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# Restructuring Sovereign Debt: An English Law Opportunity

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## Key Points

- Unsustainable sovereign debt is a serious problem for nations, as well as their citizens and creditors, and a threat to global financial stability.
- The existing contractual approach to restructuring unsustainable debt is inadequate and no treaty or other multilateral legal framework exists, or is currently likely to be adopted, that would enable nations to restructure unsustainable debt.
- Because a significant percentage of sovereign debt is governed by English law, there is an opportunity to modify the law to fairly and equitably facilitate the restructuring of unsustainable sovereign debt. This policy brief proposes a novel legal framework, focusing on governing law, for doing that.
- This framework would legislatively achieve the equivalent of the ideal goal of including perfect collective action clauses (CACs) in all English-law-governed sovereign debt contracts. It therefore should ensure the continuing legitimacy and attractiveness of English law as the governing law for future sovereign debt contracts.
- Even absent the legislative proposal, the analysis in this policy brief can contribute to the incremental development of sovereign debt restructuring norms.

## Introduction

The threat of default can harm countries that find themselves indebted beyond their ability to pay — in recent years, these have included Greece, Argentina, Ukraine and now Venezuela — as well as their citizens and their creditors. An actual default can jeopardize the very stability of the financial system.[1]

The problem of unsustainable sovereign debt is especially serious because international law — unlike domestic bankruptcy law for companies and individuals — does not yet facilitate reasonable debt restructuring. Sovereign debt restructuring has therefore been limited to contractual negotiation, raising the holdout problem.[2] This is a type of collective action problem in which one or more creditors refuse to agree to a debt restructuring plan that proposes to change critical payment terms — such as principal amount, interest rate and maturities, which may require unanimity to change — in order to extract more than their fair share of a debt-restructuring settlement. The "drastic rise

1 See e.g. Jay L Westbrook, "Sovereign Debt and Exclusions from Insolvency Proceedings" in Christoph G Paulus, ed, *A Debt Restructuring Mechanism for Sovereigns: Do We Need a Legal Procedure?* (Oxford, UK: Hart Publishing, 2014) at 251.

2 Steven L Schwarcz, "Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach" (2000) 85 Cornell L Rev 956 at 960 [Schwarcz, "Sovereign Debt Restructuring"], online: <http://scholarship.law.duke.edu/faculty_scholarship/508/>.

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of sovereign debt litigation" by holdout creditors shows that this problem is only getting worse.[3]

Some sovereign debt contracts, including bond contracts governed by English law, contain provisions, called CACs, that attempt to mitigate the holdout problem by enabling a specified supermajority, such as two-thirds or three-quarters, of the contracting parties to change critical repayment terms.[4] Relying solely on such a contractual approach, however, has been insufficient.[5] Even in sovereign debt contracts that include CACs, holdouts may be able to purchase vote-blocking positions.[6] More critically, a CAC ordinarily binds only the parties to the particular contract that includes it; hence, the parties to any given sovereign debt contract can act as holdouts in a debt restructuring plan that requires parties to all such contracts to agree to the plan.[7]

To attempt to address this cross-contract holdout problem, the International Capital Market Association (ICMA) has proposed — and the International Monetary Fund (IMF) and the Group of Twenty have supported — CACs that also aggregate voting across debt issues.[8] But aggregate-voting CACs have some of the same limitations as other CACs, notably binding only creditors who are parties to agreements that include them.[9] More importantly, even if all new sovereign debt contracts were to include aggregate-voting CACs, it

3 Julian Schumacher, Christoph Trebesch, & Henrik Enderlein, "Sovereign Defaults in Court" (2014) i, online: <https://ssrn.com/abstract=2189997>.

4 Westbrook, *supra* note 1 at 255.

5 *Cf* Anna Gelpern, "A Skeptic's Case for Sovereign Bankruptcy" in Christoph G Paulus, ed, *A Debt Restructuring Mechanism for Sovereigns: Do We Need a Legal Procedure?* (Oxford, UK: Hart Publishing, 2014) (characterizing sole reliance on a contractual approach as "deeply dysfunctional and produc[ing] bad law" at 262).

6 See e.g. John A E Pottow, "Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign Debt Restructurings" (2013) Law & Economics Working Papers No 81, online <http://repository.law.umich.edu/law_econ_current/81> (vulture funds "may easily be able to marshal blocking positions, especially when a sovereign has issued multiple rounds of debt" at 5).

7 Schwarcz, "Sovereign Debt Restructuring", *supra* note 2 at 960.

8 See "Standard Aggregated Collective Action Clauses ('CACS') for the Terms and Conditions of Sovereign Notes" (2014) ICMA at 3.

9 *Cf* Joseph E Stiglitz et al, "Frameworks for Sovereign Debt Restructuring" (2014) IPD-CIGI-CGEG Policy Brief from a 17 November 2014 conference held at Columbia University (observing that ICMA's CAC aggregate-voting clauses "are improvements over the old terms, but are not sufficient to solve a variety of problems faced in sovereign debt restructurings" at 2).

will be many years before existing debt contracts, which do not include them, are paid off.[10]

CACs are therefore an inadequate substitute for pursuing a more systematic legal framework for sovereign debt restructuring. However, a multilateral framework, such as a convention or treaty, is not currently politically feasible. In 2014, for example, the United Nations General Assembly voted to begin work on a "multilateral legal framework" for sovereign debt restructuring.[11] But both the United States and the European Union opposed the resolution, to some extent paralleling opposition to an earlier IMF proposal for a Sovereign Debt Restructuring Mechanism (SDRM) convention. Although the United Nations Conference on Trade and Development has been tasked with moving the General Assembly's approach forward, there is skepticism as to whether any such framework is feasible without US and EU support.

This policy brief proposes an inventive, and potentially more effective, approach to achieving a legal framework for restructuring unsustainable sovereign debt, which is to focus on the governing law. Most sovereign debt claims are governed either by the debtor-state's law or by New York or English law.[12] This policy brief examines how English law could be modified to fairly and equitably facilitate the restructuring of unsustainable sovereign debt claims governed by English law, based on the text of a model law suggested in the Appendix.[13]

# A Model-law Approach

A model law is suggested legislation for individual governments to consider enacting as domestic law in their jurisdictions. In contrast, a treaty or convention — the terms are synonymous — is a multilateral agreement or compact among nations. The more relaxed nature of a model-law approach can be more appealing than a formal treaty.[14]

In the case of sovereign debt restructuring, for example, a model-law approach could bypass the current political impasse to achieve a treaty. A model-law approach could also be pursued in parallel as part of an overall strategy for developing a multilateral legal framework for sovereign debt restructuring, helping "to develop consensus around [debt restructuring] ideas that are commercially sound and legally effective."[15]

This policy brief proposes that the model law be enacted into English law. English law refers to the law governing England and Wales, which are semi-autonomous subnational regions within the United Kingdom. Statutory changes to English law are made by the UK Parliament, which would enact the model law in the same way that it legislates any other bill.[16]

10 See e.g. IMF, "Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring" (2014) [IMF, "Strengthening the Contractual Framework"], online: <www.imf.org/external/pp/longres.aspx?id=4911> (observing that approximately 29 percent of all sovereign bonds outstanding, and 21.2 percent of all such bonds governed by English law, "will mature after ten years" at 33–34).

11 See United Nations, "Proposal for Sovereign Debt Restructuring Framework among 6 Draft Texts Approved by Second Committee", UNGAC2, 69th Sess, 37th Mtg, UN Doc GA/EF/3417 (2014), online: <www.un.org/press/en/2014/gaef3417.doc.htm>.

12 See e.g. Philip R Wood, "Governing Law of Financial Contracts Generally" in *Conflict of Laws and International Finance* (London, UK: Sweet & Maxwell, 2007) at 12; Brad Setser, "The Political Economy of the SDRM" (2008) Initiative for Policy Dialogue Task Force on Sovereign Debt Brief, online: <www.cfr.org/content/publications/attachments/Setser_IPD_Debt_SDRM.pdf> (observing that "[a]lmost all international bonds are now governed by New York law, English law, and to a lesser extent Japanese law" at 16).

13 For claims governed by the debtor-state's law, that nation itself could enact law to facilitate its debt restructuring. See Schwarcz, "Sovereign Debt Restructuring", *supra* note 2 at 1034. For claims governed by New York law, I have elsewhere examined in depth how that state could enact law to facilitate sovereign debt restructuring. See Steven L Schwarcz, "Sovereign Debt Restructuring: A Model-Law Approach" (2016) 6:2 J Globalization & Dev 343 [Schwarcz, "A Model-Law Approach"].

14 See e.g. John A E Pottow, "Procedural Incrementalism: A Model for International Bankruptcy" (2005) 45 Va J Intl L 936 at 984–86 (discussing possible explanations for the recent success of model laws).

15 Oonagh Fitzgerald, "Next steps towards a multilateral debt workout process" (4 June 2015), *CIGI Global Rule of Law* (blog) at 3–4.

16 The process by which Parliament enacts a bill normally involves four stages. See e.g. online: <www.gov.uk/guidance/legislative-process-taking-a-bill-through-parliament>. The first stage is for a draft bill incorporating the provisions of the model law to be proposed for consultation by a government department and issued to interested parties or to select committees in the House of Commons or House of Lords. After approval by the applicable select committee, the second stage involves the bill being presented for debate before Parliament, as a proposal for a new law. In the third stage, the bill must be approved by a majority of both the House of Commons and the House of Lords. If the bill receives that approval, the fourth and final stage is to send the bill to the monarch for royal assent, which is normally regarded as a formality. After royal assent, the bill becomes an act of Parliament, creating binding law.

## Scope of the Model Law

The model law is designed to facilitate the restructuring of unsustainable sovereign debt claims that are governed by English law. The debtor-state itself would make the determination of debt sustainability, certifying that it "needs relief under this [Model] Law to restructure claims that, absent such relief, would constitute unsustainable debt of the State."[17] The debtor-state should be guided by the best practices and norms in making that determination.[18]

Article 2(2) of the model law broadly defines the types of debt claims that are covered. Notably, the model law's coverage is not limited to bond debt or other debt instruments traded as securities. The model law covers all payment claims against a debtor-state for monies borrowed or for the debtor-state's guarantee of (or other contingent obligation on) monies borrowed. Furthermore, the model law covers both long-term and short-term maturities. This recognizes that, increasingly, most sovereign debt "bailouts have come in response to the [rollover] of short-term claims."[19]

The model law contemplates that its "Supervisory Authority" be a "neutral international organization."[20] It is unclear what organization might currently qualify. Existing international organizations, such as the IMF, the World Bank and the United Nations Commission on International Trade Law, are thought to be too political or conflicted. To minimize controversy, the model law limits the role of the supervisory authority mainly to ministerial tasks such as fact-checking information, maintaining a list of creditors, verifying claims and overseeing the creditor voting process.[21] Any disputes under the model law would be resolved through arbitration.[22]

Article 7 of the model law addresses the holdout problem.[23] Article 7(2) legally mandates supermajority voting that, assuming the requisite percentages agree, can bind dissenting classes of claims. Article 7(3) of the model law, coupled with article 6(1), also enables a debtor-state to aggregate creditor voting beyond individual contracts. As discussed, aggregate voting is critical for at least two reasons: it can prevent creditors of individual sovereign debt contracts from acting as holdouts vis-à-vis other sovereign debt contracts; and it allows a debtor-state to designate large enough classes of claims to prevent vulture funds (or similar holdouts), as a practical matter, from purchasing enough claims to block a restructuring plan or otherwise control the voting.[24]

Chapter IV of the model law addresses the critical need for a financially troubled debtor-state to obtain liquidity during its restructuring process. Although this funding has often been provided in the past by the IMF, the "IMF's lending policy… is not enough to resolve the problems posed by debt burdens beyond the country's ability to pay."[25] Absent the IMF, whose loans have de facto priority, no one would lend new money without obtaining a priority repayment claim. Chapter IV of the model law establishes a procedure that could allow such a priority, thereby enabling a debtor-state to finance its debt restructuring through the capital markets. Nothing in the model law would prevent a debtor-state from also obtaining such financing through a governmental or multi-governmental source, such as the IMF.

Article 1(2) of the model law provides an option to make the law's provisions retroactive — applicable not only to future but also to existing sovereign debt claims. This offers a unique opportunity because a significant portion of those existing claims are governed by English

17 See Appendix, Sovereign Debt Restructuring Model Law, art 3(2)(b) [Model Law].

18 There does not yet appear to be a consensus, however, on what constitutes debt sustainability. See e.g. Martin Guzman & Daniel Heymann, "Debt Sustainability Analysis: The IMF Gets It Wrong" (2015), forthcoming in the *Journal of Globalization and Development*.

19 Setser, *supra* note 12 at 4.

20 Model Law, *supra* note 17, art 2(5).

21 *Cf* Barry Eichengreen, "Policy Proposals for Restructuring Unsustainable Sovereign Debt" in Inge Kaul & Pedro Conceição, eds, *The New Public Finance: Responding to Global Challenges* (New York, NY: Oxford University Press, 2006) at 444 (arguing that a sovereign debt resolution forum need only engage in ministerial actions).

22 See Model Law, *supra* note 17, art 10(2).

23 See *supra* notes 2–3 and the accompanying text.

24 See *supra* notes 6–8 and the accompanying text.

25 Stiglitz et al, *supra* note 9 at 2.

law.[26] Retroactive application would enable the model law to resolve unsustainable sovereign debt problems that arise under those claims, but some might criticize retroactive application of the model law as impairing sanctity of contract. This policy brief next analyzes the model law's legal, economic and political feasibility, including the feasibility of choosing optional retroactivity.[27]

## Legal Feasibility

Even if enacted with retroactive effect, the model law's principal operative provisions — supermajority aggregate voting and the granting of priority to financiers of a debtor-state's debt restructuring — should not be discriminatory or arbitrary.[28] Those provisions should therefore be enforceable under international law.[29]

The model law (including the optional retroactivity) would also be valid and enforceable under English law if and when enacted by Parliament. The sovereignty of Parliament doctrine recognizes Parliament as the supreme legal authority of the United Kingdom, with authority to create or repeal any law.[30] At least after Brexit, when any potentially conflicting EU law will no longer be relevant, even British courts could not overrule parliamentary legislation.[31]

The only potential post-Brexit complication might be the First Protocol to the European Convention on Human Rights, which has been incorporated into English law.[32] Article 1 of that protocol provides that every person is "entitled to the peaceful enjoyment of his possessions," raising a question about the model law's optional retroactivity. At least one decision interpreting the First Protocol confirms that a right to payment, such as a claim against a debtor-state, is a "possession" thereunder.[33] Nonetheless, the First Protocol, by its terms in article 1, can be trumped by laws that either deprive a person of possessions "in the public interest" or "control the use of property in accordance with the general interest." Retroactivity under the model law should arguably satisfy both tests (although it would only need to satisfy either) because unsustainable sovereign debt can harm debtor nations, their citizens and their creditors, and can also jeopardize the stability of the financial system. Moreover, after Brexit, the First Protocol could be modified or repealed by Parliament acting alone.[34]

Parliamentary sovereignty thus logically allows the enactment of retroactive laws. That raises the normative question of why Parliament should want to enact the model law. The answer is that such enactment — even including the optional retroactivity — would provide important social benefits and little harm, and thus should be morally imperative.

The social benefit would be the debt relief that the model law could provide to countries whose unsustainable debt claims are governed by English law. A significant portion of all sovereign debt claims are governed by that law.[35] Enactment of the model law, especially with retroactivity, would give those countries the reasonable opportunity, if needed, to

26 See e.g. Michael Tomz, "Empirical Research on Sovereign Debt and Default" (22 October 2012), online: <http://web.stanford.edu/~tomz/working/TomzWright2012-w18598.pdf> (finding that around one quarter of sovereign debt contracts are governed by English law with 28 percent by value and 22 percent by number); IMF, "Strengthening the Contractual Framework", *supra* note 10, (estimating that "international sovereign bonds governed by the laws of [England]…represent approximately…40 percent of the notional amount of the outstanding stock of international sovereign bonds" at 6).

27 The model law omits certain provisions that one might otherwise associate with a legal framework for sovereign debt restructuring, such as a stay of enforcement actions, a cram-down alternative in the event one or more classes of claims fails to agree to a debt-restructuring plan, and a formal creditors' committee. For a detailed analysis of why the model law omits these provisions, see Steven L Schwarcz, "Sovereign Debt Restructuring and English Governing Law" (forthcoming 2017) 12 Brook J Corp, Fin & Comm L [Schwarcz, "English Governing Law"].

28 See Schwarcz, "Sovereign Debt Restructuring", *supra* note 2 (analyzing those same types of retroactive provisions under international law and concluding that none of the provisions on "super-majority voting, discharge, and the granting of priority to financiers of the State's debt restructuring… discriminates based on the nationality of the bondholders…[or] is arbitrary because all are essential to a debtor-State's ability to restructure its debt" at 1012–14).

29 Legal retroactivity is respected under international law so long as it is neither discriminatory nor arbitrary. *Ibid* at 1012–13 (citing sources including Robert Jennings & Arthur Watts, eds, *Oppenheim's International Law: Volume 1; Peace*, 9th ed [Oxford, UK: Oxford University Press, 1992] at 918–21).

30 See UK Parliament, online: <www.parliament.uk/about/how/role/sovereignty/>.

31 See e.g. Ivor Jennings, *The Law and the Constitution*, 5th ed (London, UK: University of London Press, 1959) ("Parliament can enact legislation dealing with any subject and the legislation of the Parliament is superior to the jurisdiction of the courts" at 170).

32 See *Human Rights Act 1998* (UK), c 42.

33 See *Agneessens v Belgium* (1988), 58 Eur Comm'n HR DR 63; (1980) 19 Eur Comm'n HR DR 172.

34 See UK Parliament, *supra* note 30 and the accompanying text (observing that Parliament has authority to repeal any law).

35 See *supra* note 26 and the accompanying text.

try to renegotiate those claims to sustainable levels. There is strong recent precedent for Parliament enacting law to facilitate sovereign debt relief.[36]

Enactment of the model law would impose little harm. Even if the law applies retroactively, the only parties whose expectations would be impaired would be holdout creditors. Any such impairment, however, would be limited to changes that are voluntarily agreed to by a supermajority of *pari passu* creditors[37] based on the debtor-state's deteriorating economic circumstances, and thus should reflect the economic reality — and therefore the reasonable expectations — of what those creditors expect to receive as payment under the changed circumstances. Although the changes might impair a holdout creditor's ability to blackmail a country's debt restructuring, in order to extract value from the other creditors, such holdout behavior would be morally repugnant and should not be protected.

## Economic Feasibility

The economic feasibility of the model law will turn on its costs and benefits, both to debtor-states and to their creditors. Debtor-states that use the model law to restructure their unsustainable debt would certainly benefit, but would the model law increase other nations' borrowing costs by making creditor claims more subject to bail-in?

Leading economists have argued that, to the contrary, uncertainty due to the absence of an effective sovereign debt resolution framework actually "increases the costs of borrowing."[38] However, even if such a framework might increase costs, overall sovereign borrowing rates should not be affected any more than if — as most agree would be desirable — workable aggregate-voting CACs were in fact included in all sovereign debt contracts. Empirical analysis suggests that the inclusion of those clauses should not increase (and may even reduce) sovereign borrowing rates.[39] That analysis has since been reinforced by the actual market pricing of sovereign bonds that include those clauses.[40]

The model law should also benefit creditors by reducing uncertainty.[41] A potential cost, however, is that the model law might appear to facilitate the transfer of value from creditors to a debtor-state if a class of claims agrees to a restructuring that reduces its principal amount or interest rate. That reduction nonetheless would be bargained for; each class of claims has the power to veto the debtor-state's restructuring plan.[42] Moreover, because any such reduction would reflect the economic reality of what those creditors expect to be paid in light of the debtor-state's deteriorating economic circumstances,[43] that deterioration, and not the model law, causes the transfer of value.

## Political Feasibility

This policy brief has already advanced several reasons why a model-law approach to sovereign debt restructuring should be politically more feasible than a treaty.[44] Experience shows that a model law's more relaxed nature, being domestic law, and (for that reason) less formal enactment process and minimal interference with sovereignty can succeed where a formal treaty approach can languish.

It is also informative to assess the political feasibility of a model-law approach from the perspective of the politics of the IMF's failed SDRM.[45] That approach failed because it was opposed by major financial industry associations and also by certain emerging market countries that feared it would raise their cost of borrowing.

36 *Debt Relief (Developing Countries) Act 2010* (UK), c 22.

37 See Model Law, *supra* note 17, art 7(3).

38 Stiglitz et al, *supra* note 9 at 1.

39 See Michael Bradley & Mitu Gulati, "Collective Action Clauses for the Eurozone" (2013) 18 Rev Fin 2045 (finding that the presence of CACs is associated with a lower cost of capital, possibly due to an expectation of faster debt restructuring).

40 See e.g. IMF, "Second Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts" (Washington, DC: IMF, 27 December 2016) at 6.

41 See Stiglitz et al, *supra* note 9 and the text accompanying note 38.

42 See Model Law, *supra* note 17, art 7(1) (providing that a restructuring plan needs the agreement of each class of claims to become effective and binding).

43 See *ibid*, art 7(3) and the text accompanying note 37.

44 Most significantly, a model-law approach would not require general acceptance by the world's nations for its implementation and thus would not face the "profound difficulties [of] building international consensus behind any sweeping change in global financial regulation." Setser, *supra* note 12 at 3.

45 See *supra* notes 11–12 and the accompanying text.

As discussed, a model-law approach should not increase, and may actually reduce, that cost.[46]

A model-law approach should also surmount most other reasons suggested to explain the SDRM's failure. When the SDRM was proposed, many believed that "[e]xchange offers, combined with the ability to amend a bond's terms[,] provide a mechanism for [sovereign] debt restructuring even in the absence of a [statutory debt restructuring] regime."[47] Experience, however, has undermined that belief.[48] Also, at that time, "the major emerging economies — and particularly the Latin American economies — feared losing access to large scale emergency credit from the IMF in return for legal protection of only marginal value."[49] But debtor-states can no longer count on the IMF for that credit,[50] whereas a model-law approach can also give a debtor-state the ability to finance its debt restructuring through the capital markets.[51]

Finally, some may have opposed the SDRM because of "[s]uspicions about the role the IMF would play in a restructuring process designed by the IMF."[52] This appears to explain, for example, the financial industry's opposition.[53] The model-law approach is not designed by the IMF, nor is the IMF necessarily part of its supervisory process.[54]

A model-law approach could also provide clear positive political benefits. By helping to privatize interim funding to a debtor-state,[55] it could reduce the burden on IMF-member countries of funding bailout loans.[56] Reducing the need for IMF funding would also reduce the conditionality that the IMF, politically, imposes on borrowing nations, which can sometimes exacerbate the nation's economic woes.[57] Furthermore, a model-law approach could provide a political cover for painful austerity decisions, which could be attributed by a state to a supervising entity or to legal requirements.[58]

# Conclusion

Enacting the model law into English law should be legally and economically feasible, if not also politically feasible. Because it would achieve the equivalent, by operation of law, of the ideal goal of including aggregate-voting CACs in all English-law-governed sovereign debt contracts, it should also ensure the continuing legitimacy and attractiveness of English law as the governing law for future contracts.

Even if the model law is not enacted into English law, however, this policy brief's explanation of a model-law approach and its consequences should help to develop sovereign debt restructuring norms. The incremental development of norms has strong precedent in the legal ordering of international relationships, especially "where law reformers possess limited authority and where the subject is either controversial or technical"[59] — such as the problem of restructuring unsustainable sovereign debt.

## Author's Note

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46 See *supra* notes 38–40 and the accompanying text.

47 Setser, *supra* note 12 at 5.

48 Schwarcz, "A Model-Law Approach", *supra* note 13 at 31.

49 Setser, *supra* note 12 at 5.

50 See Stiglitz et al, *supra* note 9 and the text accompanying note 25.

51 *Ibid*.

52 Setser, *supra* note 12 at 17.

53 See e.g. Sean Hagan, "Designing a Legal Framework to Restructure Sovereign Debt" (2005) 36 Geo J Intl L 299 at 391–93; Setser, *supra* note 12 at 6, 16.

54 The Model Law specifies that the supervisory authority must be a "neutral international organization." Model Law, *supra* note 17, art 2(5).

55 See Stiglitz et al, *supra* note 9 and the text accompanying note 25; see also Model Law, *supra* note 17, arts 8, 9.

56 Cf Setser, *supra* note 12 at 3 (discussing that many IMF-creditor countries favoured the SDRM for this same reason).

57 Arjun Jayadev & Mike Konczal, "The Boom Not the Slump: The Right Time for Austerity" (New York, NY: Roosevelt Institute, 2010).

58 Westbrook, *supra* note 1 at 256.

59 Cf Susan Block-Lieb & Terence Halliday, "Incrementalisms in Global Lawmaking" (2007) 32 Brook J Intl L 851 at 852 (discussing global insolvency reform).

# Appendix

[suggested text for a]

## Sovereign Debt Restructuring Model Law[60]

### Preamble

The Purpose of this Law is to provide effective mechanisms for restructuring unsustainable sovereign debt so as to reduce (a) the social costs of sovereign debt crises, (b) systemic risk to the financial system, (c) creditor uncertainty, and (d) the need for sovereign debt bailouts, which are costly and create moral hazard.

### Chapter I: Scope, and Use of Terms

*Article 1: Scope*

(1) This Law applies where, by contract or otherwise, (a) the law of [this jurisdiction] governs the debtor-creditor relationship between a State and its creditors and (b) the application of this Law is invoked in accordance with Chapter II.

(2) Where this Law applies, it shall [operate retroactively and, without limiting the foregoing, shall] override any contractual provisions that are inconsistent with the provisions of this Law.

*Article 2: Use of Terms*

For purposes of this Law:

(1) "creditor" means a person or entity that has a claim against a State;

(2) "claim" means a payment claim against a State for monies borrowed or for the State's guarantee of, or other contingent obligation on, monies borrowed; and the term "monies borrowed" shall include the following, whether or not it represents the borrowing of money per se: monies owing under bonds, debentures, notes, or similar instruments; monies owing for the deferred purchase price of property or services, other than trade accounts payable arising in the ordinary course of business; monies owing on capitalized lease obligations; monies owing on or with respect to letters of credit, bankers' acceptances, or other extensions of credit; and monies owing on money-market instruments or instruments used to finance trade;

(3) "Plan" means a debt restructuring plan contemplated by Chapter III;

(4) "State" means a sovereign nation;

(5) "Supervisory Authority" means [name of neutral international organization].

### Chapter II: Invoking the Law's Application

*Article 3: Petition for Relief, and Recognition*

(1) A State may invoke application of this Law by filing a voluntary petition for relief with the Supervisory Authority.

(2) Such petition shall certify that the State (a) seeks relief under this Law, and has not previously sought relief under this Law (or under any other law that is substantially in the form of this Law) during the past [ten] years, (b) needs relief under this Law to restructure claims that, absent such relief, would constitute unsustainable debt of the State, (c) agrees to restructure those claims in accordance with this Law, (d) agrees to all other terms, conditions, and provisions of this Law, and (e) has duly enacted any national law needed to effectuate these agreements. If requested by the Supervisory Authority, such petition shall also attach documents and legal opinions evidencing compliance with clause (e).

(3) Immediately after such a petition for relief has been filed, and so long as such filing has not been dismissed by the Supervisory Authority [or this jurisdiction] for lack of good faith, the terms, conditions, and provisions of this Law shall (a) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of [this jurisdiction]; (b) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of another jurisdiction that has enacted law substantially in the form of this Law; and (c) be recognized in, and by, all other jurisdictions that have enacted law substantially in the form of this Law.

60 The interpretation of this model law is more fully informed by Schwarcz, "English Governing Law", *supra* note 27.

*Article 4: Notification of Creditors*

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

(2) The Supervisory Authority shall prepare and maintain a current list of creditors of the State and verify claims for purposes of supervising voting under this Law.

## Chapter III: Voting on a Debt Restructuring Plan

*Article 5: Submission of Plan*

(1) The State may submit a Plan to its creditors at any time, and may submit alternative Plans from time to time.

(2) No other person or entity may submit a Plan.

*Article 6: Contents of Plan*

A Plan shall

(1) designate classes of claims in accordance with Article 7(3);

(2) specify the proposed treatment of each class of claims;

(3) provide the same treatment for each claim of a particular class, unless the holder of a claim agrees to a less favourable treatment;

(4) disclose any claims not included in the Plan's classes of claims;

(5) provide adequate means for the plan's implementation including, with respect to any claims, curing or waiving any defaults or changing the maturity dates, principal amount, interest rate, or other terms or cancelling or modifying any liens or encumbrances; and

(6) certify that, if the Plan becomes effective and binding on the State and its creditors under Article 7(1), the State's debt will become sustainable.

*Article 7: Voting on the Plan*

(1) A Plan shall become effective and binding on the State and its creditors when it has been submitted by the State and agreed to by each class of such creditors' claims designated in the Plan under Article 6(1). Thereupon, the State shall be discharged from all claims included in those classes of claims, except as provided in the Plan.

(2) A class of claims has agreed to a Plan if creditors holding at least [two-thirds] in principal amount and more than [one-half] in number of the claims of such class [voting on such Plan] [entitled to vote on such Plan] agree to the Plan.

(3) Each class of claims shall consist of claims against the State that are *pari passu* in priority, provided that (a) *pari passu* claims need not all be included in the same class, (b) claims of governmental or multi-governmental entities each shall be classed separately, and (c) claims that are governed by this Law or by the law of another jurisdiction that is substantially in the form of this Law shall not be classed with other claims.

## Chapter IV: Financing the Restructuring

*Article 8: Terms of Lending*

(1) Subject to the provisions of this Article 8, the State shall have the right to borrow money on such terms and conditions as it deems appropriate.

(2) The State shall notify all of its known creditors of its intention to borrow under Article 8(1), the terms and conditions of the borrowing, and the proposed use of the loan proceeds. Such notice shall also direct those creditors to respond to the Supervisory Authority within 30 days, stating (a) whether they approve or disapprove of such loan, (b) the principal amount of their claims against the State, and (c) the principal amount of those claims that are governed by this Law or by the law of another jurisdiction that is substantially in the form of this Law.

(3) Any such loan must be approved by creditors holding at least two-thirds in principal amount of the claims of creditors responding to the Supervisory Authority within that 30-day period.

(4) In order for the priority of repayment (and corresponding subordination) under Article 9 to be effective, any such loan must additionally be approved by creditors holding at least two-thirds in principal amount of the "covered" claims of creditors responding to the Supervisory Authority within that 30-day period. Claims shall be deemed to be "covered" if they are governed by this Law or by the law of another jurisdiction that is substantially in the form of this Law.

*Article 9: Priority of Repayment*

(1) The State shall repay loans approved under Article 8 prior to paying any other claims.

(2) The claims of creditors of the State are subordinated to the extent needed to effectuate the priority payment under this Article 9. Such claims are not subordinated for any other purpose.

(3) The priority of repayment (and corresponding subordination) under this Article 9 is expressly subject to the approval by creditors under Article 8(4).

## Chapter V: Adjudication of Disputes

*Article 10: Arbitration*

(1) All disputes arising under this Law shall be resolved by binding arbitration before a panel of three arbitrators.

(2) The arbitration shall be governed by [generally accepted international arbitration rules of (name of neutral international arbitration body)] [the rules of the International Centre for Settlement of Investment Disputes (ICSID)/ International Centre for Dispute Resolution/ ICC International Court of Arbitration].

(3) Notwithstanding Article 10(2), if all the parties to an arbitration contractually agree that such arbitration shall be governed by other rules, it shall be so governed. Such agreement may be made before or after the dispute arises.

(4) The State shall pay all costs, fees, and expenses of the arbitrations.

## Chapter VI: Opt In

*Article 11: Opting in to this Law*

(1) Any creditors of the State whose claims are not otherwise governed by this Law may contractually opt in to this Law's terms, conditions, and provisions.

(2) The terms, conditions, and provisions of this Law shall apply to the debtor-creditor relationship between the State and creditors opting in under Article 11(1) as if such relationship were governed by the law of [this jurisdiction] under Article 3(3).

## About the International Law Research Program

The International Law Research Program (ILRP) at CIGI is an integrated multidisciplinary research program that provides leading academics, government and private sector legal experts, as well as students from Canada and abroad, with the opportunity to contribute to advancements in international law.

The ILRP strives to be the world's leading international law research program, with recognized impact on how international law is brought to bear on significant global issues. The program's mission is to connect knowledge, policy and practice to build the international law framework — the globalized rule of law — to support international governance of the future. Its founding belief is that better international governance, including a strengthened international law framework, can improve the lives of people everywhere, increase prosperity, ensure global sustainability, address inequality, safeguard human rights and promote a more secure world.

The ILRP focuses on the areas of international law that are most important to global innovation, prosperity and sustainability: international economic law, international intellectual property law and international environmental law. In its research, the ILRP is attentive to the emerging interactions between international and transnational law, Indigenous law and constitutional law.

## About CIGI

We are the Centre for International Governance Innovation: an independent, non-partisan think tank with an objective and uniquely global perspective. Our research, opinions and public voice make a difference in today's world by bringing clarity and innovative thinking to global policy making. By working across disciplines and in partnership with the best peers and experts, we are the benchmark for influential research and trusted analysis.

Our research programs focus on governance of the global economy, global security and politics, and international law in collaboration with a range of strategic partners and support from the Government of Canada, the Government of Ontario, as well as founder Jim Balsillie.

## À propos du CIGI

Au Centre pour l'innovation dans la gouvernance internationale (CIGI), nous formons un groupe de réflexion indépendant et non partisan qui formule des points de vue objectifs dont la portée est notamment mondiale. Nos recherches, nos avis et l'opinion publique ont des effets réels sur le monde d'aujourd'hui en apportant autant de la clarté qu'une réflexion novatrice dans l'élaboration des politiques à l'échelle internationale. En raison des travaux accomplis en collaboration et en partenariat avec des pairs et des spécialistes interdisciplinaires des plus compétents, nous sommes devenus une référence grâce à l'influence de nos recherches et à la fiabilité de nos analyses.

Nos programmes de recherche ont trait à la gouvernance dans les domaines suivants : l'économie mondiale, la sécurité et les politiques mondiales, et le droit international, et nous les exécutons avec la collaboration de nombreux partenaires stratégiques et le soutien des gouvernements du Canada et de l'Ontario ainsi que du fondateur du CIGI, Jim Balsillie.

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