

Shill on Boilerplate Shock

Gregory Shill (Denver Sturm College of Law) has posted Boilerplate Shock on SSRN.

No nation was spared in the recent global downturn, but several Eurozone countries arguably took the hardest punch, and they are still down. Doubts about the solvency of Greece, Spain, and some of their neighbors are making it more likely that the euro will break up. Observers fear a single departure and sovereign debt default might set off a “bank run” on the common European currency, with devastating regional and global consequences. What mechanisms are available to address — or ideally, to prevent — such a disaster?

One unlikely candidate is boilerplate language in the contracts that govern sovereign bonds. As suggested by the term “boilerplate,” these are provisions that have not been given a great deal of thought. And yet they have the potential to be a powerful tool in confronting the threat of a global economic conflagration — or in fanning the flames.

Scholars currently believe that a country departing the Eurozone could convert its debt obligations to a new currency, thereby rendering its debt burden manageable and staving off default. However, this Article argues that these boilerplate terms — specifically, clauses specifying the law that governs the bond and the currency in which it will be paid — would likely prevent such a result. Instead, the courts most likely to interpret these terms would probably declare a departing country’s effort to repay a sovereign bond in its new currency a default.

A default would inflict damage far beyond the immediate parties. Not only would it surprise the market, it would be taken to predict the future of other struggling European countries’ debt obligations, because they are largely governed by the same boilerplate terms. The possibility of such a result therefore increases the risk that a single nation’s departure from the euro will bring down the currency and trigger a global meltdown.

To mitigate this risk, this Article proposes a new rule of contract interpretation that would allow a sovereign bond to be paid in the borrower’s new currency under certain circumstances. It also introduces the phrase “boilerplate shock”

to describe the potential for standardized contract terms drafted by lawyers — when they come to dominate the entire market for a given security — to transform an isolated default on a single contract into a threat to the broader economy. Beyond the immediate crisis in the Eurozone, the Article urges scholars, policymakers, and practitioners to address the potential for boilerplate shock in securities markets to damage the global economy.