Manuscript version: Published Version
The version presented in WRAP is the published version (Version of Record).

Persistent WRAP URL:
http://wrap.warwick.ac.uk/144584

How to cite:
The repository item page linked to above, will contain details on accessing citation guidance from the publisher.

Copyright and reuse:
The Warwick Research Archive Portal (WRAP) makes this work by researchers of the University of Warwick available open access under the following conditions.

Copyright © and all moral rights to the version of the paper presented here belong to the individual author(s) and/or other copyright owners. To the extent reasonable and practicable the material made available in WRAP has been checked for eligibility before being made available.

Copies of full items can be used for personal research or study, educational, or not-for-profit purposes without prior permission or charge. Provided that the authors, title and full bibliographic details are credited, a hyperlink and/or URL is given for the original metadata page and the content is not changed in any way.

Publisher’s statement:
Please refer to the repository item page, publisher’s statement section, for further information.

For more information, please contact the WRAP Team at: wrap@warwick.ac.uk
The G20 Debt Service Suspension Initiative: what of commercial creditors?

Draft legislation, for potential inclusion in the Corporate Insolvency and Governance Bill 2020 (CIGB), to introduce a moratorium on debt service on English law governed sovereign bond contracts entered into by highly indebted states, to free up resources for those countries to support health, humanitarian and social and economic measures during the COVID-19 pandemic, was blocked at the last minute. Whilst the proposal did not fit with the UK-focused aims of CIGB 2020 the issues remain and are discussed in this article.

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 one finds in Sch 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 and 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, 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) – 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.

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 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.
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 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, ie the purchase of distressed debt on the secondary markets by speculative investors with the aim of recovering the face value at a later date. The 2010 Act was enacted to prevent this free-rider problem and together with similar legislation in other jurisdictions, such as Belgium and France, 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 they 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 co-ordinated 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), 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.

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

---

4 IMF, IMF Executive Board Approves Immediate Debt Relief for 25 Countries’


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.


Further Reading:
- LexisPSL: Preying on distressed debt: limiting the scope for transfer to vulture funds.