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Gregory Makoff
Harvard Kennedy School

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Advice for New York State and International Policymakers Regarding Sovereign Debt Reforms at the State Level

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By Gregory Makoff, Senior Fellow, Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School

The possibility of sovereign debt legislation at the state level has been an underexplored area in sovereign debt policy—that is until the New York State Legislature became the center of serious contention over three proposed bills during the last two legislative sessions. The bills pitted social activists seeking to help relieve sovereign debts against bond-market organizations claiming that the bills would drive business out of New York State and raise the cost of financing for developing countries. Rhetoric flew and lobbying was intense. Yet a constructive outcome was achieved: two of the bills were dropped while the New York Senate passed the third bill after incorporating significant changes required by the market. The purpose of this working paper is to recount the legislative history of these three bills and to use their differing features—and outcomes—to draw policy rules regarding the appropriate scope of sovereign debt reforms carried out at the state level.

The first sections of this paper review the origins of the three bills and the events that occurred during the 2023 and 2024 legislative sessions. The final sections address the

three central questions raised by these events: Should sovereign debt reforms be carried out at the local level when the IMF, the G-20, and the US Treasury generally handle such matters? If so, how should state lawmakers coordinate with the international community when developing such legislation? And what is the appropriate substantive scope of state legislation affecting sovereign debt restructuring? The paper concludes with some policy recommendations.

Origin of the Proposals

The New York legislation stemmed from frustration in the activist community over Puerto Rico's 2016 bankruptcy. Angered by the debt-related suffering on the island—along with the human toll Hurricanes Irma and Maria and subsequent earthquakes had wrought—the policy team at activist organization New York Communities for Change (NYCC) led by Alicé Nascimento and José Gonzalez began in 2019 to look into changing New York law as a way of easing the suffering of indebted sovereign borrowers.

After completing their initial research, Nascimento and Gonzalez chose to support the model-law proposal, an existing effort to insert a formal, legal sovereign debt restructuring mechanism into New York law. Originally promoted by Duke Law School professor Stephen Schwarcz and others, the model law was seen as a way to enact the IMF's Sovereign Debt Restructuring Mechanism (SDRM) proposal of 2001 via local means, since the original effort generated insufficient support to be enacted through a vote of the IMF's board.[1] The idea was that New York would pass an SDRM–like law and that the U.K. and other jurisdictions would follow.

However, legal and financial experts working in the market told the NYCC activists that the model-law approach was not legally or commercially feasible, even though several professors from leading universities and lawyers consulted by promoters were telling them it could work. While still eager to achieve the high-impact outcome promised by the model law, the NYCC team looked for a second, less contentious bill to concurrently promote. Ultimately, the second prong of their strategy was to pursue the restoration of the "champerty" defense, which would once again make it illegal under New York law to buy claims "with the intent and purpose to sue." Under this law, a creditor's lawsuit could be dismissed and its claims become valueless if the debtor could prove that the creditor had purchased the debt with future litigation as the goal. Its restoration would offer a certain historical justice because New York's champerty defense was eviscerated in 2004 when—after lobbying from hedge funds[2]—the state enacted a safe harbor in its champerty law shielding claims of $500,000 or greater from its operation (§489 of the Judiciary Law). Legal experts said this second approach could work.

In promoting the model law and the restoration of the champerty defense, NYCC worked as a member of a coalition that included the Center for Popular Democracy, two New York–based groups (Strong Economy for All and Churches United for Fair Housing), and several Puerto Rican groups. This work culminated in the filing of two draft laws in the 2023 session: Bill S5542A/A2102A sponsored by Senator Gustavo Rivera and Assembly Member Maritza Davila (model law)[3], and Bill S5623A/A5290 sponsored by Senator Liz Krueger and Assembly Member Jessica González-Rojas (champerty).[4]

Debt relief activist group Jubilee USA later announced support for a third reform proposal, the implementation of a cap on judgments granted on sovereign debt claims documented under New York law. Their idea borrowed from a 2010 UK law that capped judgments granted by UK courts with respect to claims against poor countries that were being granted debt relief under the Highly Indebted Poor Country (HIPC) initiative.[5] Designed to prevent private creditors from getting repaid in full after more than $100 billion in bilateral and multilateral lender losses were incurred to help the poor countries recover,[6] judgments were capped to limit recoveries to the levels already agreed with bilateral creditors. Senator Brad Hoylman-Sigal and Assembly Member Patricia Fahy introduced the New York judgment cap bill as S4747/A2970.[7]

The scope of the Hoylman-Sigal–Fahy bill was much broader than the UK law, however. While the UK law applied only to completed debt negotiations in which the affected countries and cap terms were already known, the proposed New York law would apply on a forward-looking basis and to any debt restructured with respect to any "international initiative," which was defined to include "any mechanism, framework or initiative in which the United States government and other sovereign states have engaged with international financial institutions….including but not limited to the Heavily Indebted Poor Countries Initiative…the Debt Service Suspension Initiative…the Common Framework…and any successor or similar international mechanism, framework or initiatives." In other words, any developing country that restructured its debt—poor or middle income—would have its New York bond claims capped at the level negotiated with bilateral creditors. Moreover, the negotiation with bilateral creditors would fix the applicable judgment cap level even if bilateral creditors held only a small

portion of the country's debt. In sum, the New York judgment cap bill targeted a much larger universe of borrowers than the precedent 2010 UK bill.

The 2023 Legislative Session

The public record has little to say about New York State's 2023 legislative process with respect to the sovereign debt bills. Unlike the US Congress, neither the Senate nor the Assembly regularly carries out public hearings on policy topics. With that said, the author was able to piece together a picture of the 2023 legislative session by meeting with civil-society groups, investors, legal experts, and Washington– and Albany–based policymakers. New York[8]– and London[9]–based law firms published critiques of the laws, so there is a good public record of the technical criticisms from that one segment.

Ultimately, the only official action taken in the 2023 legislative session was the Senate Finance Committee's approval of the champerty bill in May. None of the three bills was brought for a vote on the floor of the Senate or the Assembly, although rumors that one or more of the bills might be created anxiety in the market and triggered fierce lobbying in the last two weeks of the session.

Between the 2023 and 2024 Legislative Sessions

Columbia professors Joseph Stiglitz and Martín Guzmán, along with New School professor Barry Herman, hosted a seminar on the pending bills on November 13, 2023.[10] The guest list to the invitation-only event included New York Senate and Assembly senior staffers, civil society activists, professors, legal experts, and one expert from the US Treasury. Two bond investors also joined the event, although only one stayed to the end.

Attendees report heated discussion of the model-law and judgment-cap bills and a relatively even-toned discussion of the champerty proposal. Legal experts voiced particular concern about the model-law proposal, pointing to federal preemption in matters of bankruptcy. One attendee suggested that the champerty proposal be replaced with a bill that would reduce the prejudgment interest rate applicable to sovereign debt claims in New York to a floating market rate from its prevailing rate of nine percent, a level set in the 1980s when market rates were much higher, effectively making sovereign debt litigation less profitable.

The 2024 Legislative Session

The action surrounding the sovereign debt bills kicked off in the 2024 legislative session on February 28, when sponsors of two of the laws posted a new bill. Backed by Senator Rivera, Assembly Member Fahy, and a long list of cosponsors, and supported by Jubilee USA, NYCC, and Oxfam, the revised S5542/A2970 amalgamated the judgment-cap bill and the model law into one bill.[11] Known as “The Sovereign Debt Stability Act,” the new bill would give debtors the right to choose which mechanism would apply in their case. Addressing concerns that either the model-law or the judgment-cap components might be deemed unconstitutional, the bill provided for the severability of its two parts.

The market responded negatively. The Institute of International Finance (IIF), the Credit Roundtable, and other investor groups issued a joint statement, saying the new law could push “developing countries that are already struggling with higher interest rates and tighter global financial conditions…toward debt distress.”[12] The *Financial Times* reported that investors were considering moving the sovereign debt market to

Texas.[13] Several law firms released memorandums and opinion pieces criticizing the bill.[14] One piece written by Zambia's lawyers from White & Case in London explained how the proposed Sovereign Debt Stability Act would have made Zambia's long-delayed sovereign debt restructuring much more complicated to execute.[15]

In support of the amalgamated bill, Oxfam released an open letter to Governor Hochul and members of the New York State Legislature on April 25, 2024.[16] The letter was signed by eighty-two former heads of state, artists, academics, concerned citizens, and policymakers. Two weeks later, on May 7, the former President of Costa Rica visited Albany to lobby the legislature directly to support the Sovereign Debt Stability Act.[17] Yet this bill did not progress.

In contrast, Senator Krueger released a new draft of her champerty bill on May 20, 2024, which was responsive to the market feedback she had received after the previous legislative session. The revised bill featured two significant changes: a) it introduced a safe harbor to protect buy-and-hold investors and cooperative distressed debt investors from its operation; and b) it added a provision to reduce the judgment interest rate in New York State, as had been suggested by an investor at the November 13 Columbia meeting and subsequently recommended by US Treasury Undersecretary for International Affairs Jay Shambaugh in an April 2024 interview.[18] Senator Krueger invited public comment on the revised draft bill, receiving responses between May 20 and May 28.[19]

Senator Krueger and Assembly Member González-Rojas posted a revised bill on June 3, 2024. It included the following additional changes suggested by market participants: 1) further clarification of the scope of the safe harbor for buy-and-hold and

cooperative distressed debt investors;[20] 2) narrowing of the scope of the champerty law to apply to sovereigns but not to state-owned companies; 3) limiting discovery in future champerty litigation to the facts and circumstances related to an investor's sovereign debt business; 4) clarification that the change in the judgment interest rate would apply only to defaults occurring after May 15, 2024; and 5) removal from the draft law of an innovative provision that would have inserted into New York law a positive obligation of creditors to work "in good faith" toward the resolution of sovereign debt distress.[21]

In addition to addressing concerns of the market, the Krueger–González-Rojas bill won the support of the proponents of the competing bills: on June 3, Oxfam released a letter encouraging the legislature to pass the bill;[22] on June 7, Jubilee USA posted a letter in support of the bill;[23] and also on June 7, Columbia professors Joseph Stiglitz and Martín Guzmán tweeted their support for the bill.[24]

The revised bill passed a vote of the Senate on June 6, 2024, the penultimate day of the legislative session. While the Assembly did not vote on the Krueger–González-Rojas bill, it is expected to take it up during next year's legislative session.

Policy Analysis and Recommendations

In short, the model-law and judgment-cap bills did not progress while Senator Krueger's champerty bill survived and seems poised to be enacted next year. This result begs the question what qualities of the champerty bill and its development process allowed it to advance? Or, conversely, what was it about the other two bills that caused them and their amalgamation to stall?

My belief is that the model-law and judgment-cap bills died for the very good reason that they would conflict with existing sovereign-debt restructuring laws, norms,

and processes. The model law would have created an entirely new legal process in New York State that would have competed with international restructuring processes and the operation of Collective Action Clauses. It was a commercial nonstarter. Moreover, legal experts gave it a low chance of surviving a legal challenge. On the other hand, the broadly scoped judgment-cap bill was simply a commercial nonstarter.

In contrast, Senator Krueger's bill would change existing laws only incrementally, broadening the scope of an existing champerty law and decreasing the state's prevailing judgment interest rate. Most important, the law would have *no effect* on the operation of Collective Action Clauses or international negotiations carried out by the Paris Club or under the Common Framework. In addition, it would work to lower the incidence of disruptive holdout creditor litigation, thus allowing the existing international system to function better.

In sum, Senator Krueger's bill progressed because it *complements* existing laws, norms, and processes, while the model-law and judgment-cap laws died because they *conflict*. But process mattered, too. Senator Krueger's bill evolved and improved with feedback from the market and various experts. In contrast, the proponents of the two other bills ignored feedback and tried to sell their bills to the legislature with heavy lobbying.

These powerful differences of substance and process—and the contrasting outcomes—allow us to answer the three questions posed in the introduction of the paper:

Why enact any sovereign debt reforms at a state level when the IMF, the G-20, and the US Treasury generally handle such matters? Sub-national laws, particularly those of

New York and England, have an important bearing on the outcome of sovereign-debt restructurings, particularly with respect to litigation.

How should state lawmakers coordinate with the international community when developing laws? They should incorporate feedback from representatives of the IMF, the G-20, investors, developing market borrowers, and legal experts when designing legislation that could affect international debt negotiations.

What is the appropriate substantive scope of state legislation? State legislation should complement the international framework for sovereign debt restructuring, including Collective Action Clauses and the Common Framework, not conflict with it.

Policy Recommendations:

1. State legislators should seek guidance and support from the IMF, the G-20, borrower countries, and other experts before voting on legislation that potentially conflicts with existing international norms and processes for restructuring sovereign debt. The model-law and judgment-cap bills presented in the 2023 and 2024 sessions are examples of bills that should not have been pushed without the support of the international community.
2. During its 2025 session the New York State Legislature should focus on enacting the champerty bill the Senate passed in June because it complements existing laws, norms, and processes, and because it was developed in an appropriate consultative manner.
3. Because New York and English law are most pertinent, the US and the UK should chair a working group to study the risks and opportunities of reforming sovereign debt restructuring laws at the sub-national level rather than just

responding to initiatives as they arise. State level reforms should also be a topic of discussion at the upcoming meeting of the G-20's Global Sovereign Debt Roundtable in October 2024. That would also be the right forum for proponents of the judgment-cap bill to try to get their idea moving again. International policymakers might favorably consider a narrowly tailored reformulation of Jubilee USA's judgment-cap bill, one that would cover only commercial debt instruments not covered by 2014 ICMA Collective Action Clauses,[25] filling a gap in the current architecture. Working together is the right way forward.

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[2] Martin Guzman, "An Analysis of Argentina's 2001 Default Resolution," CIGI Papers No. 110, October 2016, at 12, https://www.cigionline.org/sites/default/files/documents/CIGI%20Paper%20No.110WEB_0.pdf

[3] New York State Senate Bill A2102A, 2023-2024 Legislative Session (model law), https://www.nysenate.gov/legislation/bills/2023/A2102/amendment/A. Note: an earlier version of this bill had been posted in 2021.

[4] New York State Senate Bill S5623A, 2023-2024 Legislative Session (champerty, as amended), https://www.nysenate.gov/legislation/bills/2023/S5623/amendment/A.

[5] UK Public Acts, Debt Relief (Developing Countries) Act 2010, https://www.legislation.gov.uk/ukpga/2010/22.

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[8] Cleary Gottlieb, "New York State Legislature Considers Sovereign Debt Restructuring Legislation," Alert Memorandum, June 7, 2023, https://www.clearygottlieb.com/-/media/files/alert-memos-2023/new-york-state-legislature-considers-sovereign-debt-restructuring-legislation.pdf.

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[10] Institute of Global Politics, "Sovereign Debt—New York Legislation," November 29, 2003, https://igp.sipa.columbia.edu/news/sovereign-debt-ny-legislation.

[11] New York State Senate Bill S5542, 2023-2024 Legislative Session (amalgamated model law and claims cap), https://www.nysenate.gov/legislation/bills/2023/S5542/amendment/A.

[12] Zijia Song and Zach Williams, “Wall Street Slams NY Lawmakers Over Sovereign Debt Bill,” Bloomberg, March 13, 2024, https://www.bloomberg.com/news/articles/2024-03-13/wall-street-pushes-back-on-new-york-s-latest-sovereign-debt-bill.

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[14] Cleary Gottlieb, “New York State Legislature Revives Sovereign Debt Restructuring Proposals,” March 26, 2024, https://www.clearygottlieb.com/news-and-insights/publication-listing/new-york-state-legislature-revives-sovereign-debt-restructuring-proposals.

[15] Melissa Butler, Ian Clark, Stuart Matty and Dimitrios Lyratzakis, “Reimagining Zambia’s Restructuring in an Alternative New York Dimension,” Financial Times, https://www.ft.com/content/418594b1-7319-4e8f-917e-f8f4a2d0a897.

[16] “Open Letter to Governor Hochul and Members of the New York State Legislature on the Sovereign Debt Stability Act,” April 25, 2024, https://webassets.oxfamamerica.org/media/documents/Open_Letter_to_Governor_Hochul_and_Members_of_the_NYS_Legislature.pdf.

[17] Gustavo Rivera, “Yesterday, I was honored to welcome…” post on X, @NYSenatorRivera, May 8, 2024, https://x.com/NYSenatorRivera/status/1788322934261444850.

[18] Peterson Institute for International Economics, “Jay Shambaugh, U.S. Treasury, Discusses US Vision for Global Debt and Development Finance,” PIEE Events, April 11, 2024, at 24:15, https://www.youtube.com/watch?v=XSqcBuggoWg.

[19] Liz Krueger, “Legislators Announce Updates to Champerty Bill,” Press Release, May 20, 2024, https://www.nysenate.gov/newsroom/press-releases/2024/liz-krueger/legislators-announce-updates-champerty-bill.

[20] The specific language of the draft law seeks to exclude all but the most litigious investors from the operation of the champerty law, as follows: “Section 1. Legislative intent. The intended purpose of this act is to restore the champerty defense in sovereign debt lawsuits for claims greater than $500,000 with respect to suits brought by litigious holdout investors. The restoration is not intended to apply to conventional and generally cooperative investors who may occasionally choose to sue, where "conventional investors" includes investors that regularly buy and hold sovereign debt purchased in the primary market and "cooperative investors" includes distressed debt investors that regularly purchase debt at a discount in the secondary market and have a record of supporting the consensual resolution of sovereign debt distress through serving as a member of creditor committees or by generally participating in transactions accepted by other creditors following a negotiation.”

[21] Lee C. Buchheit and Mitu Gulati, “The Duty of Creditors to Cooperate in Sovereign Debt Workouts (with Spanish Translation)”, Virginia Public Law and Legal Theory Research Paper No. 2021-51, Virginia Law and Economics Research Paper No. 2021-26, December 6, 2021, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3950529.

[22] Oxfam, “Oxfam Reaction to Updated Text of Sovereign Debt Bill,” Press Release, June 3, 2024, https://www.oxfamamerica.org/press/press-releases/oxfam-reaction-to-updated-text-of-sovereign-debt-bill/.

[23] Jubilee USA et al, “NYS Council of Churches, Jubilee USA, Oxfam and Partners in Health Statement on the New York Senate Passage of the ‘Champerty’ Bill,” June 7, 2024, https://www.jubileeusa.org/statement_assembly_passage_champerty.

[24] Joseph Stiglitz and Martín Guzmán, “Statement from Martin Guzman and Joseph Stiglitz About NY Legislation for Sovereign Debt,” X post, @Policy_Dialogue, https://x.com/Policy_Dialogue/status/1799082490856100044

[25] An effective judgment cap bill that complements existing norms and processes might have the following features: a) the judgment cap only applies to debt instruments not documented with ICMA 2014 Collective Action Clauses; b) the judgement cap only applies to borrowers heavily dependent on official funding, for example those with GDP/Capital less than $3,000 a year; c) the judgment cap legislation is promoted for concurrent enactment in New York and the U.K. after winning support from the G-20 and leading market participants; and d) to avoid disputes in court over valuation, the judgment cap applicable to non-2014 ICMA CAC bonds will be fixed at the secondary market price of the consideration received by the holders of any 2014 ICMA CAC bonds restructured by the same issuer as part of the same restructuring transaction, where applicable.