GOVERNMENT LOANS

Questions and Answers

Question - Robert Baxt:

With the growing adoption of the 1958 New York Convention, is it likely that we are going to see arbitration as a means of dealing with dispute settling in this particular area?

Answer - Philip Wood:

I think that the 1958 Convention has the big advantage that it enables an arbitration award to receive recognition in the signatory countries. I still think you have all the disadvantages of arbitration in that you have got to go through the arbitration procedure first, often in a neutral country, and you still get all of the delays which are a feature of arbitration. So I am not too sure that it is the sort of thing which will come into being in loan contracts. As I said earlier, I really do not think it is appropriate for loan contracts. It is fine for contracts which involve expert matters of fact, difficult questions of fact. In loans you don't get questions like that, all you do is you get a question of whether or not a creditor has the ability to enforce his claim and therefore the ability to be taken seriously when he is talking to the debtor.

Question:

I would like to ask Philip Wood about his view on the effectiveness of a choice of law clause in the situation where you are forced to have law of the borrowing state, and the effectiveness of a clause in those circumstances which attempts to freeze the law at the date of the agreement choosing it. That was mentioned by yourself, Mr Chairman, in the remarks you have just made. It seems to me that the effectiveness of such a choice of law depends upon how the court in the chosen jurisdiction will interpret such a clause and apply the law in those circumstances.

Answer - Philip Wood:

I think there is a two-pronged answer to that. The first is that there is no case which I know of where there is a state obligation, where the state itself has changed the deal by legislation. Because there, you see, there is a collision between two principles. One is, you take the risk of your borrower's system of law. That is in collision with the other principle of the law contract, that one side cannot unilaterally

change the deal. So there is no case that I am aware of where the risk of the borrower's system of law has been applied to the creditor where the borrower happens to be a government.

Now, so far as the freeze clauses are concerned, there is some case law. I'm sorry I can't remember what the cases are but where you freeze the system of law, you are not choosing a system of law, you are incorporating a system of law - that is rather different. When you incorporate a system of law it is like saying that the term subsidiary has the definition in the Australian Companies Act. You are picking up a piece of the law instead of writing it out in full. If you say the law which applies is that which is in force at the date of this agreement, you are just absorbing the law as it is then incorporated. But you still haven't chosen your system of law and of course the freeze clause can be over-ridden by the moratorium or the exchange control decree. I don't think freeze clauses are affected. You will still use them, of course.

Question - David Mitchell (Macquarie Bank Ltd):

Philip, when the wheel falls off in the case of a corporate entity, the lenders may be permitted to influence the future direction of that entity to recover their debt. You mentioned the Ottoman Debt Council. Are there any contemporary examples that suggest that the lenders can take a more pro-active approach to a sovereign risk in default other than just rescheduling?

Answer - Philip Wood:

In one case in Peru in the mid 1970s, the creditors did write a stabilization program which they inserted into the loan agreement, but it didn't work because it was just politically embarrassing. The banks didn't have the power to see that it was enforced and it was a constant source of friction with the Peruvian government, for obvious reasons. But the banks do get it by the back door, because one of the covenants in a rescheduling agreement is that the borrower will comply with the IMF program, and it is an event of default if the performance criteria in the standby arrangements are not observed or if the standby lapses. And it is a condition precedent that there will be an IMF stabilization program.

It is much more difficult for the state itself. It is easy for them to default in favour of a whole lot of foreign money lenders, but it is much more difficult for the state to default towards the rest of the international financial community governments. So that is how it is done.

The IMF is a receiver. They are in the same position as a receiver, but it is done by a process of fiscal diplomacy instead of the gun-boat methods which used to prevail. Of course it is very abrasive, it is very antagonistic for discussion, so on the whole I think it works reasonable well when you consider the political requirements of the state.

They have also got to look after their people. They may have made an awful mess of their finances but money isn't everything

of importance when you come down to it, so it is difficult to negotiate. But in my view it is amazing how well it has worked so far.

Question - Norman O'Bryan (Gillotts):

Mr Chairman, I would like to address a question or at least ask Mr Wood to comment on the choice of law, once again. I observe that the lawyers seem to have found this particular aspect of Mr Wood's paper a very interesting and informative discussion. I wonder, Mr Wood, whether you could comment on what appear to be rather special considerations which apply to the Australian banks. Particularly to the new entrants into the Australian markets, who it seems to me, will be looking at borrowings - particularly in the Asia and Pacific regions. This is somewhat different to the borrowing with which a London lawyer might be more familiar, where the choice of law in a sense has become a secondary issue, because of the development of centralized law making systems in the European context, particularly with the EEC; but also in the American context, where there seems to be a very heavy forum centred towards America.

Do you think the Australian banks can, with confidence, contract on the basis of a sovereign state's law in the Asian and Pacific region? I am thinking particularly of the sorts of changes which you mentioned in relation to Iran for example, and similar, sudden changes which have been occurring in that region. It seems to me to pose special risks for contracting with a law maker himself unless you freeze the law at the time of a particular transaction. Bearing in mind also, that in common law systems, there are ways of changing the laws including of course appointing the relevant Judge.

Answer - Philip Wood:

I think that Australian banks which are lending to states in this area should use Australian systems of law. They are highly impartial, they are very highly developed - I think they give both sides a fair crack of the whip; they are business orientated systems of law and I think they should be used.

I believe the insulation is equally important. I don't think one wants to assume that just because you are dealing with a highly so-called responsible state that the responsible state is not going to put the interests of its people before the foreign money lenders. They always do. The United Kingdom, France, Germany have all done it in the last 25 years and so I think it is important in this region. I can't see anything special about them, in not to use the borrower's system of law if you can possibly help it.

Of course there are some cases, eg if you are lending to Japan where it is different, and it may well be that one could take this view upon the situation. Columbia was a country where the creditors did take it. Columbia always insisted on having their own law because of the Calvo Doctrine, the gun-boat 1902 problems, and creditors did accept that. But that was a very special case.

Comment - Robert Baxt:

If I could just make a brief addition to that comment from Philip Wood. In the book by Pryles and Iwasaki, Norman, they do deal at length with some of the issues that you have raised in the context of the Japanese situation.

Question - David Bailey:

I will pose the idealist question, and that is that a lot of the problems that we have been talking about, choice of law, sovereign immunity etc, are matters where you get two points of view depending on whether you are a borrower or a lender. It is interesting I think that on sovereign immunity a number of states are opposed to any modification of the traditional doctrine, particularly some of the socialist states. They see that as a challenge to their own authority. I wonder, as an idealist, what the prospects for a multilateral treaty about borrowing and lending by governments is. I know it is one of those things that might take 20 years to develop but it seems to me that these questions are universal questions. States are both borrowers and lenders from time to time, as are banks for that matter, and perhaps we ought to be looking at some of these things on a multilateral international basis.

Answer - Philip Wood:

I am not too sure that treaties will resolve the question of bankruptcy. In negotiations with states, they often object to this huge pile of paper which the creditors produce. And while I realise that a lot of the things which lawyers write, are really not necessary - they are just part of the ceremony of getting the sort of agreement which the market thinks is right. It is important to realise that creditors only have the piece of paper, whereas the states have got the money. The piece of paper has got to stand for the money, because that is all that the creditors have. I am not quite sure where idealism can come into that..

Question - Adrian Henchman (Allen Allen & Hemsley):

I would like to ask Marshall Browne whether he thinks that the commercial banks, in the light of recent experience, will as enthusiastically embrace loans to Costa Rica or Nicaragua, as they have in the past?

Answer - Marshall Browne:

I think really this rescheduling and the working out of it is going to go on for a long time there, so we are going to be living with this experience for quite a few years yet. Obviously banks have had many cases of traumatic experiences and I can't see them entering into the scale of lending that we have seen in the past. I think the lesson has been a signal one.

Also I think their methods of assessing country risk, and country exposure techniques, have improved very considerably. Obviously part of the LDC's rescheduling agreements is that new money has

to be brought forward as part of the deal and is put in by the banks. I think too, that commercial banks, as years go forward, and as countries are seen to be making progress, will come forward with further new money. They may be looking for the international financial agencies or governments to provide more, a greater ratio than they did in the past.

Question - Michael Crommelin:

The question is to Mr Wood and it relates to the doctrine of sovereign immunity. To what extent, if at all, do the benefits of that doctrine have any application in a Federal system to a state level of government, such as here or in Canada or in the United States?

Answer - Philip Wood:

That is entirely a matter of internal domestic law. In the UK we have a Crown Proceedings Act whereby you can sue the Crown. It doesn't get you very far if they don't want to pay. But most countries have actually got a similar arrangement whereby the government can be sued. There are one or two countries where you can in fact levy execution against public assets. I think India is one of them.