These notes refer to the Debt Relief (Developing Countries) Bill as brought from the House of Commons on 7th April 2010 [HL Bill 53]

DEBT RELIEF

(DEVELOPING COUNTRIES) BILL

EXPLANATORY NOTES

INTRODUCTION

1. These Explanatory Notes relate to the Debt Relief (Developing Countries) Bill as brought from the House of Commons on 7th April, 2010. They have been prepared by Her Majesty's Treasury with the consent of Baroness Quin, the Peer in charge of the Bill, in order to assist the reader of the Bill and to help inform debate on it. They do not form part of the Bill and have not been endorsed by Parliament.

2. The Notes need to be read in conjunction with the Bill. They are not, and are not meant to be, a comprehensive description of the Bill. So where a clause or part of a clause does not seem to require any explanation or comment, none is given.

SUMMARY AND BACKGROUND

3. The enhanced Heavily Indebted Poor Countries Initiative ("the Initiative") is an international initiative to provide debt relief to heavily indebted low income countries. Under the Initiative, the International Monetary Fund ("the IMF") and World Bank calculate the proportionate reduction required in the country's external debts in order to return them to 150% of the country's annual exports[1], which is considered to be a sustainable level. All creditors – multilateral, bilateral and commercial – are expected to provide the proportionate reduction that will achieve this. At present, the Government, and many governments of other countries, multilateral lenders and commercial creditors do so.

---

[1]Countries with high exports relative to the size of their economy may also qualify under the 'revenue window', if their ratios of exports of goods and services to GDP and fiscal revenue to GDP exceed 30% and 15% respectively. For these countries, a ratio of 250% debt to fiscal revenue is assessed as sustainable and the HIPC Initiative expects the reduction that will lower their debts to this level. Subsequent references in these notes to sustainable levels of debt assume this point.

4. 40 countries have been designated as eligible or potentially eligible for the Initiative. The current position of eligible or potentially eligible countries in the Initiative is given in the table below.

Eligible for the HIPC Initiative		*Potentially eligible for the HIPC Initiative*
Post-Completion Point (28)	*Post-Decision Point (7)*	*Pre-Decision Point (5)*
Afghanistan Benin Bolivia Burkina Faso Burundi Cameroon Central African Republic Republic of Congo Ethiopia The Gambia Ghana Guyana Haiti Honduras Madagascar Malawi Mali Mauritania Mozambique Nicaragua Níger Rwanda São Tomé Príncipe Senegal Sierra Leone Tanzania Uganda Zambia	Chad Côte d'Ivoire Democratic Republic of Congo Guinea Guinea-Bissau Liberia Togo	Comoros Eritrea Kyrgyz Republic Somalia Sudan

5. While many creditors reduce their debts in accordance with the Initiative, some creditors have instead sought to recover the full value of the debt plus accumulated interest

and any associated charges owed to them. Repayment of these creditors diverts the resources provided through debt relief, which are intended to support development and poverty reduction in the country.

6. The Bill addresses this by preventing creditors from recovering an amount in excess of that consistent with the Initiative. It also promotes the negotiated settlement of these debts on terms compatible with the Initiative by excluding from the scope of the legislation debts where the HIPC government does not offer to settle on such terms.

7. The Government issued a consultation document – *Ensuring effective debt relief for poor countries: a consultation on legislation* – on this issue on 21st July 2009 and has published a response to that consultation. Both are available on the HM Treasury website[2].

TERRITORIAL EXTENT AND APPLICATION

8. The Bill extends to all parts of the United Kingdom.

9. This Bill does not contain any provisions falling within the terms of the Sewel Convention. Because the Sewel Convention provides that Westminster will not normally legislate with regard to devolved matters in Scotland without the consent of the Scottish Parliament, if there are amendments relating to such matters which trigger the Convention, the consent of the Scottish Parliament will be sought for them.

COMMENTARY ON CLAUSES

Clause 1 – Meaning of "qualifying debt" etc

10. *Clause 1* defines the debts to which the Bill applies. This is limited to those debts on which relief is expected under the Initiative, and which are incurred before commencement of the Bill. It also limits the legislation so that future changes that might be made to the conditions for eligibility for the Initiative would not extend or reduce the debts to which the Bill applies.

11. *Subsection (3)* gives the broad definition of the debts to which the Bill applies. The expressions used there are further defined in Clause 2.

12. *Subsections (3)(c) and (6)* extend the Bill to the countries that have been identified by the World Bank and IMF as potentially eligible for debt relief under the Initiative on the grounds of their low income and high level of indebtedness, but which are yet to meet the

[2] available from http://www.hm-treasury.gov.uk/consult_debt_relief.htm

conditions allowing the Boards of the World Bank and IMF to approve the country's entry onto the Initiative at Decision Point. Five countries currently fall into this category.

13. *Subsections (4) and (5)* cater for the restructuring of debts. The Bill 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.

14. *Subsections (11) and (12)* restrict the legislation to apply to the debts of countries that meet the eligibility conditions for the Initiative as they stand at commencement. They stop the scope of the Bill from expanding (or contracting) if a future policy decision were reached to change these conditions. 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.

Clause 2 – Qualifying debts: further definitions

15. *Clause 2* defines in more detail the debts to which the Initiative applies and to which the Bill applies. The definition is based on that used by the World Bank and IMF in determining which debts are included within the Initiative.

Clause 3 - Amount recoverable in respect of claim for qualifying debt etc

16. *Clause 3* reduces the amount recoverable on a debt to which the Bill applies to the amount which the creditor could recover if the creditor provided the level of debt relief expected under the Initiative.

17. *Subsection (1)* reduces both qualifying debts and causes of action associated with those debts to the relevant proportion. A cause of action associated with a qualifying debt might, for example, be a damages claim.

18. *Subsections (3) and (4)* apply to instances where an agreement has been reached to reduce – "compromise" – a debt or related cause of action. For example, the creditor and debtor may have agreed to reduce a debt from £100 to £50, while the level of reduction expected under the HIPC Initiative is 90%. The effect of these clauses is to apply that 90% reduction to the original £100, rather than the £50 value of the debt at the time the legislation is applied. In the example, the amount recoverable would be £10 rather than £5. The subsections ensure that a creditor that has agreed to such a compromise is not disadvantaged in comparison to a creditor that has not.

19. *Subsections (5) and (6)* have the same effect as *(3) and (4)* but cover agreements that reduced the debtor's obligations through rescheduling the terms of repayment or which replaced the original debt with a new debt. Subsection (5) refers to the net present value of future payments. The discount rate applied in association with the Initiative is the relevant Commercial Interest Reference Rate, as published by the Organisation for Economic Co-operation and Development ("the OECD").

20. *Subsection (8)* ensures that the reduction will apply when the qualifying debt is a secured debt, and the secured creditor attempts to enforce the security.

21. The effect of *subsection (9)* is that UK courts must apply the reduction even if they are applying foreign laws.

Clause 4 – Meaning of "the relevant proportion"

22. *Clause 4* defines the reduction in the amount of a debtor's obligations brought about by the Bill.

23. *Subsection (2)* applies to the debts of countries that have reached Decision Point under the Initiative. It defines the relevant proportion of a debt by referring to the reduction in accordance with the Initiative. Practice under the Initiative is as follows. At Decision Point, the IMF and World Bank calculate the percentage reduction which is required from all creditors holding debts included in the Initiative in order to reduce the country's indebtedness to a sustainable level. These organisations publish within their Decision Point document the Common Reduction Factor. This sets the reduction expected from all creditors after they have provided so-called traditional relief of 67%. The amount the debt would be if it were reduced in accordance with the Initiative is the amount it would be if firstly reduced by the application of traditional relief at 67% and secondly if further reduced by the proportion set by the Common Reduction Factor.

24. For example, 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 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%.

25. The assumption, if it is not the case, that Completion Point has been reached, is included for the following reason. While individual Decision Point documents set out the debt relief a country needs in order for that country's debt burden to become sustainable, under the Initiative debt relief need not be provided until a country reaches Completion Point. In practice, creditors who voluntarily participate in the Initiative give relief from Decision Point onwards, in the form of interim reductions in the debt service payments. The purpose of the Bill is to ensure that once a country has reached Decision Point, creditors should only be able to recover that proportion of their debts that is consistent with the reduction expected in

the IMF's Decision Point analysis. That is done by the assumption that countries have reached Completion Point.

26. Some countries are assessed as needing additional 'topping up' of assistance at Completion Point. In these instances, a higher Common Reduction Factor is published by the World Bank and IMF in the Completion Point documents. HIPC Initiative practice is to apply the most recently published Common Reduction Factor, and that is the outcome expected under this clause.

27. *Subsection (3)* applies to the debts of countries yet to reach Decision Point. For these countries, the World Bank and IMF will not (in general) have calculated the Common Reduction Factor by which debts must be reduced in addition to the provision of the traditional reduction of 67%. To be designated as a country potentially eligible for the Initiative, its debts must be sufficiently high as to remain unsustainable even if creditors provided this traditional relief. It is known that, upon reaching Decision Point, the expected reduction will be assessed as at least 67%. As its value cannot be determined beyond this, the subsection applies the 67% reduction alone to these debts and sets the relevant proportion at 33%.

Clause 5 – judgments for qualifying debts etc

28. *Clause 5* reduces the value of judgments and arbitration awards relating to debts to which the Bill applies. It applies to judgments given in the UK before commencement of the Bill, so that such judgments may be enforced only for the reduced amount. Clause 5 also applies to the enforcement of awards and foreign judgments in the UK, and those awards and judgments may only be enforced for the reduced amount.

29. *Subsection (6)* has the effect of ensuring that a creditor that has compromised a claim is not disadvantaged, as with clause 3(3) and (4).

Clause 6 – Exception: debtor failing to make offer to pay recoverable amount

30. *Clause 6* contains an exception to the legislation, excluding debts where the debtor does not make an offer to repay the amount which remains recoverable by the creditor under the terms of the Bill. This provision does not correspond to an existing element of the Initiative. Its purpose 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.

31. This provision will not apply to proceedings to enforce judgments given before the commencement of this legislation (or proceedings to enforce foreign judgments registered before that date, or to enforce arbitration awards where permission has been given before that date for the award to be enforced as if it were a judgment.) In those situations, the reduction will apply to the judgment or award, without the need for the debtor to make an offer.

32. *Subsection (2)* refers to the net present value of future payments. The discount rate applied in association with the Initiative is the relevant Commercial Interest Reference Rate, as published by the OECD.

Clause 7 – Exceptions for overriding EU or international obligations

33. *Clause 5* applies the Bill to certain foreign judgments or arbitration awards. The UK is obliged to enforce foreign judgments and awards under a number of international instruments. The reduction in this Bill will apply where, under the relevant international instruments (for example EU Regulation 44/2001 – 'Judgments Regulation'), the UK is entitled to refuse to enforce judgments and awards, where to do so would be contrary to the UK's public policy.

34. *Clause 7* excludes foreign judgments and arbitration awards from the effects of the Bill where the UK is obliged under international instruments to enforce them in full, even where such enforcement is contrary to the UK's public policy.

35. *Subsection (2) (a) and (b)* exclude from the Bill two procedures for fast-track enforcement under EU Regulations. Both procedures apply only to uncontested claims.

Clause 8 - Saving

36. *Clause 8* prevents the Bill from requiring repayment by the creditor of an amount already paid by the debtor in relation to any of the liabilities dealt with by the Bill.

Clause 9 – Duration of Act

37. *Clause 9* provides that the Act will expire one year from commencement, unless it is extended - either for a further year or permanently - by order made by Treasury. The Treasury's order-making powers are subect to affirmative procedures in Parliament. If the Act expires by reason of clause 9, it is to be treated as never having been in force, and any judgment given while the Act was in force will be treated as if it had not been reduced by the operation of clause 3.

FINANCIAL EFFECTS AND PUBLIC SECTOR MANPOWER

38. The Bill is not expected to have any effect on the United Kingdom public finances or on public sector manpower requirements.

SUMMARY OF THE IMPACT ASSESSMENT

39. The Impact Assessment estimates the impact of the Bill as a resource transfer of £145m from creditors that would otherwise have recovered sums in excess of that expected under the Initiative to the HIPCs that would otherwise have had to pay. It considers the uncertainties around this impact arising from the nature of the underlying evidence. It also

considers the likelihood of indirect costs and benefits arising from the legislation and its distributional effects.

40. The Equality Impact Assessment states that no adverse equality impact with respect to race, disability or gender is expected as a result of the legislation.

41. Copies of the Impact Assessment have been placed in the Vote Office. An electronic version is available from HM Treasury's website.

COMPATIBILITY WITH THE EUROPEAN CONVENTION ON HUMAN RIGHTS

42. 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 is set out in detail in its Response to Consultation, and its Impact Assessment. In brief, the policy reasons for the Bill are as follows. First, the Bill promotes fairness among creditors. 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 vast majority of commercial creditors. The Bill will prevent this occurring in the UK courts, and will help to bring about a fair resolution of HIPCs' debts. Second, the Bill promotes the development of HIPCs. Creditors who obtain the full value of their debt from HIPCs divert resources intended for development purposes, including debt relief and international aid provided by the UK Government.

Article 1 of the First Protocol

43. 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.

44. 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).

45. 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.

46. In the context of overall HIPC debt levels, and in the absence of comparable measures by other countries, the Bill's impact will inevitably be limited. However, the sums involved in typical cases are large in the context of individual HIPC finances (for example the mean sum in UK litigation has been $56.5 million). In supporting the Bill, the Government hopes to provide international leadership, and to encourage other countries to consider further steps to address the issue of uncooperative creditor litigation against HIPCs.

47. 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 the Northern Rock litigation, which also involved matters of high social policy, the test applied by the Court of Appeal was whether the disputed measure was 'manifestly without reasonable foundation': see *R (on the application of SRM Global Master Fund LP and others) v HM Treasury Commissioners* [2009] EWCA Civ 788, at paragraphs 75 to 77.

48. There has been consultation on the Bill's proposals, which strike a careful balance between the aims of promoting fairness among creditors, the development of HIPCs, and the interests of the financial services and legal industries. The reference point for debt reduction is the Initiative, which is an internationally agreed framework for reducing HIPC debt. Further, following the consultation, the proposals contain an exception whereby the debt reduction will apply only in circumstances where the debtor has already made an offer to settle on terms comparable with the Initiative. This exception is intended to promote settlement on HIPC terms, and will assist creditors who wish to settle on those terms, in circumstances where the debtor is uncooperative.

49. For the reasons more fully explained in the Response to Consultation, and the Impact Assessment, the government considers that the policy advantages of the Bill outweigh any risk, which is assessed as small, that the Bill might have a negative effect on the availability

of new lending to low income countries or to the position of the UK's financial services and legal sectors, particularly as the Bill is a strictly limited measure designed to apply to historical debt.

Article 6

50. These proposals raise Article 6 issues, because they will reduce the enforceability of judgments, including judgments already given before the commencement of the legislation. The ECtHR has repeatedly found an infringement of Article 6 in circumstances where states have refused to enforce judgments, or have delayed in doing so: see, eg, *Immobiliare Saffi v Italy* (2000) 30 EHRR 756. The Bill's provisions may be distinguished from those decisions on the following grounds:

- The decided cases tend to involve either situations in which the state was itself a party to the proceedings (*Brumarescu v Romania* (2001) 33 EHRR 35) or situations in which the state could and should have adopted other measures to achieve its objectives (e.g. *Immobiliare Saffi v Italy*).

- 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.

- In this particular context there is very little difference in principle between those creditors who have obtained a judgment debt, and other creditors. Whether or not creditors have gone through the court process, which may have been no more than a formality, is not a robust basis for distinguishing between creditors.

- Judgment debts are possessions within A1P1. It would be inconsistent for the state to be given a wide margin of appreciation in relation to A1P1 for judgment debts, but to be subject to an absolute prohibition when controlling the use of judgment debts by the terms of Article 6.

51. For the reasons given above, the government considers the Bill to be proportionate, within the margin of appreciation afforded to states, and compatible with the Convention rights.

COMMENCEMENT

52. The Bill will come into force two months after receiving Royal Assent.

DEBT RELIEF (DEVELOPING COUNTRIES) BILL

EXPLANATORY NOTES

These notes refer to the Debt Relief (Developing Countries) Bill as brought from the House of Commons on 7th April 2010 [HL Bill 53]

Ordered to be Printed, 7th April 2010

LONDON: THE STATIONERY OFFICE

Printed in the United Kingdom by
The Stationery Office Limited

£x.00