

Binding Creditors to a Sovereign Debt Restructuring Plan: Methods and Implementation

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I. Assumptions

A. Sovereign Debt Restructuring Mechanism (SDRM): The Insolvency Law of the Insolvency Jurisdiction

Law or regulation of the Insolvency Jurisdiction—a sovereign state, which may or may not be debtor state, or an international intergovernmental organization, e.g., IMF

I. Assumptions (cont'd)

B. Contents of the Insolvency Law:

- E.g., initiation and plan proposal by debtor state, classification of claims, supermajority voting (per ICMA Model CACs) on plan, creditor priorities undisturbed, no cramdown of dissenting classes, etc.
- Model CACs have become/are becoming accepted norm in voluntary sovereign debt restructurings.

I. Assumptions (cont'd)

C. Restructuring Plan:

- Plan has been approved by supermajority of each class of claims in accordance with the Insolvency Law.
- Plan modifies terms of pre-restructuring debt and provides new debt contracts in exchange.

II. The Insolvency Law vs. Recognition and Application

- A. Two independent processes.
- B. The Insolvency Law governs the process under which a restructuring plan is proposed and approved.
- C. A totally separate issue is whether the courts of *another state* (e.g., an Enforcement State) would recognize, enforce, and apply the restructuring plan over a creditor's objection.

II. The Insolvency Law vs. Recognition and Application (cont'd)

- D. The law of an enforcement state need not include an SDRM, such as the Insolvency Law, for the courts of an enforcement state to be obligated to recognize, enforce, and apply the restructuring plan.
- E. Stated otherwise, the courts of an enforcement state may be obligated to recognize, enforce, and apply the restructuring plan whether or not the law of an enforcement state includes an SDRM.

II. The Insolvency Law vs. Recognition and Application (cont'd)

F. This is one point where the approach that I advocate differs from Steven Schwarcz's Model Law proposal. That proposal would tie a state's obligation to recognize, enforce, and apply the restructuring plan to the state's enactment of an SDRM in the form of the proposed Model Law.

III. Methods and Implementation for Binding Creditors to a Restructuring Plan

A. Recognition or Application of Restructuring Plan

- Adopting states would recognize restructuring plans proposed and approved in accordance with a law incorporating agreed standards (such as those incorporated in the Insolvency Law).
- The same result could be achieved by adopting states' application of the law of the Insolvency Jurisdiction if its SDRM conformed to, and plan was approved in accordance with, the agreed standards.

III. Methods and Implementation for Binding Creditors to a Restructuring Plan (cont'd)

B. Multilateral Convention or Reciprocal Model Law on Recognition and Choice of Law

- States would become bound to recognize and apply restructuring plans as parties to a convention or by adopting a model law.

III. Methods and Implementation for Binding Creditors to a Restructuring Plan (cont'd)

C. Binding Creditors as Nationals of Adopting States

- States would require creditors that are nationals to be bound by restructuring plans and restrict nationals from transferring claims to non-nationals unless the latter agrees to be bound by any qualifying restructuring plan.

III. Methods and Implementation for Binding Creditors to a Restructuring Plan (cont'd)

D. Expansion of Scope of Law Governing Debt to Include SDRM and Restructuring Plan

- States adopting a convention or model law would agree that (i) the law governing a debt contract would include that state's adoption of the convention or model law and (ii) holders of that debt would be bound by a restructuring plan under that state's law or the law of another adopting state.

III. Methods and Implementation for Binding Creditors to a Restructuring Plan (cont'd)

D. Expansion of Scope of Law Governing Debt to Include SDRM and Restructuring Plan (cont'd)

- This approach is similar to Steven Schwarcz's Model Law proposal based on the idea the New York's adoption of the Model Law would be sufficient to restructure and modify New York law-governed debt contracts.

III. Methods and Implementation for Binding Creditors to a Restructuring Plan (cont'd)

D. Expansion of Scope of Law Governing Debt to Include SDRM and Restructuring Plan (cont'd)

- But this would not provide assurance that a restructuring plan would be recognized and applied by a court outside of New York.
- That a foreign court would respect a choice-of-law provision in a debt contract does not ensure that the court would recognize a judgment or restructuring plan effected under the chosen state's law.

IV. The No-Tribunal SDRM—A Next Step?

THE EMPTY BENCH



IV. The No-Tribunal SDRM—A Next Step? (cont'd)

- IMF SDRM proposal sticking point: Stakeholders' submission to jurisdiction to a tribunal.
- The No-Tribunal SDRM(NTSDRM)—the Insolvency Law—would impose the terms of the Model CACs, as substantive rules, *as if* the debtor state's debt contracts all contained those terms.
- This would be consistent with the approach of Chapter 11 in the U.S. and any insolvency laws that require a restructuring plan to be approved by a supermajority of classes of creditors to bind all creditors.

IV. The No-Tribunal SDRM—A Next Step? (cont'd)

- The debtor state would propose a plan and a vote would be conducted.
- Provisions to supplement the Model CACs would be necessary, however, to accommodate debt other than the debt securities contemplated by the Model CACs.
- Also, such other debt would not be covered by a registry identifying the holders. An international sovereign debt registry would be helpful in this respect.

IV. The No-Tribunal SDRM—A Next Step? (cont'd)

- Would the NTSDRM be acceptable to states? It would, perhaps, but only if acceptable to the market—*i.e., the investors*.
- The relevant investors: The 90+% that have accepted exchange offers in recent years.
- The NTSDRM based on the Model CACs would embrace what is becoming the market standard for bond contracts.
- This approach would impose the Model CACs without waiting a decade or so for incorporation into debt contracts.

IV. The No-Tribunal SDRM—A Next Step? (cont'd)

- Dispute resolution would be handled in the NTSDRM in the same way it would be handled were disputes to arise in the operation of the Model CACs.
- Disputes could arise concerning matters such as the validity of a claim, the identity of the holder of a claim, the conduct of voting by creditors, and whether a restructuring plan was otherwise proposed and approved in accordance with the Insolvency Law.

V. Constitutional Impediments, Retroactive Application to Pre-Existing Creditors' Claims, and Extraterritorial Application

Contents of Insolvency Law and States' Obligations to Recognize and Apply Restructuring Plan

- Must be tested against a state's constitutional framework: Powers, authority, retroactive application to pre-existing claims, protections of contract and property rights, etc.
- Must be tested against international law: Extraterritorial application of state's prescriptive jurisdiction.

V. Constitutional Impediments, Retroactive Application to Pre-Existing Creditors' Claims, and Extraterritorial Application (cont'd)

- Given unique nature of SDRM, enforceability of SDRM regime may be uncertain in some jurisdictions.
- E.g., U.S. Constitution:
 - Article I, Section 10 (Contracts Clause): “No State shall . . . pass any . . . Law impairing the Obligation of Contracts.”
 - XIV Amendment, Section 4: “The validity of the public debt of the United States . . . Shall not be questioned.”

V. Constitutional Impediments, Retroactive Application to Pre-Existing Creditors' Claims, and Extraterritorial Application (cont'd)

- A cornerstone of Steven Schwarcz's Model Law proposal is that New York's enactment of the Model Law would permit restructuring and modification of New York law-governed debt under that law without running afoul of the Contracts Clause of the U.S. Constitution.
- I am quite skeptical about that conclusion and even if the argument were sound I suspect that it would be adequate to support the *ex ante* reliance necessary for the restructuring framework to be successful.

V. Constitutional Impediments, Retroactive Application to Pre-Existing Creditors' Claims, and Extraterritorial Application (cont'd)

- Further study on a multijurisdictional basis is warranted, perhaps by NGOs such as the International Insolvency Institute.

VI. (Not Particularly Happy) Tentative Conclusions

- *Even assuming*, a political consensus were to emerge in favor of a statutory SDRM, the legal issues implicated in binding creditors to a restructuring plan would loom large.
- Many of these issues have been under-studied and under-conceptualized.
- Further research and investigation may reveal that notwithstanding perceived benefits of a statutory SDRM, resolving the legal issues on a worldwide basis would make the approach impractical.