

**ON THE WAY TOWARDS INTERNATIONAL RULES  
FOR STATE INSOLVENCIES  
by Prof. Dr. Christoph G. Paulus, Berlin<sup>1</sup>**

**A. General Remarks**

I. Reasons for Introducing a New Body of Law

In these days, we are witnessing the creation of a new body of law – the International Monetary Fund (IMF) calls it Sovereign Debt Reduction Mechanism (SDRM)<sup>2</sup>, but for reasons which will become clear from what is written below (sub C) it appears to be preferable to name it public international insolvency law. Even though the topic has been in the air, so to speak, for a long time before, it came as a surprise for everyone when in end-November 2001 Anne Krueger from the IMF came up with not only the idea of establishing such public international insolvency law but also with quite a detailed proposal of how it should look like.<sup>3</sup>

Seen from a historical perspective, it is tempting to speculate about the reasons of why the IMF went public at this time. It is commonly said that this has to do with the crisis in Argentina. However, this is open for doubts; since that crisis was from the outset and still is quite contained to just that one country. Compared with the East-Asia crisis in 1998 which crept from the so-called Tiger States over to Japan, then to Russia and finally to Brazil, Argentina is not really a global problem. Nevertheless, in those days nobody came up with the proposal of a public international insolvency law. Therefore, it is very likely that the true (and, maybe, subconscious) incentive had been the events of September 11, 2001. They have made the people feel – at least for a moment – that the world is nothing more than a group of some 200 states which inevitably are bound together and which, therefore, have to find a *modus vivendi* for how to come along with each other in a fair and durable manner.

II. Sovereignty as a Counter-Argument?

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<sup>1</sup> The talk was given on March 25, 2002.

<sup>2</sup> A Sovereign Debt Restructuring Mechanism – Further Reflections and Future Work (IMF 2002 b). This paper (not yet available on the internet) specifies what the IMF has brought up in late 2001: International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring (IMF 2001), [www.imf.org/external/np/speeches/2001/112601.htm](http://www.imf.org/external/np/speeches/2001/112601.htm); and what has been elaborated in early 2002: The Evolution of Emerging Market Capital Flows: Why We Need to Look Again at Sovereign Debt Restructuring (IMF 2002 a), [www.imf.org/external/np/speeches/2002/012102.htm](http://www.imf.org/external/np/speeches/2002/012102.htm). See also A. Krueger, New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking, [www.imf.org/external/np/speeches/2002/040102HTM](http://www.imf.org/external/np/speeches/2002/040102HTM) (2002 c).

<sup>3</sup> See IMF 2001.

Whatever the true reason might have been, Anne Krueger's speech wiped off (almost) all until then existing objections against such proceeding. One of the most prominent of these counter-arguments had always been that the concept of sovereignty was said to be incompatible with the application of an insolvency proceeding over states. This, however, is for several reasons questionable:

First of all, the chapter 9-proceeding of the US Bankruptcy Code deals with the break down of municipalities – thereby strictly balancing the maintenance of sovereignty and the needs of an insolvency proceeding. E.g., New York's bankruptcy in the mid-seventies was dealt with and solved by such a chapter 9-proceeding, which, incidentally, was amended because of the peculiarities of that particular case. Secondly, what is traditionally understood as the concept of sovereignty, is – as a matter of fact – quite outdated: Bodin's idea of independent and autonomous entities which are the exclusive subjects of public international law has been tottering ever since the Nuremberg Trials; suffice it to refer to the forthcoming of the public international criminal law which nowadays is taking care of individuals such as Pinochet or Milosevic. But also the conditionality under which both the IMF and the World Bank are lending money to countries can hardly be brought into conformity with that traditional concept.<sup>4</sup> And finally, an insolvency proceeding, which is adapted to the peculiarities of a state insolvency – according to the present proposal – will be applied only if the state in question files a respective petition. All this taken together, it becomes clear that an infringement of a state's sovereignty is not an issue in the present context.

### III. The Old Model after Which the New one is to be formed

#### 1. The Method

The way of how this new procedure is about to be developed is insofar interesting as it exemplifies once again the way of how jurists generally „discover“ „new“ law.<sup>5</sup> Still the best illustration of this way is the report about the ten-men-committee in ancient Roman times. Being entrusted with the task to enact a written law for the stabilisation of social order they did not sit down and worked on a preliminary draft. Instead, they first travelled to Greece in order to see how other laws looked like. In pretty much the same way the new rules on state insolvencies are emerging: One does look at existing examples and adapts them to the new needs.

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<sup>4</sup> See, e.g., Weigeldt, Die Konditionalität des Internationalen Währungsfonds in ihrem Verhältnis zur Staatssouveränität und zu den Menschenrechten – zugleich ein Beitrag zu den Entwicklungen staatlicher Souveränität im modernen Völkerrecht, 1999.

<sup>5</sup> Cf. Paulus, Verbindungslinien zwischen altem und neuem Recht, in: Festschrift für Mayer-Maly, 2002, p. (forthcoming).

## 2. Disciplining function of any insolvency law

It does not really come as a surprise that these examples are looked for within the traditional (i.e. private) insolvency law. This is legitimate for at least two reasons: Firstly, there exists a body of law, which is dealing with exactly the same problem at stake – namely the inability of an entity to satisfy its creditors. And over millennia, this body of law has developed strategies of how to deal with this situation. Secondly, one of the underlying reasons for the „invention“ of private insolvency law was the attempt to discipline the market participants; the threat of the commencement of an insolvency proceeding serves quasi as a „red light“ beyond which different rules from those within the general course of business are to be applied. It is exactly this disciplining effect that is more and more seen as an extraordinary important feature also for the public law sector. It is recognized that the sheer existence of such proceeding might fulfil its function even if it never comes to its application.<sup>6</sup>

## 3. The „career“ of the plan proceeding

Coming back to the existing examples; apart from the above-mentioned chapter 9-proceeding, they are above all the so-called plan proceeding which was enacted by the US legislation as their famous chapter 11-proceeding and which has its roots in that country in the need for reorganising the railway companies when they went bankrupt in the 19<sup>th</sup> century. In short, it means a proceeding where the debtor and his creditors are trying to find an agreement on a plan about how to rescue the debtor; a neutral third person is presiding; and the unanimity requirement of the out of court-negotiations is replaced by a majority vote.

The plan proceeding is understood as an alternative to the traditional and time-honoured liquidation proceeding; as such it was taken over by numerous other national bankruptcy laws in the end of the 20<sup>th</sup> century when a – still ongoing – wave of insolvency legislation literally swept around the world. An additional driving force behind this development are the said Bretton Woods institutions IMF and World Bank: within the last few years, they have put down principles and guidelines respectively on how to draft a modern and effective insolvency law.<sup>7</sup> They both are in agreement that the plan proceeding therein plays an essential role. The above-mentioned conditionality guarantees that legislators of borrower countries will not ignore this feature.

## 4. A Change of Values

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<sup>6</sup> For this “legal derivative” of the former politics concept: Peace through Deterrence see, e.g., IMF 2002, sub 10.

<sup>7</sup> International Monetary Fund-Legal Department, *Orderly and Effective Insolvency Procedures – Key Issues*, 1999; World Bank, *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, 2001.

This astonishing career of the plan proceeding within private law brings with it an important change of values – at least outside of the US. There, the almost worldwide felt flaw of bankruptcy<sup>8</sup> was from early on and quite generally replaced by the idea that a debtor should be given a chance of a fresh start – probably due to the foundation myth of a new beginning in the New World and due to the needs of pioneering and colonializing the West. Almost the complete rest of the world could (so to speak) afford to criminalize and penalize those who failed in economic life and who went bankrupt. Examples reach from social stigmatisation like the ancient Roman *infamia* to death penalty.

However, both the present growth of the service society („Dienstleistungsgesellschaft“) all over the world and the actual needs of the so-called transition economies lead to a general change of this attitude. Within the service sector, creditors are better helped if their debtor re-enters the economic stage; since usually he has nothing or not much that can be sold in order to satisfy his creditors. The typical goods of such debtors are very personal ones – such as know-how, good will, ideas, skills, etc. Instead of liquidating these goods for almost no return, the debtor gets the chance of a fresh start by means of a plan proceeding.

The same is true for many if not almost all enterprises within transition countries. If there the standards for commencing a liquidation proceeding would be applied in the way how this is done in countries like Germany, Italy or the like, practically all companies would have to be wiped off. In order to avoid such unacceptable results, the plan proceeding is seen to be the appropriate solution; since it offers the debtor at least the chance for a re-beginning – provided, of course, the majority of the creditors does agree.

#### IV. The Former and Present Ways of Dealing with States' Insolvencies

If, accordingly, insolvency does not necessarily mean a whatsoever form of civilian death but implies also the fresh start-option it becomes adaptable to situations where liquidation is unfeasible right from the outset. Such situation, and even a paradigmatic one, is it when states become broke. As a matter of fact, liquidation is not even thinkable in these cases – who should sell what to whom? But reorganisation is what is seen as the primary (if not exclusive) goal ever since there are negotiations about debt restructuring.

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<sup>8</sup> Instructive, e.g., J. Whitman, *The Moral Menace of Roman Law and the Making of Commerce: some Dutch Evidence*, 105 *The Yale Law Journal* p. 1872 seq. (1996).

This history reaches quite far back – even before the institutionalisation of the Paris Club.<sup>9</sup> The formation of this Club in 1956, however, meant a step forward in the proceduralization of the common efforts. But when, beginning in the seventies, loans were literally showered over the poor countries which, admittedly, had been more than willing to accept them, and when the repayment necessity turned later into the famous debt-trap and as such into a mass phenomenon, it became clear that the proceedings of the Paris Club as well as the London Club defied any compliance with requirements set up by the rule of law. There, creditors had been – and still are – all in once: creditors, judges, donors and accusers. This is especially true for the Bretton Woods institutions. They are not just creditors and advisors but are as such, moreover, bound in their decisions by the majority of their members that happen to be pretty much the same as the main creditor countries.

#### V. Restrictions of what is to be developed now

Taking this development into account, Anne Krueger's above-mentioned proposal means a grand step forward into the direction of applying the rule of law also in this area. In order to keep things moving forward under the present political circumstances and economic interests, it appears to be prudent to start with the construction of a procedure and to refrain from filling in too many substantive features. Therefore, e.g., there will be no quasi-automatic discharge at the end of such proceeding – unless the creditors' majority agrees on that.

Accordingly, the present author presents here what appears to be a feasible solution; since this contrasts with the IMF proposal, it will briefly outline what is seemingly the latest shape of the Fund's concept.

#### B. The IMF concept

The IMF's SDRM is designed in a way that confers this institution the decisive function for and within such proceedings. The earlier idea that even the filing of a petition for commencing a SDRM should be subject to the approval of the IMF is given up in the latest reflection on this topic.<sup>10</sup> Instead, however, one of the most important features of any insolvency regulation – namely the immediate stop on any creditor action right

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<sup>9</sup> See, in detail, IMF 2002 a. Additionally, IMF Working Paper, prepared by Rogoff/Zettelmeyer: Early Ideas on Sovereign Bankruptcy Reorganization: [www.imf.org/external/pubs/ft/wp/2002/wp0257.pdf](http://www.imf.org/external/pubs/ft/wp/2002/wp0257.pdf).

<sup>10</sup> IMF 2002 b plus c.

upon the commencement of the case (“automatic stay”) – shall be made dependant on either the IMF’s or the creditors’ consent.<sup>11</sup>

Moreover, the reason for commencing a case shall be the existence of unsustainable debts – whereby it is the Fund that judges whether or not (un)sustainability is given.<sup>12</sup> And finally, the plan shall be subject to the Fund’s final approval – thus, the IMF has a sort of final saying in how to rescue the debtor’s desolate financial situation.<sup>13</sup> Under these circumstances, it is not much more than just a nice concession to the rule of law that this proposal provides also for independent judges: they are entrusted with the tasks of verifying the creditors’ claims and settling disputes arising there from.<sup>14</sup>

### **C. An alternative**

In sight of this proposal be it repeated: the IMF is not just advisor and creditor of most of the countries in question but is, moreover, an institution that is put together by numerous members the richest of which are at the same time mostly also creditors and have a decisive saying within the IMF. Seen from the fundamental requirements of the rule of law, such a collision of functions and interests disqualifies this institution for any major role within an insolvency proceeding. Therefore, the following construction of a proceeding appears to be preferable – even though it is to be admitted, that a number of questions remain unanswered and that most features still need further elaboration and precision.<sup>15</sup>

#### **I. General Features**

##### **1. Neutral third party**

###### **a) Selection**

The principle of the rule of law, which it is generally demanded or recommended must apply, means that a debt regulation procedure cannot be entrusted solely to the affected parties (let alone to a creditor<sup>16</sup>) but – at least in the final instance – must be

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<sup>11</sup> IMF 2002 b, 14 seq., 28 seq.

<sup>12</sup> IMF 2002 b, 4

<sup>13</sup> IMF 2002 b, 27.

<sup>14</sup> IMF 2002 b, 58 seq.

<sup>15</sup> What follows, is an elaboration of what I have proposed already in earlier publications – in the order of their drafting: Staatliche Schuldenregulierung: (1) Verfahren und mögliche Inhalte, BMZ-spezial Nr. 38, 2002 (= [www.bmz.de/infothek/fachinformationen/spezial/spezial038/index.html](http://www.bmz.de/infothek/fachinformationen/spezial/spezial038/index.html)); (2) Überlegungen zu einem Insolvenzverfahren für Staaten, Wertpapier-Mittlungen 2002, S. .. (in English: Some Thoughts on an Insolvency Procedure for Countries, to appear in the American Journal of Comparative Law 2002); (3) Ein Insolvenzverfahrensrecht für Staaten, Humboldt Forum Recht, [www.Humboldt-Forum-Recht.de/1-2002/index.html](http://www.Humboldt-Forum-Recht.de/1-2002/index.html).

<sup>16</sup> Sometimes (and especially in the US), it is the debtor who is in charge with dealing its own insolvency (= debtor in possession) – but he is under surveillance of an independent court.

under the surveillance of a neutral third party. Only then can the same benefits emerge as are to be found in private insolvency law. Therefore, in contrast to the IMF proposal this independent third party cannot be entrusted with just a few minor tasks but must play a bigger role in the proceeding.

With respect to the selection, the first thing to note is that only a limited number of candidates should be considered. Because the issue is such an important one it is vital that, as quickly as possible, a body of expertise develops; this is not only of great importance for the predictability of the procedure but also means that the wealth of experience accumulated enables the procedure to be carried out to the highest possible standard. This objective is naturally easier to achieve the smaller the number of candidates for the position of neutral third party is kept.

Next to this priority issue, it is of only secondary importance how such a pool is defined and where it is situated. It could possibly be linked to an institution – for example the UN or one of its specialist agencies or (the obvious choice from a lawyer's point of view) the International Court of Justice (ICJ). It would, however, be entirely feasible for the pool to be designed in a more open way and for the parties to have the option, as in normal arbitration proceedings, of each nominating a person of their choice, who in turn nominates a third party to take on the supreme role. The difficulty in that case then, of course, is to decide who is to be in the pool and who is to have the authority for creating the pool. The "arbitration" option has the advantage of being more flexible and perhaps more readily accepted because at least one of the decision-makers has been nominated by the parties concerned themselves. The "institution" option, however, has the advantage of greater neutrality and of being easier to define.

Therefore, the present author is in favour of creating a new Chamber at the ICJ – an insolvency Chamber. But it would not suffice to extend the new tasks to the existing ones of the currently acting judges. Since the kind of work envisaged in the present proposal is quite different from the "usual" task of a dispute-resolving judge. A number of highly economic, political, sociological (and only finally also legal) issues are to be taken into account – in addition to the ability to "steer" negotiations between strong parties instead of deciding a case which has arisen between them.

#### b) Functions

The list of (legal) functions to be performed by that third party could vary. The details will be discussed below. As indicated already, it is not just a judiciary role; it is more: apart from the legal control, the verification of claims, and the settlement of disputes, it

has also to manage the discussions between debtor and creditors, has (at least to a certain degree) to survey the debtor state's affairs, and has – quite predictably – to serve as a general advisor for the parties affected, due to his influence and dependent on his charisma or personal character. Instead of putting him on a level with a judge, he should rather be seen as a sort of administrator.

## 2. Qualification of the debtor

A short answer to the posed question would be that only states are qualified to be treated as debtors in the sense of the present procedural proposal. This would exclude regions, which form – constitutionally spoken – part of a state.<sup>17</sup> Problems, however, will arise, e.g., when such part of a bigger unit unilaterally claims independence for itself. But that will not suffice for being qualified as a debtor – and be it just for the reason that abuse of this proceeding would be too easy.

## 3. Who qualifies as creditor?

As simple as this question might appear as difficult is it to give a comprehensive answer to it. Of course, each natural and legal person is creditor of the debtor state who has a legal claim against it. But in the present context it is to be answered which one of these creditors shall be included into the insolvency proceeding? This cannot be questionable with respect to other states and organized lenders such as the Bretton Woods institutions, banks, and other entities alike – no matter if they are foreign or domestic. The same is true with private lenders when they are bondholders.

The answer becomes problematic when it comes to private individuals of the debtor state who are not bondholders but creditors of, e.g., a tax repayment claim. If they were included, the responsible politicians of that state might be all too reluctant to commence an insolvency proceeding. Thus, political or electoral tactic might undermine economic necessities. Maybe, that a solution would be that these domestic private creditors are to be included on an ad hoc-basis, dependent on a judgement of the neutral third person about the general circumstances of the case at hand.

## 4. Type of proceeding

After all what has been said supra about the no longer existing exclusivity of liquidation within insolvency law and about the emergence of the plan proceeding, it is clear that the only type of proceeding has to be the latter one. There cannot be any option what-

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<sup>17</sup> It would become more and more questionable whether or not member states of the European Union are to be seen as independent units, which might file a petition. A similar problem might arise when a former uniform state splits up into two or more parts – as, e.g., in the case of Yugoslavia, which is (at the present time) planning (or has already perfected) to be named Serbia-Montenegro – with consequences that are somewhat unclear.

soever to expel the insolvent state from the community of all the other states. Quite to the contrary: The plan proceeding is the given tool to find a path on which the insolvent state can be lead back to the market on which all states are acting.

## 5. Enforced community

The probably biggest hurdle for a direct adaptability of the private law insolvency concept to the public international surrounding is the lack of competence there to form what German scholarship is used to phrase as „Zwangsgemeinschaft“ and what might be translated as “enforced community”. Any national legislator has the power to subdue all creditors to the insolvency proceedings of their subordinates – no matter if they want it or not, no matter if they know about the proceeding or not, and no matter whether they are co-nationals or foreigners. Having this power, private law insolvency is in the unique position to clear all of the debtor’s financial relationships through a singular proceeding.

This competence is also pre-supposed in all existing legal acts dealing with cross-border insolvencies. But it definitely does not exist within the sphere of the present topic. On our globe there is up to now no such authority, which could force all the above-mentioned creditors to participate in the state insolvency proceeding. This opens avenues for free-rider behaviour. The only solution under the given circumstances is to recur to contractual obligations. They are known as “exit consent-clauses”, “collective action clauses”, or “pari passu clauses”.<sup>18</sup> However, they certainly do not bind the private domestic creditors of the said tax repayment claim; and they certainly do work for the rest of the creditors only if the respective contract clauses are indeed used without exception. But it can safely be predicted that the poorer the countries are and the more they need access to the capital market, the more they will make their offers attractive by waiving such clauses.

Therefore, it is an applaudable approach of the IMF to plea for an international treaty that, then, is to be made binding for individuals by national legislations. However, instead of changing for this purpose the IMF statute (and thereby conferring the above-mentioned key function to this institution) it is for the said reasons preferable to amend the statute of the ICJ. Pursuant to Art. 93 (1) of the UN Charta, such an amendment would bind all the member states.<sup>19</sup> Be it added that Art. 95 of the UN Charta more or less explicitly addresses the possibility of the creation of a new Court.

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<sup>18</sup> Cf. Paulus in: Humboldt Forum Recht (fn 15), p. 6-2-1.

<sup>19</sup> For details, see, e.g., Tomuschat, *International Law: Ensuring the Survival of Mankind on the Eve of a new Century* (General Course on Public International Law), 2001, p. 413 seq.

## II. Commencement of the proceeding

### 1. Reasons for opening

In private law, it has not yet been possible to identify or define in legal terms the reasons that would trigger an insolvency procedure in a truly satisfying way. Insolvency law has, nevertheless, been functioning for millennia, so this difficulty is no argument against the introduction of a debt restructuring procedure. However, over-indebtedness as a trigger for insolvency proceedings presents so many considerable problems in private law, that it would be highly problematic applying it to the sovereign area under discussion here. If anything, it would appear advisable to return to the generally accepted reason of suspension of payments or inability to make payments. Such a situation is deemed to exist when the debtor is unable to fully honour existing debts as they become due. One option that could be seriously considered in this context is whether imminent inability to pay might act as a sufficient trigger. By bringing forward the initiation of proceedings in this way, there is a greater chance of debt restructuring being implemented more rapidly; at this early stage, liquid assets have not been used up to the same extent, as is inevitably the case when the debtor has already reached the stage where it is unable to make payments.

However, it could be asked whether this is the point at which it would be best to depart from the model of private insolvency law. The crucial question that must be answered before a debt restructuring process is opened is, in any case, whether the petition has been filed in good faith or not. Whatever this term is to cover, it must surely also cover situations in which sufficient reserves are in fact available to service current debt.

### 2. Right to file a petition

Seen from a private insolvency law perspective, the right to file a petition should be granted to both the debtor and the creditors. Since only then both sides have the power to threaten the other one with such filing and only then insolvency law can exercise its disciplining function. However, even within this body of law there are exceptions of this general rule: Sometimes the right to file is even left exclusively with a controlling authority, and sometimes it is granted the debtor alone – the most prominent and best fitting example for the present context being the chapter 9-proceeding of the US Bankruptcy Code.

Thus, if even municipalities should be given the sole right to file, this must be all the more the case when states become bankrupt. If any other institution or any person had that right, the sovereignty of the debtor state would be truly undermined. Having no

influence on filing a petition would mean that that state had to change its politics from one moment to the other; creditors could blackmail a government to the detriment of the state's population. This just cannot be done.

To be sure, if the debtor state has the exclusive right to file the petition, it must be noted, that it is given a surplus of power over the creditors. Since it is only him who can break up the negotiations at the Paris or London Club. These negotiations will and shall, according to the present author's understanding, not be abolished; they shall have the function of what the so called out of court settlement talks are within the field of any enterprise insolvencies: they are the final attempt to rescue the debtor and to escape from the insolvency proceedings. Anyway, that power surplus of the debtor must be out-balanced in order to strengthen the creditors' position under these circumstances. This can be done by submitting the debtor's petition a rather strict control as to its permissibility.

### 3. Permissibility of the petition

The said control should be exercised by the administrator. Apart from legal expertise, he needs for it also the support from the IMF or the World Bank.

#### a) Viability of the plan

The petition has to be handed over to the ICJ together with a plan. Therein, the debtor has to put down how the country's debt restructuring shall be performed. Even though its final acceptance is dependent on the creditors' approval, the administrator should have the task to check the plan on a rough manner as to its feasibility and realization chance. If this were not done, a debtor country would be too easily attempted to "flee" into this proceeding – and be it just for the sake of gaining time.

#### b) No abuse

What has been said so far is closely connected with a further part of the administrator's initial task – namely to control whether or not the petition is filed in an abusive manner. It is probably impossible to define in abstract terms, which cases would fall into this category. E.g., if a debtor submits a plan, which is designed to discharge this country partially or in toto from its reparation payments after a lost war, one would rather assume this to be abusive. But things might be seen differently if this country is now lead by a completely different government and debt reconstruction is sought for other than the reparation obligations. Presumably, examples of this sort are endless; they make clear that the administrator's expertise is indispensable and that, therefore, the institutionalised variant of the neutral third party is to be preferred.

There is one sort of abuse, however, which is not dependent on personal judgment but on facts: repeated petitions. One could state, e.g., that an insolvency proceeding in the present form can be commenced only every two, three, five, eight or whatsoever years. This would work as a hindrance for any debtor state to file a petition unless for good reasons and on a solid basis. Such a rule would also be a sufficient incentive for drafting the plan in a way that makes it acceptable for at least the majority of the creditors. This rule would work as the abovementioned out-balancing of the debtor's power surplus with respect to his exclusive right to initiate the proceeding.

c) Minimum requirements of the plan's substance?

A further part of the administrator's control task could be that the plan has to contain certain substantive minimum requirements such as, e.g., improvements of the school system, abstaining from certain costly prestige objects, etc. Examples for that might be found – at least to a certain degree – in the context with the IMF's and the World bank's conditionality.

Even if the idea of requesting such substantive features within a plan might be too ambitious for the present time, it should be agreed upon that a debtor state must in any case be left with what private law terminology phrases as minimum income level (however this is to be defined). Since the here proposed state insolvency proceeding is, be it repeated, a plan proceeding which aims not at the debtor state's liquidation. To the contrary, the proceeding shall serve as a means to bring this state back into the community of financially and economically healthy states.

#### 4. Effect of petition

It has already been said supra that the most important initial consequence of opening an insolvency proceeding is that from this very moment on the creditors are barred from any action against the debtor's estate, which might have a detrimental effect on the creditors in their entirety and their chance of satisfaction. The same holds true, of course, for any respective (trans)actions done by the debtor. This so-called "automatic stay" is in the public international insolvency law surrounding as crucial as it is in the private law pendant. Therefore, it must also be part of the present scheme.

However, unlike in the IMF proposal, this stay should be independent on any consent. Since if the creditors (or just one of them) were to agree, the disciplining pressure is taken away from them and is left alone with the debtor. This would correspond with the situation which exists right now – e.g. in the Paris or London Club – and which is supposed to be overcome by institutionalising the new proceeding.

To be sure, the debtor, too, has to be kept under the disciplining pressure. Therefore, not only that the automatic stay would be lifted immediately as soon as the neutral third

party discovers any abusive intent; in addition, a new attempt of achieving the benefits of an insolvency proceeding would be possible only after a number of several years (see supra at 3 b). Moreover, it might be considered if the – automatic – stay should not be limited to a period of time of, e.g., three months. There could be a possibility of prolongation, which could possibly granted by the neutral third party.<sup>20</sup>

### III. The proceeding

Once these commencement requirements are met, the second phase begins – the discussion of and voting on the plan.

#### 1. Negotiations

The plan, which is to be presented by the debtor, is, of course, subject to changes and amendments in the course of the negotiations between the debtor and its creditors. They are presided by the neutral third party. It is, thereby, by no means prohibited to act also as a sort of mediator between the two sides who brings things forward by making its own proposals or by discussing issues separately, etc.

#### 2. Accepting the plan

According to the present proposal of an insolvency proceeding, the negotiations at the Paris and London Club are not to be abolished. However, they will have a different meaning since they cease to be something like the last instance. They will rather form something what in its private law equivalent is called “out-of-court negotiations”. They take place before literally all insolvency proceedings: Thereby, the debtor tries to reach an agreement with its creditors which solves the problems of its financial, economic, structural, etc. distress without having to go through an insolvency proceeding. However, outside of this proceeding such an agreement needs unanimity in order to be binding on all parties involved.

This changes within an insolvency proceeding. As one of the consequences of the abovementioned “enforced community”, the unanimity requirement is replaced by a majority vote. This is decisive for unfolding the said disciplinary effect: Since knowing that one can be outvoted once an insolvency proceeding has been commenced, might reduce the degree of strictness with which a single creditor tries to push through his own interests in the negotiations before (the so called “free-rider” problem). Sometimes, this retroactive effect of the mere existence on an insolvency law is called

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<sup>20</sup> The second best solution were to require for any prolongation the consent of a certain majority of the creditors.

“peace through deterrence” – thereby implicitly stating that an insolvency regime can be successful even if it is never (or rarely) used in practice.<sup>21</sup>

From what has been said so far it will have become self-evident that, in the present context, unanimity must be given up as well and that instead of that a majority suffices for acceptance of the plan. How the majority is to be formed, is a technical question which shall not be addressed here in greater detail. As a general observation, however, it should be noted that the exact determination corresponds with the degree of discipline of the participants. The closer the majority comes to 51 %, the stronger the position of the debtor – and vice versa. The private law insolvency counterpart provides, therefore, sometimes for combined majority requirements such as a certain majority of the creditors in addition to a further majority of the sum of claims.

### 3. Avoidance powers?

It might be too early to promote the idea of introducing also the possibility of recovering some of the debtor’s money or assets that had been given away before the commencement of the proceeding under conditions which are objectionable. This mechanism, the so-called “actio Pauliana”, is an essential part in virtually all existing (private law) insolvency codes. One could think of transferring this “actio” also to the public international insolvency context and, thereby, empower the neutral third party to retrace and recover, e.g., certain payments to particularly pressing creditors or other entities, etc.

However, such an idea is admittedly ambitious and needs a very careful consideration of defining what can be recovered and under what circumstances. What if the debtor’s head of state has bought numerous shoes for his wives, what if he has constructed a prestigious office building without any sound business plan – or a huge airport in the middle of somewhere where nobody makes use of it, etc.? The examples one could think of are endless. Suffice it at this stage of the development to note that this option should be kept in mind: It not only increases the disciplinary effect on both the debtor and the creditors, it also helps to improve the debtor’s financial condition for the benefit of its creditors.

## IV. Implementation of the plan

Once the plan has been accepted by the requisite majority, the third phase begins – the implementation of the plan. However, if the majority was not reached the debtor is in the same position in which a debtor is nowadays when confronted with the necessity

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<sup>21</sup> Cf. already supra at fn 6.

to approach the Paris or/and London Club. At these negotiations, the debtor has for the abovementioned time limit (supra II 3 b) no option of re-commencing the insolvency proceeding with (the old or) a new plan. This consequence serves as a pressure on him to keep the interests of his creditors in mind at the previous plan discussions (as described supra at III 1) and not to overdo with pushing through its own interests.

But if this majority has been reached the ideas and proposals, which form the plan, have to be put into reality. It is obvious that this cannot be left completely to the self-responsibility of the debtor. A certain degree of control is necessary which has to be exercised by the neutral third party. But since this is just one person with probably not too big a staff, the control needs be complemented by the threat of a sanction for failing with the plan implementation. Again, the sanction could be that the plan becomes (retroactively) void; thereby, the debtor were anew confronted with all the former claims of its creditors and were barred from initiating another insolvency proceeding.