Problems of litigation against HIPCs

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Outline

1. International Debt relief initiatives
2. HIPC and Poverty Reduction
3. Comparability of treatment
4. Vulture fund litigation
5. Costs for HIPCs
6. Losses and protracted recovery
7. Case of DRC
8. Case of Zambia
9. Ongoing litigation against HIPCs
10. Ad hoc measures taken – UK, Belgium, World Bank, PC
11. Gap in the current system is being exploited
12. Debt workout mechanism has the potential to address this hole and treat all creditors at once

International Debt Relief Initiatives

- Heavily Indebted Poor Country (HIPC) Debt Relief Initiative
  - Supplemented by the Multilateral Debt Relief Initiative (MDRI)
- Stated Objectives:

  i) provide a permanent 'exit' from debt rescheduling through reduction of external debt,

  ii) raise long-term economic growth, and

  iii) reduce poverty of the poorest countries

HIPC and poverty reduction

- The original HIPC Initiative (1996) was enhanced in 1999 to deliver “faster, deeper and broader debt relief”
- The objective was “to strengthen the links between debt relief, poverty reduction and social policies”
  - sought to redirect resources to poverty reduction expenditures
- The HIPC Initiative proved to be a lengthy process for countries to complete
- Debt relief was not delivered without considerable effort and investment on the part of the HIPCs.

Comparability of treatment

- Clause of “comparability of treatment” aims to ensure balanced treatment among all external creditors of the debtor country.
- Under Paris Club agreements the debtor country commits itself to seek a rescheduling on comparable terms from non-multilateral creditors (non-Paris Club and private)
- Securing participation of commercial creditors in debt relief initiatives has been a challenge to delivering full HIPC debt relief.
- Vulture litigation in addition to lack of participation has compounded this negative effect and lead to inequitable burden sharing among creditors

Vulture Fund Litigation

- Vulture funds are hedge funds that speculate upon the debt of countries in debt distress
- Funds purchase debt of financially distressed countries on secondary market at a deep discount and then they sue the debtor country for full repayment of the original loan plus interest
- Exert pressure on the sovereign debtor by attempting to obtain attachment of the government's assets abroad.
- Profits have ranged from 300%-2000%
- Large profits create an incentive for creditors to not participate in debt restructuring

Costs for HIPCs

In the case of a judgment issued in favor of the creditor:

- Resources freed from debt relief are then diverted away from poverty expenditures to settle the judgment for the creditor.
- Countries incur expensive legal fees associated with litigation that can drag on for years
- Additional costs are acquired from interest on arrears and additional administrative fees

Losses and protracted recovery

- Countries are faced with significant setbacks
  - Social cost of loss revenue for poverty reduction
  - Development losses towards achievement of MDGs
  - Complicates financial and reserve management
- It is estimated to take HIPCs around six years to rebound from such litigation that was already drawn out for 3-10 years.
- High returns on this opportunistic behavior creates the wrong incentives

Case of Democratic Rep. of Congo

- DRC reached decision point in 2002, and the completion point 2010 under HIPC (long process)
- The government defaulted on its debts during its Civil War, the fund FG Hemisphere purchased $3 million of discounted debt
- Fund refused to participate in the debt relief scheme and sued the Congolese government in numerous courts seeking $100 million.
- Going after the government’s assets abroad FG Hemisphere won an award of $30 million through Australian courts -- plus $2 million in legal fees and court-imposed fines
- This was but one of many creditors pursuing large profits through litigation against the DRC

Case of Zambia

- Donegal International purchased $44 million of Zambia’s debt owed to Romania for $3.2 million (7.2%)
- Donegal sued the government for the debt and settled for a payment of $16 million.
- After a missed payment, Donegal sued the government for full payment of the $44 million in UK courts.
- Donegal was awarded a settlement of $17.5 million, constituting over 540% profit

Ongoing litigation

- Currently 11 ongoing commercial creditor lawsuits against 6 HIPCs
  - Democratic Republic of Congo, Republic of Congo, Ethiopia, Honduras, Sudan and Uganda
- Thanks to debt relief all are at low to moderate risk of debt distress
  - except Sudan which is in debt distress and has not yet benefited from HIPC debt relief
- Court locations vary considerably
  - South Africa, France, Russia, Honduras, Sudan, Dubai, Uganda, Republic of Congo, (previous cases in US, UK, Sierra Leone)

Ad hoc measures taken

A few examples of measures taken to mitigate the activity of vulture funds

- Belgium "Anti-Vulture Fund" legislation (2008)
- UK Debt Relief Act (2010)
- World Bank Debt Reduction Facility
- Paris Club commitment not to sell claims on HIPC countries to creditors who do not intend to provide debt relief

Belgium “Anti-Vulture Fund” legislation and resolution

- Senate adopted “Anti-Vulture Fund” legislation in 2008
  - Following attempts by vulture funds to seize Belgian development aid, Belgium approved a resolution and law to safeguard Development Cooperation and debt relief from actions taken by Vulture Funds.
- Further passed a resolution calling for measures at the national, international and multilateral levels to prevent Vulture Funds from undermining debt relief Initiatives for HIPCs
  - Called for new instruments, conditions, concessional financing, technical assistance on debt policies and debt management

UK Debt Relief Act (2010)

- The Debt Relief Act places a cap on the amount commercial creditors may recover from HIPC countries
  - The objective is to diminish the incentive to abstain or hold out from restructuring processes by prohibiting creditors from collecting more than set by the HIPC formula
  - Calculations are made on a country by country basis
  - the amount of the reduction varies from 67-90% of the original value
  - Commercial creditors automatically subject to write downs in UK courts

World Bank Debt Reduction Facility

- An instrument to provide incentive for the commercial creditors to participate in HIPC and MDRI debt relief Initiatives
  - Effectively reduces the amount of debt that could be purchased by vultures on the secondary market
- Provides financial and legal resources to countries to execute debt buy backs at deep discounts.
- Assistance is available for debt that is external, commercial and sovereign for IDA only countries
  - medium & long term debt of the public sector and short term debt in arrears
  - Owed to commercial, external creditors that are non-collateralized and un-guaranteed

Gaps in the financial architecture

- While these separate measures are welcome, they are incomplete and far from sufficient.
- Fragmentation of the resolution of sovereign debts across different forums, national courts, and creditors has created opportunities for vulture funds to profit and sabotage sovereign debt relief initiatives
- Current status quo undermines incentive for creditors to participate in restructurings

  → resulting in long drawn out litigation and heavy costs in financial and social terms.
- This problem is not limited to HIPCs, relevant to all member states

A multilateral legal framework for sovereign debt restructuring processes

- Vulture practices undermine international development efforts in the poorest countries. (not limited to HIPCs)
- Many of these challenges may be addressed by a legal framework that can address:
  - Equal burden sharing among creditors
  - Increasing transparency and predictability
  - Reducing costs of litigation
  - Ensuring development aid/debt relief is not diverted from its intended purpose