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AS GREECE GOES, SO GOES THE E.U.: DEFENDING EUROPE WITH A SOVEREIGN DEBT RESTRUCTURING FRAMEWORK

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I. INTRODUCTION

The European sovereign debt crisis has devolved into a complex whack-a-mole game, confounding expert policymakers, global financial analysts, and pundits. Each day brings new headlines as the crisis continues to evolve with no end in sight. Every new development sends a shockwave through the global financial markets and spreads uncertainty from large international financial institutions down to average working men and women. In response to this volatility, European policymakers gathered in October 2011 at the Euro Summit.[1] The meeting concluded months of posturing and set the framework for a precarious compromise—the Euro Summit Statement (the Statement): a mix of bailouts, austerity measures, and haircuts for the banks. Then, in December, the Euro Summit moved forward with its promises under the Statement and signed an intergovernmental treaty. The treaty set the terms for "structural reforms and fiscal consolidation" in order to enhance E.U. fiscal "monitoring and [to correct] macroeconomic imbalances."[2]

However, this *ad hoc* solution, the Statement, and the treaty reform steps, have done little to quell fears.[3] Instead, Europe is faced with a new set of questions: How long can these European Financial Stability Facility (EFSF) bailout funds last? What role will the non-Eurozone European Union (E.U.) member states[4] play in the current bailout and future fiscal reforms? Can Greece be saved and will Europe be able to

* Staff Attorney, Seyfarth Shaw LLP. I am grateful for comments from Robert Dremluk, Esq., Professor Edward Janger of Brooklyn Law School and the participants in the Brooklyn Law School Bankruptcy and Commercial Law Colloquium.

1 Euro Summit Statement, Euro Summit (Oct. 26, 2011), http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/125644.pdf.

2 Presidency Conclusions, Brussels European Council, (Dec. 9, 2011), http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/126714.pdf [hereinafter *Conclusions*].

3 *See* Sudeep Reddy, *Geithner Presses Europe for Debt Solution*, WALL ST. J., Dec. 7, 2011, http://online.wsj.com/article/SB10001424052970204770404577082512791508098.html; Patrick Donahue, *Greek Debt Talks Risk Derailing EU Summit*, BLOOMBERG, Jan. 30, 2010, http://www.bloomberg.com/news/print/2012-01-29/greek-debt-talks-risk derailing-eu-summit/ ("The fact we're still at the beginning of 2012 talking about Greece is a sign this problem hasn't been dealt with." (quoting George Osborne, U.K. Chancellor of the Exchequer)).

4 The Eurozone is composed of seventeen out of twenty-seven member states of the European Union who have adopted the euro as their common currency. *Introduction*, EUR. CENTRAL BANK, http://www.ecb.int/euro/intro/html/index.en.html (last visited Nov. 12, 2011).

regroup to save Spain, Italy, and potentially, Portugal—or will the seventeen nations that joined together to adopt one common currency dissolve and end the euro experiment?[5] Now, the world waits as the Eurozone member states, and the greater E.U., attempt to address these concerns and continue to battle this evolving debt beast.[6] This uncertainty is worrisome in an increasingly inter-connected financial world.[7] Therefore, to respond to this crisis and likely, future crises, a clear framework to efficiently and effectively restructure sovereign debt is necessary.

The creation of a European framework can accomplish the goal of restructuring sovereign debt efficiently and effectively.[8] The framework must provide "adequate incentives to ensure the timely and orderly restructuring of unsustainable sovereign debts."[9] The need for such a framework is not a recent development.[10] Sovereign insolvency and the need for a restructuring mechanism are issues that have continually faced sovereign nations and sovereign debt purchasers. Therefore, sovereign debt scholars and institutional entities have previously proposed mechanisms to respond to these sovereign debt crises, including: (1) the International Monetary Fund's (IMF) Sovereign Debt Restructuring Mechanism (SDRM) and (2) the Collective Action Clauses (CAC). For the time being, both of these proposals remain fixtures of academic discussion and debate. The IMF formally removed the SDRM from consideration, and CACs, while common components in sovereign bond contacts, have never been used to implement a full-scale restructuring.[11] Therefore, these proposals, in addition to the Statement, provide the foundation from which to frame a new proposal: the creation of a European Debt Restructuring Framework (EDRF).[12]

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[5] Liz Alderman, *Banks Build Contingency for Breakup of the Euro*, N.Y. TIMES, Nov. 25, 2011, http://www.nytimes.com/2011/11/26/business/global/banks-fear-breakup-of-the-euro-zone .html?_r=1&hp [hereinafter Alderman, *Banks Build Contingency for Breakup of the Euro*]; *see* Donahue, *supra* note 3.

[6] While not all E.U. member states have agreed to adopt the euro, all E.U. member states are vulnerable to uncertainty in the euro and have an interest in rebuilding fiscal security in Europe. *See* FRANÇOIS GIANVITI ET AL., A EUROPEAN MECHANISM FOR SOVEREIGN DEBT CRISIS RESOLUTION: A PROPOSAL 21–23 (Andrew Fielding ed., 2010) [hereinafter GIANVITI].

[7] GIANVITI, *supra* note 6, at 3 (noting that the *ad hoc* solutions are incomplete and fail to provide a framework to address "future debt crises in the euro area").

[8] *See* GIANVITI, *supra* note 6, at vi ("As French XVIIth-century churchman and occasional conspirator Cardinal de Retz used to say, 'one leaves the realm of ambiguity at one's peril.'").

[9] ANNE O. KRUEGER, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING v (2002), *available at* http://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf.

[10] *Id.*

[11] *See* Part II, A & B *infra*. *But see* Landon Thomas Jr., *Next Time, Green May Need New Tactics*, N.Y. TIMES, Mar. 9, 2012, http://www.nytimes.com/2012/03/10/business/global/greece-debt-restructuring-deal-private-lenders.html?hp=&pagewanted=print [hereinafter Thomas, *Greece May Need New Tactics*] (noting the Greek's recent use of collective action clauses to force creditors to support a new debt relief plan).

[12] In order to address the full scope of a sovereign's debt burden, a restructuring, not a rescheduling, is required. In a rescheduling parties agree to amend the "timetable of repayments without changing their present value." GIANVITI, *supra* note 6, at 4 n.1. Whereas a restructuring involves:

In response to the growing sovereign debt crisis, E.U. policymakers should revive the SDRM, addressing the problems that led to its failure and adapting its successful elements, to create the EDRF. The IMF's premier international economists worked to develop the SDRM.[13] Even though the SDRM ultimately failed to gain international support, the mechanism provides a useful foundation for drafters writing a new framework tailored to the E.U.'s needs. This framework would allow a sovereign-debtor and its creditors to initiate and conduct negotiations for orderly debt restructuring and the efficient administration of the debtor and creditor interests.[14] In addition, it would alleviate the growing burden on debtor nations, while also protecting (or at least addressing) the other E.U. member states and European nationals' interests.

Part II will outline the history of sovereign debt and its reoccurring crises and discuss previous proposals to curb these crises, specifically the SDRM and CACs. Part III will address the current crisis in Europe, most specifically, the debt crisis in Greece and the Euro Summit's *ad hoc* response. Part IV will argue for the creation of a new restructuring framework, EDRF, allowing for the orderly and efficient restructuring of sovereign debt. Finally, Part V will address potential criticisms of the EDRF and argue that despite these concerns, the EDRF is the most efficient and effective response to sovereign debt restructuring because it can protect the interests of the sovereign-debtor, its creditors, and its citizens.

II. A HISTORY OF CRISIS & FAILED SOLUTIONS

Countries issue sovereign bonds in order to raise capital. The terms of the bond contract define the rights and obligations of the bond issuer (the sovereign nation) and the bond purchaser (the creditor).[15] If a country becomes overleveraged and undercapitalized, it may be either unwilling or unable to continue payment to bondholding creditors. When sovereigns default on this contractual agreement, a sovereign debt crisis may ensue.[16]

> a combination of fiscal adjustments by the defaulting government on the one hand and, on the other, cutting the amount of debt outstanding, prolonging the maturity of the remaining debt and reducing the interest paid on it. Its main purpose is to return the debtor-country back to a state of sustainable public finances. At the same time, it aims at a fair distribution of the cost of restructuring between the borrower and the creditors.

Id. at 10.

[13] KRUEGER, *supra* note 9, at v.

[14] *See, e.g.*, GIANVITI, *supra* note 6, at 4.

[15] MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (forthcoming Dec. 2012).

[16] BANK FOR INT'L SETTLEMENTS COMM. ON THE GLOBAL FIN. SYS. STUDY GROUP, CGFS PAPERS NO. 43: THE IMPACT OF SOVEREIGN CREDIT RISK ON BANK FUNDING CONDITIONS 1–2 (2011).

Sovereign debt crises have occurred more frequently in the past few decades. In the 1980s, Mexico was the harbinger of a debt crisis that spread throughout Latin America.[17] In the 1990s, "excessive indebtedness fuel[ed] excessive consumption," leading to a crisis in East Asia.[18] Most recently, Argentina, Ecuador, Pakistan, Ukraine, and Uruguay have all faced economic crises requiring them to restructure their sovereign bonds.[19]

In response to these crises, sovereign debt scholars and institutions, such as the IMF, decided to develop a framework for the orderly restructuring of sovereign debt.[20] The two solutions that emerged from this scholarship are the SDRM and CAC proposals. Neither proposal has been subsequently adopted—In 2003, the IMF formally removed SDRM from consideration, while CACs are now a common clause in bond contracts, but have never been used collectively to affect a full-scale restructuring.[21] While these proposals are not adequate solutions, they provide a useful foundation for the development of a new European framework for restructuring sovereign debt.

A. The IMF's Sovereign Debt Restructuring Mechanism

After the sovereign debt crises in Latin America, when the IMF was forced to assume the role of "the lender of last resort,"[22] a team of economists at the IMF, led by Anne O. Krueger, drafted the SDRM.[23] The central goal was to "facilitate the orderly, predictable and rapid restructuring of unsustainable sovereign debt, while protecting asset

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[17] Lee C. Buchheit & G. Mitu Gulati, *Greek Debt: The Endgame Scenarios*, 10 Duke Law Faculty Scholarship, Paper No. 2380 (Apr. 18, 2011), *available at* http://scholarship.law.duke.edu/faculty_scholarship/2380 ("In August of 1982, Mexico was forced to declare a moratorium on the repayment of its external debt owed to commercial banks. Over the course of the next two years, more than twenty other countries followed suit—it later came to be called "the global debt crisis" of the 1980s."); Ross P. Buckley, *The Bankruptcy of Nations: An Idea Whose Time Has Come*, 43 INT'L LAW. 1190, 1194–96 (noting the "severe crisis" in Argentina).

[18] Buckley, *supra* note 17, at 1194 (noting the East Asia crisis from 1996 through 1998 spread across Malaysia, Korea, Indonesia, Thailand and the Philippines); *see also* Lee C. Buchheit, *A Quarter Century of Sovereign Debt Management: An Overview*, 35 GEO. J. INT'L L. 637, 639 (2004) [hereinafter Buchheit, *An Overview*] ("Since 1982, not a single year has passed without sovereign debt issues occupying a prominent place in the headlines . . . .The time has now come when some of those borrowers will have to master the technique of restructuring those securities.").

[19] *See* Buchheit, *An Overview*, *supra* note 18, at 638.

[20] KRUEGER, *supra* note 9, at 39 ("Sovereigns with unsustainable debts often wait too long before they seek a restructuring, leaving both their citizens and their creditors worse off. And when sovereigns finally do opt for restructuring, the process is more protracted than it needs to be and less predictable than creditors would like.").

[21] *See infra* notes 35, 48–62.

[22] *See* Jeffrey D. Sachs, Director of the Harvard Center for International Development, Remarks delivered at a conference: The International Lender of Last Resort: What are the Alternatives?, 181, *available at* http://www.earth.columbia.edu/sitefiles/file/Sachs%20Writing/1999/FedResBankofBoston_InternationalLenderofLastResort_June1999.pdf (last visited Oct.29, 2012).

[23] KRUEGER, *supra* note 9, at v, 4.

values and creditors' rights."[24] Therefore, SDRM allows a sovereign to exercise an option to restructure its debt when "no feasible set of sustainable macroeconomic policies would enable the debtor to resolve the immediate crisis and restore medium-term viability."[25] The SDRM mechanism for restructuring debt can be initiated only by the sovereign; the IMF and/or creditors cannot impose a sovereign's debt restructuring under the SDRM.[26]

Three main components defined the SDRM plan:

> **Majority Restructuring:** The restructuring plan could be approved by a vote of a "supermajority of creditors" whose vote would bind all creditors.[27] Here, the goal was to expedite the plan approval process and eliminate "distributive litigation."[28]
>
> **Protect creditor interests with "adequate assurances**"[29]**:** For example, the sovereign could not make payments to non-priority creditors or the sovereign would agree to "conduct policies in a fashion that preserves asset values."[30] In order to regulate this provision, certain transparency requirements would be established.[31]
>
> **Priority Financing:** Creditors would be ranked in seniority order, and creditors who provide fresh capital to the sovereign would be awarded most-senior status.[32] This would allow the sovereign to continue operating as a sovereign entity.[33]

Combining all three principles, the SDRM would have provided a sovereign with the opportunity to restructure its debt while also balancing creditors' interests. Protections, such as the adequate assurances and priority financing, incentivized creditors to participate in the restructuring.[34] Through the exercise of SDRM, the sovereign-debtor and its creditors could negotiate a restructuring plan allowing the

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[24] KRUEGER, *supra* note 9, at 39; *Fail safe: What do German calls for an orderly sovereign-default scheme mean in practice?*, ECONOMIST, Nov. 4, 2010, http://www.economist.com/node/17414142.

[25] KRUEGER, *supra* note 9, at 4.

[26] KRUEGER, *supra* note 9, at 4.

[27] KRUEGER, *supra* note 9, at 14–15.

[28] KRUEGER, *supra* note 9, at 14–15; *see also A Factsheet: Proposals for Sovereign Debt Restructuring Mechanism (SDRM)*, INT'L MONETARY FUND [IMF] (Jan. 2003), http://www.imf.org/external/np/exr/facts/sdrm.htm [hereinafter IMF, *Factsheet*].

[29] KRUEGER, *supra* note 9, at 16–17.

[30] KRUEGER, *supra* note 9, at 16–17.

[31] IMF, *Factsheet*, *supra* note 28.

[32] KRUEGER, *supra* note 9, at 17.

[33] IMF, *Factsheet*, *supra* note 28.

[34] To the extent creditors' rights are not sufficiently protected then "[a] dispute resolution forum would be established to resolve disputes that may arise during the voting process or when claims are being verified." IMF, *Factsheet*, *supra* note 28.

sovereign to continue to function as a nation while also paying off its debts.

Despite the best efforts of Anne Krueger and the IMF, the SDRM failed to gain sufficient international support and the proposal was formally removed from consideration.[35] Investors, who may have been creditors under this structure, feared the SDRM would reduce their potential payoffs from indebted sovereigns[36] and would allow for "ex post facto modification of their contractual rights under outstanding bonds."[37] This was considered an unreasonable imposition on a creditor's right to repayment under the sovereign bond contract. In addition, creditors ran the risk that the SDRM may "lead to less demand for their funds and higher risks for funds they provide."[38] On the other hand, sovereigns feared that the SDRM would "raise the price of credit due to the increased ease of restructuring and the corresponding decrease in bailouts."[39] Additionally, nations feared the SDRM would interfere with a nation's right of absolute sovereignty in general, and its sovereign immunity in particular.[40] As a result of these concerns, the SDRM was quick to attract opponents and slow to garner support. Finally, at the spring 2003 IMF meeting, the IMF's governing body decided to drop the SDRM from future consideration.[41]

B. Collective Action Clauses

The proposed use of CACs for restructuring debt arose as bond-issuing sovereigns, specifically, the Group of Ten,[42] responded to SDRM.[43] A CAC is a clause that is included in the bond contract to allow a set percentage of creditors, usually at least a majority, to bind a minority of dissenters to a restructuring agreement.[44] A CAC can "facilitate bond restructurings by lowering the threshold for agreement to a restructuring by bondholders from unanimity to an agreed-upon percent

[35] Buckley, *supra* note 17, at 1213; *see also* GIANVITI, *supra* note 6, at 19.

[36] Hal S. Scott, *A Bankruptcy Procedure for Sovereign-debtors*, HARVARD LAW (9/3/2003 1:44 PM), http://www.law.harvard.edu/programs/about/pifs/research/10scott.pdf; *see also* Sergio J. Galvis & Angel L. Saad, *Collective Action Clauses: Recent Progress and Challenges Ahead*, 35 GEO. J. INT'L L. 715 (2004).

[37] Galvis & Saad, *supra* note 36, at 715.

[38] Scott, *supra* note 36, at 50.

[39] *Id.*; Robert Gray, *Collective Action Clauses: Theory and Practice*, 35 GEO. J. INT'L L. 693, 697–98 (2004). This is an especially large concern for developing nations, who face a higher risk of default, and yet are most in need of the financial assistance provided by issuing sovereign bonds. *See* GIANVITI, *supra* note 6, at 19.

[40] Buckley, *supra* note 17, at 1213 (citing John B. Taylor, Sovereign Debt Restructuring: A U.S. Perspective (Apr. 2, 2002) ("It appears that the United States opposed the SDRM partly because it represented an expansion of IMF powers . . . ")); Gray, *supra* note 39, at 694–95.

[41] Buckley, *supra* note 17, at 1213.

[42] The Group of Ten includes Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States, which "consult and co-operate on economic, monetary and financial matters." *G10*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/list/g10publications/index.htm (last visited Dec. 10, 2011).

[43] *See* Gray, *supra* note 39, at 695.

[44] *See* Gray, *supra* note 39, at 695–96.

super-majority rule."[45] The threshold percentage of creditors to establish consent is set by the terms of each particular CAC.[46] When creditors reach the threshold, a restructuring can occur.[47] The CAC's goal is to ensure that the bargaining tactics of a minority group of holdouts does not indefinitely frustrate negotiations.[48] These clauses had been included in English law bonds since the nineteenth century.[49] However, CACs only arose in bonds governed by New York law in response to the SDRM.[50] Proponents of this contractual solution argued that CACs provided the same restructuring relief without the intrusive SDRM provisions, in particular the requirement of IMF oversight.[51] Opponents argued that including a CAC would send a negative signal to investors.[52] In 2003, however, Mexico issued the first CAC in a New York bond without alarming investors.[53] This successful CAC experiment opened the door for the use of CACs in future bond issuances. As a result, CACs are now common terms in the majority of sovereign bond issuances—governed by either English or New York law.[54]

Even though CACs are now commonplace, the power of the CAC as a restructuring mechanism is limited. Each CAC defines the ability to renegotiate the terms of the bond contract for its particular issuance. The voting majority of creditors, as defined by the CAC, can only agree to a restructuring that would be binding on all holders of that issue.[55] In the event that a sovereign must engage in a large restructuring of all sovereign debt bonds, the "CAC approach would require separate decisions from holders of each individual bond issue."[56] The nation is faced with an aggregation problem, whereby a nation having sold many bonds through many different issuances, must invoke the CAC in each

[45] Patrick Bolton & Olivier Jeanne, Structuring and Restructuring Sovereign Debt: The Role of a Bankruptcy Regime, (2007), http://www.imf.org/external/pubs/ft/wp/2007/wp07192.pdf.

[46] GROUP OF TEN, REPORT OF THE G–10 WORKING GROUP ON CONTRACTUAL CLAUSES 2 (2002) [hereinafter G-10 REPORT], http://www.imf.org/external/np/g10/2002/cc.pdf (for bonds issued under English law the qualified majority is typically set at 75% of bondholders).

[47] GULATI & SCOTT, *supra* note 15, at 36.

[48] G-10 REPORT, *supra* note 46, at 4 (asserting that the majority provision will reduce the risk that an "organized minority" will "hold up the process that a reasonable majority support[]"); Galvis & Saad, *supra* note 36, 714–15.

[49] Gray, *supra* note 39, at 695; *see* Elmar B. Kock, *Collective Action Clauses: The Way Forward*, 35 GEO. J. INT'L L. 665, 667 (2004).

[50] Gray, *supra* note 39, at 695 (adopting CACs in the New York bonds required "convincing the U.S. investor community that the use of CACs did not represent a threat to their interests.").

[51] Gray, *supra* note 39, at 695.

[52] Gray, *supra* note 39, at 695.

[53] Gray, *supra* note 39, at 698 (the first "New York-law, SEC-registered bond to include CACs" was issued by Mexico in February 2003. Mexico "had previously expressed its skepticism about . . . adopting CACs. This suggested to the market that its move was indeed a measure of its concern with the threat of the SDRM alternative to its access to capital."); *see also* Galvis & Saad, *supra* note 36, at 715–16 ("Mexico's bonds incorporate . . . a 'majority amendment' clause permitting holders of seventy-five percent or more of the total outstanding principal amount of the bonds to amend 'reserve matters,' which include basic payment terms . . . .").

[54] GULATI & SCOTT, *supra* note 15, at 36; *see also* Galvis & Saad, *supra* note 36, at 717–18.

[55] G-10 REPORT, *supra* note 46, at 3.

[56] IMF, *Factsheet*, *supra* note 28.

issuance and negotiate with each group of creditors separately.[57] As a result, the CAC's usefulness on a large-scale is questionable.[58] In addition, unlike the SDRM, "[c]reditors of issues not accepting a restructuring offer would have the right to pursue their interests in the courts of the country/state under whose laws the debt instruments were issued."[59] While creditors are limited in their enforcement options against sovereign-debtors, the absence of an aggregate action provision among all CACs,[60] or an automatic stay, leaves the sovereign without any protection in the event creditor litigation is successfully executed.[61]

For practical purposes, the SDRM and CAC approaches remain "thought experiments" in the context of a full-scale sovereign debt restructuring rather than an applicable policy.[62] Not only did the IMF remove the SDRM from consideration, but Europe also responded to the present crisis by negotiating its own *ad hoc* response. While the policymakers are certainly experts in the field, informed about both proposals, neither proposal was formally invoked in the Statement or the Treaty. As the European sovereign debt crisis highlights, the absence of a clear framework for restructuring leads to greater uncertainty, which fuels the crisis further.

III. ENTERING CRISIS MODE: THE EUROPEAN SOVEREIGN DEBT CRISIS

A. Sovereign Nations on the Brink

Over the last three years, the E.U. member states have approached and receded from the precipice of a massive default.[63] While Greece and Italy are the "crises de jour,"[64] these are only two nations in the domino

[57] *See, e.g.*, GIANVITI, *supra* note 6, at 15.

[58] David A. Skeel, Review Essay, *Can Majority Voting Provisions Do It All?*, 52 EMORY L.J. 417, 422 (2003) ("Majority voting provisions may be all the sovereign needs to effect a restructuring if it has only issued one or two classes of bonds. But the voting strategy is much less attractive if the sovereign's borrowings are more elaborate.").

[59] IMF, *Factsheet*, *supra* note 28.

[60] For more information on aggregate reforms see Galvis & Saad, *supra* note 36, at 727.

[61] Skeel, *supra* note 58, at 423–24.

[62] Skeel, *supra* note 58, at 424 (arguing that the contractual approach is more appropriately defined as a thought experiment. Therefore, "we really do need a sovereign debt restructuring mechanism if we are serious about addressing the sovereign debt crisis.").

[63] Landon Thomas, *As Greece Struggles the World Imagines a Default,* N.Y. TIMES, Sept. 19, 2011, http://www.nytimes.com/2011/09/20/business/global/as-greece-struggles-the-world-imagines-a-default.html?pagewanted=all [hereinafter Thomas, *As Greece Struggles*]; Steven Erlanger & Stephen Castle, *Europe Agrees to Basics of Plan to Resolve Euro Crisis*, N.Y. TIMES, Oct. 29, 2011, http://www.nytimes.com/2011/10/27/world/europe/german-vote-backs-bailout-fund-as-rifts-remain-in-talks.html [hereinafter Erlanger & Castle, *Europe Agrees to Basics of Plan*].

[64] *Times Topics: Global Recession*, N.Y. TIMES, http://topics.nytimes.com/top/reference/timestopics/subjects/e/european_sovereign_debt_crisis/index.html?ref=global (last updated Feb. 13, 2012) [hereinafter *Global Recession*] ("The debt crisis first surfaced in Greece in October 2009, when . . . Prime Minister George A. Papandreou announced that his predecessor had disguised the size of the country's ballooning deficit . . . . Greece took advantage of this easy money to drive up borrowing by the country's consumers and its government, which built up $400 billion in debt."); Thomas, *As Greece Struggles*, *supra* note 63; Cullen Roche, *Five Possible Outcomes for the Euro Crisis*, BUS. INSIDER Sept. 2011.

line of highly leveraged and nearly insolvent European nations—which also include Ireland, Spain, and Portugal.[65] These nations, already known as the Eurozone's "weakest economies,"[66] ignored the debt limits set by the Stability and Growth Pact [67] and engaged in practices that led to "enormous" and likely insurmountable, debt loads.[68] The growing crisis sparked "[a] series of negotiations, bailouts and austerity packages," but these measures "failed to stop the slide of investor confidence or to restore the growth needed to give struggling countries a way out of their debt traps."[69]

As the policymakers "flail[ed] in their efforts to come up with a big plan, fast, to get to grips with the region's debt crisis,"[70] the world watched in increasing consternation.[71] Nationals demonstrated in public plazas across Europe;[72] leading governments were voted out of office—mainly in response to the harsh and unprecedented austerity measures;[73] and markets reacted frequently and wildly to each new report—most especially, reports regarding the broad exposure of European banks, which are deeply invested in government bonds.[74] Despite this growing

[65] *Global Recession*, *supra* note 64; *see also* BANK FOR INT'L SETTLEMENTS, *supra* note 16, at 1.

[66] *Global Recession*, *supra* note 64.

[67] The Stability and Growth Pact is an accord signed by each member state of the Eurozone to set national debt and deficit limits that strive to "maintain budget discipline in order to avoid excessive deficits." *Stability and Growth Pact and Economic Policy Coordination*, EUROPA, http://europa.eu/legislation_summaries/economic_and_monetary_affairs/stability_and_growth_pact/index_en.htm (last visited Nov. 12, 2011); Resolution of the European Council on the Stability and Growth Pact, 1997 O.J. (C 236), *available at* http://europa.eu/legislation_summaries/economic_and_monetary_affairs/stability_and_growth_pact/l25021_en.htm; *see also European Report*, BLOOMBERG LAW, Sept. 9, 2011, www.bloomberglaw.com ("The pact was shown to be ineffective when the crisis hit, as more than 20 member states were found to be running too-high budget shortfalls.").

[68] *Global Recession*, *supra* note 64 (noting that European leaders were forced to respond to concerns about Italy and Spain through intervening in the market because many see these countries as "too big to bail out").

[69] *Global Recession*, *supra* note 64.

[70] *The Plan to Have a Plan: Solving the Euro-zone Crisis*, ECONOMIST, Oct. 8, 2011, http://galenet.galegroup.com/servlet/BCRC?vrsn=unknown&locID=nysl_me_brooklaw&srchtp=adv&c=1&ste=31&tbst=tsVS&tab=2&RNN=A268890969&docNum=A268890969&bConts=2 [hereinafter *The Plan to Have a Plan*].

[71] In fact, large financial institutions are beginning to lose confidence that the euro will survive this crisis and are preparing for the worst. Alderman, *Banks Build Contingency for Breakup of the Euro*, *supra* note 5.

[72] *Global Recession*, *supra* note 64 ("Protests by traditional interest groups like public sector unions were joined by crowds of young people who camped out in Madrid and Athens in imitation of the Arab Spring demonstrations.").

[73] *Global Recession*, *supra* note 64 (noting that harsh austerity measures have led to the "ouster of governments in Ireland and Portugal, dragging the government of Greece to the brink and weakening the ruling party in Spain"); In order to implement the measures adopted in the Statement, both Greece and Italy removed the ruling government and new leaders are charged with the responsibility of implementing these new economic reforms. *See* Guy Dinmore & Giulia Segreti, *Italian Vote Paves the Way for Berlusconi Exit*, FINANCIAL TIMES, Nov. 12, 2011, http://www.ft.com/intl/cms/s/0/b4217efa-0d52-11e1-a47c-00144feabdc0.html#axzz1dWWCa4aP.

[74] *Global Recession*, *supra* note 64 (discussing the concerns about bank exposure, which arose in October of 2011, but remain precarious into December. For example, on December 21, 2011 the European Central Bank issued "cheap three-year loans" totaling almost a half a trillion euros "as part of its unprecedented effort to keep credit flowing.").

volatility, "Europe's progress [was] hampered by the usual mixture of public bickering and behind-the-scenes brinkmanship."[75] Finally, in October 2011, the Euro Summit met in Brussels with all eyes and ears attentively waiting for a deal, for a solution, for any hope that the policymakers could collectively act to stop the growing crisis in Greece and contain the problem.[76]

B. The Euro Summit Statement: Greece's Bailout Compromise

The Euro Summit, a meeting of fiscal policy leaders from all seventeen Eurozone member states, agreed to a set of compromises set forth in the Euro Summit Statement.[77] The Summit had two main objectives: (1) immediate aid to Greece, and (2) prevent the spread of the crisis, or limit the expansion of the crisis to other "at risk" nations.[78] The Statement attempted to accomplish those objectives with the following:

Greek Provisions

Greece: Will reduce its public debt to GDP ratio to 120% by 2020 and introduce austerity measures to accomplish this goal; [79]

European Banks: Will accept a 50% loss on the face value of all Greek debt[80] and will raise $147 billion in new capital by the end of June 2011 to protect themselves against losses on loans to Greece and Portugal;[81]

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[75] *The Plan to Have a Plan*, *supra* note 70.

[76] Liz Alderman, *Europeans Struggle Towards Debt Solution*, N.Y. TIMES, Oct. 15, 2011, http://www.nytimes.com/2011/10/16/business/global/europeans-struggle-toward-debt-solution.html?_r=1&ref=world. To be fair, the U.S. policymakers have been similarly unable to respond to the debt ceiling debate and reforms therein. While this does not justify the inaction by either set of policymakers, it does note a common tension between prudent financial reform and politics (e.g. re-election concerns).

[77] *See generally* Euro Summit Statement, *supra* note **Error! Bookmark not defined.**.

[78] *See generally* Euro Summit Statement, *supra* note 1, at 1; Alderman, *Europeans Struggle towards Debt Solution*, *supra* note 76; *see* Main Results of Euro Summit, Euro Summit (Oct. 26, 2011), http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/ 125645.pdf ("These measures reflect our unwavering determination to overcome together the current difficulties and to take all the necessary steps towards a deeper economic union commensurate with our monetary union.").

[79] Euro Summit Statement, *supra* note 1, at 1; *see also Frequently Asked Questions: Greece*, IMF, http://www.imf.org/external/np/exr/faq/greecefaqs.htm (last updated Sept. 30, 2011) [hereinafter *FAQ: Greece*].

[80] Erlanger & Castle, *Europe Agrees to Basics of Plan*, *supra* note 63.

[81] Erlanger & Castle, *Europe Agrees to Basics of Plan*, *supra* note 63 (noting that the $147 billion was set as the target because policymakers believe it is crucial for global confidence that the banks "increase their holdings of safe assets to 9 percent of their total capital . . . given their large portfolios of sovereign debt."); The money should be raised from private sources, "including through restructuring and conversion of debt to equity instruments." Euro Summit Statement, *supra* note 1, at 1; In the event this is not possible then the banks may seek support from national governments, or the ESFS as a last resort. *Id*; Banks are also required to constrain distribution of dividends and bonus payments until the target of 9% is achieved. *Id.* at 15.

Eurozone member states: Will contribute to the private sector involvement (PSI) package with up to 30 billion euros;[82]

IMF: Will provide additional aid to Greece under the "EU-IMF multiannual program for Greece," which will be put in place at the end of 2011, [and] will finance up to 100 billion euros";[83]

All Parties: Will work to develop a strong legislative package within the E.U. structure to create a better system of economic governance.[84]

Long-Term Eurozone Crisis Measures:

Stronger European Financial Stability Facility (**EFSF**): Will leverage its 440 billion euro fund 4 or 5 fold to build a 1 trillion euro "'firewall' against contagion from the debt crisis."[85] The leveraging measure will increase the funds available to countries in crisis without extending the guarantees already provided by member states;[86]

European Nations: Will, if necessary, "provide guarantees to the banks (the criteria and conditions for such guarantees will be coordinated at EU level) to facilitate their access to medium-term funding" in order to "avoid a credit crunch[;]"[87]

Member states: Will agree to greater E.U. oversight and coordination of future fiscal planning in member state financial decision-making and crisis response mechanisms.[88]

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[82] Main Results of the Euro Summit, *supra* note 78, at 1.

[83] Main Results of the Euro Summit, *supra* note 78, at 1; *see also FAQ: Greece*, *supra* note 79 ("On May 9, 2010, the IMF's Executive Board approved a three-year SDR 26.4 billion (€30 billion) Stand-By Arrangement for Greece in support of the authorities' economic adjustment and transformation program.").

[84] Main Results of the Euro Summit, *supra* note 78, at 2 (determining that greater coordination of fiscal policy will occur at the "EU level" even "before national decisions are taken").

[85] Main Results of the Euro Summit, *supra* note 78, at 2.

[86] Main Results of the Euro Summit, *supra* note 78, at 2. The Statement is not entirely clear how the EFSF will be leveraged and if this will, in fact, create a sustainable "firewall." For a discussion of the various possibilities see Stephen Fidler, *EFSF Leverage: A Rundown on Ways to Bulk up the Euro Zone's Bailout Fund*, WALL ST. J. (REAL TIME BRUSSELS BLOG) (Sept. 27, 2011, 2:31 PM), http://blogs.wsj.com/brussels/2011/09/27/efsf-leverage-a-rundown; Stephen Fidler, *Don't Believe New EFSF Number*, WALL ST. J. (REAL TIME BRUSSELS BLOG) (Oct. 26, 2011, 8:02 AM), http://blogs.wsj.com/brussels/2011/10/26/dont-believe-new-efsf-number.

[87] *Way Out of the Debt Crisis*, EUR. COUNCIL, http://www.european-council.europa.eu/home-page/highlights/way-out-of-the-debt-crisis.aspx?lang=en (last visited Dec. 10, 2011).

[88] Euro Summit Statement, *supra* note 1, at 7–9; The implementation of these coordination mechanisms will require treaty revisions setting forth the steps by which fiscal decisions will be made and to ensure compliance with and enforcement of these decisions. *See id;* The first steps of these treaty revisions were initiated at the Euro Summit held from December 8–9. *See* Steven Erlanger & Stephen Castle, *German Vision Prevails as Leaders Agree on Fiscal Pact*, N.Y. TIMES,

As a cohesive response to the current crisis and a call to action to assist in debt-alleviation, the Statement has largely met the goals of its drafters.[89] However, as a long-term sovereign debt crisis response mechanism, the Statement is not effective.[90] The Statement is only an *ad hoc* response, which relies on all members of the Eurozone to finance an expensive bailout scheme. Imposing austerity measures while simultaneously building a "firewall," the measures are as inconsistent as they are burdensome. In addition, these commitments impose a heavy burden on E.U. member states both financially and politically.[91] As a result, the Statement, and the subsequent actions thereto, have tested the bonds between E.U. states and the euro experiment itself.[92] In addition, the Statement neglects the long history of sovereign debt crises, which have arisen despite "sound macroeconomic policies."[93] Europe has dealt with a symptom, but it has failed to address the true problem—the absence of a clear sovereign debt-restructuring framework. In the event a European nation fails to uphold its austerity and debt restriction commitments under the Statement, and/or the future treaty provisions written to implement the Statement provisions, the European Union will need an orderly mechanism to address this problem, or, potentially, face the Union's demise.[94]

IV. A CRISIS RELIEF VALVE: THE EUROPEAN DEBT RESTRUCTURING FRAMEWORK ("EDRF")

As the global financial leaders grasp at straws to implement the *ad hoc* solution set forth in the Statement, a mechanism for debt restructuring is, and has been, available all along: the SDRM. SDRM was specifically developed to assist sovereign-debtors.[95] Its drafters included some of the world's foremost economists.[96] Therefore, even though the IMF formally removed the SDRM from consideration, the

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Dec. 9, 2011, http://www.nytimes.com/2011/12/10/business/ global/european-leaders-agree-on-fiscal-treaty.html.

[89] Euro Summit Statement, *supra* note 1, at 1.

[90] The Statement has failed to elevate the crisis in Greece. Greece has failed to meet its obligations under the terms of the Statement and has required further bailout money. Donahue, *supra* note 3; Thomas, *Greece May Need New Tactics*, *supra* note 11; *see also* Euro Summit Statement, *supra* note 1, at 9 (stating that the new structure of fiscal governance through the E.U. will "rely on a stronger preparatory structure").

[91] Thomas, *Greece May Need New Tactics*, *supra* note 11 ("Greece, in essence, has become a financial ward of Europe. And, because the I.M.F. will probably be reluctant to put in new bailout money in the coming years, the burden will increasingly fall to Europe, led by Germany, to finance Greece.")

[92] *See* Erlanger & Castle, *German Vision Prevails*, *supra* note 88.

[93] Creating a broad "preparatory structure" is an insufficient response to this reoccurring problem, which has colossal effects on the global economy. *See* Buckley, *supra* note 17, at 1193–94 (quoting Laurence Meyer, Board of Governors of the U.S. Federal Reserve System)("[S]ound macroeconomic policies do not preclude crises.").

[94] *See* Alderman, *Banks Build Contingency for Breakup of the Euro*, *supra* note 5.

[95] KRUEGER, *supra* note 9, at 2.

[96] *See, e.g.*, KRUEGER, *supra* note 9, at v.

mechanism should be revived to serve as a model—allowing policymakers to adopt the positive elements and reform the negative ones to accommodate Europe's particular needs, creating a "new and improved" EDRF. The EDRF would provide a systematic and predictable structure for all parties to engage in negotiations and produce a restructuring plan.[97] In light of the current debt crisis and the unique regional cooperation required by the euro, the E.U. has the opportunity to build on the principles set forth in the SDRM and to create a viable framework for sovereign debt restructuring.

A. Building the Framework for Negotiations

Creating a new framework for parties to engage in a structure negotiation requires both an administrative and a legal infrastructure. For the administrative component, the EDRF needs a venue with financial investigative resources and economic experts available to facilitate the negotiations. The European Court of Auditors (ECA), with the power and the resources to investigate any persons or organization using E.U. funds, would serve this function.[98] When a crisis presents itself, the EDRF can function as a division within the ECA dedicated to administrating EDRF negotiations. These negotiations will operate within an E.U.-created statutory framework,[99] creating predictability and ensuring equitable treatment of all parties. The framework would be adopted through an E.U. resolution, which is immediately binding and non-waivable for all E.U. member states and written into a universal treaty, which will ideally function to expand the scope of authority beyond the European Union to reach the global community of sovereign debt creditors. Together, the administrative and legal infrastructures create the foundation necessary to build a new structure.

1. Finding a Venue

The ECA with its professional E.U. auditors (Auditors) and access to tools for comprehensive investigative economic research is the natural institution to house the EDRF. Including the EDRF within the ECA would streamline E.U. resources used to support the negotiations and investigations. The ECA is empowered to investigate the use of E.U. funds through audits and to provide an annual report on the E.U's

[97] *See, e.g.*, GIANVITI, *supra* note 6, at 4 (proposing a similar structural reform of SDRM to create: "A procedure to initiate and conduct negotiations between a sovereign-debtor with unsustainable debt and its creditors leading to, and enforcing, an agreement on how to reduce the present value of the debtor's future obligations in order to reestablish the sustainability of its public finances.").

[98] *European Court of Auditors*, EUROPA, http://europa.eu/about-eu/institutions-bodies/court-auditors/index_en.htm (last visited Nov. 7, 2011). *Cf.* GIANVITI, *supra* note 6, at 4 (proposing the use of the Court of Justice of the European Union as the "natural institution for this purpose").

[99] *See* Skeel, *supra* note 58, at 422–24.

financial status to the European Parliament.[100] Therefore, the ECA is the E.U. administrative body most well informed about the use, and abuse, of E.U. finances. The Auditors, representing each E.U. member state, are charged with inspecting "E.U. institutions, member countries and countries receiving E.U. aid,"[101] and "any persons or organization handling E.U. funds," whose inspection findings are reported to the European Commission and the E.U. national governments.[102] Therefore, the Auditors have unique professional and institutional knowledge and are in the best position to oversee the EDRF. With the approval of the nation-states, the Auditors would facilitate the progress of negotiations by ensuring that the framework of rules is observed.

2. *Establishing Authority*

The statutory framework governing the use of the EDRF would be passed as an E.U. regulation, a legislative act immediately binding on all E.U. members.[103] A uniform law would compel all E.U. member states, those that have adopted the euro and those that have not, to recognize the EDRF and to abide by its provisions. [104] Under the law's terms, any E.U. member state would have access to EDRF relief. In return, all member states, including their corporations and citizens, would be bound through a non-waivable provision to support the framework's operation, either as parties to the negotiation, as creditors, or as financiers of the restructuring plan (as EFSF guarantors).[105] While expanding the scope of the EDRF beyond the Eurozone will provide a greater body of participants, the restructuring of a sovereign's debt will require the participation of a global community of creditors—some of whom may fall outside the E.U.'s regulatory authority. Therefore, additional steps must be taken to bind this global creditor community—international corporations, financial institutions, hedge funds and/or individual investors.

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[100] *European Court of Auditors*, *supra* note 98.
[101] *European Court of Auditors*, *supra* note 98.
[102] *European Court of Auditors*, *supra* note 98.
[103] This would bind some nations, like the U.K., that are not currently members of the Eurozone. However, fluctuations in the euro create distress in non-euro nations. It would be to the benefit of these nations to have a place at the table or involvement in the negotiations. It seems these nations desire to use their current fiscal position to exert greater control over the E.U. and this legislation may be one such tool to exert that power. *See Euro Crisis Opportunity for UK to Reclaim Powers*, BBC NEWS (Nov. 14, 2011), http://www.bbc.co.uk/news/uk-politics-15730084; However, the U.K. has consistently been reluctant to adopt any fiscally restrictive provisions. *See e.g.*, Erlanger & Castle, *German Vision Prevails*, *supra* note 88.
[104] *See* KRUEGER, *supra* note 9, at 33 (discussing the benefits of creating a statutory scheme rather than a series of contracts as proposed under the CAC system).
[105] *About EFSF*, EUR. FIN. STABILITY FACILITY, http://www.efsf.europa.eu/about/index.htm (last visited Dec. 11, 2011) ("EFSF is backed by guarantee commitments from the euro area Member States for a total of €780 billion and has a lending capacity of €440 billion.").

In order to compel recognition by the global community of creditors, a universal treaty should be adopted.[106] The treaty's terms would outline the process required for the EDRF negotiation and thereby establish the legitimacy, and ideally the universal recognition, of the EDRF negotiations and its negotiated plan. The treaty can follow the Model Law's format on Cross-Border Insolvency (Model Law) promulgated by the United Nations Commission on International Trade Law (UNCITL), which was drafted "to formulate a modern, harmonized and fair legislative framework to address more effectively instances of cross-border insolvency."[107] Similar to the Model Law, all parties to the treaty would agree to cooperate, and compel their citizens, both private individuals and corporations, to cooperate with a pending EDRF negotiation.[108] Once the negotiation is complete and a plan is in place, the treaty would require "automatic recognition and enforceability" of the plan in other member states.[109] Not only will the treaty ensure all necessary parties engage in the negotiations, but also, it will prevent derivative litigation actions and ensure the finality of the restructuring plan.[110]

While the treaty provides a convenient vehicle for universal recognition, there is a potential drawback to this method: requiring sovereign nations to sign a binding treaty.[111] Unlike the SDRM that failed to gain support from individual nations, the EDRF is a more palatable option for restructuring, especially in the context of the current crisis. The treaty will ask nations to honor Europe's new framework, essentially a formal agreement to ensure the observance of the customary international law principle of "comity."[112] This commitment is similar to that required by the Model Law, which has been adopted into the statutory laws of eighteen nations, including the United States, the European Union, Mexico, Australia, and New Zealand.[113] It is reasonable

[106] KRUEGER, *supra* note 9, at 33.

[107] U.N. Secretariat, Draft Guide to Enactment of the UNCITRAL Model Legislative Provision on Cross-Border Insolvency, Note by the Secretariat, 30th Sess., May 12–30, 1997, U.N. Doc. A/CN.9/436 (Apr. 16, 1997); *See also* Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law [UNCITRAL], G.A. Res. 52/158, U.N. Doc. A/RES/52/158 (Jan. 30, 1998), *available at* http://www.cnudci.org/uncitral/en/uncitral_texts/insolvency/1997Model.html [hereinafter UNCITRAL Model Law].

[108] *See, e.g.*, *id.* pmbl.

[109] *See, e.g.*, *id.* art. 25; *see also* Council Regulation 44/2001, art. 17(1), Jurisdiction and the Recognition of Judgments in Civil and Commercial Matters, 2000 (EC), *available at* http://www.guildhallchambers.co.uk/uploads/docs/section9/Cross-borderInsolvencyIssues_SPR&GMcPhie.pdf.

[110] *See, e.g.*, UNCITRAL Model Law, pmbl; *see also* KRUEGER, *supra* note 9, at 15.

[111] *See* GIANVITI, *supra* note 6, at 32.

[112] In the absence of a formal treaty, the principle of comity would require that other nations respect the laws of the E.U.—here the reach of the EDRF. While this principle may accomplish many of the same goals as the treaty, the treaty is a more clear and effective compliance tool.

[113] The Model Law has been adopted by: Australia, Canada, Columbia, Eritrea, Greece, Japan, Mauritius, Mexico, Montenegro, New Zealand, Poland, Republic of Korea, Romania, Serbia, Slovenia, South Africa, United Kingdom of Great Britain and Northern Ireland and the United States. *See* Status, UNCITRAL, http://www.cnudci.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html (last visited Nov. 7, 2011).

to conclude that a treaty addressing cross-border restructuring would attract at least the same number, and hopefully, more, parties as a Model Law for cross-border insolvency proceedings. Many of the same interests for cross-border harmonization in administering a debtor's international assets and debts are present in both circumstances. In addition, the present crisis has demonstrated the intensely sensitive and interconnected nature of the modern global economy.[114] Where the SDRM asked for international support for reform after the crisis in emerging Latin American and East Asian nations, here the EDRF arises as a response to a crisis that is shaking the foundations of the Group of Ten. If the EDRF can return calm to the markets and allow for future growth, then it is not unreasonable to assume nations will sign its formational treaty.

Even if some or all sovereign parties are reluctant to sign the treaty, individual creditors have a financial interest in participating in the negotiations in order to receive some return on their investment. Upon the conclusion of the negotiations and adoption of a plan, all creditors and sovereign parties would be bound by the mutually agreed upon terms. The EDRF terms will ensure the sovereign-debtors are not subject to subsequent litigation to re-negotiate these terms. This will protect the plan's finality and encourage greater participation of all relevant parties.

B. The Rules of Engagement

The EDRF will guide the sovereign-debtor[115] and its creditors through a negotiation with the goal of developing a restructuring plan that is in the best interests of all parties. The plan will ensure debts are repaid in an amount and within a timeframe that is reasonable to creditors, but also protects the potential for future growth and stability of the nation. While each EDRF negotiation will be tailored to meet the needs of the particular sovereign-debtor and its creditors, the statutory framework will set the "rules of engagement."[116] The EDRF rules will begin with a threshold inquiry. The threshold rules will define "who" may use the EDRF and obtain relief as a sovereign-debtor. To ensure EDRF resources are used efficiently and preserve the stability of the market for sovereign bonds, only eligible debtors should be able to use the resources of the EDRF and obtain restructuring relief from creditors. The Auditors, in their administrative role, will oversee this process to ensure the threshold requirements are met. Once a debtor is accepted into the EDRF, the rules will define the procedures for the negotiation. The main

[114] *See* GIANVITI, *supra* note 6, at 32–33; *see supra* Part III.

[115] Following the principles of Chapter 9 of the U.S. Bankruptcy Code, which allows municipalities to declare bankruptcy, the sovereign-debtor would remain in power to use and sell property or to borrow funds through the pendency of the negotiations. *See e.g.*, 11 U.S.C. §§ 903, 904; Buckley, *supra* note 17, at 1205–06 ("Perhaps the most important section of Chapter 9 from the point of view of its applicability to services is section 904 . . . The debtor can therefore go about its day-to-day activities and borrow money without recourse to the court.").

[116] The EDRF rules will use Chapter 9 of the U.S. Bankruptcy Code ("Chapter 9") as a loose model. *See, e.g.*, 11 U.S.C. § 109.

principles, following the SDRF model, will include: (1) majority restructuring, (2) adequate assurances for creditors, and (3) priority financing.[117] Together, these threshold and fundamental protocols will create a framework for restructuring sovereign debt that provides efficient and effective relief to sovereign-debtors and ensures the equitable treatment of creditors.

1. *Who is a Sovereign-Debtor?: The Threshold Inquiry*

The scope of the EDRF must be clearly defined through a threshold inquiry. The inquiry will ensure only "sovereign-debtors" have access to EDRF. Therefore, the first step of the threshold analysis is defining "who is a sovereign-debtor" with a set of identifiable criteria. Only those debtors who meet these criteria would be eligible to engage in EDRF negotiations and obtain relief. As the administrator of the negotiations, the Auditor will apply the criteria and engage in the threshold inquiry. The Auditor will ask two questions:

1. Is the potential sovereign-debtor an E.U. member state?[118]
2. Has the potential sovereign-debtor previously attempted to negotiate with creditors in good faith?[119]

The first question for the threshold inquiry is whether the potential debtor is an E.U. member. An eligible debtor must be a sovereign-nation, who has been accepted as an E.U. member.[120] This requirement is necessary on jurisdictional and financial grounds. First, the EDRF would be formed pursuant to an E.U. Regulation, which is immediately binding on all E.U. members. Therefore, each member state would be bound to accept the EDRF as a legitimate debt relief framework. In addition, the EDRF would be financed by E.U. funds and supported by the EFSF. Therefore, it is reasonable to limit the use of this tool to those who support its existence both in theory and in fiscal reality.

The remaining threshold requirement is that the sovereign-debtor must attempt to negotiate in good faith with creditors.[121] This requirement partially arises from the CAC approach. The prevalence of CACs in bond contracts means that nations have the opportunity to negotiate with creditors in specific bond issuances.[122] When the

[117] *See supra* notes 27–33 and accompanying text.

[118] *Cf.* 11 U.S.C. § 109(41).

[119] *See* 11 U.S.C. § 109(c)(5)(B).

[120] For more information on which nations are members of the E.U., which nations have applied for membership, and the criteria for obtaining membership in the E.U., see *Countries*, EUROPA, http://europa.eu/about-eu/countries/index_en.htm (last visited Dec. 10, 2011).

[121] The requirement of negotiating in good faith also arises in Chapter 9. *See* 11 U.S.C. § 109(c)(4).

[122] *See supra* Part II.B.

sovereign realizes its debts are unserviceable, it must exercise due diligence and attempt to exercise its CACs and negotiate with creditors. Only after these negotiations have failed, or individual CAC negotiations have been clearly insufficient, can the sovereign exercise the EDRF.

The goal of the "prior negotiations" inquiry is to limit the use of EDRF to only good faith sovereign-debtors. Therefore, the framework must strike a balance between encouraging sovereigns with "unsustainable debts to approach its creditors promptly"[123] on the one hand, and limiting the preemptive use of the restructuring framework by "countries with sustainable debts to suspend payments rather than make necessary adjustments to their economic policies"[124] on the other. In applying this standard, the Auditors will review the proof of prior attempts to engage in good faith negotiations. Evidence, at a minimum, should include an affidavit from the Secretary of Treasury attesting to the existence of such a meeting, evidence of a drafted "term sheet" for such a negotiation proposal, or financial reports demonstrating the futility of individual CAC negotiations. A sovereign-debtor that is an E.U. member and a good faith debtor under the terms of the EDRF framework will be able to proceed to negotiate with its creditors and draft a restructuring plan.

2. *Framing the Negotiations*

A simple and clear set of provisions will govern the restructuring negotiations. As originally set forth by the IMF, the predictability of the framework will be important to protect the stability of global financial markets and ensure the participation of each party.[125] The main provisions adapted for the SDRM remain applicable in the EDRF context: (1) majority restructuring; (2) protect creditor interests with "adequate assurances"; and (3) priority financing.

Majority restructuring, a provision central to both SDRM and CAC approaches, allows an "affirmative vote of a qualified majority of creditors to bind a dissenting minority to the terms of a restructuring" plan.[126] This prohibits a minority group of holdout creditors from preventing a deal or from acting as a "hold out," attempting to extract more benefits as a condition of agreeing to the plan.[127] Therefore, majority restructuring creates party equity and preserves the value of the assets financing the plan.[128] Adopting the SDRM statutory framework on top of the contractual CAC clauses, allows EDRF to overcome the

[123] KRUEGER, *supra* note 9, at 4.
[124] KRUEGER, *supra* note 9, at 2.
[125] KRUEGER, *supra* note 9, at 4–5.
[126] KRUEGER, *supra* note 9, at 14.
[127] *See* GIANVITI, *supra* note 6, at 24. The parties may also consider exercising a "most favored nation" technique, which would allow the hold out creditors to separately negotiate an alternative plan, adopt the most favorable plan, and share the benefits among all parties.
[128] *See* KRUEGER, *supra* note 9, at 14.

CAC's aggregation problem and engage in total debt, rather than just bond-specific, negotiations. All creditors would be included in the negotiations, and if necessary would be grouped into committees of like-debt holders, such as bond debt holders, bank claims, and domestic debt.[129] A majority vote of all creditors, or creditors' committees, would bind all parties to adopt the restructuring plan.[130] The EDRF majority restructuring would ensure all classes of creditors are at the negotiation table, which streamlines the negotiations and plan approval process and eliminates "disruptive litigation" by binding all parties through the majority vote.[131]

The EDRF will include adequate assurances to protect creditors' financial interests and incentivize creditors to engage in the negotiations. Adequate assurances may include certain promises, such as the sovereign-debtor will make no payments to "non-priority creditors" or will "conduct policies in a fashion that preserves asset values" and certain structural insurances, such as restrictions on future relief through EDRF.[132] However, creditors may fear that the sovereign-debtor will return to "business as usual" and fail to honor its promises after the plan has been approved. Therefore, this provision may require additional negotiations to arrive at an agreed upon set of transparency or leadership transition measures.

While financial transparency and oversight might approach the sensitive line of sovereignty, it is not an unreasonable imposition. Unlike the SDRM, which empowered the IMF to act as the overseer, here the ECA, an E.U. regional institution with personnel representing each E.U. member state, is employed for this purpose. At a basic level, it may seem less invasive, and thereby more palatable for sovereign-debtors, if an E.U. institution is observing the fiscal policy of an E.U. member state. In addition, Auditors are already empowered to investigate the use of E.U. funds.[133] Since most EDRF plans will include EFSF financing, the Auditors would be acting within the scope of their authority under the ECA. Finally, the parties to the EDRF have the flexibility to define the level of transparency and depth of Auditor review.[134] Therefore, on a balance sheet basis, the terms can be written to protect the sovereign

[129] Creditor committees are commonly used in bankruptcy reorganizations governed by Chapter 11 of the U.S. Bankruptcy Code. *See* 11 U.S.C. §§ 1102, 1103; *see also* Chapter 11, U.S. COURTS, http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter11.aspx (last visited Dec. 11, 2011).

[130] *See* KRUEGER, *supra* note 9, at 15.

[131] *See* KRUEGER, *supra* note 9, at 15.

[132] *See* KRUEGER, *supra* note 9, at 16.

[133] *European Court of Auditors*, *supra* note 98.

[134] Currently, Italy has entered into such an observation agreement with the IMF as part of its commitment to uphold the requirements set forth in the Euro Summit Statement. In the event that a nation, such as Italy, has been unable to or reluctant to make necessary fiscal changes, this type of observation would be necessary for a successful restructuring. *See, e.g.*, Liz Alderman, *Italy Agrees to Allow I.M.F. to Monitor its Progress on Debt*, N.Y. TIMES, Nov. 4, 2011, http://www.nytimes.com/2011/11/05/world/europe/italy-agrees-to-imf-oversight.html [hereinafter Alderman, *Italy*].

interests of the debtor, while also providing an extra layer of accountability for the creditors.

Finally, a successful restructuring requires new capital to finance on-going expenses and necessary future expenditures. This funding can come from two sources: (1) EFSF bailout funding, as currently provided under the Statement, or (2) creditors. To induce creditors to provide funds or fresh capital, the EDRF must offer the creditor priority financing, which ensures senior status in repayment.[135] Therefore, all parties give and take: the sovereign-debtor promises priority financing and receives fresh capital; the creditor offers new funds and receives priority repayment. As originally stated in the SDRM proposal, "[i]t is in the collective interests of private creditors and the sovereign-debtor that new money be provided in appropriate amounts."[136] Fresh capital allows the nation to continue to finance the restructuring plan, but also, and perhaps more importantly, to fulfill its governance obligations and ensure the availability of its social net for its citizens.[137] Priority financing provides incentives to both parties at the negotiation table and helps ensure the plan will be effective in the long term.

3. "The Plan"

The purpose of the EDRF is to negotiate a restructuring plan that the sovereign-debtor and a majority of creditors can agree upon and maintain through completion. Unlike the acceptance of a Chapter 9 bankruptcy plan, where the plan must meet criteria set forth in the Bankruptcy Code and must be approved by the bankruptcy judge,[138] here the goal is to reach a consensus agreement, without court involvement, through the EDRF structured negotiations. While the EDRF frames the rules for the negotiations, additional incentives or penalties, i.e., carrot or stick, measures, may be necessary to encourage parties to engage the

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[135] *See* KRUEGER, *supra* note 9, at 17.

[136] *See* KRUEGER, *supra* note 9, at 17.

[137] A sovereign-debtor is in a unique position with the responsibility to provide for the well-being of its citizens, in addition to its commitments to repay its creditors. It is important that a plan include both spending restrictions, i.e. austerity measures, but also, sufficient fresh capital to protect citizens relying on government support and services. The conflict between austerity reforms and social safety net spending is discussed in a variety of news and human rights publications. *See, e.g.*, Nicholas Kulish, *Euro Crisis Pits Germany and U.S. in Tactical Fight*, N.Y. TIMES, Dec. 10, 2011, http://www.nytimes.com/2011/12/11/world/europe/euro-crisis-pits-germany-and-us-in-tactical-fight.html?src=un&feedurl=http%3A%2F%2Fjson8.nytimes.com%2Fpages%2Fbusiness%2Fglobal%2Findex.json (noting the conflict between Germany's push for austerity and economists' concerns that "forcing austerity plans on Europe's troubled economies — while a good long-term solution — could lead to deep recessions in the short term, compromising any chance for effective change"); *The Austerity Zone: Life in the New Europe*, N.Y. TIMES, http://www.nytimes.com/interactive/2010/09/23/business/global/20100923-europenow.html?ref=europeansovereigndebtcrisis#/1 (last visited Dec. 22, 2011) (an interactive feature article interviewing citizens across the E.U.).

[138] *See* 11 U.S.C. 943(b)(7) (the plan must both be in the best interests of the creditors and feasible).

framework and reach a consensus.[139] These components, as seen in the Euro Summit Statement, will include:

1. **New Financing**: Debtor access to bailout funds from the EFSF and availability of priority financing from creditors;

2. **Haircuts**: Agreement that creditors will reduce their total outstanding debt amount to be paid by the debtor;

3. **Adequate Assurances & Reform**: Promises from the sovereign-debtor to protect the remaining assets to ensure creditors are paid back in accordance with the new restructuring plan, which terms would be agreed upon as part of the negotiations. Upon adoption of the plan, the sovereign debtor would not be eligible to obtain relief or enter negotiations under EDRF for a period of ten (10) years.

These carrot and stick options are reciprocal arrangements that are chosen by the parties as part of the negotiations. For example, creditors providing new financing will be privileged with senior status for repayment, and creditors willing to accept a haircut can reciprocally demand adequate assurances—with the option to have the Auditors oversee compliance. These options are not rules to be drafted into the terms of the EDRF statutory framework. Instead, the carrot/stick options are extra tools, which can be used by negotiators in drafting a plan.

New money, debt discounts, and compliance were all options used in drafting the Statement. However, unlike the prolonged negotiations, which produced the Statement, the EDRF has a statutory framework to ensure the efficient administration of the negotiations. In addition, these rules will also ensure that only those parties necessary to the restructuring are allowed to participate in negotiations– i.e. the sovereign-debtor and its creditors.[140] Where the Euro Summit invited all Eurozone leaders to negotiate a solution for Greece and the other precariously positioned European states, the EDRF would ask the sovereign-debtor to take the lead. Streamlining the procedure and restricting participation provides efficiency in the face of a financial crisis.[141] In addition, these measures empower the carrot and stick

[139] *See* Jonathan Wilkenfeld et al., *Mediating International Crises: Cross-National and Experimental Perspectives*, 47 J. CONFLICT RESOL. 279, 284 (2003) (discussing the use of "carrot-and-stick measures" to "augment the appeal of [] solutions by adding and subtracting benefits to/from the proposed solution"); Robert B. Ahdieh, *Between Mandate and Market: Contract Transition in the Shadow of the International Order*, 53 EMORY L.J. 691, 734 n.206, 734–36 (2004).

[140] *See* GIANVITI, *supra* note 6, at 25–26 (discussing the importance of limiting negotiations to the relevant parties so the restructuring does not become a "*de-facto* international negotiation involving states").

[141] *See* GIANVITI, *supra* note 6, at 10 ("The lessons from the 2010 crisis, however, are that it

options since each party at the table will be impacted by their use or disuse. Together, the EDRF framework for negotiations and the carrot and stick options will allow the parties to reach a restructuring plan, which protects the interests of creditors and ensures the long-term viability of the sovereign-debtor.

V. TAKING A LEAP TO SAVE THE EURO

Learning from the mistakes of the SDRM and CAC approaches, and inefficiencies of the Statement, the EDRF can serve as a viable framework to address future sovereign debt crises. Using the ECA infrastructure, the professional knowledge of the Auditors, and EFSF financing maintains European authority over a European issue. Whereas SDRM invited the involvement of the IMF, here the E.U. can resolve a member state's debt crisis using the regional infrastructure that is already in place.[142] Employing a statutory framework would ensure the EDRF can invoke the participation of all classes of bond holders and all types of creditors, thereby avoiding the CAC's aggregation problem.[143] Finally, EDRF reduces the burden imposed on E.U. members by the terms of the current Statement in two ways. First, the EDRF statutory framework sets forth guidelines for negotiations. A clear and predictable structure avoids wasting time and resources developing an *ad hoc* solution.[144] Second, EDRF helps the relevant parties arrive at a sustainable restructuring plan, rather than forcing the E.U. member states to fund an expensive and extensive bailout plan.[145] While the EFSF bailout funds and fresh capital from creditors would be available to incentivize further negotiations, these funds are part of a package deal, not the only game in town. While the proposed EDRF structure has many benefits and overcomes the obstacles faced by prior proposals, there remain potential critics and criticisms.

First, critics may fear that the availability of a restructuring scheme will send a negative signal to investors, and potentially, undermine the European bond market. This is a reasonable concern, but empirical evidence of the impact is difficult to quantify.[146] When CACs were first proposed, similar concerns were expressed. But those concerns were

can take a long time to reach an agreement and that delays involve costs: while policymakers negotiate, markets speculate about the probability, nature and depth of a compromise. To rely once again on improvisation to find a solution would involve significant risks for the stability of the euro area.").

[142] *See also* GIANVITI, *supra* note 6 at 28–30.

[143] *See supra* notes 55–61 and accompanying text; *see also* Galvis & Saad, *supra* note 36, at 722.

[144] *See* GIANVITI, *supra* note 6, at 10 (discussing the costs which arise in the absence of a clear solution for a financially troubled nation and noting that "[t]o rely once again on improvisation to find a solution would involve significant risks for the stability of the euro area.").

[145] While the European leaders have sought support from the BRIC countries, and further funding from the IMF, these efforts have proved unsuccessful. *See* Alderman, *Italy*, *supra* note 134.

[146] *See* GIANVITI, *supra* note 6, at 34.

proven unnecessary when Mexico introduced the "first New York-law, SEC-registered bond to include CACs in February 2003 (U.S. $1 billion, 6.625% global notes due 2015)."[147] Now, CAC clauses are common clauses in all bond issuances. In fact, "[i]t is also safe to assume that the market will question the motivation of any issuer that does not adopt CACs."[148] Similarly, the inclusion of a bankruptcy clause in a contract, either consumer or corporate, is a risk which has been assumed in the price of a contract and contract negotiations.[149] Therefore, it seems reasonable to assume that ERDF will follow the same path as its predecessors. The change in the legal regime for repayment of sovereign bonds will initially cause a ripple in the markets, but will likely be accepted as a measure necessary to ensure greater long-term market stability.[150] In addition, some scholars believe this type of mechanism will actually strengthen the sovereign bond market:

> If anything, this evidence suggests that the introduction of rules for dealing with sovereign default will contribute to the tendency of markets to distinguish between high- and low-quality borrowers and to price loans and bonds accordingly. This would strengthen market discipline and contribute to the goal of sustainable public finances laid down in the European treaty, and thereby to the sustainability of the euro itself.[151]

While the EDRF may potentially spook the bond market in the short term, it is equally, if not more, likely to support the long-term growth and sustainability of the euro market. Just as CACs and bankruptcy arose despite market concerns, the EDRF can provide greater security if adopted.

Second, like the SDRM, the EDRF would require certain sacrifices of sovereignty. While this remains a large obstacle, the E.U. and the euro itself, are products of fiscal policy coordination and subordination to a centralized institution.[152] Therefore E.U. member states, especially the members that adopted the euro, have already agreed to a "partial loss of

[147] Gray, *supra* note 39, at 698; *see also id.* at 699 ("The favourable reaction to Mexico's bond reflected in large part the market judgement [sic] that Mexico and its advisers had achieved an equitable balance between its interests and those of the bondholder community. Mexico's initiative was followed in rapid order with CAC bonds from Brazil, South Africa, Korea, and, of greatest interest, Uruguay.").

[148] Gray, *supra* note 39, at 699–700.

[149] *See* Chrystin Ondersma, *Undocumented Debtors*, 45:3 U. MICH. J.L REFORM 517, 549 (2012).

[150] GIANVITI, *supra* note 6, at 34.

[151] GIANVITI, *supra* note 6, at 34.

[152] *See* GIANVITI, *supra* note 6, at 22–23 ("Supranationality and partial loss of national sovereignty, the fears of which were a major reason for the rejection of the SDRM proposal, are therefore part and parcel of the existing EU.").

national sovereignty."[153] In addition, the on-going crisis has reached a boiling point where desires for fiscal security might further tip the scales in favor of regional solidarity over nationalistic instincts.[154] At each Euro Summit held in response to the crisis, European policymakers have reaffirmed their member states' commitment to the "principle of solidarity."[155] In October, as part of the Statement, policymakers drafted the "Ten Measures to Improve the Governance of the Euro Area" (the Ten Steps). The Ten Steps identified the "need to strengthen economic policy coordination and surveillance within the euro area."[156] They also set forth a system allowing for centralized fiscal decision-making and greater intrusion into member state fiscal policy.[157] Then in December, E.U. leaders moved forward with these Ten Steps by signing an intergovernmental treaty. The treaty adopted "structural reforms and fiscal consolidation" in order to enhance E.U. fiscal "monitoring and [to correct] macroeconomic imbalances."[158] Together, the Ten Steps and the treaty indicate a willingness of European policymakers to sacrifice components of fiscal sovereignty as a necessary step towards long-term fiscal security. On paper and in practice, Europe has moved towards greater fiscal unity.[159] The stability and predictability of an EDRF framework would follow as the next step on the path towards greater regional fiscal security and future E.U. economic growth.

Finally, as was the case with SDRM, creditors may worry that EDRF will create a "moral hazard problem," whereby debtors will strategically exercise EDRF to avoid repaying large debts.[160] Structurally, EDRF addresses this concern through the threshold test. Only sovereign-debtors who meet the threshold requirements, including the "good faith" inquiry, can obtain relief.[161] This test ensures that opportunistic debtors do not abuse the framework. In addition to the EDRF structural safeguards, market realities limit the incentive for sovereigns to default. Sovereigns rely on the issuance of bonds to raise future capital. If sovereigns actively default or preemptively exercise EDRF, this could potentially

[153] GIANVITI, *supra* note 6, at 23.

[154] Alderman, *Banks Build Contingency for Breakup of the Euro*, *supra* note 5.

[155] GIANVITI, *supra* note 6, at 10.

[156] GIANVITI, *supra* note 6, at annex 1, at 11.

[157] GIANVITI, *supra* note 6, at annex 1, para. 4, at 12 ("[T]he Eurogroup will ensure ever closer coordination of the economic policies and promoting financial stability. Whilst respecting the powers of the E.U. institutions in that respect, it promotes strengthened surveillance of Member States' economic and fiscal policies as afar as the euro area is concerned. It will also prepare the Euro Summit meetings and ensure their follow up.").

[158] Presidency Conclusions, Brussels European Council 1–2 (Dec. 9, 2011) *available at* http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/126714.pdf.

[159] Not only are some nations willing to sign a Statement, and now a treaty, to cooperate, but also, Italy has agreed to allow the IMF to observe its implementation of its promised austerity measures. Alderman, *Italy, supra note* 134 ("Italy said it had offered to allow the fund to scrutinize its books every three months to make sure a $75 billion austerity package is carried out according to plan. A team from the European Commission will also travel to Rome next week to start monitoring Rome's efforts. . . .").

[160] GIANVITI, *supra* note 6, at 8l; Skeel, *supra* note 58, at 425.

[161] *See supra* Part IV.B.1.

restrict their access to certain types of investor funds.[162] Therefore, it is directly opposed to a sovereign's fiscal interests to repeatedly or strategically fail to pay creditors. Together, the threshold requirements and market-reputational concerns preserve the EDRF as a tool only for "good faith" sovereign-debtors.

VI. CONCLUSION

The experiment that began with the creation of the supranational entity, the E.U., and evolved further to the adoption of a uniform currency, the euro, is on the precipice of disaster. As policymakers draft new policies to steer the E.U. away from this danger, they have avoided facing the real problem: reoccurring crises of unsustainable sovereign debt. Reviving and reforming SDRM to construct a new restructuring framework, the EDRF, would establish a uniquely European statutory mechanism for qualifying sovereign-debtors to engage in negotiations with creditors. Through this supervised, but still deferential framework, parties can negotiate a restructuring plan tailored to their particular needs—in general, protecting the financial interests of the creditors and ensuring the economic stability of the sovereign-nation.

EDRF is a clear solution, which draws on the lessons learned from prior proposals, SDRM and CACs, and resolves the *ad hoc* confusion of the Statement. It also addresses the current debt crisis, and the future crises that history has proven will likely occur. The precarious condition of the European economy and the uniquely interconnected nature of the E.U. put these policymakers in the position to take the leap to allow sovereign restructuring. Europe defied principals of sovereignty in agreeing to supranational governance first in the creation of the E.U., and then in the creation of the euro. Now, Europe must make a swift and radical action to preserve that Union and the structural integrity of its political and fiscal institutions. European policymakers should take the lead in regional solidarity again and pave the way toward sovereign crisis-response reform with a revised framework for sovereign debt restructuring: the EDRF.

[162] *See* Buchheit & Gulati, *supra* note 17, at 10–11; Sachs, *supra* note 22, at 182.