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WHAT CONSTITUTES A DEBT IN THE SOVEREIGN DEBT RESTRUCTURING CONTEXT?

CONTENTS: 1. A Brief Survey Over Recent Developments in Sovereign Debt Restructurings. – 2. The Most Comprehensive Solution: A Full-Fledged Procedure. – 3. Details. – 4. A Practical Example. – 5. What Are Lodgable Claims? – 6. Conclusion.

1. It is just a bit more than 100 years ago that Gunboat Diplomacy was seen as the given habit of dealing with sovereigns which refused to pay back their debts to the creditor states.

A. *Various Methods*. For instance, in 1902 Germany and England showed up at the Venezuelan coast with a number of war vessels in order to give point to their demands of repayment¹. When and if one is willing to draw a parallel from this way of enforcing one's claims with the beginnings of what is nowadays known as the private law bankruptcy/insolvency law we are back in the times of the twelve table-legislation of the early-republican times (450 b.C.): *tertius nundinis partis secanto. Si plus minusve secuerunt, se fraude esto* (tab. III 6). In the sphere of public international law, it was the former Argentinean secretary of state, Drago, who initiated a ban on this method of enforcement (at least with respect to the American states) through the so called Drago-Doctrine from 1907².

Ever since the collection of debts is usually done in a more humane way. For instance, it can be performed on an *ad hoc* basis such as the London Debt Agreement from 1953 which relieved Germany from the bulk of her reparation obligations³; other examples are the well known Iran-U.S. tribunal or the less

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¹ Cf. MANES, *Staatsbankrotte – wirtschaftliche und rechtliche Betrachtungen*, III ed., Berlin, 1922, pp. 181 ff., 188 ff.

² DIETL, *USA und Mittelamerika: Die Außenpolitik des William J. Bryan 1913-1915*, Stuttgart, 1996, p. 86; HERSHEY, *The Calvo and Drago Doctrines*, in *AJIL*, 1907, p. 26 ff.; DRAGO, *State Loans in Their Relation to International Policy*, in *ASIL*, 1907, p. 692 ff.

³ Cf. ROMBECK-JASCHINSKI, *Das Londoner Schuldenabkommen. Die Regelung der deutschen Auslandsschulden nach dem Zweiten Weltkrieg*, *Schriftenreihe des Deutschen Historischen Instituts London*, No. 58, München, 2005.

known equivalent Iraq tribunal for the restructuring of the Saddam-era debts⁴. In contrast, debt restructuring can also be offered through a more institutionalized method: prime examples here are the Paris Club and the London Club⁵. In a sense, J.C. Trichet's former proposal of a Code of Good Conduct⁶ which was meant to bind all creditors of a sovereign and which reflects to a certain degree the experiences of the so called London approach⁷ and the Djakarta initiative⁸ fits also into this category through its standardized pattern.

These two approaches, however, are not yet exhausting the arsenal of tools for the needs of over indebted states. At this point of time, the primary tool is contract law, surprisingly enough. However, as a consequence of the remarkable increase of the global capital market's importance sovereigns, too, act on this market – and they do so (like any other actors) through indentures and related contractual means. Therefore, it has some inherent logic that the contracts are amended with what is nowadays well known as Collective Action Clauses (CACs)⁹. These CACs prescribe in some detail how the contractual terms will change in the case of a default – the most prominent change being the replacement of the unanimity requirement by a (super)majority voting.

Another contractual solution is sought by means of creditor behaviour: under the heading of «odious debts» a huge debate is going on right now as to the legal validity of this concept. Even though it is to be stated upon closer inspection that this is not a legal concept at all, the present discussion is likely to lead sooner rather than later to a legal category of creditors' co-respon-

⁴ Cf. DEEB, *Project 688: The Restructuring of Iraq's Saddam-Era Debt*, in *Cleary Gottlieb Restructuring Newsletter*, Winter 2007, p. 3 ff. See also CARON, *The Reconstruction of Iraq: Dealing with Debt*, in *UC Davis J. of Int'l L.*, 2004, p. 123 ff.

⁵ For these two Clubs, just see MARAUHN, *Restrukturierung ausländischer Staatsschulden*, in MARAUHN (ed.), *Streitbeilegung in den internationalen Wirtschaftsbeziehungen*, Tübingen, 2005, p. 87 ff.

⁶ Cf. www.banque-france.fr/gb/publications/telechar/bulletin/111edito.pdf.

⁷ For this, Cf. FINCH, *Corporate Insolvency Law*, II ed., Cambridge, 2009, p. 251, 307 ff.

⁸ For this, see for instance MEYERMAN, *The London Approach and Corporate Debt Restructuring in East Asia*, in ADAMS, LITAN, POMERLEANO (eds.), *Managing Financial and Corporate Distress – Lessons from Asia*, Washington, 2000, p. 299 ff.; for further references, see search.worldbank.org/all?qterm=jakarta%20initiative&os=0.

⁹ For them, see for instance GALVIS, SAAD, *Collective Action Clauses: Recent Progress and Challenges Ahead*, in *Georgetown J. of Int'l L.*, 2004, p. 713 ff.; GUGIATTI, RICHARDS, *The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers*, *ibidem*, 2004, p. 815 ff.; SZODRUCH, *Staateninsolvenz und private Gläubiger*, Berlin, 2008, p. 219 ff.; SCHIER, *Towards a Reorganisation System for Sovereign Debt*, Leiden, Boston, 2007, p. 19 ff. See, additionally, HOPT, *Neues Schuldverschreibungsrecht – Bemerkungen und Anregungen aus Theorie und Praxis*, in GRUNDMANN, KIRCHNER, RAISER, SCHWINTOWSKI, WEBER, WINDBICHLER (eds.), *Festschrift Eberhard Schwark*, München, 2009, pp. 441 ff., p. 451 ff.

sibility¹⁰. It might be violated when and if a lender ignores certain indicators of the loan's bad use in the hands of the borrowing state. The legal consequence might be the nullity of the claims resulting from such loan or transaction. A somewhat vague private law parallel might be the underlying protective attitude of the modern consumer protection law¹¹.

B. *Debt in Public International Law*. One general observation about debts might be well in place before going into more specific deliberations: the most prominent appearance of the term «debt» in public international law is in the context of international economic law – and, here, primarily together with critical developments; i.e. when the particular exposure of an obligation shall be emphasized. Debt has become here almost synonymous with debt crisis and, thus, with a problem which, despite its long lasting history of (at least) several centuries, has become a worldwide acknowledged legal problem only in recent years. One might speculate about this increased prominence and see the reasons for it in the meanwhile achieved degree of globalization with its automatic spreading of risks such as energy costs, environmental catastrophes, etc., or in the general accessibility to capital markets, the capital flight, and so on all over the globe, or in the incremental juridification of all aspects of life, or in a greater awareness (i.e. through modern communication systems) for the needs of the global population, or in a combination of all these reasons – the equation of debt with debt crisis indicates that lawyers are beginning to search for broader solutions of this phenomenon.

2. There is still one more tool in the box which, however, has surfaced the public-political discussion only for a short while. In the peak of the Argentinean crisis in 2001, the International Monetary Fund (IMF) came forward with a proposal for a full-fledged insolvency procedure. This remarkable innovation was named Sovereign Debt Restructuring Mechanism (SDRM) and was drafted to a certain degree after the model of the reorganisation proceeding (Chapter 11 of the U.S. Bankruptcy Code). After initial irritations about and harsh objections against the unbearable one-sidedness of the first proposal and the blunt favouritism of the drafting institution itself, the IMF aligned its proposal increasingly with the requirements of the rule of law (according to which the roles of creditor, judge, and master of the proceeding must not be taken over by

¹⁰ For references, see *infra*, fn. 39 ff.

¹¹ However, it should be noted that the discussion about introducing a state insolvency law is not (and should not be) restricted to aid-dependent states; it is, in other words, not a development aid tool. It should rather be understood to be (come) applicable globally.

the same entity). However, these efforts came to a sudden end in April 2003 due to (probably) political interference¹².

This interruption «killed» the public discussion about this approach towards a sovereign debt restructuring; and it is uncertain whether it ever will come up again and if so when. This is all the more deplorable since more than 2000 years of experience in the realm of private and commercial law makes it highly likely that a full-fledged proceeding serves the purpose best to come to an overall solution for any debt restructuring attempts. It is particularly for this reason that further efforts should be made to get the discussion about any kind of an all-encompassing debt restructuring mechanism resurfacing the public debate. One effort of this kind is the proposal to establish a court-like institution, a debt restructuring tribunal, which might or could be modelled similar to the abovementioned Iran-U.S. and the Iraqi debt tribunal. The advantage of such an institutionalized tribunal would be that in the course of time, it could develop a body of law which might ultimately lead to a full-fledged insolvency proceeding¹³.

3. It is to be admitted that the abovementioned comparison with the commercial insolvency law is somewhat dangerous in the present context of public international law for several reasons. One of them is that it might lead to an annihilation or at least a belittlement of the peculiarities and complexities inevitably connected with a sovereign's default. This problem shall be demonstrated by the subsequent discussion of what constitutes a debt in the context of a sovereign debt restructuring procedure. However, before going into this it appears to be appropriate to give an overview about what especially the IMF thought to be standard features for its SDRM¹⁴.

¹² For this development, see for instance KRUEGER, *A Financial Architecture for 2002: New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking, Address Given at the «Conference on Sovereign Debt Workouts: Hopes and Hazards»*, Institute for International Economics, April 2002, available at: www.imf.org; HAGAN, *A Legal Framework to Rescue Sovereign Debt*, in *Georgetown J. of Int'l L.*, 2005, p. 299 ff.; SZODRUCH, *op. cit.*, p. 38 ff.; SCHIER, *op. cit.*, p. 15 ff.; MAYER, *Wie nähert man sich einem internationalen Insolvenzverfahren für Staaten?*, in *ZInsO*, 2005, pp. 454 ff., p. 456.

¹³ For this idea, PAULUS, *Rechtliche Handhaben zur Bewältigung der Überschuldung von Staaten*, in *RIW*, 2009, p. 11 ff.

¹⁴ Taken from HAGAN, *Designing a Legal Framework to Restructure Sovereign Debt*, in *Georgetown J. of Int'l L.*, 2005, p. 299 ff. For other proposal's features see, e.g., MAYER, *op. cit.*, p. 454 ff.; PAULUS, *A Statutory Proceeding for Restructuring Debts of Sovereign States*, in *RIW*, 2003, p. 401 ff.

A. *Debts*. Thus, it was considered that in the context of which debts shall be admissible in such Mechanism a distinction should be drawn between domestic debts and external debts. The first ones are defined as those which are governed by domestic law and subject of the jurisdiction of domestic courts – examples being public sector salaries¹⁵, construction expenses, etc.; the latter are claims which are governed by a foreign law or subject to the jurisdiction of a foreign court. Domestic debts were thought to be excluded from the SDRM, i.e. because of the reduced risk of collective action problems and because internal debts should not be brought under an international dispute resolution body. In contrast, the so called official bilateral creditors should be included albeit forming a separate class. This would give them the opportunity to receive a special treatment since different classes were said to be excluded from the equal-treatment-necessity; i.e., each class could be given different rights and obligations.

Multilateral debts such as those owed to the IMF or the World Bank should receive a preferred-creditor status in order, i.e., to preserve those institutions' functions as lenders of last resort. Due to the complications inevitably connected with the inclusion of secured creditors – for instance, in order to bar them from foreclosing their collaterals the introduction of some kind of automatic stay would have become necessary – they, too, should be excluded from the SDRM. And so should the so called non-sovereign debts – i.e. debts which particularly because of their short-term nature can lead rapidly to over indebtedness in the banking and corporate sector, as the Asian crisis has plainly demonstrated. Since this problem is likely to cause capital flight of residents which, in turn, necessitates the sovereign's capital and exchange control mechanisms. The IMF did not want to be involved in this kind of policies for various reasons.

B. *Commencement*. The commencement criterion favoured by the IMF in the end of the ongoing discussion was that a sovereign claimed the unsustainability of its debts. Whereas initially the understanding prevailed that a kind of gate-keeper (probably the IMF itself because of its unique data collection about each of its members) should have the right to challenge such a proposition in order to prevent debtor moral hazard, this idea was given up later on. The remaining risk was deemed to be bearable because of the experience that measures against a sovereign's default usually are taken too late.

¹⁵ If, for instance, a sovereign has engaged a huge working force (civil servants and other employees), the labour law obligation alone to pay a 13th salary per year might be a heavy burden on the budget (this was the case, not long ago, in a transition country).

C. *The Stay on Creditor Enforcement.* The so called automatic stay is a standard feature in practically all insolvency legislations no matter whether consumer oriented or corporation oriented. It is understood as an indispensable blockade against any creditor action in order to guarantee the equitable treatment of all creditors¹⁶. Therefore, it does not come as a surprise that corresponding considerations were given to the sovereign context. However, in the end, the IMF could not come to a clear recommendation because of the intricacies inherent in this particular issue: part of them is the lack of effective enforceability of such stay against sovereign debtors. But the so called hotchpot rule, according to which an out of proceeding-satisfaction prevents the creditor from receiving any further payments from the debtor until all other equivalent creditors have been satisfied to the same percentage, which might replace an automatic stay has also its deficiencies: it is no deterrence when and if a creditor is to receive more through litigation than he would under an agreement.

D. *Improving the Dialogue.* In order to guarantee transparency and to accelerate the proceeding, the sovereign debtor should have certain information duties against its creditors right from the outset. Additionally, the SDRM encouraged the creation of a creditors' committee(s) for improving the inter-creditor as well as the creditor-debtor communication.

E. *Priority Financing.* In order to attract new financing possibilities commercial insolvencies usually provide for the restructuring process to grant such lenders a super priority – i.e. a preferred status in security and/or in repayment. Since all sovereign debt restructuring cannot be anything else than a restructuring (as opposed to a liquidation) such priority financing must be taken into consideration. The solution offered by the SDRM was to leave such preferential treatment to the decision of a creditors' majority.

F. *Voting and Classification.* The intricacies of this feature stem from the need to verify the alleged claims in order to make sure that only admissible, valid, and existing claims are lodged and do participate in the proceeding. This task was assigned to the so called Dispute Resolution Forum (DRF) – a court-like institution whose creation and composition was extensively discussed and regulated¹⁷. As to the voting, the experience with the commercial insolvency law and its class formation served as a model. Accordingly, the SDRM was

¹⁶ For this fundamental principle, see just WESSELS, MARKELL, KILBORN, *International Cooperation in Bankruptcy and Insolvency Matters*, Oxford, 2009, p. 16 ff.

¹⁷ See also PAULUS, *Die Rolle des Richters in einem künftigen SDRM*, in GERHARDT,

designed to permit the classification of creditors and to alleviate, thus, the voting process.

4. A. *The Problem in General.* After this overview, it shall be demonstrated by means of a factual example how complicated and difficult the practical details still are even if the establishment of the SDRM would have been successful. It is easily stated that in such proceeding, the creditors are to lodge their claims at the competent authority. But – in practice – which creditors are included of which debtor and of which content? It has been shown *supra* (sub 3 C) that some of these questions – or at least parts of it – are addressed in the SDRM's program. Others, however, are not – suffice it to name but a few: is the national bank to be equalized with the sovereign? Or are so its provinces, regions, Länder, clans, etc.? Are bond holders to be included or trade creditors? How about depositors and creditors of nationalized banks? – and about creditors of enterprises which had been bailed out by the sovereign in question? And what if it was made clear from the very beginning that the loan (or parts of it) had to be transferred to a private account of the ruler? In contrast to the commercial insolvency law, a Sovereign Debt Restructuring Mechanism might have to cope with political complications or implications which are phrased in legal terminology. For instance, what is called a loan might, in fact, be nothing but a purchase of a political option.

All these questions and intricacies deserve and need a full discussion¹⁸. However, in this contribution to the Festschrift of my eminent and distinguished colleague and friend Paolo Picone only the last mentioned problem shall be addressed. In order to have the details not too fictitious, a practical example shall serve the point. Evidently, daily political life offers

HAARMAYER, KREFT (eds.), *Festschrift für Hans-Peter Kirchhof*, Kvelaer, 2003, p. 421 ff. For a modernized version and as the kernel of a future state insolvency law, ID., *Rechtliche Handhaben*, cit., p. 15 ff.

¹⁸ Illuminating in this context the proposed UK Debt Relief (Developing Countries) Act 2010 that defines in its Section 2: «[...] (2) “Debt” includes – (a) a liability that falls to be discharged otherwise than by the making of a payment, (b) an obligation to repurchase property that arises under an agreement for the sale an repurchase of property (whether or not the same property), and (c) a liability of the lessee under a finance lease (except a liability so far as relating to the operation or maintenance of property subject to the lease). (3) “Debt” does not include – (a) a liability to pay for goods or services that arose on the delivery of the goods or the provision of services [...] (5) A debt is a “public” debt of a country if it was incurred by – (a) the country or any part of it (or the government of the country or any part of the country or any department of any such government), (b) the central bank or other monetary authority of the country, or (c) a body corporate controlled (directly or indirectly) by anything within paragraph (a) or (b)».

endless choices and variations; it is, thus, somewhat at random that here the negotiations and transactions between China and Nigeria in the years 2006 through 2009 are chosen. There is a very handy and thorough report about this occurrence in one of the Chatham House Reports¹⁹ from which the following description primarily is taken. It shows very nicely how politics – in particular the need for cash for enabling a re-election on the one side, and the need for saving access to oil reserves on the other side – determine the flow of money and the promise of participation.

B. *The Facts*. In their endeavours to lessen their dependence on the uncertainties of the Middle East oil supply, several Asian countries – among them China – sought for alternative sources for their needed supply. In Africa²⁰, they spotted primarily Angola and Nigeria which, incidentally, created a situation that deviates somewhat from the stereotype according to which poor African countries are dependent on support from the powerful outside or are exploited by aggressive and resource-hungry intruders. Whereas the access to the Angolan oil worked out satisfactorily for China²¹ – its import from Angola amounts to 16 % of its overall oil import –, Nigeria proved to be much harder accessible.

In 2004, the then president Obasanjo actively encouraged Asian interested parties to participate in (several²²) bidding rounds for the allocation of so called blocks, i.e. portions of the oil reserves on Nigerian ground. The explicit understanding was that infrastructure should be built up in consideration for the allocation of blocks («oil-for-infrastructure» scheme). These bidding rounds have been successful to a very limited degree for a variety of reasons: there was a failure of linking the mutual contractual duties – i.e. legal technicalities had been grossly neglected; in late 2009, at least, none of the infrastructure projects

¹⁹ VINES, WONG, WEIMER, CAMPOS, *Thirst for African Oil – Asian National Oil Companies in Nigeria and Angola*, 2009 (henceforth: *Thirst*), available at: www.chathamhouse.org.uk/. See also HANSEN, *China, Africa, and Oil*, June 6, 2008, available at: www.cfr.org.

²⁰ For further economic interests, activities, and endeavours of China in Africa see, for instance, MÜLLER, *Chinas Engagement in Afrika: Rhetorik und Realität*, in *China aktuell*, n. 6, 2006, p. 90 ff.; *The China Monitor*, May 2006, p. 6 ff., and July 2006, p. 4 ff., available, e.g., at: www.ccs.org.za/; *China und Afrika streben nach gemeinsamer Entwicklung*, available at: www.emfis.de/afrika. Of a global interest ADOLF, KÖSTNER, *China versus USA: Der neue Kampf um Afrika*, in *Blätter für deutsche und internationale Politik*, n. 4, 2007, available at: www.blaetter.de.

²¹ To be sure, it is not just the access to oil that works between the two countries, see, for instance, FANDRYCH, *China in Angola – nachhaltiger Wiederaufbau, kalkulierte Wahlkampfhilfe oder globale Interessenpolitik?*, available at: www.fes.de.

²² Cf. *Thirst*, p. 12 ff.

have «got off the ground»²³ despite the fact that China has been awarded a few (just four) blocks²⁴. Another reason for the failure was a mixture of private and political reasons: Obasanjo wanted, in open contradiction to the constitution, to stand for a third time as president; for this reason he was in dire need for financial means and was therefore applying corrupt practises in these bidding rounds by making the deals' perfection dependent on additional duties to the more or less open benefit of his supporters, collaborators and family.

His attempt to get the constitution changed failed and he was replaced by Yar'Adua after the elections in 2007. The new president started an investigation into the background of the biddings in the Obasanjo era. Even though the appointed committee was ordered to confine its examination only to one of the bidding rounds (2007) it «expressed a strong view on the oil-for-infrastructure scheme, noting that [...] in its view 'many companies took advantage of it to have access to concessions with high potential without fulfilling their commitments to government by initiating downstream/infrastructure projects of strategic national importance which formed basis of the philosophy.' As a result, the committee recommended that the 2005 and 2006 rounds should also be revisited»²⁵. It seems as if this had been the ultimate end of this form of permitting access to the domestic Nigerian resources²⁶.

Nevertheless, in the run of these four to five years China entered into some considerable commitments:

1. In January 2006, CNOOC (China National Offshore Oil Corporation – a state controlled Chinese Oil producer) acquires a 45 %-participation in an Nigerian offshore-oilfield for the price of \$ 2,27 bln.
2. In March 2006, China grants a loan of \$ 200 mln. for the execution of Nigeria's communication satellite project²⁷. This demonstration of a commitment was strengthened by a subsequent trip of Hu Jintao through some African states, including Nigeria, in April 2006.
3. In May 2006, China awarded a loan of \$ 2,5 bln. to Nigeria for the modernization of the railroad system. Moreover, in this very month, the

²³ *Thirst*, p. 3; additionally IKOKWU, *Nigeria: U.S. \$ 20 Billion Investment At Risk, Says Study*, available at: allafrica.com.

²⁴ In September 2009, China announced its plan to buy a sixth of the Nigerian oil reserves.

²⁵ *Thirst*, p. 21.

²⁶ Elsewhere in Africa, particularly in Angola and Sudan, oil-for-infrastructure deals have proven to be successful.

²⁷ Cf. Consulate General in Lagos, available at: ng2.mofcom.gov.cn.

state controlled Chinese oil producer China National Petroleum Corporation (CNPC) acquired four exploration blocks for the amount of \$ 16 mln. This acquisition was somehow somehow connected (but obviously not made conditional upon) with the buyer's obligation to invest \$ 2 bln. in the Nigerian Kaduna refinery²⁸.

4. In June 2006, a wholly owned subsidiary of CNOOC is awarded a loan of \$ 1,6 bln. from the Chinese Export-Import Bank – primarily for the purpose of investment in oil projects in Nigeria²⁹.

5. In November 2006, on occasion of the so called China-Africa-Summit³⁰, «Nigeria had signed a loan facility agreement with China for US \$ 2,5 bln. – of which \$ 1,3 bln. was to be dedicated to the first phase of the new Lagos-Kano railway. The loan comprised two facilities. The first was valued at \$ 500 mln. provided through the Chinese ExIm Bank on concessionary terms with an interest rate of 3%, a repayment period of twenty years including a grace period of five years; and the second, for \$ 2 bln., was to be provided directly by the ExIm Bank on the same terms. However, the most significant condition on the loan facility was that it was linked directly to the lifting of crude oil by Chinese companies and the allocation of four oil blocks (one of which had to be producing) in the upcoming 2007 licensing round. [...] But, crucially, the MoU (Memorandum of Understanding) required to confirm the terms of the loan facility agreement had not been signed by the time President Obasanjo left office, nor has it been since. The signature of such an MoU had been imperative for drawing on this facility»³¹.

6. In April 2008, finally, China awards a credit of \$ 2,5 bln. to Nigeria (possibly a renegotiation of the earlier loan facility agreement). This sum was meant to be used for financing various infrastructure projects. Additionally, China's official export credit guarantee agency Sinosure has offered Nigeria insurance cover of up to \$ 50 bln. to help fund investments³².

5. A. *The Political Superstructure*. This course of events as described in the preceding chapter shall serve as model for the following discussion. It turns

²⁸ www.gulfoilandgas.com.

²⁹ www.zoomchina.com.cn.

³⁰ Cf. *Action Plan Adopted at China-Africa Summit, Mapping Cooperation Course*, available at: www.china-botschaft.de.

³¹ *Thirst*, p. 23 ff.

away from the real world and the facts are now transformed into a virtual world in which there exists already a sort of insolvency proceeding for states – be it in the shape of the above described SDRM, be it in any other shape which shows similarities with a commercial insolvency law. Needless to point out that these considerations, thus, are hanging somewhat «in the air» as there it is impossible to make reference to any rules of such «insolvency law» – and as there is furthermore no recognition of a contractually agreed upon applicable law (a clause which is highly likely to be found in the Sino-African agreements and contracts).

(i). As a consequence of these deficiencies, the humble goal of all what follows is to give a feeling for such seemingly fundamental issues' complications and intricacies. They stem not least from the context's property of a political superstructure which is inherent in practically every state action. This is an important difference to the commercial context where the analogy to such superstructure would be the striving for profit that is inescapably intertwined with the possibility of loss. The immemorial paradigm for the latter, the risk, is the *concursum creditorum*, bankruptcy, *fallimento*, *quiebra*, *Insolvenz*, *faillite* – or however it might be called. The political superstructure has – so far – no such twin-term: political striving for power, wealth, prosperity, or anything else of this kind is, as a matter of fact, subject to the risk of failing. But this risk is not concentrated on monetary values; it rather tends to be all-encompassing and affecting all facets of societal and political life of that very state.

Thus, when and if there exists a SDRM-type of proceeding, it is clear that the political implications must be excluded; they cannot be at stake. Irrespective of a pending state insolvency proceeding, this very sovereign debtor must be kept going in its fundamental state functions. For instance, schools must continue their education, state employees must receive their salaries, electricity and water supply must be guaranteed, etc. A nice example or model for this exclusion can be found in the well-known Chapter 9-proceeding of the U.S. Bankruptcy Code. It deals with the Bankruptcy of municipalities³³ by adjusting the even more famous Chapter 11-proceeding to the special needs and circumstances of a political unit in financial troubles.

³² Cf. *Nigeria: China Offers \$50bn for Infrastructure*, available at: allafrica.com/stories/200803311205.html; *China Offers Nigeria Export Credit Guarantees*, in *Financial Times*, April 2, 2008, available at: uk.reuters.com.

³³ For a comprehensive discussion of this issue in general, Cf. LIU, WAIBEL, *Subnational Insolvency – Cross-country Experiences and Lessons*, available at: papers.ssrn.com; IANCHOVICHINA, LIU, NAGARAJAN, *Subnational Fiscal Sustainability Analysis – What Can We Learn from Tamil Nadu?*, World Bank Policy Research Working Paper, June 2006.

(ii). The preceding deliberations make one wonder whether or not the fact that, in our hypothetical, the creditor state – henceforth: Creditor – establishes all its relations with and investments in the debtor state – henceforth: Debtor – for the politically motivated reason to safeguard its own future commodity supply has any influence on the legal interpretation of the transactions as they have taken place? Transformed into the context of commercial insolvency law, such a background might possibly lead to the conclusion that an agreement which on paper is called «loan» is in fact nothing but a purchase. This question touches on the intricate issue as to how far lawyers shall, must, or may go into the motives of the parties involved when they interpret their actions and transactions and attribute them to a particular legal institution. An enlightening private law example³⁴ shall highlight the point: is a donation of € 1.5 mln. to a foundation whose purpose is the reconstruction of a church (Dresdener Frauenkirche) to be qualified as a gift – as the German Supreme Court so decided? Could not, instead, be argued that this payment is the prize for the purchase of an immortality monument³⁵? After all, one of the restored pinnacles is called after the donator.

However, lawyers are not supposed to go to the very end of all of the parties' motivations involved when it comes to the interpretation and qualification of contractual agreements. The very concept of the implicit purpose of a contract (*Geschäftsgrundlage*)³⁶ amplifies that lawyers acknowledge different layers of intents: there is quite some freedom left to the parties as to how they want their contractual relationship to be qualified. Behind this agreement lawyers see and recognize the said *Geschäftsgrundlage* which usually creates legal consequences only when and if this implicit purpose is known to all parties involved. Therefore, it is fair to state in the present context that the political superstructure might form something like the *Geschäftsgrundlage*; it has, however, no impact on the interpretation and qualification of each individual contract: i.e., loans remain loans despite this background.

³⁴ Taken from Urteil des Bundesgerichtshofes vom 10 Dezember 2003 – IV ZR 249/02, BGHZ 157, 178 = JZ 2004, p. 971.

³⁵ «Immortality» meaning here: being remembered. For further details about this term and its importance, cf. PAULUS, *Die Idee der postmortalen Persönlichkeit im römischen Testamentsrecht – zur rechtlichen und sozialen Bedeutung einzelner Testamentsklauseln*, Berlin, 1992, pp. 13 ff., 20 ff.

³⁶ Seminal for this legal concept OERTMANN, *Die Geschäftsgrundlage*, Leipzig, 1921; as to this concept's expansion into the realm of public international law, Cf. just art. 62(1)(a) of the Vienna Convention on the Law of Treaties: VILLIGER, *Commentary on the 1969 Vienna Convention on the Law of Treaties*, Leiden, Boston 2009, Art. 62, para. 16; SHAW, FOURNET, in CORTEN, KLEIN (eds.), *Les Conventions de Vienne sur le droit de traités. Commentaire article par article*, Bruxelles, 2006, Art. 62 – Convention de 1969.

(iii). It is a similar question but nevertheless a separate one whether or not the integration of the abovementioned transactions into the oil-for-infrastructure scheme has any influence on their qualifications? Comparable with the preceding case, this scheme forms the political background for the Debtor. However, unlike there that scheme is not a general and overarching policy issue but closely intertwined particularly with the oil-related deals. They are, thus, so to speak loaded with these political implications. This diagnosis provokes anew the question whether or not a lawyer's interpretation shall or even must be determined thereby? The answer, however, is again negative. Since the freedom of contract allows the parties, generally speaking, to determine the contract type they wish to enter into when and if their concrete business' goal can be reached on this way. When it is agreed that the money delivered is to be repaid at some future time, the contract is and remains a loan and cannot be changed into a purchase through lawyers' fiat.

(iv). The result of the foregoing discussion is that the political background behind all the above listed transactions can be ignored – at least as a rule of thumb. It might be that under certain circumstances and in various contexts that background steps into the foreground and influences the legal and doctrinal considerations. But in the present context of the legal determination of contracts and transactions the political implications can be ignored.

B. *The Individual Transactions.* With this result in mind, it is time now to look at each one of the abovementioned deals and to discuss what their possible fate would be in case of the commencement of a debt restructuring proceeding for the Debtor. The legal validity or invalidity of those transactions shall not be questioned; it is, however, a matter of fact, that the compliance with the respective rules, be they national or international law (and here primarily the Vienna Convention on the Law of Treaties), and including the constitutional issues of competence for the conclusion of certain contracts, would have to be examined first in a practical scenario. Due to the hypothetical nature of the subsequent discussion it must suffice to point at these issues without going further into them³⁷.

(i). The deals begin with the Creditor's National Offshore Oil Corporation January 2006 acquisition of a 45 %-participation in a Debtor's offshore-oilfield for the price of \$ 2,27 bln. This is on the face of it a plain purchase which, absent particular circumstances, remains unaffected from any kind of insolvency

³⁷ Needless to state that enormous problems might arise in this respect when, for instance, a ruler usurps powers for himself which are contrary to the law or even to the constitution but are tolerated because of political suppression, fraud and/or corruption.

proceeding when and if both sides have already perfected their respective delivery duties. I.e., if the Corporation has already been registered as partner and if the price has already been paid, this transaction will not be influenced by the proceeding's commencement.

The fact that the purchaser is a company controlled by but not identical with the Creditor state has no specific insolvency related impact. After all, it has been shown *supra* (at II D) that in a sovereign insolvency proceeding the qualification of being a creditor is not dependent on being a sovereign itself. Similarly, when and if the oilfield would not be owned by the Debtor (a sovereign) but by, for instance, a private law company it would not be affected by the proceeding – at least not legally. This is to say that political fine-tuning might change this picture.

(ii). The next transaction is the Creditor's (more precisely: its ExIm Bank) loan of \$ 200 mln. for the execution of the Debtor's communication satellite project in March 2006. As pointed out *supra* (5 A), the political (and possibly economic) interrelation of this deal with the acquisition of four exploration blocks from the Debtor later on in that year has no influence on the answer to the legal question whether the contract is to be seen as a loan or not.

In the commercial insolvency context, a loan is the paradigm for a bankruptcy claim. Once the lender has transferred the respective sum to the borrower, the active part on the lender's side is more or less over. The time thereafter is, so to speak, his waiting period for the repayment – whereby his risk of non-payment is usually alleviated by securities and is remunerated by the accumulation of interest. In the context of sovereign lenders and/or borrowers, the same is true, at least generally speaking.

This *caveat* is necessary at this point of time since it is not yet to be foreseen what outcome the current heated debate about the nature of «odious debts»³⁸ will have in the future. Even though it is quite evident for the time being that there is not yet anything like a valid legal concept of this kind³⁹ there are increasingly indications that, sometime in the near future, a legal concept might emerge of a creditor's co-responsibility for a loan given to the borrower. Thus, for instance, has Norway, without acknowledging a legal obligation, waived a number of claims against other sovereigns (Ecuador, Egypt, Jamaica, Peru, and

³⁸ See already *supra*, fn. 10.

³⁹ Cf. PAULUS, *The Evolution of the "Concept of Odious Debts"*, in *ZaöRV*, 2008, p. 391 ff. But see also HOWSE, *The Concept of Odious Debt in Public International Law*, UNCTAD Working Paper No. 185, July 2007. See further the contributions of NEHRU, THOMAS, *The Concept of Odious Debt: Some Considerations*, p. 205 ff.; SANDER, *Odious Debt as a Principal-Agent Problem*, p. 229 ff.; and DÖMELAND, SANDER, BRAGA, *The Economics of Odious Debts*, p. 261 ff.; all in BRAGA, DÖMELAND (eds.), *Debt Relief and Beyond*, Washington D.C., 2009.

Sierra Leone) arguing that they had been entered into for purely selfish reasons⁴⁰. Even though this was declared as a unilateral and unique act, the global impact of such action on other sovereign creditors is likely to exist. The long-term implications of such loans are, moreover, emphasized by the UN Human Rights Council: in 2008, it founded the office of an Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights⁴¹.

In case that these indications will really open out into a legal concept of a creditor's co-responsibility, the present case might be a good and possibly even a high-priority candidate for its application. Since a loan given for the purpose of the development of a communication satellite program to a state which has so far not yet developed the slightest space technology appears to be somewhat fancy. However, it is to be admitted that the details of this deal might reveal a serious background and might offer a valid justification. Information gathered exclusively from public media certainly do not suffice to give a definite judgment on the legality of such loan. Serious investigations into the underlying intents and official documents are, as a matter of fact, indispensable.

(iii). In May 2006, three deals were perfected between Creditor and Debtor: the chain of events began with the Creditor's award of a loan of \$ 2,5 bln. for the modernization of the Debtor's railroad system. This was followed by the state controlled Creditor National Petroleum Corporation's acquisition of four exploration blocks for the prize of \$ 16 mln. The third deal was a kind of by-bargain: the Creditor had to accept the obligation to invest \$ 2 bln. in a refinery from the Debtor state owned by a close ally of the Debtor's ruler and the Debtor's wealthiest businessman; this deal, however, was never perfected⁴².

The latter deal is likely to be ignorable, irrespective the facts that, firstly, the loan has never been awarded and, secondly, the contractual partner might be a private law entity and, as such, by no means identifiable with or attributable to the sovereign. This deal is so much spoiled by corruptive connotations – beyond the (rather small) purchase prize, a (over-dimensional) payment obligation to the company of a powerful ally of the ruler who, at that time, fights for his unconstitutional re-election with all sorts of tricks and gifts – that it is hard to believe that it would stand against any law's closer scrutiny.

Things are (probably) different with the first mentioned loan – even though the money was never used for the indicated purpose. However, this connection

⁴⁰ See just, www.twinside.org.sg/title2/finance/twninfofinance009.htm.

⁴¹ Cf. www2.ohchr.org/english/issues/development/debt/index.htm.

⁴² For details, Cf. *Thirst*, pp. 16, 17, 24.

complied with the Debtor's overarching policy of the oil-for-infrastructure scheme which has proven to be successful in other African states before and after. It is for this reason that the legal validity of the loan can be supposed and that the re-payment claim, thus, constitutes the abovementioned paradigm of an insolvency claim. Since the above quoted media sources refer exclusively to «the Debtor» as the contracting party it is undisputable that the claim is directed against the insolvent sovereign. This is to say that in the case at hand, there are no difficulties with the determination of which institution from the Debtor state is in the position to create a sovereign's debt. Therefore, the loan's repayment claim would have to be acknowledged by the competent debt rescheduling body⁴³.

The purchase of four exploration blocks is unaffected from the debt restructuring proceeding when and if the mutual obligations have been fulfilled (which is likely to be the case) and when and if the underlying contracts enjoy legal validity according to the applicable law. Since property rights are, generally speaking, immune from insolvency proceedings they can become involved in them only with the consent of the owner.

(iv). The next deal is one which takes place only within the Creditor state and has implications with the Debtor state just in an indirect way. Since in June 2006, a wholly owned subsidiary of the abovementioned Creditor's National Offshore Oil Corporation is awarded a loan of \$ 1,6 bln. from the Creditor's ExIm Bank – primarily for the purpose of investment in oil projects in the Debtor state. In case of the Debtor's default, such indirect transactions with no direct attachment to any of the Debtor's assets are entirely neglectable. It remains the exclusive risk of the Creditor when and if it enters into such agreements. Given these restricted information and facts, there is no liability on the Debtor's side to take care of those agreements' realization.

(v). The next agreement, from November 2006, relates to a loan facility awarded by the Creditor's ExIm Bank to the Debtor. Its purpose was related to further infrastructure programs such as the development of a railroad project. However, the agreement was made conditional upon the lifting of crude oil by Creditors' companies and the allocation of four oil blocks (one of which had to be producing) in the following licensing round – a condition which was never fulfilled. Moreover, the validity of the agreement was made conditional also upon the signing of a confirming Memorandum of Understanding; but this signature was never provided.

Since there are two conditions which have not been materialized, the

⁴³ For this institution, cf. HAGAN, *op. cit.*; PAULUS, *Die Rolle, cit.*, p. 426 ff.; ID., *Rechtliche Handhaben, cit.*, p. 15 ff.

contract is invalid and no claim results therefore. As a consequence, this deal, too, can be ignored in a debt restructuring proceeding. But it is worthwhile noting that a valid contract which conditionalizes the delivery of one side on the advance delivery of the other side usually keeps its regulation scheme within an insolvency proceeding. I.e., as long as the Debtor has not yet performed it is not entitled to request the other side's performance.

(vi). Finally, there is another loan agreement in April 2008 – possibly resulting from an attempt to get the failed loan facility agreement running from two years before. And there was the Creditor's official export credit guarantee agency which has offered the Debtor insurance cover of up to \$ 50 bln. to help fund investments. It is likely that the second attempt, too, has failed so that the renewed loan facility agreement is again to be left outside of further consideration.

But the insurance cover agreement seems to have been put into motion so that the necessity arises to specify the legal nature of such deal. As the name of the promisor indicates, the offer of such insurance coverage is obviously the award of a credit. The sources from which the information regarding this deal is taken are silent as to the Debtor's consideration; instead, it is repeated that the Creditor shows keen interest in any investment in the Debtor's state – i.e. to get access to further oil blocks. Since this mere interest and wishful thinking doesn't suffice to constitute a credible consideration it is hard to believe that such a multi-billion engagement is done exclusively for good will alone. It is rather likely that there are related obligations agreed upon from the Debtor's side. Taken this assumption as given, the deal displays the features of what in the commercial insolvency law context is called *executory contract*⁴⁴ – i.e. a contract which is subject to specific insolvency rules since both sides have not yet fully performed their mutual obligations at the commencement of the proceeding⁴⁵.

However, neither the IMF's SDRM proposal nor any other's has come up so far with the idea of transplanting this standard feature of the commercial law to the international law of insolvent sovereigns. Instead, it is understood that the fate of ongoing contracts in general (i.e. not just those which are not yet fully performed from both sides) should be left to the details of the rescuing plan. It is, thus, up to the drafter of such plan whether at all and if so to which degree deals of any kind continue or not or however they are to be treated as a consequence of the proceeding. Since this plan has ultimately to be accepted by

⁴⁴ This is the terminology of the U.S. Bankruptcy Code, p. 365.

⁴⁵ For this, see WESTBROOK, BOOTH, PAULUS, RAJAK, *A Global View of Business Insolvency Systems*, Leiden, Boston, 2010, p. 91 ff.

the creditors' vote, the plan drafter is bound to take into account the justified expectations of the other contract parties.

6. Be it repeated here at the end of the deliberations that the preceding discussion covers just a minor segment of the issues to be expected in case that there will be one day in the future introduced and established a sovereign debt restructuring proceeding. An enormous increase of complexity and difficulty is to be expected as the result of the application of existing national and international law when it comes to the factual question whether a contract, for instance, is valid or not. However, it is to be hoped that this humble and somewhat abstract investigation has made already clear that even though the problems are manifold and intricate they are manageable not least because of their vague similarity with their commercial insolvency counterparts. Nevertheless, the assumption will be realistic that it will take quite some time until generally accepted standards for this new area of law will have been evolved. In any case, it is fair to say that the task is appealing and necessary.