

Unlawfully-Issued Sovereign Debt

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In 2016, its economy in shambles and looking to defer payment on its debts, the Venezuelan government of Nicolás Maduro proposed a multi-billion dollar debt swap to holders of bonds issued by the government's crown jewel, state-owned oil company Petroleos de Venezuela S.A. (PDVSA). A new government now challenges that bond issuance, arguing that it was unlawful under Venezuelan law. Bondholders counter that this does not matter, that PDVSA freed itself of any borrowing limits by agreeing to a choice-of-law clause designating New York law.

The dispute over the PDVSA 2020 bonds implicates a common problem. Sovereign nations borrow under constraints imposed by their own laws. Loans that violate these constraints may be deemed invalid. Does an international bond—i.e., one expressly made subject to the law of a different jurisdiction—protect investors against that risk? The answer depends on the text of the loan's choice-of-law clause, as interpreted against the backdrop of the forum's rules for resolving conflict of laws problems.

We show that the choice-of-law clauses in many international sovereign bonds—especially when issued under New York law—use language that may expose investors to greater risk. We document the frequent use of “carve-outs” that could be interpreted to require the application of the sovereign's local law to a wide range of issues. If interpreted in this way, these clauses materially reduce the protection ostensibly offered by an international bond. We explain why we think a narrower interpretation is more appropriate. We close by exploring implications of our findings, including for the dispute over the PDVSA 2020 bonds.

* University of North Carolina School of Law and Duke University School of Law, respectively. Thanks to John Coyle for comments and suggestions on earlier drafts and to Renxiang Wei for research assistance. We also owe a large debt to the twenty senior sovereign debt lawyers who took the time to discuss the core questions in our paper with us. For reasons of confidentiality—and given that the matters discussed here are in litigation that might implicate some of their law firms—we cannot thank them by name or share the notes with the editors. Responsibility for the accuracy of what we report on that score therefore is solely ours. The research was done under the Duke Human Subjects Protocol 1192.

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I. INTRODUCTION

In 2016, its economy in shambles and looking to defer payment on its debts, the Venezuelan government of Nicolás Maduro proposed a multi-billion dollar debt swap to holders of bonds issued by the government's crown jewel, state-owned oil company Petroleos de Venezuela S.A. (PDVSA). In exchange for the outstanding bonds, which were soon to mature, bondholders received new bonds that did not mature until 2020. To sweeten the deal, the new bonds, unlike the old, were secured. As collateral, the government pledged fifty-one percent of the equity in Citgo, PDVSA's wholly-owned oil refining company in Texas.¹

Now, in 2020, Venezuela's economic crisis has deepened and the PDVSA 2020 bonds are in default. Bondholders want to seize the collateral. Desperate not to lose the country's most valuable foreign asset, a new government claims that its predecessor could not lawfully pledge the Citgo shares.² Under Venezuelan law, contracts in the "national public interest" must be approved by the legislature.³ The Maduro regime did not seek approval, expecting perhaps that the opposition-controlled legislature would not grant it. The new government asked a federal judge in New York to invalidate the bonds and collateral pledge, allowing it to retain control over Citgo, which the government characterizes as indispensable to the country's economic recovery.⁴ But there is a problem with this argument. The PDVSA 2020 bonds include a choice-of-law clause stipulating that the

1. See Mary Anastasia O'Grady, *Bondholders and Venezuelan Democracy*, WALL ST. J. (Oct. 13, 2019), <https://tinyurl.com/5ywc4wer>; *Offering 50% of Citgo Venezuela's PDVSA Gets \$2.8 Billion of \$7.1 Billion in Debt Holders to Extend*, LATIN AM. HERALD TRIB. (2016), <https://tinyurl.com/7pu6krxf>.

2. Although Nicolás Maduro is still in charge in Caracas, the United States government recognizes opposition leader Juan Guaidó as interim president. See Press Release, U.S. Embassy & Consulate in Ecuador, Statement from President Donald J. Trump Recognizing Venezuelan National Assembly President Juan Guaido as the Interim President of Venezuela (Jan. 23, 2019), <https://tinyurl.com/becj8njd>. Historically, PDVSA's oil exports generated ninety-five percent of Venezuela's foreign currency earnings. See Gillian B. White & Bourree Lam, *What's at Stake in Venezuela's Economic Crisis*, ATLANTIC (July 5, 2016), <https://tinyurl.com/2y7h7azb>. And, at least before the current U.S. sanctions regime blocked transactions, Citgo was a key source of both dollars and refined fuel for Venezuela. See Clifford Krauss, *Venezuela's Crisis Imperils Citgo, its American 'Cash Cow'*, N.Y. TIMES (Oct. 1, 2018), <https://tinyurl.com/yfhx7uf>. Thus, "Citgo is considered critical to a future recovery of the country's economy." Clifford Krauss, *Citgo Gets a U.S. Lifeline in Holding off Creditors*, N.Y. TIMES (Oct. 24, 2019), <https://tinyurl.com/zbuyaact>.

3. See CONSTITUCIÓN DE LA REPÚBLICA DE VENEZUELA art. 150 (amended 2009).

4. See Complaint for Declaratory and Injunctive Relief ¶ 9, *Petróleos de Venez. S.A. v. MUFJ Union Bank*, No. 19 Civ. 10023, 2020 WL 7711522 (S.D.N.Y. Oct. 29, 2019); Andrew Scurreia, *Venezuelan Opposition Files Lawsuit Attacking Citgo-Backed Bonds*, WALL ST. J. (Oct. 29, 2019), <https://tinyurl.com/ydexkf5h>. If the court were to invalidate the collateral pledge only, bondholders would be left with an unsecured claim. Even an unsecured creditor will eventually threaten the governments' control over CITGO; indeed, Canadian mining company Crystallex threatens it now. The reason is that PDVSA's only U.S. asset is an equity interest in CITGO's ultimate U.S. parent company, and this asset can be attached and sold to satisfy a judgment creditor's claim. At present, however, U.S. sanctions prevent such a sale.

bonds are to be governed exclusively by the law of New York. The indenture trustee responded to the government's suit by arguing that it does not matter what Venezuelan law says about the country's ability to borrow. In the trustee's view, the country freed itself of domestic borrowing limits by agreeing to the choice-of-law clause. What matters is the content of New York law, which, the trustee argues, requires enforcement.⁵

The dispute over the PDVSA 2020 bonds implicates a common problem. When borrowing, sovereign nations operate under legal constraints imposed by their own laws. These constraints take many forms. Some limit the amount of debt the sovereign can incur. Others cabin the borrowing authority of executive branch or finance ministry officials by requiring a legislature or other political institution to approve loans. Still others regulate borrowing mechanics such as questions of loan execution—say, by specifying which official must sign loan-related documents. Whatever the nature of the constraint, the sovereign's own law will also define the consequences of a violation. In some cases, the sovereign may avoid the obligation to repay entirely.⁶

Our inquiry is motivated by a desire to understand how these domestic legal constraints work in *international* sovereign loans like the PDVSA 2020 bonds. We use the term to refer to loans that are enforceable in foreign courts or arbitration tribunals and that are governed by foreign law, rather than by the borrower's local law.⁷ Sovereign debt is often bond debt, so we will mostly use that term (rather than loan) and refer to investors (rather than lenders). However, our discussion is not limited to any particular form of borrowing.

An international sovereign bond typically includes a waiver of sovereign immunity, a clause submitting to the jurisdiction of foreign courts, and a choice-of-law clause stipulating to the application of foreign law.⁸ Mostly, this means New York or English law.⁹ These contractual provisions work

5. In October, the district judge ruled that the PDVSA 2020 bond was valid and enforceable. *Petróleos de Venez. S.A. v. MUFJ Union Bank*, No. 19 Civ. 10023, 2020 WL 6135761 (S.D.N.Y. Oct. 16, 2020). That decision is now on appeal.

6. For instance, in the U.S. municipal context, see, e.g., *Chem. Bank v. Wash. Pub. Power Supply Sys.*, 691 P.2d 524 (Wash. 1984), *State v. Spring City*, 260 P.2d 527 (Utah 1955), and *State ex rel. Nuveen v. Greer*, 102 So. 739 (Fla. 1924).

7. See, e.g., CARMEN REINHART & KENNETH A. ROGOFF, *THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY* 9 (2009) (describing external debt as “normally subject to the jurisdiction of foreign creditors”); Anna Gelpern, *Domestic Bonds, Credit Derivatives, and the Next Transformation of Sovereign Debt*, 83 CHI.-KENT L. REV. 147, 149 (2008) (emphasizing the importance of governing law but also noting the difficulty of drawing neat distinctions between foreign and domestic borrowing).

8. W. Mark C. Weidemaier, *Sovereign Immunity and Sovereign Debt*, 2014 U. ILL. L. REV. 67, 86 n.120; Stephen J. Choi, Mitu Gulati & Eric A. Posner, *The Evolution of Contractual Terms in Sovereign Bonds*, 4 J. LEGAL ANALYSIS 132, 139-40 (2012).

9. See Stephen J. Choi, Mitu Gulati & Robert E. Scott, *The Black Hole Problem in Commercial Boilerplate*, 67 DUKE L.J. 1, 25 (2017). Typically, such a loan would also be denominated in a foreign

together to shield investors from the risk of legal instability, including the risk that the sovereign will change its law to reduce its payment obligations.¹⁰ History teaches that the risk is significant. In the 1930s, as countries abandoned the gold standard, the United States changed its law to retroactively eliminate contractual protections indexing bond payments to gold.¹¹ In 2012, Greece undertook the largest sovereign debt restructuring in history by passing a law retroactively allowing a subset of bondholders to agree to a restructuring of the country's local-law debt and to bind dissenters to the outcome.¹² In 2018 and 2019, Barbados modeled its restructuring of local-law debt on the Greek template.¹³

Domestic debt—that is, debt lacking the contractual protections mentioned above—can readily be restructured using such methods. The issuing sovereign's local law may already authorize it to conduct a debt restructuring without the consent of all creditors; if not, the law can be changed.¹⁴ And while domestic courts might act to prevent the worst misuses of this power, they often will defer to political actors in a financial crisis.¹⁵ Indeed, even when the sovereign's local law incorporates explicit investor protections, the available evidence suggests that these offer little value to investors.¹⁶ By contrast, in an international loan, the designated foreign law and courts will likely place great emphasis on enforcing contracts in accordance with their terms. In its 2012 debt restructuring, Greece's retroactive legal changes affected only its local-law debt. Investors who held international debt were unaffected, and many escaped the restructuring altogether.¹⁷

currency, although for our purposes the governing law is what matters. For a discussion, see Michael Bradley et al., *Pricing Sovereign Debt: Foreign Versus Local Parameters*, 24 EUR. FIN. MGT J. 261 (2018).

10. Choi et al., *supra* note 8, at 139-40.

11. SEBASTIÁN EDWARDS, *AMERICAN DEFAULT: THE UNTOLD STORY OF FDR, THE SUPREME COURT, AND THE BATTLE OVER GOLD* (2018).

12. Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, *The Greek Debt Restructuring: An Autopsy*, 28 ECON. POLICY 513, 554 (2013).

13. See Andrew Shutter, *Barbados Sovereign Debt Restructuring 2018-2019—Like the Island, Small but Perfectly Formed*, 15 CAP. MKTS. L.J. 250 (2020); Sui-Jim Ho & Edward Crane, *Building a Climate Resilient Debt Portfolio*, INT'L FIN. L. REV. (Mar. 20, 2020); Myrvin Anthony, Gregorio Impavido & Bert van Selm, *Barbados 2018-2019 Sovereign Debt Restructuring—A Sea Change?* 9-10 (Int'l Monetary Fund, Working Paper No. WP/20/34, 2020).

14. See, e.g., W. Mark C. Weidemaier, *Restructuring Euro Area Sovereign Debt: Have the Options Narrowed?*, 6 J. FIN. REG. 125 (2020).

15. See Mitu Gulati & Georg Vanberg, *Paper Tigers: Or How Much Will Courts Protect Rights in a Financial Crisis?* (Duke L. Sch. Pub. L. & Legal Theory Series, Paper No. 2018-45, 2018).

16. Mitu Gulati, Ugo Panizza, W. Mark C. Weidemaier & Gracie Willingham, *When Governments Promise to Prioritize Public Debt, Do Markets Care?*, 6 J. FIN. REG. 41 (2020).

17. Greece's international bonds allowed investors to collectively vote on whether to accept a restructuring proposal. A portion of the international bonds were restructured through this mechanism, but a significant proportion of the debt refused to participate, and these holdouts were paid in full. See Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, *The Greek Debt Restructuring: An Autopsy*, 28 ECON. POL'Y 513 (2013).

By submitting to foreign law and jurisdiction, sovereign borrowers commit the legal version of “original sin,” in which a country issues debt denominated in a foreign currency.¹⁸ Just as the promise to repay in foreign currency protects against the fluctuating value of the borrower’s currency, the submission to foreign law and jurisdiction protects against instability in the borrower’s legal regime. But international debt also creates a tension. Debt limits and other borrowing constraints serve important policy objectives.¹⁹ They cannot serve these objectives if local officials can evade them through the simple expedient of signing a loan contract that stipulates to foreign law and jurisdiction.

The PDVSA 2020 bond dispute is a real-world example of the tension. Another involves Ukraine. In 2013, that country issued a \$3 billion bond governed by English law, the entirety of which was purchased by the Russian sovereign wealth fund.²⁰ Ukraine now seeks to avoid repayment because (among other reasons) the loan put the country over the maximum amount of external debt permitted by Ukrainian law.²¹ The dispute has made its way up to the Supreme Court of the United Kingdom, which must decide whether to enforce the loan. And there are other examples involving both sovereign nations (e.g., Mozambique) and sub-sovereigns (e.g., Puerto Rico).²²

To what extent do such violations of the sovereign’s local law matter in an international loan? As a theoretical matter, the question is a difficult one: Should the sovereign’s agents be able to evade borrowing constraints so easily? But this theoretical question presumes the answer to a more foundational one: *Do international loans in fact protect against the risk that a loan will turn out to be in violation of the sovereign’s local law?* This turns out to be a complicated question. Both the Ukraine and Venezuela cases reveal confusion about whether, in an international loan, the designated law in fact governs disputes concerning the validity and enforceability of the loan.²³

18. Barry Eichengreen, Ricardo Hausmann & Ugo Panizza, *The Pain of Original Sin, in* OTHER PEOPLE’S MONEY, DEBT DENOMINATION AND FINANCIAL INSTABILITY IN EMERGING MARKET ECONOMIES (Barry Eichengreen & Ricardo Hausmann eds., 2005).

19. See *infra* Part II.B.

20. W. Mark C. Weidemaier, *Contract Law and Ukraine’s \$3 billion Debt to Russia*, 11 CAP. MKTS. L.J. 244 (2016); Ian Talley, *What’s \$3 Billion Between Enemies? Ukraine and Russia Battle Over Debt Terminology*, WALL ST. J. (Mar. 28, 2015), <https://tinyurl.com/3dm4pjrt>.

21. For a summary of these arguments, see *Law Debenture Trust Corp. v. Ukraine* [2017] EWHC (Comm) 655 [23]-[33].

22. See Mary Williams Walsh, *Puerto Rico Seeks to Have \$9 Billion in Debt Declared Unconstitutional*, N.Y. TIMES (May 2, 2019), <https://tinyurl.com/y27hbjuk>; Borges Nhamire & Matthew Hill, *Mozambique Wants to Void \$622 Million Credit Suisse Loan*, BLOOMBERG (Mar. 1, 2019), <https://tinyurl.com/pvykn5jf>; Steven Bodzin, *Bolivia Issuance Plan Could Lead to Legitimacy Fight*, REDD INTELLIGENCE (July 2, 2020) (on file with authors) (noting all of these cases).

23. See also *Law Debenture Trust Corp. v. Ukraine* [2017] EWHC (Comm) 655 [58] (“Ukraine does not plead any English conflict of law principle that requires application of Ukrainian law to determine Ukraine’s capacity to enter into the agreements, or otherwise explain the relevance of

The answer to that question depends mostly on the text of the choice-of-law clause in the loan. But the text will not always provide clear guidance. As experts have long warned, choice-of-law clauses can leave much to interpretation, and minor textual variations can produce different outcomes.²⁴

At least anecdotally, there is evidence that international sovereign bonds do not include standardized governing law clauses. Consider the differences in the governing law clauses applicable to the bonds issued by Ukraine and PDVSA:

- **Ukraine:** This Trust Deed and any non-contractual obligations arising out of or in connection with it are governed by English law.²⁵
- **PDVSA:** THIS INDENTURE AND THE NOTES SHALL BE CONSTRUED IN ACCORDANCE WITH, AND THIS INDENTURE AND THE NOTES AND ALL MATTERS ARISING OUT OF OR RELATING IN ANY WAY WHATSOEVER TO THIS INDENTURE AND THE NOTES (WHETHER IN CONTRACT, TORT OR OTHERWISE) SHALL BE GOVERNED BY, THE LAWS OF THE STATE OF NEW YORK WITHOUT REGARD TO THE CONFLICTS OF LAW PROVISIONS THEREOF (OTHER THAN SECTION 5-1401 OF THE NEW YORK GENERAL OBLIGATIONS LAW).²⁶

Leaving aside the fact that one specifies English and the other New York law, the clauses differ in ways that might prove important. Most notably, Ukraine's clause is relatively generic. For example, it does not clearly indicate whether English law governs disputes over the *validity or enforceability* of the loan. Nor does it indicate whether, by designating English law, the intent was to exclude the application of English conflicts of law rules. By contrast, PDVSA's clause includes broad language designating New York as the governing law for "all matters arising out of or relating in

Ukrainian law to an English law governed agreement." *Compare* Memorandum of Law in Support of Defendants and Counterclaim Plaintiffs' Motion for Summary Judgment at 23-26, *Petróleos de Venez. S.A. v. MUFG Union Bank*, No. 19 Civ. 10023, 2020 WL 6135761 (S.D.N.Y. June 16, 2020) (arguing that New York law governs the validity of the collateral pledge), *with* Memorandum of Law in Support of Plaintiffs' Motion for Summary Judgment, *Petróleos de Venez. S.A. v. MUFG Union Bank* at 23-27, No. 19 Civ. 10023, 2020 WL 6135761 (S.D.N.Y. June 15, 2020) (arguing that the question is governed by Venezuelan law notwithstanding the designation of New York Law in the contract).

24. See John F. Coyle, *The Canons of Construction for Choice-of-Law Clauses*, 92 WASH. L. REV. 631, 643-47 (2017); Glenn West, *Making Sure Your "Choice-of-Law" Clause Chooses All of the Law of the Chosen Jurisdiction*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 18, 2017), <https://tinyurl.com/m2r9x69k>.

25. Trust Deed Relating to U.S. \$1,250,000,000 7.50 Per Cent Notes due 2023 ¶ 25.1.

26. Indenture for Petróleos De Venezuela, S.A. 8.50% Senior Secured Notes Due 2020 § 10.03.

any way to this indenture” and also expressly excludes the application of New York’s conflicts of law rules.

These textual differences need not produce different interpretations.²⁷ Sometimes, contract verbiage is simply encrustation, an overlay of legal jargon that accumulates as lawyers tinker with a contract template.²⁸ But some textual differences change meaning. That fact motivates our inquiry here. To understand the relationship between international loans and local-law borrowing constraints, one needs information about how international sovereign bonds designate foreign law—that is, information about what choice-of-law clauses actually say—and a sense of how courts will interpret these provisions. At present, there is no good information about either subject. This article attempts to correct the deficit.

Part II explains the contracting dynamics in this setting. In a lawsuit, the governing law will be selected by applying the forum’s conflict of laws rules, which will typically but not always honor the parties’ choice of law.²⁹ Yet even when the choice-of-law clause designates foreign law, courts sometimes look to the sovereign’s local law. Courts often look to that law to decide whether the parties in fact formed an enforceable choice-of-law agreement. More broadly, courts look to the sovereign’s law to decide *whether* a loan was validly issued but look to the designated foreign law to determine the *consequences* of a violation. Yet there is a great deal of uncertainty, and both investors and sovereign borrowers should value clarity in this context. Part II describes this dynamic and explains why some sovereigns might bargain to have their local law govern a relatively wide set of issues. The short explanation is that this is the only way to ensure that local-law borrowing constraints serve their important objectives.

Part III presents the results of a survey of international bonds issued by a representative sample of sovereign borrowers, supplemented by a similar data from bonds issued by state-owned firms and other sub-sovereigns. We identify several common “carve-outs”—i.e., provisions explicitly reserving a subset of issues for resolution under the sovereign’s local law. For example, bonds frequently carve out questions of “authorization” and “execution” from the choice-of-law clause. As an example, consider this clause from a bond issued by Brazil in 2017 (emphasis ours):

27. With regard to Ukraine’s trust deed, for example, Ukraine argued that “questions of its capacity and powers are, under the principles of English conflict of laws, governed by Ukrainian law.” *Ukraine v. Law Debenture Trust Corp.* [2018] EWCA (Civ) 2026 [38]. The Court of Appeal did not agree. For PDVSA’s trust deed, even without the express exclusion of New York conflicts rules, a court would likely interpret the clause to incorporate only New York’s local law. *See* Coyle, *supra* note 24, at 643-47.

28. Choi et al., *supra* note 9; John F. Coyle & Mark C. Weidemaier, *Interpreting Contracts Without Context*, 67 AM. U. L. REV. 1673 (2018).

29. *See, e.g.*, RESTATEMENT (SECOND) OF CONFLICT OF L. § 187 (AM. L. INST. 1981).

The indenture and the debt securities will be governed by, and interpreted in accordance with, the laws of the State of New York without regard to those principles of conflicts of laws that would require the application of the laws of a jurisdiction other than the State of New York . . . ; **provided, further, that the laws of Brazil will govern all matters governing authorization and execution of the indenture and the debt securities by Brazil.**³⁰

Language like this might prove important in a dispute over the validity of a loan issued in violation of the sovereign's domestic law—at least if the violation was understood to implicate a matter of “authorization” or “execution.” Likewise, the absence of such a carve-out might suggest that the issuer was content to have foreign law govern these questions. Indeed, the indenture trustee makes precisely this argument in seeking to enforce the collateral pledge in the PDVSA 2020 bonds, which do not include the authorization and execution carve-out.³¹ Puzzlingly, we show that language of this sort appears almost exclusively in bonds governed by New York law.

Part III also documents the use of an unusual, open-ended carve-out applying local law to an unspecified set of “other matters.” Once again, this carve-out appears only in bonds governed by New York law. For example, this clause, used over the last decade and a half by Turkey, includes both the carve-out for matters of authorization and execution and an additional carve-out (in bold; emphasis ours) for “any other matters required to be governed by the laws of Turkey.”

[The] securities will be governed by and interpreted in accordance with the laws of the State of New York, *except with respect to the authorization and execution of the debt securities on behalf of Turkey and any other matters required to be governed by the laws of Turkey, which will be governed by the laws of Turkey.*³²

Part IV tries to make sense of these contracting practices. If the goal is to provide clarity, these clauses fall short. The carve-out for matters of “authorization” and “execution” is ambiguous, but it is at least possible that it would change the result in disputes like those over the Ukrainian and PDVSA bonds. If so, the carve-out would give real teeth to local-law constraints on borrowing. Yet this may not have been the intended result. The disclosure documents accompanying these loans do not inform investors of any additional risk associated with the loan. Nor, in numerous

30. Prospectus, Federative Rep. of Brazil U.S. \$10,000,000,000 Debt Securities (Dec. 28, 2017).

31. See Memorandum of Law in Support of Defendants and Counterclaim Plaintiffs' Motion for Summary Judgment, *Petróleos de Venez. S.A. v. MUFJ Union Bank* at 10-11, No. 19 Civ. 10023, 2020 WL 6135761 (S.D.N.Y. June 16, 2020).

32. Prospectus Supplement to Prospectus dated February 18, 2004, Republic of Turk., U.S. \$750,000,000 (June 24, 2004).

conversations, have experienced sovereign debt lawyers been able to explain the meaning of these carve-outs with any confidence.³³

If the authorization and execution carve-out is a puzzle, the “other matters” carve-out is confounding. This proviso leaves open the possibility that additional, unspecified matters might be governed by the sovereign’s local law. Indeed, it implies that the sovereign’s own law (rather than, say, the conflicts rules of the forum) might define the range of issues falling within the “other matters” exception. If so, the clause creates substantial risk for investors, for it potentially allows the government to create new exceptions to the governing law clause. Again, the disclosures accompanying the bonds do not flag this risk.

It may be that most transactional lawyers gloss over the language of the choice-of-law clause.³⁴ Yet these textual variations can prove vital, as we are seeing in the ongoing PDVSA litigation in New York. Part V concludes by exploring some implications of our findings, including for the dispute over the PDVSA 2020 bonds.

II. CONTRACTING DYNAMICS AND GOVERNING LAW

To frame our empirical inquiry, we first describe the contracting dynamics in play when a sovereign, in conjunction with its underwriters and their respective lawyers, negotiates the terms of an international sovereign bond.³⁵ Three points emerge from this discussion.

First, although the choice-of-law clause in an international loan aims to insulate investors from risks lurking in the sovereign’s local law, it is an imperfect tool. Among other reasons, the fact that a contract calls for the application of foreign law does not necessarily mean that a tribunal will in fact apply the designated law when presented with a dispute over the contract’s existence or validity (as opposed to disputes over interpretation, remedies, etc.).³⁶ This tendency to apply local law to such questions,

33. We spoke to twenty senior sovereign debt lawyers in London and New York about our project. We promised them anonymity as a condition of our research involving human subjects in accordance with Duke Human Subjects Protocol 1192.

34. See John F. Coyle, *Choice of Law Clauses in U.S. Bond Indentures*, 13 CAP. MKTS. L.J. 152, 165 (2018) (“Since both the issuers and the underwriters generally view the ancillary language in the choice-of-law clause as unimportant, this language is virtually never discussed or negotiated.”).

35. Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L. REV. 1627, 1636-37 (2006) (describing the key contracts underlying a sovereign bond as “a product of issuer-manager negotiations with their respective lawyers”).

36. For articulations of this view by leading commentators, see Symeon C. Symeonides, *Choice of Law in the American Courts in 2001*, 50 AM. J. COMPAR. L. 1, 21 (2002) (identifying “existence, validity, scope, and enforceability” as “the four sequential logical steps that a court takes before applying the law chosen by the clause”); Michael Gruson, *Governing-Law Clauses in International and Interstate Loan Agreements—New York’s Approach*, 1982 U. ILL. L. REV. 207, 223 (giving as an example the need to consult the law of a bond issuer’s state of incorporation even when the trust indenture designates New York as the governing law); John F. Coyle & Christopher R. Drahozal, *An Empirical Study of Dispute*

combined with the inherent unpredictability of conflict of laws doctrine, puts a premium on careful drafting.

Second, from the perspective of the sovereign borrower, domestic borrowing constraints serve important governance objectives. If a loan contract's designation of foreign law will undermine these objectives, many sovereigns may hesitate to agree. One solution would be to carve out a set of important matters from the scope of the choice-of-law clause. As noted, some tribunals effectively establish such a carve-out by default, by looking to the sovereign's local law to resolve disputes over validity. But a carefully drafted carve-out could remove any uncertainty.

Finally, the optimal balance of these considerations may vary from bond issuance to bond issuance. For example, sovereigns that attach value to honoring domestic borrowing constraints will seek to apply their own law to questions affecting the enforceability of the loan. Although investors may resist such demands for fear that the sovereign will manipulate its law to expropriate value, they may compromise if the sovereign has a reputation for respecting property rights and maintaining the stability of its legal system. If so, we should expect variation across the governing law clauses used by different sovereigns. That expectation motivates our examination of sovereign bond contracts, discussed in Part III.

A. The Benefit (and Limits) of Designating Foreign Law

In a stylized sovereign bond issuance, both investors and sovereigns want *ex ante* certainty about the legal rules that will govern the loan. Uncertainty complicates the assessment of legal risk and may cause investors to demand a premium.³⁷ A choice-of-law clause can reduce uncertainty.³⁸ Without such a clause, the governing law cannot be determined until a legal dispute occurs, at which point the tribunal will identify the governing law by

Resolution Clauses in International Supply Contracts, 52 VAND. J. TRANSNAT'L L. 323, 341 (2019) (“[I]t is unclear whether the parties may choose the law that will determine questions of a contract’s validity—most courts have held that this question will always be determined by forum law.”).

37. *See, e.g.*, Frank J. Fabozzi & George P. Kegler, *Federal Agency Securities*, in FINANCIAL MARKETS & INSTRUMENTS 243, 248 (Frank J. Fabozzi ed., 2008); Mark Hallerberg & Guntram B. Wolff, *Fiscal Institutions, Fiscal Policy and Sovereign Risk Premia in EMU*, 136 PUB. CHOICE 379, 382-83 (2008); *cf.* Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PA. L. REV. 47, 69 (1977) (noting that the risk that income tax changes might be repealed might cause taxpayers to expect an uncertainty premium); Kimberly D. Krawiec, *Altruism and Intermediation in the Market for Babies*, 66 WASH. & LEE L. REV. 203, 250 (2009) (“[L]egal uncertainty regarding the enforceability of surrogacy contracts . . . causes those that remain in the surrogacy sector to charge a risk premium.”).

38. Although in practice, many question whether contracting parties know very much about the law they select. LEA BRILMAYER ET AL., CONFLICT OF LAWS: CASES AND MATERIALS 698 (7th ed. 2015); *see also* Coyle, *supra* note 24, at 633 (noting that a party that has written a choice-of-law clause into its agreement will “rarely” have “conducted extensive research into the law of the chosen jurisdiction.”).

applying the conflict of laws rules applicable in that forum.³⁹ These rules do not always yield clear answers.⁴⁰ Moreover, conflicts rules differ across jurisdictions. International sovereign bonds rarely provide for exclusive jurisdiction in any forum, meaning courts in multiple countries as well as arbitration tribunals may hear disputes under the same loan contract.⁴¹ Thus, without a choice-of-law clause, the rules of the game will not become clear until long after the contract is executed. Of course, a choice-of-law clause need not designate *foreign* law. But the point of an international loan is to protect investors against the risk that the sovereign will change the rules of the game after the loan is made.⁴²

When the contract includes a choice-of-law clause, tribunals usually respect the parties' choice and apply the law designated in the contract. However, when a sovereign challenges a loan contracted in violation of its local law, the outcome is less clear. Before applying the law designated in the contract, the tribunal must resolve disputes over the existence, validity, and scope of the choice-of-law clause.⁴³ It will apply the forum's conflicts rules to identify the law governing such disputes, and these rules will often point to the sovereign's local law.⁴⁴ Moreover, courts have typically found the sovereign's local law applicable in resolving a range of questions related to the formation and validity of the contract itself. Thus, the sovereign's

39. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 59 (1995) (describing a choice of law clause as "a substitute for the conflict-of-laws analysis.").

40. For example, in the approach taken by U.S. jurisdictions that follow the Restatement (Second) of Conflict of Laws, the governing law is generally that of the state with "the most significant relationship to the transaction and the parties." *See, e.g.*, RESTATEMENT (SECOND) OF CONFLICT OF L., § 188 (AM. L. INST. 1971). In the absence of an effective choice-of-law clause, this rule also determines which law will govern disputes over the loan's validity, including disputes over whether the borrower had capacity to incur the loan, whether its agents were authorized to act on its behalf, and whether the loan was properly executed. *See, e.g.*, RESTATEMENT (SECOND) OF CONFLICT OF L., § 198, 292, 301, 302 (AM. L. INST. 1971). The generality of the rule leaves courts with significant discretion in selecting the governing law. For general criticism of the incoherence of conflicts doctrine, see, e.g., Kermit Roosevelt III, *The Myth of Choice of Law: Rethinking Conflicts*, 97 MICH. L. REV. 2448 (1999); Douglas Laycock, *Equal Citizens of Equal and Territorial States: The Constitutional Foundations of Choice of Law*, 92 COLUM. L. REV. 249 (1992); Shirley A. Wiegand, *Fifty Conflict of Laws 'Restatements': Merging Judicial Discretion and Legislative Endorsement*, 65 LA. L. REV. 1 (2005). For an argument that conflict of laws analysis may be more predictable in the international context, see Christopher A. Whytock, *Myth or Mess? International Choice of Law in Action*, 84 N.Y.U. L. REV. 719 (2009).

41. W. Mark C. Weidemaier & Mitu Gulati, *International Finance and Sovereign Debt*, in PUBLIC LAW AND LEGAL INSTITUTIONS ¶ 23.3 (Francesco Parisi ed., 2017).

42. *See, e.g.*, Marcos Chamon et al., *Foreign-Law Bonds: Can They Reduce Sovereign Borrowing Costs?*, 114 J. INT'L ECON. 164 (2018) (finding that foreign-law bonds issued by euro area governments carried lower yields during periods of financial distress).

43. *See* Symeonides, *supra* note 36, at 21; *see also infra* note 50 (discussing New York law regarding the enforceability of a choice-of-law clause that designates New York law).

44. Courts also apply the procedural law of the forum, rather than the procedural law of the designated jurisdiction.

local law will usually define the requirements for a properly-issued loan, the actual authority of purported agents, and the legality of the loan's issuance.⁴⁵

It is important to bear in mind the limited nature of these questions. A purported agent who lacks actual authority may nevertheless have apparent authority (although some jurisdictions may not permit lawsuits against foreign states based on a theory of apparent authority).⁴⁶ Likewise, the fact that a contract violated the sovereign's local law does not mean that it cannot be enforced.⁴⁷ And on these questions—on questions of *enforceability*—courts typically look to the law designated in the contract.⁴⁸ As one federal court in New York put it:

In cases alleging a violation of foreign law, the existence of illegality is to be determined by the local law of the jurisdiction where the illegal act is done, while the effect of illegality upon the contractual relationship is to be determined by the law of the jurisdiction which is selected under conflicts analysis.⁴⁹

When the contract includes a choice-of-law clause, conflicts analysis will almost inevitably result in the application of the designated law.⁵⁰ Thus, in

45. See *infra* notes 54-54; see also *Exp. Imp. Bank of China v. Cent. Bank of Liber.*, No. 15-CV-09565 (ALC), 2017 WL 1378271 (S.D.N.Y. Apr. 12, 2017), *vacated at request of parties*, *Exp.-Imp. Bank of China v. Cent. Bank of Liber.*, No. 15-CV-09565 (ALC), 2018 WL 1871436 (S.D.N.Y. Feb. 6, 2018) (“Where a commercial transaction is with a foreign state and that state has the most significant relationship to the transaction, New York law turns to the law of the foreign state in order to determine actual authority of the agent to enter into a contract.”).

46. In the United States, the law on this question is unclear. Compare *First Fid. Bank, N.A. v. Gov't of Ant. & Barb.*, 877 F.2d 189 (2d Cir. 1989) (recognizing jurisdiction based on apparent authority), with *Phaneuf v. Republic of Indon.*, 106 F.3d 302 (9th Cir. 1997) (ruling that the commercial activity exception to sovereign immunity requires a showing of actual authority).

47. Technically, the relevant jurisdiction is the one where the allegedly illegal act occurred, although in our context this will typically point to the sovereign's local law.

48. See, e.g., RESTATEMENT (SECOND) OF CONFLICT OF L. § 202 cmt. c (AM. L. INST. 1971) (“A distinction must here be drawn between the effect of illegality upon the validity of the contract and the existence of illegality as such.”).

49. *Korea Life Ins. Co. v. Morgan Guar. Trust Co.*, 269 F. Supp. 2d 424, 438 (S.D.N.Y. 2003).

50. In some circumstances, courts may refuse to give effect to a choice-of-law clause. See, e.g., RESTATEMENT (SECOND) OF CONFLICT OF L. § 187(2) (AM. L. INST. 1971); Commission Regulation 593/2008, 2008 O.J. (L 177) 10, art. 3(3), 3(4). Conflicts law in the United States generally lets a court override the parties' choice of law when that choice offends a mandatory rule of law representing a fundamental policy of another state with a materially greater interest. See RESTATEMENT (SECOND) OF CONFLICT OF L. § 187(2) (AM. L. INST. 1971). In New York, General Obligations Law § 5-1401, which applies to business contracts involving \$250,000 or more where the parties choose New York law, has been interpreted to eliminate this “fundamental policy” exception. See *Supply & Bldg. Co. v. Estee Lauder Int'l, Inc.*, 2000 WL 223838 (S.D.N.Y. Feb. 25, 2000). Virtually all sovereign loans involve amounts greater than \$250,000. However, some courts have added a qualification: a contract illegal in its place of performance will not be enforced if the intent of the contract was to violate the law. See *Lehman Bros. Com. Corp. v. Minmetals Int'l Non-Ferrous Metals Trading Co.*, 179 F. Supp. 2d 118 (S.D.N.Y. 2000); see also *Commercial Contracts: Strategies for Drafting and Negotiating* § 6.05[C] (Vladimir R. Rossman & Morton Moskin eds., Wolters Kluwer 2019). Although § 5-1401 does not explicitly dispense with the “fundamental policy” exception, some U.S. states have statutes that do so. See, e.g., N.C. Gen. Stat. § 1G-3.

the *Korea Life* case quoted just above, Korean insurance law determined whether a contract between a Korean insurer and a New York bank constituted an illegal guaranty.⁵¹ But New York law determined whether the contract's violation of Korean law rendered the contract unenforceable. It did not.⁵²

A similar distinction is sometimes drawn between questions of actual and apparent authority. For instance, in litigation over the enforceability of Ukraine's \$3 billion bond issuance, the parties agreed that Ukrainian law determined whether government officials had actual authority to approve the loan, but the Court of Appeal applied English law, designated by the indenture, to evaluate whether officials had ostensible (i.e., apparent) authority to bind the sovereign.⁵³ Likewise, in the context of the Foreign Sovereign Immunities Act, U.S. courts generally look to the sovereign's local law to determine the scope of an official's actual authority but to the law designated in the contract to determine whether the official had apparent authority to bind the sovereign.⁵⁴

Nevertheless, parties sometimes argue that an international sovereign bond requires the application of foreign law to all such questions. This appears to be how the trustee for the PDVSA 2020 bonds understands New York law.⁵⁵ The argument draws on recent New York cases, most notably *IRB-Brasil Resseguros v. Inepar Investments*.⁵⁶ There, a Brazilian company that had guaranteed notes issued under New York law argued that the guarantee was void under Brazilian law because the company's board had not authorized it. The company argued that the contract's designation of New York law included the state's conflicts rules, which pointed to the law of Brazil, the company argued, to resolve disputes over the validity of the guarantee. The New York Court of Appeals disagreed, ruling that the

51. *Korea Life*, 269 F. Supp. 2d at 437-38.

52. *Id.* at 442.

53. *Law Debenture Trust Corp. v. Ukr.* [2017] EWHC (Comm) 655 [136]; *Ukr. v. Law Debenture Trust Corp.* [2018] EWCA (Civ) 2026 [76]-[78]; *see also Indosuez Int'l Fin. B.V. v. Nat'l Reserve Bank*, 774 N.E.2d 696 (N.Y. Ct. App. 2002) (applying New York law on question of apparent authority). Even when conflicts rules do not directly select the sovereign's local law on questions of actual authority, courts may reach that result indirectly. *See, e.g., Northrup Grumman Ship Sys. v. Ministry of Def. of Republic of Venez.*, 575 F.3d 491, 497 (5th Cir. 2009) (ruling that Mississippi law governed questions of actual authority but included an exception in which a foreign sovereign's law determined the actual authority of its purported agents).

54. *See, e.g., Themis Capital v. Dem. Rep. Congo*, 881 F. Supp. 2d 508, 520-21 (S.D.N.Y. 2012); *Phaneuf v. Republic of Indonesia*, 106 F.3d 302 (9th Cir. 1997); *Packsys, S.A. v. Exportadora de Sal*, 899 F.3d 1081 (9th Cir. 2018); *Morgan Guar. Trust v. Republic of Palau*, 657 F. Supp. 1475 (S.D.N.Y. 1987).

55. Memorandum of Law in Support of Defendants and Counterclaim Plaintiffs' Motion for Summary Judgment at 24-25, *Petróleos de Venez. v. MUFG Union Bank*, No. 19 Civ. 10023 (KPF) (S.D.N.Y. June 16, 2020) (noting only a potential exception for cases where the choice of law clause itself was the product of fraud).

56. 982 N.E.2d 609 (N.Y. Ct. App. 2012).

choice-of-law clause incorporated only the local law of New York.⁵⁷ Although that general proposition is uncontroversial,⁵⁸ both the outcome and the Court of Appeals' unqualified language arguably imply that all disputes are to be resolved in accordance with the law designated in the contract. As the Court of Appeals put it in a subsequent case, "when parties include a choice-of-law provision in a contract, they intend that the law of the chosen state—and no other state—will be applied."⁵⁹

Yet it is not clear that cases like *IRB-Brasil* signal a material departure from past practice, even in New York.⁶⁰ New York law is often characterized as more willing to respect the contracting parties' chosen law than competing jurisdictions,⁶¹ but does not strike us as materially different in this respect from English law (or, indeed, the law of many other jurisdictions).⁶² To be fair, it is usually through the application of forum conflicts rules that a tribunal will select the sovereign's local law to govern an issue. *IRB-Brasil* holds that a choice-of-law clause incorporating New York law presumptively excludes these rules.⁶³ But the context for that holding was quite specific. The transaction in *IRB-Brasil* involved two contracts, a fiscal agency agreement and a guarantee. Each included a choice of law clause selecting New York law, but only the fiscal agency agreement expressly disclaimed the intent to incorporate New York's conflicts rules.⁶⁴ The guarantor argued that the omission of this disclaimer from the guarantee meant that the parties intended for those rules to apply. The Court of Appeals quite sensibly rejected this argument. It has long been the rule in New York and elsewhere that a choice of law clause incorporates only the

57. *Id.* at 612.

58. For instance, the Restatement (Second) of Conflict of Laws understands a choice-of-law clause to refer only to the designated state's local law. Parties who wish to incorporate the designated jurisdiction's conflicts rules (which might point to the law of another state) must do so expressly. RESTATEMENT (SECOND) OF CONFLICT OF L. § 187(3) (AM. L. INST. 1971).

59. *Ministers & Missionaries Benefit Bd. v. Snow*, 45 N.E.3d 917, 924 (N.Y. Ct. App. 2015).

60. Indeed, the unqualified language of cases like *Ministers & Missionaries* is hard to square with other aspects of New York's conflicts law, such as the presumption that a generic choice of law clause does not apply to non-contractual claims. See Coyle, *supra* note 24, at 667-68.

61. See, e.g., Geoffrey P. Miller & Theodore Eisenberg, *The Market for Contracts*, 30 CARDOZO L. REV. 2073, 2087-89 (2009); Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 679-80.

62. For example, the Rome I regulation generally treats a contractual choice of law as conclusive, see Regulation 593/2008, of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome I), 2008 O.J. (L 177) at art. 3(1), with limited exceptions to protect mandatory rules of member states or the European Community, see *id.* art. 3(2), 3(3). The United Kingdom may take an even dimmer view of allowing a mandatory provision of foreign law to override the parties' chosen law, although the parties' choice does not receive absolute deference. See JAN-JAAP KUIPERS, EU LAW AND PRIVATE INTERNATIONAL LAW: THE INTERRELATIONSHIP IN CONTRACTUAL OBLIGATIONS 168 (2012).

63. *IRB-Brasil*, 982 N.E.2d at 612.

64. *Id.* at 610.

local (or “internal”) law of the designated state.⁶⁵ This is an interpretive rule—the canon in favor of internal law—that “is followed by U.S. courts almost without exception.”⁶⁶ In Europe, it is expressly incorporated into the Rome I Regulation.⁶⁷

But to presume that a choice-of-law clause excludes the conflicts rules of the designated jurisdiction is not to say that the designated law governs all issues. It would be non-sensical, for instance, to apply the designated law without first determining that the parties in fact agreed to the choice-of-law clause. Thus, forum conflicts rules determine which law governs disputes over contract formation.⁶⁸ Nothing about *IRB-Brasil* purports to change this sensible rule. Indeed, it is not even clear that *IRB-Brasil* means to reject the distinction, drawn in cases like *Korea Life*, between the legality of a contract and the consequences of illegality.⁶⁹ That distinction has long been thought compatible with the canon in favor of internal law.⁷⁰ In fact, it would make little sense to apply foreign law to determine the legality of an international sovereign bond, the formalities required for its issuance, or the actual authority of government agents. The designated foreign law will not have anything to say on such matters. For instance, neither English nor New York law will help identify which official or institution, within the potentially vast bureaucratic apparatus of some foreign state, must execute loan documents on the state’s behalf.⁷¹ Thus, it is widely accepted that, despite a choice-of-law clause designating foreign law, the “legal status and capacity of the borrower, including his contracting and borrowing limits can . . . be determined only by national [i.e., local] law.”⁷² Experienced practitioners in sovereign debt markets generally concede the point.⁷³ This result is also

65. See, e.g., *Reger v. Nat’l Ass’n. of Bedding Mfrs.*, 372 N.Y.S.2d 97, 118 (N.Y. Sup. Ct. 1975) (choice of law clause designating Illinois law); *Weiss v. La Suisse, Société d’Assurances sur la Vie*, 293 F. Supp. 2d 397, 402 (S.D.N.Y. 2003).

66. Coyle, *supra* note 24, at 646.

67. See Council Regulation 593/2008, 2008 O.J. (L 177), *supra* note 62, art. 20.

68. *Schnabel v. Trilegiant Corp.*, 697 F.3d 110, 119 (2d Cir. 2012). Technically, forum conflicts rules determine the law applicable to disputes over formation of the *choice-of-law clause*, although typically the dispute will implicate the entire contract.

69. *Korea Life Ins. Co. v. Morgan Guar. Trust Co.*, 269 F. Supp. 2d 424, 438 (S.D.N.Y. 2003).

70. RESTATEMENT (SECOND) OF CONFLICT OF L. § 202 cmt. c (AM. L. INST. 1971) (noting importance of distinguishing the fact of illegality from the consequences of illegality).

71. Cf. Joseph W. Dellapenna, *Suing Foreign Governments and Their Corporations: Sovereign Immunity*, 85 COM. L.J. 486, 487-88 (1981) (noting, in the context of the act of state doctrine, that “who is better suited to determine whether the action is legal than the highest legal authority of the state (often, of course, the very officials whose conduct is in question)?”).

72. Thomas Wälde, *The Sanctity of Debt and Insolvent Countries: Defenses of Debtors in International Loan Agreements*, in JUDICIAL ENFORCEMENT OF INTERNATIONAL DEBT OBLIGATIONS 125 (David M. Sassoon & Daniel D. Bradlow eds., 1987).

73. “A contractual choice of law clause in a loan agreement does not mean that the stipulated law will govern every aspect of the transaction. For example, the corporate authority of a party to enter into the agreement or the due execution of the contract by a party are matters that will probably be determined under the law of the place where the party is domiciled, not under the chosen governing law of the contract.” LEE C. BUCHHEIT, HOW TO NEGOTIATE EUROCURRENCY LOAN

consistent with corporate law's internal affairs doctrine, under which the law of the place of incorporation typically governs matters concerning relations among the corporation and its officers, directors, shareholders, and agents.⁷⁴ These rules do not necessarily help a sovereign borrower like Venezuela—a subject we address in Part V. But they are sensible enough that we hesitate to assume that *IRB-Brasil* meant to discard them.

Whatever the meaning of cases like *IRB-Brasil*, the rules discussed in this section may be problematic in an international sovereign loan. Recall that both sovereign issuers and investors have reason to favor ex ante clarity about the rules that will govern the loan.⁷⁵ The law described in this section is far from a model of clarity, and this creates uncertainty about how courts will resolve a sovereign's challenge to the enforceability of a loan issued in violation of its local law. For example, in the dispute over the collateralized PDVSA 2020 bond, the indenture trustee has argued that New York law governs *all* issues, and that Venezuelan law requiring legislative approval of contracts in the “national public interest” is simply irrelevant.⁷⁶ PDVSA, by contrast, argues that Venezuelan law determines not just whether the loan and collateral pledge required legislative approval but the validity of the contract in the absence of approval.⁷⁷ Both sides overstate the law in favor of their clients.

With the caveat that the law is far from clear, we think the law is somewhere in between the positions of the lawyers in the PDVSA litigation, although it generally favors investors by allowing the contract's designated law to determine the consequences of any violation of the sovereign's local law. Nevertheless, the wording of the clauses gives the parties room to argue for the application of different law to these questions. This is an unavoidable consequence of the lack of bright line rules for resolving conflict of laws

AGREEMENTS 129 (Rob Mannix ed., 2d ed. 2004); *see also* J. G. Collier, CONFLICT OF LAWS 208 (3d ed. 2001).

74. Commercial Contracts: Strategies for Drafting and Negotiating § 6.03[C] (Vladimir R. Rossman & Morton Moskin eds., Wolters Kluwer 2019) (noting that the law of the place of incorporation governs matters such as “whether or not the appropriate corporate actions have been taken to authorize an agreement and whether the persons who signed the agreement in the name and on behalf of a corporation or other entity . . . were properly elected or appointed officers, authorized to act on behalf of the corporation or other entity and to bind the corporation or other entity by their action”).

75. *See supra* pp. 10-11.

76. *See* Memorandum of Law in Support of Defendants and Counterclaim Plaintiffs' Motion for Summary Judgment at 25, *Petróleos de Venez. v. MUFJ Union Bank*, No. 19 Civ. 10023 (KPF) (S.D.N.Y. June 16, 2020) (“Section 5-1401 precludes the PDVSA Parties' reliance on alleged requirements of Venezuelan law to escape their agreement that the Governing Documents are subject to the law of New York.”).

77. Memorandum of Law in Support of Plaintiffs' Motion for Summary Judgment at 24, *Petróleos de Venez. v. MUFJ Union Bank*, No. 19 Civ. 10023 (KPF) (S.D.N.Y. June 15, 2020) (“The Transaction Documents' New York choice-of-law provisions are irrelevant in determining whether the 2020 Notes Transaction is valid in the first place.”).

problems. More pragmatically, it is a consequence of the fact that sovereign debt disputes involve so-called “big conflicts,” in which deep-seated policies of multiple states come into conflict.⁷⁸ In the context of sovereign debt disputes, the conflict is between New York and London, which have firmly-entrenched policies in favor of enforcing contracts, and the foreign state, for which constraints on borrowing seek to promote important governance objectives. We next explore the nature of these governance objectives and their potential implications for the terms of sovereign loan contracts.

B. Why Constrain Borrowing? A Word on Inter-generational Conflict and Agency Costs

Thus far, we have seen that conflict of laws rules generally look to the sovereign’s local law to decide whether a loan was validly issued but to the law designated in the contract to define the consequences of any violation. Though somewhat unclear in application, this rule generally favors investors by allowing courts to enforce even those loans that concededly violate the sovereign’s law. This result is also consistent with the general intent of an international loan to protect investors from legal risks lurking in the sovereign’s law. From the perspective of a sovereign borrower, however, it is problematic. It is one thing to give up the right to retroactively change the law in ways that undermine investor rights. That is one way to describe the restructuring methods employed by Greece in 2012 and Barbados in 2018-19, and it clearly describes the U.S. government’s abrogation of gold clauses in its own debt in the 1930s.⁷⁹ It is quite another to issue debt that is *at that very moment* forbidden by the sovereign’s own law. If an international loan is enforceable despite such a violation, the sovereign loses a key tool of governance.

Debt limits (e.g. Ukraine), legislative approval requirements (e.g., PDVSA), and other borrowing constraints serve important objectives. In broad terms, one might characterize debt limits as tools to mitigate the inter-generational tension inherent in government borrowing.⁸⁰ When a community borrows, it monetizes the earning capacity of its future members and uses the funds for present consumption or investment. Because

78. Katherine Florey, *Big Conflicts Little Conflicts*, 47 ARIZ. ST. L.J. 683 (2015).

79. In the cases of Greece and Barbados, an argument can be made that the retroactive legal changes benefitted creditors as a collective by preventing individual creditors from impeding a restructuring. There is also evidence that markets reacted favorably to the abrogation of gold clauses in U.S. corporate bonds. See Randall S. Kroszner, *Is it Better to Forgive than to Receive? Repudiation of the Gold Indexation Clause in Long-Term Debt Before the Great Depression* (Nat’l Bureau of Econ. Research, Working Paper No. 481, 1998).

80. *Mayor & Recorder of Nashville v. Ray*, 86 U.S. 468, 475 (1873) (“The power to borrow money is different. When this is exercised the citizens are immediately affected only by the benefit arising from the loan; its burden is not felt till afterwards.”).

community membership changes over time, those who will repay the debt may have had no say in the decision to incur it.⁸¹ Their lack of political influence creates incentives for current members to fund spending needs through debt.⁸² Borrowing caps do not eliminate these incentives but can limit the extent of the imposition on future members.

Legislative approval and other process-based constraints mitigate agency problems inherent in debt, in which public servants may have incentives to borrow in ways that do not increase overall welfare.⁸³ These constraints take many forms, from the Venezuelan requirement of legislative approval for loans in the “national public interest” to requirements that voters approve the loan and a tax increase sufficient to fund debt service (common in the U.S. municipal context).⁸⁴ More broadly, both hard debt limits and process-based constraints can be viewed as efforts to reduce profligate borrowing—i.e., borrowing that does not benefit the people who will be expected to repay.⁸⁵

The importance of such borrowing constraints is evidenced by the fact that they are commonplace at all levels of government in the United States.⁸⁶ They are no less important when adopted by foreign sovereigns. And their importance is undermined when courts apply foreign law to determine the consequences of a violation. The sovereign’s local law will usually treat borrowing constraints as mandatory rules, not defaults, for reasons that are obvious. A constraint that local officials are empowered to waive cannot

81. Clayton P. Gillette, *Direct Democracy and Debt*, 13 J. CONTEMP. LEGAL ISSUES 365, 391-92 (2004); Stewart E. Sterk & Elizabeth S. Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301, 1301.

82. See, e.g., Richard C. Schragger, *Citizens Versus Bondholders*, 39 FORDHAM URB. L.J. 787, 790 (2012).

83. Lars P. Feld & Gebhard Kirschgässner, *The Political Economy of Direct Legislation: Direct Democracy and Local Decision-Making*, 16 ECON. POL. 329, 355 (2001).

84. See generally *Citizen Participation in the American Federal System*, ADVISORY COMM’N INTERGOV’ TAL REL. 254 (1979) (discussing the role of citizen participation in the municipal debt authorization process).

85. Gillette, *supra* note 81, at 365-66; Christiana Ochoa, *From Odious Debt to Odious Finance: Avoiding the Externalities of a Functional Odious Debt Doctrine*, 49 HARV. INT’L L.J. 109, 112-113 (2008); Lee C. Buchheit, Mitu Gulati & Robert B. Thompson, *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201, 1208-20 (2007).

86. The federal government operates under a statutory debt ceiling (currently suspended through July 2021), which allows Congress substantial control over the federal budget. See Anita S. Krishnakumar, *In Defense of the Debt Limit Statute*, 42 HARV. J. LEGIS. 135, 163 (2005). Beginning in the late 19th century, debt limits, authorization requirements, and other constraints were increasingly imposed on U.S. municipalities. See generally Stewart E. Sterk & Elizabeth S. Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301, 1309; Joan C. Williams, *The Constitutional Vulnerability of American Local Government: The Politics of City Status in American Law*, 1986 WIS. L. REV. 83, 93-94; Nadav Shoked, *Debt Limits’ End*, 102 IOWA L. REV. 1239-41 (2017). Some states operate under similar constraints, many stemming from the wave of defaults and repudiations in the 1830s and 1840s. See, e.g., John J. Wallis, *Institutions, Corporations, and Corruption: American States and Constitutional Change: 1842 to 1852*, 65 J. ECON. HIST. 211, 217 (2005).

meaningfully constrain their incentives to over-borrow.⁸⁷ When a court applies foreign law to determine the consequences of a violation, and subsequently enforces the loan, it effectively converts these mandatory rules into defaults.⁸⁸ After all, a loan enforced under a theory of apparent authority burdens future generations just as much as a loan enforced under a theory of actual authority.

C. Drafting Hypotheses (and Difficulties)

The foregoing discussion implies a lack of standardization in the governing law clauses in sovereign loans. For example, consider two stylized sovereign borrowers seeking to raise money in capital markets in New York or London. Both operate under borrowing constraints. The first, a rich country, has a reputation for respecting property rights and a legal system that is transparent and known to investors. It satisfies most of its borrowing needs by issuing debt governed entirely by its own law but occasionally, as in our example, issues debt governed by foreign law.⁸⁹ Even when it issues international debt, such a country might expect its local law to govern all disputes over the enforceability of the loan. Investors might accept this debt without demanding significantly higher yields.⁹⁰ By contrast, a poor country with an unfamiliar legal system might face a significant yield penalty if it insisted on such a clause. This would be especially likely if investors had reason to doubt the sovereign's long-term willingness or ability to pay. It is not always easy to detect when a loan triggers a borrowing constraint in the sovereign's local law.⁹¹ In a financial crisis, a sovereign borrower may have

87. We oversimplify somewhat. For instance, restrictions on the form of a waiver—for example, a rule requiring local officials to make a clear, public statement of the intent to waive any restrictions imposed by local law—might somewhat constrain discretion by increasing the political accountability of the official who approves the loan.

88. This possibility is commonplace in conflict of laws, which gives significant weight to party autonomy and authorizes tribunals to apply the parties' chosen law even when the outcome will violate another state's mandatory law. *See, e.g.*, RESTATEMENT (SECOND) OF CONFLICT OF L. § 187(2) & cmt d (AM. L. INST. 1971); Regulation 593/2008, of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome I), 2008 O.J. (L 177) at art. 3(3), 3(4). It is also a consequence enabled by other areas of law. For instance, at least in theory, parties can avoid the effect of mandatory rules by agreeing to resolve disputes in arbitration. *See* Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law through Arbitration*, 83 MINN. L. REV. 703, 711 (1999).

89. Among many reasons for this, a sovereign's issuance of foreign-law debt can set a benchmark yield curve to facilitate the issuance of foreign-law corporate debt. *See, e.g.*, WORLD BANK & INTERNATIONAL MONETARY FUND, DEVELOPING GOVERNMENT BOND MARKETS: A HANDBOOK 3 (2001) (making the point with regard to domestic debt).

90. The available evidence, although limited, suggests that foreign-law bonds offer pricing benefits during periods of financial crisis. *See* Chamon et al., *supra* note 42, at 178. Rich countries posing little default risk derive few pricing benefits from foreign-law debt and would presumably incur no serious penalty by carving out a wide range of issues for resolution under local law. *See* Bradley et al., *supra* note 9, at 290.

91. In U.S. federal courts, disputes over the content of foreign law often involve extensive testimony and documentary evidence. *See, e.g.*, FED. R. CIV. P. 44.1. In the dispute over the PDVSA

incentives to interpret its domestic borrowing constraints expansively in hopes of invalidating some of its debt. Issuers with sterling reputations for repayment may be able to persuade investors to take this risk. Issuers without such reputations may have to submit to foreign law on the widest possible range of issues.

This contracting dynamic might generate different approaches to drafting the choice-of-law clause. For example, the parties might use a generic clause stating only that the contract will be “governed by” the designated law.⁹² As noted, with the generic clause, the sovereign’s local law will probably determine whether the loan violates a borrowing constraint, but the designated law will determine the consequences of any violation. However, the generic clause leaves room for parties to argue—as in the dispute over the PDVSA 2020 bonds—over the range of issues, if any, governed by local law.

Alternatively, investors seeking greater certainty and reduced risk might prefer language making clear that the designated law will cover the widest possible range of issues, including those related to the validity and enforceability of the loan. There are ready-made models of such language. For instance, in the arbitration context, federal law in the United States allows courts to resolve disputes over the enforceability of the agreement to arbitrate, unless the agreement “clearly and unmistakably” sends such issues to arbitration.⁹³ Many arbitration contracts, and some institutional arbitration rules, include examples that could be adapted for this context. As an example, the JAMS arbitration rules for employment disputes expressly require the arbitrator to resolve disputes over the arbitration agreement’s “formation, existence, [and] validity.”⁹⁴ Similar language could be used to express the parties’ intent to apply foreign law broadly, including to disputes over the formation, existence, and validity of the loan. This would not always guarantee the application of foreign law. As noted, courts sometimes apply the borrower’s local law notwithstanding a choice-of-law clause to the contrary, as when a question in a corporate loan implicates the internal affairs doctrine.⁹⁵ But it would minimize risk to investors by instructing tribunals to apply foreign law whenever the law permits.

2020 bonds, for instance, the parties have submitted hundreds of pages of exhibits contesting the need for legislative approval of the loan. *Cf.* *Korea Life Ins. Co. v. Morgan Guar. Trust Co.*, 269 F. Supp. 2d 424, 440 (S.D.N.Y. 2003) (noting the judge’s hesitancy to “declare his opinion on such a difficult and disputed point” as the validity of a guaranty under Korean insurance law).

92. Coyle, *supra* note 24, at 666.

93. *See* *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 944 (1995) (citation omitted).

94. *See, e.g.*, JAMS Employment Arbitration Rules and Procedures, Rule 11(b) (July 1, 2014), <https://tinyurl.com/w6nea6np> (providing that such issues “shall be submitted to and ruled on by the Arbitrator.”).

95. *Cf. Wälde, supra* note 72, at 125 (“The legal status and capacity of the borrower, including his contracting and borrowing limits can . . . be determined only by national law. These are matters of ‘non-choice.’”).

Finally, sovereigns seeking to give teeth to their domestic borrowing constraints might negotiate carve-outs—i.e., language clarifying that, despite the general designation of foreign law, the sovereign's local law will govern disputes over the validity and enforceability of the contract. We will call this approach the local-law carve-out. Any attempt to craft a local-law carve-out will place a premium on careful drafting. Assume, for instance, that a sovereign issuer wants to ensure that its own law will govern questions concerning the validity of the loan, thereby ensuring that local law borrowing constraints will serve their purpose. Two problems complicate this objective.

First, any carve-out must identify which legal issues are reserved for resolution under local law. But when a sovereign contests the enforceability of a loan made in violation of its domestic law, it is not always clear how to describe the legal issues raised by the challenge. Consider the argument that the loan violates a constitutional or statutory debt limit. Does the debt limit negate the sovereign's capacity to borrow, limit the authority of government officials to bind the sovereign, or make the loan illegal or contrary to policy?

By analogy to contract law, a sovereign that lacks capacity to enter a loan contract can incur only voidable obligations with respect to that contract.⁹⁶ It cannot form a binding contract to borrow and repay the money.⁹⁷ Capacity normally is understood as a characteristic of the party, not of the contract. So understood, it would seem illogical to argue that a state lacks capacity to incur debt when it is concededly able to form other types of binding obligation. Despite this, constraints such as constitutional debt limits are sometimes framed as limits on the capacity to borrow.⁹⁸

An alternative way to understand a borrowing constraint is as a limitation on the authority of state actors. The state may have the capacity to incur debt but, like any other fictitious legal entity, it can only act through agents.⁹⁹ Perhaps borrowing constraints define the circumstances in which officials are empowered to bind the state to a loan contract. Or perhaps laws constraining sovereign borrowing simply articulate a public policy against the enforcement of particular contracts, much like laws forbidding the enforcement of contracts that immunize a party for intentional torts.¹⁰⁰ To complicate matters further, different borrowing constraints may prompt

96. *See, e.g.*, RESTATEMENT (SECOND) OF CONTS. § 15 (AM. L. INST. 1981).

97. It is a separate question whether the sovereign must pay restitution as a condition of being allowed to avoid the contract. *See, e.g.*, *Hayward v. City of Corpus Christi*, 195 S.W.2d 995, 998 (Tex. Civ. App. 1946); *Olds v. Town of Belleair*, 41 F. Supp. 453, 457 (S.D. Fla. 1941).

98. *Ukr. v. Law Debenture Trust Corp.* [2018] EWCA (Civ) 2026 [23]-[75] QB 1121 (Eng.); *State v. Spring City*, 123 Utah 471, 473-74 (1953).

99. W. Mark C. Weidemaier & Mitu Gulati, *The Relevance of Law to Sovereign Debt*, 11 ANNUAL R. L. & SOC. SCI. 395-408 (2015).

100. *See, e.g.*, *Strawbridge v. Sugar Mountain Resort, Inc.*, 320 F. Supp. 2d 425, 432-33 (W.D.N.C. 2004).

different legal characterizations. As noted, in the U.S. municipal debt context, courts often treat debt limits found in the state constitution as limits on municipal capacity.¹⁰¹ By contrast, courts treat voting and other procedural requirements as conditions that must be satisfied for a loan to be properly authorized.¹⁰²

On the merits, the categorization may prove important. For example, a borrower can later ratify an unauthorized loan; this is not possible if the borrower lacks capacity.¹⁰³ The distinction between a lack of capacity and a lack of authority may also affect an investor's right to restitution if the loan is deemed invalid, as in the U.S. municipal finance context.¹⁰⁴ But merits aside, the categorization dilemma complicates the task of drafting an appropriate carve-out from a foreign-law choice-of-law clause. An overly-broad clause exposes investors to unwanted risk. An unduly narrow clause allows the loan to circumvent limits on the sovereign's ability to borrow.

The categorization problem has caused confusion in practice. With regard to Ukraine's \$3 billion bond, for instance, the country argued that the loan exceeded borrowing limits set by the budget law in effect at the time and also that the issuance failed to comply with procedural rules governing approval by the Cabinet of Ministers.¹⁰⁵ Before the English courts, the country argued that these defects meant that it lacked capacity to incur the debt.¹⁰⁶ But it also characterized the argument as challenging the authority of the Minister of Finance to bind the country to the agreement.¹⁰⁷ The indenture trustee, by contrast, insisted that these were matters affecting the authority of the country's representatives but not the capacity of the country itself.¹⁰⁸ Likewise, in the litigation over the PDVSA 2020 bonds, the parties characterize the dispute, variously, as implicating questions of authority (both actual and apparent) and capacity.¹⁰⁹

101. *See, e.g., Spring City*, 123 Utah at 473-74.

102. *See, e.g., Olds*, 41 F. Supp. at 457.

103. Again, borrowing from contract and agency law, ratification is possible only when the incapacity has been removed. *See, e.g., Silver v. U.S.*, 498 F. Supp. 610, 612 (N.D. Ill. 1980) (principal who lacked capacity at time agent entered contract may ratify contract after regaining competence).

104. *See, e.g., RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT* § 33 cmt. e (AM. L. INST. 2011) (discussing the distinction but attributing it to the fact that ultra vires loans more likely yield no benefit to the municipality and its taxpayers).

105. *Ukr. v. Law Debenture Trust Corp.* [2018] EWCA (Civ) 2026 [35], [42], [40]-[70] QB 1121 (Eng.).

106. *Id.* [37].

107. *Id.* [70.1].

108. The dispute over characterization had significant implications even though the bond included a choice of law clause selecting English law. The parties agreed that, if characterized as a question of actual authority, then Ukrainian law would govern. By contrast, the Court of Appeal applied English law to resolve disputes over questions of capacity and apparent authority. *Id.* [37], [71] (capacity); [76]-[133] (referencing only English cases in ruling on ostensible authority).

109. The indenture trustee makes each of these arguments. *See* Memorandum of Law in Support of Defendants and Counterclaim Plaintiffs' Motion for Summary Judgment at 26-32, *Petróleos de Venez. v. MUFG Union Bank*, 19 Civ. 10023 (KPF) (S.D.N.Y. Oct. 16, 2020). By contrast, PDVSA's

Drafting a local-law carve-out involves a second difficulty, related to but distinct from the first. The problem involves the difficulty in reaching agreement on the scope of the carve-out. Consider the question of whether the sovereign must pay restitution to investors who hold bonds that turn out to be invalid. Should local law govern that issue? If so, how can the choice-of-law clause be drafted to express this intent without creating new interpretive problems (which the issuer might later exploit to reduce its obligations)? Put in economic terms, any effort to draft a suitable local-law carve-out will involve high specification costs.¹¹⁰ But without careful drafting, such a clause can introduce new risks into the loan.

III. HOW SOVEREIGN BONDS ADDRESS GOVERNING LAW

To understand how these dynamics play out in practice, we constructed a dataset of international sovereign bonds. We hand-coded the choice-of-law provisions in bonds issued by a randomly-selected group of sovereign nations. We also examined bonds issued by a randomly-selected group of sub-sovereign borrowers, including cities, provinces, and state-owned entities (e.g., PDVSA and Mexican state oil company Pemex). Debt issued by such entities often benefits from an explicit or implicit state guarantee, so one might expect to see parallel drafting practices in the two settings.

In total, we coded over 500 bonds: 386 sovereign bonds, issued by 96 sovereigns, plus an additional 163 bonds issued by 57 sub-sovereign entities. Our coding relies on prospectuses and other sales documents, which describe or reprint key bond terms. The dates of issuance range from 1976 to 2019, although most are recent and pertain to bonds that have not yet matured. Because sovereign borrowers tend to use the same terms in each bond issuance, and because we include bonds issued by nearly half of all sovereign states, we are reasonably confident that the sample is representative of sovereign bond contracts. We have less confidence in the representativeness of the sub-sovereign samples and include it primarily for comparison purposes.

None of the bonds include an expansive choice-of-law clause expressly applying foreign law to disputes over the contract's formation, validity, or enforceability.¹¹¹ Each clause begins with the generic template, stating only that the designated law "governs" the contract or, occasionally, that the

brief characterizes the question as whether the borrower could give "valid consent" without legislative approval and as whether the loan was illegally executed. *Id.* at 19, 31.

110. See generally Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814 (2006) (analyzing the choice of vague or precise contract terms as a trade-off between investing at the front- or back-end of the contracting process); Christopher R. Drahozal & Erin O'Hara O'Connor, *Unbundling Procedure: Carve-Outs from Arbitration Clauses*, 66 FLA. L. REV. 1945 (2015).

111. Such clauses do exist in other settings, but we did not find any in our dataset of sovereigns and quasi sovereigns. For discussions of the other settings, see Coyle & Drahozal, *supra* note 36, at 341.

contract is to be “governed by and interpreted in accordance with” the designated law.¹¹² The most significant variation in the clauses involved the nature of any local-law carve-outs.

These carve-outs took various forms. The most common reserved questions of “authorization and execution” for resolution under local law. We previously gave an example from a Brazilian bond.¹¹³ Here is one from Argentine bonds issued in 2016:

The Bonds and the Indenture are governed by and construed in accordance with the laws of the State of New York, except with respect to the authorization and execution of the Bonds and the Indenture by and on behalf of Argentina, which shall be governed by the laws of Argentina.¹¹⁴

As discussed below, it is not clear what this authorization and execution carve means.¹¹⁵ The apparent intent is to narrow the range of issues that will be governed by foreign law. *But by how much?*

Another common carve-out expressly disclaims the intent to incorporate the foreign jurisdiction’s conflict of laws rules. Here is an example from a bond issued by Bolivia in 2012, which also includes the authorization and execution carve-out:

The Notes and the Indenture will be governed by and interpreted in accordance with the laws of the State of New York without regard to any conflicts of law principles thereof that would require the application of laws of a jurisdiction other than the State of New York. However, matters concerning authorization and execution of the Indenture and the Notes by Bolivia, as well as the enforcement of any foreign judgment against Bolivia before Bolivian courts, will be governed by the laws of Bolivia.¹¹⁶

Here, the point is not to reserve a subset of issues for resolution under the sovereign’s own law but to eliminate the risk of *renvoi*—i.e., the scenario in which a court applies the designated jurisdiction’s conflicts rules to select a different law (potentially the sovereign’s own) to govern the contract.¹¹⁷ Potentially, a court might interpret this “conflicts carve-out” to forbid the use of the sovereign’s local law to answer *any* question, even one asking only whether the sovereign violated an applicable borrowing constraint in

112. Most courts interpret these provisions in the same way. See Coyle, *supra* note 24, at 656-61.

113. See *supra* p. 8.

114. Offering Memorandum, Republic of Argentina Series A-D Bonds at 209 (May 4, 2016) (on file with authors).

115. *Infra* Part IV.

116. Prospectus, Estado Plurinacional De Bol. U.S. \$500,000,000 5.95% Notes Due 2023 at 134 (Aug. 22, 2013).

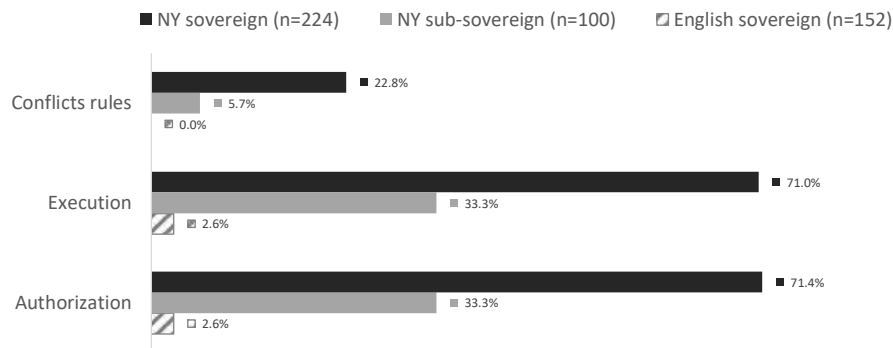
117. See BLACK’S LAW DICTIONARY (11th ed. 2019).

contracting the loan. The logic behind this interpretation is that the sovereign's local law becomes relevant only when selected through application of conflicts rules, which the contract arguably forbids.¹¹⁸

Interpreted this way, the conflicts carve-out is functionally similar to an expansive choice-of-law clause that expressly applies foreign law even to questions of contract validity and enforceability.¹¹⁹ However, recall that most courts already interpret the generic choice-of-law clause to refer only to the designated jurisdiction's local law, not to its conflicts rules.¹²⁰ To the extent it merely restates this default rule, the conflicts carve-out is surplusage, with no effect on the likelihood that a court will apply the sovereign's local law to any issue.¹²¹

The figure below reports the proportion of sovereign and sub-sovereign bonds with carve-outs for questions of authorization and execution and with the conflicts carve-out. To simplify, we include only bonds governed by New York or English law, as there are relatively few international bonds issued under other laws and thus few such bonds in our dataset. This leaves us with a total of 376 sovereign and 154 sub-sovereign bonds. The figure omits sub-sovereign bonds issued under English law, none of which contained any carve-out.

Frequency of Carveouts in Sovereign and Sub-Sovereign Bonds Issued Under NY and English Law



118. *See supra* note 43 and accompanying text.

119. Again, there were no such clauses in our data.

120. *See* RESTATEMENT (SECOND) OF CONFLICT OF L. § 187(3) (AM. L. INST. 1971); *see also supra* notes 65-67 and accompanying text.

121. *Cf.* BUCHHEIT, *supra* note 73, at 131 (“[T]he addition of this phrase in the governing law clause is not necessary . . .”). Nevertheless, the clause is puzzling. Some conflicts rules are mandatory; they purport to override any contractual choice of law. It is not clear whether the conflicts carve-out purports to dispense with the application of these rules and, if so, whether a court will enforce that choice.

Two aspects of the data are immediately apparent. First, drafting practices for sovereign and sub-sovereign bonds differ, at least in bonds issued under New York law. Second, each carve-out appears more frequently in bonds governed by New York law. In our data, the carve-outs appear in a vanishingly small proportion of English law sovereign bonds, and never in English-law sub-sovereign bonds.

Focusing on the difference between sovereign and sub-sovereign bonds under New York law, part of the explanation may be that different law firms tend to be involved in these deals. In our dataset, for instance, Cleary Gottlieb appears most frequently as counsel for both sovereign (31.3%) and sub-sovereign (47.3%) issuers of New York law bonds. But the secondary players differ. On the sovereign side, Arnold & Porter (30.9%), Allen & Overy (5.5%), and White & Case (5.0%) occupy the next three places in terms of the proportion of issues handled. None of these three firms appear as counsel for any appreciable number of sub-sovereign issuers.¹²² To the extent law firms favor document templates developed in house, this may partly explain the difference we observe between sovereign and sub-sovereign issuers of New York law bonds.

Still, whatever role law firms or other intermediaries play in producing different deal templates, there is no obvious *functional* reason why choice-of-law clauses in sovereign bond deals should differ from those in sub-sovereign deals. The lack of standardization is especially odd in cases where, from an economic perspective, the sovereign and sub-sovereign entity represent essentially the same credit. For instance, take Venezuela and PDVSA. Because the state oil company has historically generated nearly all of the country's foreign currency earnings, most observers would regard the entities as similar if not identical credits. Yet drafting practices differ. For example, a 30-year sovereign bond issued under New York law in 1997 includes carve-outs for questions of authorization and execution and also excludes application of New York's conflicts rules. We do not see these carve-outs in PDVSA bonds issued under New York law.

Nor is there an obvious explanation for the different documentation practices under New York and English law. Once again, there are differences in the law firms that handle a high volume of deals in these

122. The law firms representing underwriters, fiscal agents, and other financial intermediaries also differ between sovereign and sub-sovereign deals. Shearman & Sterling is a major player in both markets, representing the financial intermediary in 18.9% of sovereign and 22.5% of sub-sovereign issuances. But the firm that represents the largest share of underwriters on the sovereign side, Sullivan & Cromwell (31.6%), plays a much smaller role in sub-sovereign issuances (10%). Likewise, Davis Polk, which represents the largest proportion of underwriters in sub-sovereign deals (27.5%), plays a lesser role in sovereign issuances (3.8%).

markets.¹²³ But we have not been able to identify any aspect of New York law, nor any attribute of issuers in the New York market, that would explain the greater tendency to use each of the carve-outs described above.¹²⁴ To be sure, the conflicts rules applicable in English courts are not identical to those in New York. As an example, English conflicts law might be more likely to point to the issuer's local law to assess questions of capacity and related matters, even when the contract includes a choice-of-law clause providing for the application of foreign law.¹²⁵ If so, issuers might see less need to insist that the choice-of-law clause include a local-law carve-out. As noted, however, New York law also usually looks to the issuer's local law on such questions.¹²⁶ So we are skeptical that the different contracting practices are due to differences in how courts in the two jurisdictions approach conflicts questions.

Notably, not one contract attempts to define the meaning of "authorization and execution" or to clarify the range of issues that fall under these terms. As we have noted, it is not clear whether local law borrowing constraints implicate the authorization or execution of a loan, the capacity of the borrower, or something else. Nor is it clear whether, given a carve-out for questions of authorization, an official's apparent (and not merely actual) authority is to be assessed under the sovereign's local law. This uncertainty introduces significant risk into these bonds, which we turn to in Part IV.

In fact, far from clarifying the range of issues that will be governed by the sovereign's local law, a number of bonds introduce additional uncertainty. Recall the Turkish bond referenced in the introduction, which carves out not only questions of authorization and execution but "any other matters required to be governed by the laws of Turkey." This clause expands

123. For instance, Clearly Gottlieb appears most frequently as counsel for sovereign issuers in New York (31.3%) but relatively infrequently in the English market (8.5%), where White & Case plays the dominant role (21.7%). White & Case appears infrequently as issuer's counsel in New York (5.0%).

124. At least at first cut, the difference does not seem attributable to the identity of the issuer, as the same issuer will vary its documentation practices depending on which law is designated as governing. Iceland, for instance, has included the authorization and execution carve-outs in bonds governed by New York law and omitted them in bonds governed by English law.

125. The Rome I Regulation excludes from its scope questions "governed by the law of companies and other bodies, corporate or unincorporated," leaving these to be determined by forum conflicts rules. Regulation 593/2008, of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome I), 2008 O.J. (L 177) at art. 1(2)(f). The exclusion would apply to state-owned corporations and many other sub-sovereign issuers, and perhaps by analogy to sovereign issuers. English conflicts rules would generally look to the law of the place of incorporation to answer questions about capacity to contract and similar matters. *See also* J. G. COLLIER, CONFLICT OF LAWS 208 (3d ed. 2001). Of course, that practice is also consistent with the internal affairs doctrine under U.S. law.

126. *See also* BUCHHEIT, *supra* note 73, at 129 ("[T]he corporate authority of a party to enter into the agreement or the due execution of the contract by a party are matters that will probably be determined under the law of the place where the party is domiciled, not under the chosen governing law of the contract.").

the local law carve-out to an unidentified, but potentially large, subset of issues. We had expected it to be an aberration, but it is not. Although rare, this additional carve-out for “other matters” appears in eight bonds issued by five separate sovereigns under New York law (Sweden, South Africa, Turkey, Philippines, and Finland). Here is an example from a 2002 bond issued by Finland:

The securities are governed by and interpreted in accordance with the law of the State of New York, except all matters governing Finland’s authorization and execution of the securities and any other matters required to be governed by the law of Finland.¹²⁷

These issuers have little in common, do not all use the same law firms or underwriters, and have included the “other matters” carve-out in bonds issued decades apart. The earliest use of this carve-out in our dataset is a Swedish bond issued in 1980, the latest is a Turkish bond issued in 2019. Even more than the carve-out for authorization and execution, this local-law carve-out potentially undermines the protection supposedly offered by an international loan.

IV. CARVING OUT WHAT?

We focus here on the local-law carve-outs, for issues of authorization, execution, and for “other matters.” Each carve-out reserves a subset of issues for resolution under local law. But what subset? In theory, a choice-of-law clause should balance the sovereign’s desire to make and enforce its own law with investors’ desire for protection against the risk that the sovereign will exploit or create legal loopholes. As Part II explained, it is essentially impossible to draft a choice-of-law clause that strikes this balance with perfect clarity. Even a contract that expressly requires the application of foreign law on all questions allows the sovereign to argue that foreign law itself directs the tribunal to consult the sovereign’s local law.¹²⁸

All of this is to say that a choice-of-law clause cannot provide complete *ex ante* certainty. But that fact does not explain why parties would introduce ambiguous exceptions into a clause that seeks, at least in part, to minimize investor risk. If ambiguity is unavoidable—that is, if it is too costly to negotiate and draft an unambiguous local-law carve-out—then why not simply use a generic choice-of-law clause designating foreign law to govern the loan? That approach would at least economize on drafting and other

127. Prospectus, Republic of Fin. 4.75% Notes Due 2007 at 46 (Feb. 26, 2002).

128. *See supra* notes 76-78 and accompanying text; *see also* Ukr. v. Law Debenture Trust Corp. [2018] EWCA (Civ) 2026 [37] QB 1121 (Eng.) (“As the Notes are governed by English law, this does not affect their validity in the current proceedings unless the capacity of Ukraine to issue the notes is, under English law, to be governed by those principles of Ukrainian law.”).

front-end costs, while allowing the parties to tap into a relatively established body of law to resolve any remaining disputes.¹²⁹ Yet, at least in bonds governed by New York law, the local-law carve-outs used in sovereign bonds introduce two important types of ambiguity.

A. “Authorization” and “Execution” Have no Clear Meaning

Begin with the carve-out for questions of authorization and execution. These virtually always appear together—they did so all but once in our data—so we address them jointly. The literature on drafting sovereign loan contracts provides little clue as to their meaning. A prominent drafting guide notes that sovereign borrowers sometimes request these carve-outs but does not describe their meaning.¹³⁰ And our consultations with twenty experienced practitioners in both New York and England left us equally confused.¹³¹ Some expressed puzzlement, noting that the carve-out seemed to impose unnecessary risk on investors. Others speculated as to the origin of the different drafting practices in New York and England but did not explain which issues the carve-out reserved for resolution under local law. Still others wondered if the carve-out might have an established meaning in the context of corporate debt. Although only one explicitly said this—a very prominent English lawyer—all implied that the carve-out for authorization and execution in bonds governed by New York law was surplusage that did not change the meaning of the clause. Yet each noted the risk of confusion. A judge might assign meaning to the carve-out, narrowing the range of issues governed by foreign law, on the assumption that lawyers would not add words unless they wanted to change meaning.

Some of our lawyer-respondents suggested that the carve-out may have originated in corporate bond documents and then migrated into sovereign bonds. We have found no evidence that this is the case. It seems that the authorization and execution carve-out rarely if ever appears outside of sovereign bonds. To our knowledge, John Coyle has conducted the most extensive studies of choice-of-law clauses. Working mostly alone, but occasionally with co-authors, he has studied clauses extracted from reported

129. See, e.g., Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814 (2006) (analyzing the choice of vague or precise contract terms as a trade-off between investing at the front- or back-end of the contracting process); Christopher R. Drahozal & Erin O’Hara O’Connor, *Unbundling Procedure: Carve-Outs from Arbitration Clauses*, 66 FLA. L. REV. 1945 (2014) (evaluating the costs of writing procedural rules into the contract). As a theoretical matter, parties should limit their investment in drafting and negotiation when these costs exceed the benefits that can be realized by further additions to the contract. *Id.* at 1949-50 (suggesting that parties do not contract over procedure, beyond the selection between litigation and arbitration, because of the costs entailed in identifying and bargaining over tailored procedural rules).

130. LEE C. BUCHHEIT, HOW TO NEGOTIATE EUROCURRENCY LOAN AGREEMENTS 132-33 (Rob Mannix ed., 2d ed. 2004).

131. We promised anonymity to respondents.

cases, standardized form books, bond indentures, and international supply agreements.¹³² Professor Coyle reports that he has never encountered a carve-out for authorization and execution in any of the contracts he had studied.¹³³ Nor do we find the carve-out in a separate sample of several hundred commercial agreements compiled by one of us for a different project.¹³⁴ It is not that contracts outside the sovereign debt context never refer to these concepts. For instance, one or both parties to a commercial contract will sometimes represent that it is has taken all steps necessary for “the authorization, execution, and delivery” of the contract.¹³⁵ But we have found nothing to clarify the scope of issues that fall within these carve-outs, nor have we found other examples in which these matters are excluded from the scope of a choice-of-law clause.

As an example of the potential confusion, consider the litigation over the \$3 billion bond issued by Ukraine under English law. Ukraine disputed the enforceability of the bond, arguing that the debt put the country over its borrowing limit and violated procedural rules governing loan approval. To date, neither the parties nor the courts have paid much attention to the text of the choice-of-law clause, which does not appear in any of the judicial opinions issued thus far.¹³⁶ The clause reads, in its entirety, “This Trust Deed and any non-contractual obligations arising out of or in connection with it are governed by English law.”¹³⁷ Even this bare-bones clause left

132. See John F. Coyle, *A Short History of the Choice-of-Law Clause*, 91 COLO. L. REV. 1147; John F. Coyle & Christopher R. Drahozal, *An Empirical Study of Dispute Resolution Clauses in International Supply Contracts*, 52 VAND. J. TRANS'L L. 323 (2019); John F. Coyle & W. Mark C. Weidemaier, *Interpreting Contracts Without Context*, 67 AM. U. L. REV. 1673 (2018); John F. Coyle, *Choice of Law Clauses in U.S. Bond Indentures*, 13 CAP. MKTS. L.J. 152 (2018); John F. Coyle, *The Role of the CISG in U.S. Contract Practice: An Empirical Study*, 38 U. PA. J. INT'L L. 195 (2016).

133. E-mail from John Coyle, Professor of L., U.N.C. Sch. of L., to Mark Weidemaier, Professor of L., U.N.C. Sch. of L., & Mitu Gulati, Professor of L., Duke U. Sch. of L. (May 15, 2020, 14:00 EST) (on file with authors):

This may well be a choice-of-law issue that is *sui generis* to sovereign debt agreements. In all my research, I have never before come across a carve out for “authorization and execution” in a choice-of-law clause. Just to make sure I wasn’t misremembering, I ran a search through (1) the 3000+ clauses I collected from published U.S. cases between 1880 and 2000; (2) the 300+ clauses from bond indentures pulled from SEC filings in 2016; and (3) the 100+ clauses that Chris Drahozal and I collected from international supply agreements in SEC filings. This carve out appeared in exactly zero clauses in these datasets.

134. For a description of the sample, see W. Mark C. Weidemaier, *Customized Procedure in Theory and Reality*, 72 WASH. & LEE L. REV. 1865, 1905-09 (2015).

135. See, e.g., Supply Agreement between Stellar Pharmaceuticals Inc. and Watson Pharma Inc. Art. 4.2(c) (Dec 12, 2006) (on file with authors).

136. *The Law Debenture Trust Corp. v. Ukr.* [2017] EWHC 655 (Comm.); *Ukr. v. Law Debenture Trust Corp.* [2018] EWCA (Civ) 2026.

137. Trust Deed Relating to U.S. \$1,250,000,000 7.50 Per Cent Notes due 2023 ¶ 25.1 (on file with authors); see also *id.* Sch. 1 p. 38 (“This Global Note and any non-contractual obligations arising out of or in connection with it, are governed by, and shall be construed in accordance with, English law.”).

room for disagreement. For instance, Ukraine's primary defense was that it lacked capacity to incur the debt, and it argued that this question was to be resolved under Ukrainian law.¹³⁸ The English courts disagreed, ultimately treating the question of capacity as governed by English law.¹³⁹ To the extent Ukraine's borrowing limits implicated the actual authority of state officials, rather than the state's capacity to borrow, the parties agreed that Ukrainian law governed, and the indenture trustee conceded that Ukraine's officials were not actually authorized to approve the loan.¹⁴⁰ But this did not help Ukraine, for the Court of Appeal ultimately ruled that state officials had ostensible (apparent) authority to bind the state. It appears to have based this holding entirely on English law.¹⁴¹

Might the result have been different if the Ukrainian bond had carved out questions of authorization and execution for resolution under local law? The carve-out is rare for English-law bonds, but does appear in a handful. The literal text of the carve-out comfortably accommodates questions of apparent as well as actual authority, although it need not be read so broadly. Even the carve-out for questions of execution, without more, might be read to encompass questions of apparent authority. That term is often understood, more narrowly, as a reference to the rules governing signature requirements and any other formalities necessary to conclude a contract.¹⁴² But lawyers have long been warned that "'executed' is a slippery word. Its use is to be avoided except when accompanied by explanation."¹⁴³

It would not be hard for a sovereign to build a case for interpreting the authorization and execution carve-out to encompass a wide range of matters. For example, sovereign bond issuances are typically accompanied by opinion letters in which lawyers affirm the legality of the loan under the sovereign's local law and under the foreign law designated as governing. Although we cannot observe the opinion letters for the bonds in our sample,¹⁴⁴ a letter opining that a loan has been "duly executed" often covers issues "not only of corporation law but also of agency law and contract

138. *See* Defense filed May 22, 2016, *The Law Debenture Trust Corp. v. Ukr.*, High Court of Justice (Queen's Bench Division) FL-2016-000002, ¶ 47.

139. The Court of Appeal acknowledged that English law could instruct the court to apply Ukrainian law but it did not look to Ukrainian law to resolve the dispute. The trial judge had also looked to international law to define Ukraine's capacity to borrow, but the Court of Appeal treated capacity as purely a matter of domestic (English) law. *See Ukr. v. Law Debenture Trust Corp.* [2018] EWCA (Civ) 2026 [37], [71]-[73].

140. *The Law Debenture Trust Corp. v. Ukr.* [2017] EWHC 655 (Comm) [136] (noting agreement on the question of governing law); *Ukr. v. Law Debenture Trust Corp.* [2018] EWCA (Civ) 2026 [76] (noting the trustee's concession on the question of actual authority).

141. *Ukr. v. Law Debenture Trust Corp.* [2018] EWCA (Civ) 2026 [76]-[133].

142. *See, e.g.*, BLACK'S LAW DICTIONARY (11th ed. 2019).

143. WILLIAM R. ANSON, PRINCIPLES OF THE LAW OF CONTRACT 26 (Arthur L. Corbin ed., 3d am. ed. 1919).

144. These letters are privileged, so we are not able to examine them in connection with any of the loans in our sample.

law.”¹⁴⁵ Certainly the lawyers will affirm that the borrower’s agents have actual authority to bind it to the loan.¹⁴⁶ This assurance matters to investors, who will be displeased to learn that their prospects for enforcing the loan depend on a tribunal’s willingness to accept a theory of apparent authority.¹⁴⁷ This overarching concern with ensuring that the borrower is bound by the acts of its officials might be taken to imply that the authorization and execution carve-out extends to all questions related to that concern, including questions of apparent authority.

Our conversations with experienced practitioners did little to dispel our confusion. Although none were willing to go on record, several agreed that the authorization and execution carve-out, if it had been present in the Ukraine case, might have changed the outcome.¹⁴⁸ None thought this the inevitable outcome, but almost all thought it possible. To be sure, there are also reasonable contrary interpretations. For example, the carve-out might simply apply local law to a narrow set of questions concerning the need for formalities such as a signature and the actual (not apparent) authority of government officials. But so interpreted, the additional words about execution and authorization are essentially meaningless, and courts generally take the position that words are used to add meaning. This gives the sovereign room to argue for an expansive interpretation of the carve-out.¹⁴⁹

B. *The “Other Matters” Carve-Out is a Trap for the Unwary*

We do not see how sovereigns or investors benefit from the ambiguous carve-out for matters of authorization and execution. But that carve-out is a model of clarity compared to the carve-out for “other matters.” Using the Turkish bond as an example, recall that this clause provides that questions of authorization, execution, “and any other matters required to be governed by the laws of Turkey . . . will be governed by the laws of Turkey.”¹⁵⁰ As noted, the clause raises but fails to answer a fundamental question: *Required by what law?*¹⁵¹

145. DONALD W. GLAZER ET AL., *GLAZER AND FITZGIBBON ON LEGAL OPINIONS: DRAFTING, INTERPRETING, AND SUPPORTING CLOSING OPINIONS IN BUSINESS TRANSACTIONS* 280 (3d ed. 2008).

146. *Id.*

147. *Report of the Tri-Bar Opinion Committee: Third Party “Closing” Opinions*, 53 *BUS. LAW.* 591, 653-54 (1998) (the opinion letter on authorization, execution, and delivery “is intended to respond to the understandable concern of the opinion recipient that those who executed the agreement had actual and not merely apparent authority to act on the Company’s behalf.”).

148. This assumes, of course, that Ukrainian law would reject the theory that government officials had apparent authority to approve the loan.

149. *See* *JFE Steel Corp. v. ICI Am., Inc.*, 797 F. Supp. 2d 452, 469 (D. Del. 2011).

150. Prospectus Supplement to Prospectus dated February 18, 2004, Republic of Turk., U.S., \$750,000,000 (June 24, 2004).

151. *See supra* p. 10.

One possibility is that the sovereign's local law defines the range of issues required to be governed by its law. So understood, the "other matters" exception threatens to eviscerate the protection ostensibly offered by the designation of foreign law in an international bond. The reason is not just that the sovereign's law may be unfamiliar to investors and may later turn out to require the application of local law in unexpected contexts. It is that, in a financial crisis, the sovereign will have incentives to create such rules if they do not exist already.

For instance, consider a sovereign in financial crisis, which, anticipating a debt restructuring, enacts legislation mandating the application of local law to all disputes over the validity and enforceability of creditor claims. Such a step might seem opportunistic, even in bad faith. But there are plausible, good faith justifications for legislation of this sort. Some debt restructurings are relatively straightforward and involve only few debt instruments and classes of private creditor (e.g., loans and banks; bonds and bondholders).¹⁵² Others are more complicated and involve a large and diverse universe of creditors. In such cases, a primary task is to identify valid claims and to reconcile the amounts that the restructuring will recognize.¹⁵³ For instance, trade creditors may inflate the value of their claims in anticipation that the restructuring will impose a discount. The reconciliation process seeks to prevent this. It can also provide a forum for examining legal weaknesses in creditors' claims. During the restructuring of Iraqi debt that began in 2004, a key issue was how to treat oil contracts previously negotiated by Saddam Hussein's government, which were subject to a number of legal challenges.¹⁵⁴ In any restructuring of Venezuelan and PDVSA debt, the reconciliation process will have to resolve disputes over the enforceability of debt instruments with dramatically inflated face values, which the obligors issued to favored creditors.¹⁵⁵ Creditors who will not participate in the reconciliation process or abide by its results can seek to enforce their rights in any available judicial or arbitral forum.

The effort to validate and quantify creditor claims is made significantly more complicated when the claims are subject to many different legal regimes. This is all the more true when the sovereign asserts a common

152. Lee C. Buchheit & Mitu Gulati, *Sovereign Debt Restructuring and U.S. Executive Power*, 14 CAP. MKTS. L.J. 114 (2019).

153. See, e.g., Charles W. Mooney, Jr., *A Framework for a Formal Sovereign Debt Restructuring Mechanism*, 37 MICH. J. INT'L L. 57, 92 (2015).

154. Although the challenges were often presented as implicating the relatively untested doctrine of odious debt, see, e.g., Adam Feibelman, *Equitable Subordination, Fraudulent Transfer, and Sovereign Debt*, 70 LAW & CONTEMP. PROBS. 171 (2007), they typically also implicate well-established doctrines of municipal law, see *id.*; Lee C. Buchheit, Mitu Gulati & Robert B. Thompson, *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201, 1230-50 (2007).

155. See generally Susan Block-Lieb & W. Mark C. Weidemaier, *Lenders' Roles and Responsibilities in Sovereign Debt Markets*, 2019 U. ILL. L. REV. 1589, 1603.

objection to multiple types of claim. For instance, consider the scenario in which the sovereign's present government believes that corrupt members of the former government unlawfully approved the issuance of multiple instruments, each governed by a different law, to favored creditors.¹⁵⁶ Current officials are not likely to see any merit in distinguishing among these creditors. The easiest way to ensure equivalent treatment, while giving effect to the sovereign's own policies, would be to assess the validity of each instrument under the sovereign's own law. Whatever else one might say about that impulse, it hardly demonstrates bad faith on the sovereign's part.¹⁵⁷

In the typical case, the sovereign could not insist on comparable treatment, nor could it insist on any particular substantive outcome. Creditors' rights would be determined by the law of the jurisdiction designated in the instrument, which might well insist on enforcing the obligation notwithstanding any violation of the sovereign's local law. But all bets are off when the instrument's choice-of-law clause includes the "other matters" exception. The sovereign could enact a law requiring that the validity of each instrument be assessed under its local law. It could also enact a law declaring each instrument invalid, or it could leave that decision to (presumably compliant) local courts in an effort to minimize the legal risk created by this strategy.¹⁵⁸

Of course, an alternative understanding of "other matters" carve-out is possible. The foregoing interpretation posits that the sovereign's own conflicts rules define the set of issues to be resolved in accordance with its local law. But perhaps the carve-out instead means to incorporate any mandatory conflicts rules of the foreign jurisdiction specified in the choice-of-law clause (or of the forum, if these differ). As an example, consider the internal affairs rule, a conflict of laws principle directing courts to apply the law of the place of incorporation to questions concerning the relations

156. This is the Venezuelan scenario. Although U.S. sanctions currently block any restructuring, guidelines issued by the interim government—which has no practical power but is recognized by the U.S. as the legitimate government of Venezuela—envision a reconciliation process to examine "questionable claims," including claims issued with inflated face values and claims "procured or tainted by demands of corruption allegedly committed by officials in the Chávez/Maduro regimes." See Memorandum from Off. of the Special Att'y Gen. of the Bolivarian Republic of Venez., Guidelines for the Renegotiation of the Chávez/Maduro Era Legacy Public External Debt, at 2 (July 1, 2019).

157. Indeed, it is arguably consistent with creditors' expectations, as it is common for creditors to accept comparable treatment during a restructuring notwithstanding formal differences in their legal entitlements. In Iraq, for instance, the past due interest owed to commercial claimants was calculated at a uniform rate even though some creditors had negotiated instruments with much higher penalty rates of interest. See Lee C. Buchheit & Mitu Gulati, *Responsible Sovereign Lending and Borrowing*, 73 *LAW & CONTEMP. PROBS.* 63, 91-92 (2010).

158. The fact that creditors can bring suit in foreign courts would somewhat constrain these impulses. But at least as a formal matter, the extent of the constraint would also be within the sovereign's control. For instance, it could pass a law requiring that its own law be used to assess the legality of retroactive changes to governing law.

among the corporation, its shareholders, directors, officers, and agents.¹⁵⁹ The rule is often understood to require application of the law of the place of incorporation even when the contract's choice-of-law clause specifies another law.¹⁶⁰ The internal affairs doctrine is not directly applicable to contracts involving foreign states. But it is an example of how a choice-of-law clause might select a body of law that will itself require application of some other law (likely, in this context, to be the sovereign's local law). Perhaps the "other matters" exception simply means to acknowledge the possibility of such rules and to clarify that, when they exist, the choice-of-law clause does not purport to contract around them. So understood, a New York-law bond with the "other matters" carve-out means only to confirm that, if New York law happens to *require* the application of the sovereign's local law, this result is consistent with the parties' intent.

This interpretation is plausible, but it ignores the purpose of a local-law carve-out, which is to reserve for resolution under local law issues that have fundamental governance import to the sovereign.¹⁶¹ Thus, it is usually the sovereign that bargains for a carve-out for authorization, execution, and the like.¹⁶² It is the sovereign's law, not New York or other foreign law, that will constrain borrowing in ways that the terms "authorization" and "execution" do not neatly encompass. For example, the borrower's law may impose detailed requirements for the formation of government contracts.¹⁶³ And it is the sovereign's law that can best identify which of these requirements serve important governance purposes. Given all this, it would be odd for the sovereign to rely on the conflicts rules of a foreign jurisdiction to define the range of issues that will be governed by its local law.

However one thinks this interpretive question should be resolved, it is surprising to see such a fundamental ambiguity in a contract term that exists mostly to protect investors against legal risk. When we put the question to experienced sovereign debt practitioners, a number of them agreed that the clause created significant risk for investors. One wondered how a lawyer could write a legal opinion letter affirming the enforceability of a bond without knowing which matters were in fact required to be governed by the sovereign's local law. To borrow a poker analogy, others saw the ambiguity we mentioned and raised us. They drew our attention to similar ambiguities

159. *See* *Edgar v. MTE Corp.*, 457 U.S. 624, 645 (1982); RESTATEMENT (SECOND) OF CONFLICT OF L. § 302 cmt. a (AM. L. INST. 1971).

160. *See, e.g.*, Jennifer J. Johnson, *Risky Business: Choice-of-Law and the Unincorporated Entity*, 1 J. SMALL & EMERGING BUS. L. 249, 288 (1997).

161. *See supra* Part II.B.

162. LEE C. BUCHHEIT, *HOW TO NEGOTIATE EURO CURRENCY LOAN AGREEMENTS* 133 (Rob Mannix ed., 2d ed. 2004).

163. Hector Mairal, *Issues Arising from the Legal and Constitutional Validity of the Debt Under the Debtor's Own Law*, in *JUDICIAL ENFORCEMENT OF INTERNATIONAL DEBT OBLIGATIONS* 119, 119 (David Bradlow & Daniel Sassoon eds., 1987).

that they had recently noticed in other sovereign bond provisions. For example, in some sovereign bonds the issuer waives sovereign immunity only “to the extent that the Republic is lawfully entitled to do so.”¹⁶⁴ The language apparently is intended to acknowledge that the sovereign’s law constraints its ability to waive immunity and that, in consequence, an investor’s enforcement rights may be limited.¹⁶⁵ But such language might also enable the government to retroactively narrow the scope of its waiver.

V. CONCLUSION

As academics who study contracts, we find it hard to make sense of the frequent use of these ambiguous, local-law carve-outs. The fact of ambiguity itself is not the puzzle. Contracts often include vague or ambiguous terms, which effectively defer the provision of detail until later (when it can be supplied by a court or other tribunal if the parties cannot agree). The puzzle is that parties would introduce ambiguity on such an important question.

The purpose of an international bond, after all, is to protect investors from risks lurking in the sovereign’s local law, including the risk that this law will change. Although forum conflicts rules may insist on applying the sovereign’s local law to a subset of issues, the authorization and execution carve-out invites a tribunal to expand this subset. To the extent a tribunal accepts the invitation, the protection offered by an international bond diminishes accordingly. In effect, the authorization and execution carve-out delegates to courts or arbitrators the authority to decide, *ex post*, just how much protection an international bond offers against legal risk.

The “other matters” carve-out is even stranger. As with the authorization and execution carve-out, a tribunal might interpret this carve-out narrowly, effectively rendering it meaningless. But investors have no assurance of this result. And the broader interpretation delegates to the sovereign itself the authority to decide, *ex post*, which issues will be governed by its local law. Because the sovereign also decides the content of that law, the “other matters” carve-out potentially exposes investors to the risk that retroactive legal change will undermine their rights. That is precisely

164. *See* Offering Circular for Republic of Croatia, 3% Bonds due 2027 at 29 (Mar. 16, 2017) (on file with authors).

165. For example, under U.S. law, a broad waiver would entitle the investor to attach and potentially force an execution sale on any sovereign asset “used for a commercial activity in the United States.” 28 U.S.C. § 1610(a)(1) (2012). With a narrower waiver, U.S. law would allow attachment only if an asset met this requirement and also “is or was used for the commercial activity upon which the claim is based.” 28 U.S.C. § 1610(a)(2) (2012). In other jurisdictions, a broad waiver of immunity might also allow an investor to seize property even when not used for commercial purposes. Finally, the sovereign’s law may restrict its ability to waive immunity with regard to assets located within its own territory (although here the right to attach property, if it exists, is of mostly theoretical value, as few domestic courts are willing and empowered to oversee such a process).

the risk that a foreign law bond seeks to avoid. We do not mean to suggest these results are guaranteed. In fact, a tribunal might interpret both carve-outs narrowly to avoid these seemingly odd results. But it is puzzling to see ambiguities of this sort, which undermine a central purpose of the contract.

We return now to the question raised in the Introduction, which involved litigation over the grant of collateral in the PDVSA 2020 bond. Lawyers for the sovereign say that the grant of collateral was invalid, since the proper legislative approval required under local Venezuelan law was not obtained. Lawyers for the creditors emphasize that, even though the carve-out for authorization and execution appears in some Venezuelan sovereign bonds, it is absent from the choice-of-law clause in the PDVSA 2020 bonds. They emphasize the omission, arguing that it demonstrates that the PDVSA 2020 bonds were specially designed to avoid having Venezuelan law govern such matters. The district judge sided with the creditors, although without giving special emphasis to the omission of the authorization and execution carve-out. With respect to the conflict of laws question, the district judge ruled that New York's conflicts rules designated New York law to govern the validity of the PDVSA 2020 bonds. Most relevant here, the judge reasoned that, because the bonds called for performance (i.e., payment) in New York, that state's law should determine the validity of the bonds.¹⁶⁶

In our view, the district judge was right not to assign much significance to the omission of the authorization and execution carve-out from the PDVSA 2020 bond. Our examination of sovereign bonds and discussions with practitioners lead us to believe that the carve-out is mere surplusage. Although the authorization and execution carve-out appears in nearly three-quarters of the New York law bonds in our sample, we hesitate to assign meaning to the presence (or absence) of that language. The contrary inference would make the carve-out into a trap for investors, even the most informed of which could not know in advance precisely which issues would be governed by the sovereign's local law. (Although not relevant to the PDVSA 2020 bonds, we have the same reaction to the "other matters" carve-out.) But words that the transactional lawyers think to be a pretty gloss on the obvious can become weapons in the hands of litigators, especially given the judicial tendency to assume that added words mean added meaning.

However, we are hesitant to accept the district judge's implication that, because the bonds were to be paid in New York, that state's law should "control[] this dispute in its entirety."¹⁶⁷ Among other reasons for our hesitancy, recall that New York conflicts rules generally look to the law

166. *Petroleos de Venez. S.A. v. MUFG Union Bank*, No. 19 Civ. 10023, at 60-62 (S.D.N.Y. Oct. 16, 2020).

167. *Id.* at 62.

where an illegal act was committed in order to determine *whether* a violation of law occurred.¹⁶⁸ Although the PDVSA 2020 bonds call for payment in New York, and much of the pre-issuance negotiation took place in New York, the failure to seek National Assembly approval occurred in Venezuela, as did all decisions related to whether to seek such approval. It is not self-evident that the violation of Venezuelan law, if one occurred, took place in New York rather than Venezuela. Our hesitancy is deepened by the fact that New York law has nothing whatsoever to say about the legal constraints on borrowing by the Venezuelan government and its instrumentalities. Thus, it seems more appropriate to look to Venezuelan law to establish *whether* the PDVSA 2020 bond was issued in violation of governing law.

Despite our reluctance to accept this aspect of the district judge's reasoning, the ultimate ruling in favor of the indenture trustee is plausible. Although cases like *Korea Life* arguably suggest that Venezuelan law should determine whether a legal violation occurred, one can reasonably argue that New York law should determine the effect of a violation. Although we do not think the answer is clear under New York law, the outcome will likely depend on whether investors could reasonably rely on contemporaneous assurances as to the loan's legality, including representations to that effect by PDVSA in the transaction documents.

Whatever the ultimate outcome of the PDVSA 2020 bond dispute, it is clear that the choice-of-law clauses in sovereign bonds merit more attention. Governments appear increasingly willing to contest the enforceability of public debt (e.g., Venezuela, Ukraine, Mozambique, Puerto Rico), and the economic fallout of the Covid-19 crisis may encourage further challenges. The principles at stake are important, pitting laws designed to encourage fiscal discipline against investors' legitimate desire for protection against legal risk. In resolving that conflict of principles, it would help tribunals to have contracts that clearly expressed the parties' intent.

168. *See* *Korea Life Ins. Co. v. Morgan Guar. Trust Co.*, 269 F. Supp. 2d 424, 438 (S.D.N.Y. 2003).

* * *