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A Politically Viable Approach to Sovereign Debt Restructuring

A. Mechele Dickerson

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ABSTRACT

The failure to enact a statutory system to restructure sovereign debt suggests that the international community is still unwilling to adopt a unified global response to insolvency issues. Since nations refused to enact uniform legislation to facilitate more orderly business insolvencies within a sovereign, it is not surprising that recent attempts to create uniform legislation that addresses the insolvency of sovereigns themselves have been unsuccessful. While a comprehensive statutory approach can predictably and efficiently restructure all of a sovereign's debts, the failed experience with uniform cross-border insolvency legislation suggests that sovereigns will not accept an inflexible statutory scheme that contains mandatory, uniform terms. Moreover, any system that requires sovereigns to cede total control of the debt restructuring process to third parties, that transfers sovereign assets or resources to lenders, or that subjects sovereigns to the jurisdiction of a nonsovereign court is not politically viable.

This Article argues that a politically viable approach to resolving sovereign debt crises is to develop a flexible statutory framework that encourages sovereigns to activate early restructurings. To give sovereigns such incentives, the IMF should condition future lending on sovereigns' willingness to enact basic mandatory debt restructuring procedures. While sovereigns should be encouraged to enact comprehensive debt restructuring legislation, they should be allowed to customize their debt restructuring procedures by negotiating a private written "protocol" with their creditors. If the sovereign and its creditors are unable to reach agreement on the protocol before the sovereign activates the mandatory debt

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restructuring provisions (including a brief standstill and stay on enforcement actions), the restructuring initially should be governed by paired prodebtor and procreditor default terms selected by a neutral third-party entity.

INTRODUCTION

The impasse involving the adoption of the Sovereign Debt Restructuring Mechanism (SDRM)[1] prepared by the International Monetary Fund (IMF or Fund) is the second time in recent history that the international community has resisted adopting a unified global response to insolvency issues. Specifically, despite widespread consensus that a uniform international statute or treaty is needed to govern the insolvency proceeding(s) of a multinational business,[2] the international community has rejected all global solutions to cross-border insolvencies. Since nations are unwilling to enact uniform corporate cross-border insolvency legislation, it is not surprising that they also have been unwilling to embrace uniform sovereign debt restructuring legislation. Sovereign debt restructurings tend to be costly and inefficient largely because sovereigns fail to enter into early debt renegotiations. Sovereigns appear to delay both defaulting on their debts and then attempting to restructure those debts with their creditors because of the political and economic ramifications associated with default—even though creditors' rights upon default are limited.[3] Indeed, the difficulties creditors face when they attempt to enforce their contractual rights lead many commentators to argue that any proposal to resolve the sovereign debt crisis must be governed by the single principle of protecting, or even enhancing, creditor interests.[4] Others suggest that any system that is not creditor-focused will give sovereigns an incentive to opportunistically default on debts they can easily repay.[5] Even if some sovereigns may be willing to share control of the debt restructuring process (or of their assets) with private- or public-sector creditors when they think doing

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[1] Report of the Managing Director to the International Monetary and Financial Committee on a Statutory Sovereign Debt Restructuring Mechanism (Apr. 8, 2003) ("At this stage, there does not appear to be the requisite support among the Fund membership to establish the [Sovereign Debt Restructuring Mechanism] through an Amendment of the Fund's Articles."), *available at* http://www.imf.org/external/np/omd/2003/040803.htm.

[2] *See* Jay Lawrence Westbrook, *Multinational Enterprises in General Default: Chapter 15, The ALI Principles, and EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1, 1-2 (2002).

[3] *See infra* notes 32-41 and accompanying text.

[4] *See infra* notes 39-41 and accompanying text.

[5] *See infra* notes 59-60 and accompanying text.

so will allow them to borrow on more favorable terms, national pride and fear of creditor abuse will prevent sovereigns from agreeing ex ante that creditors can control the debt restructuring process or the sovereign's assets.

This Article argues that any debt restructuring procedure that requires the sovereign's political leaders to cede control of the sovereign's assets or the restructuring process to private creditors or to a multilateral agency (like the IMF) will not give sovereigns adequate incentives to restructure their debts early and, moreover, is not politically feasible. Part I of the Article describes the international community's failed attempts to enact corporate transnational insolvency legislation and suggests that those legislative efforts failed largely because sovereigns were unwilling to cede control over firms (or the firm's assets) located within their borders to creditors located in other countries. This Part then describes the sovereign debt crisis, briefly explains the typical progression of sovereign debt restructurings, and suggests that the biggest impediment to an early sovereign debt restructuring is the sovereign's concern that entering into debt restructurings will have detrimental economic and political effects.

Part II discusses the current proposals for resolving the sovereign debt crisis. While acknowledging the dominant role bonds play in sovereign lending, this Part argues that contractual approaches standing alone cannot resolve the sovereign debt crisis because they do not create a single collective proceeding that binds all creditors. Moreover, adopting a sovereign debt restructuring system that is effective only if bond debt is the dominant form of sovereign financing may not work in the long term because there is no guarantee that bonds will always be the majority of sovereign debt. This Part also rejects the approach used in the IMF's SDRM largely because of its inflexibility and because of the degree of control over the restructuring process the SDRM gives to the Fund. While rejecting the SDRM, this Part concludes by stressing that a statutory approach is preferable to a contractual one largely because a statutory approach can best ensure that all the sovereign's debts will be resolved in an efficient, predictable, collective proceeding.

While any sovereign debt restructuring approach should attempt to protect creditors' contract rights, Part III argues that the primary goal of a debt restructuring procedure should be to give sovereigns an incentive to initiate early discussions with their creditors. Part III proposes that the IMF condition its future lending on sovereigns' willingness to enact a limited number of mandatory debt restructuring procedures. Other than enacting these IMF-mandated terms, however, sovereigns should be allowed to customize their debt restructuring procedures based on the structure or complexity of their debt and their overall economic, political, or cultural needs. To discourage sovereign and lender moral hazard, there should be a presumption that the IMF will lend to sovereigns after they activate their restructuring procedures only if lenders in the capital markets are unwilling to provide postactivation financing. This Part further suggests that any IMF support package be used to resolve a liquidity crisis or make limited external debt payments and that the payments not be used to repay private debt in full. This Part also argues that IMF loans should contain terms comparable to those available in the capital markets. To encourage sovereigns to initiate early restructurings, however, loans made to sovereigns that activate an early, predefault debt restructuring should have more favorable interest terms than the terms provided in postdefault loans.

Because sovereigns likely will need at least a temporary standstill of their debt payments, Part III argues that all statutory frameworks should mandate that the sovereign have a limited reprieve from paying their debts and that there be a limited (thirty-day) stay of creditor enforcement activities. Though sovereigns should be encouraged to enact comprehensive debt restructuring legislation, this Part argues that sovereigns should be allowed to enact only the IMF-mandated terms. Sovereigns that fail to enact comprehensive debt restructuring legislation could then customize their debt restructuring procedures by negotiating a private "protocol" with their creditors. This Article suggests that instead of creating a new, permanent international bankruptcy court, sovereigns and their creditors should generally be allowed to select the entity that will resolve disputes that arise during the restructuring from a panel drawn from global insolvency experts recommended by sovereigns or creditors. The IMF-mandated stay on enforcement actions would expire thirty days after the sovereign starts the restructuring procedure, but it likely will take more than thirty days to negotiate a permanent protocol to govern the restructuring. Given this, Part III concludes by arguing that sovereigns should be bound by an initial temporary protocol that consists of terms drawn from a menu of options created by a neutral third-party international organization that is not a sovereign creditor (like the American Law Institute (ALI) or the United Nations Commission on International Trade Law (UNCITRAL)) or by an ad hoc group (that consists of representatives selected by emerging nations and representative creditors). To decrease the likelihood that sovereigns would select only those options that give strong debtor protections, the menu should pair prodebtor options (like a permanent stay of creditor collection activities) with procreditor options (such as allowing creditors to initiate the restructuring process) and should mandate that sovereigns select only the paired options (one sovereign-friendly and one creditor-friendly).

I. INTERNATIONAL INSOLVENCY CRISES

A. Corporate Cross-Border Insolvencies

Despite the international consensus that a cost effective procedure is needed to govern a multinational business insolvency, no uniform international statute, convention, or treaty governs how an insolvency proceeding of a multinational business (i.e., a transnational or cross-border insolvency) will be governed. As is true in the sovereign debt context, attempts to resolve cross-border insolvencies on a voluntary basis often are impeded by individual creditor enforcement actions and by the requirement that multinational businesses obtain unanimous creditor consent to change payment terms for the existing classes of debt.[6] Several organizations, including UNCITRAL, ALI, and the Business Law Section of the International Bar Association have drafted model legislation.[7]

UNCITRAL drafted model cross-border legislation (the Model Law) that countries could adopt as part of their domestic laws.[8] The Model Law was designed to help courts recognize, and ultimately be willing to defer to, insolvency proceedings opened in other countries. The Model Law primarily

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[6] *See* Proposed Framework for Expedited Insolvency Procedures to Facilitate Cross-Border Restructurings 2, *at* http://www.insolvency.ca/papers/ProposedFrameworkForExpeditedInsolvency.pdf (2001); *infra* note 82 (discussing the creditor holdout and aggregation problem in sovereign debt restructurings).

[7] U.N. COMM'N ON INT'L TRADE LAW, UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY, U.N. Doc. A/52/17, U.N. Sales No. E.99.V.3 (1997) [hereinafter UNCITRAL MODEL LAW], *available at* http://www.uncitral.org/english/texts/insolven/insolvency.htm; AM. LAW INST., GUIDELINES APPLICABLE TO COURT-TO-COURT COMMUNICATIONS IN CROSS-BORDER CASES (2000), *available at* http://www.iiiglobal.org/international/projects/ali.pdf; COUNCIL OF THE INT'L BAR ASS'N, CROSS-BORDER INSOLVENCY CONCORDAT (Sept. 17, 1995), *reprinted in* Mike Sigal et al., *The Law and Practice of International Insolvencies, Including a Draft Cross-Border Insolvency Concordat*, 1994-1995 ANNUAL SURVEY OF BANKRUPTCY LAW 1, 138-54. The World Bank and IMF also have conducted research or developed initiatives designed to help nations reform their insolvency laws. *See* INT'L MONETARY FUND, ORDERLY AND EFFECTIVE INSOLVENCY PROCEDURES (1999); The World Bank Group, World Bank Insolvency Initiative (2002), *at* http://www.worldbank.org/legal/insolvency_ini.html. Other entities that have been involved with attempts to create enactable cross-border insolvency legislation include the Asian Development Bank and the Organization for Economic Cooperation and Development. *See* Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT'L L. 31, 96 (2001) (providing overview of international bankruptcy reform projects).

[8] *See* UNCITRAL MODEL LAW, *supra* note 7.

is a procedural statute whose main goal is to create a higher level of cooperation between the courts involved in cross-border insolvency. It does not, however, attempt to harmonize either the procedural or the substantive provisions of domestic insolvency laws.

ALI also has been involved in efforts to improve cooperation between national courts that are involved in transnational insolvencies. The ALI Transnational Insolvency Project developed guidelines and principles that could be used in transnational insolvency cases involving assets or creditors in one of the three North American Free Trade Association countries (Canada, United States, and Mexico).[9] The Project has not, however, produced a model procedural law that sovereigns could adopt, nor has it proposed substantive laws to govern a transnational insolvency. The Project limited its scope to providing procedural guidelines, largely because those involved with the Project recognized that neither proposing new substantive laws nor attempting to harmonize different sovereigns' existing laws would have been politically feasible.[10]

The Business Law Section of the International Bar Association also created a transnational insolvency initiative, the Cross-Border Insolvency Concordat. The Concordat created a framework to harmonize cross-border insolvency proceedings principally by suggesting generalized principles that courts or parties could incorporate into a private agreement, commonly known as a "protocol."[11] A protocol is essentially a mini-treaty that the courts involved in a corporate cross-border insolvency agree will be used to govern and coordinate the insolvency proceeding(s).[12] By proposing general principles that could then be tailored to fit the circumstances of the proceedings, the Concordat envisioned a flexible framework that would consider the needs of sovereigns,[13] creditors,[14] and the overall international financial community.[15]

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[9] *See* AM. LAW INST., *supra* note 7.

[10] *See* Jay Lawrence Westbrook, *Creating International Insolvency Law*, 70 AM. BANKR. L.J. 563, 564-69 (1996); Westbrook, *supra* note 2, at 30-33.

[11] The purpose of the Concordat is to suggest generalized principles, which the participants or courts could tailor to fit the particular circumstances and then adopt as a practical approach toward dealing with the process. *See* COUNCIL OF THE INT'L BAR ASS'N, *supra* note 7.

[12] The first successful use of a protocol in a large transnational insolvency was used in the U.S. and U.K. bankruptcy proceeding involving Robert Maxwell's commercial enterprises. *See* Maxwell Communications Corp. v. Société Générale (*In re* Maxwell Communications Corp.), 93 F.3d 1036 (2d Cir. 1996). The parties in *Barr v. Charterhouse Group International, Inc.* (*In re Everfresh Beverages, Inc.*), 238 B.R. 558 (Bankr. S.D.N.Y. 1999), relied on the principles contained in the Concordat, as did the parties in *In re Blackwell*, 267 B.R. 741 (Bankr. W.D. Tex. 2001), and *In re Hackett*, 184 B.R. 656 (Bankr. S.D.N.Y. 1995).

[13] "[L]egislation reflecting a particular jurisdiction's policies regarding such matters as priorities among

Moreover, it was specifically designed to serve only as an interim measure until sovereigns adopted more comprehensive transnational insolvency legislation.[16]

Finally, after years of unsuccessfully attempting to enact a cross-border insolvency treaty, in 2000 the European Union (EU) finally adopted a Regulation that introduces conflict of laws rules in insolvency proceedings of a multinational located in more than one member state.[17] Since the EU Regulation is binding only on EU members,[18] a multinational business that is involved in an insolvency proceeding in an EU member state and in the United States would not be governed by the EU Regulation. The EU Regulation, which came into force on May 31, 2002, also was not designed to (and does not attempt to) harmonize either the substantive law or policies of the member countries.[19]

Some nations, including the United States, have cross-border insolvency laws that make it easier for their domestic courts to recognize foreign or transnational insolvency proceedings.[20] Those laws (like the EU Regulation) are not automatically enforceable in other nations and, unless all nations enact legislation that recognizes another sovereign's insolvency proceedings, the effect and enforceability of a nation's domestic legislation will be confined to the borders of the enacting country.[21] Indeed, even when countries have

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claims . . . must be given due weight where jurisdictionally appropriate, as should regulatory laws governing businesses such as banking or insurance." COUNCIL OF THE INT'L BAR ASS'N, *supra* note 7, at 139.

[14] "[T]hese principles should reflect respect for the legitimate private expectations of the parties transacting business with the debtor, including their reasonable reliance upon laws of particular jurisdictions." *Id.*

[15] "To be supportive of international commerce, any insolvency regime must be reasonably predictable, fair and convenient." *Id.*

[16] "The Concordat is not intended to be used as, or as a substitute for, a treaty or statute but is intended to guide practitioners in harmonizing cross-border insolvencies in the absence of governing treaties or statutes." *Id.* at 140.

[17] Council Regulation 1346/2000 of May 29, 2000 on Insolvency Proceedings, 2000 O.J. (L 160) 1, *available at* http://europa.eu.int/eur-lex/pri/en/oj/dat/2000/l_160/l_16020000630en00010018.pdf.

[18] Denmark is not bound by the regulation. *Id.* (33), 2000 O.J. (L 160) 1, 4.

[19] Sprecher Grier Halberstam LLP, European Insolvency Regulation, Council Regulation (EC) No. 1346 of 2000: SGH Keynotes, *at* http://www.sghlaw.com/european_insolvency_regulation.htm (last revised Jan. 6, 2003).

[20] *See* 11 U.S.C. § 304 (2000).

[21] For example, while § 541 of the Bankruptcy Code purports to give the U.S. court that is deciding a cross-border insolvency case jurisdiction over all assets of the multinational business, if assets are located in another nation, U.S. courts cannot force that nation to turn over the assets. *Id.* § 541. Similarly, while § 362 of the Code provides that almost all creditor collection activities are stayed upon the filing of the bankruptcy

enacted parts of the various model laws,[22] these enactments cannot globally resolve the problems raised with cross-border insolvencies, largely because the model laws do not even attempt to harmonize insolvency laws. Though harmonization arguably is the best solution, creating a single transnational insolvency law is not politically viable at least for the near future. Indeed, even the most ardent advocates of uniform transnational insolvency laws recognize "the difficulty of achieving legal integration in the complex field of insolvency"[23] and concede that "a single international bankruptcy law administered by a single international court system" is, at least for now, implausible.[24]

The international community's refusal to enact uniform corporate cross-border insolvency legislation stems, in large part, from the wholesale effects that a large corporate insolvency has on nations involved with the multinational and also on nations' unwillingness to give assets located within its borders to nonforum creditors.[25] Countries may also resist enacting transnational insolvency legislation because it (like sovereign debt

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case, the U.S. court lacks jurisdiction to enforce this injunction against a non-U.S. creditor who violates it by seizing assets in another nation. *Id.* § 362.

The U.S. Congress has proposed stronger cross-border insolvency legislation. A new Chapter 15, based on the Model Law, is part of comprehensive bankruptcy reform legislation that has been stalled for almost a decade because of controversial consumer provisions that would use a means test to determine consumer debtors' eligibility for bankruptcy relief. Though the cross-border insolvency provisions are not controversial and are distinct from (and could be implemented independently of) the controversial consumer provisions, congressional leaders appear unwilling to pass any individual part of that legislative package. *See* 150 CONG. REC. H212-13 (Jan. 28, 2004) (statement of Rep. Baldwin) (indicating that favorable, noncontroversial parts of bankruptcy reform legislation were used as pawns to help passage of the comprehensive bankruptcy reform bill); 149 CONG. REC. S10,604 (daily ed. July 31, 2003) (statement of Sen. Leahy) (commenting that part of reform legislation was being "used as leverage" for the controversial larger bankruptcy reform bill).

22 Only Mexico appears to have fully embraced and implemented the principles contained in the UNCITRAL Model Law in enacting domestic insolvency legislation. Japan, Poland, Romania, Spain, and the Republic of Montenegro (a member of the Yugoslav Federation) have adopted legislation that contains many of the principles of the Model Law. *See* E. Bruce Leonard, *The International Year in Review*, AM. BANKR. INST. J., Dec. 2003-Jan. 2004, at 76, 77-78. South Africa passed legislation designed to enact the Model Law, though it does not appear to have been implemented. *See id.* at 77. The United Kingdom, Argentina, Australia, New Zealand, and Canada also have considered legislation that would adopt the model law. *Id.* at 78; *see also* Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2278-79 (2000) (discussing legislative proposals).

23 Westbrook, *supra* note 22, at 2292.

24 *Id.* at 2294 (arguing that a universal transnational bankruptcy system is possible, though likely not in the short term); *see also* Donna McKenzie, *International Solutions to International Insolvency: An Insoluble Problem?*, 26 U. BALT. L. REV. 15, 17 (1997) (observing that harmonization was "the guiding light of some earlier efforts" in cross-border legislative proposals but "has now been accepted by many as an unrealistic goal for the foreseeable future").

25 *See* Tung, *supra* note 7, at 45-48 (discussing difficulty of harmonizing countries' bankruptcy laws).

restructuring legislation) necessarily will implicate a number of substantive areas of the law (tax, labor, private contract) and may have devastating effects on the sovereign's economy.[26] Finally, nations appear to have resisted attempts to enact any of the legislative proposals because the proposals did not sufficiently consider nations' political and cultural differences and their divergent views on the appropriate methods and goals of a bankruptcy system.[27]

B. *Sovereign Debt Crisis*

1. *Background*

No one cause is cited to explain why developing nations have increasingly faced financial crises since the 1990s, and there appears to be no way to predict when a crisis will occur. Indeed, there is widespread consensus that both the reasons for sovereign financial crises and the manner in which they are resolved are unique.[28] Though countries may face debt crises for any number of reasons,[29] most agree that it is imperative that sovereigns, once in a crisis, make certain economic changes and then quickly attempt to resolve the

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[26] *Id.* at 47; *cf.* Nouriel Roubini & Brad Setser, Improving the Sovereign Debt Restructuring Process: Problems in Restructuring, Proposed Solutions, and a Roadmap for Reform 5 (Mar. 9, 2003) (unpublished manuscript) (discussing the disruptive effect a default has on a country's financial system), *available at* http://www.iie.com/publications/papers/roubini-setser0303.pdf.

[27] Tung, *supra* note 7, at 48; *cf.* Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51, 63 (1992) (stating that the more diverse parties are, the less likely it will be that a universal rule will be created).

[28] *See* Peter B. Kenen, *The International Financial Architecture: Old Issues and New Initiatives*, INT'L FIN., Spring 2002, at 23, 25-26; Alfred Mudge, *Sovereign Debt Restructure: A Perspective of Counsel to Agent Banks, Bank Advisory Groups and Servicing Banks*, 23 COLUM. J. TRANSNAT'L L. 59, 60 (1984); Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 975 (2000); Hal S. Scott, *A Bankruptcy Procedure for Sovereign Debtors*, 37 INT'L LAW. 103, 104-05 (2003) (citing data).

[29] Reasons given for the most recent sovereign default crises include weak financial systems, the government's decision to guarantee foreign debts of their insolvent (or nearly insolvent) domestic banks, the insolvency of large nonfinancial entities in the country, international economic sanctions, internal political instability or poor governance, excessive fiscal deficits or levels of public debt, high inflation, low savings rates, fall in the growth of (or weak prices for) exports, sudden reversals in capital inflows, exchange rate depreciation or devaluation, and contagion. *See* JEAN TIROLE, FINANCIAL CRISES, LIQUIDITY, AND THE INTERNATIONAL MONETARY SYSTEM 5, 7-12, 37 (2002); Richard Brealey, *The Asian Crisis: Lessons for Crisis Management and Prevention*, *in* FINANCIAL CRISES, CONTAGION, AND THE LENDER OF LAST RESORT 471, 472-74 (Charles Goodhart & Gerhard Illing eds., 2002) (suggesting that high levels of bank borrowing and maturity and currency mismatches rendered banks insolvent and triggered sovereign financial crisis); Kenen, *supra* note 28, at 25-26; Anne O. Krueger, The Need to Improve the Resolution of Financial Crises: An Emerging Consensus, Address Before the Finance Club of Harvard University Business School (Mar. 27, 2003), *available at* http://www.imf.org/external/np/speeches/2003/032703.htm.

crisis.[30] Currently, sovereigns that are facing either a solvency or liquidity[31] crisis lack adequate incentives to promptly and efficiently resolve the crisis and often wait too long to initiate a debt restructuring, thus increasing the likelihood of default and the costs associated with the delayed attempt to renegotiate the debt.[32] Indeed, despite the recent interest in creating a framework to help sovereigns restructure their debts, few willingly default.[33]

Sovereigns appear reluctant to default for three main reasons. First, countries resist defaulting (or even approaching their creditors predefault to restructure their debts) because they fear that there will be economic dislocation, including harm to their domestic banking system, and political upheaval.[34] When a sovereign's leaders initiate a debt restructuring, the

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[30] Changes sovereigns should make include limiting disruptions to the domestic economy, correcting macroeconomic imbalances, stemming capital outflows, and restoring confidence in the sovereign's economy. *See* Int'l Monetary Fund, IMF Board Discusses Economic Policy Issues Arising in the Context of a Sovereign Debt Restructuring 2 (Int'l Monetary Fund Public Information Notice No. 03/42, Apr. 2, 2003), *at* http://www.imf.org/external/np/sec/pn/2003/pn0342.htm.

[31] A solvency crisis occurs when a country cannot pay its ultimate debts from its then owed assets. *See* John H. Chun, Note, *"Post Modern" Sovereign Debt Crisis: Did Mexico Need an International Bankruptcy Forum?*, 64 FORDHAM L. REV. 2647, 2659 n.101 (1996); *see also* BLACK'S LAW DICTIONARY 1400 (7th ed. 1999) (stating that the definition of "solvency" is the "ability to pay debts as they come due"). In contrast, a country has a liquidity crisis when it lacks sufficient currency immediately available to meet its creditors' demands. Chun, *supra*, at 2652 n.44; *see also* BLACK'S LAW DICTIONARY, *supra*, at 942 (stating that liquidity is "the state of being readily convertible into cash").

Though it is not always clear whether the financial crisis is a liquidity or solvency crisis, some suggest that responses to a sovereign's financial crisis and proposals to prevent debt crises should vary depending on whether the crisis is a liquidity or solvency crisis. *See* Kenen, *supra* note 28, at 32.

[32] Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1360 (2002) (observing that "if history teaches any lesson, it is that sovereigns often delay taking necessary debt management measures until a point when the severity of those measures is needlessly aggravated"); Anne Krueger, Int'l Monetary Fund, International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring, Address Before National Economists' Club, American Enterprise Institute (Nov. 26, 2001) ("[T]oo many countries with insurmountable debt problems wait too long, imposing unnecessarily heavy economic costs on themselves, and on the international community that has to help pick up the pieces."), *available at* http://www.imf.org/external/np/speeches/2001/112601.htm.

[33] Political leaders may be inclined to repudiate debts incurred by a prior repressive governmental regime—especially if the new leaders conclude that repaying those debts is not in the best interest of the sovereign's citizens because the prior leaders used the proceeds from those loans for personal activities. For a general discussion of the problem of "odious" debt, see Anupam Chander, *Odious Securitization*, 53 EMORY L.J. 923 (2004).

[34] *See, e.g.*, ANNE O. KRUEGER, INT'L MONETARY FUND, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING 2 (2002); Brealey, *supra* note 29, at 480 (stating that countries that receive IMF assistance suffer domestic unrest and undergo changes in both the government and administration of the central bank); Scott, *supra* note 28, at 110-11 (citing the continuing deterioration in the Argentine economy after announcing debt defaults); Jody Daniel Newman, Note, *Exchange Controls and Foreign Loan Defaults:* Force Majeure *as an Alternative Defense*, 71 IOWA L. REV. 1499, 1499 n.1 (1986); Int'l Monetary Fund, Proposals for a Sovereign Debt Restructuring Mechanism (SDRM): A Factsheet, *at* http://www.imf.org/external/np/exr/

restructuring necessarily is a political process that will be shaped by the leaders' ability to effectively negotiate with groups (both domestic and external) that will be affected by any proposed reforms.[35] These leaders will only propose compositions that will not significantly harm the country's citizens, because the leaders realize that a debt restructuring that triggers a recession, forces severe cuts in public expenditures on social programs, or increases taxes likely will cause citizens to oust them at the next available opportunity.[36]

Sovereigns also avoid debt restructurings because of their concern that default signals that the sovereign is not creditworthy and that such a signal diminishes a sovereign's reputation in, and access to, international capital markets.[37] Finally, sovereigns likely avoid debt restructurings because of uncertainty: with no uniform framework available to restructure all debts, sovereigns cannot reasonably predict whether the restructuring will be successful. The fear of suffering the consequences of defaulting on debt obligations also appears to cause sovereigns to delay initiating restructuring discussions with their creditors and instead to engage in other more costly activities to avoid default.[38]

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facts/sdrm.htm (Jan. 2003).

[35] Domestic debtholders likely will be politically powerful banks, pension funds, or other political elites whose support will be needed for any successful restructuring. *See* Anna Gelpern, *Sovereign Debt Crisis: Creditor's Rights vs. Development (Beyond Balancing the Interests of Creditors and Developing States)*, 97 AM. SOC'Y INT'L L. PROC. 221, 221-22 (2003).

[36] *See* LEX RIEFFEL, RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD HOC MACHINERY 111-12 (2003) (discussing political factors involved with sovereign debt workouts); J. Oloka-Onyango, *Reinforcing Marginalized Rights in an Age of Globalization: International Mechanisms, Non-State Actors, and the Struggle for Peoples' Rights in Africa*, 18 AM. U. INT'L L. REV. 851, 868 (2003) (discussing government's duty to protect citizens from acts of private parties); Cynthia Mullock, *Sovereign Debt Restructuring Proposals and Their Effects on Emerging Markets Debt Investment*, CHAZEN WEB J. INT'L BUS., Fall 2003, at 2 (stating that sovereign's primary duty is to its citizens when restructuring sovereign debt), *at* http://www-1.gsb.columbia.edu/journals/files/chazen/SDR_proof.pdf.

[37] *See* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Restructuring and the Best Interest of Creditors*, 57 VAND. L. REV. (forthcoming 2004); Harold L. Cole & Patrick J. Kehoe, *The Role of Institutions in Reputation Models of Sovereign Debt*, 35 J. MONETARY ECON. 45, 46 (1995); Anne O. Krueger, The Difference Is in the Debt: Crisis Resolution in Latin America, Address at the Latin America Conference on Sector Reform (Nov. 14, 2003), *available at* http://www.imf.org/external/np/speeches/2003/111403a.htm.

[38] *See* Jeremy Bulow, *First World Governments and Third World Debt: A Bankruptcy Court for Sovereign Lending?*, *in* BROOKINGS PAPERS ON ECONOMIC ACTIVITY 2002:1, at 229, 232 (William C. Brainard & George L. Perry eds., 2003) (stating that countries sometimes issue excessive amounts of short-term debt in an attempt to avoid defaulting on existing debt), *available at* http://www.brook.edu/dybdocroot/es/commentary/journals/bpea_macro/papers/200204_bulow.pdf; Barry Eichengreen, *Restructuring Sovereign Debt*, J. ECON. PERSP., Fall 2003, at 75, 75 (stating that countries run down cash reserves, and increase interest rates to avoid suspending debt payments).

When a sovereign defaults on its debts, its creditors have significantly fewer options than do the creditors of a distressed business. For example, unlike a defaulting business, a sovereign cannot be seized by its creditors and liquidated. Moreover, because nearly all sovereign lending is unsecured, creditors do not have the right to seize collateral to satisfy their claims upon default.[39] Even if the loans are collateralized, sovereign creditors have limited enforcement rights since they likely will be unable to enforce their claims in the sovereign's own courts and can only enforce those obligations in the courts of a few other nations, most notably the United States and United Kingdom.[40] Because a distressed sovereign is unlikely to leave attachable assets in any country (especially the United States or the United Kingdom), many argue that a sovereign's creditors have little power to enforce their contractual obligations and must instead rely on the sovereign's fear of damage to its reputation to induce it to pay its bills.[41]

2. *Current Sovereign Debt Restructuring Process*

Sovereigns can reschedule official bilateral debt through an informal arrangement known as the Paris Club,[42] if the IMF has certified that the country cannot meet its debt service obligations and the country agrees to comply with certain policy changes specified by the IMF.[43] Though the restructuring procedures used in Paris Club negotiations are not particularly transparent,[44] sovereigns and their official creditors tend to reach agreement quickly (and relatively inexpensively) in a Paris Club rescheduling, often because these public creditors are willing to make concessions based on

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[39] *See* Bulow, *supra* note 38, at 4. *See generally* CRISIS? WHAT CRISIS? ORDERLY WORKOUTS FOR SOVEREIGN DEBTORS (Barry Eichengreen & Richard Portes eds., 1995).

[40] Sovereigns can be sued in the courts of these two countries because those countries have relaxed their laws on sovereign immunity. *See* Foreign Sovereign Immunities Act of 1976 §§ 2(a), 4(a), 28 U.S.C. §§ 1330, 1605-1607 (2000); State Immunity Act, 1978, c. 33, §§ 1(1), 2-11 (Eng.).

[41] *See* Bratton & Gulati, *supra* note 37; Anna Gelpern, *How Collective Action Is Changing Sovereign Debt*, INT'L FIN. L. REV., May 2003, at 19 (discussing argument that default be made "unspeakably horrible" to combat the challenge creditors face in collecting their claims from a debtor whose assets are largely inaccessible).

[42] The members of the Paris Club include the large creditor nations and also are the large shareholders of the IMF. Permanent members include the United States, the United Kingdom, Canada, France, Germany, and Japan. *See* RIEFFEL, *supra* note 36, at 64 n.11 (listing members).

[43] *See id.* at 77-78.

[44] *Id.* at 81, 103.

political considerations.[45] However, even an efficient resolution of public debt does not obviate the need for distressed sovereigns to restructure their private debt. Private negotiations between sovereigns and their private commercial bank lenders, in an arrangement known as the London Club, tend to be lengthier and more expensive.[46] Various reasons are cited to explain why London Club negotiations are not as efficient as Paris Club restructurings. First, unlike the relatively limited number of public-sector creditors involved with Paris Club restructurings, private commercial creditors tend to be the ones involved with London Club negotiations, and reaching an agreement requires almost unanimous creditor consent.[47] Moreover, unlike the official public creditors in a Paris Club negotiation, commercial banks are less likely to forgive debt for political or other nonfinancial reasons.[48]

While sovereigns and their public or private creditors are attempting to restructure the sovereign's debts, international financial institutions (IFIs) are asked (and often expected) to offer new loans to the sovereigns. Where the IMF is the IFI, the loans are conditioned on the sovereign reforming certain economic policies.[49] Though no one disputes that sovereigns in a financial crisis need additional financing, IMF lending is controversial. In general, the IMF will lend to sovereigns when private lenders will not and on terms not offered by capital market lenders. Moreover, the IMF often lends in its capacity as an international development institution that provides humanitarian

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[45] *See id.* at 82 (stating that Paris Club creditors have never charged sovereigns a restructuring fee); *see also* Michelle J. White, *Sovereigns in Distress: Do They Need Bankruptcy?*, *in* BROOKINGS PAPERS ON ECONOMIC ACTIVITY 2002:1, *supra* note 38, at 14.

[46] *See* RIEFFEL, *supra* note 36, at 130; Alan Schwartz, *Priority Contracts and Priority in Bankruptcy*, 82 CORNELL L. REV. 1396, 1411 (1997); Scott, *supra* note 28, at 106; White, *supra* note 45, at 14-15. *But cf.* Arturo C. Porzecanski, *Dealing with Sovereign Debt: Trends and Implications*, *in* SOVEREIGN DEBT AT THE CROSSROADS (Chris Jochnik & Fraser Preston eds., forthcoming 2004) (arguing that bondholders and banks have helped to expeditiously resolve the sovereign debt crisis, whereas official bilateral and multilateral agencies have been unwilling to make substantial concessions quickly), *available at* http://www.law.georgetown.edu/international/documents/Porzecanski_000.pdf.

[47] White, *supra* note 45, at 14.

[48] *See* RIEFFEL, *supra* note 36, at 112 (observing that London Club banks routinely resist pressure from the IMF or the Paris Club to accept commercially indefensible restructuring terms simply for the purpose of advancing political objectives); Scott, *supra* note 28, at 106.

[49] The IMF conditionality seeks to influence the behavior of governments that accept the IMF loans by encouraging them to pursue different long-term programs and policies such as closing insolvent financial institutions and nonviable firms, strengthening legal systems and financial laws, and creating policies to protect low-income groups. *See* TIROLE, *supra* note 29, at 17; Scott, *supra* note 28, at 95. In theory, once private lenders see that the country has accepted certain economic reforms, they will view it as more creditworthy and will be willing to lend to it, thus eliminating the need for ongoing IMF loans. *See* GRAHAM BIRD, THE IMF AND THE FUTURE: ISSUES AND OPTIONS FACING THE FUND 142, 181 (2003).

aid, rather than as a financial institution that makes lending decisions based solely on the sovereign's borrowing capacity.[50] Others argue that IMF lending decisions are driven by the economic or political desires of its politically powerful members (often the United States) who demand that the IMF lend to sovereigns that owe money to the members' domestic banking institutions[51] or who insist that IMF support packages be given to countries for geopolitical (not economic) reasons.[52] Some critics suggest that the IMF should narrow its focus by providing short-term emergency lending to sovereigns that are facing a liquidity crisis and that it should not attempt to act as a lender of last resort to help resolve a sovereign's insolvency crisis.[53]

While few contend that IMF lending is always inappropriate, commentators argue that the prospect of an IMF support package arguably[54] creates a moral hazard risk by encouraging countries both to maintain domestic economic policies that are not fiscally sound and to borrow recklessly from private capital markets. The belief that the IMF will provide funds either to prevent a

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[50] For example, the IMF often lends to one country to prevent a liquidity crisis from worsening into a solvency crisis and to prevent one country's crisis from spreading to neighboring countries. *See* Eric Dorkin, *Development, the IMF, and Institutional Investors: The Mexican Crisis*, 9 TRANSNAT'L L. & CONTEMP. PROBS. 247, 268 (1999); Chun, *supra* note 31, at 2648-49; Mary C. Tsai, Note, *Globalization and Conditionality: Two Sides of the Sovereignty Coin*, 31 LAW & POL'Y INT'L BUS. 1317, 1325-26 (2000).

[51] *See* INT'L FIN. INSTS. ADVISORY COMM., 106TH CONG., IFIAC (MELTZER) COMMISSION REPORT 44 (Mar. 2000) [hereinafter MELTZER REPORT] ("The IMF should not be used as a 'slush fund' to satisfy decisions of the G-7 finance ministers or other groups of powerful members. Such practices undermine the IMF's role as a supplier of liquidity, [and] distort the incentives of lenders and borrowers in international capital markets . . . ."), *available at* http://www.house.gov/jec/imf/meltzer.pdf.

[52] *See* BIRD, *supra* note 49, at 6, 44-49; RIEFFEL, *supra* note 36, at 53, 111 (arguing that prior lending to Poland was supported by IMF members because Poland chose to break out of the Soviet bloc and that lending to Jordan was deemed necessary to help support its campaign against terrorism).

[53] Some commentators have suggested that the IMF narrow its focus to exchange rate regimes, monetary policy, and fiscal policy and that it limit its support packages to countries that reach unsustainable debt levels. *See IMF, World Bank Overhaul: Hearing Before the Joint Econ. Comm.*, 107th Cong. (2002) (statement of John B. Taylor, Under Secretary of the Treasury for International Affairs), *republished as* Grants and Sovereign Debt Restructuring: Two Key Elements of a Reform Agenda for the International Financial Institutions, *available at* http://www.treas.gov/press/releases/po1016.htm). Others argue that the IMF should not and cannot serve as a lender of last resort. *See* Forrest Capie, *Can There Be an International Lender-of-Last-Resort?*, *in* FINANCIAL CRISES, CONTAGION, AND THE LENDER OF LAST RESORT, *supra* note 29, at 437, 447-48 (stating that there can be no international lender of last resort because there is no international currency); Anna J. Schwartz, *Earmarks of a Lender of Last Resort*, *in* FINANCIAL CRISES, CONTAGION, AND THE LENDER OF LAST RESORT, *supra* note 29, at 449, 458-59 (suggesting that emerging countries can now raise funds from private international markets); Scott, *supra* note 28, at 112 (expressing the view that the IMF is not a classical lender of last resort because it cannot print its own currency).

[54] Without empirical support, it is impossible to state definitely whether IMF lending practices leads to a sovereign/borrower moral hazard problem. *See* Brealey, *supra* note 29, at 480 (suggesting that the moral hazard danger likely is overstated, although recognizing that "it is difficult to provide convincing evidence" to refute assertions of that danger).

default or to help facilitate a postdefault debt restructuring causes sovereigns to make risky borrowing decisions, and any future IMF "bailout" also insulates sovereigns from the costs of the imprudent borrowing.[55] Even if, as many argue, countries would not willingly adhere to reckless financial policies while simply waiting for an IMF bailout,[56] IMF lending arguably creates a lender moral hazard problem as well. That is, the prospect of a support package from the IMF arguably encourages creditors to take excessive risks and lend recklessly: once the IMF provides a financial package to a distressed sovereign, the creditors are then insulated from the costs of their inadequate risk assessment.[57] Moreover, if the sovereign defaults or initiates debt restructuring negotiations to avoid defaulting, the prospect of an IMF support package also is said to distort creditors' incentives during those debt renegotiations by causing them to refuse to make meaningful concessions.[58]

In short, although creditors have limited enforcement rights if a sovereign defaults on its debts, sovereigns are reluctant to default or even to initiate early debt renegotiations with their creditors. Even when sovereigns *do* initiate debt restructurings, the existing procedures to restructure their debts take too long, are too expensive, and often fail to result in a renegotiation of all debts.[59] A system that leads to a quick, predictable, and orderly restructuring of the sovereign's private and public debt would ultimately reduce the future cost of sovereign borrowing, because creditors would receive a higher recovery under such a system and this should cause them to decrease the cost of sovereign

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[55] *See* Schwarcz, *supra* note 28, at 961-62; Scott, *supra* note 28, at 115 (concluding that sovereigns incurred "more debt or engaged in less prudent fiscal and monetary policies than they otherwise would have had they known no official support would be forthcoming").

[56] Not all agree that countries happily borrow from the IMF or that the risk of moral hazard has no restraints. *See* BIRD, *supra* note 49, at 197 ("[M]ost countries find borrowing from the Fund sufficiently unpalatable that they only do it as a last resort, when all other options have been closed. Since crisis situations usually require crisis solutions, IMF conditionality tends to be strict."); Schwarcz, *supra* note 28, at 962 n.28 (recognizing that sovereigns will prefer to avoid the reduced autonomy over their economies that IMF conditionality imposes).

[57] *See* Scott, *supra* note 28, at 113 (suggesting that private creditors are more likely to make bad loans if they will be bailed out by the IMF). *But cf.* Brealey, *supra* note 29, at 475-76 (presenting the sharply divided opinions over the effectiveness of the IMF and its role in causing sovereign debt crises).

[58] *See* Bratton & Gulati, *supra* note 37 (discussing potential moral hazards posed by IMF emergency liquidity loans); Eichengreen, *supra* note 38, at 7-8 (discussing validity of lender moral hazard problem); Kenen, *supra* note 28, at 26.

[59] Thomas I. Palley, Sovereign Debt Restructuring: What Is the Problem? 2 (Jan. 22, 2003) (unpublished manuscript) (observing that "restructuring negotiations under both the Paris and London club arrangements are long and uncertain, giving rise to economic dislocation during the negotiating period"), *available at* http://www.imf.org/External/NP/EXR/seminars/2003/sdrm/pdf/palley.pdf.

lending.[60] As Part II notes, however, which resolution is best has been the subject of heated debate for the last few years.

II. CURRENT PROPOSALS TO RESOLVE THE SOVEREIGN DEBT CRISIS

A. *Contractual Proposals*

1. *Background*

Lending to emerging nations has vacillated over the last two centuries between bank and bond lending. Though bond lending was the dominant form of sovereign debt financing in the nineteenth and early twentieth centuries,[61] bank lending was the most common form of sovereign debt financing for most of the twentieth century.[62] Indeed, commercial banks (largely through medium- to long-term syndicated bank loan agreements) provided most of the lending to sovereigns until the 1990s.[63] The composition of sovereign debt financing changed dramatically in the 1990s largely due to losses banks sustained in the Latin American crises in the 1980s.[64] Starting in the 1990s, the amount of sovereign debt to banks significantly decreased[65] and now the majority of external sovereign debt is in the form of bond debt.[66] The change from bank to bond debt also appears to have changed the dynamics of sovereign debt restructuring negotiations.

The dominance of bond lending created a coordination problem for sovereigns by increasing the number of creditors with which the sovereign would have to negotiate if it needed to restructure its debts. While bank lending in the 1970s and 1980s largely consisted of syndicated loans that involved a limited number of participants, significantly more bondholders are

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60 *See* Eichengreen, *supra* note 38, at 77-78.

61 *See* Enrique Carrasco & Randall Thomas, *Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539, 546-48 (1996); Rory Macmillan, *The Next Sovereign Debt Crisis*, 31 STAN. J. INT'L L. 305, 336-37 (1995).

62 *See* RIEFFEL, *supra* note 36, at 96 (noting that bond debt was the bulk of sovereign lending for more than 100 years before World War II).

63 *See id.* at 107; Lee C. Buchheit, *Cross-Border Lending: What's Different This Time?*, 16 NW. J. INT'L L. & BUS. 44, 46-51 (1995).

64 Bratton & Gulati, *supra* note 37; Schwarcz, *supra* note 28, at 1004.

65 Scott, *supra* note 28, at 106-12 (chronicling crises in Mexico, Asia, Russia, Ecuador, Turkey, Argentina, and Brazil).

66 Buchheit & Gulati, *supra* note 32, at 1334-35 (discussing evolution of emerging market borrowing).

involved with individual bond issues.[67] Bargaining with bank lenders was relatively simple, because sovereigns had to negotiate with only a limited number of creditors and the large banks were repeat players who expected to have ongoing lending relationships with the sovereigns.[68] This expectation of future lending arrangements gave the lenders an incentive to compromise their existing claims during debt restructurings in anticipation of future lending opportunities with the sovereign.[69] Unlike repeat player bank lenders, bondholders have little incentive to compromise their claims because they have no expectation of an ongoing relationship with the sovereign.[70] Moreover, even if bondholders act in good faith during the negotiations and do not engage in self-interested opportunistic behavior, restructuring bond debt is logistically challenging because of the sheer number of agreements a sovereign must reach, because the turnover of the bond owners increases the time and cost involved in contacting new owners to negotiate with them, and because governmental entities no longer can use regulatory incentives or moral suasion to convince the now-dispersed group of bondholders to renegotiate the sovereign's debts.[71]

2. *Majority Action Clauses*

While restructuring commercial banking debt through the London Club may be slow and somewhat cumbersome, there is at least a collective forum sovereigns can use to restructure bank debt. Currently, no such forum exists to restructure bond debt. The greatest impediment to reaching a quick, inexpensive, and comprehensive restructuring agreement with bondholders has been the presence of unanimous action clauses (UACs) in bond contracts. UACs condition the amendment of the bond contract's payment terms on the

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[67] *See* Eichengreen, *supra* note 38, at 36.

[68] *See* Gelpern, *supra* note 41, at 19. *But see* Roubini & Setser, *supra* note 26, at 31 n.27 (suggesting that sovereign debt restructurings with bank syndicates were not as efficient as they are currently portrayed).

[69] *See* RIEFFEL, *supra* note 36, at 111 ("The driving motivation for most banks . . . was the desire to continue doing business with the debtor country.").

[70] Schwarcz, *supra* note 28, at 1005 n.285.

[71] Eichengreen, *supra* note 38, at 264-65; Joseph J. Norton, *"International Financial Law," an Increasingly Important Component of "International Economic Law": A Tribute to Professor John H. Jackson*, 20 MICH. J. INT'L L. 133, 142 (1999); Schwarcz, *supra* note 28, at 1004-05; Richard Euliss, Comment, *The Feasibility of the IMF's Sovereign Debt Restructuring Mechanism: An Alternative Statutory Approach to Mollify American Reservations*, 19 AM. U. INT'L L. REV. 107, 112-13 (2003); Anne O. Krueger, New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking, Address Before Institute for International Economics (Apr. 1, 2002), *available at* http://www.imf.org/external/np/speeches/2002/040102.htm.

unanimous consent of the bondholders.[72] Bonds governed by English law contain collection action clauses (CACs), which allow bondholders to amend payment terms by an affirmative vote of a supermajority (typically seventy-five percent) of the bondholders.[73] Most sovereign bonds are issued on the New York bond market and until very recently always contained UACs.[74] Since even an overwhelming majority of the holders of New York bonds cannot renegotiate payment terms absent unanimous bondholder consent, if the sovereign's bonds contain UACs, it cannot force recalcitrant bondholders to accept a restructuring agreement even if it is acceptable to the majority of the bondholders.[75] Moreover, because they cannot be forced to compromise their claims, rogue bondholders can coerce a sovereign into giving them a better deal by refusing to accept an offer that is acceptable to the majority of bondholders. Likewise, because they are not bound by any decision the sovereign reaches with other bondholders, recalcitrant bondholders can attempt to collect their claims by accelerating the debt or filing an attachment proceeding against the sovereign in a foreign court even if the other bondholders have agreed to forbear from collecting their claims during the debt restructuring negotiations.[76]

Despite the challenges sovereigns face when they attempt to restructure bond debt, many (especially those in the private sector) argue that the best solution to resolving the sovereign debt crises is a private contractual

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[72] The Trust Indenture Trust Act of 1939 prohibits reductions in payment terms of publicly issued corporate bonds unless all bondholders consent. 15 U.S.C. § 77 (2000). While this Act does not apply to sovereign bonds, the drafters of New York sovereign bonds routinely include the unanimity requirement in those bonds. Nonpayment terms can be changed by a smaller majority, typically fifty to sixty percent of the bondholders. *Id.*

[73] *See* Under Secretary of the Treasury John B. Taylor, Sovereign Debt Restructuring: A U.S. Perspective, Address Before Institute for International Economics (Apr. 2, 2002), *available at* http:// www.iie.com/publications/papers/taylor0402.htm.

[74] Eichengreen, *supra* note 38, at 13. Bonds issued in New York contain choice-of-law clauses that give New York courts jurisdiction to hear almost all matters arising out of the bond contract. *See* Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. REV. 59, 59 (2000). Since 2001, Belize, Brazil, Colombia, Costa Rica, Hungary, Italy, the Philippines, Venezuela, and several other emerging countries have issued bonds, including some of investment-grade category, with CACs. Sergio J. Galvis & Angel L. Saad, *Collective Action Clauses: Recent Progress and Challenges Ahead*, 35 GEO. J. INT'L L. (forthcoming 2004).

[75] *See* Schwarcz, *supra* note 28, at 961 n.25 (discussing the difficulty Brazil faced in restructuring its debts when its fourth largest creditor held out and refused to convert Brazil's debt into collateralized bonds).

[76] One commentator has suggested that one way to eliminate the collective action problem and curb rogue creditors is for the United States and the United Kingdom to repeal their sovereign immunity laws, because this would prevent creditors from attaching assets in nonsovereign courts. *See* Bulow, *supra* note 38, at 14-15.

approach.[77] Specifically, commentators suggest that exchange offers and exit amendments can be used to encourage bondholders whose bonds contain UACs to agree to restructure the debt.[78] During an exchange offer, bondholders are asked to exchange voluntarily their old bonds for new ones that generally contain terms more favorable to the bondholders, but that also contain CACs.[79] In theory, bondholders would agree to accept these more favorable bonds, even though doing so requires them to exchange bonds with UACs for bonds with CACs. In practice, not all bondholders will agree to these substitute bonds either because they may not understand the offer or because they want to hold out for a better offer. Thus, exchange offers often are combined with exit consents that operate by requiring bondholders who agree to accept the new bonds to automatically consent to amendments of nonpayment terms in the old bonds. These amendments would be designed to impair the secondary-market value of the old bonds or otherwise make them less attractive to hold, which should give the holders of the old bonds a strong incentive to accept the new bonds.[80]

A contractual approach to resolving a sovereign debt crisis, though appealing because it leaves the process in the hands of privately bargaining parties, does not provide a comprehensive solution to the sovereign debt crisis. First, even if all new bonds contained CACs, there would still be a creditor coordination problem because the holders of old, longer maturity bonds could still rely on the UACs in those bonds to thwart the sovereign's debt restructuring negotiations. Though the holders of old bonds with UACs could be encouraged to exchange those bonds for new bonds with CACs by using exit consents, even some supporters of a contractual approach have questioned whether courts would be willing to enforce exit consents that radically altered

[77] *See* BARRY EICHENGREEN, TOWARDS A NEW INTERNATIONAL FINANCIAL ARCHITECTURE 65-70 (1999); GROUP OF TEN, THE RESOLUTION OF SOVEREIGN LIQUIDITY CRISES: A REPORT TO THE MINISTERS AND GOVERNORS PREPARED UNDER THE AUSPICES OF THE DEPUTIES (1996) (proposing draft CAC clauses), *available at* http://www.bis.org/publ/gten03.pdf; Taylor, *supra* note 53. The International Primary Market Association (a London-based association of underwriters that issue market practices for international bonds), the Institute of International Finance (which represents the largest private financial institutions), and several other private sector organizations (collectively known as the "Gang of 6") publicly support an increased use of CACs to resolve the sovereign debt crisis and developed a template that could be used in future bond issues. *See* Gelpern, *supra* note 35; Letter from Charles H. Dallara, Managing Director, Inst. of Int'l Fin., to The Honorable Gordon Brown, Chairman, Int'l Monetary & Fin. Comm. (Apr. 9, 2002), *available at* http://www.iif.com/data/public/icdc0402.pdf; *see also* Kenen, *supra* note 28, at 31-34.

[78] *See* Buchheit & Gulati, *supra* note 74, at 59.

[79] *See* Krueger, *supra* note 29 (discussing exchange offers).

[80] Bratton & Gulati, *supra* note 37; Buchheit & Gulati, *supra* note 74, at 65-70; *see also* KRUEGER, *supra* note 34, at 31.

the nonpayment terms of the bond contract.[81] In addition, an exchange offer plus exit consent might not work if the issuer is forced to pay a premium to convince a sufficient majority of the old bondholders to accept the new bonds, something sovereigns may be unable to afford.

Even if CACs are included in all bond contracts, there still may be a holdout problem, because one creditor or a small group of creditors could purchase a blocking position and cause the bond to be accelerated, prevent the debt from being restructured, or otherwise extract better terms for themselves at the expense of other bondholders.[82] In addition, even if CACs could solve the creditor holdout problem among holders of individual bond issuers, they do not provide for the aggregation of holders across bond issues.[83] Likewise, they cannot fully solve the creditor holdout problem for nonbondholder creditors. That is, although bond lending is now the dominant form of sovereign financing, lending to sovereigns has switched between bondholders and commercial banks several times over the last two hundred years and there is no way to determine whether bond, syndicated bank, or some other form of lending will be the most common form of sovereign financing in the future. An increased use of CACs (even with exchange offers plus exit consents) would not solve the coordination problem, because banks, trade creditors, and the sovereign's domestic creditors would not be bound by the CACs and would instead have the right to insist that the sovereign engage in individual negotiations with them through slower, costlier proceedings.

In short, with a pure contractual approach, the sovereign would need to do at least the following: issue new bonds with CACs; have multiple exchange offers that included legally enforceable exit consents; negotiate with all nonbondholder creditors; then, convince all bondholders across all issues and all nonbondholder creditors to agree to the proposed restructuring. This process, while perhaps not as burdensome as Paris Club negotiations or negotiating with a multitude of bondholders whose bonds contain UACs, would still be time-consuming and could be extremely costly. Thus, although sovereigns and the capital markets now seem willing to accept New York

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[81] Bratton & Gulati, *supra* note 37; Scott, *supra* note 28, at 119 (questioning whether U.S. courts would uphold changes to bond terms if the minority bondholders were being abused).

[82] For a comprehensive discussion of holdout creditors and a suggestion that these creditors actually add value in the international financial architecture, see Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043 (2004).

[83] *But cf.* Eichengreen, *supra* note 38, at 22 (discussing use of representative committees to address the cross-issue coordination problem).

bonds containing CACs,[84] a contractual approach remains an incomplete solution to the creditor coordination problem. For that reason, the international community must seriously consider the viability of a statutory approach.

B. Statutory Approach

1. IMF Sovereign Debt Restructuring Mechanism

a. Summary

The IMF presented the current sovereign debt restructuring mechanism (SDRM) model in 2001.[85] The model proposed a treaty framework that would create, then implement, the SDRM by amending the IMF's Articles as long as three-fifths of IMF's member governments that had eighty-five percent of the total voting power voted in favor of the amendment.[86] Because the United States holds over seventeen percent of the voting power and currently does not support the SDRM, even if all other members endorsed the SDRM, it cannot be enacted until U.S. officials endorse it and Congress approves it.[87]

The goal of the SDRM is to create a formal insolvency regime that predictably, expediently, and inexpensively restructures sovereign debts, that protects creditors' rights, and that preserves the value of the sovereign's assets.[88] The SDRM was designed to give countries with unsustainable debt[89]

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[84] *See* Galvis & Saad, *supra* note 74.

[85] *See* Krueger, *supra* note 32. While this version is the one currently debated, suggestions for a formal statutory insolvency framework have been made several times over the last two decades. *See* Kenneth Rogoff & Jeromin Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2001*, 49 IMF STAFF PAPERS 470 (2002) (surveying earlier sovereign debt statutory proposals), *available at* http://www.imf.org/External/Pubs/FT/staffp/2002/03/pdf/rogoff.pdf; Schwarcz, *supra* note 28, at 956.

[86] KRUEGER, *supra* note 34, at 34.

[87] *See* ARTICLES OF AGREEMENT OF THE INTERNATIONAL MONETARY FUND, art. XXVIII(a) (July 22, 1944) [hereinafter IMF ARTICLES OF AGREEMENT] (discussing process to amend Articles), *available at* http://www.imf.org/external/pubs/ft/aa/aa.pdf; Int'l Monetary Fund, IMF Members' Quotas and Voting Power, and IMF Board of Governors, *at* http://www.imf.org/external/np/sec/memdir/members.htm (last updated May 13, 2004) (calculating voting power of United States); *see also* Eichengreen, *supra* note 38, at 20.

[88] Int'l Monetary Fund, Report of the Managing Director to the International Monetary and Financial Committee on a Statutory Sovereign Debt Restructuring Mechanism, *at* http://www.imf.org/external/np/omd/2003/040803.htm (Apr. 8, 2003).

[89] The term "unsustainable debt" generally is defined as a situation where "no feasible set of sustainable macroeconomic policies . . . would enable the debtor to resolve the immediate crisis and restore medium-term viability unless they were accompanied by a significant reduction in the net present value of the sovereign's debt." KRUEGER, *supra* note 34, at 4. Factors to be considered when determining whether the sovereign's debt is sustainable include whether government leaders can mobilize and sustain support for their debt adjustment efforts, how the sovereign's economy likely will respond to economic policies designed to remedy the

an incentive to initiate early restructuring agreements, while at the same time ensuring that countries with sustainable debts are not given an incentive to opportunistically suspend payments rather than adjust their economic policies.[90] Quickly facilitating the sovereign's return to medium-term viability, the IMF concluded, would help reduce the overall cost of the restructuring process,[91] would prevent sovereign assets and reserves from being exhausted, and would limit the economic dislocations associated with default.[92]

The SDRM is modeled after principles contained in Chapter 11 of the U.S. Bankruptcy Code.[93] In its current form,[94] the SDRM could be initiated by any sovereign that represented that its debts were unsustainable,[95] as long as that representation is not subject to challenge by creditors.[96] While the most recent version of the SDRM does not advocate imposing an injunction against creditor collection activities,[97] earlier versions of the SDRM recommended a limited stay against creditor enforcement proceedings if approved by a supermajority of creditors.[98] Because one of the goals of the SDRM is to preserve the country's asset values, the availability of a stay was deemed necessary to prevent creditors from engaging in a "grab-race" for assets. Preventing creditors from seizing available assets or otherwise seeking repayment of their claims through national courts would also eliminate disruptions to the sovereign's predefault (or early default) debt restructuring negotiations with its creditors. Thus, as long as the country implemented a sensible economic adjustment package and negotiated in good faith on a

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sovereign debt crisis, and the impact of those economic policies on the domestic financial sector. Krueger, *supra* note 29.

[90] KRUEGER, *supra* note 34, at 4-5.

[91] The IMF notes that the SDRM, to be successful, must be part of an overall effort to strengthen the framework for crisis prevention and resolution, including the IMF policies on lending into arrears and access to IMF resources. *See* Int'l Monetary Fund, *supra* note 88.

[92] KRUEGER, *supra* note 34, at 5.

[93] 11 U.S.C. §§ 101-1330 (2000).

[94] The SDRM has been retooled several times in response to creditor concerns about various provisions. *See* Kenen, *supra* note 28, at 34-36, 37-39 (comparing changes in SDRM plans).

[95] Int'l Monetary Fund, *supra* note 88. An earlier version effectively required sovereigns to get IMF approval before activating the SDRM. *See* INT'L MONETARY FUND, THE DESIGN OF THE SOVEREIGN DEBT RESTRUCTURING MECHANISM—FURTHER CONSIDERATIONS 25-27 (Nov. 27, 2002), *available at* http://www.imf.org/external/np/pdr/sdrm/2002/112702.pdf.

[96] Int'l Monetary Fund, *supra* note 88.

[97] *See* Int'l Monetary Fund, *supra* note 34.

[98] *Id.* Earlier versions of the SDRM proposed an automatic stay on creditor enforcement actions and a general suspension of debt payments during the restructuring. *See* Krueger, *supra* note 29, at 12 (discussing earlier proposals). An earlier version of the SDRM also gave the IMF influence over stays. *Id.*

nondiscriminatory basis,[99] the SDRM-imposed stay would protect creditors by preventing individual creditors from grabbing assets.[100]

To make the process more predictable and transparent to creditors, the SDRM requires sovereigns to provide to creditors all information concerning its indebtedness, including the claims it seeks to restructure (and those it does not).[101] To prevent sovereigns from favoring certain creditors, the SDRM stays payments to nonpriority creditors.[102] The SDRM suggests, however, that loans made by official multilateral entities (including its own claims), debts owed to official bilateral creditors in the Paris Club, and debts held by the sovereign's domestic creditors be viewed as priority claims and, thus, be excluded from the restructuring.[103] The SDRM recommends against restructuring this debt because of the unique nature of multilateral and bilateral lending and because of concern that suspending debt payments to domestic banks might render those banks insolvent and cause even greater economic dislocation in the sovereign.[104] The SDRM seeks to prevent holdout creditors from suing sovereigns or attempting to attach sovereign assets in national courts and attempts to do this by providing that a supermajority vote by creditors in favor of the restructuring can bind dissenting creditors.[105] Finally, to encourage lenders to provide new financing, the SDRM affords priority status for credit extended to the sovereign during the restructuring process.[106]

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99 Krueger, *supra* note 32.

100 *See generally* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 12-13 (1986) (discussing bankruptcy's role as preventing creditors from engaging in inefficient grab rules of nonbankruptcy law). While a few creditors have been able to force sovereigns to pay them off by filing an attachment proceeding, some argue that an automatic stay is unnecessary because courts in the future are less likely to enter judgments allowing holdout creditors to collect on their debts this way. *See* Bratton & Gulati, *supra* note 37; Nouriel Roubini, Private Sector Involvement in Crisis Resolution and Mechanisms for Dealing with Sovereign Debt Problems (July 2002) (unpublished manuscript), *available at* http://www.stern.nyu.edu/globalmacro/fin_systems/roubinipsi.pdf.

101 KRUEGER, *supra* note 34, at 5.

102 The earlier version of the SDRM proposals considered debt such as multilateral debt "non-impaired," meaning that it was excluded from debt restructuring. *See* INT'L MONETARY FUND, *supra* note 95, at 29.

103 Int'l Monetary Fund, *supra* note 34, at B.2, B.3, B.4.

104 KRUEGER, *supra* note 34, at 18-19. The SDRM would restructure only debts claimed by the private sector. *See* Int'l Monetary Fund, *supra* note 88 ("Eligible claims [under the SDRM] would exclude . . . claims held by international organizations . . . and claims held by foreign governments or qualified government agencies.").

105 *See* Krueger, *supra* note 71. Specifically, if seventy-five percent of the creditors holding the outstanding principal of verified claims approve the financing, then this debt could be excluded from the restructuring process. *See* INT'L MONETARY FUND, *supra* note 95, at 45.

106 *See* Int'l Monetary Fund, *supra* note 88.

The SDRM creates a new entity, the dispute resolution forum (DRF), to resolve disputes that might arise during the debt restructuring. After consulting with international organizations familiar with insolvency and debt restructuring, the IMF director would select a pool of judges or private practitioners to serve on the DRF, and this panel would then identify another group of candidates who could be selected to help resolve a sovereign's crises. Four members[107] selected from this pool would then be impaneled by the president of the DRF when the SDRM is activated. The DRF would notify creditors, register their claims, and administer and verify the voting process and also would have general jurisdiction over disputes arising during the debt restructuring process. Finally, the IMF would be involved with resolving disputes during the debt restructuring and would have supervisory control over the DRF because eighty-five percent of the voting power of the Board of Governors of the IMF could overrule DRF rules and regulations.[108]

b. Critique

The IMF maintains that a formal statutory mechanism will encourage sound lending and borrowing decisions and discourage countries from becoming over-indebted and facing default in the future.[109] For a number of reasons, neither emerging market sovereigns nor their creditors supported the adoption of the SDRM. While the SDRM encourages debtors and creditors "to reach agreement of their own accord,"[110] the SDRM was widely criticized for giving the IMF too much control over, and involvement in, the restructuring process.[111] That the SDRM excludes from coverage IMF debt and those of other official creditors also did not encourage private lenders to embrace the SDRM. Similarly, because the SDRM suggests that a sovereign's domestic debt be excluded from the restructuring process, creditors outside the sovereign's borders reasonably questioned whether such a system would permit the sovereign to treat, unfairly and favorably, its domestic debt.[112]

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107 One would actually make initial determinations and the other three would serve as an appellate panel. *See id.*

108 *Id.*

109 INT'L MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING MECHANISM—FURTHER CONSIDERATIONS 3-4 (Aug. 14, 2002), *available at* http://www.imf.org/external/np/pdr/sdrm/2002/081402.pdf.

110 Krueger, *supra* note 32.

111 *See, e.g.*, Taylor, *supra* note 73.

112 *See, e.g.*, Roubini & Setser, *supra* note 26, at 4, 5 (noting as one of the "basic problems that arise in a restructuring" the "absence of an enforceable priority structure for the sovereign's own debt that helps to settle questions of equity and the relative treatment of different creditor groups" such as domestic or foreign creditors).

Moreover, because it excluded domestic debt as well as the debt of IFIs, the SDRM could fairly be characterized as being an incomplete debt restructuring procedure.

Some concluded that the SDRM was rejected because it would make restructuring too easy and ultimately would raise the price of credit.[113] Others suggested that because the SDRM decreased the probability of future IMF bailouts, it would make emerging market lending more expensive.[114] Others were concerned that the SDRM appeared to anticipate that there would be a single law that would be enforced by a single court and that such a regime would override national law and private contracts to further the IMF's developmental goals and would not protect creditor interests.[115]

Others questioned the IMF's underlying motivation for pursuing the SDRM. Many argued that the IMF's interests were in conflict with the interests of most private creditors, since it is a creditor and its overall mission to rebuild countries gives it an incentive to push for legislation that requires the private sector to make large concessions.[116] The IMF has publicly voiced its frustration that money it and other public-sector creditors lent to sovereigns facing either liquidity or solvency crises was used to repay in full private sector, often high-risk, debt.[117] This frustration, critics contend, caused the IMF to push aggressively for the approval of the SDRM because the SDRM

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[113] *See, e.g.*, Smitha Francis, IMF's SDRM Proposals: An Updated Critique of Conceptual Issues 2-3 (May 20, 2003) (unpublished manuscript) (noting that "the subsequent debate [about SDRM] has degenerated entirely into attempts by the [IMF] to consolidate its own role in global finance"), *available at* http://www.networkideas.org/feathm/may2003/IMF_SDRM_Proposal.pdf; *see also* Arturo C. Porzecanski, *The Constructive Role of Private Creditors*, 17 ETHICS & INT'L AFF. 18, 22-23 (2003) ("What then is the rationale of the G-7 and the IMF in devoting so much time and effort to facilitating future workouts of sovereign debt to private creditors? Apparently, G-7 and IMF officials are trying to ameliorate the undesirable consequences of their recent practice of bailing out certain troubled sovereign debtors."); Anthony Richards et al., *Recent Proposals for Reform of Sovereign Debt Restructuring*, BULL. (Res. Bank Austl.), Aug. 2002, at 62 (noting that "the presence of a restructuring framework would reduce the incidence of bail-outs by the IFIs and the moral hazard that results when creditors continue lending in the expectation of such official support"), *available at* http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu_aug02/bu_0802_3.pdf.

[114] Scott, *supra* note 28, at 125.

[115] Eichengreen, *supra* note 38, at 10-11.

[116] Scott, *supra* note 28, at 126 ("SDRM also has substantial design problems . . . . As a major 'priority' lender, [the IMF] has an obvious interest in seeing that its own debt is repaid which may color its decisions on many issues.").

[117] *See* Bulow, *supra* note 38, at 5 (contending that the inherently risky nature of emerging nation bond issues gives it junk bond status); Eichengreen, *supra* note 38, at 6-7 (arguing that the sovereign's citizens effectively repay private loans through increased taxes); Int'l Monetary Fund, *supra* note 30, at 6 (stating that Fund Directors stressed that IMF financing in any debt restructuring system should not be used to underwrite private debt or "to finance payments to creditors whose claims are being restructured").

structure essentially shifts the risk of default back to creditors, and away from the IMF, and contains provisions designed to discourage private lenders from relying on international public institutions to provide a rescue package when a sovereign faces a financial crisis.[118] Finally, some sovereigns may have resisted enacting this statutory system because they feared the immediate political ramifications if the system failed, and could not ensure that they would receive credit for any future benefits from the legislation.

2. *Benefits of a Statutory Insolvency Regime*

That one proposed statutory regime, the SDRM, failed to garner support does not mean that sovereigns and their creditors would reject all statutory approaches or that a contractual approach would be more effective than a well-designed statutory approach. Most statutory insolvency proposals are modeled after domestic legislation that governs insolvent businesses, principally Chapter 11 of the U.S. Code.[119] Indeed, some resistance to embracing the SDRM may result from concerns over the admittedly imperfect analogy between reorganizing a business under Chapter 11 and restructuring a sovereign's debts.[120] Likewise, critics may have rejected a statutory approach based on Chapter 11 because of the somewhat common misperception about the success corporations have when they reorganize under Chapter 11.[121] If policymakers perceive that Chapter 11 or other statutory insolvency legislation is inefficient or otherwise fails to resolve adequately a company's solvency problems, they reasonably would be reluctant to embrace a statutory approach to resolving a sovereign's solvency issues.[122]

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118 *See, e.g.*, Patrick Bolton & David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?*, 53 EMORY L.J. 763 (2004); sources cited *supra* note 113.

119 *See* Marcus Miller, *Sovereign Debt Restructuring: New Articles, New Contracts—or No Change?*, INT'L ECON. POL'Y BRIEFS, No. PB02-3, Apr. 2002, at 3 (noting that Jeffrey Sachs, Steven Schwarcz, Anne Krueger, and consequently the SDRM, all advocate "an international bankruptcy court and/or workout procedures loosely modeled on Chapter 11 of the U.S. Bankruptcy Code"), *available at* http://www.iie.com/publications/pb/pb02-3.pdf.

120 *See* Int'l Monetary Fund, *supra* note 34, at B.6 (discussing parallels between SDRM and national bankruptcy laws and noting limitations in drawing parallels because sovereigns cannot be liquidated and creditors cannot demand a change in management); Roubini & Setser, *supra* note 26, at 6-7 (discussing the similarities and differences between the sovereign debt restructuring process and corporate bankruptcy reorganizations).

121 While Chapter 11 does have its critics, supporters respond that, in the past twenty-three years, Chapter 11 has been used successfully to reorganize major corporations and has saved millions of jobs. *See* Kenneth N. Klee, *Creation of the Chapter 11 Reorganization Option*, L.A. LAW., Mar. 2002, at 24, 24-25.

122 *See* Bulow, *supra* note 38, at 19 (stating perception that Chapter 11 is "a highly inefficient, time consuming process to be avoided at all costs").

Certainly, some Chapter 11 reorganizations have been inefficient, too time-consuming, and exorbitantly expensive.[123] However, other filings (especially some of the large corporate reorganizations filed since 1990) have been quick and relatively inexpensive.[124] Indeed, this change has caused some bankruptcy scholars to conclude that the modern Chapter 11 reorganization is quicker and more efficient than older corporate reorganizations because modern Chapter 11s are essentially used to enforce agreements debtors and their creditors reach in a prenegotiated or prepackaged arrangement before the case is filed.[125] In any event, that some corporate reorganizations may not have been successful[126] and the SDRM may have had some design flaws does not mean that all statutory frameworks should be rejected.

Despite the failure of the SDRM, there are several benefits to having a statutory insolvency regime to resolve sovereign debt crises. First, a well-designed collective insolvency proceeding would give sovereigns the option of binding all creditors—bondholders, commercial banks, trade creditors, official lenders, and domestic claimants—by majority vote, thus eliminating the creditor coordination and holdout problems. In addition, a statute that gives the sovereign at least a brief reprieve from paying its debts (a "standstill") and from creditors' enforcement actions (a "stay") will give sovereigns time to negotiate with all creditors simultaneously[127] and will prevent individual creditors or groups of creditors from disrupting the restructuring either by suing the sovereign in a national court or by attempting to exact unreasonable

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[123] *See, e.g.*, *An Expensive Chapter 11*, CHI. TRIB., Aug. 16, 1986, at C7 (discussing $27.5 million legal and accounting fees in Baldwin-United Corp. Chapter 11 that lasted 2 1/2 years); Anthony Lin, *Batson Bills Enron $100 Million*, NAT'L L.J., Dec. 8, 2003, at 12; Christopher Stern, *WorldCom Fades into History*, WASH. POST, Apr. 19, 2004, at E1 (discussing $800 million bill for lawyers, accountants, and consultants).

[124] U.S. Airways, one of the huge corporate filings in 2002, filed for Chapter 11 on August 11, 2002 and gained approval of its plan on March 31, 2003. Thomas Olson & Michael Yeomans, *U.S. Airways May Face 2nd Bankruptcy*, PITTSBURGH TRIB.-REV., Dec. 19, 2003, *available at* http://www.pittsburghlive.com/x/tribune-review/business/s_170804.html. In yet another example, Texaco filed for Chapter 11 on April 12, 1987, and the plan was confirmed on March 23, 1988. Robert H. Mnookin & Robert B. Wilson, *Rational Bargaining and Market Efficiency: Understanding* Pennzoil v. Texaco, 75 VA. L. REV. 295, 306-09 (1989).

[125] *See* Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 674 (2003) ("Put concretely, in 84% of all large Chapter 11s from 2002, the investors entered bankruptcy with a deal in hand."); A. Mechele Dickerson, *The Many Faces of Chapter 11: A Reply to Professor Baird*, 12 AM. BANKR. INST. L. REV. (forthcoming 2004) (discussing businesses that use Chapter 11 to implement a pre-arranged merger or acquisition).

[126] *See* A. Mechele Dickerson, *A Behavioral Approach to Analyzing Corporate Failures*, 38 WAKE FOREST L. REV. 1, 32 n.118 (2003) (noting the difficulty in determining what constitutes a "successful" Chapter 11).

[127] Moreover, if the sovereign's debt crisis is caused by a liquidity problem that triggers creditor panic, the standstill may serve as an alternative to IMF or other official financing. *See* Kenen, *supra* note 28, at 33.

concessions during the restructuring.[128] By giving sovereigns the option of forcing all creditors to participate in, vote for, and be bound by the restructuring, a statutory system can better provide incentives for lenders to supply additional funds to distressed sovereigns.

A final benefit of a mandatory statutory approach is that it can eliminate the first-mover disadvantage the first sovereign to enact a statutory regime may have. That is, without a mandate to enact insolvency legislation, any sovereign that unilaterally chose to enact debt restructuring legislation would be forced to incur costs (to design the new statutory system and educate potential investors about it) and might be viewed in the capital markets as less creditworthy. This outcome would be especially likely for a debt restructuring statute, given the function of insolvency legislation. That is, even if the benefits of the debt restructuring legislation outweigh any harm to creditors, those benefits will not occur in the short term and, indeed, may never occur if the legislation prevents the sovereign from defaulting on its debts. Though having the legislation might prevent future defaults, thus benefiting both sovereigns and their creditors, it will be difficult to convey these benefits to potential lenders in the short term. Finally, the political leaders who caused their country to adopt such legislation likely would not get credit for future benefits because they may not be in power when the benefits are realized.

Prior attempts to enact transnational corporate insolvency legislation provide a good indication of the likelihood of sovereigns' acceptance of uniform, mandatory sovereign debt restructuring legislation. Given the failure of almost all attempts to enact corporate cross-border insolvency laws and the understanding during those attempts that only flexible, procedural legislation likely would garner support in the international community, a statutory sovereign debt restructuring regime must be flexible and sensitive to the political realities that government leaders face when their countries confront a financial crisis.[129]

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[128] A statutory system also can systematize the sovereign's treatment of "odious" debt and can give creditors notice of how their claims may be treated if a subsequent political regime deems the debt to be odious. The SDRM did not anticipate that countries would be allowed to use the SDRM to eliminate odious debt because of concerns that such use would have adverse implications for the operation of capital markets. *See* Int'l Monetary Fund, *supra* note 34, at D.10.

[129] *See* BIRD, *supra* note 49, at 246 (suggesting that government leaders who are facing a contested re-election will resist borrowing from the IMF because seeking such assistance likely will be viewed as a badge of failure).

III. CONSTRUCTING A POLITICALLY FEASIBLE STATUTORY FRAMEWORK

A. Politics

Many of the sovereign debt restructuring proposals either discount or simply ignore the political realities involved when a sovereign faces a financial crisis and then has to decide how best to resolve it.[130] Regardless of the cause of a crisis, sovereigns avoid defaulting on their debt payments and delay initiating debt restructuring negotiations because of the likely effects such actions will have internally and, externally, in the capital markets. While it is possible that making it easier to restructure debts may increase the sovereign's moral hazard risk, this is unlikely given the current reluctance of sovereigns to default on their debts despite the unlikelihood that creditors can enforce their contractual rights by seizing sovereign assets. More importantly, as is true with all forms of insurance, it would be impossible to completely eliminate the sovereign moral hazard problem without drastically altering the terms of sovereign lending, by, for example, providing that upon default title to a sovereign's natural resources will be transferred to creditors or a neutral third party. Because emerging nations would never agree to drastic results and, in any event, it would be virtually impossible to enforce such results, any approach to resolving the sovereign debt crisis must seek to contain, but not eliminate, moral hazard.

A statutory approach to resolving sovereign debt crises should have as its primary goal encouraging earlier restructurings. Most contractual proposals focus on protecting or enhancing creditors' limited enforcement options and on preventing sovereigns from dissipating funds or transferring those funds to creditors within their borders.[131] While creditors have argued against making it too easy for countries to restructure their debts, given sovereigns' extreme reluctance to initiate debt restructurings, few countries will willingly or opportunistically initiate such restructurings.[132] Entering into predefault

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[130] Krueger, *supra* note 32, at 7 ("[T]he political imponderable is whether our members are prepared to constrain the ability of their citizens to pursue foreign governments through their national courts as an investment in a more stable—and therefore more prosperous—world economy.").

[131] *See* Scott, *supra* note 28, at 119-20.

[132] Buchheit & Gulati, *supra* note 32, at 1360 (observing that "the cost and the consequences—political, social and financial—of a generalized debt restructuring are typically so high that no sovereign takes this step lightly"); Dickerson, *supra* note 125, at 31-32 (noting that, with respect to corporate reorganizations, encouraging earlier filings by imposing additional duties on managers will not increase the risk of managers filing for solvent companies); *cf.* Krueger, *supra* note 29, at 4 (noting Chapter 11's recognition that early reorganizations best protect economic value and stakeholder interests). Indeed, other than sovereigns'

negotiations will benefit both debtor nations and their creditors because the debt restructuring may prevent a default and its resulting political and economic effects. Moreover, an earlier debt restructuring should lead to a greater recovery for creditors that, in turn, ultimately should reduce the cost of the sovereign's future borrowing. Whether sovereigns will be encouraged to restructure their debts before a financial crisis will depend on whether they perceive that they will receive increased benefits (either additional capital or a write-off of existing loans) at relatively low costs (without IMF conditionality and without triggering a political crisis).

Proposed reforms that give creditors the right to control the sovereign's natural resources upon default, that transfer control rights to a neutral international entity (like an international bankruptcy court or a central bank), or that give a nonsovereign court jurisdiction to adjudicate disputes concerning the restructuring of the sovereign's debts may be theoretically possible and might ultimately produce the best economic result.[133] Such proposals, however, will be rejected by sovereigns. Moreover, even if IMF lending encourages sovereign and creditor moral hazard, it is inconceivable that the IMF will cease lending to distressed sovereigns any time in the near future. Given this, the most sensible solution for the long-run economic viability of a country (i.e., no IMF lending or a creditor- or IMF-controlled restructuring) simply is not politically feasible in the short term. Likewise, it is unrealistic to expect the international community to enact a uniform, comprehensive, one-size-fits-all treaty that does not reflect either the different political needs and pressures distressed sovereigns face or the differences in their debt structures and is not flexible enough to be easily modified to adapt to new (or the perception of new) circumstances.[134] Instead, the international community should take the "art of the possible" approach and seek an orderly, predictable solution that is politically tenable for sovereigns in the short term.[135]

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reluctance to restructure their debts early, most of the problems identified with maintaining the status quo are creditor problems such as holdouts or the collection attempts of rogue creditors.

[133] *See, e.g.*, ANDREI SHLEIFER, WILL THE SOVEREIGN DEBT MARKET SURVIVE? 10 (Harvard Inst. of Econ. Research, Discussion Paper No. 2000, 2003) (discussing having an international entity take over a defaulting sovereign's finances).

[134] *Cf.* Robert K. Rasmussen, *supra* note 27, at 62-63 (suggesting that a single bankruptcy regime might not be appropriate for all corporate debtors and noting unlikelihood that "one bankruptcy rule, whatever it may be, would be the optimal rule for all firms").

[135] McKenzie, *supra* note 24, at 17 (suggesting that harmonization of transnational insolvency laws is not feasible and arguing for an approach that is more attainable in the short term); Westbrook, *supra* note 22, at 2287 (arguing in favor of a global bankruptcy law but recognizing that such a law is not yet achievable).

B. *Statutory Framework*

The statutory framework should mandate that sovereigns implement a limited number of uniform substantive and procedural provisions. Mandatory provisions are needed principally to eliminate the first-mover disadvantage. Mandating that certain terms apply to all sovereign debt restructurings also should remove some of the uncertainties associated with these restructurings. Moreover, having some mandatory terms should help sovereigns and their creditors focus on negotiating financial terms, not on creating the framework to be used to encourage the restructuring discussions. There should not, however, be a detailed blueprint for how each sovereign debt crisis must be resolved, and any statutory framework must be flexible and comprehensive enough to accommodate any changes in the sovereign's future borrowing. A flexible, incremental framework is preferable to a rigid, uniform treaty because it can be tailored to reflect the varied causes of sovereign debt crisis and the multiple aims of debt restructuring. Requiring sovereigns to be bound by a limited number of provisions in their debt restructuring process, but otherwise permitting sovereigns to customize their debt restructuring procedures (just as parties involved in transnational insolvency proceedings do by using protocols), will more effectively resolve sovereign debt crises until all sovereigns agree to a treaty or enact comprehensive debt restructuring legislation.

1. *Role of the IMF*

Perhaps the most important requirement of any statutory approach is the involvement of the IMF. Though one of the IMF's purposes is to provide financial support to help its members "correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity," the IMF is not required to make its resources available to its members unless the member provides adequate safeguards.[136] While there should be a grace period to give sovereigns time to enact the legislation, the IMF should condition its future lending on the borrower's acceptance of the mandatory provisions of the statutory framework.[137] The

[136] IMF ARTICLES OF AGREEMENT, *supra* note 87, art. I(v).

[137] It is possible that this requirement also must be approved by a three-fifths majority of the voting power. The United States should not be as reluctant to support such an amendment, however, because it does not require the Fund to actually create a substantive statute that has significant IMF involvement. Moreover, sovereigns should be more amenable to this solution because the IMF is not mandating the complete terms of, or controlling, the outcome of the restructuring process.

IMF should mandate that sovereigns include in their borrowing instruments language that specifies that the IMF-mandated provisions, and any other procedures the sovereign adopts as part of its national law, bind the parties and that any disputes involving the debt restructuring process will be resolved by the adjudicative authority selected by the parties.[138] The IMF also should be responsible for assembling and distributing to its members the "menu options" that sovereigns that fail to implement comprehensive debt restructuring procedures must use until they reach a permanent agreement with their creditors. Other than these roles, however, the IMF should largely be removed from negotiating or designing the restructuring process.

Given the controversy involving IMF lending, there should be a rebuttable presumption that the IMF will not provide nonemergency financing to sovereigns during debt restructurings unless the sovereign cannot borrow funds from a capital market lender. Because of the potential of lender moral hazard, the statutory framework should have a "bail-in" component that encourages lenders to share a significant part of the burden of the sovereign's financial crisis.[139] The size of the emerging capital lending market suggests that private lenders can accommodate a sovereign's financial needs.[140] Private lending is preferable to IMF lending because it can be provided more quickly than an IMF support package and also because private lenders, unlike the IMF, can make lending decisions largely without regard to geopolitical concerns.[141] To encourage private lending, the debt restructuring statute should mandate that financing provided after the sovereign activates the debt restructuring process will be excluded from the restructuring and that all existing sovereign debt will be subordinated in payment to this postactivation financing debt.

A blanket prohibition on IMF lending, especially liquidity loans, is inconsistent with the IMF's purposes and, moreover, is unrealistic. Similarly, creditor nations, including the United States, would reject a blanket prohibition on nonemergency loans if their domestic financial institutions have lent money to the debtor countries.[142] Moreover, it is unrealistic to assume that the United

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[138] Of course, a sovereign and its creditors could always choose not to be bound by these IMF-mandated provisions. Making this choice would then require either existing or future lenders to provide a support package to the sovereign because IMF financing would not be forthcoming.

[139] If, as scholars recently have argued, the sovereign's citizens ultimately bear the cost of the bailout of private debt, then requiring a bail-in is even more appropriate. *See* Olivier Jeanne & Jeromin Zettlemeyer, *International Bailouts, Moral Hazard, and Conditionality*, 16 ECON. POL'Y 407 (2001).

[140] *See* Schwarcz, *supra* note 28, at 987.

[141] *See id.* (noting relative speed of private financing compared to IMF support).

[142] *See* BIRD, *supra* note 49, at 6, 44-49; MELTZER REPORT, as quoted *supra* note 51.

States or other large IMF shareholders would allow the IMF to deny loans in all circumstances to emerging nations that have critical democratic political and economic systems. Finally, until there is a more predictable system in place to help sovereigns resolve an insolvency or liquidity crisis and to prevent capital outflows or a run on their domestic banking system, it is unreasonable to expect that there will be no IMF lending.[143]

Rather than giving the IMF a prominent role in sovereign debt restructurings, the sovereign and its creditors essentially should be allowed to determine how the sovereign's debts will be restructured and the terms of the restructuring. The IMF currently refuses to lend to sovereigns in distress if it concludes that the payment stream in any proposed restructuring is not consistent with the IMF requirements for medium-term debt sustainability[144] or it concludes that the sovereign will not meet certain core requirements as a result of the restructuring. Removing the IMF from the restructuring process gives sovereigns and their creditors an incentive to create a reasonable payment plan knowing that if they fail to do so, there will be no official financing to either repay existing private debt or otherwise ease the sovereign's liquidity or solvency problems. If the parties prefer their plan notwithstanding the objections of the IMF, or if they conclude that the IMF conditions are unwarranted, then either creditors would need to agree to restructure their loans in ways that would not require the sovereign to need additional capital, the sovereign would need to find new additional financing, or one of the existing lenders would have to agree to provide postactivation financing and, in effect, replace the IMF as the lender of last resort.[145]

There, of course, is no guarantee that private creditors will lend in all circumstances. If the capital markets refuse to lend to sovereigns while they restructure their debts, then any loans provided by the IMF should have essentially market interest rates and should be used to help stabilize the country (or respond to a liquidity crisis), not merely to repay existing private

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[143] *See* Schwarcz, *supra* note 28, at 963 (noting that the IMF's refusal to act as a lender of last resort is politically untenable if sovereigns lack alternative funding sources).

[144] INT'L MONETARY FUND, A SOVEREIGN DEBT RESTRUCTURING MECHANISM—FURTHER REFLECTIONS AND FUTURE WORK 8 (Feb. 14, 2002), *available at* http://www.imf.org/external/NP/pdr/sdrm/2002/021402.pdf; *see* BIRD, *supra* note 49, at 93-126 (discussing IMF conditionality).

[145] Uruguay appears to have been able to restructure its debts without accepting IMF conditions. *See, e.g.*, Alan Beattie, *Uruguay Provides Test Case for Merits of Voluntary Debt Exchange*, FIN. TIMES, Apr. 23, 2003, at 3 (discussing Uruguay's voluntary debt exchange and absence of direct compulsion of bondholder participation in the exchange).

lenders in full.[146] To encourage sovereigns to restructure their debts early, however, the interest rate of any IMF loan should vary based on when the sovereign initiates debt restructuring discussions: sovereigns that initiate *pre*default restructurings should receive a slightly below-market interest rate on any subsequent IMF loan, whereas sovereigns that initiate *post*default restructurings should be forced to pay a higher, "penalty" interest rate.[147]

2. *Other Mandatory Features*

The statutory system must have procedures that ensure that the process is predictable and transparent. At a minimum, soon after sovereigns activate the debt restructuring process, they must be required to notify all their creditors, disclose all their claims, and explain how they intend to treat those claims (i.e., which claims they intend to restructure, and which they intend to exclude from the restructuring). Since it is unlikely that all creditors will participate in the negotiation process, once the sovereign has reached agreement with a sufficient majority of its creditors to approve the restructuring agreement, it should be required to communicate the details of the restructuring to all creditors.[148] Having clear and predictable procedures will decrease creditors' incentive to derail the process by suing the sovereign in national courts either before or after a restructuring agreement is reached to collect their debts. Moreover, a clear and predictable process should lower the cost of sovereign lending because creditors will know how their claims likely will be treated in the event of a default.

Most sovereigns that are facing a financial crisis will need some type of temporary standstill of their debt obligations. Giving sovereigns a brief reprieve from paying their debts may be ineffective, however, unless they are

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[146] *Cf.* MELTZER REPORT, *supra* note 51, at 6-7 (recommending against IMF bailouts and in favor of short-term liquidity assistance). While there should not be an outright prohibition against using IMF funding to make debt payments, to avoid the creditor moral hazard problem, sovereigns should not be allowed to repay private creditors in full using official financing.

Restricting the use of funds given during the restructuring would be similar to the restrictions private lenders routinely place on the use of funds they provide to corporate debtors who have filed a petition for relief under Chapter 11 of the Bankruptcy Code. Lenders routinely restrict the use of postpetition financing to payment of operating expenses. *See* Richard Stern & Lori Lapin Jones, *Lending to the Debtor in Possession*, *in* BANKRUPTCY DEVELOPMENTS FOR WORKOUT OFFICERS & LENDERS COUNSEL 1991, at 317, 332-33 (PLI Commercial Law & Practice Course, Handbook Series No. A4-4348, 1991).

[147] *But cf.* Kenen, *supra* note 28, at 41 (arguing that countries that do not adopt legislation that would include CACs should receive a reduction in their access to IMF credit).

[148] Sovereigns should consider relying on quicker, less expensive forms of communication and should increasingly use the Internet to communicate with their creditors.

also protected from creditor enforcement actions. Some commentators suggest that an automatic stay, even if temporary, is unnecessary since creditors cannot seize assets within the sovereign's borders and sovereigns are not likely to leave seizable assets in creditor-friendly countries. However, there have been successful creditor seizures in the past, and there is always the possibility that a sovereign will have assets (for example, aircraft owned by the national airline, foreign bank accounts, or foreign securities) outside of its borders that can be seized by creditors.[149] Moreover, because sovereigns often waive their sovereign immunity defense in lending agreements, the threat that a creditor might attempt to seize the sovereign's assets may cause the sovereign to engage in inefficient activities designed to protect sovereign property,[150] will disrupt the restructuring process, and will give the sovereign an incentive to pay the claim of the creditor who is threatening to attach assets.[151] Because it is at least theoretically possible that a sovereign will have seizable assets outside its borders, all sovereign insolvency legislation should give sovereigns at least temporary relief (of no more than thirty days) from creditor enforcement actions. To ensure the enforceability of this provision, all lending instruments should give the sovereigns' courts exclusive jurisdiction over any creditor enforcement litigation that arises during a debt restructuring.

To address the collective action problem, the statutory framework must mandate that decisions made by a majority of creditors will bind dissenting creditors. The sovereign (if it enacts comprehensive legislation) or the sovereign and its creditors (if they use a protocol) should decide whether the percentage would be a simple majority or a supermajority. There also should be a mandatory provision that explains how creditors will be selected to serve on a creditor committee, assuming one is appointed.

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[149] *See* Elliott Assocs. v. Banco de la Nacion, 194 F.3d 363, 365 (2d Cir. 1999) (noting that vulture creditor attached sovereign's interest payments on bond that were held in foreign bank account); *see also* David A. Skeel, Jr., *Can Majority Voting Provisions Do It All?*, 52 EMORY L.J. 417, 423 (2003) (noting that the stay is not as self-evidently necessary for sovereigns, but stressing that in some circumstances sovereigns would face a risk of asset seizure if no stay is imposed); Krueger, *supra* note 32 (discussing attachment of Peruvian assets in United States and Peru's decision to settle with creditor rather than be pushed into default).

[150] For example, the President of Argentina refused to travel to Europe after Argentina defaulted on its debts for fear that the presidential plane would be attached by creditors. *See The IMF and Argentina*, WASH. POST, Mar. 12, 2004, at A22.

[151] *See* Schwarcz, *supra* note 28, at 1028 (suggesting waivers of sovereign immunity are common); *see also* Michel Camdessus, Capital Flows, Crises, and the Private Sector, Remarks to the Institute of International Bankers (Mar. 1, 1999) (advocating temporary halt to creditor litigation to "maintain order" and prevent disruptive and unnecessary litigation), *available at* http://www.imf.org/external/np/speeches/1999/030199.htm.

While sovereigns, their creditors, and the IFIs have consistently rejected suggestions to create a permanent international bankruptcy court, some type of administrative or adjudicatory body will be needed to resolve disputes between the sovereign and its creditors.[152] Even though most large firms that reorganize under U.S. bankruptcy laws use prepackaged or prenegotiated plans,[153] the debtor and its primary creditor(s) still need an adjudicative body to implement their agreement.[154] One way to create such a "restructuring panel" would be to have a standing ad hoc panel of global insolvency experts who either volunteer to serve on the panel or are nominated by sovereigns or their creditors. While representatives of an IFI like the IMF are obvious choices to serve on the panel because of their expertise in international insolvency matters, the IMF is a creditor with inherent conflicts of interest, and some emerging nations perceive that the IMF serves the interests of only its creditor member nations.[155] Because of this, IMF representatives should not serve on the panel. On at least an annual basis, five members from the panel should be selected to serve on the restructuring panel in the event the sovereign needs to restructure its debts that year.[156] Sovereigns should have the right to select two panelists, their creditors should have the right to select two, and those four would be required to select the fifth member (who would chair the panel).[157]

C. *Substantive Menu Approach*

If a sovereign chooses to enact only the IMF-mandated debt restructuring provisions, it could then customize the rest of its debt restructuring process on an ad hoc basis. Allowing sovereigns to customize the process they use to resolve a financial crisis is similar to an approach debtors and their creditors use in transnational insolvency legislation—the protocol. Because no

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[152] *See* Schwarcz, *supra* note 28, at 1019 (discussing failed attempts by G-7 nations to create an international bankruptcy agency).

[153] *See* Baird & Rasmussen, *supra* note 125, at 674 n.5.

[154] *See* Dickerson, *supra* note 125, at 2-3 (noting that judicial mechanism is needed to implement the terms of pre-arranged corporate reorganizations); Lynn M. LoPucki, *The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's* The End of Bankruptcy, 56 STAN. L. REV. 645, 666-70 (2003).

[155] *See* Bulow, *supra* note 38, at 16 (arguing that the IMF and World Bank "get a bad rap" by being characterized as only "doing the bidding of the large creditor countries").

[156] Selecting the panelists annually before the sovereign is at risk of default should generally decrease the likelihood of capture and should specifically help prevent sovereigns or their creditors from selecting panelists who are known to hold certain views concerning the sovereign's financial crisis.

[157] *See* Schwarcz, *supra* note 28, at 1010 (posing other models for resolving sovereign debt restructuring disputes); Scott, *supra* note 28, at 134 (discussing similar procedure used for NAFTA whereby each party chooses members of the dispute resolution panel with a neutral party selected as the tie-breaker).

international treaty or statute regulates transnational insolvencies, multinational businesses use private protocols, essentially mini-treaties, to create or coordinate the procedures that will be used to govern the insolvency proceedings. Protocols have been used in many of the larger transnational insolvencies,[158] and parties appear to prefer them because they can be tailored to fit the particular circumstances involved in cross-border proceedings. Giving sovereigns the authority to make incremental changes to their debt restructuring procedures also gives the international community time to review the various terms that could be included in a debt restructuring treaty and to gauge the market's reaction to those terms outside the more formalized context of a treaty drafting process.

Despite the benefits of allowing the parties to customize the debt restructuring process, until the sovereign and its creditors reach a permanent agreement, default terms—i.e., a temporary protocol—will be needed to govern the debt restructuring. At least thirty days before activating debt restructuring negotiations, the sovereign should be required to prepare the temporary protocol and present it to its creditors. To ensure that sovereigns protect creditor interests, they should be required to construct a temporary protocol by selecting options from a menu jointly created by representatives of creditor groups (like the Emerging Market Creditors Association or the Institute of International Finance) and representatives of IMF emerging nation members. The joint drafting committee should pair prosovereign options with procreditor options and, to the extent possible, should use options that exist in current insolvency laws.[159] The committee should then present its menu to the IMF for distribution to all its members.[160] Once the sovereign and its creditors reach agreement on the nonmandatory terms of the debt restructuring, the final protocol would replace the temporary one. If the final protocol is silent in certain areas, then the menu options would serve as default terms.

One problem with using a menu or allowing sovereigns to customize their legislation is that there will be no uniform insolvency text or a uniform

[158] *See* Michael Fitz-James, *Use of Cross-Border Insolvency Protocols on the Rise*, CORP. LEGAL TIMES INT'L, May 2002, at 1 (explaining that bankruptcy protocols were born of necessity in 1991 during the "fraud-ridden bankruptcy of Maxwell Communications Corp.").

[159] *See* Rasmussen, *supra* note 27, at 100 (explaining that options on a bankruptcy menu preferably incorporate existing law to reduce costs of learning unfamiliar rules).

[160] Having interested parties create a framework has been mentioned by IMF representatives in the context of creating a "Code of Good Conduct." *See* Krueger, *supra* note 29, at 6 (suggesting that Code be developed by debtors, their creditors, and other interested parties, including the IMF); *see also* Roubini & Setser, *supra* note 26, at 8-10 (discussing various proposals for codes of conduct).

interpretation of that text. Because the menu options would not be included in the sovereign's debt restructuring legislation, creditors could not use prior restructurings to calculate the likely treatment of their claims in the event of a sovereign default. Also, because sovereigns would have different insolvency procedures, creditors would be required to learn each sovereign's procedures, which may increase the cost of sovereign lending. Because sovereigns will be required to enact the IMF-mandated terms discussed in Part III.B, however, creditors will generally understand how the debt restructuring process will proceed. Moreover, creditors already must consider a number of varied factors that are unique to each sovereign when pricing sovereign debt. Thus, any additional costs they might incur in estimating how their claims will be treated during a restructuring should not significantly increase the cost of sovereign lending. More importantly, while a predictable, consistent rule would be the best result, the rejection of the mandatory, uniform provisions contained in the SDRM, the fact that CAC terms in new bond issues are not uniform,[161] and the earlier rejection by the international community of uniform transnational insolvency legislation all suggest that at least in the short term an ad hoc framework is the most politically feasible.

The list of paired options, discussed immediately below, is by no means a comprehensive list of all possible menu options. Instead, these options are designed to be representative of the types of items that could be included in the sovereign's temporary protocol.

1. Restrictions on Sovereign Activation Plus No Creditor Committee

Many suggest that making debt restructurings too easy will increase the number of opportunistic defaults. Mandating that sovereigns make certain quantitative financial showings, like requiring that the IMF certify that the country has "unsustainable debt," would be one way to decrease the likelihood of opportunistic defaults.[162] Permitting the IMF to make the threshold determination of whether the sovereign has "unsustainable debt" likely will be controversial and runs the risk of being politicized just as some argue current

[161] *See* Galvis & Saad, *supra* note 74, at 2.

[162] A similar mechanism, termed "means testing," has been proposed during bankruptcy reform debates in the U.S. Congress for the last several years. This test purportedly would counter bankruptcy abuses and establish a more rigid test to determine when and how individual debtors must repay creditors. *See, e.g.*, Dickerson, *supra* note 126, at 105 n.63.

IMF lending decisions are.[163] In addition, "unsustainable debt" is not a term that can be easily defined and, moreover, is a term that is manipulable.[164] If the IMF determines that the debt is unsustainable, however, then the sovereign should be allowed to activate the debt restructuring process.

Because an entity other than the sovereign would be involved in critically examining the sovereign's financial predicament early in the debt restructuring process, this option should be paired with an option that eliminates the automatic appointment of a creditors' committee. Appointing a committee necessarily will increase administrative costs, which likely would be borne by the sovereign (as is true in U.S. corporate reorganization proceedings).[165] Moreover, if a creditor committee is appointed and the sovereign is required to pay the committee's costs, the sovereign and possibly the restructuring dispute panel will be required to determine whether the committee's expenses are reasonable.[166] Any restrictions on a sovereign's ability to initiate the debt restructuring may delay the process and increase the costs of the restructuring. Delaying (or eliminating)[167] the creation of the creditor committee will alleviate the need for sovereigns to negotiate with that group, at least at the beginning of the case, and should, accordingly, save time and decrease overall costs.

2. Good Faith Initiation Requirement Plus Automatic Creditor Committee

An earlier version of the SDRM prevented a sovereign from activating a restructuring unless the IMF certified that its debts were unsustainable. The current version is more deferential to sovereigns and gives sovereigns the unilateral authority to initiate the debt restructuring mechanism. Creditors could not challenge the sovereign's determination that it needed to restructure its debts, and sovereigns are not explicitly required to act in good faith when

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[163] *See* PATRICK BOLTON, TOWARD A STATUTORY APPROACH TO SOVEREIGN DEBT RESTRUCTURING: LESSONS FROM CORPORATE BANKRUPTCY PRACTICE AROUND THE WORLD 29 (Int'l Monetary Fund Working Paper No. 03/13, 2003) (characterizing it as "more an art than a science"), *available at* http://www.imf.org/external/pubs/ft/wp/2003/wp0313.pdf.

[164] Academic and policy commentators who have commented on the SDRM suggest that the term "unsustainable debt" is not capable of being defined in precise, nonmanipulable terms. Indeed, the First Deputy Managing Director of the IMF, Anne O. Krueger, has stressed the difficulty of determining whether debt is sustainable and admitted that it "is not an exact science." Krueger, *supra* note 29, at 2.

[165] *See* 11 U.S.C. § 503(b)(3)(F) (2000).

[166] In corporate reorganizations, the Office of the United States Trustee appoints committee members and all parties in interest have the right to object if they conclude that the committee's expenses are not reasonable.

[167] Sovereigns that have relatively simple debt structures and a limited number of creditors should be able to negotiate the terms of the restructuring without the need for a creditor committee.

they activate the debt restructuring process. If sovereigns are allowed to activate the debt restructuring process unilaterally, they should at a minimum face a financial penalty if it is later determined that it defaulted on its debts or attempted to force its creditors to restructure their debts in bad faith.[168]

To protect creditors from potentially opportunistic restructurings, giving sovereigns a unilateral right to activate debt restructuring in good faith should be paired with the automatic appointment of a creditor committee. How creditors would be notified that the debt restructuring process has been activated, how they will be represented during the restructuring discussions, and how members of the creditor committee will be selected would be IMF-mandated uniform terms in all debt restructuring statutes. Because sovereigns will be required to provide financial information to creditors, having a creditor committee automatically appointed would give creditors an early opportunity to help shape the form of the restructuring agreement or to determine that the sovereign activated the process in bad faith.

3. *Permanent Automatic Stay Plus Enhanced Creditor Control over the Restructuring*

Few sovereigns would want to have an involuntary debt restructuring because of the likely harm in both the capital markets and their domestic economies and because of the likely political fallout associated with a third-party declaration that the sovereign is insolvent. Indeed, no version of the SDRM gave creditors the right to activate a debt restructuring because of the effect this would impose on sovereign rights. The SDRM also did not give creditors the authority to force sovereigns to submit a timely restructuring agreement nor did it allow creditors to terminate restructuring discussions that had reached an irreconcilable impasse.

One of the most controversial provisions in the SDRM involved the stay of creditor enforcement actions. Because the potential harm caused by a creditor attachment of sovereign property is great, there should be a mandatory thirty-day stay. If the sovereign has a complicated debt structure, however, it likely would benefit from a more extended stay. If the sovereign anticipates that it will seek a permanent stay or that it wants the ability to extend the stay over the objection of its creditors, creditors should be allowed to either (1) force the sovereign to engage in debt restructuring discussions, (2) force the sovereign to

168 At a minimum, the sovereign should be required to pay any expenses a creditor incurs as a result of the improper debt restructuring.

submit a timely restructuring agreement, or (3) force the sovereign to terminate futile debt restructuring discussions. Thus, if the sovereign's temporary protocol indicates that it will seek an extended stay, creditors should be allowed to prevent the debt restructuring by asking the IMF to certify that the debt is sustainable.[169] Because sovereigns are required to give their creditors a copy of the temporary protocol thirty days before the restructuring is activated, creditors who object to a permanent automatic stay (or to the sovereign's right to request an extension of the stay) could attempt to prevent the restructuring altogether by requesting a certification by the IMF that the sovereign's debts are sustainable. Creditors should also be allowed to petition the debt restructuring panel to either terminate a restructuring (or exclude certain creditor debt from the restructuring) if it appears that the sovereign is not negotiating in good faith or is unwilling to prepare a timely written restructuring agreement.

4. *Restructuring Official Debt Plus Superpriority Treatment*

The IMF has argued against requiring sovereigns to suspend debt payments to multilateral or bilateral creditors or forcing sovereigns to restructure that debt because of the unique nature of public-sector lending.[170] Excluding official creditor debt has been challenged by critics of the SDRM as unfairly favoring this debt, especially since IMF and other multilateral creditor loans are almost always paid in full (likely because the sovereign anticipates that it will need more funds from these creditors in the future).[171] One way to address the perception that excluding debt favors certain creditors is to require the sovereign to include all official debt in the restructuring but to give the official lenders priority in payment as to all claims except those of the lender who provides financing during the restructuring.[172] Giving IMF loans priority in

[169] Likewise, if the sovereign has enacted comprehensive debt restructuring legislation that provides for a permanent stay, creditors should be allowed to ask the IMF to certify that the sovereign is facing a financial crisis that would warrant a debt restructuring and, upon receiving such a certification, should be allowed to force the sovereign to initiate debt restructuring negotiations.

[170] *See supra* note 104.

[171] Another reason IFI debt may be repaid is that it is always a relatively small percentage of the total sovereign debt and the loans have below-market interest rates. *See* Bulow, *supra* note 38, at 10.

[172] The Bankruptcy Code uses this approach. *See, e.g.*, 11 U.S.C. § 507(a)(3)-(4) (2000) (giving priority to employee payments); *id.* § 503(b) (permitting priority for administrative expenses); *id.* § 507(a)(7) (affording this status to alimony and child support claims).

Of course, if IMF debt is restructured and the IMF is required to forgive some or all of its loans, its ability to make future loans may be compromised because it is unlikely that its large creditor members will be willing to accept an increase of their quotas in the future because of prior restructurings. *See* Int'l Monetary Fund, *supra* note 34, at B.4.

payment also should help decrease the lender moral hazard problem. That is, if creditors know that (1) IMF loans will have payment priority in a debt restructuring, (2) the IMF presumptively will make only liquidity loans during the restructuring, (3) any nonemergency IMF support package will be offered only if private lenders refuse to lend, and (4) any postactivation financing will have priority in payment before the preactivation official creditors' debt, they should be less likely to engage in risky lending practices. Moreover, if private lenders know that postactivation financing will have priority over claims of official creditors, they should have a greater incentive to loan to the sovereign during the debt restructuring.

5. *Excluding Domestic Debt Plus Higher Voting Requirements*

Some have argued against including domestic debts in the restructuring process because of the concern that restructuring those debts and reducing the debt the sovereign owes to its domestic banking (or pension) systems will threaten the viability of the sovereign's financial system by eliminating savings, decreasing the availability of credit to the private sector, and generally disrupting the bank's payment system.[173] In response, commentators suggest that allowing sovereigns to continue to pay the claims of domestic creditors increases the likelihood that the sovereign will use its available assets to pay the debts of creditors within its borders and, thus, would have little remaining to pay private lender claims.[174] One problem with requiring sovereigns to adopt a blanket rule on whether domestic debt should be excluded is that the relative amount of sovereign domestic debt may vary greatly depending on the sovereign's debt structure.[175] Given the amount of domestic debt some sovereigns have, however, it is crucial that external creditors are given some assurances that their claims will be treated fairly during the debt restructuring.

If the sovereign wants to exclude domestic debts from the restructuring process, then this option should be paired with an option that significantly increases the percentage of creditors needed to approve the debt restructuring. Increasing the voting majority needed to approve the restructuring will force sovereigns to treat nondomestic debt fairly while still giving them the option to

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[173] *See* Gelpern, *supra* note 35, at 221-22; Int'l Monetary Fund, *supra* note 30, at 3.

[174] *See supra* note 112.

[175] For example, Brazil's domestic debt is nearly five times the size of its external debt. *See* Gelpern, *supra* note 35, at 221.

discriminate in favor of domestic debt.[176] In contrast, if sovereigns are willing to include domestic debt in the restructuring, they should be allowed to have their restructuring plans approved by a smaller percentage.

6. *Automatic Creditor Committee Plus Lower Voting Threshold*

If creditors deem it crucial to have a mandatory creditor's committee, then this requirement should be paired with an option that allows the sovereign to have a lower voting threshold to approve the restructuring. If creditors have not been actively involved with the restructuring process, or have received only the IMF-mandated information, then a higher voting percentage (of, for example, at least seventy-five percent) would be reasonable because they may not understand how the sovereign intends to restructure its debts and may not have had an opportunity to raise objections to, or help mold, the restructuring. Though all sovereigns would be required to give creditors information concerning their debts and to identify which debts they intend to restructure, a working creditor committee will have a greater opportunity to negotiate with the sovereign. Moreover, assuming the sovereign and creditors are negotiating in good faith and are willing to make reasonable compromises,[177] the creditors who likely would vote against the debt restructuring would be the opportunistic holdout creditors, and it is fair to have the majority of creditors bind these holdout creditors to a reasonable restructuring.

7. *Cramdown Plus Fairness Protections for Creditors*

In corporate reorganizations, debtors can confirm a plan of reorganization over the objection of a dissenting class of creditors (i.e., the "cramdown") if certain conditions are met.[178] Though some commentators have discussed including a cramdown provision in a statutory insolvency system, and have suggested that sovereigns be allowed to group creditors in classes,[179] the SDRM does not endorse the concept of mandatory class voting or the use of a cramdown.

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[176] Whether that percentage should be 75% (as favored by the G-7), or 90% (as recommended by private creditors), should be decided by the drafting committee. *See* Taylor, *supra* note 73.

[177] Most Chapter 11 plans are consensual, and modern ones are prearranged before filing. *See* Baird & Rasmussen, *supra* note 125, at 674.

[178] 11 U.S.C. § 1129(b) (2000). A Chapter 11 debtor can ask the court to confirm a plan over the objection of creditors if the court concludes that the plan is fair and equitable (generally, that it satisfies the absolute priority rule) and that it gives the dissenting creditor at least as much as it would have received in a hypothetical Chapter 7 liquidation. *Id.*

[179] *See* Bolton & Skeel, *supra* note 118, at 793-801.

If sovereigns want the ability to place creditors in classes and then cram down a restructuring plan over the objection of some of those classes, then this option should be paired with one that ensures that the voting process is fair. Chapter 11 debtors can gerrymander classes of creditors—that is, place creditors in classes in such a way that ensures that at least one class of creditors whose claims will not be paid in full will vote in favor of the plan (a requirement for a cramdown under U.S. law).[180] Sovereigns should not, however, be allowed to gerrymander classes. In addition, if national creditors are included in the restructuring process, they should be placed in a class different from offshore creditors to ensure that they do not dominate the class and dilute the vote of the offshore creditors. While sovereigns should not be allowed to gerrymander classes, sovereigns and their creditors should otherwise be allowed to determine how to create classes or subclasses and what percentage of affirmative votes is needed for a class to approve the debt restructuring.

CONCLUSION

A solution to sovereign debt crises, like a solution to transnational insolvencies, remains as a Holy Grail: "desirable but elusive, notwithstanding continuing efforts at many levels to attain it."[181] Recent history suggests that not all financial crises are the same and that resolving individual sovereigns' debt crises may depend on the political and domestic economic pressures facing the sovereign's leaders. Indeed, all proposed solutions to the sovereign debt crisis concede that any solution necessarily will have political implications and that sovereign nations likely will resist any attempt to force them to be governed by the laws of another nation or to subject themselves to the jurisdiction of another sovereign's courts.

The most politically feasible approach is to create a restructuring procedure with negotiation-friendly measures that facilitate early debt restructurings.

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[180] *See* 11 U.S.C. § 1129. Yet, while the practice of gerrymandering in the context of business reorganization is not explicitly prohibited by the Bankruptcy Code, there is a circuit split regarding when, if at all, this reclassification may be permitted. *See, e.g.*, Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (*In re* Greystone III Joint Venture), 995 F.2d 1274, 1279 (5th Cir. 1991) (holding that multiple classification "may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims"). *But see, e.g.*, Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (*In re* U.S. Truck Co.), 800 F.2d 581, 587 (6th Cir. 1986) (permitting manipulation when there exists a distinct "noncreditor interest").

[181] McKenzie, *supra* note 24, at 15.

Rather than mandating that each sovereign enact the same debt restructuring process, the IMF should mandate that sovereigns enact a limited number of debt restructuring provisions in their domestic laws. Sovereigns should otherwise be allowed to customize their debt restructuring statutes or processes using menu options that best suit their political needs. Adopting a flexible approach also gives the international community time to determine what types of provisions should be included in a debt restructuring treaty and time to create a more comprehensive solution to the sovereign debt crisis that can respond to future changes in capital market financing.