

“IDIOT’S GUIDE” TO SOVEREIGN DEBT RESTRUCTURING

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INTRODUCTION

There is a wonderful series of books entitled “Idiot’s Guides.”¹ These guidebooks are clearly not intended for idiots; rather, they aim to provide a systematic, accessible, and easy-to-grasp overview of their topics, so that readers can understand issues in context and go on to more advanced study.

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¹ These books, published by the Alpha Books division of Pearson Education, Inc., are more specifically published under the rubric, “The Complete Idiot’s Guide to” whatever the relevant subject. See *The Complete Idiot’s Guide To*, at <http://www.idiotsguides.com> (last visited June 17, 2004). Because my aim is to, in a vein similar to the Idiot’s Guide books, summarize in a useful way the relevant information on the topic of sovereign debt, this Article draws from my previous works which laid groundwork on many of the concepts in this area.

This Article attempts to achieve the same goal for the complex and confusing topic of sovereign—that is, country, or State—debt restructuring.

In particular, a great deal of confusion abounds between what I will refer to, for convenience, as public-law and private-law approaches to sovereign debt restructuring.² By public-law approaches, I mean those requiring rules among States, such as the sovereign debt restructuring mechanism (SDRM) approach proposed by the International Monetary Fund (IMF)³ and similar international-treaty or international-convention approaches that I (and others) had proposed earlier from which the SDRM approach appears to take inspiration.⁴ By private-law approaches, I mean those not necessarily requiring rules among States, such as collective action clauses (CACs) which essentially allow payment terms to be changed through supermajority, as opposed to unanimous, voting;⁵ bond-exchange offers with exit consents,

² I use the terms public law and private law loosely, recognizing the diminishing distinction between public and private international law. Traditionally, public international law dealt with rules between States, whereas private international law was concerned with private entities to the extent their activities crossed national borders. BARRY E. CARTER & PHILLIP R. TRIMBLE, *INTERNATIONAL LAW* 19 (3d ed. 1999). In recent years, however, “[t]he distinctions between public and private international law have become increasingly artificial as many states and their instrumentalities have entered the marketplace in a major way . . . and as commerce and foreign policy have become increasingly intertwined.” *Id.* at 19-20. The sovereign debt restructuring convention that I use to exemplify a public-law approach would regulate not only the relationship between States but also between a debtor State and its creditors (such as foreign commercial banks and private investors) that are private citizens of other States.

³ This approach includes the following features: (1) initial activation of a stay on both payments and legal enforcement actions; (2) the debtor State would have to conduct its economic policies so as to put itself back on the road to viable growth; and (3) priority would be given to repayment of new private funds loaned to the debtor State. Although this approach envisions creation of a judicial entity to arbitrate disputes and oversee voting, key decisions are to be made by the stakeholders in the negotiations. Thus, the decision to utilize the SDRM is to be initiated by the debtor State but, in most cases, must be approved by a majority of creditors; a supermajority of creditors could extend the stay if negotiations are not concluded by the end of the original stay period; and the debtor State and a supermajority of creditors would vote to adopt a restructuring plan. Anne Krueger, *New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking*, Address to the Institute for International Economics Conference Sovereign Debt Workouts: Hopes and Hazards (Apr. 1, 2002), available at <http://www.iie.com/publications/papers/krueger0402.htm>.

⁴ See, e.g., Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956 (2000); Jeffrey D. Sachs, *Do We Need an International Lender of Last Resort*, Frank D. Graham Lecture at Princeton University 8 (Apr. 20, 1995) (transcript on file with author). The main difference between my proposal and the IMF’s later SDRM approach, for example, is that the latter contemplates a potential stay mechanism. Nonetheless, my proposal explicitly allows the possibility of imposing a stay mechanism, Schwarcz, *supra*, at 1010, and the original SDRM approach did not include a stay.

⁵ CACs are clauses in individual loan agreements and bond indentures that enable, typically, a “supermajority” of creditors (i.e., some percentage of creditors higher than a simple “greater-than-fifty-percent” majority) parties to any such contract to modify essential payment terms—such as the amount of principal owed, the interest rate thereon, and maturities. Schwarcz, *supra* note 4, at 1016. Some commentators

which attempt to replace a State's existing bonds with bonds permitting supermajority voting to change essential payment terms;⁶ and other such approaches negotiated between a debtor State and its creditors.⁷ This Article tries to remove that confusion.

This Article also attempts to determine which approach, public-law or private-law, is more effective and pragmatic. Although these approaches are not necessarily inconsistent, advocates of each approach often treat them as if they were.⁸ That dichotomy has some justification: a public-law approach supersedes the need for a private-law approach, whereas focus on a private-law

advocate including CACs in all sovereign debt loan agreements and bond indentures. *See, e.g.*, BARRY EICHENGREEN, TOWARDS A NEW INTERNATIONAL FINANCIAL ARCHITECTURE 65-70 (1999); Christopher Greenwood & Hugh Mercer, *Considerations of International Law*, in BARRY EICHENGREEN & RICHARD PORTES, CRISIS? WHAT CRISIS? ORDERLY WORKOUTS FOR SOVEREIGN DEBTORS 110 (1995); Peter Cook, *The Next Inevitable Debt Crisis*, GLOBE & MAIL, Oct. 20, 1999, at B2 (arguing that CACs would allow for an orderly restructuring of a country's bond debt, thereby shifting some of the burden from the IMF to the private sector); *Diminishing Returns: There Are Scores of New Designs for the International "Financial Architecture"*, ECONOMIST, Oct. 9, 1999, at 98 (advocating CACs for all sovereign bond contracts, in accordance with recommendations by the Council on Foreign Relations); Under Secretary of Treasury John B. Taylor, *Sovereign Debt Restructuring: A U.S. Perspective*, Address at the Institute for International Economics Conference Sovereign Debt Workouts: Hopes and Hazards (Apr. 2, 2002), available at <http://www.iie.com/publications/papers/taylor0402.htm>. Taylor's comments are particularly notable because they represent the position of the U.S. Treasury. *See Sovereign Bankruptcies*, ECONOMIST, Apr. 6, 2002, at 98.

⁶ In a bond-exchange offer with exit consents, a State offers bondholders the option of exchanging their existing bonds for new bonds having less stringent payment terms. In order to induce bondholders to agree to the exchange, consenting bondholders are required to waive various protections in the bond indenture, such as cross-default and negative-pledge covenants, that can be waived without unanimity; and thus bondholders who do not agree to the exchange may find those contractual protections gone if a sufficient majority of bondholders consent. *See* Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. REV. 59, 71 (2000). Ecuador used this strategy in 2000. *Sovereign Restructurings: Putting Too Much Faith in Exit Consents*, MOODY'S INVESTORS SERVICE GLOBAL CREDIT RES., Mar. 2001. Although beyond the scope of this Article, legal questions remain as to whether waivers of contractual protection by exchanging bondholders, effectively a form of coercion, are enforceable. *See, e.g.*, Michael M. Chamberlin, *At the Frontier of Exit Consents*, Remarks at the Bear Stearns & EMCA Sovereign Creditors Rights Conference (Nov. 8, 2001) (noting that "some bond terms (notably governing law, right of acceleration for non-payment, waiver of sovereign immunity and submission to jurisdiction) seem so fundamental to a sovereign bondholder's payment rights that they should not be changed without its consent," and that the likelihood that "courts will uphold such fundamental changes by exit consent as within the intent of the parties is doubtful but remains to be seen").

⁷ I later argue that a debtor State and its creditors can most effectively negotiate a debt restructuring plan when their negotiations occur under the shadow of a sovereign debt restructuring convention. *See infra* Part II. As mentioned *supra* note 2, I regard that as a public-law approach—even though such negotiations might occur solely between the State and its creditors—because the convention itself shapes the negotiations.

⁸ *See, e.g.*, Randall Dodd, *Sovereign Debt Restructuring*, 9 FINANCIER 46 (2002) (typical of many articles, this sets up the choices considered as binary: either a public-law solution or a private-law solution).

approach can politically sidetrack public-law approaches.⁹ To fit within the existing public debate, this Article provisionally follows that dichotomy.

The Article concludes that a public-law approach is not only much more effective than a private-law approach but, surprisingly, is also easier and less expensive to implement. To understand why, one must first understand the problems inherent in sovereign debt restructuring.

I. THE PROBLEMS OF SOVEREIGN DEBT RESTRUCTURING

Sovereign debt restructuring gives rise to three distinct problems: the holdout, or collective action, problem; the moral hazard problem; and the taxpayer-funding problem. Consider first the collective action problem.

A State cannot restructure its debts unilaterally without suffering significant reputational cost in the world financial community.¹⁰ Therefore, any such debt restructuring is likely to be consensual. Achieving consensus, however, is a haphazard affair. The conflicting interests of the State and its creditors make it difficult, and sometimes effectively impossible, to reach complete agreement on a restructuring plan. This difficulty is exacerbated by the collective action problem of reaching agreement *among* creditors.¹¹ Loan agreements and bond indentures typically require unanimous consent of the

⁹ For example, the G-7 countries, including the United States, have relegated exploration of public-law approaches (such as the IMF's proposed SDRM) to the long term, while advocating present use of CACs. See Hal S. Scott, *A Bankruptcy Procedure for Sovereign Debt*, 37 INT'L LAW. 103, 118 (2003).

¹⁰ William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. (forthcoming 2004) (recognizing that the primary cost of default to debtor-States is generally seen to be the future exclusion from the credit markets caused by reputational loss and not any enforcement cost associated with a specific default).

¹¹ Another collective action problem is that creditors that otherwise may favor a negotiated settlement may be motivated to try to enforce their claims against the State because they fear that other creditors will be the first to enforce their claims against assets that are insufficient to pay all claims—the so-called creditor “grab race.” This problem, however, is less significant in a sovereign debt context than in a corporate context because creditors can only attempt to attach the State's assets that are located in other jurisdictions, and “[u]sually, only limited assets exist outside the debtor country and much of that is legally immune from attachment.” James B. Hurlock, *The Way Ahead for Sovereign Debt*, INT'L FIN. L. REV., July 1995, at 10, 11; see also EICHENGREEN & PORTES, *supra* note 5, at 31 (“While the debtor state may have some assets within the jurisdiction of the courts in another country, it is frequently very difficult to levy execution against such assets, because of the law of sovereign immunity.”); G. Mitu Gulati & Kenneth N. Klee, *Sovereign Piracy*, 56 BUS. LAW. 635, 635 n.4 (2001); Rory Macmillan, *The Next Sovereign Debt Crisis*, 31 STAN. J. INT'L L. 305, 353 (1995). For a detailed discussion of whether a public-law sovereign debt restructuring approach should include a mechanism to stay the potential “grab race” against a debtor-State or its assets, see Schwarcz, *supra* note 4, at 984-85 (concluding that the costs of such a stay mechanism generally would outweigh its benefits).

creditors in order to alter essential terms such as the amount of principal, the rate of interest, or the maturity schedule.¹² Therefore, one or more creditors may hold out, hoping that the overall desire to reach an agreement will induce the debtor or other parties to buy out their claims or pay them a premium.¹³ Holdouts, however, discourage all creditors—even those who otherwise wish to reach an agreement—from agreeing to a debt restructuring plan.

In recent years, this problem has become even more intractable as court rulings have encouraged holdout behavior¹⁴ and States have shifted from bank to lower-cost bond financing.¹⁵ This latter trend particularly exacerbates the collective action problem. Bondholders that invest in a particular State tend to have smaller individual investments and therefore are more numerous than banks that lend to the same State.¹⁶ Bondholders are also less likely than banks to agree to any accommodations in order to maintain a commercial relationship with the State.¹⁷ Furthermore, because bonds are actively traded, the identity of bondholders constantly changes.¹⁸ These factors make the required

¹² Schwarcz, *supra* note 4, at 1003. The advent of CACs, however, does mitigate this problem somewhat. See *infra* notes 40-45 and accompanying text.

¹³ See, e.g., Alan Cowell, *More Trouble Seen on Defaulted Russian Debt*, N.Y. TIMES, Mar. 16, 1999, at C4 (describing dispute arising in Russia's debt restructuring when one of nineteen banks broke ranks to announce the creation of a ruble-based investment fund, for which the bank indirectly would be paid a two percent management fee).

¹⁴ For example, in *Allied Bank International v. Banco Credito Agrícola de Cartago*, 757 F.2d 516 (2d Cir. 1985), the court upheld a holdout creditor's claim. A member of a bank syndicate that refused to join a restructuring agreement between Costa Rican sovereign debtors and other syndicate members sued in the United States for repayment of its defaulted loan. *Id.* at 519. The court granted summary judgment in favor of the objecting bank on the basis that the loan was clearly due and payable, notwithstanding Costa Rica's unilateral regulation suspending its external debt payments. *Id.* at 522-23. The court first found that the U.S. Act of State Doctrine, under which "the courts of one country will not sit in judgment on the acts of the government of another done within its own territory," was inapplicable because the situs of the property in question—the holdout bank's right to receive payment from the Costa Rican debtors—was New York, where the debt was payable. *Id.* at 520-21. The court then held that Costa Rica's unilateral suspension of debt payments was "inconsistent with the orderly resolution of international debt problems . . . [and] contrary to the interests of the United States." *Id.* at 522. The same court also upheld a holdout creditor's claim in *Elliott Associates v. Banco de la Nacion*, 194 F.3d 363 (2d Cir. 1999). A vulture fund (one that invests in distressed debt) bought debt of two Peruvian banks, guaranteed by the Republic of Peru, at a deep discount. The fund then received, but refused to participate in, an offer to exchange that debt for new bonds. Instead, it sued Peru for payment. Although a lower court dismissed the suit on champerty grounds, the appeals court reversed and granted judgment. The case, however, was eventually settled. See Gulati & Klee, *supra* note 11.

¹⁵ Whereas sovereign debt restructurings in the 1980s and early 1990s primarily involved bank debt, the advent of "Brady Bonds" in the mid-1990s began a trend in which States obtain financing through the public issuance of bonds in the lower-cost capital markets. Schwarcz, *supra* note 4, at 1004.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

unanimous creditor consent much more difficult to obtain. Consequently, “[a]t each stage of a financial workout, collective action problems plague the readjustment of debt claims, to the detriment of the creditors as well as the debtor.”¹⁹

The second problem, moral hazard, can arise where nondebtor States or, more typically, multilateral governmental entities such as the IMF, act as lender of last resort to financially troubled States, enabling them to avoid default and its consequences. Although the term “moral hazard” has various related meanings,²⁰ in a general economic context it simply refers to the greater tendency of people who are protected from the consequences of risky behavior to engage in such behavior.²¹

Moral hazard encompasses both State and creditor moral hazard. The State moral hazard problem is that countries anticipating an IMF bailout might have less reason to take a prudent economic course.²² The creditor moral hazard problem is that lenders who anticipate being protected from default might have a greater tendency to take unwarranted financial risk.²³

There is much debate over the extent to which moral hazard exists. Some believe it is overstated,²⁴ and the IMF itself has taken recent steps to attempt to mitigate its impact.²⁵ Nonetheless, the potential for moral hazard has figured prominently in the media debate:

¹⁹ Sachs, *supra* note 4, at 6.

²⁰ In the insurance context, for example, it means “the deliberate efforts by the insured to bring about the insured event, as when the owner of life insurance commits suicide.” Richard A. Epstein, *Products Liability as an Insurance Market*, 14 J. LEGAL STUD. 645, 653 (1985).

²¹ See Charles G. Hallinan, *The “Fresh Start” Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 84 (1986) (relying on the economic definition of moral hazard: debtors and creditors that are protected from the consequences of default “could be expected to increase both excessive borrowing and excessive resort to bankruptcy”).

²² Schwarcz, *supra* note 4, at 961-62.

²³ *Id.* at 962.

²⁴ See, e.g., Paul Blustein, *IMF Ready to Resume Russia Aid*, WASH. POST, Apr. 29, 1999, at E1 (arguing that the IMF’s delay in funding Russia during its economic crisis in 1998, and Russia’s resulting default, may have reduced moral hazard); cf. Ilan Noy, *Do IMF Bailouts Result in Moral Hazard? An Events-Study Approach* (Oct. 2003) (unpublished manuscript) (suggesting from empirical evidence that creditor moral hazard has not increased as a result of IMF bailouts during the period 1994-2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=470661#PaperDownload.

²⁵ In recent years, the IMF has attempted to reduce moral hazard by refusing, in certain cases, to bail out a debtor State. Sometimes termed a “bail-in,” the IMF refused in 1999, for example, to act as a lender of last resort, as a result of which Ecuador defaulted on Eurobond payments and was forced to use an exchange offer with exit consents to attempt to manage the crisis (as a result of which the bonds lost about forty percent of their net present value). Similarly, in Argentina in 2001, the IMF refused to initiate a bailout and also

Some economists believe that bailouts increase "moral hazard" by rewarding and encouraging bad policies by governments and excessive risk-taking by banks. . . .

. . . .

IMF economists like to argue that these moral-hazard problems are minimal. But consider the case of the recent \$42 billion [IMF] package for Brazil. How did the Brazilians qualify for this support? They did so mostly by not exercising sound fiscal policies. If their policies had been better, they would not be in their current difficulties

. . . .

Russia is another example. . . . Since [1993], the availability of IMF and other foreign money provided an excuse to avoid making tough political decisions. Instead of cutting public outlays or increasing tax collections, undertaking efficient privatizations or enacting legal reforms, the government counted on foreign bailouts to hold things together.

. . . .

The sequence of unrestrained global bailouts began with Mexico in 1995 [where] the IMF-U.S. lending package was effectively a reward for corrupt and risky bank lending and poor macroeconomic policies. . . .

. . . .

. . . [T]he IMF might consider changing its name to the IMH—the Institute for Moral Hazard.²⁶

The third problem of sovereign debt restructuring arises to the extent citizens of nondebtor States are taxed to provide the funding that is critical to a debtor State's economic rehabilitation. A financially troubled State will need "fresh working capital during restructuring, so that critical governmental functions don't collapse."²⁷ Much of this money is presently provided by the IMF in the form of loans. The IMF, however, raises this money from its

repeatedly refused to lend new money (although the IMF did agree to reschedule existing loans). For a more detailed discussion of IMF practices in various sovereign debt crises, see Scott, *supra* note 9, at 108-11.

²⁶ Robert J. Barro, *The IMF Doesn't Put Out Fires, It Starts Them*, BUS. WK., Dec. 7, 1998, at 18. Some even argue that IMF loans provided at subsidized interest rates may also increase the risk of moral hazard. See Charles W. Calomiris, *The IMF's Imprudent Role as Lender of Last Resort*, 17 CATO J. 275, 277 (1998); STAFF OF JOINT ECON. COMM., 105TH CONG., IMF FINANCING: A REVIEW OF THE ISSUES 8 (Comm. Print 1998) [hereinafter IMF FINANCING].

²⁷ Sachs, *supra* note 4, at 13.

member States,²⁸ which in turn raise the money directly or indirectly through their taxing power.²⁹ This practice has been criticized as causing taxpayers of wealthier IMF member States to effectively subsidize not only defaulting States but also the creditors of the defaulting States.³⁰ Though some argue that dealings with the IMF have not forced taxpayers to bear additional costs,³¹ that view appears to rest more on form than substance. Although some also characterize IMF capital subscriptions as “investments,” because “member countries earn interest on their deposits in the IMF,”³² repayment by the IMF, although anticipated,³³ is not guaranteed.³⁴ Moreover, even if repayment occurs, the IMF pays less than a market rate of interest.³⁵ In some cases, this

²⁸ The IMF’s primary means of financing is by “capital subscriptions,” which represent quotas assessed against each member-State in amounts “broadly determined by its economic position relative to other members.” *IMF Quotas and Quota Reviews*, at <http://www.imf.org/external/np/exr/facts/quotas.htm> (last updated Apr. 2004) [hereinafter *IMF Quotas*]. In 1999, for example, total quotas assessed increased by 45%, from approximately \$200 billion to \$290 billion. *See id.*

²⁹ Schwarcz, *supra* note 4, at 964.

³⁰ *Id.*

³¹ *See, e.g., Implications of Asian Financial Crisis: Hearing Before the House Comm. on Banking & Fin. Servs.*, 105th Cong. (1998) (statement of Robert E. Rubin, U.S. Secretary of the Treasury, Jan. 30, 1998) (arguing that “over the past fifty years, our contribution to the IMF has not cost the taxpayer one dime. There are no budget outlays. Our contribution does not increase the deficit, or divert resources from other spending priorities”).

³² *See, e.g., Stanley Fischer, The Asian Crisis: A View from the IMF*, Speech at the Midwinter Conference of the Bankers’ Association for Foreign Trade (Jan. 22, 1998) (transcript on file with author).

³³ *See Foreign Operations, Export Financing, and Related Programs Appropriations for Fiscal Year 1999: Hearings on H.R. 4569/S. 2334 Before a Subcomm. of the House Comm. on Appropriations*, 105th Cong. 93 (1998) [hereinafter *Appropriations Hearings*] (statement of Robert E. Rubin, U.S. Secretary of the Treasury) (arguing that “[t]he likelihood that the IMF would fail to repay the U.S. is extremely remote”). Because the IMF is a financial cooperative, member States pay capital subscriptions when they join and theoretically have the right to a return of capital if they ever withdraw as members. *See IMF Quotas, supra* note 28.

³⁴ *See, e.g., IMF FINANCING, supra* note 26, at 3 (concluding that “[i]t is doubtful that [payment of the U.S. quota subscription to the IMF] will ever be fully recovered”); *see also The International Monetary Fund and the National Interests of the United States: Hearing Before the Joint Economic Comm.*, 105th Cong., 2d Sess. 136-37 (1998) [hereinafter *Hearings on the IMF*] (statement of C. Fred Bergsten, Director, Institute for International Economics) (noting that “at least one private sector analysis of the IMF balance sheet found that if it were a bank, serious questions could be raised about the IMF’s capital adequacy”). One might question whether the Fund would ever have sufficient funds to repay its largest members, especially at a time when other members are seeking to withdraw their subscriptions or IMF loans are in default.

³⁵ The IMF pays interest on the U.S. reserve position at a rate “determined as the weighted average of representative short-term [government borrowing] rates in the United States, Japan, Germany, France and the United Kingdom.” *Appropriations Hearings, supra* note 33, at 93-94 (statement of Robert E. Rubin, U.S. Secretary of the Treasury). Unfortunately, that rate often is lower than the rate for three-month U.S. Treasury bills, making it not only below-market for U.S. government investments but also below the U.S. government’s cost of funds (i.e., the rate on U.S. Treasury bills). *See Hearings on the IMF, supra* note 34, at 69. Only a foolish investor would accept a rate of return that is equal to or less than its cost of funds.

interest rate is even below the member State's own cost of funds!³⁶ IMF funding therefore clearly imposes a cost on taxpayers.³⁷

These problems cry out for solutions. As Part II will demonstrate, only a public-law approach can solve each of these three problems.

II. A PUBLIC-LAW APPROACH CAN SOLVE THESE PROBLEMS

The striking advantage of a public-law approach for solving these problems of sovereign debt restructuring is that it imposes a legal framework binding on parties, including holdout creditors, who do not agree to the solution. A public-law approach generally would be implemented by a sovereign debt restructuring treaty or convention, the terms being synonyms³⁸ (hereinafter, a "Convention"). Although the Convention's provisions would be primarily directed at solving the aforesaid problems of sovereign debt restructuring, those provisions also should have at least three normative constraints: they should foster, or at least not impair, the State's ultimate economic rehabilitation; they should minimally affect contractual incentives of creditors; and they should require only minimal adjudicatory discretion in their administration.³⁹

A. Solving the Collective Action Problem

A Convention would solve the collective action problem for debtor States in much the same way that bankruptcy reorganization law solves that problem for debtor corporations: by supermajority voting that supersedes contractual or statutory voting restrictions.⁴⁰ For example, § 1126(c) of the U.S. Bankruptcy Code (hereinafter, the "Bankruptcy Code") overcomes the collective action problem by providing that an affirmative vote by creditors holding "at least

³⁶ See *Hearings on the IMF*, *supra* note 34, at 69. The Joint Economic Committee explains that "One diversion in an IMF performance review is the dubious contention that under existing budget rules the IMF appropriation is not a net outlay and therefore involves no taxpayer cost. Although current accounting rules mask the cost of the IMF quota increases to the U.S., economic analysis clarifies the true nature of the transaction: real economic resources are transferred at subsidized interest rates from the U.S. economy to other nations." IMF FINANCING, *supra* note 26, at 3.

³⁷ To be sure, taxpayers benefit indirectly from IMF loans that preserve the integrity of the world's financial system. But I show that these same benefits can be achieved by privatizing the funding of sovereign debt restructuring.

³⁸ Schwarcz, *supra* note 4, at 966.

³⁹ *Id.* at 975-80.

⁴⁰ *Id.* at 1003-06.

two-thirds in amount and more than one-half in number” of the claims binds *all* creditors—even those who vote negatively or fail to vote.⁴¹ Without supermajority voting imposed by law, any attempt by a debtor State to change the essential terms of its bargain with creditors would require unanimous approval,⁴² which is difficult and sometimes impossible to achieve.

As mentioned above, however, any Convention should foster, or at least not impair, the State’s ultimate economic rehabilitation; should minimally affect contractual incentives of creditors; and should require only minimal adjudicatory discretion in its administration. A supermajority voting mechanism largely achieves these normative goals. To the extent it permits a debtor State and its creditors to agree more rationally on settling claims, supermajority voting fosters economic rehabilitation. It also might be applied without exercising adjudicatory discretion.⁴³ The only potential drawback is that supermajority voting would affect contractual incentives by modifying voting procedures that require unanimity. However, that impact should be economically insignificant if, as under the Bankruptcy Code, the supermajority voting is done by classes of claims that are “substantially similar to the other claims . . . of such class.”⁴⁴ The presumption is that a vote by holders of the requisite supermajority that benefits their claims will also benefit holders of substantially similar claims.⁴⁵

⁴¹ 11 U.S.C. § 1126(c) (2000); *cf.* CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 7 (1997) (observing that “[o]ne primary reason that workouts do not succeed [outside of bankruptcy] is that dissenting creditors cannot be bound to the restructuring agreement”).

⁴² Although a State theoretically could attempt to settle with creditors individually notwithstanding their contractual protection of unanimity, that settlement would not bind other creditors, who could then sue the State on the original claims. *See Allied Bank Int’l v. Banco Credito Agricola de Cartago*, 757 F.2d 516 (2d Cir. 1985) (in which a member of a bank syndicate that refused to join a restructuring agreement proposed by a debtor-State successfully sued for repayment of its defaulted loan). The right of such holdout creditors to recover their original claims could undermine the willingness of other creditors to settle their claims. Also, if the State must grant significant concessions to induce the settlement, it may only want to settle on an overall basis.

⁴³ *See* Schwarcz, *supra* note 4, at 1005.

⁴⁴ 11 U.S.C. § 1122(a); *see also id.* § 1126(c) (requiring voting by classes of claims). For an introduction to how a Convention should divide claims into classes for supermajority voting purposes, *see* Schwarcz, *supra* note 4, at 1006 (noting that courts have interpreted substantial similarity under the Bankruptcy Code to mean that claims have the same priority in bankruptcy, and in a sovereign debt context all unsecured claims appear to have the same priority; and also explaining that because the Bankruptcy Code does not require all claims of the same priority to be classed together, merely that different priority claims cannot be classed together, *pari passu* claims could be classed separately if there was a rationale for separate classification such as giving each claim of a State or multilateral agency its own classification or classifying private foreign creditors separately from private domestic creditors).

⁴⁵ Schwarcz, *supra* note 4, at 1006.

Thus, a Convention incorporating supermajority voting could solve the collective action problem without undermining sovereign debt restructuring norms.

B. Solving the Moral Hazard and Taxation Problems

A Convention can solve the moral hazard and taxation problems of sovereign debt restructuring in much the same way, again, that bankruptcy reorganization law solves similar problems for corporate debt restructuring: by enabling the debtor to attract private reorganization financing. In a corporate context, if the government acts as a lender of last resort to financially troubled firms, firms anticipating a government bailout would have less reason to take a prudent economic course, and creditors anticipating such a bailout would have a greater tendency to take unwarranted financial risk.⁴⁶ Moreover, any government bailout almost certainly would have to be funded, directly or indirectly, by taxpayers.⁴⁷ Thus, the moral hazard and taxation problems are similar to those of sovereign debt restructuring.

Section 364 of the Bankruptcy Code, however, sets out a mechanism, commonly referred to as debtor-in-possession (DIP) financing, to avoid these problems by enabling a debtor firm to obtain financing for its reorganization *from private, free-market—as opposed to governmental—sources of funds*.⁴⁸ Section 364 achieves this goal by granting priority to lenders and investors that provide DIP financing.⁴⁹ Without a priority, private financing would likely be unavailable because the information asymmetry between the corporation and potential financiers is typically large (a bankrupt company rarely has full financial transparency) and also because new financiers will not want to be “taxed” by the claims of existing creditors.

⁴⁶ Compare *supra* text accompanying notes 20-26, with notes 20-26 (discussing moral hazard in a sovereign debt restructuring context).

⁴⁷ Compare *supra* text accompanying notes 27-37, with notes 27-37 (discussing the taxation problem of sovereign debt restructuring).

⁴⁸ These sources of funds are typically the credit and capital markets, the former referring to banks, finance companies, and other traditional institutional lenders and the latter referring to “markets where capital funds—debt and equity—are traded. Included are private placement sources of debt and equity as well as organized markets and exchanges.” JOHN DOWNES & JORDAN ELLIOT GOODMAN, *DICTIONARY OF FINANCE AND INVESTMENT TERMS* 59 (3d ed. 1991).

⁴⁹ See 11 U.S.C. § 364(a). Moreover, if the priority scheme laid out in § 364(a) is inadequate to attract sufficient financing, the judge may authorize the granting of collateral. See *id.* § 364(c), (d). If necessary, the judge may even authorize the obtaining of credit secured by a senior lien on property already pledged as collateral if the original secured party is adequately protected. See *id.* §§ 361, 364(d) (defining adequate protection).

Shifting the funding of sovereign debt restructuring from the IMF or other politically motivated organizations to private financing similarly should solve the moral hazard and taxation problems. It would solve the moral hazard problem by depriving States and their creditors of assured funding. Although the amount of private funding is large enough to accommodate the legitimate financing needs of restructuring States,⁵⁰ a State will have no assurance that private funding will be available. That lack of assurance should thus motivate States to take more prudent economic courses and should motivate creditors to avoid unwarranted risks. Shifting to private funding also would solve the taxation problem by avoiding taxpayer-funded governmental sources.⁵¹

To motivate the private markets to fund sovereign debt restructuring, the Convention could provide a priority-granting mechanism like that of § 364 of the Bankruptcy Code.⁵² As discussed, though, the Convention, and therefore any such mechanism, should foster or at least not impair the State's ultimate economic rehabilitation, should minimally affect contractual incentives of creditors, and should require only minimal adjudicatory discretion in its administration.

Switching from governmental to private financing will not impair a State's ultimate economic rehabilitation to the extent it simply provides a substitute funding source. Nonetheless, eliminating governmental lending of last resort⁵³

⁵⁰ See, e.g., Moisés Naím, *Mexico's Larger Story*, 99 FOREIGN POL'Y 112, 122-23 (1995) ("Today, the magnitude of the funds controlled by private investment managers makes the volumes typically supplied by the IMF and the World Bank almost irrelevant."); John H. Chun, Note, "Post-Modern" Sovereign Debt Crisis: Did Mexico Need an International Bankruptcy Forum?, 64 FORDHAM L. REV. 2647, 2671 n.185 (1996) (noting that "the amount of money controlled by bondholders and mutual fund managers dwarfs a typical loan granted by the IMF").

⁵¹ A shift to private funding also could significantly shorten a State's timeframe for obtaining credit. While the IMF can sometimes take months to secure funding, private financiers can usually arrange credit within weeks. As a result, "IMF loans are usually too little, too late[;] [b]y the time they arrive, the government may have lost control of the situation." Sachs, *supra* note 4, at 14; see also EICHENGREEN, *supra* note 5, at 61 & 61 n.4 (arguing that "international assistance as currently constituted" cannot protect debtor-States from "serious damage," because "[a]ll too often, IMF-led rescues are ineffective in containing a panic because the Fund's resources are limited and doled out a drop at a time," and that "this is inevitably the case").

⁵² Indeed, granting a priority in order to attract private financing may be even more important in a sovereign than a corporate debt restructuring context because the information asymmetry between the debtor and potential financiers may be larger. Sovereign States, unlike corporations, are not ordinarily subject to financial reporting, and State officials might not be liable under applicable national law for providing misinformation.

⁵³ I recognize, however, that no Convention is likely to, or should, cut off all governmental funding. Governments might find it prudent, for example, to provide loans—if private-market funding were unavailable—to an economically imprudent State with a large nuclear arsenal in order to preserve the political stability of the State. Cf. EICHENGREEN, *supra* note 5, at 60 (observing that the "rationale for the [1997] South

creates a risk that, even by offering priority, a State might sometimes be unable to obtain private market funding at any cost, thereby forcing the State into default. On balance, though, allowing default in those circumstances can therefore have a positive long-term effect; even the IMF now appears to prefer default to a bailout.⁵⁴ Furthermore, governmental lending of last resort may well be appropriate in circumstances where the debtor State has been economically and financially prudent, and the factors causing default are largely exogenous, such as a financial panic.⁵⁵ At the very least, such funding would not then foster moral hazard, and the State should be able to repay the loan when the panic subsides.⁵⁶

Switching from governmental to private financing also should only minimally affect contractual incentives of a State's creditors. Although giving priority to financiers of the State's debt restructuring could adversely affect those incentives by subordinating existing creditor claims, any harm should be relatively minimal for two reasons: granting priority would, in and of itself, not lower the State's debt rating,⁵⁷ and an IMF loan already has de facto priority

Korean [loan] package [led by the United States and the IMF], in security circles at least, was that the Korean Peninsula is too important geopolitically for [its] economy to be left unaided").

⁵⁴ See *Emerging Market Bonds, A Crash Course in Default*, EUROMONEY, Oct. 10, 1999, at 47, 50 (noting that permitting default is a new approach by creditor States and the IMF). Thus, the IMF suggested to Romania that it may have to renegotiate at least eighty percent of its Eurobond payments falling due in May and June 1999 in order to obtain IMF funding. See *From Bail-Out to Bail-In*, ECONOMIST, Mar. 27, 1999, at 71, 71. But see Deepak Gopinath, *Who's Afraid of the Big Bad Bail-In?*, INSTITUTIONAL INVESTOR, June 1, 1999, at 79, 79 (arguing that default could jeopardize a State's access to financial markets at a time when it most needs money); Belinda Rabano, *Tired After Asia, Russia and Brazil, Lenders Seek Private "Bail-Ins,"* ASIAN WALL ST. J., Sept. 27, 1999, at 25 (arguing that higher costs effectively could shut off access to international capital markets for States rated "B" or lower); Richard Waters, *Concern Over Emerging Market Rescue*, FIN. TIMES, Apr. 14, 1999, at 4 (arguing against a "bail-in" policy).

⁵⁵ The Mexican financial crisis of 1994-95 exemplifies such a liquidity crisis to some extent. Because of market volatility, Mexico was unable to roll over its \$28 billion in short-term bonds and—with only \$6 billion in foreign reserves—was unable to pay those bonds. See EICHENGREEN, *supra* note 5, at 57. Some commentators argue that Mexico was healthy, but for the market volatility. See Chun, *supra* note 50, at 2656, 2659, 2664-65 (arguing that the 1994-95 Mexican crisis was one of liquidity rather than solvency, in contrast to the Mexican financial crisis in 1982).

⁵⁶ The IMF's organizers originally envisioned this role at Bretton Woods in 1944. See Chun, *supra* note 50, at 2696-97.

⁵⁷ See Telephone Interview with Joanne W. Rose, Senior Managing Director, General Counsel and Chair of the Ratings Policy Board, Standard & Poor's Ratings Services (June 10, 1999) (notes on file with author). Ms. Rose said that ratification of a Convention that provides priority for new lending and supermajority voting should not affect Standard & Poor's ratings—which are based on the likelihood of default and not on the amount of recovery expected in default—because such a Convention would not affect the likelihood of default. Thus, a State whose debt was rated investment grade would not experience a ratings change as a result of ratifying a Convention. Ms. Rose suggested, however, that a sovereign debt analyst might be tempted to

over other claims.⁵⁸ Furthermore, even on an absolute basis, the harm may be minimal. I have argued, in a corporate lending context, that allowing debtors to grant priority to attract new money credit “tends to create value for unsecured creditors,” even though those creditors’ claims are subordinated to the new money.⁵⁹ The availability of new money credit increases a debtor’s liquidity, thereby reducing its risk of failure and increasing the expected value of unsecured claims.⁶⁰ Likewise, allowing a debtor State to grant priority in order to increase liquidity should reduce the risk of economic failure.⁶¹

Finally, switching from governmental to private financing should require only minimal adjudicatory discretion in its administration because the market itself determines the terms and conditions of funding.⁶²

Thus, a public-law approach using a Convention can solve the moral hazard and taxation problems of sovereign debt restructuring by reducing governmental lending of last resort and replacing it with a priority-granting mechanism to enable a debtor State to attract private reorganization funding. That approach also can solve the collective action problem of sovereign debt restructuring by providing for supermajority voting by classes of claims.⁶³

slightly reduce the rating of a financially troubled State that had ratified a Convention, such as from “B” to “B-.”

⁵⁸ See EICHENGREEN & PORTES, *supra* note 5, at 24 (stating that the IMF is regarded as a preferred creditor).

⁵⁹ Steven L. Schwarcz, *The Easy Case for the Priority of Secured Claims in Bankruptcy*, 47 DUKE L.J. 425, 425 (1997). Although this article deals with secured lending priorities, its argument applies equally to any set of lending priorities that arise merely by operation of law.

⁶⁰ See *id.* at 430. Without liquidity, the debtor State cannot order crucial imports, purchase equipment, or continue with modernization. The effect can be similar to an economic boycott.

⁶¹ Despite the benefit of liquidity, however, new money credit could decrease value to unsecured creditors if overinvestment occurs—meaning that the debtor State invests the new money in a less valuable project. To prevent overinvestment, the Bankruptcy Code allows concerned creditors to scrutinize and object to an excessive amount of DIP financing and, where appropriate, to monitor its use. 11 U.S.C. §§ 364(c), 1109(b) (2000) (permitting DIP financing only after notice and a hearing, at which creditors have the right to appear and be heard). A Convention could utilize a similar procedure to mitigate the risk of overinvestment in a sovereign debt restructuring context. See Schwarcz, *supra* note 4, at 989-90.

⁶² An existing multilateral governmental institution, such as the IMF, could perform the limited functions associated with reducing the risk, discussed *supra* note 61, of overinvestment. See Schwarcz, *supra* note 4, at 990 (noting that the IMF could “effectively perform the tasks of scrutiny and monitoring by acting . . . as [a nonrecourse] intermediary funding source” and describing how the IMF could act in that capacity).

⁶³ A consequence of supermajority voting is that claims are discharged to the extent they are *not* provided for in the approved restructuring plan. See *id.* at 999. Discharge “permits a State that is greatly overburdened with debt to cancel at least a portion of those debts.” *Id.* On the other hand, creditors are protected because the supermajority voting requirement permits any class of creditors that feels unfairly treated by the discharge to vote to disapprove, and thereby veto, the plan. *Id.*

III. PRIVATE-LAW APPROACHES ARE INADEQUATE

Private-law approaches alone cannot, for two reasons, solve the problems of sovereign debt restructuring. The first reason is that private-law approaches, being contractual, cannot bind noncontracting parties in order to solve the collective action problem. If, as is likely, a State has existing creditors whose bonds⁶⁴ lack supermajority voting provisions for changing essential payment terms, a private-law approach cannot bind those creditors unless they agree, ex post, to include those provisions in their bond indentures. Bond exchange offers with exit consents, used to try to coerce that agreement, are of only limited utility, however,⁶⁵ and are extremely costly.⁶⁶ Furthermore, the coercive strategy itself may well create legal problems.⁶⁷ In contrast, a public-law approach, such as a Convention, would bind all existing creditors if stated to be retroactive.⁶⁸

⁶⁴ Such bonds may well have long-term maturities.

⁶⁵ In 2000, for example, Ecuador engaged in a bond exchange offering under which the new bonds had both a buyback provision and a principal reinstatement provision that were considered favorable to accepting creditors. At the same time, creditors accepting the exchange were bound by exit consents that significantly altered the nonfinancial terms of the existing bonds to the detriment of holdout creditors. Even with this aggressive approach, three percent of creditors continued to hold out and could theoretically bring an *Elliott Associates*-type of action. See *supra* note 14; see also Eric Lindenbaum, *Debt Restructuring, Legal Considerations, Impact of Peru's Legal Battle and Ecuador's Restructuring on Nigeria and Other Potential Burden-Sharing Cases*, MERRILL LYNCH EMERGING MARKETS RES. (Oct. 30, 2002), at <http://www.emta.org/keyper/linden1.pdf>.

⁶⁶ For example, Ecuador's bonds lost about forty percent of their net present value due, at least in part, to that State's exchange offer. Scott, *supra* note 9, at 108-11. And that does not even take into account the transaction costs of effectuating the exchange offer. *But cf.* E-mail from Lee C. Buchheit, Partner, Cleary, Gottlieb, Steen & Hamilton, to Steven L. Schwarcz (Mar. 16, 2004) (on file with the author) (contending that the 40% net-present-value reduction in the Ecuador bonds was not caused by the exchange offer but "reflected the level of debt relief that the country (and IMF) determined to be necessary to return Ecuador to a sustainable footing," and that "[p]resumably, the same level of relief would have been necessary had a statutory framework been in place").

⁶⁷ See *supra* note 6. Although Uruguay recently was able to attract over ninety percent bondholder participation in an exchange offer with relatively noncoercive exit consents, the still-significant number of holdouts had to be "paid off in full, effectively levying a tax on the restructuring" and potentially "trigger[ing] an epidemic of holdout behavior" in the future. Anna Gelpern, *Building a Better Seating Chart for Sovereign Restructurings*, 53 EMORY L.J. 1115, 1139 (2004). Despite this potential "epidemic of holdout behavior," at least some bondholders seeking to sell their bonds prior to maturity should opt for the exchange offer since, at least according to one observer, "[t]he real pressure on potential holdouts in an exchange offer comes from the fact that, post-exchange, they will be holding illiquid paper whose market value (if it can be determined at all) will be less than that of the new securities issued in the exchange." E-mail from Lee C. Buchheit, *supra* note 66.

⁶⁸ Schwarcz, *supra* note 4, at 1012-13. Legal retroactivity is respected under international law as long as it is neither discriminatory nor arbitrary. See 1 OPPENHEIM'S INTERNATIONAL LAW 918-21 (Sir Robert Jennings & Sir Arthur Watts eds., 9th ed. 1992) (discussing retroactivity in the context of expropriation and

For this same reason (i.e., private-law approaches, being contractual, cannot bind noncontracting parties), a private-law approach cannot even completely solve the collective action problems for future creditors. Some future creditors simply may refuse to agree to supermajority voting for changing essential payment terms.⁶⁹ Although theoretically a State could refuse to borrow from such creditors, States sometimes may decide they need money or lower interest rates⁷⁰ more than they need to insist that supermajority voting be included in all of their new loan agreements and bond indentures.⁷¹ Inevitably, some loan agreements, and some bond indentures, will not permit such supermajority voting.⁷² In contrast, a public-law approach, such as a Convention, would bind all creditors from States signing the Convention, and (as discussed below) might well bind creditors that are parties to loan agreements or bond indentures governed by the law of such a State,⁷³ to the Convention's supermajority voting provisions. This can be especially important when the debtor State has a significant amount of domestic debt, because foreign creditors may be reluctant to take a "haircut" on their debt claims where domestic creditors are paid in full.⁷⁴

confiscation). None of the Convention's provisions (supermajority voting and the granting of priority to financiers of the State's debt restructuring) would fail under that test. Schwarcz, *supra* note 4, at 1012-14.

⁶⁹ Professor Hal Scott also argues that States themselves may try to avoid these voting provisions "given their concern that they may increase their debt costs and signal their increased likelihood to default." Scott, *supra* note 9, at 129.

⁷⁰ This assumes that bondholders will demand a higher interest rate to invest in bonds that allow supermajority voting, as opposed to unanimous consent, to change essential payment terms. Although the U.S. Treasury believes the contrary, that bondholders rationally should prefer bonds with supermajority voting in order to reduce holdout problems, the absence of widespread noncoercive exchange offers indicates that the market values unanimous consent more highly. See William W. Bratton, *Pari Passu and a Distressed Sovereign's Rational Choices*, 53 EMORY L.J. 823, 828-29 (2004).

⁷¹ Cf. Larry Light, *Bondholder Beware: Value Subject to Change Without Notice*, BUS. WK., Mar. 29, 1993, at 34 (observing, in a corporate context, that parties to bond indentures tend to quickly forgo contractual protection for interest-rate benefits). The IMF, however, might influence this by requiring, for example, IMF member States to include CACs in all of their new loan agreements and bond indentures. Barry Eichengreen, *Crisis Resolution: Why We Need a Krueger-Like Process to Obtain a Taylor-Like Result*, at <http://emlab.berkeley.edu/users/eichengr/policy/iiekruenger.pdf> (Apr. 29, 2002).

⁷² A private-law approach also cannot bind creditors that have no opportunity to consent. Schwarcz, *supra* note 4, at 1016. In a sovereign debt context, those creditors would be expected to be relatively minor, however.

⁷³ See *infra* Part IV.A.

⁷⁴ See, e.g., Gelpern, *supra* note 67, at 1116 ("[Since early March 2004], Wall Street analysts have reported with alarm that [Argentina's] plans to restructure nearly \$100 billion in defaulted external debts would spare roughly \$80 billion in performing and multilateral credits. They predicted that asking private external creditors to subsidize the rest would poison the atmosphere and prolong negotiations Argentina is only the latest and most elaborate example of [this] recurring pattern.").

There is, furthermore, an important additional reason why a public-law approach is preferable to a private-law approach for solving the collective action problem. Even if, in a mythical universe without transaction costs, a State were able to persuade all of its existing and future creditors to agree to supermajority voting provisions, a public-law approach still would be a much more effective solution. This is because supermajority voting under a public-law approach, such as a Convention, can include all of the State’s creditors holding *pari passu* claims, *voting as a single group*.⁷⁵ This is a powerful solution because it gives individual holdouts much less ability to stymie the will of the supermajority of the State’s creditors. In contrast, supermajority voting provisions in a loan agreement or bond indenture invariably contemplate, in my experience, voting solely by the parties to such agreement or indenture as a separate group. Thus, a sufficient minority of creditors from a single loan agreement or bond indenture⁷⁶ could hold out, creating a collective action problem for the State and all of its other creditors.⁷⁷ Indeed, even a single creditor that makes a nonsyndicated loan could hold out and create a collective action problem.⁷⁸ A State therefore cannot rely on a private-law approach to solve the collective action problem.⁷⁹ A public-law approach, however, would more reliably solve that problem.

The second, and perhaps more important, reason private-law approaches are inadequate is that they do not, and cannot, even purport to address the moral hazard and taxation problems of sovereign debt restructuring. Those problems are caused by the inability to attract private funding for sovereign debt restructuring without an internationally-recognized priority scheme, and

⁷⁵ This is how I envision supermajority voting would work under a Convention. *See infra* Appendix. For detailed analysis of whether individual creditors could be prejudiced by this voting arrangement, compare Schwarcz, *supra* note 4, at 1003-11 (explaining how to structure such voting to protect individual creditors) with INT’L MONETARY FUND, THE RESTRUCTURING OF SOVEREIGN DEBT—ASSESSING THE BENEFITS, RISKS, AND FEASIBILITY OF AGGREGATING CLAIMS (Sept. 3, 2003) (surveying issues arising under “aggregation” voting), available at <http://www.imf.org/external/np/pdr/sdrm/2003/090303.htm>.

⁷⁶ By “sufficient minority,” I mean a minority of holdouts large enough to stymie nonholdouts from achieving a supermajority.

⁷⁷ *Accord* Patrick Bolton & David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?*, 53 EMORY L.J. 763, 767, 768 (2004); A. Mechele Dickerson, *A Politically Viable Approach to Sovereign Debt Restructuring*, 53 EMORY L.J. 997, 1031 (2004). Professors Bolton and Skeel also argue that collective action clauses can leave a sovereign debtor with too much debt, and moreover such clauses are ineffective where “the sovereign debtor has a relatively simple capital structure.” Bolton & Skeel, *supra*, at 821-22.

⁷⁸ Anne Krueger of the IMF has also made this observation. *See* Scott, *supra* note 9, at 122.

⁷⁹ *Accord id.* at 129 (concluding that “[t]he insertion of collective action clauses in sovereign bonds is an exercise in futility”).

the resulting continuing need for a governmental lender of last resort.⁸⁰ Any such priority scheme would be in the realm of public, not private, law.⁸¹ Therefore, only a public-law approach can effectively solve those problems.⁸²

Finally, some have suggested that a private-law approach is preferable to a public-law approach because the latter would completely remove litigation rights.⁸³ If, however, there is concern over removing litigation rights, a public-law approach simply could embrace a convention that does not remove those rights; and, indeed, the Convention does not purport to remove those rights.⁸⁴

IV. A PUBLIC-LAW APPROACH WOULD BE EASY TO IMPLEMENT

I have heard, or heard of, vague or unsupported allegations that an international sovereign debt restructuring convention would be difficult to implement, and thus a private-law approach is preferable. To the contrary, a public-law approach in the form of a Convention would be easy to implement.

Implementing a Convention raises three potential issues: (1) how the Convention should bind States and their creditors; (2) how the Convention should be administered; and (3) how questions arising under the Convention should be adjudicated. I next address these issues.

A. *Binding States and Their Creditors to a Convention*

I have stated above that a public-law approach, such as a Convention, would bind all creditors from States signing the Convention, and might well

⁸⁰ See *supra* Part II.

⁸¹ It is, for example, “often impracticable to lend to sovereigns on a collateralized basis.” Bolton & Skeel, *supra* note 77, at 766-67. For a detailed discussion of why the aforesaid priority scheme needs to be established under international law, see Schwarcz, *supra* note 4, at 967, 967 n.53, 993.

⁸² Accord Bolton & Skeel, *supra* note 77, at 764, 775 (arguing that IMF bailouts “create a serious risk of moral hazard” and that CACs do “not address the sovereign’s need for new financing”). Professor Bratton also argues that CACs raise the level of bondholder consent needed to remove a *pari passu* clause in an exchange offer, thereby inadvertently increasing the risk of an *Elliott Associates*-like challenge (discussed *supra* note 14). Bratton, *supra* note 70, at 841. He is, of course, correct, though his concern could be addressed more minimally by excluding *pari passu* clauses from the supermajority voting protection. For an interesting foreign perspective on these questions, see Christoph G. Paulus, *A Statutory Procedure for Restructuring Debts of Foreign States*, RECHT DER INTERNATIONALEN WIRTSCHAFT, June 2003, at 401 (favoring statutory over contractual approaches for sovereign debt restructuring).

⁸³ See, e.g., Eichengreen, *supra* note 71.

⁸⁴ See *infra* note 115 (arguing against a stay of litigation). Although the Convention does contemplate a limited adjudicatory mechanism (discussed *infra* Part IV.C), that mechanism only purports to adjudicate issues arising under the Convention.

bind creditors that are parties to loan agreements or bond indentures governed by the law of such a State. Creditors from signatory States would be bound because, once a State ratifies the Convention, it would be directly bound, and creditors within that State would be bound by the State’s enactment of the Convention’s rules into national law.⁸⁵ Because it is reasonable to expect that States generally will want to ratify the Convention,⁸⁶ most creditors should be bound in this way.

Creditors from nonsignatory States also might be bound to the provisions of the Convention to the extent such creditors are parties to loan agreements or bond indentures governed by the law of a signatory State.⁸⁷ The State, however, would have to legislatively provide, under its national law, that the supermajority voting provisions of the Convention supersede contractual voting provisions where the Convention applies. This legislation, even if retroactive, should be enforceable, for example, under the legal systems of both New York (including, to the extent applicable, that of the United States)⁸⁸

⁸⁵ Therefore, the Convention should require each ratifying State to enact the legislation necessary to make the Convention’s provisions part of the State’s national law.

⁸⁶ See Schwarcz, *supra* note 4, at 1014 (arguing that the Convention’s rules generally benefit States by providing incentives for new credit and by imposing supermajority voting to minimize the collective action problem; yet these provisions of the Convention should not decrease the availability of credit or make it more expensive).

⁸⁷ To the extent creditors from nonsignatory States are parties to agreements without a contractually-chosen governing law, international law principles hold that the legal relationship between a State and those creditors should be governed by the law of that State—in our case, the debtor State. Derek W. Bowett, *Claims Between States and Private Entities: The Twilight Zone of International Law*, 35 CATH. U. L. REV. 929, 931-32 (1986); Rainer Geiger, *The Unilateral Change of Economic Development Agreements*, 23 INT’L & COMP. L.Q. 73, 80 (1974); see also *Serbian & Brazilian Loans Cases*, 1929 P.C.I.J. (ser. A) No. 20 at 42, 121. Therefore, those creditors also would be bound to the provisions of the Convention.

⁸⁸ If the U.S. Congress enacts this legislation, it would preempt New York law. Such legislation would be enforceable provided the retroactivity is not unconstitutional. In a bankruptcy context, retroactivity should be constitutionally permitted; that was the effect, for example, when 11 U.S.C. §§ 364, 1126, and 1141 were enacted as federal law, which granted priority to DIP financing and imposed supermajority voting in both bankruptcy and discharge regardless of unanimity requirements in state law contracts. *Cf. Eastern Enters. v. Apfel*, 524 U.S. 498, 528 (1998) (holding that Congress generally has the power to affect contractual obligations between parties); *Hanover Nat’l Bank v. Moyses*, 186 U.S. 181 (1902) (holding that Congress has power under the Bankruptcy Clause of the U.S. Constitution to retroactively impair contractual obligations); James Steven Rogers, *The Impairment of Secured Creditors’ Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 987 (1983) (arguing that secured creditors know, or should know, of potential bankruptcy-law restrictions on their rights, and therefore take their rights subject to those restrictions).

If New York enacts the supplemental legislation, it would likewise face the retroactivity challenge. See *People v. Martello*, 717 N.E.2d 684, 688 (N.Y. 1999); *Americorp Sec., Inc. v. Sager*, 656 N.Y.S.2d 762, 764 (N.Y. App. Div. 1997). The constitutional issue is somewhat different because the retroactivity is imposed by a state legislature, not by Congress. Nonetheless, retroactive legislation should be constitutional so long as it

and the United Kingdom.⁸⁹ Because most sovereign debt loan agreements and bond indentures explicitly state their governing law,⁹⁰ and New York or United Kingdom law is typically chosen,⁹¹ the United States and the United Kingdom should have substantial control over the Convention's effectiveness.

B. Administering a Convention

Although some scholars assume that a neutral international institution would need to administer a Convention,⁹² a Convention should be largely self-administering. This avoids the costs and political sensitivity of creating, and running, a new international institution.⁹³ To understand why a Convention should be self-administering, one must appreciate that the experience of corporate debt restructuring, even under Chapter 11, confirms that the parties themselves—debtors and their creditors—do the negotiating: “[M]ost U.S. bankruptcies are self-executing in that creditors, in concert with the debtor, collectively determine the economic terms upon which the enterprise will be restructured.”⁹⁴

does not constitute a “taking” by completely destroying property rights in a way that the affected parties could not have anticipated. *See Eastern Enters.*, 524 U.S. at 528-29 (“[L]egislation might be unconstitutional if it imposes severe retroactive liability on a limited class of parties that could not have anticipated the liability”); *United States v. Riverside Bay Homes*, 474 U.S. 121, 128 n.5 (1985). If the legislation did constitute a taking, it still would be constitutional if adequate compensation was paid, but that would impose a cost on the State. *See Riverside Bay Homes*, 474 U.S. at 128. The consensual relinquishment of rights—a plan being subject to supermajority voting—should not constitute complete destruction of sovereign bonds. The only right that is completely destroyed is an individual bondholder’s right to hold out for greater gain by threatening to veto a plan desired by other bondholders; that right, however, is an unreasonable private expectation that would not be protected. *See* Jan G. Laitos, *Legislative Retroactivity*, 52 WASH. U. J. URB. & CONTEMP. L. 81, 100 (1997). Further, granting priority to a financier of the State’s debt restructuring may actually increase the expected value of existing claims, much less completely destroy their value.

⁸⁹ *See, e.g.*, 44(I) LORD HAILSHAM OF ST. MARYLEBONE, HALSBURY’S LAWS OF ENGLAND ¶ 1283, at 764 (4th ed. 1995) (“[A]n amending enactment may say, expressly or by implication, that its effect is retrospective.”); R. J. WALKER, *THE ENGLISH LEGAL SYSTEM* 99 (6th ed. 1985) (“Parliament is sovereign and statutes may be, and occasionally are, expressed to be retroactive even where this operates to deprive a person of a vested right in property.”).

⁹⁰ *See* Greenwood & Mercer, *supra* note 5, at 106.

⁹¹ *See* Macmillan, *supra* note 11, at 87. Although some bonds governed by U.K. law already may be subject to a form of supermajority voting, *see* E-mail from Michael Buchanan, Capital Account Issues Division, PDR, International Monetary Fund, to Steven L. Schwarcz (Oct. 22, 1999) (on file with author) (stating that bonds issued under U.K. law “(nearly) all have some form of majority restructuring provision”), such supermajority voting is much weaker than that contemplated by the Convention; the Convention’s supermajority voting is among *all* creditors whose claims are *pari passu*.

⁹² Benjamin J. Cohen, *A Global Chapter 11*, 75 FOREIGN POL’Y 109, 124 (1989).

⁹³ *See generally* Chun, *supra* note 50, at 2677-84 (discussing a failed previous attempt by the G-7 nations to create an international bankruptcy agency).

⁹⁴ Hurlock, *supra* note 11, at 12; *see* DAVID G. EPSTEIN ET AL., *BANKRUPTCY* § 10-2, at 734 (1993) (“It

It may well be, however, that corporate bankruptcy negotiations in the United States are self-executing *because they take place under the shadow of bankruptcy law*. To what extent, therefore, can we expect sovereign debt negotiations to be similarly self-executing? To answer this, in a prior article, I compared the incentives for negotiation under the Bankruptcy Code with those contemplated by a Convention of the type discussed in this Article. The previous article concluded that such a Convention would give a debtor-State "substantially the same 'powerful aids in its negotiations' as a corporate debtor enjoys under the [Bankruptcy] Code."⁹⁵ From a creditors' standpoint, that article also found that such a Convention "would effectively provide roughly the same incentives for cooperation in sovereign debt negotiations that the [Bankruptcy] Code imposes on corporate bankruptcy negotiations."⁹⁶ The article therefore concluded, "[t]o the extent that corporate bankruptcy negotiations are self-executing, sovereign debt negotiations should similarly be self-executing, and the parties would not need an institution generally to administer or supervise the process."⁹⁷ To the extent any administrative tasks arise, they could be performed by "the IMF or another neutral multilateral institution that monitors priority funding."⁹⁸

C. Adjudication and Enforcement

The final implementation issue is enforcement of a Convention and adjudication of claims arising thereunder.⁹⁹ Scant precedent exists for an adjudicative body to resolve disputes between a State and its creditors.¹⁰⁰ Two

would be wrong to think of the Chapter 11 process as primarily a litigated, judged-ruled adversarial process. Plans proposed and adopted in Chapter 11 almost always have been produced by negotiation, not by litigation." Although U.S. bankruptcy law assigns certain oversight activities to an official known as a U.S. trustee, "[t]hose activities are not relevant to sovereign debt restructuring." Schwarcz, *supra* note 4, at 1019-20.

⁹⁵ Schwarcz, *supra* note 4, at 1021 (quoting ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 476 (3d ed. 1996)).

⁹⁶ *Id.* at 1022.

⁹⁷ *Id.*

⁹⁸ *Id.* at 1031. That article also found that "a sovereign debt restructuring process does not need an administrative institution to prevent strategic manipulation: the narrowly circumscribed provisions of the Convention are already designed to prevent manipulation." *Id.* at 1022.

⁹⁹ This discussion only purports to address adjudication of issues arising under the Convention. It does not suggest that the adjudicating authority should have jurisdiction over sovereign debt restructuring issues that the Convention does not cover—such as whether a foreign creditor obtaining a judgment against a debtor State not involving enforcement of the Convention may attach assets located within that State.

¹⁰⁰ See PAUL E. COMEAUX & N. STEPHAN KINSELLA, *PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW* 36 (1997). Established international courts, such as the International Court of Justice, are only competent to hear cases between States. Schwarcz, *supra* note 4, at 1023.

possible solutions are to broaden the jurisdiction of existing international courts or to create a new international tribunal competent to adjudicate these disputes.¹⁰¹ However, a relatively low-cost and unbureaucratic procedure, described below, already exists under international law for adjudicating certain disputes between States and nationals of other States and presents a superior solution to the enforcement and adjudication issue.

The International Centre for Settlement of Investment Disputes (ICSID), an autonomous body created under the auspices of the World Bank, provides fora for arbitration of investment disputes between contracting States and nationals of other contracting States.¹⁰² A small Secretariat, consisting of a secretary-general, one or more deputy secretaries-general, and an administrative staff, manages ICSID and maintains a panel of multinational arbitrators with recognized competence in the fields of law, commerce, industry, and finance.¹⁰³ ICSID covers its expenses by charging for use of its arbitration facilities.¹⁰⁴

The arbitration itself is relatively uncomplicated. The arbitral tribunal consists of one or more arbitrators upon whom the parties agree, or absent agreement, three arbitrators.¹⁰⁵ A Secretariat staff lawyer serves as the tribunal's secretary and acts as a channel of communication between the parties, who agree to the rules of law.¹⁰⁶ The tribunal decides disputes by majority vote.¹⁰⁷ Decisions are binding on the parties and not subject to appeal.¹⁰⁸

ICSID's arbitration procedures are well-established and have broad support. At least 147 States are signatories to the ICSID Convention, and 131 of those States (including the United States) have ratified it.¹⁰⁹ Moreover, the

¹⁰¹ See Schwarcz, *supra* note 4, at 1024 (proposing possible solutions).

¹⁰² See Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *opened for signature* Mar. 18, 1965, art. 1, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID Convention].

¹⁰³ See ICSID Convention, *supra* note 102, arts. 9-11, 13-14. Panel members are also representative of the principal legal systems of the world. *See id.* art. 14.

¹⁰⁴ *See id.* art. 61.

¹⁰⁵ *See id.* art. 37.

¹⁰⁶ *Id.* art. 48, para. 1.

¹⁰⁷ *Id.*

¹⁰⁸ *See id.* art. 53. Contracting States are required to "recognize an award rendered pursuant to this [ICSID] Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State." *Id.* at art. 54.

¹⁰⁹ See *ICSID List of Contracting States (as of Nov. 3, 2003)*, at <http://www.worldbank.org/icsid/constate/c-states-en.htm> (last visited June 17, 2004).

ICSID arbitration procedure is commonly used and widely accepted, and provisions for ICSID arbitration are frequently found in contracts between States and nationals of other States.¹¹⁰

Accordingly, to the extent that a tribunal is needed to resolve sovereign debt restructuring disputes arising under the Convention, ICSID is a useful model. A tribunal based on that model could maintain a panel of neutral arbitrators having a recognized competence in bankruptcy and insolvency law. Rules could require panel members to have different nationalities, and to be representative of the principal bankruptcy and insolvency law systems of the world. As with ICSID, the tribunal's expenses could be met by charging a fee for the arbitration. The arbitration itself also could follow ICSID's simple format: a panel of up to three arbitrators who decide disputes by majority vote in accordance with applicable rules of international law, and who render decisions that are binding and not subject to appeal.¹¹¹ Thus, to the minimal extent a need exists for a tribunal to adjudicate sovereign debt restructuring disputes arising under the Convention, the ICSID arbitration format provides an appropriate model.

In any event, disputes should rarely occur in a sovereign debt context, assuming (as this Article argues) the Convention's rules are narrowly crafted to minimize adjudicatory discretion. Any disputes regarding the rules' interpretation would most likely concern the ability of creditors to object to an excessive amount of priority financing. But, corporate creditors "very rare[ly]" object to an amount of DIP financing as excessive,¹¹² and in a sovereign debt restructuring, the need to object would be equally rare because of the public scrutiny involved. It also is unlikely that creditors or debtor States will even need a tribunal to enforce the Convention. Debtor States should want to adhere to the Convention on their own, not only because its provisions are largely for their benefit, but also because their reputations—necessary to regain access to capital market funding at a later date—will depend on compliance.¹¹³ And if a creditor located in a nonsignatory State objects to a

¹¹⁰ Schwarcz, *supra* note 4, at 1025.

¹¹¹ Although there are distinctions between ICSID and a sovereign debt restructuring tribunal, those distinctions should not prevent ICSID from being used as a model. *See id.*, at 1027-28.

¹¹² Telephone Interview with Lester M. Kirshenbaum, Bankruptcy Partner, Kaye, Scholer, Fierman, Hays & Handler (May 28, 1999).

¹¹³ *See* ABRAM CHAYES & ANTONIA HANDLER CHAYES, *THE NEW SOVEREIGNTY: COMPLIANCE WITH INTERNATIONAL REGULATORY AGREEMENTS* 10, 27 (1995) (observing that in the world climate of increasing interdependence, States are prone to comply with their treaty obligations in order to preserve their international reputations).

restructuring plan achieved through supermajority voting or to another creditor's new money priority, the creditor's only remedy would be to sue the debtor State. If the creditor brings the suit before the new tribunal, the tribunal would simply apply the rules of the Convention. The objecting creditor could attempt to bypass the tribunal, perhaps by suing in a foreign court outside the debtor State. However, even if the objecting creditor wins that lawsuit,¹¹⁴ the only practical remedy is to attach the debtor State's foreign assets, a remedy that would be, in most cases, inconsequential.

The public-law approach discussed in this Article, i.e. implementing a Convention, therefore would be relatively easy to implement. States themselves have an incentive to become signatories to the Convention because its primary goal is to foster the State's ultimate economic rehabilitation after a time of crisis. Under the Convention, debt negotiations would be largely self-executing. In the rare instance that disputes arising under the Convention between a State and its creditors require adjudication, hearings could occur on an ad hoc basis either before an existing international judicial body or before a new low-cost tribunal established by the Convention based on the ICSID model.

CONCLUSION

Sovereign debt restructuring gives rise to three distinct problems. The conflicting interests of the State and its creditors, as well as the collective action problem among creditors, make it difficult to reach agreement on a restructuring plan. In addition, attempts by governmental and multilateral entities to act as lenders of last resort have not only created a risk of moral hazard but also have fostered taxpayer subsidy of debtor States and their creditors.

This Article argues that private-law approaches alone cannot solve these problems. In contrast, a simple international convention based on two fundamental and universally recognized principles of bankruptcy reorganization law *can* effectively solve these problems. These principles are that financiers of a State's debt restructuring should have priority over claims of other creditors, and creditors of the debtor State should be bound to a plan of reorganization that such creditors agree to by supermajority voting. Such a

¹¹⁴ A court might uphold the objecting creditor's claim. See *Allied Bank Int'l v. Banco Credito Agricola de Cartago*, 757 F.2d 516 (2d Cir. 1985).

Convention, in fact, would embody the core features of the IMF's SDRM approach.¹¹⁵

Appendix I sets forth a possible model of such a Convention.¹¹⁶ This convention would be largely self-executing.¹¹⁷ To the limited extent disputes must be adjudicated under the Convention, that task could be performed by establishing a simple arbitration procedure, perhaps based on the existing low-cost ICSID model.

One might ask why, if an international convention or other public-law approach is so effective and easy to implement, one has not yet been implemented. There are at least several answers. One answer is the novelty of the approach. Even though "[m]any actors in the world of international finance, including the International Monetary Fund, would like to see [such a public-law approach] instituted,"¹¹⁸ "[u]ntil quite recently, these proposals were viewed as intriguing but a bit far-fetched."¹¹⁹ Another answer is interest-group influence: "The most vigorous opponents of [a public-law approach] are the banks and lawyers that underwrite sovereign bonds in New York, together with investors who currently hold them," on principle because those parties believe such an approach "will make it too easy for sovereign debtors to default" and, less on principle, because those parties believe that "the existing bailout approach usually assures that bondholders will be made whole."¹²⁰ Yet another answer is the failure to appreciate the importance of a public-law approach, coupled with concern over ceding sovereignty: "Since nations are unwilling to enact legislation that would help facilitate more orderly business insolvencies within a sovereign, it is not surprising that" attempts to achieve more orderly sovereign debt restructuring legislation that cedes some

¹¹⁵ See *supra* note 4 and accompanying text (describing the SDRM). The SDRM also contemplates the possibility of a stay on legal actions and payments. See Krueger, *supra* note 3. I have argued, however, that such a stay is not essential to a sovereign debt restructuring convention. See Schwarcz, *supra* note 4, at 984-85.

¹¹⁶ That model is based to some extent on technicalities, such as how to commence a sovereign debt restructuring case, not discussed in this Article but examined at great length in Schwarcz, *supra* note 4, at 980-1010.

¹¹⁷ Although, as discussed, a neutral multilateral institution might be necessary to monitor priority financing. See *supra* note 98 and accompanying text. That same institution also could perform any incidental administrative functions.

¹¹⁸ Bratton, *supra* note 70, at 826.

¹¹⁹ Bolton & Skeel, *supra* note 77, at 763.

¹²⁰ *Id.* at 745-65. Professors Bolton and Skeel argue, *id.* at 764, that existing evidence suggests the belief that a public-law approach will encourage defaults is overstated because "[s]overeigns are reluctant to default on their debt, and do so only as a last resource, because of the reputational consequences of default."

sovereignty are “not politically feasible.”¹²¹ And, at least in one case, the answer is simply political: “The United States Treasury . . . rejects [a public-law approach] due to a preference for market solutions over regulatory intervention.”¹²² One nonetheless hopes that as the problems of sovereign defaults mount, nations will become more sophisticated and principled about the need for effective solutions.

¹²¹ Dickerson, *supra* note 77, at 999.

¹²² Bratton, *supra* note 70, at 832.

APPENDIX¹²³*Model Sovereign Debt Restructuring Convention*

Chapter I: Scope and Use of Terms

ARTICLE 1: SCOPE

This Convention applies to debt restructurings between sovereign States and their creditors.

ARTICLE 2: USE OF TERMS

For purposes of this Convention:

- (1) "Contracting State" means a sovereign State for which this Convention is in force;
- (2) "creditor" means an entity that has a claim for payment against a Contracting State;
- (3) "debtor State" means a Contracting State that has filed for relief under this Convention;
- (4) "Plan" means a debt restructuring plan;
- (5) "Supervisory Authority" means the [International Monetary Fund or other neutral multilateral organization].

Chapter II: Invoking the Convention

ARTICLE 3: PETITION FOR RELIEF

- (1) A Contracting State may invoke application of this Convention by filing a voluntary petition for relief with the Supervisory Authority.
- (2) Immediately after such a petition for relief has been filed, and so long as such filing has not been dismissed by the Supervisory Authority for lack of good faith, the provisions of this Convention

¹²³ An early iteration of this Model Convention first appeared in Schwarcz, *supra* note 4, at 1032.

shall apply to the relationship between the Contracting State and its creditors.

ARTICLE 4: NOTIFICATION OF CREDITORS

Within 30 days after filing its petition for relief, the debtor State shall notify all of its known creditors of its intention to negotiate a Plan under this Convention.

Chapter III: The Debt Restructuring Plan

ARTICLE 5: SUBMISSION OF PLAN

- (1) The debtor State may submit a Plan to its creditors at any time, and may submit alternative Plans from time to time.
- (2) No other person or entity may submit a Plan.

ARTICLE 6: CONTENTS OF PLAN

A Plan shall:

- (1) designate classes of claims in accordance with Article 7(3);
- (2) specify the proposed treatment of each class of claims; and
- (3) provide the same treatment for each claim of a particular class, unless the holder of a claim agrees to a less favorable treatment.

ARTICLE 7: VOTING ON THE PLAN

- (1) A Plan shall become effective and binding on the debtor State and its creditors when it has been submitted by the debtor State and agreed to by each class of such creditors' claims. Thereupon, the debtor State shall be discharged from any debt then in existence,¹²⁴ except as provided in the Plan.
- (2) A class of claims has agreed to a Plan if creditors holding at least [two-thirds] in amount and more than [one-half] in number

¹²⁴ Alternatively, the Convention could except discharge of debts owed to entities that neither had notice nor actual knowledge of the Plan.

of the claims of such class [voting on such Plan]¹²⁵ [entitled to vote on such Plan] agree to the Plan.

(3) Each class of claims shall consist of claims against the debtor-State that are *pari passu* in priority, provided that (a) *pari passu* claims need not all be included in the same class, and (b) claims of governmental or multigovernmental entities each shall be classed separately.

Chapter IV: Financing the Restructuring

ARTICLE 8: TERMS OF LENDING

The Supervisory Authority shall have the right, but not the obligation, to lend money to a debtor State on such terms and conditions as the Supervisory Authority deems appropriate, taking into account the debtor State's use of the loan proceeds.

ARTICLE 9: PRIORITY OF REPAYMENT

- (1) Debtor-States must repay loans made by the Supervisory Authority prior to paying any other claims.
- (2) Such priority of payment shall extend to any assignee of the Supervisory Authority.

ARTICLE 10: NONRECOURSE BORROWING BY SUPERVISORY AUTHORITY

- (1) To finance its lending to a debtor State, the Supervisory Authority may borrow on such terms and conditions as it may negotiate, provided that neither the Supervisory Authority nor its assets shall be liable, contingently or otherwise, for repayment of such borrowing except as set forth below.
- (2) As collateral for a borrowing, the Supervisory Authority may assign as security its right to payment under the loan made from the proceeds of such borrowing.

¹²⁵ The Plan can be more easily approved if this alternative is selected, but reliable notice to creditors then becomes more important.

(3) The Supervisory Authority may borrow on a general recourse basis in order to make loans to debtor States whose financial distress results primarily from factors that are [unforeseeable and] beyond their control.

Chapter V: Adjudication of Disputes

[This Chapter could follow the model of the ICSID Convention, except that States ratifying this Convention would thereby subject themselves and their nationals to submit all disputes arising under the Convention to the jurisdiction of the adjudicatory tribunal. This Chapter would not, however, grant the adjudicatory tribunal jurisdiction over sovereign debt restructuring issues that the Convention does not cover.¹²⁶]

Chapter VI: Ratification

ARTICLE 11: PROCEDURES

- (1) This Convention shall enter into force upon ratification or other approval by at least [three] sovereign States.
- (2) On or before ratifying or otherwise approving this Convention, each Contracting State shall undertake such legislation or other measures as may be necessary for making this Convention effective as national law in its territories.

ARTICLE 12: EFFECT OF RATIFICATION

Ratification of this Convention shall be binding on each Contracting State and on each national thereof, irrespective of contractual provisions that are inconsistent with the provisions of this Convention or the date that a national's claim against a Contracting State arose.

¹²⁶ For example, this Chapter would not give the adjudicatory tribunal jurisdiction to determine whether a foreign creditor obtaining a judgment against a debtor State not involving enforcement of the Convention may attach assets located within that State.