



# **INTERNATIONAL INSOLVENCY INSTITUTE**

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## **INTERNATIONAL ADR 2.0: BIG SOLUTIONS FOR BIG PROBLEMS**

*Arbitration of a Country's Financial Reorganization*

*By*

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Houston

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## MEMORANDUM

**TO:** International Insolvency Institute Twelfth Annual Conference, Paris, France  
**FROM:** Zack Clement  
**DATE:** June 22, 2012  
**RE:** Arbitration of a Country's Financial Reorganization

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### A. Overview

Greece has provided an example of what happens when a sovereign European country (a "Country") needs to reorganize its finances. It is asked by potential refinancers ("Refinancers") (1) to pursue austerity (by lowering spending on social programs, government worker expenses, pensions and other things essentially involving payments to humans); (2) to raise taxes and other sources of revenues, and (3) to cut payments to existing capital providers (by cutting the principal amount owed on government bonds and otherwise). Once these things are done, the Refinancers (which might be a combination of the International Monetary Fund, the European Central Bank and other such agencies, German Banks and other strong financial institutions) indicate that they will be willing to lend more money to the reorganized Country.

This process inevitably involves spending cuts and revenue increases that the Country does not really want, and *de facto* loss of sovereign decision making as Refinancers demand austerity and tax increases based on what they think the financial analysis requires as the solution to the debt crisis. Politicians who are seen as too indentified with the goals of the Refinancers risk loss of political support. We could interview George Papandreou for more details on how and to what extent this occurs.

This Proposal describes an alternate approach in which a Country could actually maintain more sovereignty by (1) proposing a plan of reorganization to an arbitral panel containing the (a) austerity, (b) tax increase and (c) bond debt discharge that it believes appropriate; (2) having a forum to contend publicly with its labor and capital creditors and Refinancers about what is a fair plan and (3) having an independent Panel of experts give the final decision about the painful cuts and tax increases necessary to have a fair plan that Refinancers will fund with new money.

This would work in the same manner as agreements to arbitrate multibillion Euro commercial disputes. As described in the Proposal section below, the major parties to a Country's debt structure, including labor creditors, capital creditors and potential Refinancers could sign an

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agreement to arbitrate the restructure and refinance of the Country's finances (attaching as exhibits the documents evidencing the claims at issue) and agree to have the dispute decided pursuant to reorganization principles summarized in another exhibit to the arbitral agreement.

The reorganization community can point to a law that address these very issues - - Chapter 9 of the U.S. Bankruptcy Code. United States' Circuit court cases from the Great Depression of the 1930's analyzed these very same issues - - has there been enough austerity and tax increase so that it can be said that bond creditors are being paid "all they can reasonably expect under the circumstances" to justify the amount of proposed discharge of their debt?

Picking the arbitral panel will be crucial. It is predictable that labor creditors and capital creditors will want to select their own arbitrators. Hence, assume a panel with two creditor arbitrators, two Country arbitrators and a neutral head of panel - - someone whom everyone could trust in such a role - - my favorite is Colin Powell. People who have spent their professional life in the arbitral community will be able to advise us on how best to approach the panel selection process.

Why would the various potential parties to such an arbitration agree to such a process? The sovereign Country government has reason to agree to arbitrate because it can act like an advocate, picking its arbitrators, preparing and proposing its restructuring plan, advocating in a public hearing why its proposed level of (1) austerity and the timing therefore, (2) tax increase and the timing therefore and (3) bond debt discharge are all fair and should be approved by the expert panel. It will have a public forum to air its views and will have an arbitral order at the end of the case enforceable by the New York Convention concerning, among other things, the amount of debt discharged. Most importantly, it will have an expert to point to for having made politically unpleasant ultimate decisions about austerity and increased taxes.

Labor providers have a similar motivation to agree to arbitrate. Demands for austerity are often aimed at them in a backroom. They would give them a public forum to argue for less drastic, or move delayed, austerity measures, and a panel of experts who might actually heed some part of their plea.

Capital provider creditors will have similar incentives to sign on to a public forum to argue that more austerity and taxes are appropriate to free up more money to pay them. They too will have a chance to convince a panel of experts that they are correct instead of being forced in a back room to agree to the view of the Refinancers.

The Refinancers will even have their own incentives to agree to such a process. They will have the comfort of a Plan that has been thoroughly and publicly arbitrated as to its fairness, and is, thus, more likely to be sound. They too will be able to advocate their position in favor of more cuts and revenues and will have a panel of experts to make the final call on what must be cut or raised before the plan is found to be fair. They might gain substantial benefit from not being seen as the sole parties imposing these difficult measures.

With this as background, the Proposal is described below.

**B. Proposal for Arbitration of a Country's Financial Reorganization**

1. An arbitration concerning the fairness of a country's plan to reorganize its finances (a "Country," and a "Plan") can begin when the debtor Country agrees with representatives of its major suppliers of labor, capital and other goods and services, and certain other relevant parties in interest to submit to arbitration their differences concerning the Country's proposed Plan pursuant to a set of Reorganization Principles (a "Submission to Arbitration").
2. A form of Submission to Arbitration is attached hereto as Exhibit A. A set of Universal Reorganization Principles that could be used in such an arbitration is attached as Exhibit B.
3. A debtor Country will not agree to such a Submission unless a sufficient number of its creditors (holding a sufficient percentage of its outstanding debt) and other parties in interest have agreed to the arbitration. Its creditors and possible financiers will not agree unless they perceive that they will be able to assert their views to a fair panel of arbitrators, under reasonable principles, with a reasonable chance of achieving something in favor of their position.
4. This proposal permits a debtor Country to keep its power to devise and propose a Plan. It can advocate this Plan through a public arbitration proceeding where it can explain why it is fair in difficult circumstances. It can decide whether to modify its Plan in response to suggestions from the expert panel of arbitrators (a "Panel") to improve its chances of confirmation. If it prevails, it can enforce its Plan through the New York Convention. For a debtor Country, this is a good mixture of retaining power to lead and allowing an expert panel to resolve some of the most difficult issues and be seen as requiring unpopular, but fair, restructuring measures.
5. Creditors (both labor and capital) will only agree to participate in such a process, where the debtor Country could have the power to enforce its Plan at the end of the case, if they believe they will receive a fair hearing and have a chance of achieving something for their interests.
6. Refinancers might actually like the fact that Plan terms, including covenants in their financing, are enforceable.
7. Issues of fairness and trust will be dealt with implicitly as the parties try to agree on a Panel. Permitting the Country (on one side) and its labor and capital creditors (on the other side) to pick an equal number of arbitrators on the two sides will convince both that their views will be heard in the decision making process.
  - a. A Submission to Arbitration can contain the parties' agreement on (1) the members of the arbitral Panel that will hear and decide the matter, (2) the

- Reorganization Principles to be applied, (3) the place of the arbitration, and (4) such other details as the parties wish to agree on.
- b. Requiring a majority vote or, failing that, giving power to the neutral head of the Panel to decide, means that picking the neutral will be a most important measure of the parties' willingness to try to work together.
  - c. There are people in the insolvency and diplomatic fields with such a reputation for knowledge and fairness that they could be trusted to be the neutral head of such a Panel.
  - d. If the Parties are unable to agree on a neutral head of panel for this Ad Hoc arbitration, they can pick an appointing authority to select the neutral.
8. The Panel can apply the chosen Reorganization Principles in a reasonable, fair and just manner, and may look for precedent in the law of the debtor Country, or in the reorganization laws of major commercial countries, including Germany, France, England, the United States, or such other countries' laws as the Panel believes are an appropriate source for precedent concerning the chosen Reorganization Principles.
  9. Unless specified by the Parties, the Panel can decide what procedural rules it will apply (UNCITRAL, or other), and other details of the arbitration. Conducting public hearings will help air the issues and build consensus toward acceptance of the final arbitral award.
  10. Presumably, the arbitration will begin with the debtor Country proposing a Plan to restructure its debts, including proposed austerity and revenue enhancement measures. Creditors will have the opportunity to raise issues with and objections to the Plan. Accordingly, a reasonably prompt processing of the arbitration could involve the debtor Country preparing its Plan and papers supporting it in one month, creditors responding in one month, an arbitral hearing two weeks later and a ruling two weeks later, finishing in 3 months. These time periods could be adjusted to give the panel six weeks to decide and still finish in 4 months.
  11. Awards of the Panel, including those concerning confirmation of the Plan, should be enforceable through the New York Convention.

## **EXHIBIT A**

### **Agreement to Submit Dispute Concerning Debtor's Plan of Reorganization to Arbitration**

1. \_\_\_\_\_ (the "Debtor" or the "Country") and certain of its creditors, including, (1) certain representatives of labor providers and pension and other benefits recipients, including: \_\_\_\_\_ ("Labor Providers" and "Labor Representatives"); (2) certain providers of loans and other forms of capital ("Capital Providers" and "Capital Representatives"); and (3) certain providers of other goods and services ("Other Creditors" and "Other Creditor Representatives") (collectively the "Parties" and "Representatives") have a dispute concerning what is a fair plan of reorganization for the Country to reorganize its finances to reach a sustainable financial condition that will permit it to pay its obligations when they come due (the "Dispute" and a "Fair Plan"). Exhibit A hereto contains a list of the Parties and their designated Representatives.
  
2. Certain potential providers of additional financing have stated that they will only do so in connection with a Fair Plan (the "Refinancers"), and subject to such additional conditions as they choose to impose. The Refinancers wish to participate in this arbitration, but not to be bound by it except as described herein.
  
3. The Dispute about what is a Fair Plan involves the following agreements, statutes and other documents (collectively the "Documents in Dispute"):
  - a. Concerning the provisions of labor (collectively, the "Labor Documents")
    - (i) \_\_\_\_\_ Labor Agreements;
    - (ii) \_\_\_\_\_ Pension Agreements;
    - (iii) Other Agreements relating to Labor, including \_\_\_\_\_;
    - (iv) The following statutes concerning labor and pensions, including \_\_\_\_\_;
  
  - b. Concerning the provision of capital by loans or otherwise (collectively, the "Capital Documents"):
    - (i) \_\_\_\_\_ Loan Documents;
    - (ii) \_\_\_\_\_ Bond Documents;
    - (iii) Other agreements for the provision of capital, including \_\_\_\_\_;
  
  - c. Concerning the provision of other equipment, goods and services (collectively, the "Other Goods and Services Documents"):
    - (i) \_\_\_\_\_ Contracts for provisions of other goods and services;

- (ii) \_\_\_\_\_ Contracts for lease (including leverage lease) of goods and equipment.
- d. Concerning the ability of the Country to raise revenue (collectively, the “Revenue Documents”).
  - (i) \_\_\_\_\_ Statutory and budgetary information regarding the Country’s revenues from all sources under the Country’s existing laws;
  - (ii) \_\_\_\_\_ Analyses, studies and other information regarding the potential revenues realistically realizable from reasonable and sustainable revenue enhancement measures, including both new measures and more rigorous enforcement of existing laws.
- 4. The Parties agree and hereby submit for final determination by arbitration the question of whether the Country’s proposed Plan, as it may be amended, is a Fair Plan.
- 5. The arbitration shall be conducted by the Arbitral Panel as described and defined below which shall apply Reorganization Principles, as set forth in the [Universal Reorganization] Principles attached as Exhibit B hereto.
- 6. The Panel shall apply the Reorganization Principles in a reasonable, fair and just manner, and may look for precedent in the law of the Debtor Country, or in the reorganization laws of major commercial countries, including Germany, France, England, the United States, or such other countries’ laws as the Panel believes are an appropriate source for precedent concerning the Reorganization Principles being used.
- 7. Refinancers shall be permitted to participate in the arbitration as if they were a Party. The Arbitral Panel shall not, however, have the power to compel them to provide any funding for a Plan confirmed as a Fair Plan; but Refinancers shall have, among other rights, the right to make as one condition of their funding that the Panel find the Plan, as it may be amended, to be a Fair Plan.
- 8. The arbitration shall be conducted by [five] arbitrators, appointed as provided in this Agreement. The Debtor Country hereby designates [\_\_\_\_, and \_\_\_\_] as arbitrators. Creditor Representatives hereby designate [\_\_\_\_\_] as an arbitrator. Labor Representatives hereby designate [\_\_\_\_\_] as an arbitrator. [The Debtor Country, Creditor Representatives and Labor Representative have agreed that [\_\_\_\_\_] shall be the neutral presiding arbitrator.] [The arbitrators so designated by the Parties shall, within a period of [30] days from the date of this Agreement, jointly designate in writing the neutral presiding arbitrator. If the four named arbitrators do not jointly designate in writing the neutral presiding arbitrator within a period of [30] days of the date of this Agreement then, on the application of a party to this Agreement, the neutral presiding arbitrator shall be designated by the appointing authority].
- 9. If a vacancy arises on the Arbitral Panel because any arbitrator dies, resigns, refuses to act, or becomes incapable of performing his or her duties, the vacancy shall be filled by the method by which that arbitrator was originally appointed. If that method fails, the

appointment(s) shall be made by the appointing authority within [30] days of being requested to do so by one of the Parties.

10. The Arbitral Panel may make its awards by a majority. In the event that no majority is possible, the presiding arbitrator may make the decision(s) as if acting as a sole arbitrator.
11. After their designation, the arbitrators shall proceed forthwith to arbitrate and determine the Dispute. In so doing, the arbitrators shall act fairly and impartially as between the parties, giving each party a reasonable opportunity of presenting its case and replying to that of the other party. The arbitrators shall adopt procedures suitable to the circumstances of the Dispute, avoiding unnecessary delay or expense.
12. The arbitrators shall have the power to decide all procedural and evidentiary matters, subject to the right of the parties to agree any matter, including:
  - a. when and where any part of the proceedings is to be held;
  - b. the language or languages to be used in the proceedings and whether translations of any relevant documents are to be supplied;
  - c. whether, and if so, what form of written submissions are to be made, when these should be submitted, and the extent to which such statements can be amended;
  - d. the extent to which documents or categories of documents should be subject to discovery between the parties;
  - e. the extent to which interrogatories should be put to and answered by the respective parties, and when and in what form this should be done;
  - f. whether to apply strict rules of evidence (or any other rules) as to the admissibility, relevance, or weight of any material (oral, written or other) and the time, manner and form in which such material should be exchanged and presented;
  - g. whether and to what extent the tribunal should itself take the initiative in ascertaining the facts and the law;
  - h. whether and to what extent there should be oral or written evidence or submissions.
13. The Arbitral Panel shall [use its best efforts to]/[will] render a final award within [x] months of the appointment of the third arbitrator.
14. Every hearing held by the Arbitral Panel shall be open to the public to attend.
15. All information and documents arising out of or in connection with the arbitration shall not be confidential and may be disclosed to a third party without notice to the Parties or to the Arbitral Panel.

16. The Arbitral Panel [shall] [shall not] have the power to award a party all or part of its legal costs.
17. The seat of the arbitration shall be [\_\_\_\_\_]
18. The Arbitral Panel shall fix and state in their award their [reasonable] fees and expenses in connection with the arbitration, and each Party agrees to pay its pro rata share of the same. If the arbitrators so direct, the prevailing party shall pay the full amount of such fees and expenses and a pro rata portion of the same may be included in the award in its favor against the other Parties.
19. The Parties intend that the award of the Arbitral Panel shall conclusively determine the Dispute between them and hereby exclude any right which the Parties might otherwise have under applicable law to appeal or to challenge any award of the Arbitral Panel in any court of competent jurisdiction.

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Debtor Country Representative

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Labor Claim Representative

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Capital Claim Representative

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Reorganization Financier Representative

**EXHIBIT B**  
Universal Reorganization Principles

1. Upon Submission to Arbitration, all parties to the Submission shall be stayed from taking collection actions until the Plan is confirmed or confirmation is denied/the Arbitral Panel renders its final award.
2. During the case the Panel shall have the power to enforce, modify or lift this stay. A creditor can obtain an order from the Panel permitting it to pursue collection if it can show that it is not receiving adequate protection.
3. During the case, the Debtor can obtain an order from the Panel approving financing and any related liens if it can show that this financing is in the best interests of its estate.
4. If the Debtor wishes to obtain such financing with the grant of a new senior lien on property already subject to a lien, such a priming lien can only be ordered if the existing lien is found to be adequately protected or is afforded adequate protection.
5. The Debtor can reject an executory contract if it can show that it is exercising good business judgment in doing so and that rejection will be in the best interests of its estate. If an executory contract is rejected that will generate a rejection damage claim that is an unsecured claim.
6. A contract can be assumed by curing defaults and giving adequate assurance of future performance. This shall include bond indenture contracts.
7. A claim shall be deemed secured to the extent of the value of the collateral securing it and the remaining deficiency claim shall be an unsecured claim. The Debtor or a creditor can bring a motion for the Panel to evaluate collateral and, thus, to fix the amount of a secured claim. Such a determination can also be made in a Plan confirmation hearing.
8. The Plan shall fairly classify claims of equal priority into separate classes and shall not discriminate in its treatment of claims of the members within the same class.
9. The Plan shall be accompanied by a Statement in Support explaining the conceptual and financial basis for the Plan, and explaining why the Plan should be confirmed.
  - a. A hearing shall be held to determine whether the Statement in Support contains adequate information.
10. The Statement in Support, ballots to vote to agree to accept or reject the Plan, and the opportunity to object to the Plan shall be provided reasonably in advance of any Plan confirmation hearing.
  - a. The Panel shall conduct a Plan confirmation hearing pursuant to such procedural rules it may adopt.

11. In deciding whether to confirm a Plan, the Panel shall take into account the following principles:
- a. The Plan must be proposed in a good faith effort for the Debtor Country to reach a sustainable level of solvency.
  - b. The Debtor Country must have made reasonable efforts to obtain agreement to the Plan.
  - c. The Plan must be feasible, meaning that it is reasonably likely to result in sustainable solvency enabling the Country Debtor to pay its debts when due after the Plan is confirmed.
  - d. The Plan must be in the best interests of creditors meaning that each member of a class will receive at least as much as it would receive if the stay were dissolved and all parties were permitted to pursue their remedies and any rights against collateral.
  - e. Each class must have voted to accept the Plan by 1/2 in number and 2/3 in amount of claims actually voting on the Plan or the class must receive fair and equitable treatment as described below.
  - f. The Plan must provide fair and equitable treatment of classes of secured claims that have not voted to accept the Plan. This can include, among other treatments:
    - (i) Allowing a secured creditor to retain its lien and to receive cash payments with a present value as of confirmation of the Plan equal to the value of its collateral;
    - (ii) Allowing a secured creditor's collateral to be sold at a public sale at which it can credit bid; or
    - (iii) Providing a secured creditor with the indubitable equivalent of its secured claim and lien.
  - g. The Plan must provide fair and equitable treatment to classes of unsecured claims that have not voted to accept the Plan, meaning that,
    - (i) Unless they are paid in full, no claimants of lesser priority to the objecting class of unsecured claims will receive any value; and
    - (ii) They are receiving all they can reasonable expect under the circumstances because the Debtor's government is reasonably and efficiently performing its core mission having made reasonable austerity measures and used its taxing power reasonably.
  - h. If the Plan is confirmed under this standard, remaining unsecured claims are discharged.

12. The Panel shall have the power to issue interim orders concerning amendments to the Plan that would make it more confirmable and the Parties agree to comply with those orders promptly. The Panel can deny confirmation of the Plan and can terminate the arbitration if it concludes that it will not be presented with a confirmable Plan.
13. If the Panel renders an award confirming a Plan, that award shall be enforceable under the New York Convention as to all of its aspects, including any restructuring of a secured claim and the discharge of unsecured claims provided for in the Plan.