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COMMENTARY

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THE PURSUIT OF GLOBAL RULE OF LAW FOR SOVEREIGN DEBT RESTRUCTURING

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On September 9, 2014, the United Nations General Assembly (UNGA) passed resolution 68/304, tabled by the Group of 77 (G77) and China, entitled, "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes." The breakdown of the vote was 124 countries in favour, 11 against and 41 abstentions, with a striking division between developing countries supporting the resolution and developed countries abstaining from the vote or opposing it. By UNGA resolution on December 29, 2014, the Ad Hoc Committee on Sovereign Debt Restructuring Processes was established, with the task of holding three meetings and reporting proposals back to the UNGA in its 69th session. Being the focal point on debt issues within the UN system, the UN Commission on Trade and Development (UNCTAD) is tasked with providing technical support to the work of the ad hoc committee. The committee held its first working session in New York City from February 3 to 5, 2015.

As initial sponsors of UNGA resolution 68/304, China and the G77 were well represented at the committee's first working session. However, the array of delegates' seats that sat empty at the meeting illustrated the deeply divided and politicized nature of the initiative. On the streets of Greece and Spain, citizens were rallying in support of political parties that were promising to renegotiate the sovereign debt burden weighing down their national economies. In the committee room at UN headquarters, however, there was no sign of the International Monetary Fund (IMF), the World Bank, the European Union or its member states, the United States, Canada or the other states that tend to support the existing rule of law for sovereign debt resolution. Civil society groups from Europe, Germany and the United States were present, expressing the urgency of this project to create a multilateral framework for sovereign debt restructuring and their desire to see their governments more engaged.

The International Insolvency Institute (III), which lends its global legal expertise to improve legal frameworks for resolution of cross-border insolvency issues and sovereign debt restructuring, participated as an observer, represented by several US and Canadian practitioners and academics, including two members of the CIGI ILRP working group on sovereign debt and cross-border insolvency resolution, Mark Jewett Q.C. (Bennett Jones), and the author.

It is hard to exaggerate the importance of the issues at stake and the depth of divisions in the perspectives and world views. To illustrate, consider the differences among stakeholders on the meaning of two recurring global governance themes: rule of law and democracy.

To those representing the interests of holdout bondholders, rule of law means that in financial transactions created through private contract, the contract should rule and be enforceable in domestic courts, regardless of compromises reached between the debtor state and the majority of its other creditors that would be binding if such a compromise occurred in the context of a purely domestic insolvency proceeding. The contract rules: if a debtor state has chosen to sell bonds in the global bond market, it has to live with the consequences of being held to the original contractual terms. If the debtor state chooses to issue bonds in a jurisdiction with a robust legal system (domestic rule of law), it benefits from that stability and enforceability by having lower interest charges on the loan. As quid pro quo, the debtor state submits to waivers of sovereign immunity such that the contract can be enforced by the domestic courts and executed against the debtor state's assets wherever they can be found and the judgment is recognized. Certainty and stability are achieved by allowing contracting parties to choose the jurisdiction to govern their contracts and by allowing contracts to be enforced in the domestic courts where the bond was issued, regardless of the degree of distress imposed on the sovereign debtor and its people, and regardless of whether the bond

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was resold and bought at a deep discount by a "vulture fund" for the sole purpose of litigating for the face value of the bond.

Since the contracting state is behaving as a private party in a commercial transaction, the view is that coordination of the behaviour of public and private creditors and negotiation of a resolution of the debt crisis should rely on contractual approaches such as inclusion of special collective action clauses in contracts to override the claims of holdouts if a sufficient majority of all the creditors can be achieved. Thus, rule of law is contract law, a private matter between parties, not to be constrained by domestic or international rule-making. The IMF and the World Bank, and the informal grouping of official creditors known as the Paris Club, have largely acquiesced to this approach to managing sovereign debt restructuring. A major consideration behind this approach is that if the path to discharging sovereign debt is made too clear and easy, it will create moral hazard, encouraging irresponsible behaviour by debtor states and undermining financial markets.

The opposing view considers that relying purely on contractual rule of law is both flawed and unjust when applied to a sovereign debtor that has become insolvent. On this view, the lack of a clear, available and certain method of resolving sovereign debt problems increases the risk and stigma, and results in debtor states waiting until (or past) the last minute to disclose their problems. Any relief, therefore, tends to amount to "too little, too late." Contractual approaches are considered to be flawed in that contracts only bind the parties and, in the absence of a neutral body that can definitively adjudicate the total resolution of sovereign debt, there is always the risk of holdout bondholders not agreeing to any negotiated compromise and, instead, bringing legal proceedings to enforce full payment of the debt. Contractual approaches are considered inadequate because they are unable to deal with the inherent complexity of the problem and its human development dimensions. Unlike the legal rules for individuals or corporations that permit relief (discharge of an individual, dissolution or restructuring of a corporation) subject to conditions, there is no definitive process to relieve the sovereign debtor. This means that the effects of bad governance and governmental profligacy unfairly weigh down the blameless future generations of citizens of the debtor state. On this view, the burden of sovereign debt is characterized as a kind of collective punishment on the citizens.

Tied in with this debate are opposing views about the relevance and applicability of democratic concepts and about the legitimacy of processes. Those seeking a more certain and merciful approach to debt restructuring through this UNGA resolution and its ensuing ad hoc committee process, argue that the current fora for debt restructuring are insufficiently representative, tend to give too much weight to developed countries and their financial sectors, and fail to address the legitimacy concerns associated with allowing the developed Western countries to dictate solutions for the rest of the world. They emphasize that the UNGA is the most democratic organ of current global governance and is well placed to develop a multilateral sovereign debt restructuring framework that works for both rich and poor states.

The counter argument might well be that large numbers of states with very little stake in the issue are using their voting weight to gang up on the few rich creditor nations and their business interests with most at stake in this problem. For those who believe sovereign debt restructuring should be exceptional and discretionary, through the somewhat opaque yet often effective processes of the Paris Club, IMF and World Bank, democracy mainly comes into play for establishing the authority of the leading developed countries to exert pressure to manage debt crises and for laying the blame for the sovereign debt crisis at the feet of the spendthrift electorate and the profligate governments the citizens had brought to power.

Members of the ILRP wondered about the value of attending the ad hoc committee process, but were encouraged by observing the commitment of its proponents, the array of well-qualified experts who presented at the meeting, and a few moderate voices urging engagement with the IMF, World Bank and absent developed countries, and the strong showing from the III. Although the UNGA Ad Hoc Committee process is unlikely to achieve a multilateral consensus in the short term, given the polarization of views, it seems worthwhile to follow this process to see what it can add to the debate about the appropriate way for the global community to manage the issue of sovereign debt, from a perspective that has not to date been well represented.

It is evident that there is an important global rule of law issue at stake: how best to address this profoundly difficult problem of sovereign debt restructuring in the context of globalized and integrated financial markets. From events so far in this UNGA process it is also apparent that there is a serious global governance gap: how to integrate the concerns of creditor and debtor, rich and poor, developed and developing states into a more predictable, transparent and fair system for sovereign debt restructuring. Members of the ILRP will continue to observe with great interest, and contribute where they can to the global legal policy debate about how to improve the legal frameworks for sovereign debt restructuring and cross-border insolvency resolution, a debate that is taking place both through the UNGA Ad Hoc Committee and at the Financial Stability Board established under the Group of Twenty. (See www.cigionline.org/publications/comments-september-29-2014-fsb-consultative-document-cross-border-recognition-of-resolu.)

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