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The G20 Debt Service Suspension Initiative: what of commercial creditors?

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- The Debt Service Suspension Initiative (DSSI) for Poorest Countries provides for a time-bond suspension of debt repayments to public creditors.
- Commercial creditors are not so bound.
- Earlier this year there was an initiative to introduce a moratorium on debt service on English law governed contracts, which was considered as part of the Corporate Governance and Insolvency Bill.

Introduction

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] Yet even though the G20 'called upon' commercial creditors to support the DSSI and develop similar terms of reference for voluntary private sector participation in the initiative, the Institute of International Finance (IIF) expressed several reservations in this regard.[2]

At the request of NGOs and members of the City of London legal community, the authors prepared a timely legislative proposal designed to support the DSSI. Draft legislation was presented to the Treasury for potential inclusion in what was the Corporate Insolvency and Governance Bill 2020. While ultimately it was determined that the proposal did not 'fit' with the UK-focused aims of that Bill, the issues which drove the proposal – not least the absence of commercial creditor engagement with the DSSI – remain. This briefing serves as intelligence for those interested in various initiatives designed to reform sovereign debt restructuring, and as an example of the kind of surgical legislative intervention possible at this time.

The proposal

The aim of the proposal was to give legislative effect to the DSSI to private creditors by granting a statutory standstill to all eligible countries on qualifying bonds owed by the country that are governed by English law. These correspond to 90 per cent. of the bond contracts owed by countries covered by the DSSI.[3]

The proposed legislation was based on the wording for the Debt Relief (Developing Countries) Act 2010, which prevented creditors of beneficiary countries of the Heavily Indebted Poor Countries (HIPC) Initiative from recovering amounts in excess of that consistent with the HIPC Initiative. In essence, it identifies qualifying debt and grants debtor states the option to seek a moratorium on execution and enforcement of that debt in the UK, in a manner similar to the insolvency moratorium

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[1] G20, 'Communiqué of the Virtual Meeting of The G20 Finance Ministers and Central Bank Governors', Riyadh, Saudi Arabia, 15 April 2020 <http://www.g20.utoronto.ca/2020/2020-g20-finance-0415.html#a2>.

[2] IIF Letter to IMF, World Bank and Paris Club on a Potential Approach to Voluntary Private Sector Participation in the DSSI, 1 May 2020 <https://www.iif.com/Publications/ID/3885/IIF-Letter-To-IMF-World-Bank-and-Paris-Club-On-a-Potential-Approach-to-Voluntary-Private-Sector-Participation-in-the-DSSI>.

[3] Jubilee Debt Campaign, 'The UK's Role in Supporting the G20 Debt Suspension' (2020) <https://jubileedebt.org.uk/wp-content/uploads/2020/04/The-UKs-role-in-supporting-the-G20-debt-suspension_04.20.pdf>.

one finds in Schedule B1, Insolvency Act 1986. In other words, it amounts to a statement by the UK that while it respects contractual obligations, it regards it as unseemly that the courts of England & Wales be used to support debt enforcement which undermines international initiatives to which it is a party.

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 official debt relief – provided through the DSSI or other channels such as the International Monetary Fund (IMF)'s Catastrophe Containment and Relief Trust (CCRT)[4] –intended to free up resources for countries to support health, humanitarian and social and economic measures during the COVID-19 pandemic. It remains on the table.

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 may apply to the court in which the proceedings have been brought to stay the proceedings during the relevant period. 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.

Rationale

As the Jubilee Campaign has shown, there are question marks 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.[5]

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.

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 of potentially eligible private debt is governed by English law, this situation has significant legal and political implications for the UK. We argue that if the DSSI is not accompanied by a statutory standstill for private debt, English courts (more than any other jurisdiction) could end

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[4] IMF, 'IMF Executive Board Approves Immediate Debt Relief for 25 Countries', 13 April 2020 <https://www.imf.org/en/News/Articles/2020/04/13/pr20151-imf-executive-board-approves-immediate-debt-relief-for-25-countries>.

[5] Jubilee Debt Campaign, 'The UK's Role in Supporting the G20 Debt Suspension' (2020) <https://jubileedebt.org.uk/wp-content/uploads/2020/04/The-UKs-role-in-supporting-the-G20-debt-suspension_04.20.pdf>.

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 2020 Act, i.e. the purchase of distressed debt on the secondary markets by speculative investors with the aim of recovering the face value at a later date.[6] The 2010 Act was enacted to prevent this free-rider problem and together with similar legislation in other jurisdictions, such as Belgium[7] and France,[8] has successfully prevented predatory behaviour that is jeopardising multilateral collective action on sovereign debt.

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 did not expect to occur, and to rationally weigh and assume the risks of what can be macroeconomic events. Outside of 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 those contracts. The temporary standstill legislation would establish the unenforceability of performance in ways that the reasonable contracting parties would have wanted had they been able to predict this contingency.

A statutory standstill to give effect to the DSSI sends a 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, including through the Department for International Development (DFID),[9] 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.

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.

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[6] See Michael Waibel, 'Elusive Certainty: Implications of Donegal vs Zambia' (*International Financial Law Review* 2007) 31-3 <http://www.iflr.com/Article/1977093/IFLR-magazine/Elusive-certainty.html> accessed 2 May 2020.

[7] Loi du 12 juillet 2015 relative à la lutte contre les activités des fonds vautours, 11 septembre 2015.

[8] Article 60, Loi n° 2016-1691 du 9 décembre 2016 relative à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique.

[9] Anne-Marie Trevelyan, 'To Protect our own Populations and Economies from COVID-19, the World Must Work Together' (*The Telegraph*, 9 April 2020) <https://www.telegraph.co.uk/global-health/science-and-disease/protect-populations-economies-covid-19-world-must-work-together/>.

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.[10] In fact, they have had the opposite effect in some cases by resurrecting debt markets following the adoption of such measures.[11] 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.

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.[12] 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.

[10] See Patrick Bolton et al, '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) <https://voxeu.org/article/debt-standstill-covid-19-low-and-middle-income-countries>.

[11] Randall Kroszner, '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 (2003); Sebastian Edwards et al, 'The US Debt Restructuring of 1933: Consequences and Lessons', NBER Working Paper No 21694 (2015).

[12] Robert Mnookin and Lewis Kornhause, 'Bargaining in the Shadow of the Law: The Case of Divorce' (1979) 88(5) *Yale Law Journal* 950.

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