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NOTE, MULTILATERALISM VS. UNILATERALISM IN THE SOVEREIGN DEBT RESTRUCTURING CONTEXT: WILL EITHER APPROACH PREVENT DEFAULT?

Kristin McFetridge*

I. INTRODUCTION

The invasion of Iraq by the United States in the spring of 2003, absent a mandate by the United Nations, launched new discourse over the age-old issue of the efficacy of the multilateral approach to resolving international issues. Effectively spurning the mechanisms in place to address international crises, the United States opted instead to act unilaterally and proceeded to invade Iraq, supported openly by only the United Kingdom and Spain. This is but one example, albeit the most salient in today’s political climate, of the United States rejecting a unified multilateral resolution. In the context of sovereign debt, the United States has acted in concert, withdrawing any support for an international bankruptcy type scheme in early 2003. Instead, the United States has urged the use of Collective Action Clauses (CACs) by the financial community as a preferable alternative, espousing the concept of the freedom of contract. Yet, the question remains whether this is indeed the optimal solution for creditors and debtors alike and whether the use of these clauses will prevent further crises or eradicate current issues in restructuring. Therefore, despite the United States’ essential declaration that a multilateral approach is null, it is still necessary in a thorough analysis of potential resolutions to examine the now defunct proposal of the Sovereign Debt Restructuring Mechanism (SDRM) by the International Monetary Fund (IMF) and its strengths and weaknesses as compared to the current prevailing recommendation of using CACs.

This paper sets out to describe the three most prevalent, and conflicting, recommendations for managing the past, current, and potential sovereign restructuring issues and to analyze the viability of each: (1) the SDRM proffered by the IMF; (2) the incorporation of CACs; and (3) the complementary use of exit consents in individual debt offerings. The

* J.D., M.B.A., Southern Methodist University, 2004. This article was completed in the Spring of 2004 and does not reflect economic, social, and political events that have transpired since. Predictions and indicators, while accurate at the time, do not reflect the current climate in the countries discussed or the sovereign debt arena generally.
multilateral versus unilateral framework encompasses this analysis. More specifically, the focus is whether an internationally unified and standard method is superior or inferior to an efficient market driven theory, whereby individuals are free to contract and will, therefore, include covenants and clauses recognizing the potential for default and adjust pricing and terms accordingly.

Before one can theorize on the ideal solution to a problem, a full understanding of the scope of the problem is necessary. To that end, part II of this paper begins with the relevant background information concerning the events of the last thirty years giving rise to the need for a restructuring solution, including a discussion of the relevant players in the international financial community. Parts III and IV, respectively, examine in depth the SDRM proposal and the use of CACs, including the status of both the benefits and criticisms of each. Finally, the conclusion compares the two approaches and exposes the shortcomings of each, suggesting that a combination of both is really the optimal solution.

II. BACKGROUND

A. FINANCIAL MARKETS IN THE TWENTIETH CENTURY

1. Example: The Latin American Debt Crisis

The unique problem of sovereign debt did not occur in a vacuum. Certain events led to changes in the international financial arena that precipitated the crises of the past thirty years, beginning with the Mexican peso crisis in the 1980s. In order to fully comprehend the suggested solutions, it is helpful to place them in the context of the entire situation. This section begins with an examination of the changes in the capital markets and their implications in sovereign indebtedness.

In the late 1970s, commercial banks in the United States were in search of borrowers, as economic conditions in the United States had curtailed the need for capital. Additionally, strong export prices in Latin American countries and the high inflation rate in the United States indicated minimal risk for borrowing nations despite high interest rates. These factors led many U.S. banks to invest heavily in Mexico and other Latin American countries with perhaps less scrutiny in terms of risk analysis than would have been pragmatic. This heyday came to a crashing halt in 1979. The oil crisis forced debtor nations to increase their borrowing to compensate for higher fuel prices and the U.S. Federal Reserve Board raised interest rates. This led to a significant exchange rate disparity and trade imbalance between Mexico and the United States (its largest trading partner), with Mexico carrying debt equal to 53 percent of its Gross

2. Id. at 2707.
3. Id.
4. Id. at 2708.
Domestic Product (GDP) in 1982.\textsuperscript{5} The debt burden became unsustainable for Mexico and in the same year the country announced its inability to meet its loan payments.\textsuperscript{6} Other Latin American nations suffered under similar conditions, and shortly after Mexico’s announcement, Argentina, Bolivia, Brazil, and Venezuela followed suit.\textsuperscript{7}

Through creative refinancing measures, U.S. banks took action to stem the onslaught of default and the crisis was averted temporarily.\textsuperscript{8} These measures consisted primarily of extending “bridge loans” that permitted the debtor nations to borrow more money to service the interest payments on their outstanding loans.\textsuperscript{9} Bridge loans were attractive to the banks and the debtor-nations because it allowed them to represent the outstanding loans as performing loans on their balance sheets.\textsuperscript{10} Additionally, the creditor committees representing the banks in negotiating restructuring terms used strong pressure to induce all of the lenders in the class to accept the revised terms.\textsuperscript{11} The IMF also exerted pressure on the commercial banks, conditioning the dispersal of funds to assist debtor nations on the cooperation of the banks.\textsuperscript{12}

Even with this assistance, the Latin American nations found themselves unable to stabilize and instead struggled with their growing debt burdens.\textsuperscript{13} The next ten years in Latin America were referred to as the “Lost Decade” due to stunted economic growth and excessive inflation.\textsuperscript{14} After several failed proposals, a resolution was suggested by then U.S. Secretary of the Treasury Nicholas Brady.\textsuperscript{15} Brady suggested uniting the banks that had lent to each particular country by pooling the outstanding loans and repackaging them as bonds that could then be sold on the secondary market to individual investors.\textsuperscript{16} This resolution appealed to the banks, allowing them to remove the liabilities of the loans from their balance sheets, and to the debtor-nations because the new bonds included a reduction in either the principal or the interest rates and were backed by U.S. Treasury zero coupon bonds.\textsuperscript{17} Once this securitization into the Brady Bonds occurred, the relationship between the debtor nations and the banks was effectively terminated, with all future debt payments made


\textsuperscript{6} Power, \textit{supra} note 1, at 2708.

\textsuperscript{7} \textit{Id.} at 2710.

\textsuperscript{8} \textit{Id.}

\textsuperscript{9} \textit{Id.}

\textsuperscript{10} \textit{Id.} At the time, loans were only shown as non-performing if the borrower was in default on the interest payment, not the principal. Non-performing loans adversely affect the balance sheet of lending banks.

\textsuperscript{11} \textit{Id.} at 2711-12.

\textsuperscript{12} Power, \textit{supra} note 1, at 2712.

\textsuperscript{13} \textit{Id.} at 2714.

\textsuperscript{14} Bergoeing et al., \textit{supra} note 5, at 1.

\textsuperscript{15} Power, \textit{supra} note 1, at 2720.

\textsuperscript{16} \textit{Id.} at 2721.

\textsuperscript{17} \textit{Id.}
to a trustee who forwarded the coupon payments to the bondholders.\textsuperscript{18} Thus began a new trend in raising capital for indebted nations.

By 1994, the amount of eligible debt converted into Brady Bonds was in excess of $190 billion, with $61 billion total forgiven.\textsuperscript{19} All of the Brady Bonds were issued with a choice of law clause selecting New York law,\textsuperscript{20} and two implications: first, the agreements were subject to the Foreign Sovereign Immunities Act,\textsuperscript{21} and second, amendments to the payment terms (including amount and schedule) often required a unanimous vote by all bondholders.\textsuperscript{22} The Foreign Sovereign Immunities Act holds that generally, sovereigns are immune from suit in a U.S. court.\textsuperscript{23} However, exceptions to this general rule include waiver or engagement by the foreign sovereign in a commercial activity.\textsuperscript{24} Both of these exceptions were applicable in this case and bondholders did (and do) have legal recourse within the United States in the event of a default by a debtor nation.\textsuperscript{25} The options for these debtor-nations to restructure were severely constrained, as bonds issued under New York law tended to require unanimity to effect changes to the payment terms of the bond agreements.\textsuperscript{26}

\begin{itemize}
\item B. \textbf{THE USE OF BONDS IN RAISING EQUITY}
\end{itemize}

Following the use of Brady Bonds in the Latin American crisis of the 1980s, more and more debtor-nations turned to bond issuances as an alternative to higher interest bank loans. The conversion of Brady Bonds also became a popular option with Mexico initiating a $2.5 billion dollar swap in 1996.\textsuperscript{27} In this new issuance, the bonds were absent one noticeable item—collateral.\textsuperscript{28} These new dollar-denominated bonds were issued at a thirty-year maturity, and the proceeds were used to pay off short-
term debt that was coming due. Argentina quickly leapt on the bandwagon by issuing three and fifteen-year Deutschemark-denominated bonds. In September 2002, Mexico issued a twenty-year, $1.75 billion bond and used the proceeds to buy back $1.3 billion worth of Brady Bonds.

One commonality between the Brady Bonds and other non-collateralized bonds is that, unlike bank syndicated loans, which are contractually held by large easily identifiable financial institutions, these bonds are highly mobile, issued in a number of different jurisdictions, and sold to a plethora of different investors. These characteristics present a unique problem for debtors wishing to revise the terms of the bond agreements—locating the bondholders to achieve their consent is difficult and depending on the structure and jurisdiction of the bond agreements, agreement by the majority or unanimity may be required. Additionally, unlike in large syndicated loans, creditors in bond packages do not know the identity of each other and have no relationship or incentive to collaborate in the event of a restructuring.

As one scholar described it, "bond investors are like patrons in a theater audience: each one has decided to see a particular play on a particular night, but none has any idea who she will be seeing it with. If you wish to carry the analogy further, the tradable nature of bonds means that fellow patrons are constantly leaving and entering the theater throughout the performance."

This is a good illustration of the anonymous nature of the relationship between bondholders. In the situation of a performing debtor, the relationship is irrelevant. In the case of a need to restructure, a myriad of problems can erupt, primarily that of the "hold-out creditor" who refuses to restructure, jockeying instead for a preferential settlement.

29. Id.
30. Id. at 76.
31. Id. at 75.
35. Id.
C. Life After Brady Bonds—Recent Events in Latin America

Following the Brady Bond bailout, the Latin American region witnessed a period of comparative stability. However, for some countries, the foreign currency-denominated bonds were a ticking time bomb waiting to explode. The market for emerging economy debt at its height in 1998 with $88 billion being raised, began to wane shortly thereafter in 1998-99 as a result of Asian and Russian economic troubles. As the U.S. economy started to turn south at the end of the millennium, exchange rates were profoundly affected, as was the trade in countries with significant financial ties to the United States. Brazil suffered a currency devaluation in 1999 and Argentina’s dollar-pegged currency that caused their exchange rate to be overvalued, stifled exports and stimulated imports. Some argue the devaluation of the Brazilian Real also adversely affected Argentina, a primary trading partner in Mercosur, as the Argentine dollar-pegged peso remained strong in comparison.

Argentina’s trade imbalance led to a dearth of foreign capital greatly needed to make payments on the outstanding foreign currency denominated bonds. With $30 billion due in 2002, and total debt equal to 50 percent of the GDP as of 2001, Argentina halted all payments on its $141 billion debt in the spring of 2003. This default resulted in a lengthy and painful process, with payments still in arrears and Argentina facing over $750 million in lawsuits, the most recent of which is the first certified class action suit against a sovereign in a U.S. court. Negotiations between the bondholders and Argentina are still underway, but the prognosis is not positive. Peter Allen, the financial advisor to the Argentina Bondholders’ Committee, commented that “[u]nfortunately, there is really very little good faith between the government and the foreign bond holders at the moment...” Further complicating the restructuring is

38. Id.
40. MERCOSUR, or Mercado Común del Sur, is a free trade and common market agreement between the following countries: Brazil, Uruguay, Paraguay, and Argentina, with Chile and Bolivia as associate members. The treaty, or Tratado de Asunción, was signed in March of 1991, and has the unique aspect of focusing on cultural alignment as well as economic growth, representing the fourth largest economic coalition in the world, with 80% of Latin American companies located within the MERCOSUR nations. The agreement has stimulated trade between members, with growth exceeding 300% in the years between 1991 and 1999. See Jerry Haar, Bring Back Competitiveness, LATINFIN, Mar. 2002, at 39. For more information see http://www.mercosur.org.uy.
42. Feldstein, supra note 39, at 8.
43. Id.
46. Paivi Munter, Argentina Faces a Restructuring Challenge: After a Dollars 95bn Default, Settlement With its Creditors Will Take Years, FIN. TIMES LTD., Mar. 5, 2003, at 35.
the complexity of Argentina's debt, which includes over 100 bonds denominated in dollars, yen, euros, pounds sterling, and Swiss francs, largely owned by European retail investors.\footnote{47}

D. FURTHER EXAMPLES OF BOND USAGE

Latin American countries are not the only nations who have turned to sovereign bonds to raise capital and then faced surmounting debt problems. The Ukraine, Pakistan, Ecuador, Russia, and Peru also utilized these financing vehicles, later dealing with the reality of disparate creditors and unmanageable payment schedules.\footnote{48}

Following years of struggle after the demise of the Soviet Union in 1993, Russia issued five dollar denominated bonds as domestic debt.\footnote{49} Again in 1996, in an attempt to raise equity, Russia issued short-term treasury bonds, and in the two years subsequent, issued several Eurobonds.\footnote{50} In 1997, when the oil market suffered a drop in prices, representing 25 percent of Russia's exports at the time, Russia's credibility was diminished and fears of currency devaluation led the IMF to offer an $11.2 billion bailout.\footnote{51} Unfortunately, this aid failed to stave off a Russian default.\footnote{52}

Similarly, the Ukraine, Pakistan, and Ecuador all utilized foreign currency denominated bonds as a means of raising capital and subsequently were forced to restructure their debts.\footnote{53} Fortunately, Pakistan and the Ukraine were able to swap their bonds for new issuances with more favorable payment terms, without facing litigation from any of their bondholders.\footnote{54} Ecuador was also able to reach a workout with its creditors when the country announced in 2000 that it would have to restructure $6.65 billion in bonds.\footnote{55} The deal involved an offer to swap thirty- and twelve-year bonds—98 percent of the Ecuadorian bondholders accepted the offer.\footnote{56} While these countries have all been able to facilitate ad-hoc restructurings, the number and frequency of nations increasingly encountering financial difficulties provided an incentive for the international financial community to devise a standardized, predictable manner of dealing with potential defaults.

\footnote{47. \textit{Id.}}
\footnote{48. \textit{RESOLVING AND PREVENTING FINANCIAL CRISSES}, supra note 33.}
\footnote{49. \textit{FREDERICO STURZENEGGER, DEFAULT EPISODES IN THE 90s: FACTBOOK AND PRELIMINARY LESSONS} 22 (June 2002), available at http://www.utdt.edu/~fsturzen/pinto2.pdf.}
\footnote{50. \textit{Id.} at 24.}
\footnote{51. \textit{Id.}}
\footnote{53. \textit{See generally STURZENEGGER, supra note 49.}}
\footnote{54. \textit{RESOLVING AND PREVENTING FINANCIAL CRISSES}, supra note 33.}
\footnote{55. \textit{Id.}}
\footnote{56. \textit{Id.}}
E. SUMMARY OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

Analyzing the existing international financial framework under which these debt instruments were issued is crucial to fully comprehending the implications of any resolution to the issue of sovereign debt. The international financial architecture has been the subject of countless debates, articles, studies, and research, and is generally thought to be comprised of a variety of international financial institutions with varying initiatives, membership, and degrees of authority.

Following the Mexican peso crisis, seven representatives of the major industrial nations convened to address the issues in Lyon, France, in 1996. At this summit, the Group of Seven (G-7) requested that the major international financial institutions develop standards for the international financial community, as well as viable solutions to avert similar crises in the future. Following that meeting, in 1998, the finance ministers and Central Bank Governors of twenty-two nations set up working groups to investigate certain aspects of international finance, including crisis management. Out of this effort came a report endorsed by the G-7 which requested that the IMF, the World Bank, the Basel Committee on Banking Supervision, and other international bodies work together to develop international standards.

The IMF became heavily involved in the structuring of the international financial architecture, in concert with the World Bank and the Basel Committee on Banking Supervision. In addition to exploring an international set of standards and rules governing the global economy, the IMF sought out to examine a possible resolution to the financial crises of its member nations. The result of that examination is the SDRM.

F. THE ROLE OF THE IMF

Through its nature of involvement in financial crises, the IMF has been at the heart of the sovereign debt discussion. The IMF is a supranational

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58. The G-7, now known as the G-8, is a supranational organization that meets annually with leaders from each of its member nations to address key economic, political and social issues in the international arena. The G-8 representatives are leaders from the following nations: Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, the United States and a member of the European Union. For more information, see http://www.g8.gc.ca/menu-en.asp.
59. Norton, supra note 57, at 901.
61. Id. at 790.
63. Id.
64. Id.
organization, founded in 1944 at the Bretton Woods conference.\textsuperscript{65} Since its inception, it has grown from forty-five member countries to 184 members.\textsuperscript{66} The IMF's Articles of Agreement explain that the purpose of the IMF is "to promote the stability of exchange rates, the financing of balance of payment deficits, and the liberalization of payments for current international transactions."\textsuperscript{67} The IMF does not see itself as a lender or as a financial institution that serves to assist debt-ridden nations.\textsuperscript{68} The funds received by qualifying nations are delivered through currency exchange transactions, whereby the IMF purchases a nation's currency with an alternate currency in order to facilitate a restoration of the balance of payments.\textsuperscript{69} However, as of September 2004, the IMF had approximately $97 billion in loans and credits outstanding to eighty-four countries.\textsuperscript{70}

The IMF has a long history of involvement with financial crises, from the Mexican Peso Crisis of the 1980s, to the East Asian Crisis in 1997.\textsuperscript{71} The IMF has been the source of much controversy, not the least of which focuses on the IMF's role in perpetuating globalization. Not everyone favors the liberalization of capital markets and globalization like the financial world does. In fact, opponents of globalization compare it to the colonialism and imperialism of times gone by, actually damaging the human rights of inhabitants of the historically known lesser developed countries (LDCs).\textsuperscript{72} Specifically, it is argued that the repayment of debt to the IMF and the World Bank prohibits spending for domestic healthcare and education.\textsuperscript{73}

Further criticism of the IMF centers on its perceived expansion of its original role in the international financial community. As one scholar notes,

\[\text{[i]t is far from evident that the IFIs are operating in accordance}\]

\textsuperscript{66} Id. \\
\textsuperscript{67} Francois Gianviti, Evolving Role and Challenges for the International Monetary Fund, 35 Iss'L. Law. 1371, 1371 (2001); see also Articles of Agreement of the International Monetary Fund, available at http://www.imf.org/external/pubs/ft/aa (last visited March 12, 2003). \\
\textsuperscript{68} Gianviti, supra note 67, at 1389-90. \\
\textsuperscript{69} Id. at 1390. \\
\textsuperscript{70} The IMF at a Glance, supra note 65. \\
\textsuperscript{71} Id. \\
\textsuperscript{73} For example, in Tanzania in 2000, debt repayment was six times that of the healthcare budget, while in Ethiopia it is four times the public spending on healthcare. And in the continent of Africa as a whole, nations spend four times more on debt repayments than they do on education or healthcare. See id. at 253. For a thorough discussion of the IMF's initiatives in this area, see International Monetary Fund, Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative, http://www.imf.org/external/np/exr/facts/hipc.htm (last visited Mar. 22, 2003) [hereinafter HIPC]. \\
\textsuperscript{74} The use of IFIs refers to International Financial Institutions, in this instance, the International Monetary Fund and the World Bank.}
with these provisions. Commentators have pointed out that, in recent times, the IFIs are playing an extraordinarily intrusive role in establishing national economic policy. They have expanded their mandate to deal with an enormous range of issues which seem far removed from the core functions they are required to perform by their Articles of Agreement. Furthermore, contrary to their Articles of Agreement, the decision-making of both these institutions appears to be based on the interests of the majority shareholders rather than on the technocratic considerations contemplated by the Articles of Agreement.\textsuperscript{75}

In addition to an alleged abuse of powers, the IMF has been criticized for making assumptions about economies that have led to these financial crises. Specifically, in encouraging globalization, the IMF anticipated that these markets “had already achieved what foreign aid is allegedly allocated to help them become: capitalist economies able to receive money and allocate it according to market principles, free from patronage and accountable creditor expectations.”\textsuperscript{76} Despite the controversy surrounding the IMF, efforts continue to work with the troubled economies of debtor nations. However, this criticism has cast a shadow on any resolutions that the IMF posits, especially the SDRM.

III. THE MULTILATERAL APPROACH: THE IMF’S PROPOSAL OF A SDRM

A. Background

At the request of the International Monetary and Financial Committee (IMFC), an advisory committee on the international monetary and financial system to the IMF,\textsuperscript{77} Anne Krueger, First Deputy Managing Director of the IMF, first introduced the proposal for the SDRM in November 2001.\textsuperscript{78} Subsequently, the IMF explored varying approaches with the international financial community and promulgated an official draft on November 27, 2002.\textsuperscript{79} On January 22, 2003, the IMF held a conference to discuss the SDRM proposal and to elicit feedback from the international community.\textsuperscript{80} Shortly thereafter, the United States indicated its unwillingness to support the proposal, despite strong support by the United Kingdom and other members of the European Union. Due to the United

\begin{footnotes}

75. Anghie, \textit{supra} note 72, at 266.
79. IMF SDRM Proposal, \textit{supra} note 32.
\end{footnotes}
States' lack of support, the SDRM was essentially shelved in lieu of the CAC approach. While it is no longer being actively pursued, the lessons learned should still be utilized in the sovereign debt context, and the IMF and the United States have urged the international community to do just that.

It bears mentioning that the SDRM was not applicable to countries with extremely low income and excessive debt. Under the Heavily Indebted Poor Countries (HIPC) initiative, the IMF endeavors to provide a form of debt forgiveness for those nations with unsustainable levels of debt, dangerous levels of poverty, and poor social and economic health. Countries included in the HIPC initiative tend to be in Africa and have to qualify for assistance under this program following a negative debt sustainability analysis. Under this debt analysis, if a country's external debt ratio exceeded 150 percent of the net present value of its debt to exports, the country was considered for eligibility and was then required to adhere to various IMF/World Bank economic and financial programs in order to receive the initiative's full benefits.

B. THE SDRM IN BRIEF

The IMF designed the SDRM under the guidelines of eleven principles:

1. the SDRM should only be used for debts that are unsustainable and should not be used in such a way as to encourage default;
2. the SDRM should include incentives for nations to quickly effectuate a restructuring;
3. conflicts with contractual obligations should be kept to a minimum and should be limited to measures that serve the best interests of the collective creditors;
4. the SDRM should promote transparency in the manner of restructuring;
5. early and active creditor involvement should be encouraged;
6. there should be no interference with the sovereignty of a debtor state to that end, activation can only be made at the sovereign's request;
7. the SDRM should only provide mechanisms to incent negotiation, and should not be a concrete plan for the restructuring process;
8. flexibility and simplicity are essential in order to provide endurance of the structure over time;
9. the SDRM should not supersede domestic insolvency structures already in place and applicable to any claims;
10. dispute resolution should be facilitated in an effective, impartial, and expedient manner; and

82. HIPC, supra note 73.
83. Id.
84. Id.
11. the IMF's role in the SDRM should be limited to its existing powers and must not be enlarged in any way.\textsuperscript{85}

C. **Claims Under the SDRM**

Claims that fell under the SDRM included “all rights to receive payments relating to the commercial activities of the sovereign.”\textsuperscript{86} A claim could be included in the restructuring when there was a clear contractual obligation to provide payment in either currency or goods in association with commercial activities.\textsuperscript{87} “The central government would have the option to include its own debt and, subject to the consent of the debtor in question, claims on: (i) the central bank and (ii) public entities or subnational governments that are not subject to a domestic insolvency framework.”\textsuperscript{88} There are often occasions where a central government has guaranteed funds for a third party or holds another contingent obligation, and these claims would not have automatically fallen under the bailiwick of the SDRM.\textsuperscript{89} However, had the claims underlying any sovereign guarantees entered into default or had the contingent claims either matured or could easily be valued at market conditions, these claims would also have been included in the debt restructuring.\textsuperscript{90}

Claims excluded from the framework included domestic debts governed by the applicable insolvency laws of the debtor nation and debts owed to international organizations, including the IMF.\textsuperscript{91} Although claims by international organizations and domestic lenders would not have fallen under the auspices of the SDRM, the handling of these claims would have been provided in the name of transparency.\textsuperscript{92}

Perhaps the most controversial aspect of the SDRM was the exclusion of international organizations from the class of creditors to be restructured. The proposal clearly defended this position, stating that multilateral development banks provide both adjustment lending and financing for investment in human and physical capital at lower costs than could be obtained from international capital markets. The financing of such public goods and capital formation promotes both financial stability and economic growth, and thereby enhances the value of private creditors' claims. The ability of these institutions to provide financing at the current cost structure depends critically on the assurance that their claims would not be captured in a sovereign debt restructuring.\textsuperscript{93}

The proposal also stated that restructuring of these outstanding debts

\textsuperscript{85} IMF SDRM Proposal, \textit{supra} note 32. at 7-9.
\textsuperscript{86} Id. at 17.
\textsuperscript{87} Id.
\textsuperscript{88} Id. at 8.
\textsuperscript{89} Id. at 20.
\textsuperscript{90} Id.
\textsuperscript{91} IMF SDRM Proposal, \textit{supra} note 32. at 9.
\textsuperscript{92} Id.
\textsuperscript{93} Id. at 22-23.
would not be expected.94 Interestingly, claims of the Paris Group95 or other official bilateral groups would have been restructured either within the SDRM as a separate class or in tandem with the SDRM.96 The SDRM proposal went on to explain creditor classification, placing all unsecured claims in the same class and allowing secured claims and official bilateral creditors to be in separate classes.97

D. Activation

The proposal also left open the question of whether a sovereign could unilaterally initiate the mechanism or whether independent validation would have been required, and if so, by whom.98 Once activated, the SDRM outlined a process whereby creditors were notified of all outstanding claims, including those that would have been structured in tandem, but not under the SDRM, and those that would not have been restructured at all.99 Once notified, all creditors were required to register their claims within a certain time period or their claims were declared null and void.100 After notification to all of the creditors, a creditor’s committee would have been created with representation from the creditors, and approval of any measures would have required a vote of 75 percent of the outstanding principal claims.101 This vote also empowered the creditors to reject the usage of the SDRM, as an option existed for the creditors collectively to vote to terminate the mechanism once the process was activated.102

E. Stay of Claims

Once activated, no stay of claims existed, as in the U.S. bankruptcy laws. Rather, any monies collected through litigation would be sub-

94. Id.
95. The Paris Club is a group of informal creditors who work to find solutions to unsustainable debts by debtor-nations, beginning in 1956 with a meeting between Argentina and its creditors at the time. A completely informal arrangement, the Club has managed to work through 366 arrangements with over seventy-five countries, with a total debt of $410 billion, since its inception. The unique aspect of the Paris Club is that it has no legal basis, status, or authority in the international arena, yet the creditor nations have agreed upon a set of guidelines to be followed. Meetings are held several times a year, always in Paris, and the group is committed to finding ways to restructuring debt, including rescheduling or reducing debt obligations. The creditor member countries are: Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, the Russian Federation, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Other official creditors who have been invited to attend meetings, but are not members are: Abu Dhabi, South Africa, Argentina, Brazil, Korea, Israel, Kuwait, Mexico, Morocco, New Zealand, Portugal, Trinidad and Tobago, and Turkey. For more information, see http://www.clubdeparis.org/en/.
97. Id. at 49-51.
98. Id. at 9.
99. Id. at 29.
100. Id.
101. Id. at 10.
tracted from any amount apportioned to that creditor through the restructuring agreement.\textsuperscript{103} This exclusion of the traditional insolvency concept was justified on the basis that it interfered with the contractual rights of parties who were already at a disadvantage in terms of bargaining power with the sovereign borrowers.\textsuperscript{104} Following notification, creditors with secured claims would have the option of seizing any collateral to the extent afforded by their contractual rights.\textsuperscript{105} Unsecured creditors could have initiated any action within their rights; however, judgments awarded but not received would also be subject to the SDRM as an additional liability and could thus be altered by a majority vote of the creditors.\textsuperscript{106} In an effort to further discourage hold-out creditors and litigation, judgments that were received would be subject to the "hotchpot" rule.\textsuperscript{107} The hotchpot rule, derived from English bankruptcy law, effectively reduces any subsequent settlement by the amount received in litigation, thereby ensuring equitable distribution of payments.\textsuperscript{108} A drawback to this approach arose where the creditor was able to receive a larger judgment than that which would have been apportioned under the SDRM. While there was no method to rectify this potential inequity, the IMF believed that the lengthy process of litigation and remuneration would have far exceeded the time required to effectuate the SDRM, thereby eliminating any potential value to the hold-out creditor.\textsuperscript{109} Rather, the creditor ended up receiving the amount to which he was entitled under the SDRM, but with the added loss of his legal expenses.

Another insolvency concept excluded from the SDRM involved interest payments. In some jurisdictions, interest payments cease to accrue upon commencement of restructuring.\textsuperscript{110} The SDRM did not recommend this action, but instead allowed any additional debt accumulated as interest to be included in the restructuring.\textsuperscript{111} Additionally, any new financing was not given priority over existing claims as is a common practice.\textsuperscript{112} Rather, if a qualified majority of the creditors approved, any new financing could be excluded from the restructuring.\textsuperscript{113}

\begin{flushleft}
103. Id. at 9. \\
104. Id. at 33. \\
105. Id. at 38. \\
106. Id. at 34. \\
107. Id. at 36. \\
108. IMF SDRM Proposal, supra note 32, at 37. For example, if Creditor A is owed $10 million dollars and receives a judgment for $5 million, that award will reduce any amount apportioned to Creditor A under the SDRM. Hence, Creditor A’s claim is still valued at $10 million and not the reduced $5 million, so a percentage of recovery is based on the original amount. If, under the SDRM, Creditor A is entitled to 75% of the debt, Creditor A will receive $7.5 million, minus the $5 million already received, rather than 75% of the remaining $5 million. Creditor A will receive $2.5 million from the restructuring, not $3.75 million. \\
109. Id. at 38. \\
110. But compare with the U.S. Chapter 11 procedure, which does not halt the accrual of interest. See 11 U.S.C. § 362 (1994). \\
111. IMF SDRM Proposal, supra note 32, at 42. \\
112. Id. at 47. \\
113. Id.
\end{flushleft}
F. Administration

Overseeing all of these procedures was the Sovereign Debt Dispute Resolution Forum (SDDRF), consisting of twelve to sixteen appointees with judicial experience in debt restructuring matters. These individuals would operate from their home nations and would comprise a pool from which judges were impaneled in the event of a crisis. For each incident, four judges were to be appointed—one to oversee the process and three to serve as an appellate forum.

The legal basis for this process involved amending the IMF’s Articles, which requires a three-fifths approval by the members holding 85 percent of the voting power. Because this amendment implicates international treaty terms, many nations, including the United States, would require legislative endorsement and possible revision of certain domestic laws and policies. Following that, a verification process would be needed where creditors and claims would be finalized, with any disputes being managed by the SDDRF.

G. Benefits

The most obvious benefit of the SDRM was the potential simplification and standardization of having an international mechanism. Removing the uncertainty would have helped to reassure creditors and debtors alike. As the current situation stood then, and continues now, any potential default is handled on an ad-hoc basis, often with the IMF stepping in with significant bailout packages (as in the case of Argentina).

The availability of a structured approach would also have likely encouraged more open communication between debtor-nations and creditors, possibly eliminating the need for costly and painful defaults, such as the one Argentina had recently experienced. When comparing Argentina’s experience with Brazil’s, it is clear that voluntary submission to reorganization bodes far better for a quick economic recovery.

H. Criticisms

The SDRM was subject to significant criticism from the international financial community and IMF member nations. But in the spring of 2003, the announcement was made to discontinue any efforts to establish the

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114. Id. at 11.
115. Id.
116. Id.
117. IMF SDRM Proposal, supra note 32 at 12.
118. Id.
119. Id. at 33.
120. Alan Beattie, Argentine “Blackmail”: As the IMF Prepares a $6bn Debt Roll-over, Doubts about the Fund’s Credibility Resurface, FIN. TIMES, Jan. 21, 2003, at 11.
multilateral approach espoused in the mechanism.\textsuperscript{122}

A very vocal criticism of the SDRM focused on the impartiality, or rather, lack thereof, of the IMF in instituting a solution. As one scholar, Christopher Paulus, has pointed out in referring to the IMF and World Bank and their ability to oversee an international insolvency proceeding, “these institutions are too allied with the creditors (even if this were true only from the debtor’s perspective) because they themselves are in fact also creditors.”\textsuperscript{123} This was a commonly held concern, exacerbated by the SDRM’s exclusion of IMF claims in any restructuring. As William Rhodes, the senior Vice-Chairman of Citigroup, Citicorp, and Citibank, stated,

[w]hile private sector creditors frequently take losses in country workouts—40 percent with Ecuador recently, on top of an earlier 45 percent under the Brady Plan—the international financial institutions, including the IMF and Paris Club of government lenders reduce their claims only for the so-called highly indebted poor countries.\textsuperscript{124}

Mr. Rhodes also felt that the institutionalizing of a formal bankruptcy standard would have

encourage[d] more restructurings, thereby further damaging emerging markets as a group and threatening contagion. One result would be reduced private capital flows and a greater need for public sector finance. At the same time, countries that are successfully meeting their debt obligations but face temporary liquidity problems might come under domestic political pressure to file for bankruptcy protection, worsening market sentiment and delaying a return to growth.\textsuperscript{125}

He was not alone in his sentiments. Although the SDRM has been criticized as being too pro-creditor, many bankers and investors were also displeased with the efforts of the IMF.\textsuperscript{126} Their concern prior to the issuance of the SDRM appeared to be that the proposal would permit sovereigns to halt payments through a stay on creditor claims.\textsuperscript{127} Voicing those concerns was Sir David Walker, a senior advisor at Morgan Stanley, who stated that “‘[i]f the market thinks a mechanism will be put in place where a sovereign borrower in trouble can pull the trigger and stop paying its debts, it will react by tightening up those debt contracts before it


\textsuperscript{124} Rhodes, \textit{supra} note 121.

\textsuperscript{125} \textit{Id.}


\textsuperscript{127} \textit{Id.}
happens.\textsuperscript{128}

Clearly, the IMF listened to these concerns, as evidenced by the exclusion of the stay on creditor enforcement and priority financing.\textsuperscript{129} This was met with a backlash from others in the international financial world who argued that a stay on enforcement is imperative, as is the need for priority treatment for any new debt issued subsequent to commencement of an insolvency procedure.\textsuperscript{130}

Finally, some parties felt that the need for a complete overhaul of the international financial crises management system was unnecessary and unrealistic. Experts at the International Institute for Economics claim that most sovereign debtors pay their debts in a timely fashion and the challenges posed by instituting the SDRM far exceeded any benefit that would be derived.\textsuperscript{131} The process for instituting this measure, including amending the IMF's Articles of Agreement and for a large part of the membership to adopt domestic legislation in support of it, was considered by some to be insurmountable.\textsuperscript{132} This was especially true given that a significant factor behind the financial crises of the past was weak domestic bankruptcy laws.\textsuperscript{133}

The nail in the coffin of the SDRM was the very public withdrawal of support by the United States. In a statement to the IMFC in April 2003, U.S. Treasury Secretary John Snow publicly rejected the use of the SDRM stating that "[t]he source of these problems lies in the relationships and agreements of debtors and their creditors. It is these parties, not an international organization that must assume responsibility for the solution. Therefore, it is neither necessary nor feasible to continue working on [the] SDRM."\textsuperscript{134}

In the same speech, Secretary Snow also called for the inclusion of CACs as an alternative and preferable approach to the sovereign debt restructuring issue, challenging the IMF to focus on encouraging the widespread use of CACs, as well as improving transparency and open disclosure.\textsuperscript{135} Following the dismissal of the SDRM by the United States, the focus did indeed turn towards the inclusion of CACs in new bond

\begin{thebibliography}{99}
\bibitem{128} Id. It bears noting that with or without a sovereign debt mechanism, countries have chosen to cease payments on their debt, including Argentina, Ecuador, and Russia. See Rhodes, \textit{supra} note 121.
\bibitem{129} Christopher G. Paulus, \textit{supra} note 123, at 547.
\bibitem{130} Id.
\bibitem{135} Id.
\end{thebibliography}
agreements and the viability of their usage in correcting existing agreements drafted under conventional unanimity terms.  

IV. THE UNILATERAL APPROACH: COLLECTIVE ACTION CLAUSES

A. BACKGROUND AND MECHANICS OF CACs

Since the abandonment of the SDRM, the international financial community has concentrated their efforts in the area of debt restructuring on the usage of CACs as a means to eradicate default. Long used in English bond contracts, CACs allow a majority of creditors to amend clauses, including those regarding payment terms of existing agreements, provided a minimum number of creditors approve the changes. The Group of Ten (G-10) issued a working report on September 26, 2002, regarding the use of contractual clauses to remedy sovereign debt problems and proffering recommended terms to be included in bond agreements. Among the clauses recommended by the G-10 for inclusion in sovereign debt agreements were CACs, termed “majority amendment clauses,” that would permit a majority of bondholders to amend their payment terms; or alternatively, a majority clause to approve an exchange for a new offering. In both cases, determining the threshold for participation would be measured by either a percentage of the outstanding principal amount or based on a quorum system, whereby a quorum of bondholders must be reached before the requisite percentage approval vote would become effective. With regard to changes in payment terms, the G-10 recommended the maximum level be 75 percent, while lowering that level to 66.66 percent for terms not related to payment.

In addition to payment clauses, the G-10 set out detailed recommendations for altering other terms of bond agreements, including the election of a bondholder representative, who is similar to a trustee and would serve as the liaison for bondholders in communications with the debtor. This bondholder representative would negotiate restructuring terms with the debtor and would have power to take legal action and

136. Id.
137. Id. at 3.
138. Id. at 5.
139. Id.
140. Id.
141. Id. at 3.
142. Id.
143. Id. at 2.
distribute any recovery to the bondholders. The need for improved disclosure and transparency also calls for additional financial covenants, requiring the debtor to provide timely and specific information regarding financial and economic status. In an effort to limit disruptive acceleration of claims and litigation, clauses would be added to provide for a majority vote to approve a stay of claims.

The examples proffered by the G-10 were soundly endorsed by the United States. John B. Taylor, U.S. Secretary of Treasury for International Affairs, outlined the American proposal in a speech to the Institute for International Economics in April 2002, calling for a majority vote binding on all bondholders, agreeing to a restructuring, a bondholder representative, and an activation process by which the sovereign could enter into restructuring negotiations while staying any litigation or claims as necessary.

Following the United States' lead, the IMF also shifted gears and issued multiple working papers and reports on the progress and surrounding issues of the use of CACs. Since the United States' dismissal of the SDRM, the IMF has explored the use of CACs in depth by examining whether an aggregation of claims could be incorporated into the approach so that creditors across the board could be considered during any vote to restructure, mimicking the all-encompassing bankruptcy style forum. While ultimately deciding that aggregation should not be pursued, the analysis did reveal areas in need of improvement and continued exploration. Additionally, the IMF has published information regarding the status and prevalence of CAC usage in the sovereign bond context.

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144. GROUP OF TEN, supra note 138, at 2.
145. Id. at 3.
146. Id.
148. Id.
150. IMF RESTRUCTURING SOVEREIGN DEBT, supra note 122.
151. Id. at 29.
152. Id. at 24.
B. Complementary Use of Exit Consents in Current Bond Agreements

While the use of CACs is a viable option to prevent default in new bond contracts, the issue still remains that there are billions of dollars in bonds already in existence, which are governed by agreements missing these provisions and structured in such a way that payment terms cannot be altered at all. As a complementary solution, debtors may have the option of swapping existing agreements for new ones that do include CACs and using the exit consents in the old offerings to provide protection from bondholders who refuse to submit to the swap.

Should a debtor choose to offer a new bond to its existing creditors, any of the bondholders have the option to accept or refuse the new contracts. The danger lies with the creditors who refuse the new agreements because once these hold-outs are established, they will comprise the majority of the bondholders. Depending on the terms of the agreement, the hold-outs could even accelerate payment in the event of a default. To combat this problem, debtors can utilize clauses in bond agreements that allow for nonpayment-related alterations to the bond. Typically, these clauses require a one-half or two-thirds vote of the bondholders, but do permit changes to the agreement. The intent is that by using these clauses in exchange for new debt instruments, bondholders will amend the agreement, rendering it invaluable to any potential hold-out creditors. The old bond agreements can then be swapped for new agreements with revised payment terms that effectively restructure the debt. Examples of the types of clauses that can be removed through this manner are financial covenant clauses that reduce the secondary market value of the bond and other clauses that impair the likelihood of repayment, hamper debt acceleration efforts, or limit the rights to pursue litigation in the event of a default.

The use of exit consents to affect a swap of old agreements to new is illustrated by the recent restructurings of Uruguay and Ecuador. Following the Argentine crisis, Uruguay was faced with a debt totaling over $11 billion and restructured close to half of that in 2003. Ecuador was the first nation to use exit consents to impair old bonds in lieu of the new bond agreements. Most bond agreements include language that permits acceleration of unmatured principal in the event of a default. A default is also not necessarily a failure to pay on that particular instrument; it can also be the failure to adhere to certain financial covenants related to solvency, liquidity etc. or a default on another loan or bond.

153. Buchheit & Gulati, Exit Consents, supra note 22, at 59.
154. Id.
155. Id.
156. Id. Most bond agreements include language that permits acceleration of unmatured principal in the event of a default. A default is also not necessarily a failure to pay on that particular instrument; it can also be the failure to adhere to certain financial covenants related to solvency, liquidity etc. or a default on another loan or bond.
157. Id. at 60.
158. Id.
159. Buchheit & Gulati, Exit Consents, supra note 22, at 60.
160. Id.
161. Id.
162. IMF Reviewing the Process, supra note 149, at 32.
issues. In Uruguay's case, the old agreements were modified to affect the waiver of sovereign immunity, and bondholders were given the option to opt out of the exit. For those who did agree to the exchange, they approved consents that limited the hold-out creditors from enforcing the debt obligation part of the bond.

C. Recent Developments in CAC Usage

The IMF has undertaken several reports to measure the usage of CACs, since the focus of the international financial community shifted from the SDRM. Mexico has been lauded as leading the way with a $1 billion offering in February 2003, governed by New York law and including a 75 percent majority action clause. In keeping with the G-10 recommendations, Mexico measured the bond threshold in terms of outstanding principal and excluded from the voting any bondholders who are directly or indirectly controlled by the government, but rejected the use of activation and transparency clauses and chose to rely instead on market drivers to establish best practices. The IMF reported this offering as successful, as there was no evidence of a yield premium in either the initial offering or secondary market. However, whether this is more likely a reflection of Mexico's investment grade is still an open question. Whether a lower grade sovereign would enjoy the same result remains to be seen. In terms of creditor action following a default, the Mexican bond did include a threshold of 25 percent outstanding principal minimum vote before acceleration of payments could begin and more than 50 percent outstanding principal vote to de-accelerate payments. With the absence of a clause representing a bondholder representative, the agreement was silent as to the result of any bondholder litigation.

Following the Mexican offering, several other sovereign nations issued bonds governed by New York law that included CACs. In the offerings by Brazil, South Africa, the Republic of Korea, Belize, and Guatemala, the IMF found no showing of a pricing disadvantage attributable to the use of CACs. The threshold for restructuring was set at 75 percent for

163. Id. at 24.
164. Id. at 33.
165. INTERGOVERNMENTAL GROUP OF TWENTY-FOUR, G-24 SECRETARIAT BRIEFING PAPER ON SOVEREIGN DEBT RESTRUCTURING (Apr. 4, 2003), http://www.g24.org/debt.pdf. The Intergovernmental Group of Twenty-Four consists of representatives from developing nations to convene over matters of international monetary and fiscal policy. The member countries are: Algeria, Cote D'Ivoire, Egypt, Ethiopia, Gabon, Ghana, Nigeria, South Africa, Democratic Republic of Congo, Argentina, Brazil, Colombia, Guatemala, Mexico, Peru, Trinidad and Tobago, Venezuela, India, Iran, Lebanon, Pakistan, Philippines, Sri Lanka, and Syrian Arab Republic. See Intergovernmental Group of Twenty-Four, About the G-24, http://www.g24.org/about.htm.
166. IMF COLLECTIVE ACTION CLAUSES, supra note 149, at 20-21.
167. Id. at 22.
168. Id. at 24.
169. Id. at 32.
170. IMF PROGRESS REPORT, supra note 149, at 3.
the Korean and South African issuances, while the Brazilian, Guatemalan, and Belizean bonds increased the percentage to 85 percent.172 All of the bonds included a 25 percent acceleration clause, and the Korean and South African bonds followed suit with Mexico by including a 50 percent de-acceleration threshold, while the remaining three countries opted for 66.66 percent.173

In total, the number of bonds issued with CACs has increased. In February 2003, the IMF reported that 33 percent of bonds issued included CACs.174 The European Union Finance Ministers have also stated that any bonds issued for European Union members that are governed by foreign law or subject to a foreign choice of forum clause will include CACs.175 Despite the small percentage of these issuances, this statement heralds strong public support for the use of CACs. In terms of actual numbers of bonds issued in the first three quarters of 2003 in the emerging markets sector, of the forty nine issuances, twenty-seven included CACs, nine of which were governed by New York law.176 Contrast this with the numbers reported in 2001 (ninety-three issuances and less than two were issued under New York law) with CACs, and it is clear that the United States' push for CACs is having an impact on market practices.177

D. Benefits

The primary benefit of using CACs and exit consents, and the reason the United States is so firmly in support of such tools, resides in the ability of individual debtors and creditors to fashion their own mutually acceptable terms and covenants. This freedom of contract is a fundamental principle in U.S. law and is evidenced in the market driven policies of the American financial community. In fact, even U.S. securities regulation is premised on disclosure rather than merit, facilitating independent decision-making on the parts of investors.178

A second, but no less prevalent, advantage of CACs and exit consents is the relative ease with which this change can take place. Rather than requiring multilateral treaty amendments and subsequent domestic legislation overhauls, parties can begin, and indeed have begun, implementing these changes immediately.

Finally, the fact remains that the United States and the international financial community have pledged their support for the use of CACs in lieu of a SDRM type structure. Regardless of whether CACs are the ideal solution, or whether debtor nations would prefer an international

172. Id. at 7.
173. Id. at 8.
174. IMF COLLECTIVE ACTION CLAUSES, supra note 149, at 15.
175. Id. at 19.
176. IMF PROGRESS REPORT, supra note 149, at 4.
177. Id.
forum for resolution, as the parties who hold the purse strings, the United States and other creditors will ultimately dictate the path chosen.

E. Criticisms

Obviously, while the merits of utilizing CACs and exit consents is that, in tandem, the two could prove immediately effective (i.e., using the exit clause to entice creditors to accept new agreements containing CACs), the problem still remains that the creditors must be willing to accept the terms of the new agreements. They must believe that what is in the best interest of the debtor is in their best interest as well. This common economic predicament is referred to as the Prisoner's Dilemma where one party must trust that their sacrifice is truly the most advantageous for all. In terms of hold-out creditors, this poses a daunting challenge. For exit consents to help reduce the number of hold-out creditors, there must first be a significant number of creditors willing to approve the use of the bond altering exit consents. The IMF reports that persuading these creditors to accept the new arrangement may be more likely when a default is already imminent, defeating the purpose of including CACs and exit consents to avert default.179 Contributing to this concept is the ever-present concern of moral hazard and the historical bail-out packages provided by the IMF. As evidenced by recent restructuring attempts, creditors are much more likely to hold-out if the option of an IMF bail out package seems imminent.

Locating and assembling a significant enough number of creditors to utilize this option also remains a formidable task. As described above, bondholders are numerous and varied, and a mechanism would have to be instituted to capture data on the individuals or institutions empowered to vote on any collective action. This mechanism could be accomplished with the G-10’s recommendation of appointing a bondholder representative. But, as evidenced by the Mexican offering, this clause may not be included.180 The IMF has also recommended a method for tracking bondholders through a voluntary registry system.181 Notwithstanding the fact that there is no forum to maintain this type of information, even if this were feasible, it would only affect new issuances. Locating and assembling data on current bondholders would be a significant and costly challenge.182

But what if exit consents are not an option? The use of CACs alone will do nothing to eliminate the current burden on nations, as it can only be applied to agreements issued here forthwith.183 It still stands that the majority of current bond contracts cannot be amended to include this

179. IMF Reviewing the Process, supra note 149, at 22.
181. IMF Reviewing the Process, supra note 149, at 16.
182. Id, at 20.
183. Id.
type of provision.184 Additionally, Jack Boorman, Special Advisor to the Managing Director of the IMF, criticizes the use of CACs because the application of the law among the varying jurisdictions would be inconsistent by virtue of the fact that each jurisdiction maintains their own legal idiosyncrasies.185 This issue is most troubling for debtor nations who could face disparate legal treatment among jurisdictions, possibly from the same bond indenture where legal action may be initiated by a multitude of bondholders. Although choice of law and forum clauses are inevitably included in each agreement, it is not atypical for sovereign debtors to hold multiple bonds denominated in various currencies and governed by different nations.

Market concerns about the signaling effects of the use of CACs also cannot be discounted, despite the comments by the IMF regarding the Mexican issuance.186 Noted economist Barry Eichengreen outlined this concern in an article published in advance of his book on the International Financial Architecture.187 Eichengreen pointed out that any nation choosing to include these types of clauses in their debt instruments may be the victim of the adverse signaling effect, whereby choosing to use these clauses indicates the likelihood of default and the need for rescheduling.188 He analogizes the use of these clauses to the use of a prenuptial agreement by a bride and groom.189 Until and unless the inclusion of these clauses becomes standard drafting technique, using such clauses may be counterproductive.

The implication of U.S. securities laws is also a factor that must be recognized. In bonds issued by Egypt, Lebanon, and Qatar in 2000 and 2001, the exemption under Rule 144A was perfected, allowing the issuers to sell only to qualified institutional buyers, thus avoiding the complex and tedious registration process.190 But it is still undetermined whether any discussions between creditors and debtors regarding a swap or new issuance would violate securities regulations preventing market conditioning. This communication between potential investors and the issuer or underwriter could be construed as an offer to sell, and, absent a statutory prospectus, would be a violation of section 5(c) of the 1933 Securities Act.191 Indeed, Ecuador and Uruguay both determined that the details of their respective debt exchanges could not be disclosed until the proper filings were made with the U.S. Securities Exchange Commission.192

Finally, the inclusion of CACs in each bond agreement fails to address the restructuring in its entirety, unless a type of aggregation is included in

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184. Id.
185. Boorman, supra note 137.
186. See Eichengreen, supra note 132.
187. Id. at 57.
188. Id.
189. Id.
190. IMF COLLECTIVE ACTION CLAUSES, supra note 149, at 19.
192. IMF REVIEWING THE PROCESS, supra note 149, at 11.
the agreement. So, while a single bond may be revised, absent a clause to the contrary, each individual debt agreement would have to be modified independently through a costly and complex process. The IMF drafted a report on the use of aggregation in the CAC context, and while finding merit in the efficacy, ultimately determined that the challenges and potential negative reaction of the market indicated that it "would not be appropriate for the Fund to endorse a particular set of aggregation provisions at this time."193 Uruguay did include a form of aggregation in their recent debt swap in that payment terms could be modified for multiple bonds via an aggregate voting mechanism.194 Specifically, the 75 percent threshold would drop to 66.66 percent on each individual bond, upon a vote to restructure by 85 percent of the bondholders of the aggregated outstanding principal amount.195 But this aggregation was limited, as it only applied to new bonds issued under the same trust agreement and governed by New York law.196 Any past issuance or other forms of sovereign debt would not be eligible for aggregation.197 The G-10 also touched on the potential for aggregation among creditors for voting purposes and came to the same conclusion as the IMF, stating that "while desirable, is not practicable within a contractually based mechanism."198

V. CONCLUSION

A. COMPARISON OF METHODS

It is not enough to merely analyze the differing proposals for sovereign debt in and of themselves, absent the underpinning motivation of the resolution. Different nations and cultures strive for varied goals in the resolution of solvency issues. For example, the United States tends to encompass a more debtor-friendly approach, encouraging the debtor to reorganize and asking the creditor to be more accommodating.199 In contrast, Germany tends to emphasize creditor rights, and France focuses on the labor force affected by the financial distress.200 While these generalities apply to corporate bankruptcy, in cases of nations where total liquidation or external management is not an option, some or all of these may still be applicable.201

So, while economic efficiency is certainly not a component in evaluating a solution, whether a plan for reorganization is designed more to protect the rights of the creditors or to encourage a fresh start for the debtor is an important factor. The use of the SDRM, exit consents, and CACs all tend to favor the creditor, an irony that cannot be overlooked given these

193. IMF RESTRUCTURING SOVEREIGN DEBT, supra note 122, at 30.
194. Id. at 6.
195. Id.
196. Id.
197. Id.
198. GROUP OF TEN, supra note 138, at 5.
199. Paulus, supra note 123, at 540.
200. Id.
201. Id. at 534.
proposals have come from supranational organizations that tend to serve as creditors. Ideally, given the context of sovereign debt, a plan for reorganization would mimic the more debtor friendly policies of the United States.

Leading economists, politicians, and legal authorities have grappled with the issue of sovereign debt for years and have failed to come up with a solution that pleases all parties. The recommendations today are no exception. Notwithstanding the current status of the multilateral approach, it is arguable that for purposes of consistency, credibility, and simplicity, the best solution is still to institute an international sovereign debt restructuring mechanism. But the SDRM falls well short of an ideal proposal. The criticisms of the SDRM are valid, but rather than completely disengaging from the multilateral perspective, the international financial community should use the lessons learned from that exercise to create a more equitable and balanced scheme.

The apparent creditor-friendly framework of the SDRM leaves the debtors smarting, while the creditors feel as though this mechanism possesses the power to alienate them from property which they are rightfully due. Neither party wants to admit that the option of default exists—the creditors because they feel that will entice debtors into a restructuring and the debtors because of the potential impact on capital flows to their home states. But default does exist and the SDRM is a good foundation for an overarching scheme to handle it. Yet in its currently crippled and weakened state, the SDRM fails. The exclusion of a stay on creditor claims and actions, the accumulation of the interest, and the enlarged power of the IMF all expose the limits of consensus philosophy in multilateral solutions. It succeeds in the aggregation of claims and the consistency and applicability of an international structure and forum. The use of CACs alone will never accomplish that same uniformity and clarity.

Structurally speaking, the use of CACs essentially provides the same majority approval process that the SDRM proposed, but manages the resolution on a micro-contractual level, retaining any choice of law/forum agreements included in the individual bond contract. In contrast, the SDRM incorporated a more macroeconomic structure, subjugating all agreements to an overarching international insolvency scheme. A balance between the two is the ideal solution—although the United States definitely favors freedom of contract, contract terms and conditions do not exist in a vacuum. Rather, there is an entire code, the Uniform Commercial Code, as well as a surfeit of case law, dedicated to eliminating ambiguity and inconsistency in contract law application. Debtors and creditors should still have the freedom to negotiate terms acceptable to both, but there should be an international forum to which nations can turn in the event of a breakdown. As the past decade has taught us, de-

202. Boorman, supra note 137.
203. Id.
fault is inevitable and pretending that it will not occur is not only harmful to all parties, but foolish and naïve.

Social contract theory tells us that communities make laws to eliminate uncertainty. In a truly global economy where nations enter into financial agreements with each other, all states are essentially a member of the same community. Adopting a non-regulatory laissez faire style ignores the reality that default and restructuring is an inevitable result and, absent a regulatory structure, leads to the type of stand-off we are seeing in Argentina today.

Critics of the SDRM, or a similar program, point to the challenges in implementation as support for abandoning the approach. While the logistics of implementing the SDRM appear unfathomable—requiring not only an amendment to the Articles of Agreement, but also for each member nation to adopt a legal structure that fits in with the regulatory concepts of the SDRM—the fact that a task is daunting is a poor excuse for failing to try.

Is the IMF really the correct proponent of this type of mechanism? As a controversial international institution, the IMF appears to be struggling with an identity crisis regarding its role in the financial community. It touts itself as being an agency to correct balance of payments problems, yet admits that most see it as a lender of last resort. It even goes so far as to exclude itself from debt restructuring because of its position as a creditor who will provide capital when all others refuse. If that action does not define it as a lender of last resort, then the concept behind its decision is clearly misunderstood. While the IMF appeared to be limiting its power on the surface by making outright declarations that the SDRM did not enlarge its power, it is truly incredible to see how the SDRM did quite the opposite. Not only did it safeguard the IMF loans from restructuring, but it put in place a quasi-judicial body to oversee the restructurings that would be hand selected by the IMF. Additionally, with the IMF’s historic policy of requiring indebted nations to institute social and economic policies as dictated by the IMF, there can be no question of the lack of impartiality or neutrality in its position with regards to these debtor nations.

While the concept of an international bankruptcy scheme is a good one in theory and by all rights an obviously necessary one given the status of the multilateral approach, the likelihood of getting stubborn, fiercely independent nations and parties to succumb to a supranational power appears dismal at best. One only need look at the current state of affairs in the United Nations, the trade squabbles in the World Trade Organization, or the impaired jurisdiction of the International Criminal Court to realize that.

Nobel Prize winning economist Joseph Stiglitz said it best when he stated that

it is good news that the IMF, after the failure if six bail-outs in as many years, finally recognized that an alternative approach was needed, and that some sovereign debt restructuring mechanism was
desirable. They are right, too, that one cannot rely on market-based approaches (a fact which they failed to recognize in East Asia), that some version of a statutory approach was desirable. It should have been obvious that in any bankruptcy procedure which is viewed as fair, a major creditor (such as the IMF) cannot simultaneously play the role as the bankruptcy judge, nor even have a central role in the process, other than as one of the claimants. To many, the IMF’s attempt to give itself such a central role says much about its political insensitivities.204

Yet, CACs do not present a viable alternative. As Professor Sitglitz has pointed out, it is evident that market efficiency based approaches are also not satisfactory and that

the long debate about bankruptcy reform in the United States should have made it clear that there is not a single “best” bankruptcy code. The fact that every government among the advanced industrial countries has taken a statutory approach (rather than relying on market mechanisms, modified by, for instance, mandatory collective action clauses) should have made it clear that the position of the U.S. Treasury (which seemed to claim that all that was required was collective action clauses) makes little sense, reinforcing the results of theoretical and empirical research on bankruptcy and bargaining.205

In line with Professor Stiglitz’s thinking, the CAC/exit consent approach suffers from its own weaknesses by relying on market actions to rectify an already tenuous situation. An impromptu, ad-hoc solution at best, it can be analogized to the little Dutch boy and the dike. No matter how often you plug the hole, water will seep from somewhere. Rather than focusing on the leaks, the best bet for international financial community is to create a consistent and all-encompassing resolution and attack the problem from a new angle. Using loopholes in existing agreements does nothing to further strengthen investor confidence, national stability, or fiscal soundness. These three components for sovereign solvency should be the focus of the many hours and energies spent in dissecting the problems with sovereign debt; creating an international forum for conflict resolution promotes these three concepts. It is far better to treat the illness than the symptom.

B. Final Thoughts

In conclusion, the best solution to alleviate the pressure of default is a combination approach of using unilateralism and multilateralism; or, in other words, maintaining the freedom to contract, but shrouded in the safety of an international bankruptcy scheme to encompass externalities. While the SDRM is an admirable effort and mimics in many ways the


205. Id.
successful bankruptcy practices of developed nations, several aspects render it lame. Primarily, without the credibility and authority of a supranational body, neutral and empowered to ensure its enforcement, it remains as idealistic, and yet as ineffective as the intergovernmental institutions in place today. Additionally, an international endorsement will not be forthcoming without the United States altering its position on the preferred solution to debt restructuring. The dogged determination of the United States to unilaterally claim that CACs are the panacea for all the ills of the current financial crises stultifies any multilateral efforts. Even if the weaknesses of the SDRM were addressed and the process fortified with more debtor-friendly and equitable elements, such as priority for debtor financing, stays on claims and interest, and a more neutral adjudicating body than the IMF, without the United States' support, any efforts appear to be moot.

Having said that, using CACs will not alone eradicate the current economic situation, for there are too many unresolved issues, such as an absence of aggregation, challenges inherent in the volume of outstanding issuances without CACs, difficulty in locating and assembling the diverse investors, and concerns regarding U.S. securities law implications. Inevitably, the international financial community will realize this problem when the next Argentine-style default occurs, and discourse will erupt again over the optimal solution. It can only be hoped that at this point, the lessons from the SDRM will be better utilized, and a consensus will be reached establishing a regulatory framework that is economically efficient, equitable, and effective.