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Should Politics be Replaced by a Legal Proceeding?

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SHOULD POLITICS BE REPLACED BY A LEGAL PROCEEDING?

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A. General deliberations

Today, in the first half of the year 2012, Europe is in the not really attractive position to look back to a period of almost five years in which one crisis replaced the other. The bad news is that, as of now, there is no safe prediction possible as to whether or not the pandemonium is over. What began as a financial crisis on a global scale due to the bursting real estate-bubble in the US and is inextricably associated with the name of the Lehman Bank, was followed by the Greek budget crisis in early 2010 that, due to the contagion effects on Ireland and Portugal (maybe also on Spain and Italy), almost caused a currency crisis of the Euro.

In sight of such a series of dramatic – previously in this intensity rather unknown – occurrences, one is tempted to raise more fundamental questions than just the usual ones as to which measures are necessary to overcome these crises, or – legally – who has to shoulder the responsibilities and liabilities. Suspicion grows that theses crises are an expression of something deeper rooted than just individual failures; they might signal the dooming of the capitalistic system as did some decades ago the collapse of the Soviet Union indicate the decline of the socialistic system.[1] Alternatively, and somewhat less fundamentally, one might think about whether or not there is a correlation between the crises particularly in those Mediterranean countries and a failure of their democratic structures? Is it, one is inclined to deliberate, indicative that the non-elected Premier Minister Monti is quite successful in leading Italy out of the problem zone as it is the comparable task of the Greek interregnum administration under Papademos? The former at least got reforms done which, under the previous, normal government regime, had proven to be politically impossible to realise.

Being still in the middle of the restructuring process, it is quite impossible to give definite answers to those ground-shaking questions. What is possible, though, is to note that the present problems are of such a magnitude that the traditional solution measures are more likely than not insufficient. The need seems to be inescapable to come up with new solutions. The question examined on the following pages is whether the proposed European Stability Mechanism (ESM) is such a good new solution or whether a different mechanism should be at place. For that purpose, a brief overview of the last two years of politicians' handling of the crisis shall be given (B) before the ESM is briefly described (C). That portrait leads to a balancing of pros and cons (D) of having politicians „steering the crisis boat", which finally is followed by an alternative proposal (E).

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[1] On this idea cf. *K.Schmidt*, Finanzkrise und Wirtschaftsrecht – Überlegungen über die Aufgabe von Juristen in Anbetracht des aktuellen Krisengeschehens, FS Hellwig, 2010, 311, 312 f.

B. How politics handled the Greek crisis

Even though commonly known, it might be appropriate to describe, at least briefly, the course of events, which lead to the situation as we face it in the first half of 2012.[2]

I. From the creation of the monetary union to Papandreou's public announcement in April 2010

Like Ireland and Spain, Greece enjoyed a period of economic boom before the outbreak of the global economic crisis in 2008/2009. The growth rate of the gross domestic product was 4 % in the years 1997 to 2007 and had been, thus, above average of the other European member states. This was owed primarily to gross domestic investments and to government spending. In contrast, private consumption was below average and the net export ratio was negative. Accordingly, the weak spot of this development had been quite from the beginning the constant high public deficits and the increasing deterioration of the Greek competitiveness.

In sight of these alarming factors, it proved to be an accumulating deficiency once the budgetary crisis had become public that the Greek governments had never used the period of relative prosperity to reduce its debt burden and that it failed to establish an efficient tax collection system. The need for money had, thus, always been satisfied by means of borrowing which, in turn, increased the budget deficit.[3] Under these circumstances, it was a matter of logic that the onset of the crisis unveiled all those previous budgetary sins. They had been grave enough so that there was no additional need for a real estate bubble like, for instance, in Spain or Ireland. Promised saving programs of the newly elected Papandreou administration in early 2010 did not impress investors; they distrusted them.

II. From chaotic actionism to the ESM

The change of the governing party in fall 2009 lead to the openly admitted misinformation about the public debt situation in Greece; nevertheless, it took another couple of months until the correct number was ultimately made known. Within the period from 2008 to spring 2010, the true budget deficit increased, thus, in pursuit of what might be called a salami technique from 2 % to 15 %.[4] It is to be assumed that

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[2] The following description is feeded from various sources; suffice it to mention *Kadelbach*, Einleitung: Die Finanzkrise, die Politik und das Recht, in: Kadelbach (ed.), Nach der Finanzkrise, 2012, p. 9 ff.; *Busch*, Scheitert der Euro? – Strukturprobleme und Politikversagen bringen Europa an den Abgrund, Friedrich Ebert Stiftung publication Feb. 2012. A detailed list of the political steps at *Schwarzer*, Die Eurozone zwischen Krisenmanagement und Reformanstrengungen, in Kadelbach, op. cit., p. 21 f.

[3] This *deficit spending* has not been, as a matter of fact, a particular Greek phenomenon, cf. *di Fabio*, Europa in der Krise, ZSE 2011, 459.

[4] General observations regarding „Defizitkriterien des Europäischen Primärrechts" cf. *Dittrich*, ZSE 2011, 574 ff.

this technique added reasons for the international investors to be sceptical about the Greek situation and makes it understandable why the interest rates skyrocketed. Accordingly, in early May 2010, Greece was practically cut off from the capital market and asked for support. The member states of the Euro-zone and the International Monetary Fund (IMF) stepped in by means of bilateral agreements[5] and provided the aggregate sum of € 110 bn – subject, however, to strict conditionality which was drafted by the EU Commission in close cooperation with the IMF.

As part of the crisis management, the European Council resolved on 8 and 9 May 2010, to establish the stabilisation mechanisms EFSF and EFSM with a lending capacity of up to € 750 bn. Both institutions were meant to be preliminary and to be replaced by the ESM in mid-2013. The latter was agreed upon by the European member states in July 2011; the deadline for ratification was end of 2012. The agreement comprises an amendment of art. 136 TFEU, which shall assure the compatibility of the new instrument with the no-bail-out-clause in art. 126 TFEU. In fall 2010 Ireland, and in spring 2011 Portugal tumbled into a position in which they are bound to ask the newly created provisional institutions for help.

In the course of early summer 2011, it became increasingly evident that the imposed conditions of structural reforms and austerity have set up a negative spiral of a deteriorating economy in practical all supported member states – with the exception of Ireland. The saving measures killed (and, as of today, still do so) any economic growth so that the estimated dates for a back-to-normal have to be adjusted again and again by the „Troika“. Every estimation was to be corrected shortly after its announcement– in late summer 2011 by eight years(!), from 2013 to 2021. In Spain, the austerity policy caused (and still does so) an unemployment rate of more than 20 %, among young people even 50 %!

The irritation on the capital market and the fear of contagion was addressed by the ECB, which bought enormous amounts of Spanish and Italian bonds.[6] In the meantime, not only in Greece but also in Portugal, Spain, and Italy, the population became more and more nervous and opposed increasingly aggressively the ever new impositions of decreasing salaries, increasing VAT, pension cuts, etc. Contrary to what was imagined with all those political measures, the situation in Greece deteriorates to a degree which puts all of a sudden in July 2011 the until then stigmatized hair-cut of the private sector on the agenda. But here again, the same pattern can be observed: what started with 21 % climbed up to 50 % only a few months later and has now reached the record height of 70-80 %. In that context, the tool box of EFSF and EFSM got widened by allowing

[5] Die verschiedentlich unternommenen Versuche, dieses Vorgehen mit der „No-Bail-Out“-Klausel des Art. 126 AEUV als gerade noch im Einklang stehend darzustellen, rufen mahnend in Erinnerung, was mir Prof. Riesenfeld aus Berkeley von seinem seinerzeitigen Unterricht an der Friedrich-Wilhelms-Universität erzählt hat. In einer seiner Vorlesungen sagte demnach Kohlrausch: “Meine Herren, denken Sie immer daran: Wir (d.h. die Juristen) sitzen auf dem Kutschbock und fahren, wohin die Herrschaft befiehlt.” S. bereits Paulus, in: Kadelbach, Nach der Finanzkrise, 2012, S. 105 ff.

[6] Zur Rolle der EZB in diesem gesamten Kontext s. auch *Sester*, Die Rolle der EZB in der europäischen Staatsschuldenkrise, EWS 2012, 80 ff.

preventive lending to potentially tumbling states, i.a. for their support of their banking and insurance sector.[7]

As soon as the July 2011 summit was over, the crisis even worsened. The ECB had to intensify their purchase policy – primarily of Italian and Spanish bonds. This ,in turn and in combination with the unsolved problems, lead to dramatic slumps on most global stock exchanges. A discussion started that the European banks had to become recapitalized, and the necessity to increase the lending capacity of the EFSF became obvious. The member states tumbled towards a recession, aggravated by the global economic slowdown but also by the austerity politics (due to its negative multiplication effects) in primarily the southern European states.

In October 2011, a new attempt for an ultimate solution is initiated. The heads of governments decided that the EFSF portfolio should be increased to more than € 1 trn; that the European banks are to hold a core capital ration of 9 %; and that the abovementioned hair-cut shall be lifted to 50 %. However, all these measures proved again to be more or less in vain. It worked as an aggravating factor that Italy was close to become insolvent due to its political and economic problems.

Only a few months later, in December 2011, a new meeting of the heads of government became inevitable in order to tranquilize the capital markets. As one tragic consequence thereof a split between the EU and the United Kingdom became apparent. Without her participation, steps were undertaken to establish a fiscal union (Fiscal Pact = Treaty on Stability, Coordination and Governance in the Economic and Monetary Union), which was supposed to enter into force in March 2012 (now postponed to January 2013).[8] One of its main features is what is called in German „Schuldenbremse" or debt break[9] that was already agreed upon in September of that year as part of the so called „Six Pack." At this point of time, it is hard to predict whether or not this step will prove to be an effective tranquilizer for the capital markets. Sceptics presume that this step, too, is made too late. In February 2012, a vast majority of private sector creditors agreed to participate in the submitted haircut which relieves Athens from a debt burden of around € 110 bln.

In early April 2012, capital markets begin to get nervous with respect to the Spanish and Italian economy. The borrowing costs are climbing dangerously.

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[7] An additional problem has been the fact that all attempts to come up with a package of measures did not take into consideration the peculiarities of the Greek economy and society but were rather strongly oriented after western economies. Interesting in this context *Doxiadis*, Kleinunternehmer, Rentiers, Oppurtunisten – Institutionen, Mentalitäten, 94 Lettre International (2011), 18 .

[8] Hierzu etwa *Calliess/Schoenfleisch*, Auf dem Weg in die europäische „Fiskalunion"? – Europa- und verfassungsrechtliche Fragen einer Reform der Wirtschafts- und Währungsunion im Kontext des Fiskalvertrages, JZ 2012, 477 ff.

[9] Aufschlussreich hierzu *Pünder*, Staatsverschuldung und Generationengerechtigkeit, in: Bucerius Law School (Hg.), Begegnungen im Recht, Ringvorlesung der Bucerius Law School zu ehren von Karsten Schmidt anlässlich seines 70. Geburtstages, 2011, S. 275 ff.

C. ESM

I. The legal structure

Part of the pre-described reactive policy – in contrast to a pro-active one – was bringing forward the starting date of the ESM by one year. Instead of July 2013, it is now July 2012 that it begins to run its business. Even a brief look through the Treaty that establishes the ESM unveils that this institution is not much more than a shell. The real actors behind that institution remain more or less the same as those who had acted already in the preceding two years.

Pursuant to art. 3, the purpose of the ESM is „to mobilise funding and provide financial assistance, under strict economic policy conditionality, to the benefit of ESM Members which are experiencing or are threatened by severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole." ESM members are all those sovereigns within the European Union that share the common currency euro; however, other member states of the Union are encouraged to act and participate in the meetings as observers.

Modelled quite closely after the IMF, the structure of the ESM is, pursuant to art. 4, a Board of Governors, a Board of Directors, a Managing Director plus staff. According to the specifications given in art. 5, decisions are to be made unanimously, by qualified or by simple majority.[10] The same article rules that the finance ministers constitute the Board of Governors. Each Governor appoints the Director of his or her member state, art. 6. The appointment of both Governors and Directors is explicitly declared to be revocable at any time. The Managing Director is appointed by the Governors and must be a qualified individual with the nationality of one of the member states but must not be a Governor or Director, art. 7.

Artt. 18 through 25 deal with the ESM's financial management and artt. 8 through 11 provide details about the institution's capital; they are likely to be subject to frequent changes and adaptations. Accordingly, artt. 12 ff. are more interesting in the present context, as they regulate the ESM's operations. In particular, art. 12 describes those operations' guiding principles. Not only that Collective Action Clauses (CACs)[11] shall be included in (practically) all euro denominated bond issuances; and not only that financial assistance is granted only under strict economic policy conditionality; this article also addresses the issue of private sector involvement (PSI), par. 2. Apparently meant to be a kind of last resort, i.e. when otherwise debt sustainability cannot be restored, it shall be linked with the requesting member state's presentation of a „credible plan for restoring debt sustainability and demonstrating sufficient

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[10] Dass hierbei die demokratische Legitimation, insbesondere das Budgetrecht der jeweiligen Parlamente, erhebliche Einbußen erfährt, soll hier nicht weiter vertieft werden.

[11] For details of CACs, see *Bradley / Gulati*, Collective Action Clauses for the Eurozone: An Empirical Analysis, available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1948534; *Hofmann / Keller*, Collective Action Clauses, ZHR 175 (2011), 684; *Hofmann*, Enfranchisement and Disenfranchisement in Collective Action Clauses, ...

commitment to ensure adequate and proportionate private-sector involvement. Progress in the implementation of the plan will be monitored under the programme and will be taken into account in the decisions on disbursements.“

The other articles need not be referred to as they contain rather technical rules, which are beyond interest in the present context.

II. Conclusion

To summarize: The ESM is a highly political institution both with respect to its staffing and its mandate. Decisions and operations are initiated and executed by the ESM or other official institutions such as the European Commission or Council. Due to the ESM’s structure, the „real actors“ in the support scenario are politicians – with the only difference to the last two years’ performance that not individual politicians will be quoted but the institution as such. In contrast, the PSI plays a subordinated role if any at all. The duty might be imposed on the support seeking member state to get into „good faith“ negotiations with its private investors for receiving a haircut. In other words, the private sector is important only insofar that it has to waive part (or all) of its rights; but it has no rights whatsoever on its own against the debtor state or against the official sector represented by the ESM. The private sector, thus, is needed for relieving the sovereign’s debt burden but has no tools or remedies to demand anything from that sovereign in exchange for its own contribution to the restructuring; that power is exclusively given to the ESM. In contrast, in a commercial insolvency context, creditors and debtor are the two stakeholders that form the two ends of the balance by negotiating for a tolerable result for both sides. They do so under the surveillance of a neutral instance, the court. We will come back to that under G.

D. Should politics be the driving force? Pros and cons

What has been presented so far need not necessarily be understood as a clear negative vote against a politician driven proceeding. Accordingly, it is worthwhile to collect arguments in favour of this approach (I) and to contrast it with counter-arguments (II).

I. Arguments pro

Even though it might appear to be a minor issue, one must not under-estimate the power of negative connotations even in areas, which are believed to be entirely rationality-driven such as politics. In the Eurozone area, as in many other parts of this globe, the word – as well as the underlying phenomenon – ‘insolvency’ is such a highly negatively occupied term. There are strong forces active in almost every corner of those societies to making word and event a taboo. That has historical reasons,[12] and it

[12] On the history of the stigmatization of insolvency, cf. just *Paulus*, Ein Kaleidoskop der Geschichte des Insolvenzrechts, JZ 2009, 1148.

would be naive to negate the fact. Given this, it is certainly advantageous to have politicians dealing with the situation of a troubled member state, as this guarantees to a certain degree continuation of the same actors on still the same level playing field; it is like doing 'business as usual' under slightly changed conditions. In contrast, if there were a procedure explicitly declared as insolvency proceeding – it is to be assumed that, here too, every effort was made to get around it – irrespective of its potential helpfulness.

There are further – at least assumed – advantages related to the just mentioned one: when and if the actors in that scenario remain (more or less) the same, they might have – or just believe to have – better control over some essentials: There is not just the chaotic situation which is necessarily connected with a failing sovereign and which shall be kept under control; suffice it to refer to the above-given description of the last two years. There is also the (at least hoped for) control over how the rating agencies or the CDS market react. And above all, when remaining in command of the situation, politicians gain and keep control over the debtor state – most evidently by imposing conditions in exchange for support and help. After all, a creditor-debtor relationship, generally, is always tainted with a power and control issue;[13] this is particularly evident in the inter-sovereign-lending context: lending in this arena is something akin to buying influence over the borrower.[14] A final control issue for politicians is that by remaining in command, they assume to be in a better position to guarantee the trustworthiness of sovereign bonds. Even though it is well known (more or less throughout) that the contrary is true, the pretence of the complete risk-freeness of sovereign bonds[15] is an eminent important factor in political and economic life. After all, it entices investors to provide their money, which is so urgently needed by sovereigns; and it alleviates banking as this pretence allows the imputation that bonds are the same as equity.

There is one more pro that is admittedly less obvious than those mentioned so far – namely that the economic costs of a sovereign default are not as awful as generally assumed. This is true, at least, with respect to earlier defaults.[16] To be sure, there are different types of costs – such as reputational costs, exclusion from the international market costs, costs to the domestic economy through the financial systems, or political costs – but Borensztein and Panizza have demonstrated that the economic costs are

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[13] Cf., very insightful, *Westbrook*, The Control of Wealth in Bankruptcy, Texas L. Rev. 82 (2004), 795.

[14] The present day Chinese lending policy in Africa is a striking example, cf. *Paulus*, Responsible Bilateral Lending and Borrowing – an Approach to a Legally Binding Concept (forthcoming in Festschrift für Rolf Knieper, 2012); *idem*, What Constitutes a Debt in the Sovereign Debt Restructuring Context?, in: Ligustro/Sacerdoti (eds.), Liber amicorum in onore di Paolo Picone, 2010, 231 ff.

[15] Gemäß Art. 79 Abs. 1 lit. a Bankenrichtlinie (RiLi 2006/ 48/EG vom 14. Juni 2006) i.V.m. Nr. 1 Anhang VI ist die Risikogewichtung zumindest bei Forderungen gegen den eigenen Staat gleich 0 %.; s. auch § 26 Nr. 2 SolvVO.

[16] See *Borensztein / Panizza*, The Costs of Sovereign Default, IMF Staff Papers Vol. 56 No. 4, 2009, p. 683 ff.

generally significant but short-lived; they contrast this from the political consequences of a debt crisis which seem to be particularly dire for incumbent governments and finance ministers.[17]

Even though one might argue with some justification that this conclusion from past experiences disqualifies it from inclusion among the pros, it should be emphasized that the handling of such debt crises so far is obviously less damaging than generally assumed. A counter argument with respect to the European situation could be, however, that this historical evidence is possibly only of diminished relevance for the Greek default. Its uniqueness stems from Greece's membership in the Eurozone and the consequential inability to depreciate her currency.[18]

II. Arguments contra politics

Seen from a legal angle, the first and foremost argument that comes to mind against a politicians-driven proceeding is a fundamental of any rule of law:[19] these politicians are (representatives of) creditors and are, as such, antagonists of the debtor. If they have problems with each other, the mechanism that has been established to overcome them has been for centuries or even millennia the empowerment of a judge – or, more generally speaking, of a neutral instance that tries to solve those problems by means of clear and fixed rules. Moreover, only when and if there is such neutral instance in place, predictability and transparency can be ensured; both are quite essential constituents of the rule of law. They have the chance to evolve when there is a pre-determined procedure – as it is the general invaluable advantage of any legal procedure to establish a structure for a potentially chaotic situation. This is particularly true with respect to a commercial or consumer insolvency. Any insolvency practitioner can tell that the days, weeks and sometimes even months before the filing of the petition at the insolvency court is a period of chaos. The need to go to court and the guarantee that the court will thereupon initiate the subsequent steps is guidance and as such an enormous help to overcome the chaos. There is no reason whatsoever visible why this should not also be the case if there existed a comparable legal procedure for sovereigns.

Additionally, (active) politicians cannot act neutrally; they are inevitably caught in a conflict of interests. The situation of the last two years in Europe is paradigmatic: politicians acted not only as representatives of creditor states; they acted also as

[17] For the latter, see also *Panizza / Sturzenegger / Zettelmeyer*, The Economics and Law of Sovereign Debt and Default, Journal of Economic Literature 2009, 47.3, p. 653, 694.

[18] To be sure, the abovementioned „uniqueness" should not be overstated. After all, in the 19th century, numerous States of the United States defaulted and „revived" without depreciation of the Dollar. On this, just see *Waibel*, Sovereign Defaults before International Courts and Tribunals, 2011, p. 3 ff.

[19] Cf. *Paulus*, A Standing Arbitral Tribunal as a Procedural Solution for Sovereign Debt Restructurings, in: Braga/Vincelette (eds.), Sovereign Debt and the Financial Crisis – Will This Time be Different?, 2010, 317 ff.;

representatives of their constituency from whom they are dependent regarding the prolongation of their mandate. This combination puts them in the awkward position to strike a balance between the diverging interests of cheering those who shall re-elect them and their country as a creditor plus the future co-habitation with the failing state. It is an inevitable consequence of this delicate mix that politicians are bound to destroy (or at least endanger) inter-state relationships. The latest developments provide ample evidence: suffice it to mention the pictures in various media showing Chancellor Merkel in a Nazi-uniform on the one side and on the other the public feeding of stereotypes about Mediterranean laziness. In sum, the politicians' ambivalent role in this scenario forces them – to use a German phrase – to smash precious political China porcelain which has taken years if not decades before to build.

Closely connected with the aforementioned is a lesson that can be learned from the Argentinian experience some ten years ago.[20] Even though this paradigm of a debtor-driven proceeding turned out to be a solution far from ideal, it had the advantage of providing clear guidance. Instead of a sometimes cacophonous chorus of creditors with diverging interests, there was one voice which could not be missed and which determined the direction in which everybody was to go. To be sure, Argentina is but a striking and highly prominent example; others exist as well. They are less popular and, maybe for this very reason, more successful.[21]

The streamlining of the default resolution process, moreover, helps to reduce costs. Here, again, the last two years in Europe are indicative. What began in the first half of 2010 with a Greek need of around € 40 bln. has grown to around € 350 bln. in early 2012! That is a high price for indulging the politicians' luxury of seeking for a fitting solution. It is to be assumed that the faster the proceeding the more reduced are the costs. In this context, the result of an economists' research paper[22] is interesting: in examining 'the elusive costs of sovereign defaults', the authors come to the conclusion that „defaults have no significant negative impact on successive output growth and, if anything, mark the final stage of the crisis and the beginning of economic growth." The latter might (also) be related to a phenomenon that has been addressed supra (sub A), namely that a crisis allows for political and economic measures which seem to be undoable under 'normal' circumstances.

E. The possible shape of a proceeding

When balancing the aforementioned pros and cons for a politics- (and, accordingly politician-)driven procedure, the scale goes down on the side of the cons; this is at least the jurist's impression. But then the next question arises of how the alternative

[20] Cf. *Paulus*, Gläubiger oder neutrale Instanz – wer soll das schlingernde Schiff steuern? (forthcoming in Zeitschrift für Staats- und Europarecht, ZSE, 2012).

[21] E.g. Poland in 1997.

[22] *Yeyati / Panizza*, The elusive costs of sovereign defaults, Journal of Development Economics 2010, ...

procedure should look like. What follows is a plea for a resolvency proceeding.[23] The new term is used in order to overcome the abovementioned (sub D I) negative connotations usually connected with „insolvency" or „bankruptcy". The resolvency proceeding is to be designed in a way that it fulfills the requirements of a fair, transparent, and predictable proceeding, i.e. complies with the rule of law which particularly the western world is proud of to calling one of its age-old pillars.

It takes not more than three steps to establish the resolvency proceeding: A contractual clause (I), a resolvency court (II), and procedural rules enacted by the resolvency court (III). Was im Folgenden allerdings nicht näher ausgeführt wird, ist die mit der Einführung eines Resolvenzverfahrens verbundene Notwendigkeit, ein Abfederungssystem für den Finandienstleistungssektor zu etablieren. Denn es ist wohl unausweislich, dass im Falle der Durchführung eines Resolvenzverfahrens dieser Kernbereich des Wirtschaftsgeschehens unmittelbar und massiv mitbetroffen ist. Es muss an dieser Stelle der Hinweis genügen, dass zum einen die Lehman-Pleite von 2008 auch den europäischen Gesetzgeber auf den Plan gerufen hat – ganz abgesehen von entsprechenden nationalen Bemühungen;[24] zum anderen ist die schon eingangs erwähnte enorme Fülle an bisherigen Staatspleiten bislang noch immer ohne einen Totalkollaps des Bankensystems abgewickelt worden. Das ändert freilich nichts an der Wichtigkeit des Gebots, kann aber doch ein wenig Druck von der Dringlichkeit nehmen.

I. Contractual Clause

In its simplest version, the resolvency clause could be phrased like: „In cases of default, the issuing sovereign is permitted, alternatively to activating the Collective Action Clauses, to activate a resolvency proceeding by filing a respective petition with the Resolvency Court."

But why should there be such a clause? What would be its advantage? The answers have to do with how things around sovereign debt restructuring evolved over approximately the last decade: In the beginning of that time-span, there is the IMF's proposal of a Sovereign Debt Restructuring Mechanism (SDRM) in the context of the

[23] The proposal is a modification of a broader model which the present author is about to publish together with *Steve Kargman* (New York) and which is meant to address a global, i.e. not just European, audience: Reforming the Process of Sovereign Debt Restructuring: A Proposal for a Sovereign Debt Tribunal as a Means of Resolving Sovereign Debt Disputes. On the European Resolvency proceeding in particular see, i.a., *Paulus*, Die Eurozone und das größere Thema eines Staateninsolvenzrechts, in: Kodek / Reinisch (eds.), Staateninsolvenz, Wien 2011, p. 9 ff.; *idem*, Prolegomena für die Schaffung eines Resolvenzrechts für Staaten, in: Kadelbach (ed.), Nach der Finanzkrise, 2012, p. 105 ff.; *idem*, Lehren aus den vergangenen Krisen und neue Ansätze zur Staatenresolvenz, in: Giegerich (ed.), Internationales Wirtschafts- und Finanzrecht in der Krise, 2011, p. 135 ff.; *idem*, Rechtliche Handhaben zur Bewältigung der Überschuldung von Staaten, Recht der Internationalen Wirtschaft (RIW) 2009, p. 11 ff.; *idem*, Geordnete Staateninsolvenz – eine Lösung mit Hilfe des Vertragsrechts, Zeitschrift für Wirtschaftsrecht (ZIP) 2011, p. 2433 ff.

[24] Speziell zum deutschen Kreditinstitute-Reorganisationsgesetz s. etwa *Paulus*, Brooklyn Journal of Corporate, Financial & Commercial Law 2011, 171 m.w.N.; ferner *Kenadjian* (Hg.), Too Big To Fail – Brauchen wir ein Sonderinsolvenzrecht für Banken?, 2012.

Argentina crisis. The debate resulting from this proposition created two camps: there were those who advocated for a statutory approach and those who preferred a contractual one.[25] A bit simplifying, this antagonism addresses the ground for the legally binding character of the respective approach. The IMF, for instance, had in mind to achieve such binding through an amendment of its Articles of Agreement; others preferred the implementation of a narrowly pre-defined model law into the national body of law.[26] Both proposals fall into the category of a statutory approach, which, for several reasons, offers all-in-all preferable solutions. However, its decisive drawback is the big effort and time needed for its realization.

The contractual approach, most prominently represented by the Collective Actions Clauses leaves it to the respective sovereigns to contractually determine the procedure in all its details. Irrespective of some considerable deficiencies (these clauses do not provide fresh money, and they address just the debt structure and not the debtor's economic and infrastructure), this approach seems to be – at least for the time being – the present day state of the art. Note that the ESM Treaty explicitly prescribes the future inclusion of such clauses in most Euro denominated bonds, art. 12 par. 3.[27]

Given this state of affairs, the present proposal takes advantage of this approach. After all, it is less ambitious than the statutory approach and it allows for an easier realisation of the concept.[28] There is no need to enter into an international agreement or to enact a statute; instead, it suffices to include the said contract clause into any borrowing agreements.[29] Accordingly, the resolvency procedure can be established without being dependent on a supra-national legislative body.

II. Resolvency Court

It is part of the just described reduced ambition to refrain from developing elaborate substantive rules and to confine the proposal to the establishment of a Resolvency Court. It should be noted that such a self-restraint is not without historical precedence: In the sixties of the 20th Century, when the decolonialisation changed the globe's political map tremendously, the details of an international investment protection system became subject of heated debates. The antagonistic interests of investors and the newly liberated sovereigns lead to an amalgam of highly complex and intricate problems which appeared unsolvable for quite some time. But yet, ultimately a

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[25] For what follows cf. *Paulus*, A Statutory Proceeding for Restructuring Debts of Sovereign States, RIW 2003, 401 ff.

[26] *Paulus*, Rechtlich geordnetes Insolvenzverfahren für Staaten, ZRP 2002, 383 ff.

[27] See the newly drafted sec. 4a ff. BSchuWG (Gesetz zur Regelung des Schuldenwesens des Bundes = Statute on the Regulation of the Federal Debt Service) in the Entwurf eines Gesetzes zur Änderung des Bundesschuldenwesengesetzes.

[28] Cf. *Malaguti*, Sovereign Insolvency and International Legal Order, Int'l Comm.L.R. 11, 2009, 307 ff.

[29] Cf. sec. 4 BSchuWG.

solution was found – namely the creation of the International Centre for the Settlement of Investment Disputes (ICSID) at the World Bank. This is just an arbitration platform for disputes arising out of investment disputes, which offers only procedural rules and support but no substantive law. As a consequence, arbitral awards rendered under the auspices of this Centre add nowadays up to a considerable body of public international investment protection law.[30] It is this model which gives rise for some optimism that a resolvency law will evolve in the long run under the auspices of a respective institution.

But there is not just this ICSID model for the overall concept, there are also further models for the details of a sovereign debt tribunal. Suffice it to refer to the Iran-US-claims Tribunal[31] or its less prominent counter-part for Iraq.[32] And finally, the IMF's SDRM, too, provided for the establishment of a court-like institution.[33] It is particularly this latter concept after which the Resolvency Court should be modelled: Accordingly, the Court would consist of a president and a pool of around 20 to 30 judges. The president and its office would be the only permanent staff; the judges would not be. They would remain in their respective positions and would become actual judges only when and if they become so appointed by the president for a particular case. According to the complexity of the case, those three or five judges would then form the Resolvency Court Chamber. The advantage of this approach is that it reduces the tribunal's current costs; they are to be paid only when acting as judges and then by the debtor sovereign.

Apart from the need of having outstanding reputation both as professionals and social competence, the judges should be in the position to develop rapidly expertise in all resolvency issues. Therefore, the pool of potential judges should be limited to the numbers mentioned above. The selection of the potential judges must be guided by various diversification criteria such as different nationality, professions, and backgrounds.

The experiences with the IMF proposal a decade ago teach us that the location of the Resolvency Court is an important issue. It is, accordingly, inacceptable to connect the tribunal with any of the existing credit institutions such as the European Central Bank in Frankfurt a.M.; the same is true also for any of the Brussels institutions as they are (or appear to be) guided by specific political interests. Given this, it would be possibly

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[30] See, e.g., *Griebel*, Internationales Investitionsrecht, 2008; *Herdegen*, Internationales Wirtschaftsrecht, 6. ed., 2007, p. 238 ff.; *Krajewski*, Wirtschaftsvölkerrecht, 2006, p. 167 ff. See additionally *Tietje*, Grundstrukturen, Rechtsstand und aktuelle Herausforderungen des internationalen Investitionsschutzrechts, in: Giegerich (ed.), Internationales Wirtschafts- und Finanzrecht in der Krise, 2011, p. 11 ff.

[31] Cf. www.iusct.net.

[32] *Deeb*, Project 688: The Restructuring of Iraq's Saddam-Era Debt, Cleary Gottlieb Restructuring Newsletter Winter 2007, p. 3 ff.

[33] For details, cf. *Paulus*, Die Rolle des Richters in einem künftigen SDRM, in: Gerhardt / Haarmeyer / Kreft (eds.), Insolvenzrecht im Wandel der Zeit, Festschrift für Hans-Peter Kirchhof, 2003, p. 421 ff.

the optimal solution to have a special and independent chamber established at the European Court of Justice in Luxembourg. But since this would require a rather time-consuming legislative act, art. 257 TFEU, the second best solution under the present circumstances appears to be to have the Resolvency Court established at the Permanent Court of Arbitration (PCA) in The Hague. This would be an act of incidental consistency: Apparently, the idea of creating there a bankruptcy court for sovereigns was indeed circulated at the time of the PCA's foundation – i.e. some 110 years ago.[34]

Alternatively, one could think also of Switzerland or Norway as places where to locate the Resolvency Court. These countries benefit from the nimbus of neutrality and would, thus, indirectly add to the Court's trustworthyness.

III. Procedural Rules

The last step for the constitution of a resolvency regime is that the Resolvency Court lays down its rules of procedure.[35] The comparison with the creation of ICSID (sub E II) suggests that these rules should be more or less restricted to providing a platform on which the stakeholders of a sovereign default are bound to find a solution under the auspices of the Resolvency Court Chamber. This is all the more advisable as the history of the last 100 years of sovereign defaults has shown that the prevalent solution of those situations has been negotiations. What is to be looked for, thus, is a platform, which offers sufficient space for such negotiations.[36]

Given this point of departure, it is recommendable to draft the rules of procedure in cautious analogy to modern commercial insolvency law. This is so because this field of law has changed its appearance enormously in the last decade or so – away from the solely liquidating mechanism towards a highly sophisticated and effective tool for restructuring the debtor. Whereas liquidation is absolutely unbearable in the sovereign context, is the latter all the more appropriate to serve as a kind of model. I.e. not the 'moneyfication' of the debtor's estate is at stake, but just and exclusively the reconstitution of the debtor's debt sustainability. For that purpose, the modern commercial insolvency law offers by now for roughly 40 years the option of the

[34] Cf. *Manes*, Staatsbankrotte, 3rd ed., 1923, S. 208.

[35] On the permissibility of such autonomous rule-setting, cf. just art. 30 par. 1 of the ICJ Statute; art. 16 of the Statute of the International Tribunal for the Law of the Sea; or art. 3 par. 2 of the Claims Settlement Declaration of the Iran-US-Tribunal.

[36] Gerade Deutschland kann darauf im Hinblick auf das Londoner Schuldenabkommen ein Hohelied singen: Abkommen über deutsche Auslandsschulden, London, den 27.2.1953, BGBl. II, S. 333 (umgesetzt durch Gesetz betr. das Abkommen vom 27.Februar 1953 über deutsche Auslandsschulden vom 24.8. 1953, BGBl. II, S. 331); dazu etwa Abs, Entscheidungen 1949 – 1953: Die Entstehung des „Londoner Schuldenabkommens", 1991. Ferner Monatsbericht 02.2003 des Bundesministerium der Finanzen, S. 91 ff.: 27. Februar 2003 – 50 Jahre Londoner Schuldenabkommen. Zu Alternativen zur konsensualen Lösung vgl. etwa *Hornfischer/Skauradszun*, Von der Staateninsolvenz zur Insolvenzfähigkeit von Staaten, KTS 2012, 1, 6 ff.

Chapter 11 proceeding (USA) or 'Planverfahren' (D) respectively.[37] To be sure, the different context – commercial enterprises here, sovereigns there – makes numerous modifications and adaptions indispensable. Nevertheless, this new insolvency approach can and should be used as model for dealing with the situation of a defaulting sovereign as it has proven to be workable with respect to defaulting municipalities, too; [38] accordingly, issues of sovereignty can be dealt with in this type of proceeding.

For the present proposal's better understanding it is certainly helpful to begin with a coherent description of how the envisaged Resolvency Procedure shall look like from the beginning to its end (1). Thereafter, a couple of selected issues shall be addressed in some more detail in order to demonstrate that the surely existing enormous legal problems can be mastered (2).

1.) The Resolvency Procedure as a whole

The procedure begins with the application by the debtor country. The application must be accompanied by the presentation of a restructuring plan which describes meticulously in every detail how the debtor imagines the restructuring of its country, i.e. the plan must explain which concessions are requested by the creditors and(!) which contributions the debtor itself is willing and ready to undertake. Note, that the plan is at this time of the procedure just a proposal that is, as a matter of fact, subject to manifold changes, adaptations, and amendments in subsequent negotiations with the creditors. Here at the commencement of the procedure, it serves also as a kind of entry control: since it is the Resolvency Court Chamber's (i.e. the freshly appointed three or five judges') first task to examine the feasibility, fairness and reasonableness of this plan.

The creditors – and this means, generally speaking,[39] all creditors[40] of that sovereign – are grouped together into classes which, of course, has to be done in accordance with rational and verifiable criteria. This is an essential feature of the proposed procedure

[37] It is of more than just academic interest that at this point of time when Europe is about to get acquainted with the idea of an resolvency proceeding for states, in the USA a heated debate has started about the need or nonsense of introducing a bankruptcy proceeding for their member states. See, e.g., *Skeel*, State Bankruptcy from the Ground Up, http://ssrn.com/abstract=1907359.

[38] This refers to Chapter 9 of the U.S. Bankruptcy Code. For a transplant to Germany, cf. *Naguschewski*, Kommunale Insolvenz – Untersuchungen zu einem Insolvenzverfahren nach Vorbild des US-amerikanischen Chapter 9, 2011, p. 27 ff. For this context, see additionally *v.Lewinski*, Öffentlichrechtliche Insolvenz und Staatsbankrott – Rechtliche Bewältigung finanzieller Krisen der öffentlichen Hand, 2011, p. …..; *Hornfischer*, Die Insolvenzfähigkeit von Kommunen, 2010; *Cranshaw*, Insolvenz- und finanzrechtliche Perspektiven der Insolvenz von juristischen Personen des öffentlichen Rechts, insbesondere Kommunen, 2007; *Frielinghaus*, Die kommunale Insolvenz, 2007; *Paulus*, Überlegungen zur Insolvenzfähigkeit von Gemeinden, ZInsO 2003, 869; *idem*., Insolvenzfähigkeit von Gemeinden – pro, NordÖR 2010, 338.

[39] As to the problem of who might qualify a creditor in a sovereign default, just see *Paulus*, as in fn. 17.

[40] This is in order to prevent segmentation as it is done by the Paris Club or its London equivalent.

since discussion about and final voting on the plan will be done through the groups. Even if the consent of each single group should be needed, such group formation implies that not every single creditor needs to concur; it rather suffices that the (however determined qualified) majority of, e.g., 66 %, 75 %, or 85 % of the creditors within one group do so. Thus, if there should be only a simple majority within a group be required, the consent of 50 % + 1 is sufficient.

However, before it comes to the voting debtor and her creditors are got to sit on the same table and discuss the proposed plan. In order to reduce the mass of creditors and in order to enable meaningful discussions, one might think of having appointed special representatives – as they are foreseen, for instance, in many modern Debenture Bond Acts (cf. § 7 of the German Schuldverschreibungsgesetz). As a matter of fact, the parties involved in this discussions will negotiate toughly; it is to be assumed that every side will strongly argue for its own benefit. The Resolvency Court's rules, however, should abstain from any substantive prescriptions; the result of the negotiations should be left to the balance of powers. This is all the more advisable as one important feature of the rules should be that different groups can be treated differently. Given this peculiarity, it is possible to take full account of a widespread concern among politicians: namely to bring together small creditors into a separate group which could receive 100 % satisfaction whereas other groups with, e.g., institutionalized creditors accept a „haircut" of 50 %. The flexibility of potential solutions in this context is as large as contractual freedom allows for adaptations to the individual case.

It is not necessarily mandatory that these negotiations are connected with those which the debtor country is likely to conduct at the same time with potential new lenders. After all, in a situation like the ones envisaged here, the debtor will be in dire need of fresh money.[41] Primary candidate for those negotiations will be the IMF or the ESM; but it cannot be excluded right from the outset that, depending on the acceptability and the reaction of the capital market to the commencement of the Resolvency Procedure, the debtor is able to get money even from the capital market (bonds) at tolerable interest rates. Whoever the respective lender is, it might be interested to participate in the plan negotiations. After all, this would increase the disciplining effect on the debtor, which is certainly one of the most important side effects of the Resolvency Procedure.

After a pre-fixed period of time, the voting must be done. As a matter of fact, the debtor is dependent on the creditors' majority's consent and is, accordingly, again under a certain disciplining pressure. Since without an accepted plan, the debtor's debt situation does not change. This dependency on the creditors is a kind of compensation for what will be described in more detail subsequently: namely the exclusive right of the debtor to pull the trigger for commencing the procedure. However, this dependency could be mitigated by reducing the requirement of unanimity regarding

[41] Mit diesem Bedarf ist die praktisch eminent wichtige Frage verbunden, welche Sicherheiten der Staat einem Neugläubiger anbieten kann? Das wird zum einen sicherlich die Einräumung einer Superpriorität, also Vorrang vor allen anderen Gläubigern, sein, und könnte zum anderen bis hin zur Verpfändung von künftigen Steuereinnahmen (Tax-farming) reichen.

the groups' consent (attention! not the voting requirements within any one of the groups). If so wished one could think along the lines of the so called „cram down rule", cf. s. 245 InsO, which allows under certain circumstances, a plan to be accepted when and if the (simple or qualified) majority of groups do concur.

If the plan is, thus, accepted the court must confirm the plan by examining the legal correctness of the proceeding so far. Given this requirement, it is advisable to have the court be present all the time during the negotiations. The judges should probably function as moderators.

If, however, the necessary majority for the plan's acceptance is not achieved a second chance should be granted for improving repair; i.e. re-negotiations should be possible, although just for a rather limited period of time. When and if this second attempt also fails the European Monetary Union (unlike the situation of other overindebted sovereigns) could possibly provide for a whole range of sanctions up to the exclusion of that particular sovereign from the Union – which would likely be the most severe of such sanctions. However, the failure of the plan's acceptance could likewise be in one (or more) of the creditors' sphere of responsibility, who try to 'hold out'. Due to the court's moderation a situation like that could be sanctioned by withdrawing that creditor's voting right or to interpret its vote as a 'yes' after special investigation of the result's fairness and reasonableness. Thereby, both sides could be disciplined.

2.) Selected issue in detail

a.) A fundamental issue of any proceeding like the one presented here is, as a matter of course, under which conditions the resolvency proceeding shall become commenced. The commercial insolvency law of, e.g., the German Insolvency Ordinance, s. 17 to 19, provides three opening reasons: insolvency, imminent insolvency, over-indebtedness. None of them is transferable to the realm of sovereign default and a resolvency proceeding. The IMF imposed in this context the requirement of 'unsustainability of debts', meaning therewith that the debt burden has become to high to reduce the principal amount and to be captured, thus, in what is commonly called a 'debt trap'. To be sure, this is just a very superficial description of what the IMF has in mind.

But one might ask if there is any need at all for pinning down a precise opening reason. It might suffice to have instead a subsequent abuse control.[42] As will be discussed in more detail below (sub b), it is one of the Resolvency Court Chamber's predominant tasks to examine the commencement prerequisites. When and if they are not given the proceeding will not be commenced and the debtor country is obliged to look for alternative solutions – a purposeful unpleasant alternative to abusing the procedure.

[42] Cf. *Paulus* (as in fn. 17), p. 385. Another alternative would be, following an English model, to leave the definition of the opening reason to the parties, cf. *Steffek*, KTS 2009, 317,348, 352.

b.) The IMF's proposal of the SDRM, too, reserved the right to petition for the commencement of the proceeding exclusively to the debtor country.[43] One might regret this from the perspective of disciplining the debtor; but issues of the debtor's sovereignty leave no alternative. Since otherwise a creditor's petition would urge the debtor into a straitjacket of actions which, in the worst case, are not needed at all. Moreover – and probably most importantly – the likelihood of such option's general political acceptance is minimal at best. Germany, France, or any other country would hardly ever agree to submit themselves to such a right of others.[44]

However, in sight of what has earlier been said about the advantage of any insolvency proceeding – namely its disciplining function for all stakeholders just by means of its mere existence – the present proposal might appear as a unilateral favouring of the debtor's position. Since if the debtor alone has the right to pull the trigger, it has therewith a bargain chip for its negotiations, for instance, at the Paris Club, London Club, or its negotiations with the private sector; the creditors have nothing to hold out against this. Nevertheless, this imbalance is for the reasons presented to be tolerated and must be compensated by other measures disciplining specifically the debtor – for instance the abovementioned (sub 3) need for the creditors' consent to the plan.

c.) Given the mere procedural approach of the Resolvency Procedure, the attribution of competences to the Resolvency Court Chamber is quintessential for success or failure of the proposal. It should be noted, however, that at this point of the proposal's evolution all what is intended is to present an overview over potential competences. Further refinement will certainly be needed in due time.

⇔ It is possibly the Chamber's single most important task to examine whether the application constitutes a potential abuse of the petitioning sovereign; if so, the application will be rejected. The Chamber has, accordingly, to review the debtor's justification for the commencement of the procedure given in the proposed plan. It should be noted that conferring this task to the Chamber underscores the care and attention needed for the selection of the judges' pool; intimate political, economical and legal knowledge is indispensable for such an examination. Since what is to be verified is the debtor's claim that all existing sources of income and other means have been exhausted. The options here at stake are innumerable: (further) privatisations[45] might be as possible and reasonable as increasing certain taxes, saving options might be available by cutting salaries in the public sector (for instance, cutting back the 13th

[43] See additionally *Hornfischer / Skauradszun*, Zeitschrift für Insolvenzrecht (KTS) 2012, 1, 16 f.

[44] The same is true for many other countries such as the US – if the proposal were to become extended to a global model. However, for the Eurozone it appears to be imaginable to give the right to trigger the proceeding to a supranational institution such as the European Council.

[45] Regarding the privatisations particularly of present Greece, see the very informative deliberations by *Kargmann / Potamitis*, A New Approach to Privatisation: An Unexplored Option for Greece in Privatising Troubled State-Owned Enterprises, International Corporate Rescue 2011, p. 389.

month's salary), certain commodities have not yet been (fully) exploited, or the gold reserves can – and be it partially – be sold, etc. To get an idea of the width of the possibilities of these resources, it could be helpful to study the conditionality catalogues of the IMF or World Bank which these institutions have previously set up for borrowing states.[46]

⇔ The claims' verification might also be seen as one of the key tasks of the court. But, as a matter of fact, the devil here, as everywhere, is in the detail: Which claims are to be included in the resolvency proceeding? Just foreign ones or also domestic ones? Claims just against the state or also those against the national bank, the subdivisions such as Länder, provinces, regions, etc., or state owned enterprises? Only contractual claims or also those based on other grounds?[47]

The preferable (but, of course, not only possible) answers to these selected questions are: Bearing in mind the need to overcome the selectivity of the Paris Club or London Club and to strive for an all-encompassing resolvency proceeding all claims should be included – be they foreign or domestic (possibly including the domestic tax- or wage claims); the debtor should include all those entities which have no separate legal existence (as for those which have such separate existence, the general insolvency law will be applicable); and there should be a restriction to contractually founded claims because for the time being the court's competence can be founded only on a contract.

⇔ It is by no means a marginal task of the SDT to moderate the negotiations and to check the legitimacy of the group formation, i.e. whether or not objective, coherent criteria have been applied. The goal of this latter task is to prevent the debtor state to strategically bind all creditors together in one group, which are likely to reject the plan. Accordingly, this task is one further piece of the puzzle to discipline the debtor state to not abuse the proceeding.

⇔ A final competence of the SDT could be the dispute resolution within the proceeding. The details should be elaborated by taking inspiration from existing commercial insolvency jurisdictions such as Austria or the US. They confer far reaching competences upon their insolvency courts regarding the resolution of disputes between the parties. Such a concentration (in the commercial context labelled as „vis attractiva concursus"[48]) serves the purpose of the proceeding's acceleration and streamlining. In addition to the dispute resolution, one might also think about permitting the judges to serve as mediators or conciliators – thereby making references to the respective powers of ICSID tribunals.

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[46] It is more than likely that cooperation of the judges is necessary at this point of the proceeding both with Eurostat and IMF; since these institutions have unique sources of information for the debtor's economy.

[47] For this, see just *Hagan*, Designing a Legal Framework to Restructure Sovereign Debt, 36 Georgetown Journal of International Law (2005), 299 ff.

[48] See just *Paulus*, Insolvenzrecht, 2nd ed. 2012, par. 47.

d.) It has already been mentioned that the time factor is of eminent importance in any restructuring and, accordingly, in any Resolvency Procedure as well. Therefore, it is key to take this facet into consideration and to provide for rather strict time frames in order to prevent strategic abuse by either side in prolonging or abbreviating the procedure to one's own benefit. However, it is to be assumed that, in most cases, it will be the debtor country which pushes for acceleration; since the earlier the plan is accepted the earlier the state can begin with the realization of the resolvency measures (see infra sub e). Based on this assumption the focus of timing rules should be in disciplining the creditors. Those rules could be, for instance, the right to ad hoc-interventions of the judges or fixed time frames after which the majority requirements could change.[49]

e.) If the plan is accepted by the prescribed majority vote and if the court has ultimately certified the legality of the procedure, this court order will be the basis for all subsequent legal changes and obligations arising from the plan. The creditors' „haircuts" are effective as of this time as are the debt deferral agreements, etc. But as of this time the debtor state, too, is obliged to begin with all those measures which, pursuant to the accepted plan, are to be done by the debtor – for instance, cutting back of salaries, privatization operations, exploring new (or increasing existing) taxing sources, etc.[50]

However, it is possibly not an entirely unlikely scenario that the debtor, once the plan has been accepted and the debt burden is accordingly reduced, becomes somewhat hesitant or less enthusiastic to comply with the imposed obligations of the plan: all of a sudden, one might feel inclined to postpone the promised tax increase until after the elections next year, or the sale of certain shares is 'unfortunately' presently not appropriate, etc. In such a case, the creditors would have recourse to the courts (which ever these might be in the given case), which, even if successful in the end, would take months if not years. Therefore, effective resolvency rules should provide for ongoing supervision by the court in this plan-realization-period in order to discipline the debtor here, too. The sanction against such retarding of the debtor could be modelled pursuant s. 255 InsO:[51] the court could be given the power to revoke the plan – with the consequence that the status quo ante is re-established and all claims do exist as they had been before the plan acceptance.

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[49] When and if the debtor state should abuse such time frame the court could be allowed to prolong the deadlines.

[50] Some of these operations have already been mentioned supra (sub 2 c). This is not so surprising in sight of the possibility that the political chances for their realization might be greater when done in the context of the resolvency plan – i.e. after the creditors' consent to do their part for the sovereign's restructuring.

[51] As an aside: The most recent Italian legislation on consumer insolvency, legge 212/2011, has in its art. 14 a respective clause.

F. Final deliberations

I. Disciplining Function

In summarizing the preceding arguments, the initial question can be answered in the positive – yes, a legal proceeding should replace politics when it comes to overcoming the challenges of defaulting sovereigns. Occasionally, it was mentioned that the Resolvency Procedure will unfold a disciplining function of either the debtor or the creditors which is a consequence of the abovementioned (sub D I) stigmatization of insolvency law. It is both to be assumed and to be hoped for that this causation serves as a deterrence from excessive borrowing and lending.[52] After all, history teaches us that default episodes accumulate after phases of lending booms.[53] Since the accumulation of debts (both in Europe and worldwide) has reached before unknown heights, it appears to be a prudent strategy to develop and establish measures, which put a break on this evolution. One of those measures could be an effective Resolvency Procedure.

To fulfil this sort of meta-function, it needs to be said – particularly in sight of the previously existing but throughout ignored disciplining measures provided for in artt. 122 ff. AFEU – that the Resolvency Procedure constitutes a credible threat. That is to say right at the outset that it displays its efficiency then and only then when everyone is ready to apply it. If this is the case, it is to be assumed that it will have the said disciplining, i.e. deterring effect. After all, which head of government would be willing to state in front of numerous cameras that his or her country has to file a petition at the Resolvency Court. Thus, if every actor on that stage is ready to comply with the legal proscription of not bailing out other member states, it follows that a Resolvency Procedure is most effective when and if it is never applied. The strategy is, thus, comparable to the earlier political motto 'peace through deterrence'.

II. Expansion

It should be noted that the comparison made supra (E II) with the evolution of ICSID to a public international investment protection law carries with it a further implication. Like there, a now and here created Resolvency Procedure could have the potential to expand from its original European application field to a global one. Even if this sounds banal: it should be remembered that the sovereign default trouble is not a European phenomenon. And it is also a seemingly banal conclusion that it is by no means true that for all other extra-European sovereigns fighting with the problem of default the

[52] Zu einem entsprechenden Versuch durch UNCTAD s. *Paulus*, Responsible Bilateral Lending and Borrowing – An Approach to a Legally Binding Concept, FS für Knieper (im Erscheinen begriffen).

[53] Cf. *Borensztein* / *Panizza*, The Costs of Sovereign Default, IMF Staff Papers Vol. 56 No. 4, 2009, p. 683, 689.

Bretton Wood-institutions would offer sufficient help. Quite to the contrary, the need for a global resolvency proceeding is ubiquitous and urgent.[54]

Accordingly, the preceding deliberations are meant (and should so be read) to include the option for such an expansion – irrespective of the then necessary modifications.[55] It is, thus, the ambition of the proposal presented here that it could also be used as a blueprint for a global sovereign default restructuring mechanism.

[54] It should be noted that the present German coalition had included in its agreement from 2009 the concern to promote the institutionalisation of a sovereign debt restructuring tool. For Switzerland, note that in end September of 2011, the Bundesrat was requested to elaborate and come forward with a proposal for a fair and independent international insolvency proceeding for sovereigns that includes also provate investors and which helps to prevent future debt crises and to guarantee stable currency and finance conditions. Cf. http://www.parlament.ch/d/suche/seiten/geschaefte.aspx?gesch_id=20114033.

[55] Cf. *Kargman/Paulus* (fn. 15).