to act in relation to the contract. For a discussion of exogenous reasons pertaining to the pari passu clause, see infra Part V.

\(^{33}\) See infra notes 65-69 and accompanying text.

\(^{34}\) See infra note 79 and accompanying text.
lenges sovereign debt restructurings. Using the example of the *pari passu* clause and the impact (or lack thereof) following interpretive shocks provided by court rulings, this article attempts to supply a framework for understanding the stickiness of boilerplate terms through a study of both endogenous and exogenous factors.

For ease of logical analysis, this article asserts a series of propositions which will be affirmed or denied. Part II studies the various interpretations of the *pari passu* clause after *Elliott* and attempts to determine the current substantive law. Part III reviews the market reaction following the interpretive shock *Elliott* delivered. Part IV examines the endogenous reasoning for maintaining the unchanged *pari passu* clause following the interpretive shock, and Part V examines the exogenous factors. Part VI contains normative, forward-looking observations, and Part VII briefly concludes.

II. INTERPRETATION OF THE PARI PASSU CLAUSE

*Proposition 1 (Interpretive Proposition):* The Belgian court’s interpretation of the *pari passu* clause in *Elliott* requiring ratable payments to all creditors is legally valid and in accordance with the prevalent legal position.

The anticipated market reaction after *Elliott*—shocks reverberating in the sovereign debt market—depends on whether the Interpretive Proposition can be affirmed. If the Interpretive Proposition is affirmed, we expect sovereigns, the participating creditors, and their lawyers to either drop the *pari passu* clause from sovereign debt documentation or to clearly identify the circumstances in which it applies to ensure holdout creditors no longer use the clause to stop payments to other creditors. If the Interpretive Proposition is denied, meaning the Belgian court’s interpretation is incorrect, parties to sovereign debt transactions would not substantially modify or drop the clause from the documentation. Instead, the parties may include clarifying language to nullify the negative effects of an erroneous court decision and guard against holdout creditors abusing the clause. Either situation should cause a change to the *pari passu* clause, the specifics being dependent on whether the Interpretive Proposition is affirmed.

The next step is to test the validity of the Interpretive Proposition in the broad historical context in which the *pari passu* clause developed.

35. See infra notes 40-60 and accompanying text.
36. See infra notes 61-74 and accompanying text.
37. See infra notes 75-88 and accompanying text.
38. See infra notes 89-130 and accompanying text.
39. See infra notes 131-34 and accompanying text.
Although the *pari passu* clause is ubiquitous in debtor-creditor agreements, little interpretive authority from prior case law defines the scope or meaning of the clause. Interestingly, the *pari passu* clause is often inserted by drafters of sovereign debt documentation who are uncertain of its meaning.  

Under these circumstances, Elliott defined the *pari passu* clause. The court determined that where a borrower without sufficient funds to pay its creditors wishes to pay some of its creditors, that borrower must pay all creditors on a ratable basis without paying some creditors more than others. This is the "ratable payment interpretation" of the *pari passu* clause.

Elliott caused a furor among creditors, lawyers, and academics in the sovereign lending community, who argued the Belgian court's interpretation was incorrect and the *pari passu* clause does not allow an interpretation preventing a debtor from paying off one of its creditors without making a ratable payment to all of its creditors. Since Elliott poses a threat to successful sovereign debt restructurings, even certain governmental authorities and other bodies in the United States have argued against the ratable payment interpretation of the *pari passu* clause.

Several arguments against the ratable payment interpretation of the *pari passu* clause exist. *First,* the *pari passu* clause is about "ranking" and not about "payment." The clause only prevents the debtor from incurring obligations that rank legally superior to the debt held by existing creditors. It does not prevent the debtor from making payments to certain creditors without making ratable payments to all creditors.

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41. See *The Pari Passu Clause in Sovereign Debt Instruments*, supra note 8, at 878.

42. Id. at 879.

43. See generally *Sovereign Piracy*, supra note 14; *The Pari Passu Clause in Sovereign Debt Instruments*, supra note 8; Bratton, supra note 15 (representing a somewhat balanced approach in critiquing the use of the *pari passu* clause to force ratable payments to all creditors); FIN. MKTS. LAW COMM., ISSUE 79 - *Pari Passu* Clauses: Analysis of the role, use and meaning of *pari passu* clauses in sovereign debt obligations as a matter of English law (2005), http://www.fmlc.org/papers/fmlc79mar_2005.pdf. [hereinafter FIN. MKTS. LAW COMM.].

44. *The Pari Passu Clause in Sovereign Debt Instruments*, supra note 8, at 920-21; *Contract as Statute*, supra note 25, at 1138. In different cases involving the restructuring of debts of Argentina, the New York Clearing House Association L.L.C., the U.S. Government, and the Federal Reserve Bank of New York filed amicus curiae briefs and statements of interest challenging the ratable payment interpretation of the *pari passu* clause. Id.

45. See *The Pari Passu Clause in Sovereign Debt Instruments*, supra note 8, at 872.

46. Id.
Second, the *pari passu* clause ought not to be confused with the timing of payment to unsecured creditors, as that would depend upon the contractual maturity of the debt. If the ratable payment interpretation is accepted, all creditors would need to be paid simultaneously even if some creditors are not yet due to be paid in accordance with the terms of their contract.

Third, in the corporate debt context, the practical consequence of the clause is most relevant during a bankruptcy or liquidation. However, unlike a corporate debtor, a sovereign cannot become bankrupt or be liquidated, and hence the *pari passu* clause in a sovereign debt obligation must have a different purpose. That leads to the fourth argument, as noted by the Financial Markets Law Committee in the United Kingdom:

> [T]he only purpose of the clause was believed to be to prevent sovereigns from "earmarking" revenues of the government or allocating foreign currency reserves to a single creditor or, more generally, to prevent the sovereign from adopting legal measures which have the effect of preferring one set of creditors against the others.

More specifically, Lee Buchheit and Jeremiah Pam, in their detailed historical account of the *pari passu* clause, allude to the previous existence of specific laws in Spain and the Philippines that enabled sovereigns to involuntarily subordinate creditors by utilizing certain prescribed procedures. This system posed a significant risk to the ranking of sovereign creditors, making the *pari passu* clause crucial for the protection of such creditors.

Fifth, several creditors have been conferred priority of payment by convention. The most popular example relates to international financial institutions such as the International Monetary Fund (IMF) which demand and receive *de facto* priority. These institutions have always received repayments on a priority basis over other creditors of sover-

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47. See id. at 876; Sovereign Piracy, supra note 14, at 637; Sean Hagan, Designing a Legal Framework to Restructure Sovereign Debt, 36 Geo. J. Int'l L. 299, 314 (2005); The Pari Passu Sub Specie Aeternitatis, supra note 40, at 12 (stating that "the existence of a conventional pari passu undertaking in a loan agreement will have no effect on the sovereign borrower's legal ability to pay one creditor even if it is then in default on its payment obligations to other creditors. . .").


49. The Pari Passu Clause in Sovereign Debt Instruments, supra note 8, at 873.


52. The Pari Passu Clause in Sovereign Debt Instruments, supra note 8, at 903-04.

53. Id. at 903.

54. See Contract as Statute, supra note 25, at 1135.
eigns and such priority has traditionally never been questioned.\textsuperscript{55} The ratable payments interpretation of the \textit{pari passu} clause runs counter to the established priority held by international financial institutions.\textsuperscript{56} \textit{Finally}, if the ratable payments interpretation is accepted, it would lead to redundancy in other clauses such as the "sharing"\textsuperscript{57} clause. Parties would not include a sharing clause in contracts if the \textit{pari passu} clause was intended to prescribe payment sharing on a ratable basis.\textsuperscript{58}

Based on the above arguments, the Belgian court considering \textit{Elliott} should not have construed the \textit{pari passu} clause as a ratable payments provision.\textsuperscript{59} The overwhelming number of arguments against the judgment in \textit{Elliott} confirms that the Interpretive Proposition cannot stand. Owing to the lack of evidence supporting the Interpretive Proposition, the market should react by clarifying the language in sovereign debt documentation to avoid similar results in the future.\textsuperscript{60} This takes us to the next phase of the inquiry to see what, if anything, was the sovereign debt market's reaction to \textit{Elliott}.

\textbf{III. Market Reaction to \textit{Elliott}}

Proposition 2 (Reactive Proposition): In response to the interpretive shock delivered in \textit{Elliott}, the markets changed the \textit{pari passu} clause to eliminate the negative effects of the shock, thereby neutralizing the power of holdout creditors and enabling sovereign restructuring for the larger benefit of participating creditors and sovereign debtors.

\textsuperscript{55} Id.
\textsuperscript{56} Bratton, \textit{supra} note 15, at 855; \textit{Fin. Mkts. Law Comm.}, \textit{supra} note 43, at 14.
\textsuperscript{57} A sharing clause is one which stipulates that if one creditor receives a disproportionate payment under the agreement, that payment will be shared ratably with other creditors who are parties to the sharing arrangement. Lee C. Buchheit, \textit{The Sharing Clause as a Litigation Shield}, 9 \textit{Int'l Fin. L. Rev.} 15 (1990) [hereinafter \textit{The Sharing Clause as a Litigation Shield}]. In a general sense, the sharing clause serves precisely the same purpose as the \textit{pari passu} clause if interpreted as a ratable payment clause as in \textit{Elliott}. Although both the sharing clause and the \textit{pari passu} clause achieve the same end-result, there are some specific differences in the operation of each clause. For instance, the sharing clause tends to impose an obligation on the creditors \textit{inter se}, while the \textit{pari passu} clause also tends to bind the sovereign debtor in addition to the creditors. See, Lee C. Buchheit, \textit{Changing Bond Documentation: The Sharing Clause}, 17 \textit{Int'l Fin. L. Rev.} 17, 17-18 (1998) [hereinafter \textit{Changing Bond Documentation: The Sharing Clause}]; \textit{The Pari Passu Clause in Sovereign Debt Instruments}, \textit{supra} note 8, at 918.
\textsuperscript{58} See \textit{Fin. Mkts. Law Comm.}, \textit{supra} note 43, at 18; \textit{The Pari Passu Sub Specie Aeternitatis}, \textit{supra} note 40, at 12.
\textsuperscript{59} See \textit{supra} notes 16-21 and accompanying text.
\textsuperscript{60} For instance, clarifying language in contracts could potentially be explicit in stating that the \textit{pari passu} clause applies only with reference to ranking of debts and not to payment on debts or timing thereof. This would expressly indicate the intention of the parties that creditors are not entitled to a ratable portion each time a sovereign debtor makes payments to one or more of its creditors.
Before testing the Reactive Proposition, it must be noted that following Elliott, other holdout creditors, refusing to be outdone, began invoking the pari passu clause to demand payments from sovereigns.61 Suits were filed in courts in the United States, the United Kingdom, and Belgium.62 These suits produced varying results—(i) some holdout creditors prevented payments to other participating creditors; (ii) some forced the sovereigns to settle; (iii) some failed to get any relief from the courts; and (iv) others did not secure the court's attention due to preliminary matters such as the lack of appropriate subject matter jurisdiction.63 Nevertheless, the courts never had a subsequent opportunity to directly address the Belgian court's interpretation of the pari passu clause in Elliott.64 Therefore, when evaluating the risk of holdout litigation in sovereign debt restructuring, note that the interpretive shock from Elliott has had a lasting impact and the results of subsequent suits do not appear to dilute its effects.

That leads to the key question regarding the market's reaction to Elliott. Although a number of years have elapsed since Elliott, the pari passu clause in sovereign debt documentation remains unchanged. Professors Stephen Choi and Mitu Gulati studied data for twenty countries which issued more than ten loan or debt instruments between 1985 and 2005.65 In their study, Professors Choi and Gulati identified a dozen versions of the pari passu clause.66 This article will consider two versions that represent the extremes: one is a pure ranking clause,67 the other is a strong version of the clause that refers to payment in addition to ranking.68 The pari passu clause in Italy was broad enough to fall into the ratable payment interpretation in Elliott.

61. The Pari Passu Clause in Sovereign Debt Instruments, supra note 8, at 880-82.
62. See id. (describing cases invoking the pari passu clause to demand payments from sovereigns).
63. See id.
64. Contract as Statute, supra note 25, at 1136 ("[m]ore important, the sovereign lawyers have not been able to get any of the courts in these jurisdictions to adopt their interpretation of the pari passu clause.").
65. Id. at 1137. In addition to reviewing the contracts entered into during the period, Professors Choi and Gulati also conducted over fifty in-depth interviews with market participants which supported the quantitative data that there was no conscious attempt to make any modifications to the pari passu clause. Id. at 1136-37.
66. Id. at 1136.
67. A pure ranking clause can be found in the Portugal (U.S. law), $2 billion, Registered Offering, 7/26/05: "The notes will rank pari passu with all other unsecured Indebtedness of the Issuer." Id. at 1148.
68. A pari passu clause that deals with both ranking and payment can be found in the Italy, $4 billion, Registered Offering, 1/13/05: "They will rank equally with all our present and future unsecured and unsubordinated general borrowing. . . . We will pay amounts due on the debt securities equally and ratably with all general loan obligations of Italy." Id. at 1149.
Despite the significant legal risks of this position, no change was forthcoming.\(^69\) The boilerplate analysis of contracts has set the clause in stone although it poses significant legal risk and uncertainty to the contracting parties.

The failure to change the \textit{pari passu} clause may be caused by several reasons. \textit{First}, network effects could prevent changing a boilerplate term such as the \textit{pari passu} clause, which has been consistently agreed to in financing contracts for several decades and used by markets across the board.\(^70\) Parties may find it costlier to change boilerplate terms for a large number of market participants than bear the risks of uncertainty and ambiguity in a potentially value-reducing boilerplate term.\(^71\) In essence, parties find change costlier than maintaining the status quo. \textit{Second}, market participants may consider changing boilerplate terms to neutralize interpretive shocks too risky because, even if parties contend the court’s interpretation is incorrect, any change subsequent to an adverse decision (for example in \textit{Elliott} to the \textit{pari passu} clause) amounts to an implicit admission that the court’s interpretation of the clause prior to amendment was correct.\(^72\) \textit{Third}, market participants may provide a coordinated response to an adverse judicial decision through litigation rather than by changing boilerplate contract terms.\(^73\) Response through litigation was evident even in the \textit{pari passu} episode.\(^74\) However, despite these measures, there was no change to the \textit{pari passu} clause following \textit{Elliott}, and hence the Reactive Proposition stands denied. This leads to an exami-

\footnotesize
\(^69\) See \textit{Contract as Statute}, supra note 25, at 1149-50. In fact, in the context of boilerplate contracts, it is difficult to assume that minor changes to wording of clauses will necessarily make a difference to legal consequences. This is contrary to popular perception that textual differences in clauses alter their interpretation generally. See \textit{id}.

\(^70\) See Kahan & Klausner, supra note 27, at 718.

\(^71\) If only some parties change the clause while others do not, that would exacerbate the ambiguity and lack of uniformity thereby upsetting a market standard. See \textit{Contract as Statute}, supra note 25, at 1138.

\(^72\) \textit{id}. at 1137.

\(^73\) \textit{Id}. at 1138. The thrust of the litigation strategy as a response to \textit{Elliott} involved a concerted action from various members of the sovereign debt community that filed amicus curiae briefs in the case involving the Argentine debt restructuring, wherein they opposed the wider interpretation of the \textit{pari passu} clause that was offered by the Belgian court in \textit{Elliott}. \textit{Id}.

\(^74\) \textit{See supra} notes 43-44 and accompanying text. In addition, several commentators were critical about the broad interpretation of the \textit{pari passu} clause in \textit{Elliott}. See \textit{The Pari Passu Clause in Sovereign Debt Instruments}, supra note 8; \textit{Sovereign Piracy}, supra note 14. The Financial Markets Law Committee in England even produced a detailed report on the role, use and meaning of \textit{pari passu} clauses in sovereign debt obligations as a matter of English law, which concluded not only that as a matter of English law the ranking interpretation is the proper interpretation of the \textit{pari passu} clause in sovereign debt obligations, but that the consequences of the payment interpretation are such that both debtors and creditors would be prejudiced by such a construction. \textit{FIN. MKTS. LAW COMM.}, supra note 43, at 22.
nation of the specific reasons why change may have eluded the pari passu clause.

IV. ENDogenous REASONing

Proposition 3 (Endogenous Reasoning Proposition): The reasons why a boilerplate contract term such as the pari passu clause does not react to interpretive shocks can be found endogenously by looking at the interpretation of the clause itself or other circumstances directly surrounding operation of the clause.\(^7\)

The Endogenous Reasoning Proposition proceeds on the basis that the reasons a boilerplate contract term will react or remain undisturbed following an interpretive shock are found in the clause itself. These reasons are evident either in an interpretation of the clause by one or more courts of law or in the way the market’s intention has been evidenced through practice and convention.\(^7\) The Endogenous Reasoning Proposition does not look beyond the clause and its interpretation (either by courts or through market practice) or the direct effects of such interpretation on the relative positions of the contracting parties. For instance, an endogenous examination of the interpretive shock produced to the pari passu clause involves a study of the market’s reaction to the clause through either modification of the clause or appealing to courts to overturn the previous interpretation to remove the effects of the shock.

As we have seen in the case of the pari passu clause, an endogenous examination of the term reveals two sets of results: (i) empirical studies that indicate no change to the pari passu clause following the interpretive shock delivered in Elliott;\(^7\) and (ii) certain endogenous reasons beyond empirical studies explain why the pari passu clause remains unchanged.\(^7\) However, neither set of results provides a conclusive answer to the mystery of the pari passu clause’s obstinacy despite its exposure to value-reducing risks. This calls for an examination, with continued assistance from the pari passu example, of some of the deficiencies of endogenous reasoning for boilerplate contract terms.

While empirical evidence helps identify the market reaction to a particular shock relating to a boilerplate contract term, empirical studies by themselves do not explain the reasoning behind the reaction.

\(^7\) For the scope of endogenous reasons for the operation of a boilerplate contract term, see supra note 31.

\(^7\) See Contract as Statute, supra note 25, at 1158-59.

\(^7\) See id. at 1136-37.

\(^7\) See supra notes 70-74 and accompanying text.
Empirical studies report what happened following an interpretive shock and when it happened, but not the crucial question of why it happened. Consequently, in the present context, the reason the pari passu clause did not react to the interpretive shock is as important (if not more) than whether and how it reacted, if at all.

The arguments favoring the continuance of the pari passu clause based on endogenous reasoning are unsatisfying. The primary argument is that network effects prevent change and any change resulting from an interpretive shock amounts to an implicit admission that the court properly interpreted the previous clause. The validity of these arguments is unclear. Boilerplate terms are susceptible to change too, albeit over a period of time. Contract terms experience market innovation even when those terms are boilerplate. If a shock is too costly to market participants, change eventually occurs. Further, parties need not always be wary of amending standard contract terms on the ground that this might be an implicit admission that the court's decision is correct. As discussed in the context of the Reactive Proposition, it is possible parties may change boilerplate language by providing clarifying language to indicate their disapproval of the court’s interpretation. Therefore, the implicit admission argument does not hold water.

Another argument explaining the continuance of the pari passu clause is that parties have adopted a litigation strategy in subsequent cases to counter interpretive shocks arising from Elliott. Anecdotal evidence culled from cases subsequent to Elliott reveals that although some sovereign debtors successfully prevented holdout creditors from enforcing the pari passu clause to ensure ratable payments, no cases

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80. See Kahan & Klausner, supra note 27.
81. See supra note 72 and accompanying text.
82. See Innovation in Boilerplate Contracts, supra note 25, at 937.
84. See supra Part III.
85. See supra notes 73-74 and accompanying text.
contradict Elliott.\textsuperscript{86} Despite the so-called litigation strategy justified by commentators,\textsuperscript{87} Elliott's impact continues to pervade the sovereign debt markets, and the interpretation could be followed by courts world-wide as containing precedential value. While the discussion following Elliott convincingly highlights the judgment's deficiencies, the effects of Elliott remain.\textsuperscript{88}

Lingering uncertainty over the clause continues in the market. Can sovereign debt markets with billions of dollars in loans afford to operate in such ambiguous circumstances? Will participating creditors worry that payments could be attached or stopped unless holdout creditors are paid out on a ratable basis? Will international financial institutions, whose basis of operation relies on priority of payments, be apprehensive about their inability to obtain priority payments? Are law firms representing contracting parties willing to vouch for the enforceability of the payment clauses despite the broad interpretation given the \textit{pari passu} clause? Why then do the markets players not attempt to modify the clause and just abate these difficulties? The Endogenous Reasoning Proposition does not answer these questions. Some other reason or justification must explain why the \textit{pari passu} clause remains untouched despite widespread adverse reaction to the interpretive shock in Elliott. This leads to the next step of exploring other reasons—beyond interpretation of the clause itself—to explain the preservation of the status quo.

\textbf{V. Exogenous Reasoning}

\textit{Proposition 4 (Exogenous Reasoning Proposition):} The reasons why a boilerplate contract term such as the \textit{pari passu} clause reacts (or fails to react) to interpretive shocks can be found exogenously by looking beyond the clause in question to other changes or developments that alter the relationships and dynamics between the parties and their strengths and weaknesses relative to each other.

\textsuperscript{86} See supra notes 61-64 and accompanying text.

\textsuperscript{87} See Coffee & Klein, supra note 2, at 1215-16.

\textsuperscript{88} It is relevant to highlight one possible view that may seek to justify the obstinacy of the \textit{pari passu} clause despite its incorrect interpretation in Elliott. This view is that Elliott is an aberration and is unlikely to be adopted in any of the common jurisdictions such as the United States or the United Kingdom, whose laws govern sovereign debt documentation. See \textit{Contract as Statue}, supra note 25, at 1137 (containing responses from lawyers who were interviewed by the authors, stating that Elliott was an aberration). However, this is merely a matter of opinion, and has not received any authoritative support, particularly because the sovereign debt community has been unable to obtain a ruling from a court either in the United States or the United Kingdom that expressly disfavors the interpretation of the \textit{pari passu} clause that has been offered in Elliott.
This inquiry requires us to approach the issue from a contract negotiations and bargaining standpoint. This approach helps determine the reasons for inaction with reference to certain boilerplate contractual terms like the *pari passu* clause. As a starting point during contract negotiation, parties prefer deferring to boilerplate terms generally used in the marketplace. This induces an element of inertia between contracting parties that prevents them from changing boilerplate language. Deviation from standard terms usually occurs only if a term is costly to market participants. In other words, if status quo is costlier than change then market participants gravitate towards change. An interpretive shock delivered by a court is a classic driver of change. But, as we have seen, interpretive changes do not always impel a drafting change in a contract.

Why does this phenomenon occur? Here, we need to look beyond the boilerplate term and its direct implications. Sometimes, exogenous factors operate to help maintain status quo. To illustrate this point, consider a scenario where a boilerplate term is affected by an interpretive shock and logically requires a change. However, exogenous factors operating simultaneously may dilute the need for change, making the change less crucial than it would have been in the absence of the exogenous factors. Contracting parties, inherently inert as they are, prefer status quo over change if the benefits arising from the change are not substantial. The logical reasoning behind interpretive shocks and the resulting endogenous reasoning followed by the exogenous reasoning is set out below:


90. The “inertia theory” of contract negotiation propounds that “[p]arties are likely to favor default terms, in many instances, because these terms are often correlated with inaction (i.e., the default terms will be operative if the parties do nothing.)” See Russell Korobkin, Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms, 51 VAND. L. REV. 1583, 1586 (1998).

91. See Innovation in Boilerplate Contracts, supra note 25, at 945 n.47.

92. The exogenous factors may be either a single factor or a group of individual factors, or more likely, a mix of factors operating contemporaneously so as to alter the negotiating leverage and balance between the parties to a contract.
I now test the validity of the Exogenous Reasoning Proposition through the example of the *pari passu* clause and its implications on sovereign debt restructuring following *Elliott*. Initially, the interpretive shock delivered in *Elliott* should have induced change. However, change did not occur. Since change did not occur, the Endogenous Reasoning Proposition was not supported. Therefore, in order to determine the reason for this, I apply the Exogenous Reasoning Proposition. To complete this analysis, one must consider the other changes occurring in the sovereign debt market during the same time frame and determine if these changes impacted the *pari passu* clause directly or indirectly, thereby explaining the maintenance of the status quo.

93. See supra Part II.
94. See supra Part III.
95. In applying the Exogenous Reasoning Proposition, we need to consider events beyond any actions directly impacting the *pari passu* clause. As regards the timeframe itself, for the purposes of this study, the time period from 2000 to 2005, namely a five-year period following *Elliott* has been considered.
This study identifies two material exogenous factors that occurred in the aftermath of Elliott, and considers the role they played in the context of the pari passu clause.

A. Exit Consents: The Shift from Unanimous Action Clauses to Collective Action Clauses

A significant shift occurred between 2000 and 2003 in collective action mechanisms contained in sovereign bond documentation. This shift had a significant impact on the feasibility of sovereign debt restructuring exercises in light of the opposition by holdout creditors. Until 2003, sovereign bonds issued under New York law required unanimous bondholder approval to amend payment terms (mainly the principal and interest). Such clauses were also known as unanimous action clauses or UACs. All other terms, being non-payment terms, could be amended by a simple majority vote of all bondholders. In light of the high threshold requirement for amending payment terms, maverick creditors had an incentive to hold out and extract higher payments because the restructuring could not be given effect if there was even a single holdout creditor. This effectively stymied a smooth restructuring of sovereign debt to such an extent that sovereign creditors, as well as the official sector, explored various alternative mechanisms to deal with debt restructuring.

Nevertheless, the market adopted a novel method of overcoming this difficulty. In 2000, Ecuador used exit consents to restructure its debt through an exchange offer. The exit consent mechanism bound

96. See Innovation in Boilerplate Contracts, supra note 25, at 956.
97. See id.
98. Exit Consents in Sovereign Bond Exchanges, supra note 1, at 66 (hereinafter Exit Consents in Sovereign Bond Exchanges). This is contrary to the position with respect to sovereign bonds issued under English law, the payment terms of which could be amended by obtaining the approval of 75% of the bondholders in terms of amount of debt held. Innovation in Boilerplate Contracts, supra note 25, at 932.
99. Exit Consents in Sovereign Bond Exchanges, supra note 1, at 66.
100. See id.
101. One such mechanism proposed was the Sovereign Debt Restructuring Mechanism (SDRM), which was subsequently abandoned. Relevant market players also explored other options to deal with the situation, including by proposing change in the contract terms to move from UAC to collective action clauses (CAC). See Hagan, supra note 47, at 318-20.
102. Innovation in Boilerplate Contracts, supra note 25, at 934. This requires explanation of two terms, viz. exchange offers and exit consents. Exchange offers are offers made by the sovereign debtor to restructure its bonds by issuing new bonds (which represent the restructured debt) in exchange for the old (pre-restructuring) debt held by the creditors. See Exit Consents in Sovereign Bond Exchanges, supra note 1, at 62. As part of the exchange offer, the sovereign debtor seeks the consent (exit consent) of the approving bondholders to amend provisions in the bonds that they are tendering in exchange (the original bonds) in order to render those bonds less attractive to any bondholder who may want to hold out. See id. at 65-66. Usually, the non-
the holdout creditors to the restructuring.\textsuperscript{103} As in the case of the \textit{pari passu} clause, there was no change to the UACs resulting from this interpretive shock.\textsuperscript{104} However, change came three years later when Mexico drafted collective action clauses (CACs) in its sovereign debt documentation instead of using the prevalent UACs.\textsuperscript{105} Following Mexico, other sovereign debt documents replaced their UAC clauses with CAC clauses.\textsuperscript{106} This ensured participating creditors with a seventy-five percent majority could restructure debt and bind the holdout creditors to this restructuring without any remedy whatsoever to them.\textsuperscript{107} When this change was introduced in New York law governed sovereign bond documentation, it tilted the balance in favor of the participating creditors rather than the holdout creditors, as the holdout creditors tended to follow the participating creditors that commanded the requisite majority and generally restructured the debts.\textsuperscript{108}

\textsuperscript{103} Exit Consents in Sovereign Bond Exchanges, supra note 1, at 66. In terms of timing, the use of the exit consent route to overcome holdout creditors began in 2000, the same year that \textit{Elliott} was decided. See \textit{Innovation in Boilerplate Contracts}, supra note 25, at 934. Therefore, within a span of a few months in the year 2000, while the holdouts emerged victorious through the Belgian court's interpretation of the \textit{pari passu} clause, their position was also substantially diluted on the other hand by the use of exit consents against them by sovereign debtors as well as the majority concurring creditors. See id. The contemporaneous nature of these two developments explains the operation of the exogenous factors, as do other exogenous factors, matters that we shall see later in this Part.

\textsuperscript{104} \textit{Id}.

\textsuperscript{105} \textit{Id.} at 934-35 (discussing the plausible reasons for the delayed reaction to exit consents by way of a change from UACs to CACs in sovereign debt documentation); \textit{Public Symbol in Private Contract: A Case Study}, supra note 83, at 1631.

\textsuperscript{106} \textit{Public Symbol in Private Contract: A Case Study}, supra note 83, at 1641.

\textsuperscript{107} \textit{Id.} As an aside, it is also interesting to note that while the approval requirement for payment terms was reduced from unanimity to 75%, the requirement for amendment of the non-payment terms such as the \textit{pari passu} clause increased from a simple majority to 75%. See \textit{id}.

\textsuperscript{108} Although the change from UACs to CACs occurred only in 2003 with Mexico's bond offering, the dynamics between sovereign debtors and participating creditors on the one hand, and the holdout creditors on the other, began to undergo a change with the implementation of exit consents that began in 2000 with Ecuador's restructuring. See \textit{Innovation in Boilerplate Contracts}, supra note 25, at 941. Hence, while the power of the holdout creditors was diluted in 2000 through the unique method of exit consents, such dilution was formalized and bolstered with the introduction of CAC in 2003.
B. The Shift from Fiscal Agent to Trustee with Sole Enforcement Powers

Most sovereign bonds governed by New York law are issued pursuant to a fiscal agency agreement, where the fiscal agent is the agent of the sovereign issuer rather than of the bondholders. In other cases, bonds are issued pursuant to a trust indenture which contains markedly different provisions from a fiscal agency agreement. The key difference is that in trust indentures, the trustee is an agent or fiduciary of the bondholders and not the sovereign issuer. Until recently, either under the fiscal agency agreement or a conventional trust indenture, the right of an individual bondholder to bring an action against the sovereign debtor in recovery of its share of principal or interest that remained unpaid was inviolable. However, a Grenada bond offering document issued in 2005 introduced a novel provision, which did not provide individual enforcement rights to bondholders. This set of provisions had two consequences.

All enforcement rights vested only with the trustee and were exercisable solely for the ratable benefit of all bondholders. This precluded individual bondholders from pressing for claims and recovering them to the detriment of other bondholders, reducing incentives for bondholders to hold out.

Individual bondholders were also precluded from initiating actions for repayment or acceleration unless a demand was made by holders of at least twenty-five percent of the outstanding amount of the bonds. Unless holdouts constituted at least twenty-five percent of the amount of the bonds, they were powerless to initiate actions against the sovereign debtor. Therefore, these provisions limited the powers of holdout creditors to initiate recovery actions. Sharing clauses and minimum threshold supports for enforcement operated in a manner similar to the "automatic stay" in the domestic bankruptcy

109. Fisch & Gentile, supra note 6, at 1102.
110. Id. at 1103.
111. Id.
112. See Lee C. Buchheit & G. Mitu Gulati, Sovereign Bonds and the Collective Will, 51 EMORY L.J. 1317, 1331-32 (2002) [hereinafter Sovereign Bonds and the Collective Will]; Lee C. Buchheit & Elizabeth Karpinski, Grenada's Innovations, 20 J. INT'L BANKING L. & REG. 227, 230 (2006) [hereinafter Grenada's Innovations] (stating that this was a feature of the Section 316(b) of the Trust Indenture Act of 1939 in the United States, and although the Trust Indenture Act was not applicable to trust indentures of bonds issued by sovereigns and there was no legal obligation to carry these rights, these provisions were nevertheless retained as a matter of practice in trust indentures for sovereign bonds).
113. See Grenada's Innovations, supra note 112, at 230.
114. Fisch & Gentile, supra note 6, at 1105.
context, so the debt restructuring could be completed successfully without interference from holdout creditors.

C. Reflecting on the Exogenous Factors

The net impact of the above changes to sovereign bond documentation is that the powers of holdout creditors are substantially curtailed. How does this relate to the pari passu clause? Are the two shifts, (i) one from UACs to CACs (which was preceded more informally by exit consents) and (ii) the other from fiscal agent to indenture trustee, the exogenous reasons that explain the failure to change the pari passu clause? This requires further analysis.

As explained, the interpretive shock delivered in Elliott arose from holdout litigation. Despite the interpretive shocks, the clause did not change and no endogenous reasoning satisfactorily explained the preservation of the status quo. However, when the Exogenous Reasoning Proposition is applied, it becomes apparent the interpretive shock in the pari passu clause occurred simultaneously with two other changes that altered equations between the parties. This cushioned the interpretive shock delivered in Elliott; it was no longer relevant. After the changes, holdouts no longer possessed the same power as when Elliott was decided. The exogenous shifts (exit consents, the CAC clause, and indenture trustees) have largely shifted the incentives and negotiating positions of holdout creditors relative to the sovereign debtors and participating creditors. Holdout creditors cannot rely on their ability to aggressively bring about legal actions to frustrate debt restructuring processes driven largely by participating creditors unless they muster enough support to surpass the necessary

116. The Sharing Clause as a Litigation Shield, supra note 57, at 16 (noting that by forcing a maverick litigant to share the proceeds with other participants, sovereign borrowers have effectively replicated a protection from disruptive litigation, which in a domestic context, is usually conveyed by bankruptcy or insolvency laws); Changing Bond Documentation: The Sharing Clause, supra note 57, at 18 (observing that in a sovereign bond offering, the main reason for including a sharing clause is to help suppress holdout litigation.). Further, Buchheit noted that:

A true maverick creditor will not much like the presence of a sharing clause in a bond issue it is about to buy. Mavericks buy debt instruments on the secondary market at steep discounts from their face value after the borrower gets into financial trouble.... If the terms of a particular bond render it unsuitable for litigation, the maverick is not likely to buy that bond.

Id.

117. See supra Parts V.A. and V.B.

118. See supra notes 22-24 and accompanying text.

119. See supra notes 25-26 and accompanying text.

120. See supra Parts V.A. and V.B.

121. See id.
Anything short of that threshold considerably weakens the power of holdouts.123

The prevailing threshold of twenty-five percent of the total debt is a significant percentage for two reasons.124 In situations where debts are diffused among many holders, the collective action problem makes forming coalitions difficult.125 In addition, in a negotiated restructuring a large number of creditors tend to restructure the debt rather than persist with legal action if the terms of the restructuring are reasonable. This leaves an arduous (and often unsuccessful) task for the holdout creditors to fragment the interests within the participating block.126 This caused a large shift in the dynamics of holdout creditors relative to participating creditors in sovereign debt restructurings.127

In this context, let us now determine the reason for status quo in the pari passu clause applying both the endogenous and exogenous factors. Approaching the problem from a sovereign debt drafter's perspective, under purely endogenous reasoning128 there is not enough evidence to justify a status quo. Hence, the drafter is more inclined to modify the clause to neutralize the interpretive shock to avoid ambiguity in the legal position and mitigate further risks to the contracting parties. This endeavor ensures holdouts do not have incentives to use the pari passu clause to assert their rights in a manner hindering sovereign debt restructurings. However, since change did not occur, the endogenous factors do not offer a sufficient explanation.

Due to exogenous factors (other reasons and shifts in boilerplate language discussed earlier), the holdouts are powerless.129 Since they may be outwitted through exit consents, CACs, enforcement and sharing clauses,130 there is no substantial risk of holdouts litigating on the pari passu clause, let alone initiating any other enforcement mechanisms. Is there incentive for holdout creditors to continue to enforce Elliott-type actions under the pari passu clause? Success in such actions will produce no benefits. Even if holdout creditors threaten to

122. See id.
123. See id.
124. See supra note 115 and accompanying text.
126. Fisch & Gentile, supra note 6, at 1093.
128. See supra Part IV.
129. See supra Part V.
130. See supra Part V.B.
use the *pari passu* clause to recover payments, the sharing clause compels them to share the spoils with all other creditors. The time, effort, and costs to holdout creditors likely exceed the benefits from such litigation. Accordingly, the risk of continued interpretive shocks like *Elliott* are substantially mitigated, inducing inertia in the drafters of *pari passu* clauses to keep the clauses within the confines of market practice and enable them to enjoy the network benefits.

The exogenous reasons are clearly more convincing than the endogenous reasons in justifying status quo to the *pari passu* clause. This illustration reemphasizes the principle discussed earlier: in examining the impact of an interpretive shock on a boilerplate contract term, both the endogenous and exogenous reasons must be considered. In this case, the Exogenous Reasoning Proposition carried more support than the Endogenous Reasoning Proposition. However, other situations could produce different results depending on the facts and circumstances of each interpretive shock, its impact on boilerplate term(s), and other surrounding factors (both endogenous and exogenous). Here, the *pari passu* clause illustrates the shortcomings of confining studies to empirical work and to endogenous reasoning. Exogenous reasoning produces different results and plays an important role in determining the type of reaction required to neutralize the interpretive effect.

VI. **Monitoring the Factors Affecting Boilerplate Terms**

From a normative perspective, relying on exogenous factors alone to examine the language of boilerplate contracts is fraught with risk. Excessive reliance on exogenous factors is problematic. At a fundamental level, exogenous factors that change over time and disturb the balance between the parties can restore ambiguity to a contract term. Returning to the *pari passu* illustration, if over a period of time, sovereign bond contracts confer more powers on holdout creditors and reverse the current trend, the *pari passu* debate would regain prominence. To mitigate such risks, parties ought to continuously monitor exogenous factors so any changes in those factors modify a boilerplate contract term or (through any other appropriate mechanism) maintain the status quo. This makes identifying and monitoring

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131. In the future, if holdout creditors become capable of initiating individual legal actions, they are likely to invoke the *pari passu* clause and its ratable payments interpretation so as to produce the same result that *Elliott* generated. This indicates that the *pari passu* debate has, at present, only been eclipsed by exogenous factors such as by clipping the powers of the holdout creditors. The debate has not been obliterated. Therefore, if exogenous factors are reversed, the *pari passu* debate is likely to come back into the forefront.
exogenous factors critical. As one of several methods assisting parties in identifying and monitoring exogenous factors, empirical studies can be employed. That holds true for the pari passu clause, where the combined operation of endogenous and exogenous factors can be studied empirically.\textsuperscript{132}

From a monitoring perspective, it is crucial to determine who will monitor the endogenous and exogenous factors affecting boilerplate language. Contracting parties themselves do not have the incentives to monitor and induce change where necessary. Contracting parties are usually bogged down with network effects, inertia, and collective action problems. Furthermore, the cost of monitoring activities is a disincentive to parties. Thus, this role is best carried out by all market participants whose interests are represented in the aggregate. An association of market players usually possesses the necessary specialized knowledge and skills to monitor changes and determine the need for altering boilerplate terms. This association may be assisted by advisers, such as law firms, who can assess the circumstances from a legal standpoint and provide expert input on whether to change boilerplate terms. Other advisers, such as investment bankers, can comment on the acceptability of such changes in the marketplace. For instance, in the derivatives arena, the International Swap and Derivative Association (ISDA) carries out that function by drafting the terms for the ISDA master agreement, which is the boilerplate for derivative contracting, monitoring both endogenous and exogenous factors, and making periodic amendments to the ISDA master agreement.\textsuperscript{133} In the sovereign debt arena, the Emerging Market Traders Association (EMTA) is the principal trade group for the Emerging Markets trading and investment community.\textsuperscript{134} The EMTA could carry out the monitoring and standard-setting role in conjunction with other players in the sovereign debt market, such as multilateral financial institutions.

\textsuperscript{132} Such empirical study can focus on the interplay of all the provisions, being the pari passu clause on the one hand (that is the subject matter of study for this paper) and other clauses such as CACs, trustee enforcement powers and similar clauses that play on the relationship between participating creditors and holdout creditors, so as to clearly arrive at an assessment as to how parties visualize the presence of each of these clauses when they decide whether or not to follow the boilerplate terms on others.

\textsuperscript{133} For a discussion on the incentives for such standard setting bodies to track interpretation of boilerplate contract terms and to ensure proper resolution of any dispute between parties to such contracts, see Contract as Statute, supra note 25, at 1139; Kahan & Klausner, supra note 27, at 761-64.

\textsuperscript{134} For details on EMTA, see EMTA: Trade Association for the Emerging Markets, http://www.emta.org (last visited October 12, 2008).
VII. Conclusion

The Elliott case and subsequent events suggest boilerplate contract terms may not necessarily change following interpretive shocks even if such terms are value-reducing in nature due to the learning and network effects of such terms. While endogenous reasons may cause the constancy of a clause following interpretive shocks, other exogenous reasons may affect the bargaining power and dynamics between contracting parties. These effects may cause boilerplate terms to continue unabated, although the terms may be ambiguous in nature due to interpretation handed down by courts.

This article advocates for the review and monitoring of both endogenous and exogenous factors that impact any boilerplate term and its interpretation. Monitoring assists the market in determining whether boilerplate terms should be left untouched (thereby continuing with the comfort of the market with such term undisturbed), or if such terms should be altered to remove ambiguities or enhance the value of those terms to the parties and the market. For contracts such as sovereign debt, which are entered into between sophisticated players, the monitoring function should be granted to market associations. These associations maximize the value of contract terms in sovereign debt documents, thereby enabling the unimpeded flow of transactions in the sovereign debt market.