CHAPTER 6
Responding to Lawsuits

Recognise that the world is hungry for action, not words.

Nelson Mandela, former South African president,
speaking in support of the Make Poverty History campaign

By refusing to participate in the debt restructuring process, vulture fund creditors prefer to opt for court proceedings so as to obtain many times the original amount they paid for the debt. Vulture fund creditors are aggressive litigators, as their only reason for purchasing debts is to make a swift profit. If a sovereign debtor does not want to suffer the effects of a vulture fund lawsuit as described in Chapter 3, Lawsuits, then immediate action is a must.

The HIPC Initiatives require voluntary participation by creditors to write off bad debts. Voluntary participation is a condition outside the control of international financial institutions and they cannot force creditors to participate. In the face of the high costs of defending themselves against litigation and lacking national expertise or resources, many countries have not put up any legal defence. However, courts have had to give judgment by default against sovereign debtors under the terms of loan agreements. (Judgment by default is a judgment given in the absence of the sovereign debtor or defendant from court when the case is heard.) Thus sovereign debtors have not benefited from putting up a defence in court.

On the other hand, from a practical perspective, a rush to court is not always the best solution, even for the creditors. A sovereign debtor which cannot repay is not likely to have many assets which can be seized by creditors. Some creditors know that repayment can be difficult in such circumstances. They nevertheless pursue cases for attachment of the sovereign's assets because of the huge return they may make, even though they may never recover any of the money.

This chapter identifies the legal and other options available to debtors when they are faced with the prospect of litigation. Some measures aim to stop further litigation processes and others constitute international support in technical assistance to minimise the impact of lawsuits. Identifying these options should empower countries

to meet the challenges they face when defaulting on payments. The chapter explores the scope for negotiation even at a late stage. It highlights three clauses in loan agreements which have an impact on lawsuits and describes the use of 'name and shame' campaigns against vulture fund creditors. It identifies sources of legal support for sovereign debtors when they are faced with litigation. Like Chapter 4, Negotiation, and Chapter 5, Debt Management, it outlines actions which can be taken, again based on the experiences of the Legal Debt Clinic.

6.1 Negotiation

The Legal Debt Clinic strongly recommends negotiation by sovereign debtors in all its seminars. Its motto has been 'Negotiation, negotiation, negotiation'. Negotiation remains a viable option at every stage. Some countries have been able to renegotiate when creditors were threatening to take them to court, for example Cameroon and Mozambique. These two countries have won positive outcomes and avoided lengthy proceedings through negotiation even after cases have been lodged in court.

Negotiation involves roundtable talks at each of the following stages:

- Prior to litigation
- During court proceedings
- Prior to judgment and post-judgment
- During attachment orders/repayment

See Chapter 4, Negotiation, for more about negotiation and what it involves. Both lawyers and financial officials should be aware of who needs to be involved in any negotiations and their role and expertise. The aim should be to discourage any further steps in litigation.

In addition, in 2008 the IMF stated in its report, *Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative – Status of Implementation*, that:

> *Active and cooperative negotiation aimed at debt restructuring agreements can be a successful strategy to limit creditor litigation and, where appropriate, should be a HIPC's first line of defense.*[54]

6.2 Contractual terms

Chapter 2, Loan Agreements, examines the main concepts and clauses of a loan agreement, which may have an impact on how vulture funds operate. Here three important clauses that have a particular impact on lawsuits are highlighted.

Collective action clauses

To recap, collective action clauses are clauses that allow the restructuring of a country's debt, as long as the majority of creditors approve. They bind all other creditors and eliminate the basis on which a vulture fund creditor can hold out. A sovereign debtor should always insist on such a clause in a loan agreement, even if the interest to be repaid is higher. However, this clause is only useful in new loan agreements, as such clauses were not used in older agreements. For instance, it is argued that the case of Elliott Associates would not have occurred if there had been a CAC clause that provided for a majority provision to bind all bondholders.

CACs allow a qualified majority of the holders of a bond issue (typically representing 75 per cent of the debt in the case of sovereign debt) to vote to bind all bondholders to a change in the terms of the bond contract. CACs are often used in UK and Luxembourg bonds.

Assignment clauses

It is essential to include a proper assignment clause which defines who the new assigned party can be (see Chapter 3, Lawsuits, for more on assignment clauses). An assignment clause can state that the contract may only be assigned to people who are willing to participate in the HIPC Initiatives or that the assignees will be IFIs or creditors of the Paris Club. (See Chapter 8, International Initiatives, for more about the Paris Club.)

An assignment clause can stipulate that the agreement can only be assigned to a creditor who has similar characteristics to the original creditor. For instance, in the loan agreement between Zambia and Romania, it is argued that if there had been such a clause, then Romania could not have assigned its right under the loan agreement to Donegal International Ltd, as the latter is not a sovereign government. As a result, the sovereign immunity principle would still have applied, as Zambia and Romania had granted each other sovereign immunity from legal action.

In the case of *Barbados Trust Co Ltd v Bank of Zambia*,[55] the sovereign debtor was able to challenge the validity of the assignment clause and the title of the new creditor. The claim by the vulture fund creditor was thus defeated.

Applicable law clauses

To recap, applicable law clauses state which legal system will govern the loan agreement if there is disagreement or default. An applicable law clause is essential in providing safeguards from some attacks by vulture funds. Choosing the jurisdiction of a country that has legislated on vulture fund activities and put a cap on the amount that can be recovered is an advisable option.

Since the USA has been active in seeking to implement legislation to regulate vulture fund activities and the UK has already passed the Debt Relief (Developing Countries) Act 2010, it is argued that these jurisdictions are a safe option for sovereign debtors.[56] The cap provided in both these jurisdictions on the amount which creditors can recover through court proceedings will discourage lawsuits in the long run. Lawsuits and opt-out options will no longer be seen as a highly profitable mechanism for creditors. At the same time, sovereign debtors will have a safeguard as they will be aware of the amount they will have to pay.

This discussion of contractual clauses highlights how important it is not only to get the loan contract right in the first place, but also to study its clauses closely if litigation is imminent.

6.3 'Name and shame' campaigns

Once a lawsuit is lodged and a country is sued, it is essential to take all measures to stop the litigation. Activists and NGOs have adopted campaigns described as 'name and shame' campaigns against original creditors upon default of payment by the sovereign debtor. Two examples of these campaigns against creditors (not strictly speaking vulture funds) are described here.

The first is the action against Nestlé, which sued Ethiopia for US$6m after refusing the Ethiopian Government's offer of a settlement worth US$1.5m. Although Nestlé is not strictly a 'vulture fund' creditor, but rather the original creditor, it withdrew its demand and offered to put back into the Ethiopian economy any money it received from the government.

The second successful 'name and shame' campaign was in Guyana. The Guyana Government expropriated the investment of a UK firm (owned by Booker Sugar Estates Ltd) that operated in the Guyanese sugar industry in the 1970s. The government had agreed to a long-term compensation plan and payment by instalments, which were stopped in 1992. The commercial creditor, Booker plc, asked for payment and sought to take the Guyanese Government to arbitration. Big Food Group, Booker plc's parent company, decided to withdraw the case. The matter was heard before the International Centre for Settlement of Investment Disputes (ICSID), which recorded the proceedings as follows:

> *Outcome of Proceeding:*
>
> *The Sole Arbitrator issues an order taking note of the discontinuance of the proceeding on October 11, 2003 pursuant to Arbitration Rule 43(1).*

Nestlé v Ethiopia

In 2002, the multinational coffee corporation Nestlé sued Ethiopia for the sum of US$6m. Nestlé's claim related to the nationalisation of ELIDCO by the Government of Ethiopia. ELIDCO was a company majority owned by the German Schweisfurth Group, which was subsequently acquired by Nestlé in 1986. In August 1998, ELIDCO was sold by the Ethiopian Government to a local private company for US$8.73m. Nestlé's claim for US$6m compensation was based on the lack of payment after the government sold ELIDCO.

When the case was lodged, the Ethiopian Government offered to settle for US$1.5m, but Nestlé insisted on being paid US$6 million at the 1975 exchange rate.

At the time, Ethiopia was struggling to cope with its worst famine for nearly 20 years, brought about by climate challenges, lack of rain for three consecutive years and a collapse in the price of coffee, the crop that supported a quarter of the country's population.

In December 2002, Nestlé dropped its claim, following a 'name and shame' process described in the following article.[57]

Nestlé, the world's largest coffee company, was forced into a humiliating climbdown yesterday after a wave of public outrage greeted its demand for a US$6m (US£3.7m) payment from the government of famine stricken Ethiopia.

The company promised to invest any money it receives from Ethiopia back in the country after receiving thousands of emails of protest in response to the story in yesterday's Guardian*.*

At an emergency meeting in its Swiss HQ last night, senior executives were mulling over the public relations damage. The claim represents about an hour's turnover for a company which posted sales of US$59.36bn and pre-tax profits of US$6.15bn last year.

Nestlé – fearing a consumer boycott of its products across Europe – is considering donating some of the money it is demanding to help feed the 11 million Ethiopians who face starvation in coming months.

Campaigners last night repeated their call for the company to abandon its claim entirely. 'I hope that Nestlé reconsiders and realises they don't need the money as much as Ethiopia. I hope they drop the issue altogether', said Sophia Tickell, senior policy analyst at Oxfam.

Nestlé was boycotted for years by protesters over its aggressive sales of baby milk formula to the developing world, where hygiene standards made breast

Last night campaigners were keeping up the pressure, although they warned that a boycott of Nestlé products could backfire by hurting poor coffee farmers in Ethiopia.

'Boycotting Nestlé products won't help the poor farmers who sell to the company', said Justin Forsyth, head of policy at Oxfam. 'What people should do if they want to help is to write or email Nestlé and ask them to drop the claim.'

By late afternoon yesterday, 8,500 people had emailed the company to complain about its treatment of the Ethiopian government, the fastest response Oxfam says it has had to a campaign.

Booker plc v Co-operative Republic of Guyana (ICSID Case No. ARB/01/9)[58]

In 2003, Guyana defaulted in its debt repayment to the Big Food Group, owner of Iceland supermarkets. Big Food Group was suing to recover a 27-year-old debt for which Guyana had paid £6m, but owed £12m. The creditor was willing to recover its unpaid debt from Guyana through an arbitration hearing. NGO campaigners caused an outcry and the lawsuit was dropped. The 'name and shame' process was successful as the following article describes.

With the echoes from Nestlé's claim against Ethiopia barely ended, the Big Food Group, owners of the Iceland chain, have backed down having aroused the wrath of debt campaigners by pursuing a claim of more than £12m in compensation against the impoverished state of Guyana.

The company has now said that it will not pursue the claim, although people close to the company suggested there was considerable anger at being forced to give way to a basic principle on property rights. ...

The debt was incurred during the nationalisation of the sugar industry in 1976. Guyana has paid back around £6m of the original debt, but defaulted on its payment in the late 1980s.

Campaigners from the Jubilee Debt Campaign argued that the company should drop the debt altogether, seeking to draw attention to the contradiction where Guyana is granted debt relief on the one hand, only to have a private company receive some of the proceeds.[59]

The 'name and shame' process has been successful in deterring original big investors from reselling their claims or pursuing their claims in court. However, in spite of the impact of these campaigns, many vulture funds have not been deterred from litigation and have won massive repayment awards.

6.4 Legal support for sovereign debtors

Another option available to a country faced with litigation is to draw on technical assistance in the form of legal support. Some Commonwealth countries which did not have this support have asked for help. In 2006 the Commonwealth Secretariat set up the Legal Debt Clinic. In 2009, the African Development Bank, with backing from international organisations, decided to fund the setting up of the African legal support facility. This is similar to the Commonwealth Secretariat Legal Debt Clinic, but with a bigger budget and the possibility of assisting with legal costs.

The Commonwealth Secretariat Legal Debt Clinic

The experiences of the Legal Debt Clinic (originally known as the HIPC Clinic) and the lessons learned from it provide much of the material on which this Handbook is based.

In the wake of lawsuits against sovereign debtors, most cases were being lodged before the courts of the UK, USA and France. When sovereign debtors received court notices, they had to obtain legal advice from city lawyers in these countries. They could not proceed until they could pay the fees of such law firms, which could amount to several thousand pounds just for advice. One of the countries the Legal Debt Clinic dealt with was quoted a fee of £10,000 simply for evaluating the letters sent by the vulture fund and advising on whether or not to put up a defence in court. The country decided not to appear in court because of the high fees and the court gave a default judgment. The Legal Debt Clinic advised challenging the default judgment through an appeal and the vulture fund subsequently dropped the case. It was clear that sovereign debtors lacked both the resources and the know-how to deal with vulture fund lawsuits.

The Commonwealth Secretariat has taken the lead in providing legal support to distressed countries. It realised that legal advice was needed to make countries aware of the options available to them when vulture funds attempted to exploit the debt restructuring process and the lack of legal capacity within the sovereign debtors, given the huge fees charged by international law firms.

The IMF and World Bank have claimed they cannot provide such support as they are required to operate with neutrality and impartiality in disputes among members or between members and third parties directly or indirectly.[60] The World Bank's principle of neutrality and impartiality is reflected in its *Operational Policy 7.40*. Unlike the IMF or World Bank, the Secretariat is not bound by these principles, as it does not interact with sovereign countries as a party to loan agreements.

The Secretariat therefore established the Legal Debt Clinic in September 2006.[61] Its

mandate came from agreements obtained at ministerial meetings of the finance and law ministers of the HIPC countries. Finance ministers gave their approval at a meeting held in Sri Lanka in September 2006, then known as the Commonwealth HIPC Ministerial Forum (CHMF).[62] Law ministers gave their approval at their meeting held in Accra, Ghana in October 2005.[63] The Legal Debt Clinic presented its annual reports to the HIPC finance ministers, and to the law ministers during their triennial meetings.

The focus of the Clinic has been two tiered: first, it advises on the actions that should be taken following a lawsuit; and second, it advises countries on global actions to avoid legal action. It also gives advice on steps that can be adopted to avoid future lawsuits through an examination of the terms and conditions of loan agreements and helps HIPC countries to negotiate such agreements.

The Legal Debt Clinic has achieved the following:

- **Awareness raising**

The Clinic has made officials in ministries of finance and debt divisions aware of the need to work in close collaboration with the Attorney-General's Office regarding the legal implications of the terms and conditions contained in loan agreements. Successful workshops have been held in Jamaica for the Caribbean countries and in Africa for most of the African HIPC countries. The following workshops have taken place:

Commonwealth Seminar on ***Debt Negotiation and Renegotiation***, Kingston, Jamaica, November 2006

Commonwealth Seminar on ***Debt Negotiation and Renegotiation***, Accra, Ghana, November 2007

Joint Commonwealth and Pole-Dette Seminar on ***Debt Negotiation and Renegotiation***, Yaoundé, Cameroon, May 2008

Joint Commonwealth and MEFMI Seminar on ***Legal Aspects of Debt Management***, Maputo, Mozambique, August 2008

Joint Commonwealth and MEFMI Seminar on ***Negotiation: Techniques and Practical Skills***, Dar es Salaam, Tanzania, June 2009

- **Bilateral assistance**

The Clinic has also assisted HIPC countries facing threats of litigation and actual litigation bilaterally. Through these meetings it has built the capacity of legal and finance officers and provided in-house training. Such bilateral meetings have taken place for Zambia (May 2007), Uganda (August 2007) and Cameroon (August 2007).

- **Capacity building**

The Clinic has delivered capacity building in loan agreements and public debt management, fiscal responsibility law, and negotiation techniques and skills. It has raised awareness of the need for a strong institutional set-up of the office dealing with debt management to help countries out of severe indebtedness. It has raised awareness of the eventual need for changes in domestic legislation. It has also provided training in practical techniques and negotiation skills.

- **Advocating change**

The Clinic has advocated changes in legislation both in the domestic laws of sovereign debtors and internationally in jurisdictions where the lawsuits take place.

At national level, it has advised each sovereign debtor to update and align its public debt laws to feature new accountability and transparency principles. It has recommended the adoption of fiscal responsibility laws which would incorporate a national debt strategy based on principles of accountability, reporting and transparency. The workshops have highlighted and presented a fiscal responsibility framework.

Another domestic change advocated by the Clinic is setting up a framework for the negotiation of loan agreements that incorporates similar rules for most countries. However, there is as yet no mandate for the development of this framework.

The Clinic has also advocated changes in legislation in the countries where the lawsuits take place to stop the profiteering activities of vulture fund creditors, especially after many creditors refused to participate in the HIPC Initiative. Vulture fund loan agreements contain clauses that are highly detrimental to the ability of sovereign debtors to defend themselves in court. The obvious solution is to enact legislation that prevents such cases being heard by the courts in the jurisdictions where these lawsuits are usually filed. This has mainly been in relation to UK legislation, as the UK is a Commonwealth member. In 2007, publicity about the Zambian case on the BBC's *Newsnight* programme generated public pressure against the UK Government, as it appeared that the UK jurisdiction was being exploited by vulture fund investors and that UK courts were a favourite jurisdiction for such cases. In spite of lobbying, it was only in May 2009 that Sally Keeble MP tabled a motion in Parliament on this issue. Finally, the UK Parliament passed the Debt Relief (Developing Countries) Act in April 2010 (see Chapter 7, Legislation).

The African Legal Support Facility

The African Legal Support Facility is another source of advisory support similar to the Commonwealth Secretariat Legal Debt Clinic. It was set up in June 2009 and

at the time of writing (early 2010) is still in the process of becoming fully functional.

In April 2008, the executive board of the AfDB approved the establishment of this legal support facility. It will come into existence when the agreement creating it is signed by at least ten participating states or international organisations. This requirement has been fulfilled and the text establishing the institutional set-up of the facility's management structures was published in June 2009. It will have a similar role to the Legal Debt Clinic. It has received funding of over £5m from the UK Department for International Development (DFID) and other international organisations.

Unlike the Legal Debt Clinic, the African Legal Support Facility will provide funding to indebted countries to meet the costs of legal expenses incurred in lawsuits.[64] The sovereign debtor will repay the legal expenses on terms that depend on the status of the country.[65] Lawsuits can be very expensive and help with legal costs is bound to reduce the number of default judgments against sovereign debtors.

Conclusion

This chapter has looked at a range of options available to indebted countries that face lawsuits. It has stressed that negotiation is an option at every stage. It has highlighted clauses in loan agreements which can safeguard against future lawsuits – CACs, assignment clauses and applicable law clauses. Another option described here is 'name and shame' campaigns conducted against creditors. Finally, the chapter describes two initiatives which provide legal support for sovereign debtors.

The important message of this chapter is that lawsuits always have a protracted impact and are a block to any economic development.

- Indebted countries should never 'do nothing' when they receive a notice from the court or the creditor's lawyers.
- Indebted countries should always talk to their creditors and keep in touch to know what action they are considering.
- The quicker a lawsuit is resolved the better.
- Both national and international efforts are needed to resolve this situation.
- Legal advice and support should be sought immediately. This will help to reduce the number of default judgments against sovereign debtors and help countries take appropriate action to respond to or avoid lawsuits.

Further reading

- The World Bank Operational Manual, http://web.worldbank.org/WEBSITE/EXTERNAL/PROJECTS/EXTPOLICIES/EXTOPMANUAL/0,,menuPK:64142516~pagePK:64141681~piPK:64141745~theSitePK:502184,00.html
- Commonwealth Secretariat Legal Debt Clinic, http://www.thecommonwealth.org/Internal/190714/190927/157583/legal_debt_clinic/
- African Legal Support Facility, http://www.afdb.org/en/topics-sectors/initiatives-partnerships/african-legal-support-facility/

PART III

Challenges and Solutions

Poverty is an international problem which involves the international financial community, including multilateral and regional organisations and governments around the world. The HIPC Initiative, established in 1996, is a bilateral and multilateral effort to help poor countries achieve economic growth and debt sustainability. Lawsuits by vulture funds are a major obstacle to such debt relief.

Part II highlighted ways in which a sovereign can avoid lawsuits in the first place and respond to them if they arise. However, when the HIPC Initiative was launched, the multilateral organisations did not envisage lawsuits by vulture funds. In view of the lack of predicted progress towards debt relief (the target year being 2015), further action by the global community is necessary.

Part III considers the challenges the international community faces in dealing with the threats posed by vulture fund lawsuits and describes a range of solutions that have been adopted so far.

Chapter 7, Legislation, looks at ways of regulating vulture fund lawsuits through legislation and argues that robust legislation is the best way forward.

Chapter 8, International Initiatives, analyses measures taken by the international community to reduce debt.

Chapter 9, Ways Forward, discusses possible further solutions for reducing the negative effects of lawsuits worldwide. Could an organised structure with codes of borrowing and lending or a single dispute resolution mechanism other than the courts be solutions?