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The HIPC Debt Relief Bill: making forgiveness compulsory

Debt relief to the world's poorest countries has been an issue since the launch of the Heavily Indebted Poor Countries (HIPC) Initiative in the 1990s. Draft UK legislation - the Debt Relief (Developing Countries) Bill - seeks to introduce a mandatory element to debt relief under the HIPC Initiative. This Briefing looks at the background to the Bill and its key features.

No insolvency procedure is available to nation states. A state remains liable for its debts regardless of whether it has the means to pay or of the negative consequences of such payment on its people or development potential. Faced with this, there has long been concern in the international community about how to deal with poor countries facing heavy debts. The relatively small number of major sovereign creditors has been able to reach agreement on debt relief in respect of some of the world's poorest countries, but that has not bound the myriad of private sector creditors, some of whom have been prepared to resort to court action to enforce their claims.

The UK Government has now published draft legislation that, if enacted, will force private sector creditors to accept deals agreed under the HIPC Initiative by the international public sector. It is not an insolvency process, and it is only applicable in the UK, but it is a step towards the compulsory reduction of the debt burden facing some of the world's poorest countries. According to Nelson Mandela, poverty "is man-made and it can be overcome and eradicated by the actions of human beings." With the proposed implementation of the Bill, the UK Government appears to be taking a step in this direction and is demonstrating that it is prepared to use legislation to compel mandatory debt relief in certain limited cases.

The HIPC Initiative

The HIPC Initiative was launched by the World Bank and the International Monetary Fund in 1996 and was supplemented by two international agreements in 1999 and 2005. The 1999 Enhanced HIPC Initiative was designed to provide faster, deeper and broader debt relief, and required HIPCs to introduce measures designed to reduce poverty. The 2005 Multilateral Debt Relief Initiative was agreed at the Gleneagles summit and provided for 100% cancellation of IMF, World Bank, African Development Bank and Inter-American Development Bank claims for countries completing the HIPC Initiative.

In a nutshell, the HIPC Initiative now aims to provide debt relief to a list of forty of the world's poorest countries. These countries have both high levels of poverty and unmanageable levels of debt. To be eligible, an HIPC country must demonstrate to the World Bank and the IMF that it has a poverty reduction plan and sound economic management policies so that savings from debt relief will be directed towards development and reducing poverty. When this point is reached (the Decision Point) the World Bank and the IMF agree triggers with the country that the country must meet in order to complete the HIPC Initiative and also set a level of debt reduction (the Common Reduction Factor) required of all creditors in order to return that country's debts to a sustainable level.

Key points

- **Debt relief under the HIPC Initiative is currently voluntary.**
- **The Bill imposes mandatory debt relief on all creditors of HIPC debt by setting the maximum amount recoverable.**
- **The Bill covers a historical amount of HIPC debt and does not apply to new HIPC lending or non HIPC debt.**
- **The Bill makes no distinction between debt held by original creditors and debt traded on the secondary market.**
- **Previous unsatisfied judgments on HIPC debt are overturned by the Bill to the extent they exceed the maximum amount recoverable.**

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The Common Reduction Factor is applied on top of the traditional 67% debt relief considered necessary for HIPCs, and aggregate debt reduction in excess of 90% is usual.

When an HIPC country has followed the poverty reduction plan for at least a year and met the reform triggers agreed with the IMF, it arrives at Completion Point. At Completion Point, all creditors, whether multilateral (such as the World Bank), bilateral (such as the nineteen governments constituting the permanent members of the Paris Club) or commercial are expected voluntarily to cancel their debt to the extent of the Common Reduction Factor in order to achieve debt sustainability for the HIPC. Many creditors, including commercial creditors, participate fully in this through, for example, the World Bank's Debt Reduction Facility, which funds (often with donor money) debt buy backs. Some multilateral and bilateral creditors go further by cancelling the entire amount of their HIPC debt.

However, as the HIPC Initiative is only voluntary, not all commercial creditors choose to participate. Some claim the full amount of the debt or sell their claims to others. There have been several cases of non-participating commercial creditors pursuing their claims through litigation. A number of these cases (such as *Donegal v Zambia* in 2007 and *Hamsah Investments v Liberia* in 2009, in both of which the debt was acquired for speculative purposes at a steep discount on the secondary markets) have caused alarm in the public sector because of their potential to limit the effect of the HIPC Initiative in reducing poverty.

Objectives of the Bill

There is conflicting data about both the extent of the participation by commercial creditors in the HIPC Initiative and the amount of potential litigation left. However, the current UK Government wants, in broad terms, to restrict the recoveries that commercial creditors can make through litigation against HIPCs. It considers that funds given to HIPCs by multilateral or government entities through debt relief should not be diverted to the litigating creditor instead of being used in the country's poverty reduction programme or to meet its development needs. In addition, it believes that commercial creditors may be deterred from participating in the HIPC Initiative if non-participating creditors are able to profit through litigation.

Consequently, the UK Government has backed the introduction of a Private Member's Bill to deal with these concerns. The Bill's objective is to prevent commercial creditors from recovering under UK law or in UK courts a proportion of their debt in excess of the sustainable level set by the HIPC Initiative. The Bill is primarily aimed at so called "Vulture Funds" (often special purpose vehicles) which acquire defaulted HIPC debt at a low market value, wait until the other creditors have voluntarily reduced their debts so that the debtor country has more funds available and then sue the HIPC debtor in order to recover the full value of the debt.

Main features of the Bill

Qualifying debt (clauses 1 and 2). The debt affected by the Bill is the debt eligible for relief under the HIPC Initiative, but it is limited to HIPC debt incurred prior to an HIPC's Decision Point and prior to the commencement of the Bill. HIPC debt incurred between Decision Point and commencement is not covered.

"Qualifying debt" includes the debt of the five countries on the HIPC list that have not yet reached Decision Point but it is limited to the debts of the countries that meet the HIPC eligibility criteria in effect at commencement. Any changes to those criteria going forward (whether resulting in an expansion or reduction of HIPCs) are disregarded by the Bill.

The Bill is therefore restricted to an identifiable stock of historic debt. Notably it makes no distinction between HIPC debt still held by the original creditor and HIPC debt that has been traded on the secondary markets.

The recoverable amount (clauses 3 and 4). The Bill limits the amount of qualifying debt (and associated causes of action such as damages claims) recoverable by a creditor in the English courts to the amount the creditor would have received if it had applied the most recently published Common Reduction Factor set by the IMF and World Bank under the HIPC Initiative (on top of the 67% "traditional relief").

For the five countries that have not yet reached Decision Point, no Common Reduction Factor has yet been set. As a result, the Bill only takes into account the 67% traditional relief, leaving a reduced amount of 33% payable. This may have the effect of encouraging creditors to settle with the five HIPCs before they reach Decision Point.

The relevant proportion of any restructured, refinanced or compromised qualifying debt is ascertained by reference to the amount of the initial debt prior to the restructuring, refinancing or compromise agreement.

There are two interesting points to note here. First, clause 3(8) makes it clear that secured assets are not immune from the reduction, effectively devaluing any security. Secondly, clause 3(9) requires the English courts to make the reduction even if the qualifying debt is governed by foreign law (on which more later). It remains to be seen whether, if enacted, there is a risk that the legislative attempt to limit the amount of qualifying debt recoverable without compensation will constitute an interference with a creditor's property rights. The European Convention of Human Rights, the Human Rights Act 1998 and the Rome I Regulation may all be relevant.

Retrospective Effect (clause 5). In addition to changing the terms of existing contracts by reducing the recoverable amount on due debts, the Bill also applies the same reduction to qualifying debts on which judgment has been obtained but not yet enforced. In other words, past judgments and arbitral awards that have not yet been enforced will be retrospectively reduced on enforcement in the English courts. This may have implications for recent judgments obtained by commercial creditors in the English High Court who may seek enforcement of their debt in other courts.

The human rights issue described above is also relevant here.

Cross-border elements. The Bill raises some cross-border issues. Clause 3(8) provides that qualifying debt includes HIPC debt governed by foreign law as well as English law. However, the effect of this may be minimal as a claimant would, as a result, be unlikely to choose the English courts as the dispute forum of a foreign law HIPC debt claim.

Further, the judgments that must be reduced under clause 5 upon enforcement are not just English judgments but also foreign judgments and arbitral awards. HM Treasury has sought to justify extending the Bill to the enforcement of foreign judgments and awards in the English courts on public policy grounds. The legislation provides that if the enforcement treaty between the UK and the relevant country requires enforcement in full, notwithstanding public policy grounds, then the foreign judgment or arbitral award will fall outside the Bill.

Debtor exception. To encourage HIPCs to settle claims on HIPC Initiative terms, the Bill excludes from its application qualifying debt in respect of which an HIPC has not offered to compromise on HIPC Initiative terms before the "relevant time" after the commencement of "proceedings" by the creditor (clause 6) (except where the relevant time occurred prior to commencement of the legislation). "Proceedings" includes proceedings for the registration of a foreign judgment or arbitral award and for permission to enforce an arbitration award in the same manner as a court judgment; it does not include enforcement proceedings. "Relevant time" is the date of judgment or when the foreign judgment or arbitration award is registered or permission to enforce an arbitration award in the same manner as a court judgment is given.

In addition, no HIPC can recover from a creditor an amount of qualifying debt already repaid by it (clause 8).

Conclusion

The issue of debt relief is a highly emotive one, and understandably the Bill has generated strong opinions from both sides of the debate. However, whatever the views on the merits of the legislation, the Bill went through its Second Reading in Parliament on 26 February and, despite the looming election, it is possible that the Bill will be enacted within the next 12 months.

Concerns have been expressed as to the impact of the legislation on the certainty of English law, the reputation of the UK as a global financial centre and the developing nation debt markets. It remains to be seen whether these concerns are justified and whether the Bill results in increased forum shopping for the dispute resolution of HIPC debt.

It is also as yet unclear whether other countries will address the issue of litigating HIPC creditors through the use of legislation such as the HIPC Bill. The UK is unlikely to want to act in this way on its own. The United States currently has similar legislation going through the Committee stage in Congress, although it applies specifically to vulture funds.