

**UNCTAD Debt Workout Mechanism (DWM):****Working Group Meeting no 2**

12 December 2013

CONCLUDING PANEL SUMMARY

1. Relevance of the rules of good faith and transparency in the DWM

The purpose of the second WG on the DWM was to identify the main questions revolving around the two principles of good faith and transparency in the context of sovereign debt restructuring. These principles had been identified as forming an essential part of a potential debt workout mechanism in the brainstorming meeting, which marked the beginning of the project on debt restructuring (Feb 2013).

Good faith and transparency are particularly relevant now, since the sovereign debt restructuring regime is poised for a new round of discussions taking place in a number of international *fora*. There are a number of contextual facts that makes this discussion even more relevant:

- The long history and rich jurisprudence of good faith in municipal contract and insolvency law can help transform general principles into specific guidelines for debt restructuring.
- Recent court decisions in several jurisdictions have highlighted concrete potential for abuse in sovereign debt restructuring, and with it, the potential contours of good faith in this context.
- The current decentralized restructuring regime is especially prone to fragmentation and information asymmetries. Such a regime demands enhanced transparency.
- While most participants acknowledge that macroeconomic data disclosure has improved over the past decade, legal and institutional information gaps remain substantial. Going forward, it is important to articulate the next generation of transparency standards, including more detailed information on debt contract terms, creditor holdings, and restructuring process history.

2. Key technicalities in motion

2.1. Good faith in DWM

Good faith was recognized as one of the oldest general principles of law with foundation in domestic jurisdictions and international treaties. This principle was further introduced in light of its specific dimensions in relation to sovereign debt.

The Working Group distinguished among the different aspects of good faith.

- Good faith in *ex ante* lending and borrowing is addressed in the UNCTAD Principles for Responsible Lending and Borrowing. Good faith *ex ante*, notably the circumstances of debt acquisition, can affect debt enforceability *ex post*, in restructuring. In this last regard, a fundamental question was posed during the meeting: “is there a good faith duty to accept the results of a negotiation?” One that has no immediate answer and must be devised on the basis of the parties' intentions (to act on good faith). Specific criteria to give an objective indication of this intention were proposed and discussed (price, timing and volume).
- Good faith in restructuring can be analyzed along substantive and procedural dimensions.
 - Substantive good faith standards would encompass the legal and economic outcomes of the restructuring. Thus a restructuring that leaves the debt stock patently unsustainable, that fails to improve the sovereign's debt dynamics, or one that treats different stakeholder groups in a clearly inequitable fashion, would be inconsistent with principles of good faith.
 - Procedural good faith standards would go to the restructuring process. In particular, conflicts of interest, voting irregularities and other abuses of the restructuring process would be inconsistent with procedural good faith. Controlled and empty voting are possible candidates for inclusion in this category; however, the group did not reach specific consensus on this point.

There on specific procedural dimension of the good faith principle, the one arising in the context of contractual relationships both private and public, possibly entailing a duty to enter into negotiations when a debt crisis emerges. This duty in turn generates a second dimension which is the duty not to obstruct negotiations. Accordingly, creditors should not recourse to law enforcement not to negotiate and creditors should not repudiate their debt at will. During the discussion about whether refusal to join or create a creditor committee constitutes an act of bad faith, an option was proposed in the sense of adapting a public law principle whereby actions of an institution's members should be in good faith to this institution. In the same spirit, if treated as an institution, creditors should uphold the same principle - independently from their ability to get organized.

2.2. Transparency in DWM

Transparency was introduced as potentially deriving from the principle of good faith, with some questions surrounding its independent emergence. It is also a principle that is commonly included in contractual relationships, especially in regards to the wish to avoid conflicts of interest. This principle raises questions about the timing and the amount of information to be shared and draws attention to the notion of material facts and shared convictions. Transparency should be read not only in the context of protecting creditors but also the generally public at large by preserving taxpayers' interests. For this reason, transparency also applies to lending. Another important aspect of transparency is confidentiality of negotiations in debt restructurings; defining the limits of transparency is part of the process of ensuring timely, fair and efficient restructurings.

The Expert Group specifically considered how duties to disclose would apply to different participants in sovereign debt restructuring, the audience for disclosure, and the distinction between data and process transparency.

- For the sovereign debtor, an obligation of data transparency would require disclosure of direct and contingent liabilities, such as guarantees, legal terms of the debtor's outstanding debt instruments, borrowing plans and macroeconomic data.
- For all public and private creditors, data transparency would entail disclosure of debt holdings and potential conflicts of interest.
- This principle entails that creditors should be informed about the debt situation of the indebted state.
- Process transparency in sovereign debt restructuring would seek to overcome the fragmented and elite character of the restructuring regime as it has evolved in recent decades. Ongoing flow of information to all affected stakeholders in readily accessible form is important at all times, but especially when the sovereign is in debt distress.
- Process transparency would be greatly enhanced if the public had access to comprehensive information about past restructuring experience. Working Group participants agreed that it could be desirable for UNCTAD to host such a comprehensive database, with input from debtors, private and public creditors, multilateral institutions, and civil society.

3. Concluding remarks

- Both principles should be included in the DWM; their practical aspect being as important as their legal source (general principle of law or emerging).
- Good faith does not mean we should override contractual clauses but it has the potential to enter a grey area when stakeholders' behaviors are inconsistent (during negotiations and for enforcement).
- Beyond law, public policy may play an important role in determining good faith.
- As a general rule, good faith should favour the negotiation process in debt restructurings.

- The DWM will elaborate on the three options proposed by Goldmann to assess whether there would be a duty to accept restructuring on good faith.
- Actions designed to undermine negotiations and, for creditors, acting against the interests of the creditor body as a whole, would not be in good faith.
- Providing false or misleading information in negotiations would not be in good faith.
- Transparency should be inscribed in the DWM with a view to ensuring that both its ex ante and ex post forms are being dealt with.
- The implementation of transparency should be guided by the objective of achieving timely and fair restructurings.
- Suggestions on the role of UNCTAD to host a database should be considered.
- Limitations provoked by unwillingness to share information have to be acknowledged as part of the process of improving the quality of debt restructurings.