
Introduction

Until recently lawsuits against sovereign states were rare. In the past, sovereign states enjoyed immunity from litigation. However, this situation changed dramatically when countries began to borrow money and entered into loan agreements to raise capital for economic development and infrastructure. Borrowing became an attractive solution for the least developed countries (LDCs), and in many cases a necessity. But borrowing means repayment, and even for a sovereign state the obligations of a loan contract do not disappear. Creditors cannot be forced to negotiate restructuring or refinancing plans, or an alternative option to demanding repayment. They cannot be barred from taking the ultimate solution under a loan agreement – suing the sovereign state before a court of law.

Vulture funds are investment funds which buy up distressed sovereign debt at a low price and then sue to secure a high return. The term 'vulture fund' is a vivid image, which describes the way these funds prey on poor countries on the brink of debt relief. Such creditors do not hesitate to take legal action. As courts of law are bound to deal with a lawsuit according to the terms of the loan agreement, judgments have had a negative, often unfair, impact on sovereign debtors, at times paralysing their economies. From the point of view of the creditors, they have been acting legally, but they have been named and shamed as vultures, and branded as immoral and perverse. However, the question that arises is: should the principles of legal egalitarianism apply when the debtor is a poor country in debt distress, and where poverty and hunger prevail?

Lawsuits against sovereign debtors became more prominent after the International Monetary Fund (IMF) called on all creditors to write off the debts of heavily indebted poor countries (HIPC). The international financial institutions (IFIs) introduced the HIPC Initiative in 1996 under pressure from millions of campaigners who believed that the burden of debt was undermining any prospect of development in some of the world's poorest countries. Progress has been slow, although the Initiative was enhanced in 1999. One reason has been that creditors are reluctant to participate in the Initiative and may choose to sell on their debts to vulture funds.

The Commonwealth Secretariat Legal Debt Clinic

By 2003 Commonwealth Heads of Government had recognised that the debt burden in developing member states was a major obstacle to developing key socio-economic sectors. They welcomed the advisory and consensus building work of the Commonwealth HIPC Ministerial Forum (CHMF) and encouraged its efforts to help heavily indebted poor countries achieve a sustainable exit from debt. At ministerial meetings, the Forum noted that debt-distressed countries were facing lawsuits from commercial and bilateral creditors that were hindering debt relief. The lawsuits were mostly taking place in foreign courts in places such as London, New York City and Paris, and the debtor countries needed legal advice to deal with the vulture funds. However, they did not have the resources to take action and could not afford to pay for legal advice from UK and US law firms. To meet this need, in 2006 the Forum set up a one stop legal referral service to assist countries that faced lawsuits, for an initial term of three years. This service is the Commonwealth Secretariat Legal Debt Clinic, originally known as the HIPC Clinic.

The Legal Debt Clinic's brief is to work with officials from ministries of both justice and finance, as vulture fund lawsuits involve both legal and debt management issues. It aims to encourage officials from the various ministries to work together, share understanding of the risks involved in loan agreements and identify actions that governments can take when they face lawsuits or the threat of lawsuits. It organises capacity-building workshops and on request provides advice for countries facing lawsuits. It has conducted four major capacity-building workshops for 11 Caribbean and 15 African countries. It has obtained collaboration and funding facilities from Pole-Dette and conducted a successful meeting for 16 indebted Francophone countries. The Clinic has assisted with capacity building and awareness-raising campaigns on the need to ensure that lawyers participate in the loan contract process. It has also been able to help countries negotiate and obtain withdrawal of lawsuits. It has successfully advocated for a change of legislation by the UK Government and has worked with the Jubilee Debt Campaign on the need for this legislation to stop further lawsuits under UK jurisdiction. In response, the UK Government has enacted the Debt Relief (Developing Countries) Act 2010.¹

About the Handbook

This Handbook is based on the experiences of the Legal Debt Clinic over three years. It reflects the needs expressed by workshop participants from both legal and financial backgrounds for knowledge, understanding and expertise to enable them to work effectively and collaboratively. The Handbook is in three parts.

Part I, Briefing, covers the background needed to understand vulture funds. It highlights concepts and myths surrounding vulture funds' activities, especially lawsuits. As loan agreements are the basis of the funds' operations, it explains key concepts and clauses in loan agreements to help countries understand what is involved before and after signing an agreement. Finally, as there is little documented information about lawsuits against sovereign debtors, especially with regard to the legal aspects, it provides a compilation of landmark cases.

Part II, Actions and Responses, offers advice on actions which can be taken by sovereign debtors to avoid lawsuits or mitigate their effects. It highlights some practices to adopt, including negotiation at all stages, understanding of debt management practices and responsible borrowing, and identifying available options when faced with litigation.

Part III, Challenges and Solutions, describes the steps being taken at the international level in terms of legislation, arbitration and regulation to try to curb the activities of vulture funds. Vulture funds are aware of their strongly protected contractual legal rights which they can exploit through lawsuits. One of the best ways of curtailing this exploitation is legislation. Only a few countries have adopted this stand and these are highlighted here.

Using the Handbook

The Handbook is intended for both legal and financial officials, and others working in related areas, such as debt relief campaigners, non-governmental organisation (NGO) advisers, and students of finance and the law. It can be used in several ways: readers may read the Handbook straight through or they can choose the chapters most relevant to their needs to fill gaps in their knowledge or expertise. In addition, it can be used as a resource to brief colleagues from other disciplines or as a basis for seminars or workshops, as it follows the pattern of the Legal Debt Clinic's own workshops.

The Handbook aims to expose the often secretive operations of vulture funds, many of which are based in tax havens and have been set up with the sole purpose of pursuing debt in poor countries. It provides the background information needed to understand how the funds work and the lawsuits they engage in. It suggests actions and responses open to sovereign debtors to avoid these lawsuits and provides advice on how to respond to them when they arise. The Handbook also points to more far-reaching solutions. Responsible borrowing and adequate fiscal policies may pave the way for sovereign states to attain greater economic stability with less intervention by IFIs. At the international level, legislation, arbitration and a compre-

hensive code of conduct and a one stop regulatory body may be the way forward. Through this Handbook, the Legal Debt Clinic hopes to extend its work and share its experience with a wider audience, enabling them to take action. Above all, when the targets of the vulture funds are poor countries where people are living on less than a dollar a day, what is needed is for all those involved – creditors and debtors, governments and international institutions – to take moral responsibility for creating a better and fairer system.

PART I

Briefing

Part I of this Handbook covers the essential background needed for an understanding of vulture funds and the way they operate. This briefing supports the actions and responses described in Part II and underpins the more far-reaching solutions proposed in Part III.

Chapter 1, Vulture Funds, explains what vulture funds are, how they operate and their culture of litigation. It discusses their legality, and contrasts this with moral and ethical arguments against their exploitation of poor countries and debt relief initiatives.

Chapter 2, Loan Agreements, shows how these agreements are the basis of vulture funds' operations. The chapter explains key concepts and clauses which should be taken into account before and after signing an agreement to avoid leaving loopholes which the fund can exploit in court.

Chapter 3, Lawsuits, provides a compilation of landmark cases, showing how the concepts and clauses explained in Chapter 2 are applied in the courts. The cases illustrate how lawsuits can exploit debt relief initiatives. The chapter demonstrates how important it is to negotiate the original loan or settlement agreement with the utmost care.

