



## ***Debt Relief (Developing Countries) Bill***

**Bill 17 of 2009-10**

**RESEARCH PAPER 10/17** 25 February 2010

This Paper has been prepared for the Bill's Second Reading debate in the House of Commons. This is a Private Member's Bill, introduced by Andrew Gwynne MP on 16 December 2009. It was published on 19 February 2010, with Second Reading scheduled for 26 February. The Government has previously consulted on legislation in this area, and supports this Bill, subject to certain conditions.

The Bill seeks to limit the amount that can be recovered by any commercial creditor of those countries designated as having unsustainable external debts. The legislation would restrict the activities of so-called 'vulture funds', which buy developing countries' sovereign debt at discounted prices, then seek to recover its value in full through the courts. It would limit successful claims to an internationally agreed level, and it would apply equally to all commercial creditors. It would cover the 40 countries in the IMF/World Bank Heavily Indebted Poor Countries (HIPC) initiative. Debts incurred after the Bill's entry into force would be excluded.

This Bill has some similarities to, though is less wide-ranging than, legislative proposals introduced contained in a ten minute rule Bill in the 2008-09 Parliamentary session.

Ian Townsend

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## Research Paper 10/17

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### Acronyms used

CAFOD	Catholic Agency for Overseas Development
DFID	Department for International Development
DRF	World Bank Debt Reduction Facility
ECHR	European Convention on Human Rights
EMTA	Emerging Markets Trade Association
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development (part of World Bank)
IDA	International Development Association (part of World Bank)
IIF	Institute for International Finance
IMF	International Monetary Fund
MDRI	Multilateral Debt Relief Initiative
NGO	Non-governmental organisation
SCIAF	Scottish Catholic International Aid Fund
SDRM	Sovereign debt restructuring mechanism

## Summary

The *Debt Relief (Developing Countries) Bill* is a Private Member's Bill introduced by Andrew Gwynne MP. The Bill seeks to limit the amount that can be recovered by any commercial creditor of those countries designated as having unsustainable external debts. It would apply to the 40 countries eligible for the IMF/World Bank Highly Indebted Poor Countries (HIPC) initiative which aims to give those countries a 'fresh start' and free up funds for poverty reduction and development.

The legislation would apply to all commercial creditors of these countries. It would limit the amount of debt that could be successfully claimed for in UK courts to the internationally agreed level necessary to reduce that country's debt to a sustainable level.

Debt incurred after the Bill's entry into force would be excluded, as would debts incurred after 'decision point' in the HIPC process, at which a country is deemed to be eligible for debt relief. However, the Bill would not generally apply in cases where debtor countries do not offer to settle with their creditors on HIPC terms. The Bill uses established IMF/World Bank definitions of public external debt.

This Bill would have the effect of restricting the activities of so-called 'vulture funds', which buy developing countries' sovereign debt at discounted prices, then seek to recover its value in full through litigation. These 'vulture funds' have been targeted by non-governmental organisations, notably the Jubilee Debt Campaign coalition of NGOs.

The UK has a distinctive role in this issue, as international business contracts are often based on English law, which is used to enforce them if necessary

This Bill has similarities with, though is less wide-ranging than, the *Developing Country Debt (Restriction of Recovery) Bill* introduced under the ten minute rule in the 2008-09 session. Legislative proposals have also been introduced in the US (the Stop VULTURE Funds Act).

The Treasury had previously consulted on possible legislation in this area in July 2009. The Economic Secretary to the Treasury has indicated that the Government supports this Bill. Its response to this consultation was published alongside the Bill on 19 February 2010.

A range of issues were raised in the consultation process. Financial services sector responses were generally opposed to legislation, whereas NGOs were in favour.

The arguments made by those against legislation included: 'in principle' objections; human rights and other legal issues; an inaccurate characterisation of the issue; an overestimation of the scale of the problem; an underestimation of the knock-on effects of legislation (including the effect on markets); that existing mechanisms were effective; and the potential negative effect on the UK as a financial services centre.

Those in favour of legislation made arguments that fell into two broad categories: economic (addressing the market failure and free-riding of creditors holding out against debt relief settlements) and developmental (reducing debt to sustainable levels and releasing aid for development, and ending the diversion of aid through debt relief to commercial creditors).

However, those in favour of legislation also called for it: to have a wider coverage than HIPC countries alone; to cover newly incurred debts; and to prohibit excessive profiteering by 'vulture funds'. There were also calls for greater transparency requirements for companies bringing cases against developing countries, and further work towards an internationally agreed 'sovereign debt restructuring mechanism' for bankrupt countries as exists for bankrupt companies.

## 1 Introduction

The *Debt Relief (Developing Countries) Bill* is a Private Member's Bill introduced by Andrew Gwynne MP. It was introduced in the House of Commons on 16 December 2009. The Bill was published on 19 February 2010 [[Bill 17 of 2009-10](#)], along with [explanatory notes](#) prepared by the Treasury.

The Bill seeks to limit the amount that can be recovered by commercial creditors from certain debtor countries that have been designated as having unsustainable external debts. In doing so, it would regulate the activities of hedge funds and investment funds that buy developing countries' sovereign debt at discounted prices, then seek to recover its value in full through the courts. These have been termed 'vulture funds' by their critics.

The Treasury [consulted](#) on possible legislation in July 2009, and published its [response](#) alongside the Bill on 19 February 2010 (see parts [4](#) and [5](#) respectively).<sup>1</sup> The Government has indicated its support for the Bill (see part [6](#)), which is scheduled to have its Second Reading on 26 February 2010.

This research paper:

- provides a brief history and background on sovereign debt relief and 'vulture funds';
- examines previous related UK initiatives and previous legislative proposals;
- summarises international initiatives, and legislative proposals in other countries;
- provides a selected summary of the issues raised through the Treasury's consultation process; and
- summarises the content of the Bill itself.

## 2 Sovereign debt relief & 'vulture funds'

### 2.1 A history of sovereign debt relief

After amassing external debt in the 1970s and 1980s, there was growing recognition that some developing countries had levels of debt that were unsustainable, and were unlikely to be repaid in full.

Bilateral creditors (such as members of the Paris Club,<sup>2</sup> an informal grouping of creditor countries) had previously rescheduled and forgiven debt. However, amid concerns that debt relief was failing to meet poverty reduction goals, there were calls, including a campaign by non-government organisation (NGOs), through the Jubilee 2000 coalition, for a new initiative that would also involve multilateral creditors, such as the IMF and World Bank.<sup>3</sup>

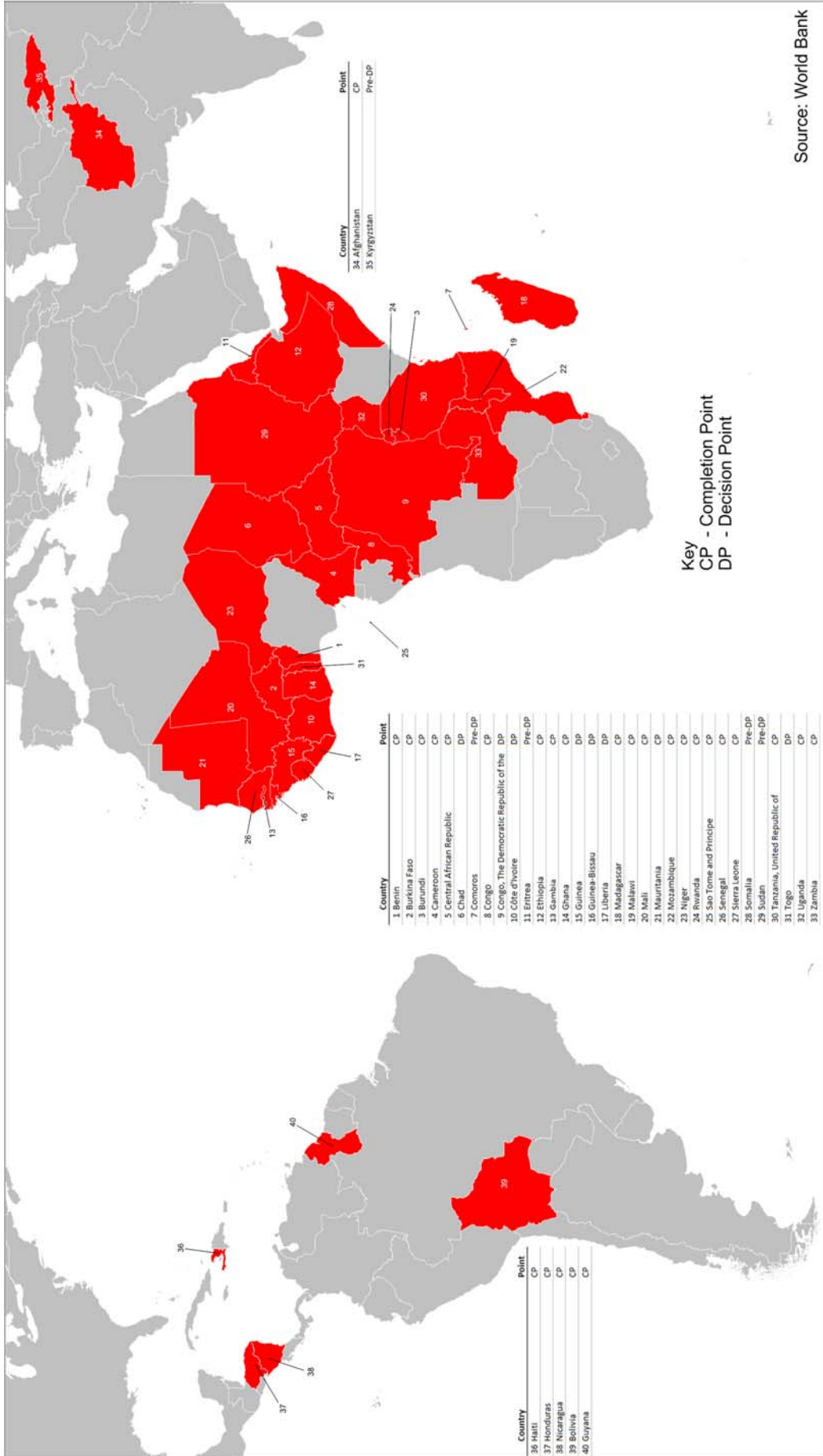
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<sup>1</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009 and

<sup>2</sup> The [Paris Club](#) "is an informal group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries." It has 19 permanent members (Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, the Russian Federation, Spain, Sweden, Switzerland, the UK and the US). Other creditor countries may take part in negotiations on an ad hoc basis subject to conditions, while international financial institutions or other countries can be invited to attend as observers (from <http://www.clubdeparis.org/sections/composition/membres-permanents-et>).

<sup>3</sup> See also "[Debt Relief for Poor Countries](#)", IMF Finance & Development magazine (37:4), December 2000

Map showing HIPC initiative countries



The Jubilee Debt Campaign, which has led a campaign in support of the aims of this Bill, is a coalition of British non-governmental organisations and the successor to the original Jubilee 2000 campaign in the UK.

### ***The Heavily Indebted Poor Countries (HIPC) initiative***

The Heavily Indebted Poor Countries (HIPC) initiative was launched in 1996 by the International Monetary Fund (IMF) and World Bank (through its concessional finance arm, the International Development Association, IDA).<sup>4</sup>

As the World Bank states, it “aims to provide a fresh start to countries with a foreign debt that places too great a burden on export earnings or fiscal revenues.”<sup>5</sup> It offers countries with unsustainable external debts relief from that debt. It calls for such relief to be offered by all creditors, which is given on a voluntary basis.

In 1999, following criticisms of the original HIPC initiative, it was ‘enhanced’ to cover more countries, deepen relief, and strengthen its link with poverty reduction. The HIPC process can enable a country’s to write off around 90% of their debt.

Eligibility is determined by countries having low income and unsustainable debts.<sup>6</sup> A ‘sunset clause’ took effect at the end of 2006, but the IMF and World Bank chose to extend the HIPC initiative to countries meeting its income and indebtedness criteria using figures as at the end of 2004. This allowed countries that had not met the policy conditions for the initiative at that time to remain eligible if they did meet them at some point in the future.<sup>7</sup>

There are two main stages to the HIPC process, which are relevant for the Bill:

- At **decision point**, a country is considered to be eligible for debt relief, and must have set out a plan to reduce poverty (an interim Poverty Reduction Strategy Paper) and have demonstrated macro-economic stability. At this stage debts are reduced proportionately to a sustainable level (generally based on external debt as a ratio to exports), with immediate relief from debt service payments from Paris Club (creditor) countries. Debt relief can be suspended under certain circumstances, such as failure to maintain macroeconomic stability.
- At **completion point**, a country receives full and irrevocable reduction in their debt under the initiative. That country must have maintained macroeconomic stability, implement those ‘trigger’ reforms agreed at decision point and have implemented its poverty reduction plan for a year. The UK and some other creditors go further, and cancel 100% of the debt owed to them.<sup>8</sup>

An annual review in 2009 found “very significant progress” in implementing the HIPC initiative, with 35 out of 40 HIPC countries reaching decision point and 26 reaching completion point by the end June 2009, and with more countries “well placed to progress

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<sup>4</sup> For more information on the HIPC initiative, see Library note, [Debt relief for developing countries \(SNEP/1365\)](#) [currently available on the Parliamentary intranet only], DFID’s [HIPC summary](#), HM Treasury [HIPC pages](#), IMF [factsheet](#) and [HIPC publications page](#), and World Bank [HIPC page](#) (including [summary](#) and [country list](#)).

<sup>5</sup> World Bank, [Debt relief at a glance](#), updated October 2009

<sup>6</sup> Specifically: countries that “(i) are eligible only for highly concessional assistance such as from the World Bank’s International Development Association (IDA) and the IMF’s Poverty Reduction and Growth Facility (formerly called Enhanced Structural Adjustment Facility); (ii) face an unsustainable debt situation even after the full application of traditional debt relief mechanisms; and (iii) have a proven track record in implementing strategies focused on reducing poverty and building the foundation for sustainable economic growth” (from World Bank [Economic Policy and Development: Frequently Asked Questions](#), undated).

<sup>7</sup> World Bank, [Debt relief at a glance](#), updated October 2009

<sup>8</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 2.6



towards completion point”.<sup>9</sup> So far, \$57.3 billion of debt relief has been provided to post-completion point and post-decision point HIPC countries. A further \$16.6 billion is expected to be provided to those HIPC countries that are yet to reach decision point, leading to total debt relief of \$73.3 billion.<sup>10</sup>

By January 2010, Afghanistan and the Republic of Congo had also reached completion point.<sup>11</sup> Of the 35 countries that have reached decision point so far, 29 are in Africa. Five countries (Comoros, Eritrea, Kyrgyz Republic, Somalia and Sudan) wish to use the initiative, but have not yet reached decision point.<sup>12</sup> Some countries that met the eligibility criteria for HIPC have opted not to take part in it (Bhutan, Laos, Nepal and Sri Lanka).<sup>13</sup>

### ***Gleneagles G8 debt commitments***

At the Gleneagles Summit in July 2005, under the UK’s G8 presidency in that year, G8 leaders made commitments to provide debt relief (and aid), in recognition of the fact that without such commitments the United Nations’ Millennium Development Goals for reducing poverty would not be met.

In the Gleneagles communiqué, the G8 agreed to cancel 100% of IMF, World Bank and African Development Fund debts for eligible HIPC countries. Department for International Development (DFID) recently outlined progress against the debt commitments made at Gleneagles:<sup>14</sup>

28 countries - 22 of which are African - have received 100% debt cancellation including Malawi, Rwanda, Zambia, Cameroon and Sierra Leone.

Last month, Afghanistan and the Republic of Congo reached [HIPC] completion point.

Seven other African countries can achieve full cancellation of debts when they meet the necessary conditions.

Full financing and implementation of the Heavily Indebted Poor Countries Initiative (HIPC) which has delivered debt relief worth over \$117 billion alongside the Multilateral Debt Relief Initiative (MDRI).

Burundi has used \$89 million HIPC funding to continue to support free primary education, building over 1000 additional classrooms, and free health services for children under five and for women in childbirth.

## **2.2 Debt relief & ‘vulture funds’**

The HIPC process identifies those countries that have unsustainable debts, but it is a voluntary arrangement. Countries offering debt relief retain the legal right to claim their

<sup>9</sup> “[Debt Relief and Continued Flexibility Alleviate the Debt Burdens of Poor Countries](#)”, a World Bank summary of World Bank/IMF, [HIPC Initiative and MDRI - Status of Implementation](#), 15 September 2009

<sup>10</sup> These figures are all in Net Present Value (discounted) terms as at the end of 2008). Source: World Bank/IMF, [HIPC Initiative and MDRI - Status of Implementation](#), 15 September 2009, table 2, p7

<sup>11</sup> DFID, [HIPC Progress Table](#), January 2010

<sup>12</sup> World Bank, [HIPC & MDRI briefing](#) for 2009 IMF/World Bank Annual Meetings

<sup>13</sup> Nepal was added to this group more recently, reducing the number of HIPC countries from 41 to 40 (see World Bank, [HIPC & MDRI briefing](#) for 2008 IMF/World Bank Annual Meetings and World Bank/IMF, [HIPC Initiative and MDRI - Status of Implementation](#), 15 September 2009, p6

<sup>14</sup> “[Meeting our Gleneagles commitments](#)”, DFID release, 3 February 2010. See also Library research paper [Gleneagles G8 commitments on debt relief and aid – two years on](#) (RP07/51) for more information.

debt,<sup>15</sup> at least until the debtor and creditor reach a bilateral agreement in line with the HIPC initiative.

While bilateral Paris Club creditor countries and major multilateral institutions do take part on this basis, “not all other sovereign creditors and commercial creditors have provided the same degree of relief.”<sup>16</sup>

### ***What is a ‘vulture fund’***

In July 2009, the Treasury described “so-called ‘vulture funds’” as those which:<sup>17</sup>

[...] buy up defaulted debts at very low prices when a country is in economic distress and aggressively litigate to recoup the debt’s full value.

These creditors “do not co-operate with international debt relief initiatives and instead seek to exploit the debt relief being delivered by the UK, and other creditors, by litigating to extract the full nominal value of these debts through the courts.”<sup>18</sup> Indeed, the Treasury states that vulture funds’ “sole intention” is “litigating for full repayment and extracting a profit at the expense of the country and of other creditors that provide relief”.<sup>19</sup>

The term ‘vulture funds’ is taken to refer to particular private investors, such as hedge funds and investment funds, that buy debt at low prices in secondary markets, discounted (often heavily) by the owner of the debt because of reduced likelihood of full repayment, and then attempt to recover the full value of that debt (including interest and fees) through court proceedings. While the term can refer to the debt of any entity, including that of companies, in the context of this Bill it refers to a country’s sovereign debt.

### ***Why are ‘vulture funds’ considered to be a problem?***

Litigation in pursuit of a debt can be an expensive and time-consuming process, and although a successful judgement may be made, enforcing the judgement for payment can be more difficult. Enterprises that are solely involved in such activities may be more likely to succeed, and at lower costs, than holders if the debt which are not so specialised.

Not all commercial creditors are considered ‘vulture funds’, although the two are often conflated. A 2009 IMF/World Bank report found that expected HIPC debt relief from commercial creditors was \$4.3 billion.<sup>20</sup> According to a July 2009 Treasury document, commercial creditors account for just under 6% of the total debt relief expected, of which around one third has been provided.<sup>21</sup>

An active secondary (reselling) market in sovereign debt is “a fundamental feature of sovereign borrowing and lending”, according to the African Development Bank, because:<sup>22</sup>

When creditors can freely sell the debt they hold on the secondary market, there is less risk involved in lending to sovereigns, and creditors are therefore more likely to provide the capital sovereigns [countries] need.

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<sup>15</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 2.9

<sup>16</sup> *ibid.*, para 2.5

<sup>17</sup> “[Legislation to ensure effective debt relief for poor countries](#)”, HM Treasury press release 69/09, 21 July 2009

<sup>18</sup> *ibid.*

<sup>19</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 1.2

<sup>20</sup> World Bank/IMF, [HIPC Initiative and MDRI - Status of Implementation](#), 15 September 2009, table 2 page 7

<sup>21</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 2.8

<sup>22</sup> “[Vulture Funds in the Sovereign Debt Context](#)”, African Development Bank (undated)

A domestic analogy would be that stock market investors are more willing to buy shares in a company when they know they can sell them back easily.

The activities of ‘vulture funds’ undermine debt relief initiatives such as HIPC. As debt relief improves the financial situation of a developing country, it increases the prospect of repayment of the debt owned by the ‘vulture funds’. Where litigation is successful, the resources freed up by debt relief, and intended for poverty reduction and development purposes, are diverted instead to the ‘vulture fund’ – which receives more than they paid for the previously discounted debt that might otherwise have been written off.

A ‘free rider’ problem arises from the fact that there is not an insolvency process for countries in the same way as there is for companies (discussed further in part 5.2), This means that a single creditor or group of creditors can ‘hold out’ on their claim, and benefit while other creditors accept a reduction in their claims. As the Treasury outline:<sup>23</sup>

[...] one creditor can refuse to participate in the necessary debt reduction. Once others have reduced their claims by the necessary amount, and the debtor country’s ability to repay recovers, the creditor that held out can pursue their debt claims for full value, at the expense of the debtor country – and, indirectly, at the expense of the other creditors.

The African Development Bank has also stated the following on ‘vulture funds’:<sup>24</sup>

In some instances, prior to decision point some HIPCs have paid commercial creditors in full either because of the litigation or the threat of litigation, a desire to avoid disrupting a commercial relationship, or the fear of losing productive assets in cases where commercial debt was secured by collateral.

The vulture fund modus operandi is simple: purchase distressed debt at deep discounts, refuse to participate in restructuring, and pursue full value of the debt often at face value plus interest, arrears and penalties through litigation, if necessary. The vulture funds grind down poor countries in cycles of litigation, a practice referred to as “champerty” and largely unknown in African legal systems. Litigation is typically protracted with many lawsuits taking three to ten years to “settle.” Legal documents indicate six years as a conservative medium estimate for recovery, which suggests that annualized returns average 50 to 333 percent. Some of these claims were bought at roughly 10 percent of face value, implying very high gross recovery rates. Subtracting legal costs, often recouped from the sovereign, these recovery rates are probably the highest in the distressed debt market.

The African Development Bank also notes that the IMF “foresees a risk of taxpayer backlash in the affected creditor countries when taxpayers realize the amount of their taxes being used to pay claims from vulture funds.”<sup>25</sup>

‘Vulture funds’ have also been criticised for being ‘shell’ companies often based in tax havens. Jubilee Debt Campaign USA have noted that the basing of these funds in ‘tax havens’ such as the British Virgin Islands and the Cayman Islands meant their activities lacked transparency, and made their “actions and their principal beneficiaries almost impossible to follow.”<sup>26</sup>

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<sup>23</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 2.10

<sup>24</sup> “[Vulture Funds in the Sovereign Debt Context](#)”, African Development Bank (undated)

<sup>25</sup> *ibid.*

<sup>26</sup> “[UK Judge Awards Funds \\$20 million](#)”, Jubilee Debt Campaign USA (un-dated), see also part 5.5.

### **Defences of 'vulture funds'**

A 2007 *Foreign Policy* article noted that: "Colloquially, if somewhat invidiously, referred to as 'vulture funds', [...] hedge funds fight governments to ensure they pay what they owe".<sup>27</sup>

Poverty activists say these so-called vulture funds are preying on the impoverished. But they're only doing what the international financial system can't -- holding corrupt and irresponsible regimes to account. [...] they do what most Western banks aren't inclined to do and what individual investors don't know how to do: They sue, harass, and shame debtor governments into paying at least a chunk of what they owe.

[...] vulture funds have become the favorite punching bags of the debt forgiveness movement.

It added:<sup>28</sup>

The vulture funds often cast themselves as surprised victims of corrupt and untrustworthy governments. In fact, they actively seek out environments where, by dint of aggressive litigation, they can do much better than the ordinary investor. But they also play an important role in the ecosystem of international capital. They create secondary markets for less aggressive investors who want to unload their holdings and, perhaps more important, they inflict pain on countries that default, which most large institutional investors aren't willing to do. They are, in a sense, the avenging angels of the debt market. "Vulture funds add value," says Mitu Gulati, a professor at Duke University's law school. "The market would not work effectively if they were not there."

Another perspective on the activities of the funds is given by Felix Salmon (now a Reuters online commentator). He notes that 'vulture funds' "get almost no defense in the press, and there are in fact quite a lot of reasons why they perform a good and useful function." He offered a detailed, "deliberately one-sided defence" of 'vulture funds', which he characterised as 'distressed-debt funds', noting:<sup>29</sup>

If a government defaults on its obligations, then, the debt doesn't simply disappear. It's still there – and, sooner or later, it will have to be dealt with. Vulture funds are long-term investors who buy defaulted debt and then try to persuade the issuer to deal with it. Because they buy the debt cheap, they're often willing to settle at much less than face value

He continued:

Oxfam has launched a [campaign](#) against Donegal [often cited as a 'vulture fund'] entitled "Don't let the debt vultures make a killing". They should remember that vultures don't kill anything. There are lots of reasons why Zambians are living in abject poverty today, and Donegal's lawsuit is not one of them. Vulture funds create the conditions under which countries like Zambia can raise money for investments in health, education, and infrastructure. Maybe Oxfam should consider sending them a thank-you letter instead.

Regardless of one's opinion of 'vulture' funds, the continuing relationship between debtor countries and the commercial financial markets cannot be ignored. For this relationship to work to the benefit of both, clear legal and commercial principles need to be upheld and this

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<sup>27</sup> Bosco, D., "[The Debt Frenzy](#)", *Foreign Policy*, 11 June 2007

<sup>28</sup> *ibid.*

<sup>29</sup> "[In defense of vulture funds](#)", [www.felixsalmon.com](http://www.felixsalmon.com) post, 24 February 2007

consideration has to an extent acted as a constraint on the proposals in the Bill to deal with the perceived abuse of the debt relief process.

### 2.3 Case studies: Zambia, Liberia & DRC

There have been several high-profile incidences where 'vulture funds' have successfully pursued developing country debt: the cases of Zambia and Liberia are summarised below.

#### Zambia

Zambia is a low income country, ranked 169<sup>th</sup> in the world on per capita income of \$950 in 2008 by the World Bank.<sup>30</sup>

In 1999, a British Virgin Islands-registered private investment fund, Donegal International, bought debt owed to Romania for \$15.5 million for agricultural equipment, for \$3.3 million (for a total claim of around \$30 million), at a time when Zambia was working towards debt relief. Donegal agreed a repayment of \$16 million in 2003, but after paying \$2.5 million Zambia defaulted on further repayments.

In 2007, the company took Zambia to the High Court for repayment of the debt plus interest totalling \$55 million. In the final award, the \$55 million was found to be penal, and \$15.5 million awarded (outstanding debt with \$2 million interest), almost five times the amount the company had originally paid for the debt.<sup>31</sup>

#### Liberia

A more recent case involved Liberia in West Africa, which has one of the lowest incomes in the world: ranked 208<sup>th</sup> on a per capita income of \$170 in 2008, above only the Democratic Republic of Congo and Burundi.<sup>32</sup>

Liberia had borrowed \$6 million from US-based Chemical Bank in 1978. In 2009, a \$20 million debt on this loan was successfully pursued through the High Court by two Caribbean-based investment funds, Hamsah Investments (British Virgin Islands) and Wall Capital (Cayman Islands).<sup>33</sup> BBC news noted that the claim was equivalent to around 5% of the country's budget.

In April 2009, Liberia had benefited from a \$1.2 billion debt buy-back using the World Bank's Debt Reduction Facility (see part 3.2) at a 97% discount on its face value. These two companies were "the only two private creditors that refused to participate" in the buy-back arrangement.<sup>34</sup> *The Independent* reported that the judge said: "The only issue raised is plainly a sad one, that Liberia is a poor country, and cannot afford it."<sup>35</sup>

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<sup>30</sup> World Bank, "[Gross national income per capita 2008, Atlas method and PPP](#)" rankings, October 2009

<sup>31</sup> See "['Vulture funds' threat to developing world](#)", BBC News, 14 Feb 2007; "[Zambia loses 'vulture fund' case](#)", BBC News, 15 Feb 2007, and also "[Unfinished business: 10 years of drop the debt](#)", Jubilee Debt Campaign, May 2008, p32 and [Zambia case study](#); "['Vulture funds' circle but debtors stay a moving target](#)", Financial Times, 18 Feb 2007; and HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, p15 (Box 2B)

<sup>32</sup> World Bank, "[Gross national income per capita 2008, Atlas method and PPP](#)" rankings, October 2009

<sup>33</sup> Based on a 2002 US court judgement for \$18.4 million, plus \$2 million in interest ("[Liberia ordered to pay 'vulture funds' over 1978 debt](#)", BBC News, 26 November 2009 and "[Vulture Funds awarded \\$20 million from Liberia in High Court](#)", Jubilee Debt Campaign, 26 November 2009. See also "[Liberian finances](#)", BBC World Service audio report, 26 November 2009

<sup>34</sup> "[UK Judge Awards Funds \\$20 million, More Than Liberia's Total Spending on Education Last Year](#)", Jubilee Debt Campaign USA (un-dated)

<sup>35</sup> "[Time to clip the wings of the vultures?](#)", *The Independent*, 28 November 2009, pp56-57

## Democratic Republic of Congo

A further recent case involved the Democratic Republic of Congo, which was reported to be “racking up fines of \$20,000 a week”, in a case involving a loan from Yugoslavia in the 1980s now valued at \$100 million and investment fund FG Hemisphere, “for failing to comply with a demand to provide detailed information about all its assets throughout the world.”<sup>36</sup>

### 2.4 NGO calls for action

NGOs, led by the Jubilee Debt Campaign, have campaigned for action to stop vulture fund activities following these and similar cases.

In 2007, Oxfam called the Zambia case “morally repugnant” and called on “the international community to introduce measures to stop cases like these for good.”<sup>37</sup>

Now that campaigners have shone the spotlight on how obscure vulture funds can behave dishonestly and still legally profit at the expense of poor countries, we are looking to the international community to introduce measures to stop cases like these for good.

The Jubilee Debt Campaign acknowledged UK and other donors’ role in assisting with Zambia’s legal fees on the case, but said “systemic changes are still needed to prevent such cases in future”, adding that NGOs were:<sup>38</sup>

[...] calling on the G8 to do what they can to prevent these companies from targeting poor countries in future – through supporting the establishment of a fair, comprehensive framework for dealing with poor country debt, and in the meantime funding legal assistance for countries targeted in this way

The UN Human Rights Council’s expert on the effects of foreign debt, Dr Cephias Lumina, called the Liberia case a “morally unacceptable trade-off” and said:<sup>39</sup>

I strongly urge the international community, the Paris Club and, in particular, the United Kingdom, the USA and France – which are preferred jurisdictions for many ‘vulture funds’ – to urgently consider enacting legislation to prevent ‘vulture fund’ activity within their jurisdictions as a clear indication of their commitment to find a durable solution to the debt problem. It is illogical to cancel poor country debt and at the same time allow unconscionable ‘vulture fund’ claims.

The Jubilee Debt Campaign has specifically called for legislation to prevent companies from using UK courts to pursue such debt. It states that ‘at least’ 54 companies have acted against 12 countries in recent years, with “claims amounting to \$1.5 billion.” It argues that resources that have been made available through debt relief are “going into the pockets of wealthy investors, not spent on health and education.”<sup>40</sup> It has also called for “existing ad hoc debt relief schemes to be replaced with an international forum - akin to a tribunal - to deal with sovereign debt work-outs”.<sup>41</sup>

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<sup>36</sup> “Vulture fund swoops on Congo over \$100m debt”, The Observer, 9 August 2009

<sup>37</sup> Letter from Phil Bloomer (Oxfam) and Trisha Roger (Jubilee Debt Campaign), “We’re not making poverty history”, *The Guardian*, 26 April 2007

<sup>38</sup> “Vulture’s wings clipped by judgment”, Jubilee Debt Campaign Press Release, 24 April 2007

<sup>39</sup> “UN expert on foreign debt regrets British court order that Liberia must pay 1978 debt to ‘vulture funds’”, UN press release, 17 December 2009

<sup>40</sup> “End the Vulture Culture”, Jubilee Debt Campaign web-page (un-dated)

<sup>41</sup> Jubilee Debt Campaign, *Evidence to International Development Committee’s inquiry on DFID’s Departmental Annual Report 2009 and White Paper*, paras 14, 35 and 37

[...] a global framework for settling sovereign debt disputes, along the lines of an arbitration tribunal mechanism, so that countries have a forum where they can bring such claims. As part of international institutional reforms currently being considered, an international, fair and transparent debt work-out process should be created and binding international responsible lending standards should be agreed. In the interim, the debt portfolios in both borrower and lender countries, including the UK, need to be audited so that illegitimate debts arising from irresponsible loans can be written off. This would help to ensure a more just and sustainable lending environment and prevent debt crises in the future.

[A] debt work-out process would also place the same moral and legal obligations on companies as it does on governments, thus tackling the current lack of participation by commercial creditors, and at the extreme end, the actions of so-called 'vulture funds'

The Jubilee Debt Campaign supported the introduction of this Bill, and also assisted with the introduction of the previous bill in session 2008-09 (see part 3.1).

In its international development "manifesto" for the forthcoming General Election, BOND, a group of British NGOs, has called for a future UK Government to commit to "cancelling all illegitimate and unpayable developing country debt through the creation of a democratic and transparent debt tribunal."<sup>42</sup>

### 3 Responses to date

#### 3.1 UK Government responses

In a 2002 speech to the United Nations, the then Chancellor of the Exchequer, Gordon Brown, said:<sup>43</sup>

We particularly condemn the perversity where Vulture Funds purchase debt at a reduced price and make a profit from suing the debtor country to recover the full amount owed - a morally outrageous outcome. The international community should consider giving technical assistance to any HIPC country being sued by a Vulture Fund and provide them with expert financial advice on debt restructuring to prevent future legal claims.

Whenever a country has to defend a legal case it has to divert considerable time, attention and resources away from focusing on poverty reduction, health and education and we must do everything we can to stop this shameful practice.

Agreement was reached at 2002 G7 Summit on action to increase creditor participation in the HIPC initiative. This tasked the IMF and World Bank to include more detail on these issues in their reports; to report on "legal action brought against HIPCs by non-participating creditors, including commercial creditors"; to investigate options for dispute resolution assistance for HIPCs; and also continuing to encourage creditors "not to sell their claims on HIPCs in the secondary debt market".<sup>44</sup> A subsequent HIPC implementation report in September 2002 included a report on creditor litigation and participation.<sup>45</sup>

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<sup>42</sup> BOND, "UK General Election International Development Manifesto: Vote global", September 2009, p7

<sup>43</sup> "Gordon Brown speech at the UN General Assembly session (Special Session on Children)", HM Treasury release 46/02, 10 May 2002

<sup>44</sup> HC Deb 15 May 2003 cc376-8W

<sup>45</sup> World Bank/IMF, [Heavily Indebted Poor Countries \(HIPC\) Initiative: Status of Implementation](#), 23 September 2002

At the 2003 IMF/World Bank Spring meetings, the UK urged those bodies “to explore further the issue of a ‘donor funded’ technical assistance facility to provide advice to HIPC countries facing litigation.”<sup>46</sup>

On the Zambia case, the then International Development Secretary, Hilary Benn, stated:<sup>47</sup>

This is the first defence in a case of this kind that has ever been even partially successful, and its impact will be felt across the world. Vulture funds cannot continue to expect to profit from the world’s poorest countries. The UK will help heavily indebted poor countries limit the impact of vulture funds.

In May 2007, after the Zambia case, the then Chancellor announced that the Government would act against ‘vulture funds’ through a facility that gave countries access to legal assistance to defend actions against them:<sup>48</sup>

I deplore the activities of so-called vulture funds that seek to profit from debts owed by the poorest countries in the world. I am determined to limit the damage done by such funds.

He committed the UK to extending access to the World Bank’s Debt Reduction Facility which would help countries eliminate commercial debt before it is sold on (and to increase the UK’s contribution to help); he also said he would investigate “a voluntary code of conduct” for responsible creditors, including participating “in collective action to reduce unsustainable debts”; work on a G8 “Charter on Responsible Lending” and to provide legal assistance to developing countries involved in litigation.

In a March 2009 written answer, the Economic Secretary to the Treasury, Ian Pearson, stated:<sup>49</sup>

We have taken a leading role in efforts to stop these [vulture] funds profiting from the debts owed by poor countries. We continue to keep all options for tackling this problem under consideration. Our action has focused on measures we believe will have the most impact in tackling this issue: preventing debts falling into the hands of vulture funds and helping countries to defend themselves in cases already under way.

### ***Developing Country Debt (Restriction of Recovery) Bill (session 2008-09)***

The current Bill shares some similarities with more wide-ranging legislative proposals introduced in the 2008-09 Parliamentary session in the *Developing Country Debt (Restriction of Recovery) Bill*. This was introduced by Sally Keeble on 6 May 2009 under the ten minute rule.<sup>50</sup> Sally Keeble outlined its four main provisions:<sup>51</sup>

First, it would stop the excessive profiteering by preventing financial institutions and companies from buying up developing countries’ debts at cut-rate prices, then suing the country’s Government through the UK courts for the full original amount of the debt. The Bill would limit the maximum recovery amount to the sum paid by the financial institution, plus a simple rate of interest and charges specified in the Bill.

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<sup>46</sup> HC Deb 15 May 2003 cc376-8W

<sup>47</sup> “Court cuts vulture fund’s claim: Zambia’s debt repayment reduced by \$40m: Judge says much of firm’s evidence was dishonest”, *The Guardian*, 25 April 2007

<sup>48</sup> HC Deb 10 May 2007 cc16-17WS. HM Treasury, *Response to Jubilee Debt and Oxfam email campaign on Vulture Fund Litigation against Zambia*, June 2007 reiterated the Chancellor’s May 2007 statement, while DFID also published a [letter responding to NGO campaigns on vulture funds](#) in December 2007.

<sup>49</sup> HC Deb 5 March 2009 cc1815-6W

<sup>50</sup> See [Bill page on UK Parliament website](#), and debate from [HC Deb 6 May 2009 c176](#)

<sup>51</sup> [HC Deb 6 May 2009 c176](#), speech by Sally Keeble proposing the Bill.



Secondly, the Bill would introduce accountability. It makes provision for controls on recovery actions and introduces reporting requirements. The financial institutions—the vultures—would have to get permission from the UK courts before starting recovery proceedings in the UK for any amount of defaulted debt from a developing country. In addition, the vulture would have to ensure that a copy of the application went to the UK Government and to the UK representative of the developing country's Government.

Thirdly, the Bill would ensure greater transparency. It would shine a light on the vultures and require the financial institutions to disclose the beneficiaries of the recovery proceedings. It has been completely impossible to get information about this in the past. We have been unable to find out who has benefited from some of these huge undertakings involving recovery actions pursued through the UK courts.

Fourthly, the Bill would help to combat corruption. It contains anti-corruption measures that would require a vulture fund to declare any payments or gifts given by it or its colleagues to the developing country's Government.

Although the Bill did not receive a second reading, 203 MPs signed Early Day Motion [1440](#) (session 2008-09) supporting it.<sup>52</sup>

### 3.2 International responses

At a G8 Finance Ministers meeting in May 2007, Ministers said they were “concerned about the actions of some litigating creditors” against HIPCs, and “agreed to work together to identify measures to tackle this problem, based on the work of the Paris Club.”<sup>53</sup>

Other initiatives in this area in recent years are summarised below:<sup>54</sup>

- In 2007, members of the Paris Club (an informal group of creditor countries) committed not to sell debt on the secondary market to creditors that refused to take part in debt relief initiatives.<sup>55</sup> Similar agreements, by EU member states followed in May 2008.<sup>56</sup> Signatories to the UN's Doha Declaration Financing for Development also stated that they were “deeply concerned about increasing vulture fund litigation”, and called “on creditors not to sell claims on HIPC [countries] to creditors that do not participate adequately in the debt relief efforts.”<sup>57</sup>
- Through the World Bank's Debt Reduction Facility (DRF), certain low income countries are offered grants allowing creditors to sell back debt on discounted HIPC terms.<sup>58</sup> Over \$9 billion of developing country debt cancelled. In April 2008, the Facility was made available to HIPCs at an earlier stage in the process. The DRF has benefited Mozambique, Nicaragua and Liberia. The UK has contributed £20 million to funding the

<sup>52</sup> Worded similarly to [Early Day Motion 618](#) in session 2009-10 (see part 6.1).

<sup>53</sup> [Pre-Summit Statement by G8 Finance Ministers](#), Essen, Germany, 19 May 2007 (original source missing)

<sup>54</sup> HC Deb 1 July 2008 c758-9W, [Ian Pearson Treasury letter to Richard Burden MP](#), 2 July 2009 and also DFID, “[Tackling the threat of vulture funds](#)”, updated 10 November 2009

<sup>55</sup> “[Press release on the threats posed by some litigating creditors to heavily indebted poor countries](#)”, Paris Club press release, 22 May 2007

<sup>56</sup> Council of Ministers, [Council Conclusions on Speeding up progress towards the Millennium Development Goals \(MDGs\)](#), 26 & 27 May 2007

<sup>57</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 2.20, see text of [UN Doha Declaration Financing for Development](#), October 2008, para 60

<sup>58</sup> See World Bank, [Debt Reduction Facility - Questions and Answers](#), 04/06/2007. For more on IDA eligibility, see World Bank, [How IDA Resources are Allocated](#), updated June 2009. Some countries with better creditworthiness are eligible for IDA funds and International Bank for Reconstruction and Development (IBRD) funds (known as ‘blend countries’), such as India and Pakistan among others, which would be excluded from the IDA-only category.

Facility.<sup>59</sup> Critics have noted that the DRF cannot help in situations where creditors ('vulture funds') seek repayment on terms more preferable than offered under debt relief agreements.

- The Commonwealth Secretariat established a HIPC Legal Clinic in September 2006, while the African Development Bank launched the [African Legal Support Facility](#) in June 2009. Supported by a £5 million UK funding contribution,<sup>60</sup> this provides African countries with advice on tackling vulture fund activity and reducing creditors' incentives to pursue debt.

### 3.3 European NGOs call for more action

An August 2008 report published by Eurodad (a network of European NGOs working on debt and development issues), reviewed announcements and actions to date, making six key recommendations:<sup>61</sup>

1. Governments enact legislative changes at the national level to prevent vulture funds from using national courts to pursue their claims. Legislation should make profiteering in the defaulted sovereign debt of developing countries illegal.
2. Governments should make it clear that internationally-agreed debt relief measures are binding on all creditors. Governments of industrialised countries should publicly support developing nations' decisions not to settle commercial speculative litigators' claims and instead demand that commercial creditors offer the same debt relief terms as other creditors.
3. The international community should vigorously promote the implementation of some form of fair and transparent debt work-out procedure at the international level. This framework will ensure that all legitimate creditors' claims are dealt with fairly and efficiently while the citizens of the debtor nations are protected. The UN FfD [Financing for Development] process should result in a concrete and time-bound plan to take forward this work.
4. The international community should support the putting in place of international – and legally binding – standards on responsible financing which contain provisions restricting the right of creditors to unilaterally assign the claim to another entity. The proposals outlined in Eurodad's Charter on Responsible Financing represent one constructive approach.
5. The international community should support urgent international action to tackle the tax haven problem. Tax havens facilitate vulture fund activities. Immediate steps to be taken include financial levies on transactions with tax havens and sanctions on tax havens who do not co-operate on the disclosure of information. Governments should actively support measures to force companies to report their financial activities with a breakdown for each country they operate in.
6. Debtor Governments should improve the loan contraction process at national levels to ensure that it is transparent, participatory and accountable to citizens. This should be combined with urgent attention to improve debt management capacities.

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<sup>59</sup> HC Deb 5 Mar 2009 c1816W

<sup>60</sup> HC Deb 5 Mar 2009 c1816W

<sup>61</sup> Eurodad, "[Taming the vultures: are new measures enough to protect debt relief gains?](#)", August 2008, p4

### 3.4 Proposals in other countries

Legislation has been introduced in the US House of Representatives seeking to “prevent speculation and profiteering in the defaulted debt of certain poor countries, and for other purposes.”<sup>62</sup> The Stop VULTURE Funds Act (Stop Very Unscrupulous Loan Transfers from Underprivileged Countries to Rich, Exploitive Funds):

[...] would make it illegal for vulture funds to use U.S. courts for the purpose of suing poor countries to obtain usurious payments. Any lawsuit demanding more than the amount the investment fund paid to buy the debt plus 6% interest per year would be considered usurious.

Countries would be excluded from its protection if they: violate human rights; support terrorism; have excessive military spending; or are non-cooperative on US drugs policy. The proposals were referred to the House Committee on the Judiciary and the House Committee on Financial Services in June 2009, then to the House Subcommittee on Courts and Competition Policy in July 2009.

Legislation related to vulture funds was also introduced in Belgium in May 2008.<sup>63</sup>

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<sup>62</sup> HR2932, introduced by Congresswoman Maxine Waters on 18 June 2009: see [press release](#) and [Jubilee USA information](#) (for further information, see <http://thomas.loc.gov/>, searching for “vulture funds”). In summary the legislation “Prohibits: (1) any U.S. person from engaging in sovereign debt profiteering, or any person at all from engaging in such profiteering in the United States; and (2) any U.S. court from issuing a summons, subpoena, writ, judgment, attachment, or execution in aid of a claim which would further sovereign debt profiteering.”

<sup>63</sup> World Bank/IMF, [HIPC Initiative and MDRI - Status of Implementation](#), 15 September 2009, para 26 (citing [Service Public Federal Affaires Etrangeres, Commerce Exterieur et Cooperation au Developpement \(F. 2008 — 1598\)](#), 6 April 2008

#### 4 Treasury consultation (July 2009)

Building on the partial success of the measures already taken by the UK and internationally, in July 2009 the Treasury published *Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation*.<sup>64</sup>

The Government sought views on proposals that would limit the proportion of debt already contracted by a HIPC that a creditor could reclaim under UK law. Support for the consultation also came from DFID.<sup>65</sup>

The consultation described ‘vulture funds’ activities as the “worst abuses” of debt relief process.<sup>66</sup> The foreword summarised the issue that legislation was proposed to address:

Some creditors of poor countries are choosing not to participate in the Heavily Indebted Poor Countries Initiative for debt relief. While that is their prerogative, it can lead to a ‘free rider’ problem: debt relief from others gives the debtor countries resources that can be siphoned off by non-participating creditors pursuing full payment of their debt.

These claims, including those brought in UK courts, mean that poor countries are forced to pay back some of their outstanding debt in full and with the addition of interest. The nature of these cases means that a small minority of creditors can divert some of the benefits of debt relief provided by the majority. The Government is determined that these actions do not prevent poor countries from using the resources freed up by debt relief for development and poverty reduction. And we firmly believe it is right to act to prevent this from happening at the expense of debt relief funded by the UK taxpayer.

The Government argued that there were “relatively few alternatives” left to legislation to tackle the issue.<sup>67</sup> While it mentioned a potential voluntary code of practice, it noted challenges in ensuring participation, and that there had been no such proposals from creditor groups.<sup>68</sup> It noted that while new government bonds are now often issued with ‘collective action clauses’, which make debt restructuring decisions “approved by a set supermajority of bondholders binding on all”, HIPCs have not issued many such bonds, and so their commercial debts are not subject to such provisions.<sup>69</sup>

The Government argued that there were two main reasons for acting:<sup>70</sup>

- developmental – debt relief is an effective way to release resources to finance development. Litigating to seek full value repayment undermines relief granted by other creditors and weakens the financing position of heavily indebted poor countries; and
- fairness amongst creditors – non-co-operative creditors profit at the expense of sovereign and commercial creditors that do provide debt relief, some of which

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<sup>64</sup> “[Legislation to ensure effective debt relief for poor countries](#)”, HM Treasury press release 69/09, 21 July 2009 and HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 3.1

<sup>65</sup> “[Public consultation launched on vulture funds](#)”, DFID press release, 21 July 2009 (revised 10 Nov 2009)

<sup>66</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 1.2

<sup>67</sup> *ibid.*, para 3.13

<sup>68</sup> *ibid.*, para 3.15 (and accompanying impact assessment in same PDF document, p4)

<sup>69</sup> *ibid.*, paras 2.16-2.17

<sup>70</sup> *ibid.*, para 3.2

is provided at a public cost. The threat of non-cooperation by some creditors can also deter other creditors from participating in the initiative.

The Government recognised that any steps taken “must not damage these countries’ future access to commercial financing for development or cause other disproportionate negative consequences.”<sup>71</sup> As a result, the proposals were “tightly targeted to avoid any impact on new lending and control the impact on existing creditors.”<sup>72</sup> The Government said it “remains committed to smoothly functioning financial markets and the right of creditors to have recourse to the law.”<sup>73</sup>

In contrast to the Bill introduced in the previous session, which would have applied to the debt of any low or middle income country, the Government’s proposals would apply to the 40 HIPC countries only. New lending would also be specifically excluded,<sup>74</sup> while the consultation proposed that courts be allowed “some discretion over the level of payment to award” in order “to minimise the risks to smoothly functioning financial markets”.<sup>75</sup>

#### 4.1 Why legislate in the UK?

The UK has a distinctive role in this issue, as its contract law is, for historical reasons, a common framework for international business. Contracts are often based on English law which is used to enforce them if necessary.

As the Treasury has noted: “A complete solution would require international agreement.” The passing of legislation in the UK would not stop private creditors from pursuing debts in other jurisdictions without such provisions.<sup>76</sup> However, legislation would cover all contracts based on UK law, and the Government believes that “a legislative approach would make a significant contribution to addressing creditor non-participation” in HIPC, and it “would encourage international partners to consider similar measures”.<sup>77</sup>

The latest World Bank/IMF HIPC implementation report notes that one of the 14 active legal cases by all commercial creditors (not necessarily by ‘vulture funds’) was being pursued through the UK courts. Other jurisdictions included: Dubai, France, Honduras, Russia, South Africa, Sudan, Switzerland, Uganda, and Zambia.<sup>78</sup> In September 2008, of the 54 active and inactive cases brought by all commercial creditors, 10 were in UK courts.

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<sup>71</sup> *ibid.*, para 3.3

<sup>72</sup> *ibid.*, para 1.4

<sup>73</sup> “[Legislation to ensure effective debt relief for poor countries](#)”, HM Treasury press release 69/09, 21 July 2009

<sup>74</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 1.4

<sup>75</sup> *ibid.*, para 3.8

<sup>76</sup> *ibid.*, para 3.9

<sup>77</sup> *ibid.*, para 3.9

<sup>78</sup> World Bank/IMF, [HIPC Initiative and MDRI - Status of Implementation](#), 15 September 2009, table 16, p57

## 5 Issues raised in consultation

The consultation period ended on 9 October 2009. The Treasury's response was published on 19 February 2010, the same day as the text of the Bill, along with collected consultation responses and a revised Impact Assessment of the Bill.<sup>79</sup> The consultation received 23 written responses and an email campaign calling for legislation in this area was supported by 1,139 people. Two stakeholder consultation meetings were also held, as were further discussions with of low income country governments.

The main issues raised by the Bill, highlighted in the consultation and summarised below were:

- the justification for legislation, with concern over proper functioning of markets and human rights issues;
- country coverage, and the possibility of wider rules on developing country debt;
- which debts should be eligible (the inclusion of 'new debt');
- valuation & courts discretion; and
- transparency.

This section does not cover all the issues raised. The Government's [consultation response](#), and accompanying [collection of consultation responses](#) and [impact assessment](#) provide further details.<sup>80</sup>

### 5.1 Arguments for & against legislation

The Treasury reported that the written responses:<sup>81</sup>

[...] were almost evenly divided between those favouring and opposing legislation. Participants from the financial services sector were typically opposed to legislation, civil society groups supported action, while responses from lawyers included both perspectives.

Several responses, on both sides acknowledged that "commercial borrowing can play a beneficial role in catalysing the growth and development of some low-income countries", however "analyses differed as to whether legislation would jeopardise future commercial finance."<sup>82</sup>

#### ***Opposing arguments***

Objections to legislation, taken from the Treasury document, are summarised below:<sup>83</sup>

<sup>79</sup> See HM Treasury, "[Ensuring effective debt relief for poor countries: a response to consultation](#)", February 2010; HM Treasury, "[Ensuring effective debt relief for poor countries: Consultation responses received](#)", February 2010; and HM Treasury, "[Impact Assessment of measures to address non-participation in debt relief](#)", February 2010

<sup>80</sup> HM Treasury, "[Ensuring effective debt relief for poor countries: a response to consultation](#)", February 2010, HM Treasury, "[Ensuring effective debt relief for poor countries: Consultation responses received](#)", February 2010, and HM Treasury, "[Impact Assessment of measures to address non-participation in debt relief](#)", February 2010

<sup>81</sup> HM Treasury, "[Ensuring effective debt relief for poor countries: a response to consultation](#)", February 2010, para 2.3

<sup>82</sup> *ibid.*, para 2.7

<sup>83</sup> *ibid.*, para 2.18

**'In principle' objections**, “most frequently based on a view emphasising the sanctity of contracts as a universal and foundational principle of English law”, with “contractual obligations of creditor and debtor are either to be seen as absolute, or require compelling reasons to override which these respondents did not see as applying in this instance.”

**Potential contravention of ECHR/Human Rights Act rights**, notably the protection of the Article 1, Protocol 1 right to property.

**Inaccurate characterisation of the issue**, including “a perception of so-called ‘vulture funds’ that did not match the typical litigating creditor” as many cases had been brought by original or trade creditors, rather than investment funds pursuing debt they had bought on the secondary market. An implicit “equivalence” in the origin and merits of commercial and bilateral/multilateral debt was also questioned: “it was seen as inappropriate that commercial creditors that had lent prudently would share in a reduction made necessary by excessive past lending from the official sector claimed to have been motivated by geopolitical interests.”

**Overestimation of the problem**, a “high proportion” of the responses opposing legislation made this point or that the estimated scale justified intervention. Supporting the latter argument they noted “the relatively low proportion (6%) of debt within the scope of the HIPC Initiative held by commercial creditors, the minority of this governed by UK laws, the limited proportion of claims on which creditors would litigate, and the low rate of enforcement of claims awarded.” The Treasury’s original Impact Assessment was based on the 2008 World Bank survey of commercial creditor cases, many of which had since been settled. The 2009 survey suggested litigation “appears to be less of a problem now” (active cases fell from 33 to 14), but warned “the threat of new litigation remains”.<sup>84</sup>

**Underestimation of spillover costs**, where legislation “was asserted to have effects on market expectations in relation to debts other than those targeted”, including:

- new lending to HIPC governments would be cut off or become more expensive as new lenders would fear that legislation would be extended in future to affect their debts;
- this expectation would extend to the borrowing of other developing countries, with similar effects on their borrowing; and
- less directly but with potentially the most wide-ranging effects, erosion of the principles underlying UK commercial law would be detrimental to the operation of markets as well as unjustified in principle.

**Existing mechanisms were already effective**, that resolution of HIPCs’ commercial debts was already satisfactory and that legislation was therefore not needed, that negotiated restructuring of some countries debt (e.g. Côte d’Ivoire) had provided better than HIPC initiative terms levels of debt relief, and that ‘vulture fund’ litigation was rare.

**Negative effects on UK as a centre for financial services**, and that “legislation along the lines put forward would be a factor counting against the choice of English law”, thereby influencing the location of relevant businesses.

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<sup>84</sup> Based on responses from around half of HIPCs, from World Bank/IMF, [HIPC Initiative and MDRI - Status of Implementation](#), 15 September 2009, paras 23 & 25 (and table 16, p57), which also notes World Bank’s Debt Restructuring Fund (DRF) activities, out of court settlements by Cameroon, Republic of Congo, Sierra Leone and Zambia, and the dropping of joint litigation against Nicaragua by five creditors.

### ***Supporting arguments***

The Government categorised positive responses to the legislative proposals under two headings: economic and development.<sup>85</sup>

**Economic rationale:** detailed in the Impact Assessment and which the proposals sought to address “a significant market failure in the resolution of defaulted sovereign debt”. HIPC had debt that could not be repaid in full, and so creditors must “accept a reduction in their claims” to a sustainable level, citing market and other evidence. It also noted that “a commercial creditor that successfully litigates and recoups the full value of its debt does so only by free-riding on the relief provided by others, including the great majority of commercial creditors.” Legislation would be effective if the benefit of stopping this free-riding exceeded the cost of “interfering with property rights.” The Government asserts that although the net benefit cannot be quantified it expected the benefits to outweigh the costs.

**Development rationale:** the case for helping HIPCs was “compelling”, both reducing debt to sustainable levels and releasing further aid “that provides additional resources for development” (with HIPC-related reforms building donors’ perceptions that their aid would be now prove more effective). The consultation response said:

The UK supports the development of HIPCs as part of its international development policy, providing bilateral grant aid, debt relief that goes beyond the HIPC Initiative and cancels all bilateral debts, and other programmes. Commercial creditor litigation draws these resources – funded by the taxpayer for international development – away from their intended purpose. It diminishes the effectiveness of aid. Legislation can prevent this leakage.

Proponents of legislation highlighted the “large value of active claims when compared to the government budgets of the HIPCs targeted or their very high levels of poverty.”<sup>86</sup> Several responses also supported the Government’s assessment that, “while measures already taken had had some success in limiting the problem, creditor litigation cases continued to cause difficulties for heavily indebted poor countries.”<sup>87</sup>

### ***Effect on debt markets***

A key issue with the proposals is the concern over the effect on efficient functioning of debt markets. The Government asserts this is unlikely to have a large effect, although private sector submissions to the consultation argue that the impact has been underestimated. For example, the Institute for International Finance (IIF).<sup>88</sup>

[...] cautions HM Treasury against initiating legislation that has the potential to destabilize capital flows to low-income countries without achieving commensurate benefits for those countries, and could damage the reputation of the UK legal system as a reliable situs for resolving international disputes and inhibit the use of English law in international contracts. In addition, we would suggest that any such legislative initiative should not be contemplated without a more extensive discussion with the debtor countries that would be affected directly or indirectly by such an initiative.

Reuters commentator, Felix Salmon, suggested that the proposals “would have a chilling effect on any foreign companies doing business in poor countries; it would also increase

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<sup>85</sup> HM Treasury, “[Ensuring effective debt relief for poor countries: a response to consultation](#)”, February 2010, para 2.3, paras 2.21-2.26

<sup>86</sup> *ibid.* para 2.13

<sup>87</sup> *ibid.* para 2.17

<sup>88</sup> Institute for International Finance (IIF), in HM Treasury, “[Ensuring effective debt relief for poor countries: Consultation responses received](#)”, February 2010, p189



borrowing costs for all such countries.” He argues that the expected benefit to poor countries would be “much lower” than the £33.2 million<sup>89</sup> annually argued in the consultation paper, arguing that while judgment against developing countries can be easy, it can be “all but impossible to actually get paid.”<sup>90</sup> In addition, he argues, in relation to proposed US legislation, that the “total amount of money that’s at issue here is minuscule, compared to the enormous effect that it could have on the capital markets as a whole. The whole issue of vulture funds looks very much like a solution in search of a problem.”<sup>91</sup>

Jubilee Debt Campaign’s view on the market disruption issue is that it is vulture funds’ activity “that creates uncertainty and instability in trading and investment relations with poor countries, and which could discourage commercial lenders from investing in such an environment.”<sup>92</sup> They also suggest that similar arguments, “that commercial lenders would stop investing in developing countries if those countries were receiving relief on their debts”, were made in the 1990s about the HIPC initiative, but this has not stopped those countries from attracting investment. Jubilee Debt Campaign sees benefits for HIPC countries from “more predictable trading and investment environment, which would help them in longer-term poverty reduction and development efforts”.<sup>93</sup>

In its consultation, the Government argued that its proposals were tightly targeted on existing HIPC debt, with courts to be allowed discretion over awards, which would “minimise the risks to smoothly functioning financial markets”.<sup>94</sup> In its response to the consultation, the Government emphasised the “tightly targeted” proposals, “at a fixed, historical stock of debt”.<sup>95</sup> Under the proposals, commercial creditors would retain the legal right to pursue their claims to the value determined by the HIPC process, which is that that has been determined to be sustainable (i.e. repayable) and therefore reflects the ‘real’ value of their debt. It may also be the case that the market value of HIPC country debt might be around HIPC terms level, and so the reduction in value might be relatively small.

The Government also said that it:<sup>96</sup>

[...] recognises that there will always remain at least a theoretical possibility of such legislation being introduced with respect to future debts by a future government. The perception of such a risk could arise irrespective of this proposed legislation. The Government remains of the view that it is unlikely that lenders will assess the increase in that risk resulting from the legislation proposed to be significant enough to affect the availability or terms of lending to low income countries.

### **Government’s conclusion**

Concluding, the Government argued that having taken objections into account, it “remains the Government’s assessment that the case for action is exceptional and justified”. It drew attention to the “tightly targeted” proposals, “at a fixed, historical stock of debt”, and argued

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<sup>89</sup> Since revised downwards to £26.3 million based on new information. Earlier figure from Impact Assessment, p2, in HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009

<sup>90</sup> “UK Treasury goes to war on vulture funds”, [blogs.reuters.com/felix-salmon/](https://blogs.reuters.com/felix-salmon/) post, 5 August 2009 (see also ‘vulture funds’ thread)

<sup>91</sup> “Is Russ Feingold joining the war on vulture funds?”, [blogs.reuters.com/felix-salmon/](https://blogs.reuters.com/felix-salmon/) post, 16 October 2009

<sup>92</sup> Jubilee Debt Campaign, “[Responding to your MP \[on vulture funds campaign\] page](#) (un-dated)

<sup>93</sup> Jubilee Debt Campaign submission, in HM Treasury, “[Ensuring effective debt relief for poor countries: Consultation responses received](#)”, February 2010, p203

<sup>94</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, paras 2.12- 2.14

<sup>95</sup> HM Treasury, “[Ensuring effective debt relief for poor countries: a response to consultation](#)”, February 2010, para 2.27

<sup>96</sup> *ibid.*, para 2.31

that there was “no intention to extend it, and that an extension beyond the HIPC Initiative would be unjustified and harmful.”<sup>97</sup>

The Government’s Impact Assessment stated that while there would be no cost to the UK itself, the transfer of resources from commercial creditors to the HIPC countries was estimated at around £145 million over five years.<sup>98</sup> The Government argued that “legislation can be expected to have an impact on a scale that is in itself significant given the tightly constrained finances of HIPCs.”<sup>99</sup> It also noted that proposals did not distinguish between creditors, and applied to all equally.<sup>100</sup> It also accepted that assessing ‘negative spillovers’ in advance was “very difficult”, but noted that:<sup>101</sup>

All the arguments put forward for spillover costs are based upon markets assuming, or at least considering there to be a significantly increased risk, that the Government would in future enact legislation different to that being brought forward. The Government remains clear that it has no intention of doing so and that such legislation would be detrimental to its development aims. The proposed legislation targets the unique historical burden of debt faced by HIPCs.

The Government also confirmed its view that the UK would “remain a preferred jurisdiction for international finance and a location of choice for participants in the primary and secondary markets”.<sup>102</sup>

In the consultation response, the Government stated that it had “not introduced legislation to do this in the current Parliamentary session, due to limits on legislative space”, although it hoped “to support a Private Member’s Bill that has been introduced on the issue, providing it is along the lines described in this response.”<sup>103</sup>

## 5.2 Coverage

Supporters of legislation called for broader proposals, both in terms of country coverage and debt coverage.

### **Country coverage**

Supporters of legislation argued that it should apply to all, or a subset of, developing countries beyond the HIPC countries. An article in *The Independent* argued the Government’s proposals did not “go far enough. There are lots of poor countries that don’t fall into the specific HIPC category, and they will still be carried under these proposals.”<sup>104</sup>

Based on 2008 research, pre-dating the global economic crisis, the Jubilee Debt Campaign coalition suggested that around 100 countries need further debt relief in order to make their debts sustainable. It called for the granting of HIPC terms to the external debts of all

<sup>97</sup> *ibid.*, para 2.27

<sup>98</sup> *ibid.*, para 2.28, in Net Present Value (discounted) terms from creditors not already voluntarily participating in HIPC initiative debt relief who would otherwise have been able to gain these repayments beyond HIPC terms. This is a downward revision from £254 million in the original Impact Assessment, due to updated results of an annual World Bank survey of creditor litigation, although the consultation response notes that: “any estimate of the effect of this legislation attempts to quantify an intrinsically uncertain process.” (*ibid.*, para 2.46; see HM Treasury, “[Impact Assessment of measures to address non-participation in debt relief](#)”, February 2010, pp17-18 for details)

<sup>99</sup> *ibid.*, para 2.28

<sup>100</sup> *ibid.*, para 2.29

<sup>101</sup> *ibid.*, para 2.30

<sup>102</sup> *ibid.*, para 2.32

<sup>103</sup> *ibid.*, para 3.2

<sup>104</sup> Johann Hari, “[We must stop the ‘vulture funds’ that feed on the world’s poor](#)”, *The Independent*, 18 September 2009

International Development Association-only countries (essentially low income ones that lack creditworthiness as determined by the World Bank, of which the IDA is a part).<sup>105</sup> It argues that the UK Government has acknowledged the need for debt relief for these countries through its own UK Multilateral Debt Relief Initiative (MDRI). This sees the UK pay its 10% share of (currently eight) countries' World Bank and African Development Bank debt service, amounting to over £68 million to date, and currently 14 low income countries are not covered neither by HIPC nor MDRI.<sup>106</sup>

Jubilee Debt Campaign suggest that debt relief should be made “sustainable on human development terms” and “not on one-time qualification for the HIPC scheme”.<sup>107</sup> Similarly, CAFOD suggested the legislation should be “based on debt sustainability and country characteristics, and not an arbitrary cut-off date.”<sup>108</sup>

The Bill introduced in the 2008-09 session (see part 3.1), would have applied to debts of any low or middle income country, not just HIPC countries.<sup>109</sup> The Jubilee Debt Campaign accept that HIPC terms may not be suitable for non-IDA countries. It calls for a ‘general prohibition on profiteering’ on developing countries’ debt. This would limit awards to the amount paid for any debt plus a ‘reasonable’ rate of interest.<sup>110</sup>

The Government noted that opponents of any legislation “had further concerns if it were to be extended to a broader group of countries.”<sup>111</sup> Consultation responses highlighted that the general prohibition on profiteering proposed would have significant market effects. The Government acknowledged development issues facing non-HIPC countries, but stated that “it would be detrimental to both international development and financial markets” to extend coverage beyond HIPC countries; the Government noted that HIPC was the only international agreement on debt relief:<sup>112</sup>

Obliging commercial creditors to provide debt relief where major bilateral and multilateral creditors are not voluntarily doing so would be unjustified on grounds of fairness and lack an economic rationale. One consequence of this is that it would run a greater risk of having a significant effect in deterring future lending and influencing secondary debt markets.

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<sup>105</sup> Jubilee Debt Campaign submission, in HM Treasury, “[Ensuring effective debt relief for poor countries: Consultation responses received](#)”, February 2010, p201. As noted above, for more on IDA eligibility, see World Bank, [How IDA Resources are Allocated](#), updated June 2009. Some countries with better creditworthiness are eligible for IDA funds and International Bank for Reconstruction and Development (IBRD) funds (known as ‘blend countries’), such as India and Pakistan among others, which would be excluded from the IDA-only category.

<sup>106</sup> Specifically: Cape Verde, Lesotho, Moldova, Mongolia, Nepal, Samoa, Vanuatu and Vietnam (DFID, [MDRI page](#)).

<sup>107</sup> Jubilee Debt Campaign submission, in HM Treasury, “[Ensuring effective debt relief for poor countries: Consultation responses received](#)”, February 2010, p201 & p203 (p3 and p4 of submission)

<sup>108</sup> Catholic Agency for Overseas Development (CAFOD) submission, in HM Treasury, “[Ensuring effective debt relief for poor countries: Consultation responses received](#)”, February 2010, p21

<sup>109</sup> *Developing Country Debt (Restriction of Recovery) Bill* (session 2008-09), clause 1. The proposed US legislation (Stop VULTURE Funds Act) would cover IDA-only countries (see [Jubilee USA FAQ](#))

<sup>110</sup> Jubilee Debt Campaign submission, in HM Treasury, “[Ensuring effective debt relief for poor countries: Consultation responses received](#)”, February 2010, p203 (p4 of submission)

<sup>111</sup> HM Treasury, “[Ensuring effective debt relief for poor countries: a response to consultation](#)”, February 2010, para 2.36

<sup>112</sup> *ibid.*, para 2.37. The Government outlined several reasons for its approach in the original consultation document (see HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 3.10).

The Government stated that the UK Multilateral Debt Relief Initiative was based on aid effectiveness and debt sustainability, and did not require such relief for debt sustainability alone.<sup>113</sup>

### **Debt coverage: new lending & creditors**

The Government suggested debt incurred after decision point should be excluded from legislation, as they are excluded from HIPC initiative (and in any case by then HIPC countries should be managing their debts on a sustainable basis), as would any new lending contracted after legislation entered into force.<sup>114</sup>

As with country coverage, supporters of legislation tended also to support its application to new lending. For example, the Jubilee Debt Campaign called for debt after post-HIPC decision point and post commencement to qualify.<sup>115</sup>

Noting the main argument behind including new lending was that the problem could recur in the future, the Government highlighted actions taken on legal, debt management and sustainability advice to HIPCs. It accepted that “some new lending to HIPCs may in the future be defaulted on and that the potential for free-riding in resolving such situations might recur.”<sup>116</sup> However, it rejected legislation to address this possibility, and also highlighted significant market distortions that would arise: if an interest cap was applied, no lending above that level would take place, while it would “largely suppress the secondary market in new HIPC debts”, resulting in higher interest rates for HIPC countries “reflecting their limited prospects for selling on the debt.”<sup>117</sup> As the original consultation had noted:<sup>118</sup>

A measure that applied to new lending would need to be taken with international agreement, as otherwise it could readily be avoided through choice of a different jurisdiction to cover new lending. This would be to the detriment of the UK’s financial services sector without achieving its intention.

The response noted that “if other countries did not follow the UK in legislating, it is likely that borrowers and lenders would continue to agree new lending but choose another country’s law to govern the debt, leaving the only effect of prospective legislation to be a movement of business away from the UK.”<sup>119</sup> The explanatory notes add that:<sup>120</sup>

[...] if the legislation were to apply to debts not yet contracted, it would be easy to avoid the impact of the legislation, for example by providing that the governing law was (say) New York law, and that US courts would have exclusive jurisdiction. This would have the undesirable effect of driving legal business away from London.

The Catholic Agency for Overseas Development (CAFOD) argued that the legislation should also apply to debts on which a judgement has already been obtained, given that creditors are

<sup>113</sup> *ibid.*, para 2.37

<sup>114</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 1.4

<sup>115</sup> Jubilee Debt Campaign submission, in HM Treasury, [“Ensuring effective debt relief for poor countries: Consultation responses received”](#), February 2010, p201

<sup>116</sup> HM Treasury, [“Ensuring effective debt relief for poor countries: a response to consultation”](#), February 2010, para 2.42

<sup>117</sup> *ibid.*, para 2.43

<sup>118</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 3.11

<sup>119</sup> HM Treasury, [“Ensuring effective debt relief for poor countries: a response to consultation”](#), February 2010, para 2.43

<sup>120</sup> [Debt Relief \(Developing Countries\) Bill - Explanatory Notes](#), para 43

able to seek judgements in several jurisdictions.<sup>121</sup> It also argued that original creditors should be covered by the proposals, “as these can also be involved in litigation against indebted poor countries, for whom debt relief has been agreed”.<sup>122</sup>

The Government noted the “unanimous view” of respondents for legislation to apply equally to original creditors and to buyers of debt on the secondary market. This would include those investment or hedge funds seeking a profit from that debt (covering ‘vulture funds’), but also ordinary exporters seeking repayment. Excluding original creditors “would also reduce the developmental benefit of the legislation, probably substantially so given the significant proportion of litigation cases brought by original creditors.”<sup>123</sup>

### **A ‘sovereign debt restructuring mechanism’?**

NGOs, notably the Jubilee Debt Campaign, suggested an “international instrument to deal with sovereign insolvency problems”: an “open, impartial and transparent debt work-out process”.<sup>124</sup>

An international sovereign debt restructuring mechanism (SDRM) which:<sup>125</sup>

[...] in the event of a sovereign default (and, in some NGO-supported models, of a developing country having both debts and unfinanced development needs) there would be a decision-making body able to set binding terms for restructuring or debt relief that would apply to all creditors.

Around 2001, there were discussions at the IMF on a proposal, with UK Government support, but a consensus could not be reached.<sup>126</sup> The Government accepted that one argument in favour of an SDRM was that it would be a mechanism to resolve the issue of activities that its proposals were attempting to address “on an international level and in a way that could be applied to future lending”, “addressing wider problems in sovereign debt markets.”<sup>127</sup> However, the Government “does not assess that international support has changed, and therefore considers this option unavailable.”<sup>128</sup>

In the consultation response, the Government noted that many submissions “welcomed the proposal in the consultation document that the Government would continue to play a leadership role in debt relief and, if legislation were brought forward in the UK, to encourage other countries to consider similar measures.”<sup>129</sup>

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<sup>121</sup> Catholic Agency for Overseas Development (CAFOD) submission, in HM Treasury, “[Ensuring effective debt relief for poor countries: Consultation responses received](#)”, February 2010, p21

<sup>122</sup> *ibid.*, p22

<sup>123</sup> HM Treasury, “[Ensuring effective debt relief for poor countries: a response to consultation](#)”, February 2010, para 2.58

<sup>124</sup> Jubilee Debt Campaign submission, in HM Treasury, “[Ensuring effective debt relief for poor countries: Consultation responses received](#)”, February 2010, p203 (p6 of submission)

<sup>125</sup> HM Treasury, “[Ensuring effective debt relief for poor countries: a response to consultation](#)”, February 2010, para 2.50

<sup>126</sup> See also IMF, “[Sovereign debt restructuring mechanism: further considerations](#)”, 2002 which discusses the rationale for an SDRM, and related issues, and Anne Krueger (First Deputy Managing Director, IMF) “[Should Countries like Argentina be able to Declare Themselves Bankrupt? A Commentary](#)”, *El Pais*, 18 January 2002

<sup>127</sup> HM Treasury, “[Ensuring effective debt relief for poor countries: a response to consultation](#)”, February 2010, para 2.52

<sup>128</sup> HM Treasury, “[Impact Assessment of measures to address non-participation in debt relief](#)”, February 2010, p11

<sup>129</sup> HM Treasury, “[Ensuring effective debt relief for poor countries: a response to consultation](#)”, February 2010, para 2.80

### 5.3 Valuation & courts' discretion

On the appropriate valuation of debts, consultation responses proposed either HIPC terms or the price paid for the debt plus a 'reasonable' interest rate (see above).<sup>130</sup>

While the latter option would prevent excessive profits and allow for a return on investments, it would not provide fairness between creditors, "two of which might be entitled to differing repayments on otherwise identical debts that were bought at different times." As some repayments to creditors would still be above HIPC terms, the development benefit of debt relief would also be reduced.<sup>131</sup> In its consultation response, the Government opted for HIPC terms, and said:<sup>132</sup>

[...] the unjust enrichment option was less logical and might have detrimental effects. Debts are freely tradable instruments and making their value contingent on the price at which they trade would be unprecedented. It would lead to otherwise identical debts having (potentially considerably) different values on the basis of their trading histories, at the cost of inter-creditor equity. Conversely, as argued by some participating lawyers, using the HIPC Initiative as a uniform benchmark follows the precedent of equal restructuring amongst creditors of equal seniority that applies in insolvency law and is brought about in many new emerging market bond issues through Collective Action Clauses.

The Government also accepted that a 67% reduction factor (the proportion of debt creditors' are called on to forgive in order to reduce the country's debt to a sustainable level) should be used for countries that had not reached HIPC decision point, and also that the reduction factor would be applied to the original debt, not any value voluntarily agreed on since.<sup>133</sup>

The original consultation suggested allowing the courts some discretion, subject to justice and equity tests, to cover exceptional cases, "would ensure that the court is always in a position to strike a fair balance between property rights and the wider public interest."<sup>134</sup>

In the consultation response, the Government noted that some critics of the proposed measures suggested an alternative would be "to leave the law as it currently is but to grant the courts the power to give a lower judgment if that was considered just and equitable."<sup>135</sup> Supporters of legislation opposed a discretion provision, arguing that a fair repayment level had already been determined through the HIPC Initiative.<sup>136</sup> For example, the Jubilee Debt Campaign argued against flexibility, as this risked "circumventing the aims of the legislation" using the proposed "just and equitable" basis, and saw this as a "particular concern in courts renowned for being creditor friendly, such as the UK".<sup>137</sup> CAFOD argued that discretion "has

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<sup>130</sup> HM Treasury, ["Ensuring effective debt relief for poor countries: a response to consultation"](#), February 2010, para 2.54

<sup>131</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 4.9

<sup>132</sup> HM Treasury, ["Ensuring effective debt relief for poor countries: a response to consultation"](#), February 2010, para 2.55

<sup>133</sup> *ibid.*, para 2.47

<sup>134</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 4.13

<sup>135</sup> HM Treasury, ["Ensuring effective debt relief for poor countries: a response to consultation"](#), February 2010, para 2.60

<sup>136</sup> *ibid.*, para 2.60

<sup>137</sup> Jubilee Debt Campaign submission, in HM Treasury, ["Ensuring effective debt relief for poor countries: Consultation responses received"](#), February 2010, p203 (p6 of submission), p204

the potential to increase uncertainty and to undermine the potential of the legislation to discourage unfair legal actions by creditors.”<sup>138</sup>

The Government opted not to include such a provision, accepting that:<sup>139</sup>

While it remains possible for specific cases to involve additional factors that might weigh in favour of or against the parties involved, it would be difficult for courts to apply in the absence of precedent in this area of law and would remove the legal certainty and clarity provided by legislation that specifies the maximum level of return. The additional uncertainty that could surround a new precedent for court discretion would also be more likely to produce the negative spillovers which the Government believes will be largely avoided by its proposal.

## 5.4 Human Rights and other legal issues

### **Background**

The right to ownership of private property has long been recognised in English law. In the eighteenth century case of *Entick v Carrington* the court considered that:

The great end for which men entered into society was to secure their property. That right is preserved sacred and incommunicable in all instances where it has not been abridged by some public law for the good of the whole.<sup>140</sup>

The right in common law, which according to Blackstone, was the third “absolute right inherent in every Englishman”<sup>141</sup> has been supplemented by the *European Convention on Human Rights* (ECHR). Article 1 to the First Protocol to the Convention provides that:

#### **Article 1 – Protection of property**

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

Lester and Pannick’s *Human Rights Law and Practice*<sup>142</sup> notes that, in its landmark judgment in *Sporrong and Lönnroth v Sweden*, the European Court of Human Rights “observed that art 1 of the First Protocol comprises three distinct rules.”<sup>143</sup>

- The first rule is of a general nature and states the principle of peaceful enjoyment of property.
- The second rule covers deprivation of possessions and subjects it to certain conditions (namely that it is in the public interest, subject to conditions provided for by law and by the general principles of international law).

<sup>138</sup> Catholic Agency for Overseas Development (CAFOD) submission, in HM Treasury, “[Ensuring effective debt relief for poor countries: Consultation responses received](#)”, February 2010, p21

<sup>139</sup> HM Treasury, “[Ensuring effective debt relief for poor countries: a response to consultation](#)”, February 2010, para 2.63

<sup>140</sup> (1765) 19 State Tr 1029, 1060

<sup>141</sup> R. Kerr (ed) *Blackstone’s Commentaries on the Laws of England* 4<sup>th</sup> Edition, John Murray, 1876, p 109

<sup>142</sup> Lester, Pannick and Herberg, *Human Rights Law and Practice*, 3<sup>rd</sup> Edition, LexisNexis, 2009

<sup>143</sup> *ibid.*, para 4.19.8

- The third rule recognises that states are entitled to control the use of property in accordance with the general interest, by enforcing such laws as they deem necessary for that purpose (such as rules regarding the payment of taxes, or other contributions or penalties).<sup>144</sup>

The three rules are not 'distinct' in the sense of being unconnected and "all forms of interference with the enjoyment of possessions must be justified by the state".<sup>145</sup>

Lester and Pannick go on to consider when an interference will be justified, indicating that:

**4.19.16** [...] A taking of property within the second 'deprivation' rule of this provision can only be justified if it is in the public interest. Interferences with property falling within the first and third rule are similarly required to be in the public, or general, interest. [...]

**4.19.17** However, the scope of review of the object or purpose of a legislative measure or other interference with property is limited. It is well established that the national authorities have a wide margin of appreciation in implementing social and economic policies, and that their judgment as to what is in the public or general interest will be respected unless that judgment is 'manifestly without reasonable foundation' [...]

In addition to being in the public, or general, interest, an interference with property should also be 'proportionate' insofar as a fair balance has to be struck between the demands of the general interest of the community and the requirement to protect the individual's rights. This will not occur if an individual or company is subject to 'an individual or excessive burden'.<sup>146</sup> The availability of compensation may be relevant in determining whether a fair balance has been struck and whether the interference was proportionate, although the Article does not guarantee full compensation in all circumstances.<sup>147</sup>

Clayton and Tomlinson's *The Law of Human Rights* states that the concept of possessions covers pecuniary assets, such as debts.<sup>148</sup>

### **Analysis**

A number of respondents to the consultation raised the issue of Convention rights, citing Article 14 (right to freedom from discrimination in relation to Convention rights) and particularly, Article 1 to the First Protocol. By Section 6(1) of the *Human Rights Act 1998* (HRA), it is unlawful for a public authority to act in a way which is incompatible with a Convention right, and the term "public authority" encompasses the courts.

Law firm, Dechert LLP, indicated that, in its view, the two schemes suggested in the consultation paper amount to a *de facto* expropriation of property<sup>149</sup> and note that such a deprivation of possessions "requires even stronger justification than other forms of interference in a person's enjoyment [of] possessions". The firm went on to state that "the compensation terms to be paid are relevant to the assessment of whether the contested measure respects the requisite fair balance, and notably, whether it imposes a disproportionate burden on the adversely affected party". It concluded that:

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<sup>144</sup> *ibid.*

<sup>145</sup> Clayton and Tomlinson, *The Law of Human Rights*, 2<sup>nd</sup> Edition, Oxford, 2009, para 18.77, 18.78

<sup>146</sup> See for example: *Sporrong and Lonnroth v Sweden* (1982) 5 EHRR at paras 69 and 73

<sup>147</sup> Lester, Pannick and Herberg, *Human Rights Law and Practice*, 3rd Edition, LexisNexis, 2009, paras 4.19.23 and 4.19.24

<sup>148</sup> Clayton and Tomlinson, *The Law of Human Rights*, 2<sup>nd</sup> Edition, Oxford, 2009, para 18.90

<sup>149</sup> Dechert LLP submission, in HM Treasury, "Ensuring effective debt relief for poor countries: Consultation responses received", February 2010



Compensation for deprivation must be ‘reasonably related’ to the value of the property taken. Whilst it is true that in some circumstances a reimbursement at less than full market value may be permissible, where the calculation of compensation is manifestly without reasonable foundation, this will amount to a breach of Article 1. (*Lithgow v UK* (1986) 8 EHRR 329 at para 122)

Each of the two proposals set out in the Consultation Paper adopts a formula for compensating the creditor which is without reasonable foundation.<sup>150</sup>

Dechert focused particularly on the “legitimate expectation” upon which the purchaser would have proceeded both in determining to purchase the debt and then (if it decided to do so) in investing in attempts to seek payment of its legitimate contractual entitlement. The firm also noted that the “retrospective application of the legislation” had the effect of depriving someone of a pre-existing “asset” that was part of his or her “possessions”, hence describing the proposal as “a retrospective interference with established rights and one which imposes an excessive burden on those who have acquired the debts in the market place and who have a legitimate expectation of realising their full market value.”

Dechert’s submission was supported by the Emerging Markets Trade Association (EMTA)<sup>151</sup> and counsel from 3 Verulam Buildings. Jonathan Nash QC and Peter Ratcliffe contended that while in the absence of a Draft Bill, it was impossible to be conclusive, they agreed with Dechert LLP that “there is a real risk that the Proposed Legislation, if enacted, would interfere with property rights of HIPC creditors in a manner that is inconsistent with the ECHR and thereby, the HRA.”

They stated, *inter alia*, that:

The Proposed Legislation would create a statutory scheme specifically intended to effect a forced redistribution of wealth from a very specific group of (principally) private persons in order to further a very broad international social justice goal. There is clearly scope for doubt as to whether, such general goal, in itself and as a matter of law, would justify such a selective interference with property rights in the absence of the payment of any form of compensation.

Moreover, we have a particular concern with the Government’s proposal that the Proposed Legislation apply to judgment debts. It is one thing (although certainly not a small thing) to cap the recoverable amount of debts due but not yet sued upon. But it is quite another to impose the same restrictions on debts on which judgment has been obtained.<sup>152</sup>

In addition to the arguments based on Convention rights, Dechert has also contended that “the proposed legislation would do irreparable damage to English law as a choice of law for commercial contracts, and to the City of London as an international financial centre”. It argued that if enacted, future lenders “would understandably lose trust in the UK, and English law, which would have shown itself as a jurisdiction prepared retrospectively to deprive lenders of their possessions without proper compensation; and which it will be assumed might well do so again.”<sup>153</sup>

In response to these concerns, the Explanatory Notes to the Bill explain that the “Treasury considers the Bill to be compatible with the Convention rights, because of the compelling public policy reasons for reducing the debts concerned.” The Government’s policy analysis

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<sup>150</sup> *ibid.*

<sup>151</sup> *ibid.*

<sup>152</sup> *ibid.*

<sup>153</sup> *ibid.*

is set out in detail in its [consultation response](#) (in particular paras 2.8, 2.33, 2.75-2.79) and its [impact assessment](#).

The [explanatory notes](#) go on to claim that:<sup>154</sup>

***Article 1 of the First Protocol***

42. The Bill reduces the recoverability of debts and judgment debts, which are possessions within the meaning of Article 1 of the First Protocol to the Convention (“A1P1”). That reduction is more likely to be a ‘control of use’, rather than a ‘deprivation’ of possessions. The European Court of Human Rights (“the ECtHR”) has found there to be a ‘deprivation’ only where there is a total practical or legal extinction of the rights of ownership. Furthermore, there are cases in which state actions led to a considerable diminution in the value of property but which were nonetheless categorised as ‘controls on use’: see, for example, *Fredin v Sweden* (1991) 13 EHRR 784. Under the Bill’s provisions, the creditors will still retain an asset of some economic value. Further, although the face value of the debts concerned will be considerably reduced by the Bill, the current market value of those debts is likely to be much lower than their face value. While market data in this area is difficult to obtain, the evidence indicates that HIPC debts currently trade at or slightly below the levels to which they would be reduced under the provisions of this Bill.

43. The Bill is retrospective, in that it applies to debts incurred, and judgments obtained, before its commencement. The Bill does not apply to debts incurred after its commencement. Retrospective measures may in principle be compatible with A1P1, although the ECtHR has referred to the need for an ‘obvious and compelling public interest’ for retrospective measures (see for example *Scordino v Italy* (2006) 45 EHRR 207 at para 132, and, in an A1P1 context, *National and Provincial Building Society v United Kingdom* (1997) 25 EHRR 127).

44. There is an obvious and compelling public interest in the proposed legislation being backwards-looking and, to that extent, retrospective. The proposed legislation is by necessity backwards-looking, because it is designed to deal with HIPCs’ historic debts. It would be contrary to the aim of the legislation if it were also to be forwards-looking, in the sense of catching debts which do not yet exist but which may be entered into in the future. Such a measure would discourage lenders from lending money to HIPCs, and would undermine development goals. Further, if the legislation were to apply to debts not yet contracted, it would be easy to avoid the impact of the legislation, for example by providing that the governing law was (say) New York law, and that US courts would have exclusive jurisdiction. This would have the undesirable effect of driving legal business away from London.

The Explanatory Notes also state that:

The government considers the Bill to be proportionate, within the margin of appreciation afforded to states, and to be compatible with A1P1. Policy in relation to third world debt involves consideration of political, economic and social issues. In such matters of ‘high social policy’, states are entitled to a wide margin of appreciation.

In relation to arguments made about the enforceability of judgment debts, the Government has said that “the aim of the Bill would be significantly hindered if it did not extend to judgment debts, given the number of creditors who have obtained judgments on their debts against HIPCs.”

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<sup>154</sup> *Debt Relief (Developing Countries) Bill* [explanatory notes](#), paras 42, 44

## 5.5 Transparency

NGOs have criticised ‘vulture funds’ for their lack of transparency.

Introducing the *Developing Country Debt (Restriction of Recovery) Bill* in the 2008-09 session, Sally Keeble noted that vulture funds were “often based in tax havens and are secretive, and it is the secrecy as well as the profiteering that this Bill seeks to address”.<sup>155</sup>

The Government noted these provisions and those within the draft legislation before the US Congress “that would oblige creditors covered by the legislation to apply for permission from the courts to litigate, with a requirement to disclose information about all of those with a significant financial interest in the action.” It acknowledged the view that “a requirement for greater openness might have a deterrent effect”, but said that was “inclined to see such a provision on its own, without further measures, as insufficient to be a robust deterrent”, and argued its preferred approach to be “sufficient, without introducing an additional procedure and transaction cost.”<sup>156</sup>

Jubilee Debt Campaign urged the Government to reconsider, calling for “transparency requirements forcing companies who wish to bring cases to disclose information about themselves and their claim”, and suggesting parallels with the successful work of the G20 group of developed and large developing countries on tax havens.<sup>157</sup> The Scottish Catholic International Aid Fund (SCIAF) argued that the secrecy of tax havens was “integral to the way many vulture funds operate”, and argued that G20 international transparency measures “do not go far enough”, and “should be supported by international proposals including automatic disclosure of information on a multilateral basis, and effective sanctions should be imposed on tax havens that do not cooperate with information exchange.”<sup>158</sup>

The consultation response noted calls for:<sup>159</sup>

[...] provision that would require those litigating to disclose certain information to the courts, such as the ultimate beneficiaries of the litigator. Responses suggested that those bringing litigation are often based in jurisdictions where little company information is made public and that these provisions would act as a deterrent to those that might want to litigate on behalf of entities that would not want to be publicly associated with the case.

The Government concluded that, while arguments in favour of disclosure provisions had “some attraction”, it was “on balance inclined against their inclusion in any legislation”, adding:<sup>160</sup>

The purpose of legislation is not to suppress or stigmatise the use of litigation by creditors where necessary to realise the proportion of debts owed to them on which they can expect repayment under the HIPC Initiative. Legislation that is effective in ensuring that creditors cannot recoup in excess of this proportion under UK laws and in UK courts will achieve its purpose without needing disclosure provisions that might place an additional burden on creditors and are not required from creditors litigating on other debts.

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<sup>155</sup> [HC Deb 6 May 2009 c175](#)

<sup>156</sup> HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009, para 4.18

<sup>157</sup> Jubilee Debt Campaign submission, in HM Treasury, [“Ensuring effective debt relief for poor countries: Consultation responses received”](#), February 2010, p199

<sup>158</sup> SCIAF submission, in *ibid.*, p232

<sup>159</sup> HM Treasury, [“Ensuring effective debt relief for poor countries: a response to consultation”](#), February 2010, para 2.65

<sup>160</sup> *ibid.*, para 2.72

## 6 The Bill

### 6.1 Introduction

The *Debt Relief (Developing Countries) Bill* would limit the amount recoverable by any commercial creditor in UK courts for the sovereign debts of the 40 countries having unsustainable external debts and having qualified for the Heavily Indebted Poor Countries (HIPC) initiative, to a level consistent with that initiative as “assessed as sustainable by the IMF and World Bank”.<sup>161</sup>

The legislation would restrict the activities of so-called ‘vulture funds’, which buy developing countries’ sovereign debt at discounted prices, then seek to recover its value in full through the courts. It would limit successful claims to an internationally agreed level, and apply equally to all commercial creditors. Debts incurred after the Bill’s entry into force would be excluded.

Following the high-profile Liberia case (see part 2.3), the Jubilee Debt Campaign called on the top ten MPs in the *Private Members’ ballot in session 2009-10* to introduce a ‘vulture funds’ Bill to constrain such activity.<sup>162</sup> The Jubilee Debt Campaign has said that the proposals could help in the case of Liberia, where the successful judgement against the country had not yet been enforced.<sup>163</sup>

Andrew Gwynne MP came third in the ballot, and opted to introduce a Private Member’s Bill in the House of Commons on 16 December 2009. The Bill was published on 19 February 2010 as Bill 17 of 2009-10, along with explanatory notes. The Bill is scheduled to have its Second Reading on 26 February 2010. It will be presented by Sally Keeble MP, as the sponsoring Member is not able to present it personally (the Bill will remain in Andrew Gwynne’s name).<sup>164</sup>

The Government has indicated that it will support the Bill, and it assisted with the preparation of the Bill’s *explanatory notes*. Following the introduction of this Bill, the Economic Secretary to the Treasury, Ian Pearson MP, said:

The Government do not consider it acceptable that a minority of creditors continue to pursue full repayment for debts that the international community has worked so hard to reduce. It calls on all creditors to provide their share of debt relief to Heavily Indebted Poor Countries (HIPC). In that regard, I fully support the hon. Member for Denton and Reddish’s (Andrew Gwynne) decision to use a Private Member’s Bill to tackle so-called vulture funds, helping to ensure that the world’s poor see the full benefits of debt relief.

In a statement on Mr Gwynne’s personal website, Mr Pearson was also quoted as saying:<sup>165</sup>

This Bill will allow poorer countries to spend more on the schools, hospitals and other vital services that are so needed to make sure that they continue to support their populations.

Commercial finance has a key role to play in building sustainable economic growth in developing countries, but it is also right that all creditors play their part in providing the debt relief that can help make that development possible.

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<sup>161</sup> “[Andrew Takes on vulture funds](#)”, Andrew Gwynne MP’s website (un-dated)

<sup>162</sup> “[Vulture Funds awarded \\$20 million from Liberia in High Court](#)”, Jubilee Debt Campaign, 26 November 2009

<sup>163</sup> “[MPs act to stop vulture funds using UK courts to pursue poor nations](#)”, *The Guardian*, 24 February 2010

<sup>164</sup> “[Time to end the Vulture Culture](#)”, Andrew Gwynne MP’s blog, 20 February 2010

<sup>165</sup> “[Andrew Takes on vulture funds](#)”, Andrew Gwynne MP’s website (un-dated)

Mr Pearson has also said the Bill "another example of where the UK is leading on debt relief".<sup>166</sup> Mr Gwynne has stated that:<sup>167</sup>

This Bill would represent a major step forward in tackling these funds. It cannot be right that companies are allowed, in British courts, to make profits out of the world's poorest people. In some of the very poorest countries almost half the population lives on just under a dollar a day. [...]

For too long, some companies have been allowed to get away with exploiting the debt relief received by developing countries for their own profit; taking vital resources away from those that need it most. Through my Private Members Bill I aim to put a stop to it.

Government support for the Bill may increase the chance of the Bill achieving all its Commons stages in one sitting. Two Private Members' Bills with Government support successfully received their Second Reading and passed through all their Commons stages on 5 February 2010.<sup>168</sup> Ahead of the Second Reading debate, Mr Gwynne commented on the Bill's chances of becoming law:<sup>169</sup>

I'm not entirely sure how likely my Bill is to make it onto the statute book. The timing of the General Election and the dissolution of Parliament will to some extent determine that.

Two days before the debate, *The Guardian* reported the Treasury Minister, Mr Pearson, as saying that "even with a general election looming, there was still a prospect that with enough support, the bill could become law before the end of the parliamentary session. "I'm optimistic we can get this on the statute book," he said."<sup>170</sup>

The Liberal Democrats have also indicated their support for the Bill.<sup>171</sup> There are no public statements available from the Conservative party. The Green Paper, [One World Conservatism - A Conservative Agenda for International Development](#) stated:<sup>172</sup>

We support steps to accelerate the process of relieving Heavily Indebted Poor Countries of their debt. Once debts have been written off it is important that countries should not start down the path of unsustainable indebtedness again. However, we recognise that the development of capital markets, in time, will play the same role in Africa that it has in the rest of the world.

The Bill has the support of 200 MPs (as of 24 February 2010) who have signed [Early Day Motion 618](#), which:

[...] expresses concern at the activities of so-called vulture funds, which seek to profit unfairly from the defaulted debts of heavily-indebted poor countries; notes that the international community has already deemed many of these countries' debts

<sup>166</sup> "MPs act to stop vulture funds using UK courts to pursue poor nations", *The Guardian*, 24 February 2010

<sup>167</sup> "Andrew Takes on vulture funds", Andrew Gwynne MP's website (un-dated), see also [15 January 2010 Blog update](#)

<sup>168</sup> Anti Slavery Day Bill 2009-10 (HC Deb 5 February 2010 c574), and Damage s(Asbestos-Related Conditions) (No 2) Bill 2009-10 (HC Deb 5 February 2010 c 582)

<sup>169</sup> "Time to end the Vulture Culture", Andrew Gwynne MP's blog, 20 February 2010

<sup>170</sup> "MPs act to stop vulture funds using UK courts to pursue poor nations", *The Guardian*, 24 February 2010

<sup>171</sup> "URGENT ACTION: Support the Vulture Funds Bill", Jubilee Debt Campaign webpage, un-dated. At the Liberal Democrat's 2009 Autumn Conference, a G20 compact was proposed, which included "Initiating measures in the UK to prevent the actions of 'vulture funds'" ("[Liberal Democrats back plans to help developing world through economic crisis](#)", 21 September 2009). The conference adopted the motion ("[Policy Motion: Development in a Downturn – carried](#)"), 21 September 2009).

<sup>172</sup> Conservative Party, Green Paper on International Development: "[One World Conservatism - A Conservative Agenda for International Development](#)", July 2009, p20

unsustainable by agreeing to reduce or cancel them; further notes the actions of a minority of creditors who litigate to seek full repayment of defaulted debt by claiming payment via international trade and even aid transactions; is concerned at the use of UK courts for a high proportion of these cases; welcomes the work by the Jubilee Debt Campaign to highlight the activities of the vulture funds; and supports the provisions of the Debt Relief (Developing Countries) Bill [...].

Progress of the Bill can be followed on the [Parliament website](#) (and the [Bill Gateway](#) on the Parliamentary intranet). An [RSS newsfeed](#) of the Bill's progress is also available from the Parliament website.

The Bill would enter into force two months after being passed.<sup>173</sup> The Bill covers all of the UK. The Government suggests that while the Bill would have no financial effect in the UK.<sup>174</sup> The Bill would see an estimated transfer of around £145 million from commercial creditors to HIPC countries, the amount that those creditors may have received beyond HIPC terms for debts pursued.<sup>175</sup>

The following sections offer only a selective summary. A clause-by-clause summary can be found in the Explanatory Notes to the Bill,<sup>176</sup> with further details available in part 5, and the Treasury's response to its consultation and revised Impact Assessment.<sup>177</sup>

## 6.2 Qualifying debt (clauses 1 & 2)

**Clauses 1 and 2** define which debts qualify under the Bill.

**Clause 1, subsection (2)** specifies that the Bill applies in relation to the IMF and World Bank Heavily Indebted Poor Countries (HIPC) initiative only.

**Clause 1, subsection (3)** defines the relevant debt for the Bill's purposes to be external public debt of a country eligible or potentially eligible for the HIPC initiative. For HIPC countries it applies to debt "incurred before decision point is reached" (subsection (3)(d)). Any additional debts occurring after decision point (before and after completion point) would therefore not be subject to the Bill's provisions. **Subsections (4) and (5)** clarify that debt incurred before the Bill enters into force and restructured after decision point is reached is to be treated as if it was incurred at its original time (and therefore remains eligible for treatment under the Bill's conditions). These subsections allow new debts to be covered if they replace old debt through debt restructuring. As the Explanatory Notes state, this approach "follows the practice of the Initiative in determining whether or not a debt is included in the Initiative on the basis of the nature of the original debt, rather than of a replacement that arises through a restructuring."<sup>178</sup>

**Clause 1, subsection (6)** clarifies that "potentially eligible" countries are determined by the IMF and World Bank, and refer to countries where decision point has not been reached. The five eligible countries which have so far not taken part in the initiative (at 'pre-decision point') are: Comoros, Eritrea, Kyrgyz Republic, Somalia and Sudan. **Subsections (11) and (12)** state that, should the HIPC initiative eligibility conditions (based on income, debt or economic

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<sup>173</sup> [Debt Relief \(Developing Countries\) Bill](#), clause 9

<sup>174</sup> [Debt Relief \(Developing Countries\) Bill - Explanatory Notes](#), para 37

<sup>175</sup> HM Treasury, "[Ensuring effective debt relief for poor countries: a response to consultation](#)", February 2010, para 2.28 & HM Treasury, "[Impact Assessment of measures to address non-participation in debt relief](#)", February 2010, *passim*.

<sup>176</sup> [Debt Relief \(Developing Countries\) Bill - Explanatory Notes](#)

<sup>177</sup> See HM Treasury, "[Ensuring effective debt relief for poor countries: a response to consultation](#)", February 2010 and HM Treasury, "[Impact Assessment of measures to address non-participation in debt relief](#)", February 2010.

<sup>178</sup> [Debt Relief \(Developing Countries\) Bill - Explanatory Notes](#), para 13

size) for debt relief change after the Bill enters into force, any such new conditions will not apply under this legislation. The Explanatory Notes state that these clauses “stop the scope of the Bill from expanding (or contracting) if a future policy decision were reached to change” the HIPC conditions.<sup>179</sup>

**Clause 2, subsections (2) and (3)** define exactly which debts are applicable and not applicable respectively under the Bill. Eligible debt is specifically that to which the HIPC Initiative applies, based on definitions used by the IMF and World Bank. Short-term debt, of under one year, is specifically excluded in **subsection (3)(b)**, unless it should have been discharged more than year before the Bill enters into force or more than a year before decision point (where a given country has reached decision point), in **subsection (4)**. **Subsections (5) and (6)** define ‘public’ debt to include that incurred by a government (including local government), central bank/monetary authority or a “body corporate controlled (directly or indirectly)” by such either. **Subsections (7), (8) and (9)** define which debt is to be regarded as ‘publicly guaranteed’ and ‘external’ for the purposes of debt qualifying under the Bill. **Subsection (10)** allows for debt to be considered as external debt (and thus qualifying) unless it is proved through proceedings over disputed debt not to be external.

### 6.3 Recoverable debt (clauses 3-5)

**Clause 3** limits the amount a creditor can recover to the amount they would have been able to recover under HIPC debt relief terms.

**Clause 3, subsection (1)** applies this principle to the original debt and any “causes of action” linked to it, such as “a damages claim.”<sup>180</sup>

In instances where a creditor and debtor have agreed to reduce a debt/cause of action, **subsections (3) and (4)** ensure that the HIPC debt reduction level is applied to the original debt, rather than the negotiated lower value, which the explanatory notes state ensures “that a creditor that has agreed to such a compromise is not disadvantaged in comparison to a creditor that has not.”<sup>181</sup> **Subsections (5) and (6)** apply the same principle to rescheduled debt repayments, while **subsection (8)** ensures debt reductions apply to secured debt, where “the secured creditor attempts to enforce the security.”<sup>182</sup> **Subsection (9)** ensures that UK courts must apply the reduction even if they are applying foreign laws.

**Clause 4** specifies what the ‘relevant proportion’ to be used in **clause 3** should be. It states that this should be the proportion under the HIPC initiative. This is essentially the sustainable debt level determined by the initiative, i.e. the ‘traditional’ level of debt relief (of 67%),<sup>183</sup> plus reduction by the ‘Common Reduction Factor’, this being the proportion of debt creditors’ are called on to forgive in order to reduce the country’s debt to a sustainable level. The Explanatory Notes offer this example:<sup>184</sup>

The Common Reduction Factor for an eligible country might be 33%. A debt of £100, if reduced in accordance with the Initiative, would first be reduced by 67% through traditional relief, to a new value of £33. Further reduction by the Common Reduction

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<sup>179</sup> *ibid.*, para 14, specifically: “The current conditions for a country to be designated eligible or potentially eligible for the Initiative include the following: (i) for the country’s income levels currently and at the end of 2004 to be below the level for qualification for lending from the World Bank’s International Development Association and the IMF’s Extended Credit Facility and (ii) for its level of indebtedness at or before the end of 2004 to be such that it would remain above sustainable levels even after provision of a 67% reduction in the net present value of its debts through so-called traditional relief.”

<sup>180</sup> *ibid.*, para 18

<sup>181</sup> *ibid.*, para 17

<sup>182</sup> *ibid.*, para 20

<sup>183</sup> Paris Club debt rescheduling on ‘Naples terms’, involving 67% debt reduction in Net Present value terms.

<sup>184</sup> [Debt Relief \(Developing Countries\) Bill - Explanatory Notes](#), para 24

Factor gives the amount the debt would be if it were reduced in accordance with the Initiative (A) as £22, and hence the relevant proportion as 22%.

The Bill assumes that the country concerned has reached completion point, even if it has not done so. This is because creditors may not actually provide debt relief at decision point (although they do in practice), only at completion point, hence the Bill assumes that envisaged debt relief will take place. If a higher Common Reduction Factor is needed at completion point, the notes state that HIPC practice of using the most recent figure would be followed.<sup>185</sup> **Subsection (3)** sets the relevant proportion as 33%, for those ‘potentially eligible’ countries which have not begun the HIPC initiative, and so have had a reduction factor calculated for their debt. On the basis that ‘traditional’ debt relief of 67% would be the minimum reduction those countries could expect (given that the purpose of the HIPC initiative was to help those countries that could not reduce their debts to sustainable levels through traditional debt relief mechanisms).

**Clause 5** allows for the value of judgments and arbitration awards to be reduced in line with Clause 4. This applies to judgments made before the Bill comes into force (two months after Royal Assent), and is therefore retrospective. It also applies to the enforcement of judgments made in foreign jurisdictions which are being pursued through the UK courts.<sup>186</sup>

#### 6.4 Remaining clauses (clauses 6-9)

**Clause 6** exempts any sovereign debts where the debtor country does not offer to reduce that debt to the level that HIPC terms would allow for. The Explanatory Notes state that the purposes of this provision, which is not part of the HIPC initiative:<sup>187</sup>

[...] is to increase the creditor’s prospects for recovering the amount to which it remains entitled, and to encourage the debtor to participate in negotiations to agree settlement of the debt rather than oblige the creditor to recover the debt through the courts.

Where judgements (or attempts to pursue foreign judgments) were made before the Bill entered into force, those proceedings are excluded from this provision. As noted above, this provision is not currently part of the HIPC initiative, and as the Explanatory Notes state: “In those situations, the reduction will apply to the judgment or award, without the need for the debtor to make an offer.”<sup>188</sup>

The Bill covers foreign judgments, but not all foreign judgements. **Clause 7** exempts judgements which the UK is obliged to implement, “even where such enforcement is contrary to the UK’s public policy,” while **subsections 6(2)(a) and 6(2)(b)** also exclude “two procedures for fast-track enforcement under EU Regulations” which apply only to uncontested claims.<sup>189</sup>

**Clause 8** ensures that nothing already paid by the debtor in relation to any of debt liabilities covered by the Bill should be returned as a result of it.<sup>190</sup>

**Clause 9** states that commencement (the entry into force of the legislation) would be “at the end of the period of two months beginning with the day on which it is passed”, that it extends to the whole of the UK, and its short title on Royal Assent.

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<sup>185</sup> *ibid.*, para 26

<sup>186</sup> see *ibid.*, para 28

<sup>187</sup> *ibid.*, para 30

<sup>188</sup> *ibid.*, para 3

<sup>189</sup> *ibid.*, paras 33, 34 and 35

<sup>190</sup> *ibid.*, para 37



## Bibliography & further resources

A list of key sources and documents is provided below. See also documents referred to in footnotes throughout this paper.

### Bill:

*Debt Relief (Developing Countries) Bill* [text of Bill](#) and [explanatory notes](#)

**HM Treasury:** [Consultation page](#), [Debt relief page](#)

HM Treasury, [Ensuring Effective Debt Relief for Poor Countries: a consultation on legislation](#), July 2009

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