LEGALFOXES LAW TIMES

COLLECTIVE ACTION CLAUSES- UNIFORM CONDITION FOR SOVEREIGN DEBT RESTRUCTURING

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Abstract:

In order to allow different collective action clauses (CACs) to be aggregated (i.e., CACs from different bond issuances), it is required that any amendment shall meet the "uniformly applicable" condition.This paper maintains the stance that a UAC in the case of CAC is required instead of different species of CACs. This paper focuses only on English Law Approach. This paper will consistently argue that there's a need for new regime of UAC for CACs.

Introduction

Collective Action Clauses (CACs) is a Sovereign Debt Restructuring Mechanism (SDRM) that permits the majority bondholders to agree to the debt restructuring process. CACs have been discovered as SDRM because the countries under the amount of accumulated debt had repayment problems and, in many cases, default as well.[1] CACs can be further classified into different categories, that is, four species of CACs to which CACs is genus. First, Collective Representation Clauses (CRC), ie, "clauses intended to coordinate representation of bondholders as a group"[2]. Second, Majority Action Clauses (MAC), ie, "clauses that provide an action to be taken by the way of majority decision"[3]. Third, Sharing Clauses (SC), ie, "clauses that provide any proceeds obtained from the debtor will be shared on pro-rata basis"[4]. Last, Acceleration Clauses (AC), ie, "common clauses included in the US bonds issued through a fiscal agent

[1] Rodrigo Olivares-Caminal, 'Restructuring and Insolvency, Collective action clauses' *Lexis Nexis* <https://www.lexisnexis.co.uk/legal/guidance/collective-action-clauses> accessed on July 21, 2021.
[2] ibid.
[3] ibid.
[4] ibid.

agreement which require 25% of the outstanding bonds to accelerate the un-matured principal upon an event of default"[5].

A pertinent contingency of thought arises, why should there be different kinds of CACs. There should be a single CAC clause,ie, an amendment should be made for a Uniform Applicable Condition (UAC). This paper answers two questions throughout, why is a new uniform applicable regime needed and how can it help in the contractual provisions and other financial considerations.

This paper maintains the stance that a UAC in the case of CACis required instead of different species of CACs. This paper focuses only on English Law Approach. This paper will consistently argue that there's a need for new regime of UAC for CACs.Section 1 explains about the origin of CACs. Section 2 explains as to why UAC regime for CACs is needed. Section 3 explains how can the uniformly applicable CACs help in the contractual provisions and other financial considerations about strengthening CACs and argues whether CACs has really developed or not and how can amendments be made to strengthen the CACs for the future. Section 4 is Critique. Section 5 is Conclusion.

Origin of CACs:

CACs since the early 2000s had become a routine and anunremarkable feature of international sovereign bond markets and were classified as low risk and ready-made that transferred to Europe.[6]Whenever debt restructuring process takes place, it is of paramount importance to protect the interest of creditors. For this, the "key concern is the avoidance of holdouts that undermine the restructuring and of free riding on adebt relief granted by other creditors"[7].A restructuring framework requires a creditor bail-in, not only reduces burden sharing, but also eliminates/reduces crisis prevention.[8]CACs that are a part of SDRM that induces creditors to assess the risk in an accurate and a possible manner.[9]Thus, it is understood that CACs are an

[5]ibid.
[6]Skylar Brooks and Eric Helleiner, 'Debt politics as usual? Reforming the sovereign debt restructuring regime after 2008' (2017) 93(5) International Affairs 1085, 1096.
[7]Jochen Andritzky, Désirée I. Christofzik, Lars P. Feld, Uwe Scheuering, 'A mechanism to regulate sovereign debtrestructuring in the euro area' (2019) International Finance 20, 23.
[8]ibid, 21.
[9]ibid.

important part of SDRM. But there are some issues! Do CACs allow to take flexible decisions. Do the CACs really protect the rights of creditors in a uniform manner. If yes, why is there is a need for separate CAC clauses i.e., CRC, MAC, SC and AC.Why not have like a Pari-Passu Clause, meaning taking equal step to protect the rights of each and every creditor in a uniform manner.This paper is about CACs so no deep discussion about Pari-Passu.

Anargument arises, "does the Pari-Passu clause and CAC adequately address holdout problem and encourage the orderly restructuring of sovereign debt?[10]"As mentioned earlier, Pari-Passu clause means taking of an equal step to protect the rights uniformly. The purpose of this clause is to maintain an equality of treatment among all the creditors to provide with pro-rata payment on becoming insolvent.[11] Thus, Pari-Passu clause fulfils the SC condition ie, the species of CACs. Similarly, CACs are presented as one answer to the holdout problem and have evolved as a result of lessons learnt through recent debt crisis episodes to prevent disruptive holdout positions.[12] "The majority restructuring provisions allow debtor and creditor to reach an agreement binding upon all bondholders including minority creditors and majority enforcement provisions bar recalcitrant creditors from enforcing claims through litigation."[13] This condition basically fulfils both CRC and MAC. Why is there not a UAC to protect the interest of creditors for every type of SDRM. Why should there be only be one CAC instead of CRC, MAC, SC and AC that explain the clauses with different conditions.

"The restructuring of single debt instruments with multiple bondholders can be facilitated in writing by each of those instruments known as CACs"[14]. CACs are specific to debt contract; they do not deal with the broader problems when the government in default has multiple debt problems.[15]Furthermore, they provide for a bondholder assembly and qualified majority voting,

[10]Akshay S. Gohil, ''The 'Great Game' Of Sovereign Debt Restructuring: Solving the Holdout Problem. A Critical Analysis of The Pari Passu and Collective Action Clauses in International Sovereign Bond Contracts' (2020) UCL Journal of Law and Jurisprudence<https://www.researchgate.net/publication/343443306_The_'Great_Game'_of_Sovereign_Debt_Restructuring_Solving_the_Holdout_Problem_A_Critical_Analysis_of_the_Pari_Passu_and_Collective_Action_Clauses_in_International_Sovereign_Bond_Contracts/link/5f2a6e53299bf13404a25c19/download> accessed on July 30, 2021.

[11]ibid, 33.

[12]ibid, 42.

[13]ibid, 42, 43.

[14]Barry Eichengreen And Ashoka Mody, 'Is Aggregation a Problem for Sovereign Debt Restructuring' (2003) 93(2) The American Economic Review 80.

[15]Jochen Andritzky, Désirée I. Christofzik, Lars P. Feld, Uwe Scheuering (n7) 21.

whether to accept a debt restructuring offer, but they do not specify a way of aggregating preference of creditors that hold different issues.[16] A pertinent question arises why not have an aggregate preference of creditors, ie, a uniform SDRM structure and a UAC for CACs.Also, there is a need for CAC clause that deals with the problems in a broad manner, that is, how to help a sovereign to come out of debt and what policies should it adopt to overcome such crisis of Sovereign Debt Restructurings in the future. It is thisUACwhere it is possible to make this amendment, that can deal with all the kinds of broad problems.

As explained above, the problem of credit holdout has led to policy proposals that aim at reducing delay and introduction of clauses into bond contracts that attempt to enforce collective action.[17] Thus, it is important to credibly establish a path towards a new regime, the proposal by the International Monetary Fund (IMF), to introduce a new regime, the gradual issuance of bonds so called Creditor Participation Clauses (CPC) akin to CACs.[18]The UAC for CACs will actually help in uniformly protecting creditor interests. It can be argued here there is there is no need to introduce CPC in order to establish a path towards a new regime. Instead of this, it would be better that a UAC is added in the CACs instead of having similar CPC and this is what IMF also should aim for.

The IMF has also proposed an enhanced CAC with more vigorous procedure aggregation features.[19] First, "a single limb voting procedure that allows aggregation of votes across all bond issues eligible in a restructuring with 75% majority threshold, design model clause of International Capital Market Association (ICMA)"[20]. The single limb voting procedure is an acceptable for benefit as it automatically brings 75% majority threshold together and there is a provision for aggregate voting, that is, democracy is ensured. Second, "a provision to ensure inter-creditor equity that protects minority groups of creditors unduly advantaged with other creditors"[21].Galli also argues that single-limb CACs are better because they allow sovereign to restructure more rapidly as a single vote is required than multiple votes for each of the series of

[16]ibid.
[17]Rohan Pitchford and Mark L. J. Wright, 'Settlement games with rank-order payoffs andapplications to sovereign debt restructuring' [2017] Econ Theory 847, 852.
[18]Jochen Andritzky, Désirée I. Christofzik, Lars P. Feld, Uwe Scheuering (n7) 21.
[19]ibid, 27.
[20]ibid.
[21]ibid.

bonds and with this the problem of holdout creditors is minimized.[22]It is also important to protect the minority groups of creditors. Thus, this enhanced system or the new developed model of CACs is beneficial as it argues both for protecting mass interests and also promote equality. An argument also arises,will the strengthening CACs help in catalysing change for CACs.

It is important to learn here that the only mechanism that has been widely accepted in the market are CACs.[23]But amendments are needed to adopt a UAC. Also, it is important to add some conditions as to how the country should avoid the menace of sovereign debt position to avoid debt restructuring position as this will basically help to overcome unnecessary burdens as explained above.

Rationale of Uniformly Applicable Condition for CACs:

This section explains the UAC for CACs as to why it's needed. The reason is that there is a need for more effective approach to achieve sovereign debt restructuring framework. The problem of unsustainable sovereign debt is serious because international law, unlike domestic bankruptcy law for companies and individuals do not facilitate reasonable debt restructuring.[24]Furthermore, some sovereign debt contracts including bond contracts are governed by English Law that include the provisions of CACs that attempt to mitigate the holdout problem by enabling a specified majority.[25]Thus, it can be said, English Law has focus towards CRC.

Even sovereign debt contracts include CACs, hold out may purchase vote blocking positions.[26] CACs only bind the parties to a particular contract and hence the parties to any sovereign debt contract can act as holdout in debt restructuring plan that requires parties to all such contracts to agree to the plan.[27] Thus, it should be argued that there should be UAC in CACs to bind the

[22]Giampaolo Galli, 'Collective Action Clauses and Sovereign Debt Restructuring Frameworks: Why and When is Restructuring Appropriate' (European Financial Infrastructure, European University Institute, April 25, 2019) <https://poseidon01.ssrn.com/delivery.php?ID=158006120024098087071115127119127023022073004041071075072105103101110064002123074099004009106006041043008021123084085004124124027034008006040082031025029001112083023004006016106082007100119080001091002004087071104112008072123085094104081003071019074097&EXT=pdf&INDEX=TRUE> accessed on July 31, 2021.

[23]Otaviano Canuto, Brian Pinto, and Mona Prasad, 'Orderly Sovereign Debt Restructuring:Missing in Action!(And Likely To Remain So)' (2014) 29(1) The World Bank Research Observer 122.

[24]Steven L. Schwarcz, 'Sovereign Debt Restructuring AndEnglish Governing Law' [2017] Brook. J. Corp. Fin. & Com. L. 73, 74.

[25]ibid, 74.

[26]ibid.

[27]ibid, 75.

parties to a particular contract and furthermore, there should also be a discussion as what amendments must be made in the contracts that can help other countries if such a situation arises with them. It is pertinent to mention that most debt contracts are governed either by the New York Law or English Law.

The ICMA has proposed CACs that also aggregate voting across debt issues. Even the aggregate voting CACs have the same limitations as other CACs, binding only the creditors who are parties to the agreement.[28] But, an amendment can be made as to the agreement should not only be binding upon the creditors who are the parties to agreement, but other creditors should also become the part of it. And this amendment must be made in UAC for CACs instead, of the proposed mechanism by the ICMA and IMF for CACs. Let us examine further how English Law could be modified to restructure sovereign debt contracts.

There is a need for a model law for governments to consider it for the enactment of domestic law in their jurisdictions. English Law refers to the Law governing England and Wales and changes were introduced within the UK Parliament. The English Model Law does cover both long-term and short-term maturity claims.[29] The ultimate rationale is to restore the debtor-state to debt sustainability in order to relieve the economic burden and reduce creditors uncertainty.[30] As sovereign debt contracts are governed by English Law; the new model Law will help to resolve the problems of sovereign debt that arise under those particular contracts.[31]

On the other hand, UK Law favours CACs that allows to alter core bond terms after a majority vote.[32] After successful vote under CACs, all bondholders are treated uniformly, irrespective of the fact whether they vote or not in the favour of renegotiation proposal.[33]"Bond Exchange offers are more profitable for equity holders than debt renegotiations with CACs or a single creditor."[34] Furthermore, "Bond exchange offers with seniority transfer mitigate debt overhang problems

[28]ibid.
[29]ibid, 77, 78, 79, 80.
[30]ibid, 79
[31]ibid, 79, 80.
[32]Ulrich Hege and Pierre Mella-Barral, 'Bond Exchange Offers or Collective Action Clauses?' (2019) Toulouse School of Economics, June 2019 <https://www.tse-fr.eu/sites/default/files/TSE/documents/doc/wp/2019/wp_tse_1016.pdf> accessed on 27 July, 2021.
[33]ibid, 17.
[34]ibid, 20.

more efficiently than debt renegotiations with collective action clauses or a single creditor"[35]. The UK approach is a favourable one because it allows for majority vote and all bondholders are treated uniformly irrespective of the fact, whether they voted or not, and this is how an amendment should only be made in UAC for the clauses.

The debt restructuring mechanism can solve the holdout problem than contractual approach and aggregate voting can prevent creditors from individual sovereign debt contract from acting as holdouts and other sovereign debt contracts and it allows debtor-state to designate large enough classes of claims to prevent Vulture Funds (VF).[36]VF are funds that invests in sovereigns that poorly perform and are undervalued. The VF strategy has attracted concerns over the years. "It consists of buying sovereign debt instruments at discounted prices in the secondary market, withholding their consent in debt restructuring and ultimately seeking debt in full, either through litigation or through the threat of litigation against sovereign debtors"[37]. Thus, VFhave a stumbling block, that is, it refuses to give consent for debt restructuring in small proportions and seeks for debt in full. Furthermore, litigation is another disadvantage of VF.

Two features can minimise the risk of Vulture Fund Litigation (VFL). First, is automatic stay of litigation as a temporary legal protection of sovereign once restructuring mechanism is activated.[38]Second, "supermajority voting that will approve binding restructuring agreement to override the existence of sovereign debt contractsthus dealing with the free-rider problem and risk of VFL"[39] An argument arises, will these really minimise the risk associated with the VF. The automatic stay of litigation will actually reduce the pressure of sovereign debt upon the nations as litigation seeks for debt in full. And when supermajority voting takes place, the pressure upon nations is reduced as consent is obtained by voting procedure. And these conditions should be inserted in CACs in order to avoid any kind of disruptions and this will themselves support CACs to achieve their aim. Why haveVF. Why not only have UAC for CACs and have flexibility.

[35]ibid, 21.
[36]Steven L. Schwarcz, (n 24) 83, 84.
[37]George Pavlidis, 'Vulture litigation in the context of sovereign debt: global orlocal solutions?' (2018) 12(2) Law and Financial Markets Review 93.
[38]ibid, 96.
[39]ibid.

On the other hand, as explained above, the IMF is also considering SDRMas to when a nation seeks funds, the IMF will have to decide as to whether nation's problem can be resolved with or without debt restructuring.[40] Moreover, it ensures legal, economic and political feasibility.[41] The UAC for CACs is needed because it is "a mechanism to bind dissenters based on acceptance by a supermajority of similarly situated creditors"[42].

Requirements for Uniformly Applicable Condition for CACs:

There is a need for new aggregate CACs in order to restructure sovereign debt securities. A question arises why UAC for CACs is needed. The key issue with the CACs is to balance the despotism of the minority faced by the majority.[43] "The risk of oppression of the minority by the issuer in corporate bond CACs ismitigated by the presence of good-faith requirement in English Law issued bonds."[44]

The English Law takes a broad approach "as to whatthe parties have the freedom to agree and is generally non-interventionist in respectingagreed contract terms"[45]. Furthermore, when the majority is given in the contractual terms, the minority becomes bound by implied power and this is based on the principles of Law and Equity.[46]Moreover, the principle requires that no discrimination should be made between the majority and the minority.[47] The debt securities, that are common law based, for example, English Law, are to be aggregated, then it should meet all the proposals, ie, amend contractual terms, voting procedures and matters of legality, validity and enforceability and to formulate a restructuring proposal.[48]

As explained in the previous section, there's a need for single limb series voting because it is an aggregate vote among all the noteholders.[49] Furthermore, the aggregated votes that are required

[40]Steven L. Schwarcz, (n 24) 85.
[41]ibid, 89, 92, 94.
[42]Susan Block-Lieb, 'Austerity, Debt Overhang, and the Design of International Standards on Sovereign, Corporate, and Consumer Debt Restructuring' (2015) 22(2)Indiana Journal of Global Legal Studies 487, 501.
[43]Stephen Moverley, Smith QC and Heather Murphy, 'Sovereign bond collective action clauses: issues arising' (2015) 2 (128A) Butterworths Journal of International Banking and Financial Law 2.
[44]ibid.
[45]Deborah Zandstra, 'New Aggregated Collective Action Clauses andevolution in the restructuring ofsovereign debtsecurities' (2017) 12(2) Capital Markets Law Journal 180, 191.
[46]ibid, 191.
[47]ibid, 192.
[48]ibid.
[49]ibid, 193.

should be around 75%, that set the required majority for significant changes, needed if any.[50] In the case of multiple series voting, they are reserved at $66^{2/3}$% of the aggregate principal amount of the outstanding debt.[51] This requires a minimum threshold to be achieved in each bond series and across all bond series to restructured.[52] Thus, 75% seems to be much better because there is more majority in this case as explained above. But, in terms of English Law perspective, even minority should be protected. And 75%protects the majority. Thus, there is a need to UAC is order to protect both the minority as well as majority.

In conventional refinancing, a sovereign issues new bonds to repay old bonds upon maturity and the new bonds could be issued in format that includes the new ICMA, CAC clause.[53]There's a need to make bond amendments that are simple for the issuers and investors, and explain why amendments are needed, ie, why there is a need to change the terms and conditions in the bond.[54] This can also help to change the terms and conditions, that will help in the insertion of new CAC clauses. Also, bond exchange offer, an investor offers the opportunity to exchange the holding of old bonds for the position of new bonds.[55] When new bonds are issued, they will have new clauses instead of old bonds clauses and whenever there is crisis, the bondholder should use bond exchange offer that has acceptable condition in order to overcome the problems in debt restructuring.[56]

Apart from the above, it's pertinent to mention that Uniform CACs in sovereign bond contracts can help in restructuring debts of the governments that are facing financial difficulties.[57] These

[50]ibid,
[51]ibid.
[52]Chanda DeLong and Nikita Aggarwal, 'Strengthening the contractual framework for sovereign debt restructuring—the IMF's perspective' 11(1) Capital Markets Law Journal 25, 30.
[53]Gregory Makoff and Robert Kahn, 'Sovereign Bond Contract ReformImplementing the New ICMA Pari Passu and Collective Action Clauses' (CIGI PAPERS, February 2015) <https://www.cigionline.org/static/documents/cigi_paper_no_56.pdf> accessed on July 30, 2021.
[54]ibid.
[55]ibid.
[56]ibid.
[57]Nicoletta Layher and Eyden Samunderu, 'The Impact of the Introduction of Uniform European CollectiveAction Clauses on European Government Bonds as a RegulatoryResult of the European Sovereign Debt Crisis' [2021] Journal of Risk and Financial Management 14<https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjU2MaLnYzyAhVTgdgFHTlKC1AQFjAFegQIDhAD&url=https%3A%2F%2Fwww.mdpi.com%2F1911-8074%2F14%2F1%2F1%2Fpdf&usg=AOvVaw2UzyDhnhjtNSevwnTPi7PV> accessed on July 31, 2021.

were introduced by the member states of European Union (EU) to restructure the debts as the governments face financial difficulties.[58]

Collective Action Clauses and Coronavirus:

The pinnacle of the effects upon the economy that has resulted because of the coronavirus crisis has put significant pressure upon the debt obligations at a global level.[59] When adverse economic conditions arise, they have led to sovereign debt defaults and dissatisfied creditors in the crisis.[60]"When creditors perceive that recourse to domestic courts is absent or inadequate, some may potentially resort to international arbitration as part of their efforts to engage with governments over the resolution of both sovereign debt defaults and restructurings."[61] Thus, CACs come in that help in to protect the rights of the creditors.

In order to review the potential arbitration of sovereign bonds disputes, it is important to review the terms of existing debt, consider whether major bondholders are subject to investment arbitration.[62] Furthermore, it is important to monitor the conduct of bondholders and the government during negotiations, assesses the legal implications of restructuring terms, assesses the legal implications of potential methods of defaulting and restructuring and assesses the legal implications of economic emergency.[63]

If UAC comes in, arbitration condition for the restructuring conditions of sovereign debts is included, this will help in restructuring nations debt without hazzles as arbitration procedures will be laid down in the UAC. Even United Nations General Assembly urges for a wakeup call for Collective Action to tackle Global Crisis after the effects of Covid-19.[64] This call was in

[58]ibid, 14.
[59]Dechert LLP, 'COVID-19 Economic Crisis: Impending Sovereign Bond Disputes and the International Investment Protection System' (*ICLG.com*, 18 May 2020) <https://iclg.com/briefing/12369-covid-19-economic-crisis-impending-sovereign-bond-disputes-and-the-international-investment-protection-system> accessed on August 5, 2021.
[60]ibid.
[61]ibid.
[62]ibid.
[63]ibid.
[64]Heeding COVID-19 'Wake-Up Call', General Assembly Urges Collective Action to Tackle Global Crises, Marks Seventy-Fifth Year of United Nations; <https://www.un.org/press/en/2021/ga12308.doc.htm> accessed on August 6, 2021.

order to encourage sustainable development and to strengthen peace, security and development across the globe and this is only possible with the economic restructuring of the countries.[65]

Critique:

CACs do encourage a positive step in the right direction, but needs an amendment. As explained in the beginning CACs are a part of SDRM, that permit majority bondholders to agree to the debt restructuring process. CACs encourage to reduce the nation's costs in the terms of nation's output in order to overcome prolonged debts.[66]The substantial benefits in promoting CACs will also require innovations in financial architecture.[67] "For example, by reducing the costs of debt restructuring, CACsmight relax the pressure on the IMF to extendfinancial assistance to countries whose debts maynot be sustainable"[68]. It is pertinent to mention as cited above that there is a need for strengthening CACs in order to administer catalyst change.

The issuer of CACs has a broad discretion to select from a menu of voting procedures either under the agreement or under the terms of a specific bond issuance.[69] It can be argued that instead of having a menu of voting procedures, there should be a UAC for the voting to take place. A pertinent issue of thought arises, why to have different voting procedures and CAC clauses and make things difficult or cumbersome to settle!

CONCLUSION

From the beginning the stance is maintained that UAC for CACs is needed in order to avoid the conflict of different CACs. In this paper, origin, rational, requirements, CACs in-relation to Coronavirus have been discussed.

Thus, it is a sum up, that to ensure the legal acceptability and market enforceability, disclosure of CACs is a must. The potential investors must be fully made aware that "in the event of a restructuring, the outcome of a vote on a restructuringcould be affected by the votes cast by the

[65]ibid.
[66]Kenneth M. Kletzer,"Resolving sovereign debt crises with collective action clauses," (2004) 20 FRBSF Economic Letter, Federal Reserve Bank of San Francisco, 3.
[67]ibid, 3.
[68]ibid, 3.
[69]ibid, 35.

holders of other bond series"[70]. If an outcome of votes on restructuring is really affected by the votes cast by holders of bond series, then an argument arises, will restructuring never take place. It is important to understand here that an amendment must be made, for UAC that will help in avoiding such conflict of thought.

[70]Chanda DeLong and Nikita Aggarwal, (n 52) 25, 35.

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