PROPOSAL FOR DEBT SUSPENSION LEGISLATION

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Executive Summary

- This is a proposal for a statutory stay on recovering commercial debt repayments owed by low-income countries to free up resources to combat COVID-19.
- The proposal enhances the effect of the Debt Service Suspension Initiative committed to by the G20 and Paris Club official creditors and voluntary arrangements of private creditors.
- The current proposal is time-bound, does not interfere with the underlying contractual rights of parties to the contract and is contingent on the country subject to such claims making a suspension request to the court.

The Proposal

In response to the global economic shock triggered by the Covid-19 pandemic, the G20 and Paris Club announced the Debt Service Suspension Initiative (DSSI) for Poorest Countries on 15 April 2020. The DSSI commits member states official creditors to a time-bound suspension of debt service to eligible countries that request such forbearance.[1] A separate commitment was made by the Institute of International Finance (IIF) to support the DSSI[2] and terms of reference for voluntary private sector participation were published on 28 May 2020.[3]

The aim of this proposal is to give legislative effect to the DSSI with respect to private creditors by granting a statutory standstill to all DSSI-eligible countries on qualifying debt owed by the country that are governed by English law. The proposal covers sovereign bonds, and those qualifying correspond to 90 per cent of the bond contracts owed by countries covered by the DSSI.[4]

The proposal is based on the wording for the Debt Relief (Developing Countries) Act 2010 which prevented creditors of beneficiary countries of the Heavily Indebted Poor Countries Initiative (HIPC) Initiative from recovering an amount of debt in

[1] G20 (2020), 'Communiqué of the Virtual Meeting of The G20 Finance Ministers and Central Bank Governors', Riyadh, Saudi Arabia', 15 April 2020.
[2] Paris Club and IIF (2020), 'Collaboration between the Paris Club and the IIF to Support the DSSI', 30 April 2020.
[3] IIF (2020), 'IIF Letter to IMF, World Bank and Paris Club on a Potential Approach to Voluntary Private Sector Participation in the DSSI', 1 May 2020.
[4] Jubilee Debt Campaign (2020), 'The UK's Role in Supporting the G20 Debt Suspension'.

excess of that consistent with the HIPC Initiative.[5] This proposal is underpinned by a similar rationale to the 2010 Act, i.e. that continuing debt service to commercial creditors at this time diverts resources provided through official debt relief (through the DSSI as well as through other channels, such as the International Monetary Fund (IMF)'s Catastrophe Containment and Relief Trust (CCRT)[6]), intended to free up resources for countries to support health, humanitarian and social and economic measures during the COVID-19 pandemic.

The temporary standstill would be voluntary, as debtor countries would have an option, not an obligation, to rely on it. Thus, whenever a creditor brings legal proceedings before an English court in respect of a qualifying debt, the debtor country is entitled to apply to the court in which the proceedings have been brought to stay the proceedings during the relevant period. In this regard, it is worth noting that the standstill would in no way release the debt of the country, nor amount to a waiver or forbearance on the part of the creditor.

The proposed legislation does not directly intervene in a contract to suspend debt payments, and as such it is still open to creditors to declare a default under the relevant contract. Instead, the legislation mirrors existing insolvency legislation in suspending the link between contractual default and the execution and enforcement of contractual rights, including with the aid of the English courts.

Rationale

The global community, including the UK, has made significant commitments to scale up aid, credit and debt relief to developing countries in the fight against COVID-19.[7] A statutory standstill on debt repayments is necessary to protect resources of low-income countries, especially highly indebted countries, from being diverted to debt service to commercial creditors.

Previous experience with the HIPC Initiative and other Paris Club restructurings has demonstrated that without enshrining debt standstills and/or cancellation into law, private creditors are unlikely to participate fully and give effect to multilaterally organised debt relief initiatives. Despite the voluntary arrangement brokered by the IIF, question marks remain over the efficacy of a voluntary agreement covering a disparate class of creditors and protection against future litigation for missed repayments under a voluntary arrangement.[8]

Reliance on a purely voluntary arrangement may also generate collective action problems in which a group of private creditors would seek to benefit from the increased repayment capacity of eligible countries, generated by the official debt standstill, in order to keep obtaining debt repayment in full during this challenging time. The current situation poses the classic free-rider problem, in which some creditors may not engage in the initiative in the hope that they can free ride on the concessions offered by other creditors. This would create a strong incentive for otherwise cooperative creditors to refuse participation in the DSSI, thus undermining the arrangement as a whole.

Since most potentially eligible private debt is governed by English law, this situation has significant legal and political implications for the UK. If the DSSI is not accompanied by a statutory standstill for private debt, English courts (more than any other jurisdiction) could end up enforcing the debts of private creditors free-riding on the DSSI, CCRT and other debt relief measures funded by the UK taxpayers.

This could give rise to the same situation which provided the impetus for the aforementioned 2010 Act, i.e. the purchase of distressed debt on the secondary markets by speculative investors with the aim of recovering the full-face value at a later date.[9] The aforementioned 2010 Act was enacted to prevent this free-rider problem and together with similar legislation in other

[5] HM Government (2011), 'Explanatory Memorandum to the Debt Relief (Developing Countries) Act 2010 (Permanent Effect) Order 2011'.
[6] IMF (2020), 'IMF Executive Board Approves Immediate Debt Relief for 25 Countries', 13 April 2020.

[7] IMF (2020), 'Policy Responses to COVID-19: Policy Tracker'.
[8] Jubilee Debt Campaign (2020), note 5.
[9] See Waibel, M (2007), 'Elusive Certainty: Implications of Donegal vs Zambia', *International Financial Law Review* 31-4.

jurisdictions, such as Belgium and France,[10] have successfully prevented predatory behaviour that is jeopardising multilateral collective action on sovereign debt and development.

Reliance on contract law provisions to give effect to the DSSI and other debt relief measures is also inadequate. For example, reliance on 'force majeure' clauses or the doctrine of frustration to set aside contractual debt service obligations, leaves too much uncertainty as to what constitutes a reasonable circumstance under which to vary or set aside the contract and does not necessarily deal with events. The difficulty with leaving negotiation of force majeure to private parties is that this places an onus on those parties to identify exactly that which they did not expect to occur, and to rationally weigh and assume the risks of what can be macroeconomic events.

Outwith specialist insurance markets this places an undue planning burden on private parties, and in no way advances the possibility of a coordinated response to the pandemic. Unsurprisingly then, the average finance contract does not contain an explicit force majeure clause at all. The contractual burden of events such as the pandemic fall almost entirely on the side of borrowers.

The only way to deal with these gaps in the law as it stands is through legislative intervention. A temporary standstill in the enforcement of debt contracts in this case serves the role of completing incomplete debt contracts. The temporary standstill legislation would establish the unenforceability of performance in ways that the reasonable contracting parties would have wanted should they had been able to predict this contingency.

A statutory standstill at this critical juncture to give effect to the DSSI sends a similar message that the UK government is committed to ensuring that low-income countries, especially highly indebted states, have at their disposal the full amount of financial resources available to them. It will also ensure that the other significant financial packages announced by the UK government to support developing countries in these times of crisis,[11] in the form of bilateral overseas development aid (ODA) and contributions to other multilateral financial initiatives, are not diluted and/or diverted to debt service and acting as an indirect subsidy to private creditors.

Implications

There are some concerns that a statutory standstill may constitute undue intervention in private debt contracts governed by English law and that this will have negative ramifications on the UK legal and financial services.

However, as the discussion above demonstrates, legislation would bring some certainty to the enforcement of debt contracts. Far from undermining credit markets, it would support these markets. Research shows that public interventions to suspend debt payments do not automatically undermine credit markets or undermine freedom of contracting.[12] In fact, they have had the opposite effect in some cases by resurrecting debt markets following the adoption of such measures.[13] The reason why debt markets recovered was that creditors had anticipated widespread default in the absence of any modification of the repayment terms.

By temporarily suspending the debt payments, the risk of an outright default was reduced. The effect of the stay of enforcement in no way releases the debtor from the liability to pay, nor does it constitute a waiver of the debt or other forbearance by the creditor. The debt remains in place and interest continues to accrue; all the

[10] See EURACTIV (2015), 'Belgium Adopts Law Against 'Vulture Funds'' and Jubilee Debt Campaign (2017), 'France Passes Law to Clip Vulture Funds' Wings'.
[11] Trevelyan, A (2020), 'To Protect our own Populations and Economies from COVID-19, the World Must Work'. Together', *The Telegraph*, 9 April 2020.
[12] See Bolton, P et al (2020), 'Necessity is the Mother of Invention: How to Implement a Comprehensive Debt Standstill for COVID-19 in Low- and Middle-Income Countries', CEPR Policy Portal, 21 April 2020.
[13] Kroszner, R (2003), 'Is it Better to Forgive Than to Receive? Repudiation of the Gold Indexation Clause in Long-term Debt During the Great Depression', Working Paper 481, University of Chicago, Graduate School of Business; Edwards, E et al (2015), 'The US Debt Restructuring of 1933: Consequences and Lessons', NBER Working Paper No 21694.

standstill does is suspend the right of creditors to execution and enforcement for a specified period.

In suspending the right to enforce legal claims, the proposed legislation foresees a continued role for the parties to bargain in the shadow of the law.[14] The proposed standstill amounts to a variation of the balance of negotiating power between the parties, removing the 'nuclear option' of legal proceedings from the table for a short period. We do not, however, expect parties to do nothing; in the changed circumstances parties should, and very likely will, negotiate a route through this crisis. By certifying through legislation that the COVID-19 crisis is a highly unusual and extraordinary event which the parties could not have reasonably described in the contract, the UK Parliament would ensure that no floodgates will be opened in English law to modify contract terms unless absolutely necessary.

The idea of a standstill during this unprecedented crisis is also supported by the doctrine of necessity in international law. This doctrine establishes that in exceptional circumstances, states may need to terminate or suspend the performance of their financial obligations – either governed by private contracts or treaties – in order to safeguard an essential interest against a grave and imminent peril.[15] This can be done provided that non-compliance by one state does not seriously impair an essential interest of the state or states to which the obligation exists, or the international community as a whole. It is argued that the COVID-19 public health emergency satisfies all these criteria.

Conclusion

The proposed legislation relieves pressure on debtor countries by blunting private creditor threats to sue. The stay of enforcement does not introduce any changes in the substantive obligations contracted by the parties. Thus, the standstill will only temporarily suspend the execution and enforcement of eligible financial obligations during the designated period. Meanwhile, interest on the principal will continue to accrue.

Enshrining a standstill in law will demonstrate the UK's leadership in global COVID-19 responses and reinforce its commitment to ensuring low-income countries have access to all the financial resources they need to contain COVID-19 and recover from this unprecedented health, social and economic crisis.

It is recognised that the current proposal is limited in resolving the longer-term debt burden of developing countries, but it is hoped that it will serve as an emergency measure to enable breathing space for countries while more comprehensive and sustainable mechanisms are being developed.

This proposal was developed by members of The IEL Collective Law and Finance Working Group in conjunction with the Jubilee Debt Campaign, UK and Oxfam GB.

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[14] Mnookin, R and Kornhause, L (1979), 'Bargaining in the Shadow of the Law: The Case of Divorce', *Yale Law Journal* 88(5).

[15] See Ohlin, DJ and May, L (2016), *Necessity in International Law*, Oxford University Press.