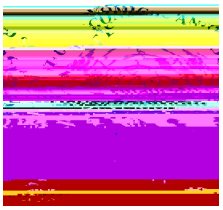

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Reforming the Process of Sovereign Debt Restructuring: A Proposal for a Sovereign Debt Tribunal

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the voluntary approach as reflected in proposed Codes of Conduct for stakeholders in the sovereign debt process; and 4) the reliance on existing institutions, notably the Paris Club (used for the restructuring of official bilateral debt) and the London Club (used for the restructuring of commercial bank debt). We will leave a more detailed description of each of these approaches for the final publication of this paper. Instead, for the purposes of this paper, we will concentrate on considering an alternative approach for reforming the process of sovereign debt restructuring: our approach focuses on the establishment of a permanent international arbitral tribunal for resolving disputes arising in sovereign debt restructurings.

II. Establishing a Sovereign Debt Tribunal for Sovereign Debt Restructurings

In an ideal world, perhaps the best and most comprehensive solution for addressing the problems of States undergoing a debt restructuring might be the introduction of a full-fledged statutory debt restructuring mechanism for sovereigns. However, for various reasons – ranging from political considerations to issues of perception – it seems unlikely, at least for the present time, that any such initiatives in that direction will come to fruition in the near term.

Under such circumstances, it appears preferable to split up the complexity of a statutory proposal such as the one put forward by the IMF and to concentrate on the introduction of certain of its component parts. Of course, the ultimate goal of such an approach is that ultimately a debt restructuring mechanism as a whole might emerge from those previously installed pieces.

Such pragmatic approach is, of course, still more than likely to be confronted with a bundle of reservations, concerns and obstacles. Therefore, it might be unrealistic to believe that there would be any kind of automatic recognition and realization of any such proposal.

It is for this reason that it is critical to give careful consideration to what aspects of a statutory approach should be looked to as the point of departure for fashioning a new approach.

For several reasons, it appears to us that the introduction of a dispute resolution panel – or, as we call it henceforth, a Sovereign Debt Tribunal – might be the most appropriate

could, at least to a certain degree and depending on the ultimate shape of such an arbitral tribunal, be reduced if not resolved through such a tribunal. Finally, a further advantage of

In contrast, our proposal envisages as a model something along the lines of the Iran-United States Claims Tribunal, which was (and still is[6]) comprised of a small number of high-profile panelists. The arbitrators would almost certainly have the opportunity to become acquainted with one another other and discuss issues of common concern and might thereby develop something resembling a common thread of reasoning in addressing similar cases.

Cre tion nd Co position of Ar itr Tri un In order to enjoy the benefits of institutional backing and a pre-existing international reputation, the arbitral tribunal should be established under the auspices of a highly reputed multilateral institution which is not a lender institution to sovereigns, i.e., an institution that may ultimately be a creditor in a sovereign debt restructuring exercise. The former (i.e. the need of a multilateral institution) excludes individual States and the latter (i.e. the need of a non-lending institution) excludes the IMF and the World Bank. These exclusions are owed to perception among certain parties of potential bias and conflict of interest. Thus, the question becomes which international institution is of sufficient international standing and is not a potential creditor that it would be well positioned to provide a home for the Sovereign Debt Tribunal. Again, the objective is to gain general and widespread acceptance of the Sovereign Debt Tribunal among those constituencies that have a vested interest in the sovereign debt restructuring process. The result is that, at present, the United Nations appears to be the most appropriate candidate.[7]

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[6] See, e.g., www.iusct.org.

[7] Further details need to be considered, e.g. where the arbitral tribunal should be located (e.g., New York, Geneva, Dehli, etc.). The idea, however, expressed, e.g., by Raffer in his contribution quoted above (fn 5) that an arbitral panel established by the UN would be in danger of becoming unduely influenced by its powerful member states, in our view, overemphasizes the potential dependencies of the selected panel of experts and neglects the strength and autonomy of what would effectively be a small "elite club. "

Some commentators have proposed that there should be enacted a kind of global

States Claims Tribunal and the debt rescheduling of Iraq after 2003.[12] The remarkable feature of these two cases is that those tribunals became enacted after the rise of the crisis.

One cannot assume, however, that such an "ex post" result can be achieved in every case. Generally speaking, in the majority of cases, it is not very likely that all stakeholders will consent to a respective sovereign's offer for arbitration once a debt crisis has begun in that particular State. It is the very experience throughout the history of sovereign defaults that so-called free riders holding a minority stake may attempt to obstruct action where a majority may be willing to act in concert. Given these facts and legal necessities, the introduction of an arbitral tribunal will usually (but not necessarily) depend on a pre-crisis consensus among the parties. This makes it critical to include an arbitration clause in each respective issuance of sovereign bonds – similar to the inclusion of CACs in issuances of sovereign bonds—or in any other relevant debt instrument used for the purposes of issuing sovereign debt.

urisdiction of Tri un : The tasks and duties of a dispute resolution panel can be

In accordance with what we consider to be our pragmatic and modest approach, we believe that, at a minimum, the arbitral tribunal should be empowered to address matters related to the verification of creditor claims as well as voting issues related to the approval of the restructuring plan and other similar matters. As a general observation, however, it should be noted that the extent to which the tribunal shall be empowered to address specific issues is

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issues of inter-creditor equity, this necessarily can be done only for those issuances that have their own respective arbitration clauses. The tribunal could then weigh, for instance, the different maturities, the risk level (rating) of each individual issuance, the promised interest rates, and all other relevant details.

However, it should be noted that the described binding effect extends only to those creditors who have agreed to subject themselves to arbitration by signing the contract by which they have bought their respective bonds or by which they have otherwise extended credit to the sovereign such as in the form of bank loans. But other creditors who have not signed such a contact containing an arbitration clause will not be bound by the tribunal's decisions. Therefore, to the extent that arbitration (as distinct from CACs) can help address the issue of potentially non-consenting creditors in a debt restructuring, this can only happen to the degree of such creditors' inclusion in the contractual binding force of an arbitration provision contained in the underlying debt instruments applicable to such creditors.

Triggers for Invoking Ar itr Mech nis : Another feature that needs to be fixed in a respective clause is the issue of when (and under which circumstances) the arbitral tribunal's task to decide on relevant issues comes into existence. In other words, what are the triggers for this mechanism and who shall be permitted to pull these triggers? The advisable answer to the first question seems to be that it is the announcement of a default – as defined in the respective issuance contract – constitutes the relevant trigger. Moreover, depending on the determination of the parties as to how they draft the specific language of a given arbitration clause, a default might commence even in something that

noted above, the parties to a sovereign debt issuance should consider whether the tribunal's competence should include the examination of whether or not the prerequisites of such a default trigger have in fact materialized.

As to the second question, it should also be specified which side shall be allowed to invoke the arbitration mechanism. The alternatives are either the sovereign alone or the creditors as well. Even though it would appear to be preferable – seen from a disciplining perspective – to bestow such a right on both sides, it might not be acceptable to sovereigns to be subjected involuntarily to such proceedings. Thus, for political reasons, pulling the trigger might be left alone to the sovereign debtor or to the sovereign debtor and creditors acting in unison.

However, since these are all contractual issues to be addressed in the respective arbitration clauses, this issue will, as a matter of fact, be left to the contractual freedom of the parties to decide whether to confer the right of invoking the arbitration proceeding to the creditors as well (whether it is each creditor individually, a certain "head"-majority of the creditors, a certain "sum"-majority of the creditors, etc.).

Governing L nd App ic e Inso venc y Ru es nd P rincip es: What shall be the relevant law for a proceeding of the Sovereign Debt Tribunal? If it is the law of a particular jurisdiction, shall issues of public international law (such as, for instance, the controversial question of "odious debts") be neglected, in toto or partially? What about the eminently important question of inter-creditor equity in cases where some bondholders, because bonds were issued under the laws of various jurisdictions, will be judged under English law, whereas other bonds, for example, will be judged under the laws of New York and yet others under German law?

Given the complexity and intricacy of these questions, it might be worthwhile considering whether or not the institution which creates the arbitral tribunal (e.g., the UN) offers as an additional option available for all respective bond issuances that the tribunal would (if agreed to by the parties to the relevant debt instrument) apply specific insolvency rules and principles. For the sake of gaining the necessary global acceptance, it may be that this would not simply be the law of a particular jurisdiction but rather something perhaps along the lines of the “law merchant.”

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instruments—whether in the bond indenture, trust indenture or otherwise—who would represent the creditors in the arbitral proceeding.

Would it be a creditors committee, and if so, how would such a creditors committee be selected and constituted, and what would be the process of consultation with the larger body of creditors? Or would it be the indenture trustee acting on behalf of the bondholders and taking instructions from the bondholders in a certain prescribed manner? These issues would need to be confronted head-on in the period prior to the issuance of the sovereign bonds. Otherwise, the arbitration process might become

Finally, if our proposal for the Sovereign Debt Tribunal can be successfully established and then successfully utilized in specific sovereign debt restructurings, it could be a useful confidence-building measure for embracing broader objectives in the area of sovereign debt reform. Any such positive experiences with the Sovereign Debt Tribunal—and particularly an ensemble of such positive experiences—might lead the stakeholders in sovereign debt restructurings to be more willing to consider other more fundamental reforms to the sovereign debt restructuring process.