FUNDING SOVEREIGN DEBT ARBITRATION IN SCOTLAND

A key point to consider when thinking about the practical realities of sovereign debt arbitration and how it is to be conducted is the way in which it is to be financed. This is crucial not only for the countries who are parties to the arbitration and who must determine the contribution they anticipate making. It is also important for Scotland itself when considering the role it can play in the promotion of its own arbitration legislation and thinking about the ways it can support the process of sovereign debt arbitration. This briefing provides the answers to three key questions concerning both the cost of a single arbitration case as well as the administration of any institution through which it is organised and supported.

How is an individual arbitration case financed under Jubilee Scotland's Sovereign Debt Arbitration Rules?

The Arbitration (Scotland) Act 2010 details in the Scottish Arbitration Rules how any single arbitration being held under Scottish law is to be funded and all associated arbitration expenses covered[1]. Jubilee Scotland's Sovereign Debt Arbitration Rules[2] have been designed so as to maintain the Act's original stipulations on this matter. Here it is the responsibility of the parties to meet the majority of any costs accumulated during the course of the dispute resolution process. In effect, this means that each arbitration will be funded predominantly on a case-specific basis with only the parties which are involved being required to make significant financial contributions. Therefore despite being held under Scottish law the cost to the Scottish tax payer of each arbitration case will be minimal.

When thinking about the costs likely to be incurred by the parties, the Rules (both the original Scottish Arbitration Rules and Jubilee Scotland's bespoke Sovereign Debt Arbitration Rules) state clearly what is to be included in any 'arbitration expenses'. These are:

- *The fees and expenses of the arbitrator(s).*

  Within Jubilee Scotland's own Rules provision is made for a multi-member panel made up of three arbitrators. Such a clause is likely to increase the cost of the arbitration from one held under the original Arbitration Act in which a tribunal consists of a sole arbitrator. It is vital however that a multi-member panel is used in a sovereign debt arbitration, as stated by the bespoke Rules, to ensure both parties have a say in the appointment of at least one arbitrator and confidence in the neutrality of the third. This marks a departure from existing debt workout mechanisms which have been creditor-dominated. It is also key to implementing a fair and transparent system in which both parties feel fairly represented. The resultant fees and coverable expenses are to be agreed in advance between the parties and arbitrator(s).

- *Expenses incurred by the tribunal, including: the fees and expenses of any clerk, agent, or employee; the fees and expenses of any expert from whom the tribunal obtains an opinion; the expenses of meeting and hearing facilities; and any expenses incurred in determining recoverable arbitration expenses.*

  Under the Sovereign Debt Arbitration Rules parties are granted the opportunity to call upon expert witnesses. This is an important principle in making sure the tribunal is able to consider fully the origins and impact of the debts in question by drawing on specialist knowledge unique to each case. Therefore in addition to more practical costs related to the holding of an arbitration such as booking rooms and employing clerks, parties will also have to cover the expenses of any experts they choose to involve. As with the arbitrators, the fees and

[1] Arbitration (Scotland) Act 2010, Part 7 – Arbitration Expenses, http://www.legislation.gov.uk/asp/2010/1/pdfs/asp_20100001_en.pdf
[2] Jubilee Scotland, 2012: Sovereign Debt Arbitration Rules, http://jubileescotland.org.uk/arbitration/rulesconsultation

expenses of any third-party or expert are not set by legislation and instead agreed between them and the parties.

- *The parties' legal and other expenses*

- *The fees and expenses of any arbitral appointments referee and any third party to whom the parties give power in relation to the arbitration*

  An arbitral appointments referee is employed under the Arbitration Act to intervene where parties are unable to agree upon an arbitrator. It is not therefore guaranteed that they will always be called upon. In the case of the Sovereign Debt Arbitration Rules however, the third neutrally appointed arbitrator is to be chosen by an appointments referee. These costs will also therefore always need to be covered by the parties.

In all these instances, if at any point the parties to fail to agree with the relevant individuals on the amount they are to be paid, the Auditor of the Court of Session is legislated to intervene and determine the amount at which any fees or expenses should be set. Such a provision is important to ensure the quick resolution of any disagreements and, particularly significant in sovereign debt arbitrations, to ensure one party does not dominate through the ability to exert greater financial strength.

Parties are deemed to be severally liable for financing the payment of any fees and expenses listed above and thus their contributions are considered separately. Together with or independent of the arbitral award, the tribunal can decide how to allocate the proportion of parties' liability. For example, each party may be responsible for meeting some costs of the arbitration but separately so they are not necessarily borne equally by both sides. The contribution of each party can, for example, consider what is within their means to pay but also the nature of the final award and in whose favour it is made. As Brandon Malone, Chairman of the Board for the Scottish Arbitration Centre, states 'these fees will normally be awarded against the other side in the event of success'[3]. Parties entering into an arbitration can therefore feel confident that if they have a strong case and are likely to be successful they will not be liable for the majority of any expenses.

Until such an award is made or where the tribunal decides not to make an award of this nature, the parties must nevertheless be aware that they remain liable for an equal share of the fees and expenses and for their own legal and other expenses.

One concern regarding the way through which fees and expenses are to be covered is the expectation that debtor countries will have less money available to fund an arbitration. In turn they may shy away from pursuing this method of debt workout. Equally, creditor countries could be reluctant to enter into arbitration if they believe they will be required to meet the majority of any recoverable expenses (as well as their potential loss of income) if the final decision is made in favour of the debtor country.

It is nevertheless felt that the advantages of arbitration in cases of sovereign debt disputes outweigh the short-term costs involved in conducting the arbitration itself. On the part of debtor countries there is the possibility of their existing debts being restructured, re-negotiated, or even cancelled which would in turn free them up to pursue their own future public spending plans. On the part of the creditors, they are badly served by existing debt workout mechanisms which leave them facing the costs of ongoing restructuring or simply seeing the debt being defaulted on[4]. Thus meeting the costs of the arbitration in the short-term, even if they lose and are found facing a bill far in excess of a half share of the expenses, will be cheaper in the long-term than meeting the costs of repeated debt restructurings. It will bring an existing dispute to an end. Moreover, in being a typically quicker process than alternative dispute resolution mechanisms such as litigation, arbitration is viewed by many as being a more economical

[3] Malone, B, 2010: 'Arbitration: A Duty to Advise of the Benefits', http://www.ciarb.org/scotland/downloads/Arbitration%20Article%20for%20CIArb%20Website%20(7)%20Brandon%20Malone.doc

[4] Panizza, Sturzenegger, Zettelmeyer, 2009: 'The Economics and Law of Sovereign Debt Default', Journal of Economic Literature; Jurgen Kaiser, Head of Policy, Erlassjahr – personal communication; Jubilee Scotland, 2012: 'Scotland: A seat of sovereign debt arbitration' http://www.jubileescotland.org.uk/sites/default/files/Arbitration%20briefing%20Nov%202012.pdf

option; ‘A straightforward arbitration with no right of appeal, will always be less expensive than years of litigation with multiple rights of appeal’[5]. It is consequently not anticipated that the costs expected to be borne by the parties will likely deter their pursuit of debt arbitration.

What role will Scotland have in financing sovereign debt arbitration?

Scotland's role in financing sovereign debt arbitration will be very much dependent on the type of model adopted in the creation of a debt arbitration panel. This panel is the place where arbitrators will be listed, accessed, and chosen from to sit on the tribunal. Jubilee Scotland's briefing 'Sovereign debt arbitration in Scotland: Creating a Debt Arbitration Panel' outlines two possible 'ideal' models in more detail, including the pros and cons of each[6]. One of the options is to have a small-scale expert-led panel. In this instance, there will be a need for bodies in Scotland, be it the Scottish Government, the Scottish legal sector, or both, to provide some financial backing for any administration of the panel, especially in its initial setting up. The model is based on the Family Law Arbitration Group Scotland (FLAGS). Membership of FLAGS is non-subscription but costs have been kept relatively low by it being a small-scale organisation through which arbitrators can be directly approached rather than accessed via FLAGS's own administration. The costs incurred are therefore largely only for initial start-up, maintaining a public list of member arbitrators, promotion, and one-off training events for panel members[7].

This funding could be provided by the Scottish Government, recognising that whilst this represents a cost to taxpayers there are additional economic benefits which come from attracting sovereign debt arbitrations to Scotland alongside the international precedent it would set[8]. It will also be largely Scottish lawyers involved, thus promoting their industry and seeing money being put back into the sector in the form of fees and expenses. This is similarly true of the Arbitral Appointments Referees. The Scottish Arbitration Centre or Chartered Institute of Arbitrators could also provide settings in which this would occur through the extension of their activities. It would be an opportunity for them to extend their membership, diversify their portfolios, and raise their profiles both for sovereign debt arbitration but also more traditional commercial arbitrations. Alternatively, as with FLAGS it may be that key figures and practices in the legal community who are interested in being members of the Debt Arbitration Panel will want to support the creation of a new body and take this on, using their own funds, potentially with Government support, to make this happen.

One way in which to recoup any costs which may be incurred in administering the panel over time, providing training opportunities, and promoting sovereign debt arbitration could be to charge a registration fee to be paid by parties. PRIME Finance Disputes based in the Netherlands runs a similar panel-based arbitration system to FLAGS and within its own governance structures requires parties to pay a registration fee for accessing its arbitrators and arbitrating under its bespoke arbitration rules[9]. Such a system would ensure the Government or any other agency funding the Panel would receive a return on any investment.

What role will the international community have in financing sovereign debt arbitration?

The alternative panel option is a for a supranational treaty-based member-led panel. In this scenario, the onus is no longer on Scotland to provide financial backing but on the international community more broadly. Adopting a similar approach to existing supranational organisations an international sovereign debt arbitration panel in which all member countries have nominated arbitrators would be funded by contributions from these member countries. As with the small expert-led panel this would be to cover

[5] Malone, B, 2010: ‘Arbitration: A Duty to Advise of the Benefits’, http://www.ciarb.org/scotland/downloads/Arbitration%20Article%20for%20CIArb%20Website%20(7)%20Brandon%20Malone.doc

[6] Jubilee Scotland, 2013: Sovereign Debt Arbitration in Scotland: Creating a Debt Arbitration Panel', http://www.jubileescotland.org.uk/content/scotland-seat-debt-arbitration#attachments

[7] http://www.journalonline.co.uk/Magazine/55-12/1009018.aspx#.UnutWCe3A_g

[8] http://www.scotland.gov.uk/News/Releases/2011/03/17120931

[9] PRIME Finance, 2012: Annex E – Schedule of Institutional Costs, http://www.primefinancedisputes.org/images/pdf/Schedule_of_institutional_costs.pdf

the costs of the ongoing administration of the arbitration panel rather than to subsidise any specific arbitration in itself. The International Court for Settlement of Investment Disputes, for example, which adopts a similar model of a list of nominated arbitrators receives funding from the World Bank, a body financed by contributions from members. Similarly, the United Nations Conference on Trade and Development (UNCTAD), the responsible lending and borrowing principles of which are referenced in the Sovereign Debt Arbitration Rules, adopts this approach. As a subsidiary of the United Nations it receives funding from countries first contributing to the UN budget, a portion of which is then allocated to UNCTAD[10]. One option therefore is for the Panel to act through an existing body, receiving its budget from members' existing contributions to that organisation.

Alternatively, the Debt Arbitration Panel could be initiated as a new and independent body with signatory countries paying a contribution directly to the administration of the Panel. Given the size of the Panel would be far larger than the smaller expert-led panel discussed above, administration costs would likely be higher with more arbitrators to organise and greater need for monitoring and assessment activities. However, split amongst such a large number of member countries, these could still be kept fairly low.

What's next?

Through this briefing, the Sovereign Debt Arbitration Rules, and its discussions of the possible options for a Debt Arbitration Panel, Jubilee Scotland has presented a workable vision for how debt justice through fair and transparent arbitration can be achieved in Scotland. It has presented policy makers, legal figures, and governments in Scotland and around the world with a range of ways in which this can happen and be financed. It is now the time for these ideas and frameworks to be debated amongst all these groups as well as with Jubilee Scotland's international debt movement sister organisations to decide how they are to be taken forward and implemented.

[10] http://unctad.org/en/Pages/About%20UNCTAD/Programme-Budget.aspx