FOR AGENDA

SM/02/173

June 7, 2002

To: Members of the Executive Board

From: The Secretary

Subject: **The Design and Effectiveness of Collective Action Clauses**

Attached for consideration by the Executive Directors is a paper on the Design and Effectiveness of Collective Action Clauses. This subject, together with the paper on Collective Action Clauses in Sovereign Bond Contracts—Encouraging Greater Use (to be issued), is tentatively scheduled for discussion on Thursday, June 27, 2002. Conclusions appear on pages 20 and 21.

The staff propose the publication of this paper after the Executive Board completes its discussion together with a PIN summarizing the Executive Board's discussion.

Questions may be referred to Mr. Hagan, LEG (ext. 37715) and Ms. Y. Liu, LEG (ext. 37643).

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INTERNATIONAL MONETARY FUND

The Design and Effectiveness of Collective Action Clauses

Prepared by the Legal Department

(In consultation with the Policy Development and Review
and the International Capital Markets Departments)

Approved by François Gianviti

June 6, 2002

Contents Page

INTRODUCTION

1. This paper examines issues relating to the design and effectiveness of collective action clauses in sovereign debt. Although it draws upon earlier staff papers that have been written on this subject, it also explores a number of new issues, including the feasibility and desirability of incorporating new types of clauses that would facilitate the debt restructuring process.[1] This is a companion paper to "Collective Action Clauses in Sovereign Bond Contracts—Encouraging Greater Use" (EBS/ --/02).

2. Section I of this paper analyzes the features of collective action clauses that can already be found in some international sovereign bonds. In that context, it discusses the extent to which there are barriers—legal or otherwise—that would prevent such clauses from becoming included in all international sovereign bonds governed by those laws that are most typically relied on by emerging market issuers for these purposes. Section II discusses issues relating to the design of new types of clauses that have recently been proposed. Section III contains a preliminary discussion of the scope of sovereign debt that should include collective action clauses, focusing on issues relating to the potential range of instruments (e.g., bonds vs. syndicated bank debt) and the distinction between domestic and international debt.

I. EXISTING PROVISIONS AND STRUCTURES

A. Overview

3. The types of collective action clauses found in a number of international sovereign bonds can be classified into two general categories. The first consists of "majority restructuring" provisions, which enable a qualified majority of bondholders of an issuance to bind all holders of that issuance to the financial terms of a restructuring, either before or after a default. The second type can be described as "majority enforcement" provisions, which enable a qualified majority of bondholders to limit the ability of a minority of creditors to enforce their rights following a default, thereby giving the debtor and the qualified majority of creditors the opportunity to agree upon a restructuring agreement. As will be seen, the effectiveness of majority enforcement provisions can be enhanced by issuing the bond under a trust structure, which can effectively discourage litigation by ensuring that any amounts recovered through litigation by a trustee (who represents bondholders as a group) must be shared with all bondholders on a pro rata basis.

4. In its discussion of the majority restructuring and majority enforcement provisions, this section analyzes the extent to which the lack of uniformity in existing international sovereign bonds is attributable to differences in national laws or, alternatively, different

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[1] See Involving the Private Sector in Forestalling and Resolving Financial Crises: Collective Action Provisions in International Sovereign Bonds, SM/99/207 (8/11/99).

practices. As most sovereign bonds issued internationally by emerging market economies are governed by the laws of either New York or England, particular attention is given to the provisions of bonds that are subject to these laws. Given their relative importance in the capital markets, attention is also given to international sovereign bonds issued in Japan that are governed by Japanese law ("Samurai" bonds) and international sovereign bonds that are governed by German law.[2] Examples of majority restructuring and majority enforcement provision that have been included in existing issuances are set forth in the Attachment I.

5. For purposes of this paper, the term "international sovereign bond" is used in the following sense:

- A bond is "sovereign" if it is issued or guaranteed by the state or central bank. While it is recognized that there may be a link between sovereign and nonsovereign liquidity crises, the restructuring of the debt of the corporate sector will necessarily involve an analysis of the design and implementation of insolvency procedures, which is beyond the scope of this paper.

- A bond is considered "international" if: (a) it is governed by a law other than the law of the issuer and (b) gives a foreign court jurisdiction over any claims that may arise under the bond. As will be discussed in Section III of this paper, these criteria may be of greatest relevance given the overall objective of collective action clauses; namely, to reduce the legal leverage that holdout creditors have in the restructuring process. For purposes of this paper, when a bond is described as being "governed by" the laws of a country, it means that the terms of the bond include a provision which specifically provides that the laws of that country will apply. Whether, in fact, a court will give effect to such a choice of law will depend on the private international law rules of the country where the court is located.

- "Bonds" are freely tradable debt instruments of a fixed maturity, normally in excess of one year, issued by the debtor in a fixed number. As will be discussed in Section III of this paper, the question arises as to whether it would be appropriate to include collective action clauses in a broader range of debt instruments.

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[2] Based on preliminary survey of outstanding international sovereign bonds issued by emerging markets as of December 31, 2001 with a total value of approximately US$354 billion: (a) $ 209.2 billion are governed by New York law (59.07%); (b) $85.18 billion are governed by English law (24.05%); (c) $35.86 billion are governed by German law (10.13%) and (d) $20.7 billion are governed by Japanese law (5.85%).

B. Majority Restructuring Provisions

6. Many international sovereign bonds include provisions that allow for the modification of certain terms of an instrument through a vote taken by bondholders at a duly constituted bondholders' meeting.[3] Only some of these bonds, however, allow for certain terms ("majority restructuring" provisions) such as the maturity date, the amount of interest and principal, and the currency of payment to be modified by a vote of a qualified majority of bondholders. While the absence of a majority restructuring provision does not actually prevent a majority from reaching an agreement with the debtor to restructure the obligations, such an agreement will not apply to any dissenting bondholder, which will still have the right to enforce its right under the original terms.

7. In terms of the outstanding stock of international sovereign bonds, majority-restructuring provisions are generally found in bonds governed by English and Japanese laws. They are not included in international sovereign bonds governed by German law or those governed by New York law. As will be discussed below, while these differences may be explained by different practices in some cases, they are necessitated by differences in national laws in others.

The Design of Majority Restructuring Provision

8. Although details of the design of majority restructuring provisions vary among bonds, they generally share a number of features:

- ***Convening of Meetings.*** The issuer generally has the right to call a bondholders' meeting during which it may propose a modification of the bond terms. Many bonds also include provisions allowing bondholders holding a minimum percentage of outstanding principal (typically around 10 percent) to call a meeting. In the case of the bonds issued under trust deeds, the trustee (which represents the bondholders as a group) also has the discretion to call a meeting.[4]

- ***Notice of Bondholders' Meeting.*** Bonds generally require that adequate notice be given to bondholders as to the date, time and location of the meeting, as well as the details of the modification proposal. They typically

[3] As will be discussed, one important exception is sovereign bonds that are governed by German law, which normally do not contain modification provisions.

[4] In the case of bonds governed by Japanese law, although the issuer has the right to call a meeting, any modification proposal must be approved by the "commissioned company for bondholders" before it can be placed on agenda. The commissioned company for bondholders can approve a modification proposal only if it determines that such a proposal would be in the best interest of all bondholders.

provide for 20 to 50 days prior notice to be given to the bondholders. If the bonds are registered with the trustee or the paying agent, notice must be conveyed to bondholders directly by mail. If the bonds are in bearer form, notice is typically given by publication in the specified financial press twice within a specific number of days before the date of the meeting. There is an increasing tendency for bonds to be issued in the form of global notes held by custodians, which is intended to eliminate the need for the physical delivery of securities whenever they are traded. In such case, notice is typically given through the clearing systems. [5]

- ***Quorum Requirements.*** In international sovereign bonds with majority restructuring provisions, key terms, including those relating to interest and principal payments, may be modified by a bondholders' meeting only if the quorum requirements for the meeting identified in the bond are met. Most sovereign bonds require a special quorum of two or more persons holding a qualified majority of the total outstanding principal of the issue (typically three-fourths, but in some cases two-thirds) to adopt a modification proposal at the first bondholders' meeting. If the quorum is not achieved, the meeting will be adjourned for a specified period (usually around 20 days). These bonds typically reduce the quorum for an adjourned meeting to bondholders holding 25 percent of the total outstanding principal of the issue. The low quorum requirement for adjourned meetings is, in part, designed to provide an incentive for bondholders to participate in the first meeting where the modification proposal will be considered.

- ***Voting Rules.*** In international sovereign bonds with majority restructuring provisions, the modification of key bond terms generally requires the support of a qualified majority of bondholders present at the duly convened meeting and entitled to vote, normally three-fourths, but sometimes as low as two-thirds, of the value of the bond issue that is *represented at the meeting*; i.e., it is not based on the total outstanding principal of the issue. Such a modification decision will be binding on all bondholders, including those not present at the meeting.

- ***Excluded Bonds.*** In order to protect the rights of individual bondholders, many international sovereign bonds with majority restructuring provisions exclude bonds that are "held for the benefit" of the issuer for quorum and

[5] Clearing and settlement services are provided by institutions such as The Depositary Trust Company in the United States and, in the case of Eurobonds, Euroclear and Clearstream Banking.

voting purposes.[6] This is designed to prevent the issuer from engineering a restructuring that is prejudicial to the interest of true creditors.

Differences in National Laws

9. As noted above, while some existing international sovereign bonds include majority restructuring provisions, many do not. The question arises as to whether these differences are explained simply by different practices or are necessitated by the different requirements of national laws. To the extent that the latter is the case, the introduction of majority restructuring provisions would require legislative changes in certain countries. As most Eurobonds are governed by either New York law or English law, this section analyzes whether the differences between these laws explain why the latter type of Eurobonds contain majority restructuring provisions while the former generally do not. In addition, this section briefly discusses the impact of the laws of Japan and Germany on the inclusion or exclusion of majority restructuring provisions in those international sovereign bonds that are issued in these countries.

10. ***English Law.*** International sovereign bonds governed by English law generally contain majority restructuring provisions. In the absence of any statutory limitation, the principle of "freedom of contract" permits bondholders freely to agree to terms such as majority restructuring provisions that will limit their individual rights in the context of a restructuring.[7] As a result of this principle, minority creditors may well find themselves in a situation where the majority agrees to restructure on the basis of motives that are not shared by them, e.g., an ongoing business relationship with the debtor. However, absent fraud in the voting process, the fact that the interests of a majority when approving an agreement may not be the same—or even may be in conflict—with the minority will generally not provide a basis under English law for challenging such an agreement. As long as the majority restructuring provision is adequately disclosed to bondholders, the potential for such a conflict is one of the risks that an investor knowingly takes when purchasing the bond. Indeed, in circumstances where the terms of the bond do not specifically exclude the bonds held for the benefit of the issuer for voting purposes, it is unlikely that a court would nullify a restructuring that was achieved on the basis of the votes cast by such holders.

11. ***U.S. Law.*** In contrast, most international sovereign bonds governed by New York law do not contain majority restructuring provisions. This exclusion, however, has arisen out of practice and is attributable to the treatment of nonsovereign bonds offered to the U.S. general public. Specifically, the U.S. Trust Indenture Act, enacted in 1939 ("TIA") prohibits

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[6] This is achieved by excluding these bonds from the definition of the term "outstanding."

[7] This principle also permits international sovereign bonds governed by English law to exclude majority restructuring provisions. Indeed, many Brady bonds governed by English law do not contain them.

any impairment of a bondholder's right to receive payments due (or to sue to recover the missed payments) without his consent, except that it allows a majority of bondholders with 75 percent of outstanding principal to postpone interest payments for up to three years. The legislative history of the TIA suggests that Congress and the Securities and Exchange Commission were concerned that bond majority restructuring clauses would not provide for judicial supervision and thus could be abused by corporate insiders.

12. Although the limitations imposed in the TIA do not apply to sovereign bonds, sovereign bond documentation governed by New York law has, as matter of practice, generally followed the documentation of nonsovereign bonds and, as a consequence, normally does not include majority restructuring provisions. However, because U.S. law does not prohibit the use of these provisions in any sovereign bond issues, it is generally recognized that this practice may be changed without any legislative modifications. Indeed, there has already been at least one case where an international sovereign bond governed by New York law has included a majority restructuring provision.[8]

13. ***German Law.*** International sovereign bonds that are governed by German law do not contain majority restructuring provisions. German law firms have generally been reluctant to issue legal opinions confirming the validity of such provisions. This may explain why sovereigns and their underwriters have not included these provisions in sovereign bonds governed by German law.

14. In Germany, a statutory regime for modification of bond terms is set out in the Act on the Joint Rights of Bondholders of December 4, 1899 ("Bondholders Act"). The Bondholders Act applies to bonds issued in Germany by issuers resident in Germany, but it does not apply to issues by nonresidents (including foreign governments) or to German government debt. Like the TIA, the Bondholders Act does not allow waiver of the bondholders' right to receive principal which is reserved to insolvency proceedings, but allows a three-quarter majority of the bond issue to reduce interest rates or postpone interest payments (in either case for up to three years) in order to safeguard the interests of individual bondholders. Because the terms of the Bondholders Act apply by law to all domestic nonsovereign issuers, they are not restated in the domestic bond documentation.

15. While it is generally recognized that the Bondholders Act does not apply to international sovereign bonds governed by German law, it is also acknowledged that the terms of these bonds may be subject to provisions contained in German Civil Code regarding standard business conditions (the "Rules"),[9] which are intended, inter alia, to provide for

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[8] Electricity Generating Authority of Thailand, U.S.$300,000,000, 7 Percent. Guaranteed Bonds Due 2008 issued in 1998.

[9] These Rules were initially contained in the Standard Contracts Act of December 9, 1976; they are now contained in Sections 304 through 310 of the Civil Code.

consumer protection. Many German legal practitioners and market participants point to the risk that a German court might be reluctant to enforce a majority restructuring provision contained in a foreign sovereign bond because its impairment of the rights of individual bondholders does not meet the standard of fairness established in the Rules. In light of this uncertainty, they believe that the validity of these clauses can only be assured through the enactment of a new statute. To that end, a group of practitioners have prepared a draft law and have submitted it to the German government for its consideration.

16. To address this uncertainty, the German Federal Government issued a statement on January 14, 2000 on the admissibility of including collective action clauses in foreign sovereign bond issues subject to German law. According to the statement, since the Bondholders Act does not apply to bonds of foreign issuers, bonds issued under German law by foreign debtors are subject to the general principle of freedom of contract as well as to limitations established in the Rules. A clause will be void under the Rules if it places a bondholder at an undue disadvantage to such an extent as to be incompatible with the principle of good faith. The statement notes that it is acknowledged in legal writings that no undue disadvantage would exist if collective action clauses were modeled on the principles of the Bondholders Act. This would require, among other things, that any restriction or waiver of the rights of bondholders be supported by a qualified majority of at least 75 percent of outstanding principal and that majority decisions be binding on all bondholders if they were passed with the intention to safeguard the joint interests of bondholders. Although the Bondholders Act does not permit majority decisions on waiver of principal, which is subject to insolvency proceedings, the statement explains that such majority decision should be permissible in foreign sovereign bonds because foreign debtors are not subject to German insolvency law.

17. To date, the statement by the German government has not affected market practice. Many practitioners have expressed the view that the statement, because it has no legal force, does not resolve the legal uncertainty that currently exists.

18. ***Japanese Law.*** The Commercial Code of Japan sets forth a mandatory regime for the restructuring of corporate bonds governed by Japanese law. The Code allows a qualified majority of creditors to bind all creditors to the revision of key terms (including payment of principal and interest), but any such modification has to be approved by a court, so as to ensure that the rights of individual creditors have not been abused by any collusion between the issuer and the majority creditors.

19. The majority restructuring provisions of the Commercial Code do not apply to international sovereign bonds. However, as a matter of practice, international sovereign bonds issued in Japan and governed by Japanese law ("Samurai bonds") have incorporated these provisions as contractual terms, with the exception that there is no specific reference to the need for judicial approval. Such clauses are valid under the provisions of the Civil Code, which applies to Samurai bonds. However, a minority bondholder could invoke the "abuse of rights" provision of the Civil Code to challenge a majority decision if such abuse could be demonstrated. There have been no court rulings on this issue.

Market Acceptability

20. Although it would be legally possible to include majority restructuring provisions in bonds governed by New York law, the question arises as to whether such clauses would be acceptable to purchasers of these bonds. New York law is often chosen for instruments that are sold to U.S. institutional investors under certain exemptions from registration requirements under the U.S. Securities Act of 1933, including the exemption under Rule144A.[10]

21. Representatives of some of these U.S. investors have indicated that, while the inclusion of majority restructuring provisions in bonds governed by New York law would be unobjectionable, the voting thresholds relied upon in bonds governed by English law would not be acceptable. Specifically, the Emerging Markets Creditors Association ("EMCA") recently proposed a number of model provisions for sovereign debt issues governed by New York law.[11] The model majority restructuring provision proposed by EMCA would allow for a restructuring of key terms on the basis of an affirmative vote of 95 percent of the bondholders.[12] According to EMCA, this relatively high voting threshold (compared to typically 75 percent in bonds governed by English law) is designed to make it more difficult for the sovereign to manipulate the voting process by influencing the votes cast by domestic institutions that are under its direct or indirect control.[13] As is discussed in the companion paper, however, U.S. institutional investors have in the past purchased international sovereign bonds governed by English law (which provide for a lower voting threshold).

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[10] Rule 144A provides a "safe harbor" from the registration requirements of the U.S. Securities Act of 1933 and is often used for the secondary sales of unregistered securities to "Qualified Institutional Buyers".

[11] See www.emta.org.

[12] Under the proposal, the key terms include not only payment terms but also nonpayment terms such as pari passu and negative pledge covenants, choice of law, waiver of immunities and consent to jurisdiction. Subjecting these nonpayment terms to the 95 percent voting threshold would eliminate the possibility of using exit consents to modify non-payment terms (through a lower majority), a technique that was successfully relied upon by Ecuador in its recent debt restructuring.

[13] The proposal also expands the scope of the bonds that are excluded for voting purposes to include those held by any entity "under the jurisdiction of, formally affiliated with, or under the control of" the issuer or its central bank. Some investors have recognized that such a broad exclusion may is not necessary given the 95 percent voting threshold. Moreover, the EMCA model clauses would eliminate the lower quorum requirement for any adjourned meetings that are normally found in existing sovereign bonds and explicitly requires a quorum of 75 percent in outstanding principal for all bondholders' meetings.

C. Majority Enforcement Provisions

Overview

22. The majority restructuring provisions discussed in the previous section may be relied upon to restructure a bond either before or after an event of default has occurred.[14] This section discusses provisions contained in many existing sovereign bonds that allow a qualified majority of bondholders to limit the ability of an individual creditor to enforce its rights against the sovereign debtor after a default has occurred ("majority enforcement" provisions). As will be discussed, the relevant provisions include restrictions on the ability of individual bondholders: (i) to declare the full amount of the bond due and payable ("acceleration") and (ii) to commence legal proceedings against the sovereign.

23. In some (but not all) respects, the possibility for a qualified majority to limit an individual bondholder's enforcement rights following an event of default will vary depending on whether the bond is issued under a trust deed. Under a trust deed, the rights of individual bondholders to enforce their rights upon an event of default are, subject to certain conditions and within certain limits, conferred upon the trustee who represents the bondholders as a group and has fiduciary obligations to them. The features of trust deeds that are discussed in this section are found in trust deeds used in connection with some international sovereign bonds governed by English law.[15] While international sovereign bonds governed by New York law are customarily issued under a fiscal agency agreement where the fiscal agent represents the issuer, New York law does not prohibit the use of the type of trust deeds discussed in this section.[16] [17]

Acceleration

24. Following an event of default, bondholders often have the right to declare the full outstanding amount of the bond due and payable. In some bonds issued under a fiscal agency agreement, each individual bondholder has the right to accelerate its own bond (but not the

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[14] Events of default typically include not only the failure to pay principal or interest when due, but also a number of other events, including a default under other indebtedness ("cross-default").

[15] A small portion of Eurobonds governed by New York law are issued under trust indentures which share some of the features of the English-style trust deeds.

[16] Sovereign bonds governed by German law do not use trustees. Samurai sovereign bonds provide for the "commissioned companies for bondholders" to represent bondholders.

[17] Trust deeds are marginally more expensive than fiscal agency agreements since the services of the trustee and the documentation are more costly.

entire issue) without limitation.[18] In other fiscal agency agreements and in trust deeds, acceleration requires a request made by bondholders holding a minimum value of the bond issue, ranging from 10 percent to 25 percent, by written notice to the fiscal agent or trustee.[19] In the case of a trust deed, the trustee also has the discretion to accelerate on behalf of all bondholders. Allowing a qualified majority to place a brake on the ability of a small group of bondholders to accelerate may be particularly relevant when the event of default is triggered by the cross-default provision. In these cases, this brake will assist the sovereign that has a number of different outstanding issues to limit the consequences of its failure to make payments with respect to a single bond issue.

25. In many international sovereign bonds governed by New York law, bondholders holding a requisite percentage of outstanding principal, typically 50 percent but in some cases as high as 75 percent, may reverse an acceleration of the issue if all payment defaults relating to the originally scheduled payments (excluding any amounts due as a result of acceleration) have been cured or waived.[20] Allowing a majority of bondholders to rescind an acceleration can act as a deterrent against litigation during the negotiating period. In the event that a qualified majority has not been able to prevent an acceleration, dissident bondholders may be discouraged from initiating litigation if they are aware that a debtor could organize a qualified majority of bondholders to reverse the acceleration before a judgment can be obtained. It is generally acknowledged that the availability of this mechanism played an important role in discouraging litigation against Ecuador during the restructuring of its debt in 1999.[21]

26. With respect to bonds governed by English law, this is normally – but not always – achieved through the majority restructuring provisions by amending the maturity date of the bond, which requires a special quorum and support of a qualified majority of bondholders. If majority restructuring provisions are to be included in bonds governed by New York law, the reversal of acceleration could also be achieved in the same way as it is currently effected under most bonds governed by English law; i.e. through the activation of the majority restructuring provision. Alternatively, the bonds could retain a special de-acceleration provision that is typically used in bonds governed by New York law and occasionally found in bonds governed by English law (see Attachment I, Section II(A)). Under this latter

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[18] This rule applies to bonds issued under German law.

[19] In the case of Samurai bonds, acceleration requires a request by bondholders holding more than 50 percent of the value of the bond issue.

[20] Sovereign bonds governed by German law and Japanese law do not contain such a provision.

[21] See Lee C. Buchheit, "*How Ecuador Escaped the Brady Bond Trap*", International Financial Review, December 2000 at 17.

approach, a lower voting threshold (e.g., 50 percent) could be used and the quorum requirements that exist in majority restructuring provisions would not apply.[22]

Initiation of Legal Proceedings

27. Unless an international sovereign bond is issued under a trust deed, individual bondholders have the right to initiate legal proceedings against the debtor following an event of default for the amount that is due and payable. When a trust deed is used, the right of individual bondholders to initiate litigation is, with some limitations, effectively delegated to the trustee, who is only required to initiate proceedings if (i) it is requested to do so by the requisite percentage of bondholders (typically between 20 percent and 25 percent) and (ii) it has received adequate indemnification.[23] Under the terms of the instrument, an individual bondholder will only be able to initiate proceedings if the trustee still fails to do so after both these conditions have been met. While the trustee may also initiate proceedings at his own discretion (i.e., in the absence of a request by the requisite percentage of bondholders), it will not normally do so because of the risks and costs involved.

28. As discussed in the previous paragraph, the terms of a bond issued under a trust deed will effectively enable a qualified majority of bondholders to limit the ability of individual bondholders to pursue litigation while they are negotiating a restructuring agreement with the sovereign. In addition to providing temporary protection for the sovereign's assets, such a limitation will enhance the prospects of a successful negotiation: creditors will be less willing to exercise forbearance and negotiate in an orderly manner if they feel that other creditors are taking advantage of this forbearance by seizing the limited supply of assets held in foreign jurisdictions by the sovereign. It should be noted that this could also be effectively achieved by allowing a qualified majority of bondholders to reverse a prior acceleration.[24]

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[22] Special de-acceleration provisions contained in existing international sovereign bonds governed by New York law and English law generally do not contain a special quorum requirement.

[23] Different from a trust deed, a U.S. trust indenture gives each bondholder the right to bring an individual enforcement action against the issuer to recover any principal or interest payments that are not paid to him when due. Only the right of individual bondholders to initiate litigation with respect to the accelerated amounts is delegated to the trustee.

[24] However, only the trust structure could effectively enable a qualified majority of bondholders to limit the ability of individual bondholders to pursue litigation after a default has occurred but before an acceleration is effected.

Sharing

29. As a consequence of the trustee's authority to initiate legal proceedings on behalf of all of the bondholders, any amounts recovered by the trustee through such proceedings are for the benefit of the bondholders as a group and, therefore, are distributed pro rata among all of the bondholders. Accordingly, even if a bondholder wishing to pursue litigation has managed to acquire a sufficient percentage of bonds to enable him to require the trustee to initiate litigation, the requirement that the trustee distribute any amounts received through litigation to all bondholders on a pro rata basis will reduce such bondholder's incentive to do so.

Differences in National Laws

30. To what extent are the differences in the treatment of enforcement rights reflected in different bonds necessitated by differences in national laws? Given the fact that the differences revolve around the treatment of minority creditors, it is not surprising that the principles applicable to majority restructuring provisions also apply to majority enforcement provisions.

31. With respect to the *English* and *U.S.* law, in the absence of controlling legislation, all of the above limitations could be—and in many cases already are—included in bond documentation that are governed by these laws. There is no legal bar in the United States to the use of the type of trust deeds that are found in some of international sovereign bonds governed by English law.

32. Regarding *German* law, individual bondholders have the right to enforce their rights (and keep the proceeds of any recovery) without any limitation. For the reasons explained in B above, many practitioners are of the view that there is legal uncertainty as to whether provisions that limit the ability of bondholders to enforce their rights could be included in future international sovereign bonds governed by German law.

33. Bonds governed by *Japanese* law generally provide that acceleration can only be effected at the request of bondholders holding at least 50 percent of the value of the issue. These clauses are modeled on the Commercial Code, although this Code does not apply to Samurai bonds. Moreover, under the terms of Samurai bonds, legal proceedings may be initiated by the commissioned company for bondholders or any bondholder. It is unclear whether a clause limiting individual bondholders' rights to initiate legal proceedings would be valid under Japanese law.

Market Acceptability

34. In general, and based on the limited contacts that have been made with market participants, investors appear to be willing to tolerate the inclusion of majority enforcement provisions in future international sovereign bonds governed by New York law. Indeed, the majority enforcement provisions regarding acceleration and reversal of acceleration are already included in many of these bonds. With respect to the use of trust instruments, which

are found in some of the bonds governed by English law (but which are typically not found in bonds governed by New York law), market participants have generally indicated that this structure would also be acceptable.

II. NEW PROVISIONS

35. This section discusses issues relating to the design and market acceptability of clauses that have not yet been included in international sovereign bonds. The discussion draws upon the analysis of "collective representation clauses" that was contained in an earlier staff paper and, other proposals that have been recently made by the official sector.[25] For purposes of assessing these provisions, primary consideration has been given to two factors: (i) whether these provisions would make an important contribution in promoting an orderly and prompt debt restructuring and (ii) whether these provisions would be acceptable to the market. ***The assessments set forth below are very tentative. Not only are a number of design issues still to be resolved, but also feedback from the market has been very limited.***

A. Representation Clauses

36. The first section of this paper has described how provisions contained in a number of existing international sovereign bonds can facilitate an orderly restructuring by limiting the ability of individual creditors to disrupt the negotiations—or undermine an agreement reached—between a debtor and the majority of its creditors. As important as these provisions are, they do not actually establish procedures for negotiations. A debtor seeking to achieve a rapid restructuring with a number of different bondholders—including holders of different bond issues—will face the unenviable task of trying to contact and negotiate with a widely diffuse and diverse body of creditors. While it can convene a meeting of bondholders for the purposes of requesting them to elect a representative that is permitted to negotiate on their behalf, such a move can be both time consuming and, from the debtor's perspective, hazardous: once the bondholders meet, they may choose, instead, to take this opportunity to enforce their rights under the bonds. For example, if the debtor has defaulted on only one bond issue, but wishes to restructure all of its debt, the holders of bonds that have not yet become due may feel the need to use the opportunity of a meeting to vote to accelerate the issue and initiate legal proceedings.

37. Even if the bond is issued under a trust deed, a trustee is not a useful negotiating counterpart under the terms of existing instruments. Because of its fiduciary relationship with bondholders, the trustee will be very reluctant to even discuss a modification of terms that would impair the rights of bondholders without prior authorization from the bondholders, which raises the problems of delay and uncertainty noted above.

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[25] These proposals include those that have been recently made by Mr. John Taylor, Under Secretary of the U.S. Treasury.

38. As a means of addressing this problem, one proposal was to expressly give the trustee the authority to act as a channel of communication between the debtor and bondholders prior to a bondholders' meeting.[26] To ensure that the bondholders' representative has adequate expertise, the trustee could delegate this function to a third party such as a financial institution. Neither the trustee nor its delegate would have any authority to legally bind the bondholders to any proposal. Moreover, when a bondholders' meeting is eventually called, the authority of the trustee would be automatically terminated, unless extended by the bondholders. (See Attachment II).

39. This proposal is, in general terms, somewhat similar to—but perhaps not as robust as—the "engagement" clause proposed by Under Secretary Taylor.[27] As described by Mr. Taylor, an engagement clause would empower a representative to negotiate with the debtor on behalf of the bondholders and, in addition, would set out in detail what data the debtor would need to provide to the creditors' representative and within what period of time. Although not explicit in the proposal, it may be assumed that the clause would not give the representative the authority to actually bind bondholders to the terms of a restructuring.

40. Early reactions from a limited number of market participants to this approach have been mixed. On the one hand, there is a recognition that any provision that facilitates early contact between a debtor and its creditors during a crisis would be welcome. Moreover, to the extent that such a provision does not authorize the representative to bind creditors, participants recognize that it will not result in any diminution of creditor rights. On the other hand, some market participants have expressed concern that any provision that would empower a designated representative to negotiate with the debtor may further delay the commencement of negotiations between the debtor and the creditors themselves. These participants stress that greater emphasis should be placed on bringing debtors together with creditors (perhaps organized in a creditors' committee)—not on bringing debtors together with intermediaries. This reaction is attributable, in large part, to concerns expressed by market participants regarding what they perceive as being the absence of a transparent and collaborative process in recent restructurings. However, to the extent that both debtors and the official community signal that greater efforts need to be made to address these "process" questions, these provisions could become more desirable. For example, given that it may take time for a representative committee of creditors to form, it may be in the interests of bondholders to have their legally designated representative meet with the debtor in the interim. Once a committee has been formed, the role of the representative would diminish.

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[26] See Lee Buchheit, "*The Collective Representation Clause*," International Financial Review, September 1998.

[27] "Sovereign Debt Restructuring: A U.S. Perspective" remarks by John B. Taylor, Under Secretary of Treasury for International Affairs at the conference "Sovereign Debt Workouts: Hopes and Hazards?", Institute for International Economics, Washington, D.C. April 2, 2002.

B. Initiation Clauses

41. As borne out by experience, after a sovereign default, it normally takes a period of time for creditors to get relevant information from the sovereign, choose a representative or form a creditors' committee, and negotiate the terms of a restructuring with the debtor. During this period, there is a risk of maverick litigation that could inhibit progress in the negotiations between the debtor and a majority of bondholders. This risk may increase to the extent that bonds contain majority restructuring provisions since, in these cases, the only opportunity for a disruptive bondholder to sue will be before a restructuring agreement is reached. To address this risk, Under Secretary Taylor has proposed the introduction of an "initiation" clause in future bonds that would provide for a "cooling off" period between the date when the sovereign announces its intention to restructure and the date that a creditor representative is chosen. Under this proposal, payments would be temporarily suspended or deferred during this period and bondholders would be prevented from initiating litigation.

42. Taking into account the above features, there are a number of ways in which such an "initiation" clause could be designed. It could simply defer creditor enforcement following the occurrence of an event of default that had been triggered by nonpayment, an announcement of a moratorium or a cross-default under another debt instrument. Alternatively, the initiation clause could provide for a grace period that would defer the occurrence of an event of default until the specified period has elapsed. While, under the former approach, creditors would have the right to accelerate their claims, under the latter approach they would not.

43. In cases of litigation following an event of default, it is not entirely clear whether such a provision would make a critical difference if the bonds already contain the type of majority enforcement provisions described in Section I. As discussed, in the event that a small group of dissident creditors do attempt to litigate, majority enforcement provisions enable a qualified majority to thwart such attempts. In cases, however, where the proposal would provide for a grace period that would delay the occurrence of an event of default, it could provide a useful breathing period.

44. It should be noted that, unlike other clauses that are being discussed in this paper—all of which address inter-creditor problems by shifting power from individual bondholders to the group—this clause would transfer leverage from the creditors to the debtor. For this reason, it may meet resistance from market participants. Preliminary contacts with some participants have confirmed this: from their perspective, the inclusion of a pre-established "cooling off" period that would apply in all cases is both arbitrary and unnecessary. In their view, there is no evidence to suggest that a sovereign default will be followed by a rush to the courthouse; they emphasize that majority enforcement provisions can adequately address these risks. More generally, they felt that any further transfer of legal leverage from creditors to the debtor would only serve to weaken emerging market debt as an asset class.

C. Aggregation Provisions

45. It is generally recognized that majority restructuring provisions and majority enforcement provisions discussed above can facilitate an orderly and rapid debt restructuring. However, because they only operate within the four corners of the bond document, these provisions only bind bondholders within the same issue. Accordingly, they have no effect on bondholders of other issuances; nor do they apply to other types of indebtedness such as bank debt and trade credit. Given the multitude of instruments that exist when a sovereign wishes to engage in a comprehensive restructuring, many of which are held by creditors with diverse interests, this limitation is a serious one. For example, for a sovereign that has many bond issuances outstanding, holdout creditors can disrupt the restructuring process by obtaining a controlling position in a single bond issuance.

46. In light of this limitation, there has been some discussion of the possibility of developing collective action clauses that would effectively aggregate creditor claims across all bonds and other debt instruments for voting purposes. These provisions would provide that, for purposes of determining whether a qualified majority of creditors support the terms of a restructuring, the votes of those that possess instruments containing these provisions—whether presently or in the future—would be aggregated with those of all other creditors who hold instruments with the same clause.

47. While the incorporation of such clauses would make a particularly valuable contribution to the restructuring process, early market reaction to this proposal has been negative. While investors recognize that the "instrument-by-instrument" approach to resolving collective action problems has its limitations, they are of the view that the introduction of "super" collective clauses that aggregate claims across instruments for voting purposes could severely undermine their rights. In particular, they are concerned that these clauses would exacerbate the risk of voting manipulation that is noted in Section II. For example, in the event that instruments held by creditors that have a longstanding relationship with the sovereign or are otherwise under the influence of the debtor are aggregated with claims of "independent" creditors, this could provide an opportunity for the sovereign to dilute the votes of this latter group of creditors. While one could attempt to address this issue by providing for language in the contract that would exclude all votes of those that are under the influence of the debtor, the application of such language would invariably be subject to dispute in specific cases. Moreover, the effectiveness of any dispute resolution process would be severely undermined by the fact that the relevant instruments would be governed by different laws and subject to the jurisdiction of different courts.

III. THE SCOPE OF SOVEREIGN DEBT TO BE COVERED

48. The previous section has discussed the design and benefits of provisions that could be included in international sovereign bonds. The question arises as to whether there is merit in including such provisions in all other forms of sovereign debt, including domestic debt and

international syndicated bank debt. An analysis of these questions raises issues that go beyond the scope of this paper and are related, for example, to any discussion of the scope of coverage of the SDRM. For this reason, this section only contains a preliminary overview of these issues, and the paper does not draw any conclusions on these questions. Moreover, while it poses the question of whether the inclusion of collective action clauses in a broader range of debt would facilitate the restructuring process, the merits of broader inclusion may also need to be assessed on the basis of other criteria. For example, and as is discussed in the companion paper, if it is concluded that the promotion of collective action clauses is facilitated by having these clauses included in a critical mass of debt, broadening the coverage may facilitate their adoption in international sovereign debt instruments.

A. Domestic Debt

49. To what extent should domestic debt include collective action clauses? Experience demonstrates that, when a sovereign's overall indebtedness is unsustainable, the inclusion of debt denominated in local currency may be necessary for a variety of reasons. First, a restructuring of such debt may be an important ingredient to achieving a sustainable balance of payments position. This is particularly the case for members that have an open capital account. In these cases, debt denominated in local currency can give rise to balance of payments pressures because of the ability of a resident or nonresident to convert and transfer the proceeds of repayment. Second, for reasons of intercreditor equity, foreign creditors may be unwilling to restructure their own claims if domestic creditors are to be paid in full. Finally, the restructuring of domestic debt may be necessary to achieve fiscal sustainability.

50. While it may be necessary to include domestic debt in any restructuring, it is less clear whether this means that collective action clauses need to be included in such debt, at least to the extent to which the debt is both governed by the law of the sovereign and subject to the exclusive jurisdiction of the courts located in the territory of the sovereign.

51. The basis for this view is best understood in light of the overall purpose of the collective action clause. Specifically, given the problem that a collective action clause is designed to address the difficulties arising from an individual bondholders' attempt to disrupt the orderly restructuring of sovereign debt through the enforcement of its legal rights; the critical question is whether this bondholder has a claim that is enforceable in a foreign court. Even if the bond documentation is drafted in a manner that gives an individual bondholder unfettered rights, a maverick bondholder will find it much more difficult to translate these rights into effective leverage against the sovereign and the majority of creditors if its claim is only enforceable in the sovereign's courts. If the debt is governed by the laws of the sovereign, an amendment of these laws may be an effective way to protect its interest. While the constitution of a country may not always permit the government to restructure the terms of its debt through a law or decree, it is generally accepted that a sovereign may, by domestic law, protect its assets from attachment in its own territory.

52. Preliminary contacts with some market participants suggest that many investors also share this view. They have expressed the opinion that a sovereign often has the legal tools to

provide for an orderly restructuring of domestic debt. For them, the critical issue is whether this restructuring will be coordinated with the restructuring of the foreign debt in a transparent manner; i.e. will foreign creditors have adequate assurance on the terms of the domestic restructuring before they are asked to vote on the restructuring of their own claims.

53. One caveat to the above analysis is warranted. In circumstances where the constitution of the sovereign does not permit it to change the terms of its debt through legislation or decree, the primary source of protection will be its domestic sovereign immunity laws, which generally protect its assets from attachment in local courts. This protection will be lost if a foreign court has jurisdiction over the claim, even if the governing law is that of the sovereign debtor. Whether or not a foreign court will have jurisdiction will depend on the private international law rules of the country where the foreign court is located. While the contractual terms will be important (i.e., the sovereign waived its immunities and consented to the jurisdiction of the specified foreign court), it may also depend on whether significant features of the transaction contemplated under the contract were performed in the country where the suit is being brought. Thus, even if the bonds do not confer jurisdiction explicitly upon a foreign court but only provide for repayment in a foreign country (which may arise when the bonds are denominated in foreign currency), they will probably become subject to the jurisdiction of that country's courts.

B. Syndicated Bank Debt

54. International syndicated bank loans generally include "sharing" provisions, which require a bank that has recovered amounts from the sovereign as a result of litigation to share the proceeds of this recovery with other banks within the same syndicate. However, these loans generally do not contain majority restructuring provisions; i.e., provisions which would enable a qualified majority of the banks within the syndicate to bind the entire syndicate to the terms of a restructuring. Should such clauses be included in international syndicated bank debt?

55. This question raises competing considerations. While syndicated bank debt may need to be included in any comprehensive restructuring, it can be argued that majority restructuring provisions are not an essential feature of this debt. Experience demonstrates that commercial banks normally behave in an orderly manner and that the risk of maverick litigation by holdout banks is very limited. As has been discussed in other papers, this behavior is a result of a combination of their ongoing business relationship with the sovereign debtor and moral suasion by supervisors.

56. However, given the evolution of international capital markets, there may no longer be a basis for assuming that syndicated bank debt can be restructured in a more orderly fashion than bonds. As a result of securitization, vulture funds can acquire such debt, as was the case in the recent litigation against Peru. More generally, there is a question as to whether efforts by the official sector to include majority restructuring provisions in all international sovereign bonds while leaving syndicated bank loans untouched will only have the effect of subordinating bonds.

CONCLUSIONS

57. ***Existing Provisions and Structures***. The provisions and structures of many existing international sovereign bonds already provide a legal framework that can help facilitate an orderly restructuring process. The two most critical components of this framework are as follows:

- ***majority restructuring provisions,*** which enable a qualified majority of bondholders to bind all bondholders within the same issue to the financial terms of a restructuring, both before and after a default; and

- ***majority enforcement provisions,*** which enable (i) a qualified majority of bondholders to limit the ability of a minority of bondholders within the same issue to accelerate their claims following a default and (ii) a simple or qualified majority of bondholders to reverse an acceleration that has already occurred. An even more effective type of provision is found in trust deeds governed by English law where, in addition, the right to initiate legal proceedings on behalf of all bondholders is conferred upon the trustee, who is only required to act if requested to do so by the requisite percentage of bondholders. Moreover, the terms of the trust deed will ensure that the proceeds of any litigation are distributed by the trustee among all bondholders.

58. ***Standardizing these Provisions and Structures***. While there is considerable variation among outstanding international sovereign bonds regarding the inclusion or exclusion of the above provisions, this variation is largely due to practice rather than the requirements of the applicable law. In particular, these provisions could be incorporated into all international sovereign bonds governed by the laws of New York or England.[28] However, based on preliminary indications from investors who are frequent purchasers of bonds governed by New York law, the voting thresholds that are typically found in the majority restructuring provisions contained in bonds governed by English law (typically 75 percent) would be unacceptably low in bonds governed by New York law. On the other hand, relying on a voting threshold that requires 95 percent support (as has been proposed by certain investors) may effectively defeat the purpose of the majority restructuring provision.

59. ***Developing New Provisions.*** Any assessment of these clauses needs to take into consideration the extent to which they: (i) make an important contribution to the restructuring process and (ii) are likely to be acceptable to the market. Since a number of design features of these clauses are still unclear and feedback from the market on these clauses has been rather limited, it is too early to draw any firm conclusions. With that important caveat, preliminary analysis suggests that the most promising of the new

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[28] On the inclusion of such clauses in international sovereign bonds governed by German or Japanese law, see Section I.

provisions discussed in Section II is a type of ***representation clause*** (or "engagement" clause). This clause would authorize the trustee of a bondholder syndicate (or its delegate) to act as a channel of communication between a debtor and bondholders as early as possible during the restructuring. While such a provision could play a helpful—but perhaps not a critical—role in the restructuring process, preliminary market reaction to date has been mixed. With respect to the ***initiation clause***, although there is still some uncertainty as to how such a provision would be designed, the market has not yet responded positively to this proposal. Finally, while it would be extremely helpful to introduce ***clauses that aggregate claims across instruments***, designing and implementing such a clause would be difficult and, to date, market reaction to this proposal has been negative.

Examples of Majority Restructuring Provisions and Majority Enforcement Provisions Contained in Bonds Issued under Trust Deeds and Fiscal Agency Agreements

I. Majority Restructuring Provisions

A. Bond issued under Trust Deed[29]

The Trust Deed contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions or the Trust Deed. Any such modification may be made if sanctioned by an Extraordinary Resolution. Any Extraordinary Resolution duly passed will be binding on all Noteholders and Couponholders. A meeting of Noteholders may be convened at any time by the Issuer or the Trustee, and the Trustee (subject to being indemnified to its satisfaction against all cost and expenses thereby occasioned) shall upon written request of Noteholders holding not less than 10 percent. in principal amount of the Notes for the time being outstanding convene such a meeting. The quorum for any meeting convened to consider an Extraordinary Resolution will be two or more persons holding or representing more than 50 percent. in principal amount of the Notes for the time being outstanding, or at any adjourned meeting two or more persons being or representing Noteholders whatever the principal amount of the Notes held or presented, unless the business of such meeting includes consideration of proposals, inter alia, (i) to modify the maturity of the Notes or the dates on which interest is payable in respect of the Notes, (ii) to reduce or cancel the principal amount of, or interest on, the Notes, (iii) to change the currency of payment of the Notes or the Coupons, or (iv) to modify the provisions concerning the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution, in which case the necessary quorum will be two or more persons holding or representing not less than 75 percent. or at any adjourned meeting not less than 25 percent. in principal amount of the Notes for the time being outstanding. Any Extraordinary Resolution duly passed shall be binding on Noteholders (whether or not they were present at the meeting at which such resolution was passed) and on all Couponholders.

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[29]The Islamic Republic of Pakistan, U.S.$150,000,000 Floating Rate Notes due 2000 governed by English law.

The expression "Extraordinary Resolution" means a resolution passed at a meeting of Noteholders duly convened and held in accordance with these provisions by a majority consisting of not less than seventy five percent of the votes cast.

B. Bond Issued under Fiscal Agency Agreement[31]

The Fiscal Agency Agreement contains provisions for convening meetings of Noteholders to consider any matter affecting their interests, including the modification by Extraordinary Resolution of these Conditions. The quorum at any such meeting for passing an Extraordinary Resolution shall be one or more persons holding or representing a clear majority of the principal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons being or representing Noteholders whatever the principal amount of the Notes for the time being outstanding so held or presented, except that at any meeting the business of which includes consideration of proposals, inter alia, (i) to modify the maturity of the Notes, (ii) to reduce or cancel the principal amount of, or interest on, the Notes, (iii) to change the currency of payment of the Notes, (iv) to modify the provisions concerning the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution, (v) to modify the Required Percentage, or (vi) to modify the Default Percentage, the necessary quorum for passing an Extraordinary Resolution shall be one or more persons holding or representing not less than two-thirds, or at any adjourned such meeting not less than one-third, of the principal amount of the Notes for the time being outstanding.

As used in this Condition [_], "Extraordinary Resolution" means a resolution passed at a meeting of the Noteholders duly convened and held in accordance with the provisions contained in these Conditions and the Fiscal Agency Agreement by a majority consisting of not less than three-fourths of the persons voting thereat upon a show of hands or if a poll shall be duly demanded then by a majority consisting of not less than three-fourths of the votes given on the poll. An Extraordinary Resolution passed at any meeting of Noteholders will be binding on all Noteholders, whether or not they are present at the meeting.

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[30] Republic of Croatia, U.S.$300,000,000 7 percent. Notes due 2002 governed by English law.

II. Majority Enforcement Provisions

A. Bond Issued under Trust Deed[32]

Acceleration

If any of the following events ("Events of Default") occurs and is continuing:

[list of events of default],

then, in each and every such case, the Trustee at its discretion may in respect of Notes of any Series, or at the request of Noteholders holding not less than 25 per cent. in aggregate principal amount of the Notes of such Series then outstanding, by notice in writing to the Republic shall, declare the principal amount of all the Notes of such Series to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable upon the date that such written notice is received by the Republic unless prior to such date all Events of Default in respect of all the Notes of such Series shall have been cured; provided that in the case of [specified events of default] the Trustee shall have certified that in its opinion such event is materially prejudicial to the interests of the Noteholders.

Reversal of Acceleration

provided further, that if, at any time after the principal of the Notes of such Series shall have been so declared due and payable, and before any sale of property under any judgment or decree for the payment of the monies due shall have been obtained or entered as hereinafter provided, the Republic shall pay or shall deposit with the Trustee a sum sufficient to pay all matured amounts of interest and principal upon all the Notes of such Series which shall have become due otherwise than solely by declaration (with interest on overdue amounts of interest, to the extent permitted by law, and on such principal of each Note at the rate of interest specified herein, to the date of such payment or deposit) and the expenses of the Trustee, and reasonable compensation to the Trustee, its agents, legal advisers, and any and all defaults under the Notes of such Series, other than the non-payment of principal on the Notes which shall have become due solely by declaration, shall have been remedied, then, and in every such case, the

[32] The Republic of Argentina, US$4,500,000,000 Euro Medium-Term Note Programme governed by English law.

Noteholders holding 75 per cent. in aggregate principal amount of the Notes of such Series then outstanding, after a meeting of Noteholders held in accordance with the procedures described in Condition [_], by written notice to the Republic and to the Trustee, may on behalf of the holders of all of the Notes of such Series waive all defaults and rescind and annul such declaration and its consequences; but no such waiver of rescission and annulment shall extend to or shall affect any subsequent default, or shall impair any right consequent thereon.

Initiation of Legal Proceedings

At any time after the Notes become due and payable, the Trustee may, at its discretion and without further notice, institute such proceedings against the Republic as it may think fit to enforce the terms of the Trust Deed and the Notes, but it need not take any such proceedings unless (a) it shall have been so directed by an Extraordinary Resolution or so requested in writing by Noteholders holding at least 25 per cent. in principal amount of the Notes of the relevant Series outstanding, and (b) it shall have been indemnified to its satisfaction. No Noteholder may proceed directly against the Republic unless the Trustee, having become bound so to proceed, fails to do so within the reasonable time and such failure is continuing.

B. Bond Issued under Fiscal Agency Agreement[33]

Acceleration

If any of the following events (each an "Event of Default") shall occur and be continuing:

[list of events of default],

then, if such event is continuing, holders of at least 25% or more in aggregate outstanding principal amount of the Bonds may, by written demand to [the Issuer] at the office of the Fiscal Agent in New York City, declare the Bonds immediately due and payable, whereupon the entire unpaid principal amount of the Bonds, all interest accrued and unpaid thereon and all other amounts payable in respect of the Bonds shall become and be forthwith due and payable, without presentation, demand, protest or further notice of any kind, all of which are hereby expressly waived by [the Issuer]. Upon receipt by the Fiscal Agent of such written

[33] Republic of Ecuador, US$1,655,395,000 Collateralized Par Bonds due 2025 governed by New York law.

demand, the Fiscal Agent shall give notice thereof to [the Issuer], as provided in the Fiscal Agency Agreement, and to the holders of the Bonds, by publication.

Reversal of Acceleration

After any such declaration, if all amounts then due with respect to the Bonds are paid (other than amounts due solely because of such declaration) and all other defaults with respect to the Bonds are cured, such declaration may be annulled and rescinded by holders of more than 50 percent in aggregate outstanding principal amount of the Bonds (or such other percentage required at a meeting of Bondholders in accordance with Paragraph [_] hereof) by written notice thereof to [the Issuer] at the office of the Fiscal Agent.

The Collective Representation Clause [34]

Coordination with other creditors

(a) In the event that the [Trustee][Fiscal Agent] receives written notice from the Issuer that the Issuer intends to seek a restructuring of the obligations evidenced by the Bonds in the context of a general restructuring of obligations owed to certain other creditors of the Issuer, the [Trustee][Fiscal Agent] is authorized, without the need to convene a meeting of Bondholders or to seek the prior instructions of the Bondholders, to meet with the Issuer, other interested parties and representatives of such other creditors to discuss the circumstances giving rise to the restructuring request, the terms of any proposed restructuring of the Bonds and the proposed treatment of the obligations held by other creditors of the Issuer; provided that the [Trustee][Fiscal Agent] shall have no authority in any such discussions to accept on behalf of any Bondholder, or to bind any Bondholder to, any modification of the terms of the Bonds falling within the proviso to Section [the provision requiring unanimous or super-majority consent to modifications of the payment terms of the Bonds].

(b) In its sole discretion, the [Trustee][Fiscal Agent] may delegate the authority given to it by this Section to participate in such discussions to another entity selected by it, including a committee representing bondholders generally or an entity that acts as a trustee in connection with other bonds of the Issuer. Prior to entering into any such discussions, the [Trustee][Fiscal Agent], or any such delegate, shall advise each other participant in those discussions of the limitation set out in the proviso to clause (a) above. All expenses of the [Trustee][Fiscal Agent], or its delegate, incurred in connection with such discussions shall be for the account of the Issuer.

(c) The authority given to the [Trustee][Fiscal Agent] by this Section shall automatically terminate as of the first meeting of Bondholders to occur following the date on which the [Trustee][Fiscal Agent] receives the written notice from the Issuer referred to in clause (a) above unless the Bondholders shall have passed a resolution at that meeting (or at any adjournment thereof) authorizing the [Trustee][Fiscal Agent] to continue to act in this capacity.

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[34]From Lee Buchheit, *The Collective Representation Clause,* International Financial Law Review, September 1998, pp. 9-11.