SCOTLAND: A SEAT OF SOVEREIGN DEBT ARBITRATION

JUBILEE SCOTLAND
Campaigning to end global debt slavery

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ARBITRATION AND SOVEREIGN DEBT DISPUTES

Since the debt crisis of the 1980s the poorest countries in the world have been held back by debts, the servicing and amortisation of which has taken precedence over the funding of essential public services such as healthcare, combating infant mortality and the spread of HIV. Where these debts prevent meeting these and other Millennium Development Goals, it has been convincingly argued that they should be defined as unpayable.[1]

In 1998 and 2005 the Highly Indebted Poor Country (HIPC) and Multilateral Debt Relief Initiative (MDRI) pledged the one-off cancellation of the debts of 40 of these countries. But this remedy was in many ways merely a sticking plaster.

Firstly, HIPC status was determined by the Debt Sustainability Framework, an essentially limited framework based solely on a country's ability to pay debts without considering their other spending needs. This has meant that countries such as Bangladesh, where nearly half the population live below the poverty line, continue to be burdened by significant sovereign debts.[2]

Secondly, even for those countries that went through the HIPC process, no lasting structures have been left in place to prevent the build up or allow for the cancellation of further unpayable debt.

Ever since the early years of the Jubilee 2000 campaign of the 1990s, many debt-campaigning organisations have called for a Fair and Transparent Arbitration process - or FTA - which would allow for the cancellation of unpayable debts.[3] The European Network on Debt and Development (EURODAD) surveys the field thus:

"Since 1990, a number of different ideas have been tabled. Kunibert Raffer of the University of Vienna has proposed the internationalisation of Chapter 9 of the US bankruptcy code. Latin American economists, Alberto Acosta and Oscar Ugarteche have tabled the idea of a permanent 'Sovereign Debt Arbitration Tribunal' (TIADS) under the aegis of the United Nations. In 2001, the IMF's Anne Kreuger put forward the idea of a 'Sovereign Debt Restructuring Mechanism' (SDRM) to be administered by the IMF. Most recently, Christoph Paulus and Steven Kargman outlined their proposals for a Sovereign Debt Tribunal which should be empowered to examine not just cases of unsustainable debt but also the legitimacy of individual creditor claims."[4]

Meanwhile, EURODAD's own Charter on Responsible Financing argues the case that *"all loan documents should provide a provision for an independent and transparent arbitration procedure in case of repayment difficulties or dispute (at the request of borrower or lender)"*.[5]

What is common to this growing strand of literature, is the desire for a form of debt cancellation that:

1 Mandel, 2006: Debt Relief as if People Mattered, New Economics Foundation
2 Jubilee Scotland, 2010: A Tale of Two Countries
3 Kaiser, 2009: An International Insolvency Framework, Erlassjahr
4 EURODAD, 2009: A Fair and Transparent Debt Work-Out Procedure
5 EURODAD, 2008: EURODAD Charter on Responsible Financing

- enables the debtor to seek debt cancellation in a neutral forum, without simply pleading with their creditor;
- is an orderly work out that does not result in any creditors receiving undue preferential treatment; and
- does not violate the rule of law, allowing one of the parties to try their own case.[6]

"...the arduous search for a solution to the Greek crisis has at least shown us that, where a debtor looks likely to default, in the future instead of disorderly ad hoc solutions there needs to be an orderly, predictable procedure that also allows for fair burden sharing. That is why we, the German government, embedded the creation of such an international debt work-out mechanism as a goal in our Coalition Agreement." Gudrun Kopp, BMZ Secretary of State

(Meeting between German Government, academics, UN representatives, and civil society in the follow-up of the official debt workout seminar of the German Government, June 2011)

Arbitration is a process whereby two parties with a grievance can come before a neutral arbiter, receive a fair hearing, and have a binding decision made. Whilst it is predominantly used for - but not limited to - disputes between corporate entities, where it is seen as a cheaper and more efficient than court-based processes, it can play a role in a far wider range of disputes. Abtitration would give both debtor and creditor countires an equal say and fair hearing, allowing debt workout agreements to be made in a way that is just and which leads to long term solutions.

A ROLE FOR SCOTLAND

Scotland has cutting edge legislation in the form of the 2010 Arbitration (Scotland) Act, as well as the new Scottish Arbitration Centre, which have provided the foundations for Jubilee Scotland's groundbreaking Sovereign Debt Arbitration Rules[7].

Following the example of the Family Law Arbitration Group (Scotland)[8] and seeing opportunity in Scotland's strong arbitration structures, Jubilee Scotland sought to develop a framework within which sovereign debt disputes could be arbitrated here in Scotland. With the support of legal professionals, academics, and international debt experts, the Sovereign Debt Arbitration Rules were launched by Fiona Hyslop MSP, Cabinet Secretary for External and Cultural Affairs, in March 2012. The rules draw heavily on Scotland's existing Arbitration Act but feature new elements specifically targeted at sovereign debt arbitrations and overcoming the inadequacies of existing international provision in debt workout or cancellation processes.

Key principles of the Rules include:

- **the mandate to decide disputes on the basis of justice, fairness or equity including taking into account matters of sustainable development, the human rights of third-parties affected, and debtor states' ability to provide basic needs and services to its citizens**
- **provision for transparency and openness, to ensure that the benefits of decisions reached in Scotland have positive ramifications in the wider international campaign.**
- **practical considerations, including the creation of an appropriate Debt Arbitration Panel and a clear range of possible awards.**

The Rules therefore ensure these arbitrations take into account matters of sustainable

6 A particular concern as far as the International Monetary Fund is concerned; a concern strong enough to derail the IMF's proposal for a Sovereign Debt Restructuring Mechanism, which would have been operating under its own auspices, while adjudicating on debts to itself.

7 Jubilee Scotland , 2012: *Sovereign Debt Arbitration Rules, http://www.jubileescotland.org.uk/sites/default/files/SDAR.pdf*

8 FLAG(S) adapted the Scottish Arbitration Rules of the 2010 Arbitration (Scotland) Act for application in and the promotion of family law arbitration, http://www.flagscotland.com/flags-arbitration-rules

development, economic assessments, human rights and the protection of basic state obligations - these are things which are typically overlooked in current debt cancellation procedures. In doing so, the arbitration will in effect be able to conduct a debt audit which examines the nature of the debts in question, including their origins and the impact on the populations of the debtor countries.

Scotland thus possesses the legislation necessary to bring affected countries together in arbitration, and in launching the Sovereign Debt Arbitration Rules has made a positive step forward in moving the idea of debt arbitration into reality. It has therefore taken an international lead by demonstrating an appetite to find fair ways of coping with unpayable and unjust debt and promoting a public, legal and international discussion about the best way to cope with unpayable debt.

WHY WOULD CREDITORS ENTER INTO ARBITRATION?

Many creditors are badly served by existing systems. One of the most recent legal analyses of sovereign default concedes that:

"the main difference between corporate and sovereign debt is the lack of a straightforward legal mechanism to enforce payment of the latter. In the event of default, legal penalties or remedies do exist, but they are much more limited than at the corporate level."[9]

Reinforcing this, Jurgen Kaiser, Head of Policy at Erlassjahr, the German debt campaign, remarks that creditors:

"are perhaps in a strong position when it comes to inflicting pain or other sanctions against a debtor, but in a very weak one, when it comes to legally or otherwise enforcing payments…. So, participating in a fair process and defending his interests through such a process tends to be more attractive than continuing to sit on old paper, which will simply not be honoured."[10]

Jubilee Scotland believes, therefore, that creditor countries will view arbitration as preferable to a situation in which indebted countries simply default on their repayments with no clear resolution on when or how these debts will be paid.

Significantly, it is also not unknown for creditor governments to rule that they now consider previously supplied loans to poor countries to be unjust, nor for them to embrace attempts for developing ways for dealing with their existing unpayable debts. For example:

- In 2006, Norway cancelled $80 million of loans previously lent to a number of countries on the basis of legitimacy. Later, in 2009, the Norwegian Government issued a political declaration stating a commitment to working towards the creation of mechanisms to deal with illegitimate debts and abolish international debts.
- The Dutch Ministry of Finance has put forward a proposal supporting the use of the Permanent Court of Arbitration for hearing disputes related to international loans between sovereign debtors and bilateral lenders, multilateral bodies and private entities.[11]

The Rules have therefore been designed with these issues in mind in an attempt to minimise any further objections. For example, all arbitrations are to be conducted by multi-member panels in which creditors and debtor countries have equal power over appointments, reassuring both that there is no bias towards one or the other. Equally, these arbitrators are chosen from a specific Debt Arbitration Panel, a highly skilled and experienced group of arbitrators whose names are made publicly available and can be reviewed before entering into an agreement. Finally, provision is made for a number of possible outcomes or awards ranging from full cancellation of a debt to a freezing or reduction of interest rates, for example, and so both sides should see oportunities in arbitration for attractive alternatives to current debt arrangements.

9 Panizza, Sturzenegger, Zettelmeyer, 2009: 'The Economics and Law of Sovereign Debt Default', *Journal of Economic Literature*

10 Jurgen Kaiser, Head of Policy, Erlassjahr – personal communication

11 Examples from: A fair and transparent debt work-out procedure: 10 core civil society principles, EURODAD, December 2009.

SHOULD THIS NOT BE LEFT TO INTERNATIONAL ORGANISATIONS OR SOVEREIGN STATES?

It is not the objective of the campaign to make Scotland the centre of international debt arbitration. Any international debt court would need the legitimacy of an appropriate supra-national body such as the United Nations. This is the focus of the Europe-wide 'Defuse the Debt Crisis' campaign,[12] which works on an ongoing basis with UN bodies such as UNCTAD, and is also building an international lobbying effort focused on the G20 meeting in November 2011.

Nevertheless, while there is disagreement as to whether a standing international insolvency court would be the final end of such a global progress, there is little disagreement that the beginning point is different arbitration panels around the world. 'It is important to stress that an international Chapter 9 insolvency procedure would not at all need a new international organisation, nor a costly bureaucracy. Arbitration panels are temporary.'[13] The openness and transparency ensured in the rules means precedents will be set as an example for future arbitrations.

Equally, whilst not a sovereign state, Scotland is a significant polity which can punch above its weight by showing a concern for development issues as well as a creative approach to tackling them. The Scottish Government has pursued its own development policy and budget, which although small has been maximised through a focus on specific countries such as Malawi.[14] Crucially in this case Scotland *qua* nation would not be voicing its own opinion, but presenting itself as a seat where parties can receive a fair hearing.

The recently established Scottish Arbitration Centre supports the view that Scotland 'has a modern, innovative arbitration regime to rival any other' and has been set up, in part, 'to promote Scotland as a place to conduct international arbitration'.[15] The remit of the Scottish Arbitration Centre shows that there is already work underway to ensure Scotland receives due consideration internationally in decisions over where to seat arbitration cases. Scotland has the skills, legislation and political will to take on this role.

WILL SCOTLAND HAVE TO PAY?

Arbitration is traditionally less expensive than other legal mechanisms, as it tends to be quicker. Further, it creates major savings by allowing parties to finalise a long-term debt arrangement eliminating a need for ongoing, ad hoc debt restructuring or defaulting which can be costly too. Moreover, the costs would be defrayed by the parties participating in arbitration, as determined by the arbitration agreement and/or the tribunal's decision, and therefore not to the Scottish tax payer. Where Scotland is chosen as the geographic seat of arbitration by parties, as well as the legal seat, Scotland can also expect to benefit economically by welcoming parties to its cities.

CONCLUSION

There are no easy solutions to the tangle of sovereign debt, but there is a building consensus that existing debt-management has failed, and that a new, fairer mechanism is required to free countries from unpayable debt. Scotland has already begin the process of promoting itself as a seat of arbitration in cases of sovereign debt distress through its Sovereign Debt Arbitration Rules, and in doing so it is supporting this movement of international concern, while drawing attention to its own new cutting-edge arbitration framework.

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12 www.defusethedebtcrisis.org
13 AFRODAD, 2002: *Issue Paper, Fair and Transparent Arbitration on Debt*
14 Scottish Government, http://www.scotland.gov.uk/Topics/International/int-dev
15 Scottish Arbitration Centre, http://www.scottisharbitrationcentre.org/index.html