SUBDUING THE VULTURES: ASSESSING GOVERNMENT CAPS ON RECOVERY IN SOVEREIGN DEBT LITIGATION

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I. INTRODUCTION

As governments consider financial regulatory reform and developing countries seek resources in the wake of the global financial crisis, the specter of sovereign debt has emerged at the forefront of international debate.[1] The problem of sovereign debt has only become more pronounced as the global financial markets have become increasingly interdependent over the past twenty years. Slow and clumsy responses by countries and international organizations have underscored the extent to which economic globalization has outpaced political globalization.

Managing sovereign debt is a very complex and time-intensive task.[2] Debt restructuring for a sovereign state is fundamentally different from corporate restructuring. With corporate debt, the parties are relatively easy to identify and

[1] *See, e.g.*, Stephen Castle, *Europe Commits to Action on Greek Debt*, N.Y. TIMES, Feb. 12, 2010, at A6; Matt Moffett & Matthew Cowley, *Argentina Sets Aside Reserves To Cut Debt*, WALL ST. J., Dec. 15, 2009, at A15; Arif Sharif & Laura Cochrane, *Dubai World Seeks to Delay Debt Payments as Default Risk Soars*, BLOOMBERG, Nov. 26, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20601110&sid=a.LazCgxcywM.

[2] *See* Joy Dey, *Collective Action Clauses Sovereign Bondholders Cornered?*, 15 LAW & BUS. REV. AM. 485, 490 (2009).

governing laws are clearly defined. Unlike other debtors, sovereigns do not have access to a formal bankruptcy process, and therefore are dependent upon the consent and cooperation of their creditors.[3] Unfortunately, the process of seeking this consent and cooperation to restructure sovereign debt remains unpredictable and disorderly.[4]

Distressed debt funds, or "vulture funds," have commanded media attention lately due to their complicated role in the sovereign debt restructuring process. A vulture fund is not a primary lender, but instead becomes a creditor through purchases of sovereign debt on the secondary market. It not only refuses to participate in any voluntary restructuring, but often attempts to use litigation to collect the full face value of its claim from the sovereign debtor.

Many poor countries, especially in Africa and Latin America, are considered easy prey for these funds.[5] In total, it is estimated that private creditors hold judgments in excess of $1 billion against some of the world's poorest countries.[6] Vultures also cause damage by interfering with the orderly restructuring of sovereign debt. The hope of legal restitution provides the owners of defaulted debt with an incentive to hold out and refuse to participate in the restructuring. In addition, if debtholders believe that the

[3] *See* Daniel K. Tarullo, *Neither Order Nor Chaos: The Legal Structure Of Sovereign Debt Workouts*, 53 EMORY L.J. 657, 669–70 (2004).

[4] *Id.* Sovereign bondholders may sometimes be widely dispersed across the globe, making it difficult to coordinate or communicate among issuers and bondholders, or among bondholders themselves.

[5] In 2000, Peru paid a vulture creditor more than $56 million for a debt the fund had bought for only $11.4 million. *See* G. Mitu Gulati & Kenneth N. Klee, *Sovereign Piracy*, 56 BUS. LAW. 635, 635 (2001). In 2007, Zambia was ordered to pay a British Virgin Islands-based vulture fund more than $15 million. Nicaragua has been ordered to pay more than $200 million to vultures. *See* David Bosco, *The Debt Frenzy*, FOREIGN POL'Y, June 11, 2007, at 48, 50. In November 2009, a High Court in London ordered Liberia to pay two investment funds more than $20 million for a debt dating back to 1978. *Liberia Ordered to Pay 'Vulture Funds' over 1978 Debt,* BBC NEWS, Nov. 26, 2009, http://news.bbc.co.uk/2/hi/africa/8380117.stm.

[6] *See* Bosco, *supra* note 5, at 50.

vultures may succeed in getting a claim on the debtor government's resources with a higher priority than their own, they may fear that nothing will be left for them after the vultures receive their share, which can hamper restructuring negotiations. Risk-averse creditors might go further, selling their debt and increasing the interest rates faced by the borrower, further decreasing the probability of repayment.

The inadequacy of international endeavors to eliminate the vulture problem has led to increasing demand for national initiatives.[7] Currently, both sides of the Atlantic

[7] *See, e.g.*, INT'L DEV. ASS'N & INT'L MONETARY FUND, ENHANCED HIPC INITIATIVE CREDITOR PARTICIPATION ISSUES, IDA/R2003-0058, Apr. 11, 2003, http://siteresources.worldbank.org/INTDEBTDEPT/PolicyPapers/20252805/2003-Apr11-1.pdf (mentioning the possibility of amending the relevant laws in creditor countries to limit creditors from receiving more than what is prescribed under the HIPC Initiative); U.N. Office of the High Commissioner for Human Rights, *UN Expert on Foreign Debt Regrets British Court Order that Liberia Must Pay 1978 Debt to 'Vulture Funds,'* Dec. 17, 2009, http://www.ohchr.org/en/NewsEvents/Pages/DisplayNews.aspx?NewsID=9689&LangID=e (reporting on the call for legislation by the UN expert on foreign debt and human rights that would limit vulture activity in the U.S., U.K., and France); Jubilee Debt Campaign, *Liberia Secures Vulture Victory*, Apr. 18, 2009, http://www.jubileedebtcampaign.org.uk/Liberia%20secures%20vulture%20victory+4804.twl (noting that a change in the law is the best way to stop vulture fund activity); Jubilee Debt Campaign, *Standing Up Against Poverty - and Vulture Funds*, Oct. 23, 2009, http://www.jubileedebtcampaign.org.uk/Standing%20Up%20Against%20Poverty%20%96%20and%20Vulture%20Funds+5115.twl (stating that the campaign was calling for a new law to outlaw vulture funds); Brittany Schell, *US Considering Debt Relief for Poor Countries*, ONEWORLD.NET, Jan. 5, 2010, http://www.commondreams.org/headline/2010/01/05-7 (discussing how advocacy groups dismayed about Liberia are now insisting on the need for new legislation); 2009 Commonwealth Ministerial Debt Sustainability Forum—Statement, Apr. 22, 2009, http://www.thecommonwealth.org/document/181889/34293/35144/152412/211279/2009_commonwealth_ministerial_debt_sustainability.htm (urging major official creditors and donors to amend legislation to prevent litigation in their jurisdictions); Eli Clifton, *Pressure Grows to Clip Vultures' Wings*, ASIA TIMES ONLINE, Aug. 21, 2009, http://www.atimes.com/atimes/Central_Asia/KH21Ag02.html (reporting that fifty advocacy organizations are calling on the United States Congress to stop vulture fund activity); Adrienne Margolis, *Clipping Vultures'*

are considering legislation designed to curb vulture activity by capping the recovery available through litigation. Introduced by California Congresswoman Maxine Waters on June 18, 2009, the Stop Very Unscrupulous Loan Transfers from Underprivileged Countries to Rich, Exploitive Funds Act (the Stop "VULTURE" Funds Act) would only allow vulture funds to recoup the purchase price of a debt plus six percent interest.[8] A similar proposal, the Developing Country Debt (Restriction of Recovery) Bill, was introduced in the House of Commons by Sally Keeble MP on May 6, 2009.[9] The bill was proposed again as a private member's bill on December 16, 2009, and was passed on April 8, 2010.[10] The legislation is only in effect for one year; in 2011, Parliament must decide whether to reject the new rule, extend it for another year, or make it permanent.[11]

Numerous activists, NGOs, and journalists have condemned vulture fund tactics for years and it is no surprise that they are vigorously lobbying in support of the legislation. They point to the potential for overwhelming debt to impair domestic social and economic programs, thereby contributing to the continuing deprivation of individuals and families and decreasing any chances for rehabilitation. The debt problem can also harm the creditor nations because developing countries with failing economies cannot be effective trading partners. At the same time, parties in opposition to the legislation consider it an unnecessary interference with private contractual rights that has the potential to actually destabilize capital flows to developing countries.

Wings, INT'L BAR ASS'N, http://www.ibanet.org/Article/Detail.aspx?ArticleUid=706e20b7-d800-4efd-a69d-ff1ec9efa5e2 (last visited Mar. 1, 2010) (stating that politicians in the U.S. and the U.K. have been lobbying their governments to curb vulture funds for several years).

[8] Stop VULTURE Funds Act, H.R. 2932, 111th Cong. § 121 (2009).

[9] Developing Country Debt (Restriction of Recovery) Bill, 2009, Bill [91].

[10] Adrian Croft & Neil Stempleman, *New Law Limits Claims By Vulture Funds*, REUTERS UK, Apr. 8, 2010, http://uk.reuters.com/article/idUKTRE63748920100408?sp=true.

[11] Debt Relief (Developing Countries) Act, 2010, c. 22, § 9.

Developing country debt is an economic, social, and political issue that elicits strong emotive reactions. In weighing the potential advantages and costs of capping vulture recovery, it is essential to first examine the development of the present complex sovereign debt market. This background will provide necessary context for an objective analysis of current proposals to cap available remedies to vulture creditors.

This Note will proceed as follows: Part II provides a historical overview of vulture fund behavior from the erosion of sovereign immunity beginning in 1976, to the development of a secondary debt market and subsequent expansion of vulture activity, including recent debate concerning litigation against sovereign participants in the HIPC (Heavily Indebted Poor Countries) Initiative. Part III discusses the failure of current private and public tools to prevent vulture litigation before turning to the recent legislative proposals to limit recovery by these funds. Part IV argues that such proposals, while well-intentioned, are both over and under-inclusive and the potential costs of such legislation far outweigh the commensurate benefits to developing countries.

II. HISTORY

Before turning to the proposed United States and United Kingdom legislation, it is necessary to examine the recent history of vulture fund litigation in the sovereign debt context. This will entail an overview of the erosion of sovereign immunity in commercial transactions since the passage of the Foreign Sovereign Immunities Act (FSIA) in 1976 as well as the growth of the sovereign debt secondary market, both prerequisites for the development of vulture litigation. This background section will conclude with a discussion of recent examples of vulture fund lawsuits, including their effect on the IMF's HIPC Initiative. This review is necessary for understanding how the new proposals for capping vulture fund recovery would fit within this existing framework.

A. Erosion of Sovereign Immunity and the First Bondholder Suits

The ability of bondholders to litigate against defaulting sovereigns is a relatively recent phenomenon. For centuries, foreign countries had to rely on political, rather than legal, means to settle disputes over debt contracts.[12] When Latin American countries began to use bond markets to finance growth in the 19th century, they were protected from lawsuits by the doctrine of absolute sovereign immunity, which posited that no government could be sued in a foreign court without its consent.[13] Although bondholders had the State Department of Foreign Office apply diplomatic pressure on defaulting countries as early as the 1930s, governments of bondholders were largely unresponsive; they did not want the private debts of their citizens or companies to interfere with diplomatic relationships.[14]

After World War II, however, countries began to use sovereign immunity as a liability shield from tort or breach of contract claims in purely commercial transactions.[15] This perceived unfairness, alongside Cold War concerns, prompted widespread criticism of the doctrine of absolute sovereign immunity.[16] The United States government

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[12] *See* Bosco, *supra* note 5, at 52. In *Schooner Exchange v. McFaddon,* 11 U.S. 116 (1812), Justice Marshall held that sovereign states have absolute immunity, a precedent which lasted for the next 150 years. Jonathan C. Lippert, *Vulture Funds: The Reason Why Congolese Debt May Force A Revision Of The Foreign Sovereign Immunities Act,* 21 N.Y. INT'L L. REV. 1, 10 (2008) (explaining that, pre-FISA, it was almost impossible to sue a sovereign nation).

[13] Sönke Häseler, *Individual Enforcement Rights In International Sovereign Bonds,* 4 (German Working Papers in L. and Econ., Paper No. 17, 2008) *available at* http://www.bepress.com/cgi/viewcontent.cgi?article=1253&context=gwp.

[14] *Id.* Creditors' options were limited to speaking through institutions such as the British Corporation of Foreign Bondholders to persuade their national governments to apply political pressure on the debtor nation. *Id.*

[15] Lippert, *supra* note 12, at 10.

[16] America disliked the idea of granting sovereign immunity to companies operating in the United States that were owned by the USSR. FEDERICO STURZENEGGER AND JEROMIN ZETTELMEYER, HAS THE LEGAL

responded in 1952 with the "Tate Letter," a State Department opinion that adopted a restrictive view of sovereign immunity.[17] Unfortunately, the Tate Letter proved too weak to hold sovereigns accountable in court.[18] As a result, Congress decided to codify the requirements to sue a sovereign state in 1976 through the Foreign Sovereign Immunities Act (FSIA).[19]

The FSIA in the United States (and, soon after, the U.K. State Immunity Act of 1978) imposed statutory constraints on absolute sovereign immunity from suit in foreign courts.[20] Under section 1604 of the FSIA, a foreign sovereign is presumed to be immune from suit in a U.S. court unless it is within a FSIA exception.[21] In *Argentina v. Weltover, Inc.*, the Supreme Court confirmed that issuing sovereign bonds constituted commercial activity within the meaning of the FSIA.[22] At the same time, suing sovereigns became more commonplace as a result of a covenant waiving sovereign immunity that became part of many debt contracts.[23] Unsurprisingly, these developments led to attempts by

THREAT TO SOVEREIGN DEBT RESTRUCTURING BECOME REAL?, 10 (2006), http://www.utdt.edu/download.php?fname=_115331294204239500.pdf.

[17] *See* Letter from Jack B. Tate, Acting Legal Adviser, U.S. Dep't. of State, to Phillip B. Perlman, Acting U.S. Attorney General, U.S. Dep't of Justice (May 19, 1952), in 26 DEP'T ST. BULL. May 1952 at 984–85 (stating that "the Department feels that the widespread and increasing practice of governments of engaging in commercial activities makes necessary a practice which will enable persons doing business with them to have their rights determined in courts").

[18] Lippert, *supra* note 12, at 10-11 (noting the numerous provisions that left U.S. citizens still largely unable to sue sovereign states).

[19] Foreign Sovereign Immunities Act of 1976 (FSIA), 28 U.S.C. §§ 1330, 1332, 1441, 1602–1611 (2006).

[20] Lee C. Buchheit, *The Sovereign Client*, 48 J. INT'L AFFAIRS 527, 528–29 (1995).

[21] 28 U.S.C. § 1604 (2006).

[22] 504 U.S. 607, 614-15 (1992).

[23] Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1076 (2004).

creditors to enforce their claims against sovereign debtors through litigation.[24]

During the wave of sovereign defaults in Latin America in the 1980s, sovereign debtors were vulnerable to suits from creditors for the first time.[25] Two cases in Costa Rica in particular set the stage for future vulture fund litigation. The first of these efforts occurred in *Libra Bank Ltd. v. Banco Nacional de Costa Rica, S.A.*[26] In July 1981, the Board of Directors of the Central Bank of Costa Rica (Banco Nacional) passed a resolution prohibiting all state-owned entities from paying interest or principal owed on debts to foreign creditors that were denominated in foreign currency.[27] When a syndicate of commercial banks could not obtain repayment of a $40 million loan made to Banco Nacional, the syndicate sought an order of attachment in New York state court.[28] After Banco Nacional first defaulted in the state court proceeding, the syndicate obtained an order of attachment for Banco Nacional's property in New York and successfully attached $800,000 in assets.[29] Banco Nacional then removed the action to federal court and moved to vacate the order of attachment on the grounds of sovereign immunity.[30] The Second Circuit held that the foreign state had explicitly waived in writing all sovereign immunity and upheld the attachment.[31] Furthermore, defenses put forward by Banco National that had been used by sovereigns in the past were unsuccessful; the court found that neither the act of state doctrine nor Article VIII, section

[24] *Id.*

[25] *See* Häseler, *supra* note 13, at 5.

[26] Libra Bank Ltd. v. Banco Nacional de Costa Rica, S.A., 570 F. Supp. 870 (S.D.N.Y. 1983).

[27] *Id.* at 875.

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *Id.*

2(b) of the IMF Bretton Woods Agreement would prohibit enforcement of the loan contract.[32]

In 1985, the court once again ruled against Costa Rica in *Allied Bank International v. Banco Credito Agricola de Cartago*, which is often cited as the first instance of holdout litigation in the sovereign debt context.[33] In the later stages of a debt restructuring, a dispute arose from the unwillingness of Allied's client, Fidelity Union, to agree to the terms of a restructuring that had already been accepted by all other banks in the syndicate.[34] Among other defenses, such as the act of state doctrine, Allied relied on the comity defense, another argument often used by sovereigns in court.[35] Comity permits a U.S. court to give effect to the actions of a foreign state so long as such actions are consistent with the laws and policies of the United States.[36] The court rejected the defense of comity, relying on an amicus curiae brief by the Justice Department criticizing the Costa Rican government's unilateral attempt to repudiate private, commercial obligations as inconsistent with U.S. policy.[37]

The litigation against Costa Rica illustrates the growing potential of creditor litigation as a remedy against a defaulting sovereign debtor. They also demonstrated that typical sovereign defenses, such as comity and the act of

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[32] *Id.* at 880. The court held that the act of state doctrine did not apply because the property that was the subject of the litigation was located in the United States, not in Costa Rica; the court held that the Bretton Woods Agreement was inapplicable because "a contract to borrow United States currency, which requires repayment in United States currency, and which designates New York as the situs of repayment, is not an exchange contract within the meaning of Article VIII, section 2(b)." *Id.* at 900.

[33] 566 F. Supp. 1440, 1441 (S.D.N.Y. 1983), *aff'd*, 733 F.2d 23 (2d Cir. 1984) (per curiam), *rev'd on reh'g*, 757 F.2d 516 (2d Cir. 1985).

[34] *Allied Bank Int'l*, 757 F.2d at 519.

[35] *Id.*

[36] Christopher C. Wheeler & Amir Attaran, *Declawing The Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253, 254 (2003).

[37] *Allied Bank Int'l*, 757 F.2d at 522.

state doctrine, would not be enough to prevent enforcement of the sovereign's contractual obligations. The decisions made clear that enforcement litigation would be a viable option for creditors in the future.

B. The Evolution of a Secondary Market for Sovereign Debt

The two Costa Rica cases thus opened the door to creditor litigation in general and holdout litigation in particular. However, during the remainder of the 1980s, creditor litigation remained rare due to the structure of the sovereign debt market.[38] In the 1970s and 1980s, the creditors of emerging market sovereigns tended to be banks. Debt took the form of syndicated loans and renegotiations were conducted through "bank advisory committees" (BACs) consisting of representatives of the major bank creditors.[39] The banks had a regulatory incentive against declaring a creditor in default, which is a prerequisite for litigation.[40]

When sovereign debt lending was primarily based on loans from commercial bank syndicates, the restructuring of the debt tended to proceed in a relatively orderly process.[41] All parties were dependent upon one another: the banks needed the debtor countries to implement austerity programs; the debtor countries would not implement

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[38] Ugo Panizza et al., *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LITERATURE 651, 655–56 (2009).

[39] *Id.* at 655.

[40] *Id.* at 655–56. Declaring a debtor in default would have required the banks to write down their loans, which banks wished to avoid. The syndicate structure would also encourage cooperation between banks because it would lead to arrangements between small group of banks with relatively similar interests and the desire for a successful restructuring. *Id.*

[41] John Nolan, *Emerging Market Debt & Vulture Hedge Funds: Free-Ridership, Legal & Market Remedies,* Derivatives Study Center, Sept. 29, 2001, http://www.financialpolicy.org/DSCNolan.htm. The typical restructuring process would begin with bilateral debt negotiations between the sovereign debtor and its sovereign creditors. These negotiations would then be followed by a restructuring of commercial bank loans. *Id.*

austerity programs unless the IMF extended loans; the IMF would not make loans unless the commercial banks extended bridge loans. This "triangular dependency" meant that all parties tended to coordinate with one another.[42]

This situation began to change in the late 1980s when the Brady Plan was introduced in response to the Latin American debt crisis.[43] The Brady Plan called for a write-down of the bank debt under the voluntary conversion of the commercial bank loans into bonds that would be collateralized by U.S. Treasury debt.[44] Through this securitization, the bank loans owed by a sovereign debtor were repackaged as bonds, which could then be sold and traded.[45] The proceeds of the bond offering were used to retire the country's outstanding bank loan indebtedness.[46] These securitized bonds were much more liquid than the commercial bank loans, providing different types of bond instruments that were potential investment options for new groups and types of investors.[47] In expanding the base of investors in emerging market debt, the Brady restructurings facilitated the expansion of the sovereign bond secondary market.[48] This expanding market created potential problems

[42] Philip J. Power, *Sovereign Debt: The Rise of the Secondary Market and Its Implications for Future Restructurings*, 64 FORDHAM L. REV. 2701, 2712 (1996).

[43] *See* Nicholas F. Brady, U.S. Sec'y of the Treasury, Dealing With the International Debt Crisis, Remarks to the Brookings Institute and Bretton Woods Committee Conference on Third World Debt (Mar. 10, 1989), in DEP'T ST. BULL., May 1989, at 53–54, *available at* http://findarticles.com/p/articles/mi_m1079/is_n2146_v89/ai_7654675/.

[44] Ross P. Buckley, *The Facilitation of the Brady Plan: Emerging Markets Debt Trading from 1989 to 1993*, 21 FORDHAM INT'L L.J. 1802, 1804 (1998).

[45] *Id.* at 1854.

[46] Power, *supra* note 42, at 2720.

[47] *Id.* at 2721 (stating that in a typical Brady Plan securitization, banks could choose from a menu of Brady bond options to receive in exchange for their sovereign loan assets).

[48] *See* Nolan, *supra* note 41.

for future restructurings as many different parties purchased sovereign bonds.[49]

The creditors to many sovereign states today consist of bondholders with widely differing institutional characteristics.[50] Sovereign bonds are held by large commercial banks, smaller commercial banks, local banks, investment banks, insurance companies, pension funds, mutual funds, retail funds, hedge funds, nonfinancial companies, and retail investors.[51] Moreover, the extent to which these various investors hold bonds issued by any particular country differs markedly across countries and issues of bonds.[52] There is no longer unified creditor representation and, unlike in commercial bank loan markets, there is very little peer pressure in bond markets.[53] There may be actors that are not "repeat players" and thus generally have no regard for the interests of other players in the market or for the overall systemic well-being of the market itself.[54]

C. The Rise of Vulture Litigation

The Brady plan and subsequent development of a secondary sovereign debt market with diverse bondholders opened the door for "vulture funds." Vulture funds, also known as "distressed-debt investors," were able to purchase bonds off of the secondary debt market at substantial

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[49] *Id.*

[50] *See* Richard E. Mendales, *We Can Work It Out: The Interaction of Bankruptcy and Securities Regulation in the Workout Context*, 46 RUTGERS L. REV. 1211, 1253 (1994) (noting that the "net effect of securitization . . . is that the pool of creditors has been enlarged, stratified into classes of claimants with degrees of priority with respect to one another that may be difficult to sort out, and distanced from the debtor in terms of the availability of information").

[51] J. Fisch and C. Gentile, *supra* note 23, at 1070.

[52] *Id.*

[53] Power, *supra* note 42, at 2745.

[54] *See* Samuel E. Goldman, *Mavericks in the Market: The Emerging Problem of Hold-Outs in Sovereign Debt Restructuring*, 5 UCLA J. INT'L L. & FOREIGN AFF. 159, 171 (2000).

discounts from their face values and then sue for the full value of the debt. Lawsuits are most commonly filed in New York, Paris, and London.[55] These jurisdictions are perceived by many commercial investors as "creditor-friendly" and more likely to enforce judgments against debtors.[56]

Many of these vulture funds are based in tax havens such as the British Virgin Islands and tend to be quite secretive. While some are owned by large, often U.S.-based financial institutions such as hedge funds, in other cases there is limited or no information regarding their ownership.[57] A vulture fund may establish a subsidiary solely to pursue a specific debt, then liquidate the new company following the completion of the relevant litigation.[58] Vultures can also file suits without notifying the debtor countries.[59]

As these funds brought suits for the full value of their claims, courts continued the erosion of sovereign immunity that began in the late 1970s and early 1980s.[60] In *CIBC Bank & Trust Co. (Cayman) v. Banco Central do Brasil*, defenses of improper assignment and champerty were

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[55] *See* Gail Hurley, *Taming the Vultures: Are New Measures Enough To Protect Debt Relief Gains?*, EURODAD REPORT (Aug. 2008), *available at* http://www.eurodad.org/uploadedFiles/Whats_New/Reports/The%20Rise%20of%20the%20Vulture%20layout.pdf.

[56] *Id.*

[57] For example, the fund Hamsah was awarded more than $11 million in a similar action against Nicaragua but very little is known about this fund. *See Liberia Ordered to Pay 'Vulture Funds' Over 1978 Debt*, BBC NEWS, Nov. 26, 2009, http://news.bbc.co.uk/2/hi/africa/8380117.stm. *See also* Elliott Assoc. L.P. v. Banco de la Nacion, 194 F.R.D. 116, 118 (S.D.N.Y. 2000) (describing how the sovereign defendant had issued discovery requests for documents and communications pertaining to principal and accrued interest on bonds and the lack of adequate disclosure by the vulture plaintiff Elliott Associates, who did not produce at any time prior to trial an expert report or disclose the name of any expert witness who might testify as to accrued interest on the debt).

[58] JUBILEE USA NETWORK, VULTURE FUNDS AND POOR COUNTRY DEBT: RECENT DEVELOPMENTS AND POLICY RESPONSES (Apr. 2008), http http://www.jubileeusa.org/fileadmin/user_upload/Resources/Policy_Archive/408briefnotevulturefunds.pdf.

[59] *Id.*

[60] *See supra* Part II.A.

rejected in response to vulture litigation.[61] In *Pravin Banker Associates., Ltd. v. Banco Popular del Peru*, the court relied on the precedent set by *Allied Bank* to again reject the defense of comity.[62]

As traditional sovereign defenses were rejected by courts, a new interpretation of debt contracts struck a further blow to sovereign debtors. After *Pravin*, Peru found itself in court again in *Elliott Associates, L.P. v. Banco de la Nacion* ("*Elliott v. Peru*"), one of the most infamous cases of vulture fund litigation.[63] In 1996, the vulture fund Elliot Associates paid $11.4 million dollars for letter agreements issued by Banco de la Nacion and Banco Popular and guaranteed by Peru,[64] for the full face value of $20.7 million dollars.[65] However, at the time, Peru was undergoing a restructuring of its debt,[66] and Elliott refused to participate in the restructuring and instead demanded full payment.[67]

In late 1999, Elliott obtained a pre-judgment attachment order against Peruvian assets in the United States that were being used for commercial purposes.[68] In so ruling, the Second Circuit rejected the district court's finding that Elliott had violated Section 489 of the New York Judicial Law,[69] which prohibits the purchase of a claim "with the intent and for the purpose of bringing an action or proceeding thereon."[70] This result was considered another significant validation of vulture strategy in courts.

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[61] 886 F. Supp. 1105 (S.D.N.Y. 1995).

[62] 895 F. Supp. 660, 667 (S.D.N.Y. 1995).

[63] 194 F.3d 363 (2d Cir. 1999).

[64] *Id.* at 366-67.

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] *Id.*

[69] N.Y. JUD. LAW § 489 (McKinney 1983).

[70] *Id.* The Second Circuit held that the investor did not violate the law because the debt was acquired for the primary purpose of enforcing it, with the intent to resort to litigation only if necessary. *See Elliot*, 194 F.3d at 372. The decision to file a claim was the consequence of not performing the payment. *Id.* at 379.

After being awarded a $55.7 million judgment against Peru in June 2000, Elliott sought court orders in New York and various European countries that would either attach Peruvian assets or bar Peru from paying interest on its Brady bonds.[71] Elliott finally succeeded when it persuaded a Brussels appeals court to order payment provider Euroclear to suspend Brady bond interest payments.[72] In October 2000, Peru settled with Elliott for $56.3 million rather than continue the legal fight and risk default on an entire stock of Brady debt.[73]

Elliott is a well-known case, not just because of the New York state court's decision, but because of the Belgian court's ruling which utilized a novel reading of the *pari passu* clause that is commonly found in sovereign debt contracts.[74] Previously, the international financial markets had understood the clause to protect a lender against the risk of legal subordination in favor of another creditor.[75] In this case, however, the court accepted Elliott's argument that the *pari passu* clause further required that equally ranking debt be paid equally.[76] Thus, according to the court, if there is not enough money for all creditors, all creditors receive a pro-rata share and debtors are not allowed to pay off one creditor in full while leaving others unpaid.[77] Prior to *Elliott*, international creditors had no legally enforceable options for

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[71] Elliott Assocs., L.P. v. Banco de la Nacion, 194 F.R.D. 116 (S.D.N.Y. 2000).

[72] *See* Panizza et al., *supra* note 38, at 657.

[73] *Id.*

[74] Rodrigo Olivares-Caminal, *Understanding The Pari Passu Clause In Sovereign Debt Instruments: A Complex Quest*, 43 INT'L LAW. 1217, 1221 (2009).

[75] Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause In Sovereign Debt Instruments*, 53 EMORY L.J. 869, 870 (2004) (stating that this legal subordination cannot happen under U.S. law without the lender's consent, but can occur involuntarily under the laws of some other countries).

[76] *Id.* at 879-80.

[77] Kenneth H. Fukuda, *FAQ: What is a Vulture Fund?*, UNIVERSITY OF IOWA CENTER FOR INTERNATIONAL FINANCE AND DEVELOPMENT, May 2008, http://www.uiowa.edu/ifdebook/faq/Vulture.shtml.

gaining bargaining power with respect to other debtholders.[78] The court in *Elliott* therefore afforded much more power to creditors by providing a legal means of preventing the sovereign from paying its other creditors without making a ratable payment to the judgment creditor.[79] The decision had the potential to disrupt the international flow of funds, prompting outcry from academics and professionals alike.[80]

Following the Belgian decision in *Elliott v. Peru*, it did not take long for other creditors to attempt to take advantage of this new "ratable payment interpretation" of the *pari passu* clause on creditor remedies. Several holdout creditors attempted to mimic Elliott's legal strategy with respect to Peru, but were unable to repeat Elliott's success.[81] These later cases (in particular an English high court judge's declaration in 2003 that the ratable payment interpretation was "novel and unprecedented") called into question the Belgian court's ruling and interpretation of the clause.[82]

[78] Michael Bradley, James D. Cox & Mitu Gulati, *The Market Reaction to Legal Shocks and their Antidotes: Lessons from the Sovereign Debt Market* at 4 (Duke Law School Public Law & Legal Theory Paper No. 211, 2008), *available at* http://ssrn.com/abstract=1138801.

[79] *See* Buchheit & Pam, *supra* note 75, at 880.

[80] *See* Bradley et al., *supra* note 78, at 4

[81] *See, e.g.*, Republic of Nicaragua v. LNC Invs. LLC & Euroclear Bank S.A., General Docket No. 2003/KR/334 P 22 (Ct. App. of Brussels, 9th Chamber, Mar. 19, 2004) (finding that, because Euroclear was not a party to the contract in which the *pari passu* clause arose, the clause did not give LNC the right to attach payments channeled through Euroclear); Kensington Int'l Ltd. v. Republic of the Congo, 2002 No. 1088, at 6:13-16 (Commercial Ct., Apr. 16, 2003) (rejecting enforcement based on the *pari passu* clause on this contractual clause was inconsistent with the fact that the plaintiff's claim had been reduced to a court judgment); Red Mountain Fin., Inc. v. Democratic Republic of Congo & Nat'l Bank of Congo, No. CV 00-0164 R (C.D. Cal. May 29, 2001) (rejecting the broad *pari passu* interpretation but issued an injunction that led to a similar result, i.e. forcing the borrower to make a proportionate payment to Red Mountain if it wished to make any other external debt payments).

[82] *See* Kensington Int'l Ltd. v. Republic of the Congo, 2002 No. 1088, at 6:13-16 (Commercial Ct. Apr. 16, 2003) (judgment of Mr. Justice Tomlinson characterizing Justice Cresswell's issuance of injunctive relief as "novel and unprecedented" and denying injunctive relief in the instant case).

Disapproving scholarship and amici briefs have widely further discredited the Belgian precedent.[83] Furthermore, the Belgian legislature in 2005 passed laws to make it harder for vultures to employ the strategy used in *Elliott*.[84]

Vulture funds have captured recent headlines as they have continued their pursuits of struggling countries. In 2007, Zambia was ordered to pay $14.78 million in a lawsuit brought by Donegal International; while it should be noted that this sum was a substantial reduction from the $42.3 million plus interest sought by Donegal,[85] the award was still significantly greater than the $3.2 million paid by Donegal to acquire the debt.[86] Other investors dealing in collection of sovereign debt include: Greylock Global Opportunity, based in the British Virgin Islands, which won a $50.9 million judgment against Nicaragua; FG Hemisphere, based in the United States, which won a $151.9 million judgment against Congo Republic and a $81.7 million judgment against the Democratic Republic of Congo; Kensington International, based in the Cayman Islands, which won a $118.6 million judgment against Congo Republic; and Grace Church Capital, based in the Cayman Islands, which has sought a $39.7 million judgment against Cameroon.[87]

D. The HIPC Initiative

The issue of vulture fund regulation has been further complicated by the recent work of the Heavily Indebted Poor Countries (HIPC) Initiative. Introduced in 1996 by the

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[83] Michael D. Goldhaber, *Vulture Culture*, AM. LAW., Sep. 1, 2008, *available at* http://www.law.com/jsp/PubArticle.jsp?id=1202423983183.

[84] Hal S. Scott, *Sovereign Debt Default: Cry For The United States, Not Argentina*, (Washington Legal Foundation, Working Paper Series No. 140, 2006).

[85] Donegal Int'l Ltd. v. Zambia, [2007] EWHC (Comm) 197, [2007] 1 Lloyd's Rep. 397.

[86] *See* Olufunmilayo B. Arewa, *Vultures, Hyenas, and African Debt: Private Equity and Zambia*, 29 NW. J. INT'L L. & BUS. 643, 644 (2009).

[87] *Flying Under The Radar*, June 16, 2008, PORTFOLIO, http://www.portfolio.com/news-markets/international-news/portfolio/2008/06/16/Funds-in-Sovereign-Debt-Business/.

International Development Association (IDA), part of the World Bank, the Initiative aims to provide a fresh start to countries with an "unsustainable" foreign debt burden.[88] In such countries, even traditional mechanisms of rescheduling, debt reduction, and concessional financing are not enough for the debtor to attain sustainable external debt levels.[89]

Countries within the HIPC Initiative work to reach two specific stages: decision point and completion point.[90] To advance between stages, countries must meet specific benchmarks designed to signal their progress towards responsible fiscal policies and debt sustainability.[91] Once a country reaches completion point, it receives the full amount of debt relief, which then becomes irrevocable.[92]

In 2006, the Initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI), which entailed

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[88] *See* The World Bank, *Debt Relief*, Oct. 2009, http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20040942~menuPK:34480~pagePK:34370~theSitePK:4607,00.html (last visited March 1, 2010) [hereinafter Debt Relief] (stating that a country's debt level is considered unsustainable if debt-to-export levels are above a fixed ratio of 150 percent or, in cases with countries with very open economies, when the debt-to-government revenues are above 250 percent of fiscal revenues).

[89] *See* The Paris Club, *Club de Paris: HIPC Initiative*, http://www.clubdeparis.org/sections/types-traitement/reechelonnement/initiative-ppte (last visited March 1, 2010) [hereinafter "Club de Paris: HIPC Initiative].

[90] Debt Relief, *supra* note 88 (stating that in order to reach decision point, a "country must have a current track record of satisfactory performance under IMF and IDA-supported programs, a Poverty Reduction Strategy (PRS) in place, and debt burden indicators that are above the HIPC Initiative thresholds").

[91] At decision point, staffs of the World Bank and IMF carry out a loan by loan debt sustainability analysis to determine the level of indebtedness of the country and the amount of debt relief it may receive. Countries then begin receiving interim relief on a provisional basis. Club de Paris: HIPC Initiative, *supra* note 89. For a country to reach completion point it must maintain macroeconomic stability, carry out the key structural and social reforms (the "triggers") agreed upon at the decision point, and satisfactorily implement a "Poverty Strategy Reduction Program" for one year. Debt Relief, *supra* note 88.

[92] *Id.*

forgiveness of 100 percent of eligible outstanding debt owed to the International Monetary Fund (IMF), the IDA of the World Bank, and the African Development Fund by all HIPC countries that had reached the completion point of the HIPC Initiative.[93] As of the end of June 2009, thirty-five countries have benefited from HIPC debt relief; twenty-six have reached the completion point, at which debt relief becomes irrevocable, and nine more are receiving interim assistance.[94]

Despite the enormous financial support these programs provide, even once a country reaches completion point, creditors retain their legal rights to enforce claims against the country concerned. Vulture creditors therefore pose a special risk to countries undergoing the HIPC process. One creditor can refuse to participate in the necessary debt reduction. Once others have reduced their claims by the necessary amount, and the debtor country's ability to repay recovers, the creditor that held out can pursue its debt claims for full value, at the expense of the debtor country, and, indirectly, at the expense of the other creditors. While this "free rider" problem exists in all cases of restructuring, it is particularly reprehensible for countries undergoing the HIPC Initiative because all of the relief is crucial for reaching a sustainable debt level. The amount of debt relief provided by the international community under HIPC is based on the "common reduction factor," the calculated level of debt relief necessary for an HIPC country to reach debt sustainability.[95] However, the common reduction factor is derived under the assumption that all creditors take part in the initiative.[96] Creditor failure to take part in the HIPC Initiative (let alone their decision to litigate) could result in HIPC countries failing to reach debt sustainability, undermining their advancement through the Initiative and, in turn, their movement towards economic prosperity.[97]

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[93] *Id.*

[94] *Id.*

[95] Club de Paris: HIPC Initiative, *supra* note 89.

[96] *Id.*

[97] *Id.* One of the major challenges of the HIPC Initiative is therefore to ensure that eligible countries receive the level of debt relief needed from

Liberia, an HIPC country, serves as an example of the threat posed by vultures to the HIPC Initiative. In April 2009, creditors holding 97.5 percent of Liberia's foreign commercial debt participated in a debt buy-back, one of the largest rates of participation in any recent sovereign debt buy-back.[98] This operation retired almost all obligations to private creditors. Liberia's deal through HIPC negotiations was seen as an important success because much of the debt was held by hedge funds and other secondary creditors rather than the original lenders.[99] These commercial lenders have typically refused to take part in debt relief processes. Furthermore, Liberia's buy-back of $1.2 billion in debt was for just $38 million, all of which was funded by the World Bank and donor governments.[100]

In spite of this progress, in November 2009, a British court ordered Liberia to pay $20 million to two funds: Hamsah Investments of the British Virgin Islands and Wall Capital of the Cayman Islands.[101] The sum is equivalent to 5% of the 2009 budget of Liberia, which is recovering from a fourteen-year civil war that ended in 2003.[102] These two

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all of their creditors. $4.3 billion of the debt relief due under the HIPC Initiative (6% of the total) is expected from commercial creditors, but, so far, the World Bank and IMF estimate that only around a third of this has been provided. *See* THE WORLD BANK, HIPC AT-A-GLANCE GUIDE, ANNUAL MEETINGS (2009), http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1240603491481/HIPCFall2009_ENG.pdf.

[98] JUBILEE DEBT CAMPAIGN, *Liberia secures vulture victory*, Apr. 18, 2009, http://www.jubileedebtcampaign.org.uk/Liberia%20secures%20vulture%20victory+4804.twl.

[99] World Bank President Robert Zoellick stated that the deal represented "the steepest discount [the bank] ever had" with commercial creditors. Bob Davis, *Liberia Cuts Foreign Debt by $1.2 Billion*, WALL ST. J., Apr. 17, 2009, at A6.

[100] *Id.* This deal amounted to only three cents paid back for every dollar owed. *See also* JUBILEE DEBT CAMPAIGN, *supra* note 98 (stating that Liberia was part of the HIPC Initiative and therefore eligible for 100% debt reduction).

[101] *See Liberia Ordered to Pay 'Vulture Funds' over 1978 Debt*, BBC NEWS, Nov. 26, 2009, http://news.bbc.co.uk/2/hi/africa/8380117.stm.

[102] *Id.*

funds were the only creditors that had refused to participate in the successful April 2009 Liberian debt reduction.[103]

Liberia demonstrates the potential consequences of the refusal of even a few vulture funds to cooperate with other creditors. This lawsuit potentially diminishes the impact of any debt relief that may be granted to Liberia by reducing resources available for investment. There is also concern that commercial creditors will be less likely to participate in negotiations in the future if such lawsuits continue to be pursued successfully. The current financial climate has only increased fears of greater litigation brought by creditors against HIPC countries.[104]

III. CURRENT ISSUE

As discussed above, changes in the legal environment since the late 1970s have made it much easier for holdout creditors to succeed in court. Litigating to seek full repayment undermines relief granted by other creditors and weakens the finances and development of poor countries. Litigation also undermines fairness between creditors; non-cooperative creditors profit at the expense of sovereign and commercial creditors that provide debt relief.

At least nine non-HIPC countries have been subject to litigation by one or more of their creditors.[105] With the exception of claims resulting from the Argentina 2001 bond default, these legal actions were brought with respect to

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[103] Brittany Schell, *U.S. Considering Debt Relief For Poor Countries*, ONEWORLD.NET, Jan. 5, 2010, http://us.oneworld.net/article/368428-us-lawmakers-move-fight-global-poverty.

[104] While HIPC judgments can be for sums with the potential of having a major impact on poor countries, it should be noted the HIPC debtors rarely pay their vulture creditors. The money comes out of international institutions such as the IMF and World Bank.

[105] *See* EMERGING MKT. TRADERS ASS'N, EMTA PRELIMINARY ANALYSIS OF CREDITOR LITIGATION IN THE NON-HIPC SOVEREIGN DEBT RESTRUCTURING CONTEXT 2 (2009), *available at* http://www.clubdeparis.org/sections/communication/evenements/rencontre-avec-secteur/secteurprive2009/rencontre-avec-secteur/document-emta/downloadFile/file/EMTA_Analysis.pdf [hereinafter EMTA REPORT].

about $1.5 billion in debt and have resulted in approximately $230 million in recovery.[106]

According to a September 2008 GAO report, twelve HIPCs have been targeted by litigation, with a total of fifty-four cases filed against them.[107] Thirty-three of these cases were still active (i.e., not settled) as of September 2008, but that number has since declined to fourteen as of September 2009.[108] These creditors hold $1.4 billion in claims, and the courts have already given judgment on approximately $1.2 billion of that figure.[109] While in the context of wider international financial flows, the $4.3 billion debt relief expected from commercial creditors within the HIPC Initiative is comparatively small, such debt relief expected from commercial creditors can constitute a significant proportion of the total debt relief expected by the heavily indebted poor country.[110]

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[106] *Id.*

[107] INT'L DEV. ASS'N & INT'L MONETARY FUND, HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE AND MULTILATERAL DEBT RELIEF INITIATIVE (MDRI)—STATUS OF IMPLEMENTATION 33 (2008), *available at* http://www.imf.org/external/np/pp/eng/2008/091208.pdf [hereinafter 2008 STATUS REPORT].

[108] INT'L DEV. ASS'N & INT'L MONETARY FUND, HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE AND MULTILATERAL DEBT RELIEF INITIATIVE (MDRI)—STATUS OF IMPLEMENTATION 14 (2009), *available at* http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:22326067~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043~isCURL:Y,00.html [hereinafter 2009 STATUS REPORT].

[109] 2008 STATUS REPORT, *supra* note 107, at 33. This amount does not include awards eliminated due to recent DRF-supported buybacks. *Id.*

[110] H.M. TREASURY, ENSURING EFFECTIVE DEBT RELIEF FOR POOR COUNTRIES: A CONSULTATION ON LEGISLATION (2009), *available at* http://www.hm-treasury.gov.uk/d/consult_effectivedebtrelief_200709.pdf [hereinafter "H.M. Treasury Consultation"]. The potential burden of lawsuits varies greatly from one country to another. Ethiopia, Nicaragua, and Niger seem to be the countries that are most negatively affected by lawsuits while countries such as Bolivia and Yemen appear to be less affected. *See* COUMBA FALL GUEYE, MICHEL VAUGEOIS, MATTHEW MARTIN & ALISON JOHNSON, NEGOTIATING DEBT REDUCTION IN THE HIPC INITIATIVE AND BEYOND (2000), *available at* http://www.hipccbp.org/files/en/open/Publications/Pub11_June07.pdf.

The financial crisis will further compromise the debt sustainability of many developing countries, as growth rates and export earnings fall.[111] Repayment ability is also highly sensitive to shifts in exchange rates because foreign debt is denominated in hard currencies.[112] Such depreciations make it more difficult to service foreign debt.[113] There is also fear that unforeseen reductions in donor commitments could slow the distribution of debt relief.[114] In addition, credit access could become more restricted because new channels of financing for low-income countries, such as sovereign bond issues, may not be available in the short-term.[115]

Several private and public law mechanisms have developed to address holdout litigation against sovereign debtors. While these innovations have helped to mitigate the threat of vulture litigation, they have not been completely successful.

A. Current Contract Tools

A number of recent contract modifications to sovereign debt issuances have proven invaluable in fighting vulture funds. While many contract provisions have developed over

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[111] *See* ANNALISA PRIZZON, THE FALLOUT FROM THE FINANCIAL CRISIS (2): EXTERNAL DEBT SUSTAINABILITY SHOULD MORE BE DONE FOR THE POOR?, 84 POLICY INSIGHTS (Dec. 2008), *available at* http://www.oecd.org/dataoecd/56/32/41804246.pdf. ("[W]ith the collapse in commodity prices and the recent appreciation of the dollar, exchange rates in many low-income countries have already been falling. For instance, the Zambian kwacha fell 24 per cent against the dollar between August and October."); U.N. CONFERENCE ON TRADE & DEV. [UNCTAD], THE IMPACT OF THE FINANCIAL AND ECONOMIC CRISIS ON DEBT SUSTAINABILITY IN DEVELOPING COUNTRIES, at 3 (Sept. 2009), http://www.unctad.org/en/docs/gdsdmfasmisc20091_en.pdf (discussing recent financial flows from HIPCs and noting that the recent crisis has demonstrated the vulnerability of developing countries to exogenous volatility).

[112] Prizzon, *supra* note 111.

[113] *Id.*

[114] *Id.*

[115] *Id.* This issue will be especially significant for countries such as Ghana, Cameroon, Uganda, Kenya, and Mongolia that have just issued or plan to issue bonds.

time, each has limitations that leave poor countries vulnerable to vulture activity.

1. Exit Consents

Exit consents appear to be a promising option for eliminating holdout litigation in future restructurings. This mechanism enables a majority of bondholders participating in a bond exchange offer to use the amendment clauses in their existing bonds to alter important nonpayment terms of the old bonds.[116] Changing provisions such as financial covenants or waivers of sovereign immunity would render those old bonds less attractive to any bondholder who may be thinking of declining the exchange.[117] By holding out, a bondholder retains the original bonds with the original payment terms, but because these bonds lack protective covenants, the value of the bonds is reduced. The bondholder is thereby encouraged to participate in the exchange with the other bondholders. The exit consent may therefore be applied to existing amendment clauses in sovereign bonds. Exit consents have been employed in numerous recent restructurings in countries such as Russia, Ukraine, Pakistan, Ecuador, and Uruguay.[118]

While they are useful in encouraging restructuring, exit consents will not completely prevent holdout litigation. An exchange might not be economically feasible if the magnitude of the changes to the payment terms of the original bonds necessary to relieve the sovereign debtor's financial crisis is too great. Even though exit consents may initially reduce the value of the bonds through alteration of nonpayment terms, the reduction of the sovereign's total debt burden upon completion of the restructuring could

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[116] Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. REV. 59, 59 (2000).

[117] *See id.* at 65.

[118] *See* Joy Dey, *Sovereign Debt Restructuring: Search for an Optimum Voting Threshold* 7 (2008), *available at* http://ssrn.com/abstract=1369523. Levels of acceptance varied: Russia 98% (1998-2000), Ukraine 95% (1998-2000), Ecuador 97% (2000), Pakistan 95% (1999), Uruguay 93% (2003) and Argentina 76% (December 2004). *Id.*

increase the value of the bonds. This increase in value caused by the restructuring, often called the "buoying-up" effect, may be greater than the decrease in value caused by the exit consents.[119] Thus, in some cases, the "buoying-up effect" of the restructuring may overcome the negative effects of the exit consents, and they will not be as effective in preventing litigation by creditors.[120]

2. Collective Action Clauses

Collective action clauses (CACs) have also become increasingly common in sovereign bond contracts since Mexico's February 2003 global note issue.[121] These provisions permit a majority or supermajority of bondholders to change the payment terms of an issue of bonds, thereby overriding objections by minority holdout creditors.[122] Once the required majority accepts a debtor's restructuring proposal, it binds all bondholders, including dissenting creditors. Thus, when a restructuring has been concluded, collective action clauses effectively prevent holdout litigation.[123] Several of the cases cited above would have had no basis if collective action clauses had been included in the loan contracts.

Collective action clauses cannot limit litigation that arises after default but before a restructuring becomes

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[119] For evidence that the "buoying-up" effect prevails, see Marcel Kahan & Bruce Tuckman, *Do Bondholders Lose from Junk Bond Covenant Changes?*, 66 J. BUS. L. 499 (1993).

[120] *See* Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 247 (arguing that an exit consent will not necessarily diminish the "buoying-up" effect accompanying the holdout problem).

[121] *See* Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L.R. 1627, 1641 (2007). According to trade association information, more than two dozen countries (such as Brazil, South Korea, Turkey, and South Africa) have followed Mexico's lead and issued bonds with majority modification provisions under New York law contracts.

[122] Häseler, *supra* note 13, at 3.

[123] *Id.* at 7.

effective.[124] Therefore, bondholders may bring a suit anytime after the debtor has defaulted until the resolution of the crisis, a period that may span years.[125] Collective acceleration has now become the standard, which reduces, but does not eliminate, the possibility of litigation during this critical period.[126] CACs in their present form therefore fail to solve collective action problems during a crucial stage of the restructuring process.

3. Trust Structure

When issuing debt, the sovereign can choose to use a fiscal agent or the increasingly popular trust structure.[127] Under a fiscal agent agreement, an agent is appointed to handle matters related to the debt issuance, such as redeeming bonds and coupons at maturity.[128] Under a trust structure (trust indenture or trust deed, depending if the bond is issued under New York or English law), a trustee is appointed as a fiduciary to manage matters related to the issuance ensuring that the issuer meets all the terms and conditions of the issuance.[129] In bond issuances with a fiscal agent, the agent acts as a representative of the issuer.[130] In contrast, the trustee is viewed as the fiduciary and representative of the bondholders.[131]

Under a trust structure, "suit can only be brought if a certain percentage of bondholders, usually 25%, instruct and indemnify the trustee."[132] The terms of the indemnification

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[124] *See id.*

[125] *See id.*

[126] *Id.*

[127] Olivares-Caminal, *supra* note 74, at 1221. Countries that have recently employed trust structures in their bond issuances include Argentina, Belize, Dominica, Ecuador, Grenada, and Uruguay. *See* Lee C. Buchheit, *Supermajority Control Wins Out*, INT'L FIN. L. REV. Apr. 2007, at 21.

[128] Olivares-Caminal, *supra* note 74, at 1221.

[129] *Id.*

[130] *Id.*

[131] *Id.*

[132] Scott, *supra* note 84, at 31.

are often very difficult.[133] An indenture trustee arrangement therefore eliminates the right of individual bondholders, like vulture funds, to bring suit. Payments done through a trustee also cannot be attached because funds deposited in a trustee's account are held by the trustee acting on behalf of the creditors and are not considered the property of the sovereign.[134] Unfortunately, the benefits of a trust structure cannot apply retroactively to outstanding debt.

B. Current Multilateral Initiatives

As private law solutions have proven incapable of completely eliminating the vulture problem due to the restrictions discussed above, the international community has intensified its efforts to discourage litigation against sovereign debtors.

The 19 members of the Paris Club, an informal group of official creditors created to coordinate solutions with struggling debtor nations,[135] resolved in May 2007 to avoid the sale of their HIPC debt to the creditors who refused to provide debt relief under the HIPC Initiative.[136] They also urged non-Paris Club creditors to behave in the same manner.[137] Since no legal means are available to persuade non-member cooperation, the international financial institutions attempt to engage non-members through moral suasion.[138] Unfortunately, efforts to encourage those outside the Paris Club to cooperate have been largely unsuccessful.[139]

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133 *See id.*

134 *See* Olivares-Caminal, *supra* note 74, at 1221.

135 Club de Paris: Frequently asked questions, http://www.clubdeparis.org/sections/services/faq/77-forum-aux-questions.

136 *See* African Development Bank Group, *Vulture Funds in the Sovereign Debt Context*, http://www.afdb.org/en/topics-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/.

137 *See id.*

138 *See, e.g.*, MADHUR GAUTAM, DEBT RELIEF FOR THE POOREST: AN OED REVIEW OF THE HIPC INITIATIVE (World Bank 2003), *available at* http://siteresources.worldbank.org/IDA/Resources/HIPC_OED_review.pdf. *See also* Nick Mathiason, *Big Food Does Big U-turn*, THE OBSERVER, Mar.

Almost all Paris Club creditors are delivering additional debt relief, beyond the amounts they committed to under the HIPC Initiative.[140] About 60 percent of the non-Paris Club official creditors have granted HIPC Initiative debt relief, but twenty-one non-Paris Club official bilateral creditors have not yet delivered any HIPC Initiative debt relief.[141]

There has also been a recent effort to support HIPCs facing litigation with legal advice or technical assistance. In 2008, the African Development Bank approved a proposal to establish the African Legal Support Facility.[142] The Facility's mission is to provide technical legal advice to members of the Facility in creditor litigation and to strengthen their legal expertise and negotiating capacity in matters pertaining to debt management, natural resources and extractive industries management and contracting, investment agreements, and related commercial and business transactions.[143] The Commonwealth Secretariat also

23, 2009, http://www.guardian.co.uk/business/2003/mar/23/corporate accountability.theobserver (discussing the case of Big Food Group, which used a bilateral trade treaty with Britain to force Guyana into arbitration but refrained from proceeding due to concern for the company's public image).

[139] *See* International Monetary Fund, Selected Decisions and Selected Documents of the IMF, Thirty-Third Issue---The Acting Chair's Summing Up-HIPC Initiative-Status of Implementation; Background Papers on the Achievement of Long-Term External Debt Sustainability and External Debt Management in HIPCs and Update on Financing of PRGF and HIPC Operations and Subsidization of Post-Conflict Emergency Assistance (July 2009) *available at* http://www.imf.org/external/pubs/ft/sd/index.asp?decision=EBM/02/40.

[140] Alberto Espejo & Anna Unigovskaya, *Debt Relief Bringing Benefits to Africa*, IMF SURVEY, Feb. 25, 2008, http://www.imf.org/external/pubs/ft/survey/so/2008/car022508a.htm.

[141] *Id.*

[142] African Development Bank Group, *The African Development Bank Group to Launch the African Legal Support Facility*, May 11, 2009, http://www.afdb.org/en/news-events/article/the-african-development-bank-group-to-launch-the-african-legal-support-facility-4588/.

[143] African Development Bank Group, *Agreement for the Establishment of the African Legal Support Facility*, *available at* http://www.afdb.org/fileadmin/uploads/afdb/Documents/Legal-

established an HIPC Clinic to provide legal advice to HIPCs that are facing or likely to face debt litigation.[144] The Clinic, which employs a resident legal advisor, aims to support sovereign debtors and assist member countries as well as other non Commonwealth HIPCs.[145] More recently, the international community expressed concern about vulture litigation in the UN's Doha Declaration Financing for Development.[146]

C. National Legislation

While there is evidence that the measures taken by international bodies to limit non-cooperative creditor activity have had some success, these methods cannot prevent creditors intent on pursuing their claims through the courts from doing so. So long as it remains possible and potentially highly profitable to sue for payment of the full value once other creditors have provided relief, creditors may choose to litigate.

Documents/Agreement%20for%20the%20Establishment%20of%20the%20 African%20Legal%20Support%20Facility%20%28ALSF%29.pdf.

144 DEVELOPMENT FINANCE INTERNATIONAL, ENHANCING ACTIONS AND INFORMATION EXCHANGE ON CREDITOR PARTICIPATION AND LITIGATION RELATING TO HIPC DEBT RELIEF, at 6 (April 2009), *available at* http://www.thecommonwealth.org/files/190138/fileName/INFORMATION EXCHANGE.pdf. The Commonwealth is a support network of 54 countries and organizations is involved in a diverse range of work, from helping trade negotiations, building the small business sector and encouraging women entrepreneurs to supporting the quality and quantity of teachers, and increasing understanding of HIV/AIDS. *See* The Commonwealth, COMMONWEALTH SECRETARIAT, http://www.thecommonwealth.org/Internal/ 191086/191247/the_commonwealth/.

145 *Id.* Development Finance International, *supra* note 144, at 6.

146 Signatories stated that they were "deeply concerned about increasing vulture fund litigation," and "call[ed] on creditors not to sell claims on HIPC [countries] to creditors that do not participate adequately in the debt relief efforts." Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, Doha, Qatar, Nov. 29–Dec. 2, *Doha Declaration on Financing for Development*, U.N. Doc. A/CONF.212/L.1/Rev.1 at 17 (Dec. 2, 2008).

As a result, there has been increasing support for legislation to help prevent (or at least, mitigate damage by) litigation by vulture creditors. Many academics, NGOs, and politicians have called for national legislation preventing vulture litigation.[147] Thus far, only Belgium has passed legislation directed against vultures, and this modest approach was simply designed to encourage more debtor-friendly debt issuances in the future. New proposals in the United States and United Kingdom are far more aggressive by seeking to cap potential recovery available through creditor litigation. These developments are discussed in greater detail below.

1. Belgium

Belgium was the first and, thus far, only country to pass legislation targeting vulture funds. In 2007, it became evident that vulture funds were increasing their activity in Belgium. For example, Kensington International, a vulture fund registered in the Cayman Islands, is involved in several court procedures in Belgium.[148] They are currently attempting to seize about €10.3 million from the government that has been marked as development aid.[149] Another claim, related to a Belgian Development grant to the National Television is pending for an amount of €587,000.[150] Vulture funds also alarmed Belgian senators by introducing more than ten claims in the Democratic Republic of Congo (DRC), a major recipient of Belgian Official Development Assistance (ODA).[151]

In 2008, the Belgian senate unanimously approved both a resolution and a law "to safeguard the Development Cooperation and Debt Relief from the actions taken by

[147] *See supra* notes 10-13 and accompanying text.

[148] Pol Vandevoort, *Belgian Senate Unanimously Approves "Vulture Fund" Legislation*, BLOG THE DEBT, Feb. 1, 2008, http://jubileeusa.typepad.com/blog_the_debt/2008/02/belgian-senate.html.

[149] *Id.*

[150] *Id.*

[151] *Id.*

Vulture Funds."[152] The Belgian law would block the appropriation of aid by vultures, describing the funds as "*insaisissables et incessibles*" (untouchable and non-transferable).[153] The legislation is fairly modest; it merely inserts clauses into future bilateral agreements preventing vulture funds from seizing Belgian aid that is set aside for specific projects.[154] A broader non-binding resolution was also passed, calling on (though not requiring) the Belgian Government to urge the World Bank and IMF to develop the necessary legal instruments to ensure debt relief programs are binding on all creditors, increase Belgium's contribution to the IDA Debt Reduction Facility, and provide technical and financial assistance to partner countries facing creditor litigation.[155]

2. United Kingdom

The U.K. courts have heard at least seven recent cases against HIPC countries, including the notorious *Donegal International Ltd. v. Zambia*[156] case in 2007.[157] Six of these cases led to judgments for creditors, totaling $236.1 million on debt with a nominal face value of just $65.3 million.[158] In November 2009, a High Court in London ordered Liberia to

[152] *See* Hurley, *supra* note 55.

[153] *See also* Service Public Federal Affaires Etrangeres, Commerce Exterieur et Cooperation au Developpement (F. 2008 — 1598), *available at* http://reflex.raadvst-consetat.be/reflex/pdf/Mbbs/2008/05/16/109374.pdf.

[154] *See* Nancy Dubosse, *IFIs Foot Dragging on Key Debt Issues*, BRETTON WOODS PROJECT, Apr. 1, 2008, http://www.brettonwoodsproject.org/art-561011.

[155] *See* Hurley, *supra* note 55.

[156] Donegal Int'l Ltd. v. Zambia, [2007] EWHC (Comm) 197, [2007] 1 Lloyd's Rep. 397.

[157] JUBILEE DEBT CAMPAIGN, *Time To Stop The Debt Vultures*, June 2009, http://www.jubileedebtcampaign.org.uk/download.php?id=817.

[158] *Id.* Vulture creditors have therefore managed to recover over 3.6 times their original investments through U.K. courts.

pay two vulture creditors more than $20 million for a debt dating back to 1978.[159]

Gordon Brown has repeatedly voiced his disapproval of vulture tactics.[160] The measures Brown appears to favor are mostly voluntary "codes of conduct" for creditors coupled with increased financial resources from the United Kingdom to help countries faced by aggressive litigation, similar to the Belgian code.[161] In 2007, 124 MPs signed an "Early Day Motion" which called on the Government to encourage the IMF to consider new international regulations targeting action by vulture funds.[162]

On May 6, 2009, Sally Keeble MP introduced the Developing Country Debt (Restriction of Recovery) Bill in the House of Commons with the goal of completely ending vulture lawsuits in the United Kingdom by capping potential recovery in the U.K. courts.[163] Even if a creditor has received a court judgment outside the United Kingdom that is legally enforceable within the country, the creditor is only entitled to receive up to a "maximum recovery amount," which is defined as the amount paid for the debt as well as interest.[164] The bill also provides for reporting arrangements to the United Kingdom and developing country governments, which should allow for more transparency in the work of the funds.[165]

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[159] *Liberia Ordered to Pay "Vulture Funds" over 1978 Debt*, BBC NEWS, Nov. 26, 2009, http://news.bbc.co.uk/2/hi/africa/8380117.stm.

[160] *See, e.g.*, Gordon Brown, Chancellor of the Exchequer, World Economic Situation and Prospects, Speech by the Chancellor of the Exchequer at the Commonwealth Finance Ministers Meeting in London (Sept. 25, 2002).

[161] *See* Hurley, *supra* note 55, at 8-9.

[162] *Id.*

[163] Developing Country Debt (Restriction of Recovery) Bill, 2009, Bill [91].

[164] *Id.*

[165] *Id.* Before even commencing proceedings in a U.K. court, a creditor must receive consent from the court. *Id.* An application for consent must include detailed information about the creditor financial history. *Id.*

In July 2009, the U.K. government put proposals out for consultation on the subject of vulture funds.[166] The government suggested limiting the amount that a commercial creditor could be awarded in U.K. courts, but, unlike the bill put forward by Sally Keeble, restricted the legislation's applicability to litigation against HIPC countries.[167] The consultation lists many reasons for restricting the scope of the legislation to HIPC countries; a clear international commitment exists to provide debt relief to these countries, the level of debt reduction required to restore sustainability is generally very high for HIPCs so there is greater potential for damage by vultures, and focusing on HIPC countries would provide a bright-line (as opposed to the vague standard in the current legislation draft).[168] The British Government is also wary of including more than the poorest countries in its legislation due to concern for the financial sector.[169]

In late 2009, MP Andrew Gwynne was designated third in the Private Members' Ballot, which gave him the opportunity to introduce legislation into Parliament.[170] On December 16, 2009, he introduced a narrower form of the Developing Country Debt (Restriction of Recovery) Bill, with Keeble attached as a co-sponsor.[171] The Bill would only cover

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[166] Department for International Development, *Public Consultation Launched on "Vulture Funds,"* July 21, 2009, http://www.dfid.gov.uk/Media-Room/News-Stories/2009/Public-consultation-launched-on-vulture-funds/.

[167] Keeble would like to see the legislation extended to protect all "Low or Middle Income countr[ies]." *See* Developing Country Debt (Restriction of Recovery) Bill, 2009, Bill [91].

[168] *See* H.M. Treasury Consultation, *supra* note 110, at 21.

[169] *See id.* at 20-21.

[170] The Private Members' Ballot is an annual event in Parliament in which MPs are balloted for Parliamentary time that could allow them to introduce their own Bill. *See* John Stormont, *Launch of Third World Debt Relief Bill Welcomed*, ONEWORLD.NET, http://uk.oneworld.net/article/view/164665/1/.

[171] Debt Relief (Developing Countries) Bill, 2009-10, Bill [17], http://www.parliament.uk/commons/lib/research/rp2010/rp10-017.pdf (stating that the new Bill "shares some similarities with more wide-

HIPC countries and would exclude debt incurred after the Bill became effective.[172] This Bill was passed on April 8, 2010, but will only be in effect for one year. After that time, Parliament will decide whether to extend the legislation, make it permanent, or simply remove the cap on vulture recovery.[173]

3. United States

The United States has recently heard eleven cases against Cameroon, the Republic of Congo, and Nicaragua.[174] Commercial investors have claimed close to $695 million on HIPC debt with an original face-value of $195.9 million.[175] Judgments in the vultures' favor have amounted to $659.4 million.[176]

The Stop Vulture Funds Act was introduced by Maxine Waters, a Democrat congresswoman from California, on June 18, 2009, and is now under discussion in Congress.[177] The Act would allow vulture funds to recoup only the purchase price of a debt plus 6% interest.[178] The bill is limited to countries that can borrow from the International Development Association (IDA) and specifically excludes countries eligible to borrow from the International Bank for Reconstruction and Development (IBRD), which lends at market rates.[179] The bill also excludes countries that commit

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ranging legislative proposals introduced in the 2008-09 Parliamentary session").

[172] *See* Debt Relief (Developing Countries) Bill 2009-10, Bill [17] http://services.parliament.uk/bills/2009-10/debtreliefdevelopingcountries.html.

[173] Debt Relief (Developing Countries) Act, 2010, c. 22, § 9. *See also* Adrian Croft & Neil Stempleman, *New Law Limits Claims By Vulture Funds*, REUTERS UK, Apr. 8, 2010, http://uk.reuters.com/article/idUKTRE63748920100408?sp=true.

[174] *See* Hurley, *supra* note 55, at 7.

[175] *Id.*

[176] *Id.*

[177] Stop VULTURE Funds Act, H.R. 2932, 111th Cong. (2009).

[178] *Id.* § 3(a).

[179] *Id.* § 6(a).

gross violations of human rights, engage in excessive military spending, support international terrorism, or fail to cooperate with the United States on international narcotics control. As in the U.K. proposal, the bill contains provisions designed to increase vulture transparency.[180]

IV. ANALYSIS

This section will address both the benefits and costs of a cap on recovery in sovereign debt litigation and will conclude that the proposed limits are undesirable. An ex post cap on recovery is a significant interference with private contract rights and should not be undertaken absent a strong public policy explanation.

Here, a retroactive cap cannot be justified by its purported policy goals. The proposals have the potential to destabilize capital flows to low-income countries without achieving commensurate benefits, thereby harming the class the policies are designed to protect. Furthermore, creditor litigation over secondary debt, while problematic, is a necessary recourse in the sovereign debt market. Vulture motivation to purchase distressed debt promotes liquidity of sovereign debt and the availability of credit to sovereign debtors. The willingness of the funds to pursue litigation also provides useful checks against opportunistic defaults and corruption.

As discussed below, such legislation is premature. At this time, the threat posed by vultures appears to be subsiding and legislative action is an unnecessarily drastic step. While the judgments by courts in favor of vulture funds have been hyped by activists and the media, the actual recovery by vultures has been far more limited than headlines would

[180] The bill would mandate that before taking legal action in a U.S. court to collect sovereign debt, a creditor must register the claim in writing with the U.S. Treasury. If Treasury officials determine that the targeted country is a qualified poor country, then the creditor must provide additional information to the court, the U.S. Treasury, and the government of the country being sued, including how much was paid for the debt. The country being sued would be entitled to discovery to investigate the substance of all claims. *Id.* § 5(b).

suggest. Furthermore, new tools may lessen the threat of vultures in the future even without new legislation. On the other hand, there are significant disadvantages to the legislation. Because the problem of vulture fund litigation is of questionable magnitude (given the low overall dollar amount needed to settle the lawsuits), the potential side effects of the legislation are not worth the minimal advantages.

A. Retroactive Cap and Adverse Effects on Lending

Proposals thus far have focused explicitly on limiting recovery in litigation concerning existing debt. This emphasis reflects recent innovations in sovereign debt contracts that can only apply prospectively. As discussed above, new contractual tools can be applied to new issuances of debt. Thus, while in theory a cap on recovery could only cover debt contracted in the future, such proposals would offer few benefits and are therefore not under serious consideration at this time. Proposals instead address the existing debt contracts that lack the new, pro-debtor provisions and therefore pose the greatest threat to debtor nations.

Proponents of a cap ignore the potentially drastic implications of imposing new conditions on existing contracts, both in principle and in practice. Privity of contract is a fundamental tenet of the common law and this general presumption against such retroactive legislation cannot be easily disregarded.[181] The world has witnessed numerous sovereign defaults since the early 1980s, yet commercial creditor rights have not been forcibly curtailed through legislation. The sovereign debt market is complex and grounded in private law contract rights; therefore, it is precisely the type of situation that could be harmed most from an ex post alteration of contract obligations. Governments have implicitly acknowledged this fact through their behavior in past debt crises; debtor sovereigns in

[181] *See, e.g.*, U.S. CONST. art. 1, § 10, cl. 1 (prohibiting states from passing legislation that retroactively impairs contract rights).

distress crises have been assisted through a variety of means, in particular direct aid and favorable restructuring terms, but these concessions have been granted through party negotiations rather than mandate.[182]

Still, contract privity is not absolute. Retroactive alteration of contractual rights is not without precedent. The common law recognizes "unconscionable contracts" and the concept of "unequal bargaining power."[183] When viewed through this paradigm, the sovereign creditor-debtor relationship may be similar to that of a sophisticated lender and poor borrower. However, such cases cite compelling public policy justifications for the decision to violate contract privity. Contract rights, while important, cannot be the sole reason to dispute such legislation. It is therefore necessary to consider the potential effects of the proposed cap beyond the elimination of vulture lawsuits.

The proposals cannot be supported on policy grounds because the legislation could adversely affect HIPC countries without offering commensurate benefits. This legislation cannot distinguish between vulture investors and other participants in the secondary markets, and therefore the proposal greatly restricts potential recovery for all debt purchased on the secondary market. These purchasers of distressed debt increase liquidity and lending by creating secondary markets for less aggressive investors who want to unload their holdings.[184] A properly functioning, liquid market depends upon investors who are prepared to accept greater risk for the greater reward afforded by a discounted purchase of a debt instrument. In removing the ability of a creditor to, in effect, enforce the debt obligations of the bonds, this legislation could significantly harm the liquidity

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[182] *See supra* Parts II.A–C.

[183] *See generally* RESTATEMENT (SECOND) OF CONTRACTS §§ 178–185, 208 (1981) (discussing contracts unenforceable on grounds of public policy as well as unconscionable contracts).

[184] *See* Bosco, *supra* note 5, at 54 (stating that vulture funds "play an important role in the ecosystem of international capital" because they create secondary markets for less aggressive investors who want to unload their holdings).

of the sovereign debt market because investors would be less likely to purchase the discounted debt.[185]

A liquid secondary market is important to the supply of credit to poor countries. Lenders are able to provide finance at lower rates of interest and with longer maturities if they expect to be able to sell these assets to the secondary market.[186] Without the option of a secondary market, original creditors will face higher risks and therefore be forced to charge higher interest rates or possibly avoid lending to poor countries altogether.[187] Limiting secondary markets could therefore increase the cost of borrowing to poor countries and severely limit the amount of available funding.

Risk-loving "vulture" investors may arguably be even more valuable when lending to countries attempting to recover from a debt crisis. Professor Michael Pettis of Peking University argues that poorer countries should focus on securing capital return to the country as quickly as possible following a crisis and therefore vultures should be encouraged to enter the sovereign debt market.[188] By buying cheap, risky assets during the most chaotic part of a collapse, vultures often act as initial stabilizers during a debt crisis. Once prices have stabilized and investor confidence has returned, capital inflows from "higher quality" investors will cause the economy to start up and the investment process to recover.[189]

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[185] *See* Dubosse, *supra* note 154 (quoting Debt Advisory International, a company that manages several vulture funds, that "the implications of outlawing the sale of sovereign debts to third parties for conversion or collection is that it will kill the secondary market for these claims as it will eliminate the buyers of last resort").

[186] H.M. TREASURY CONSULTATION, *supra* note 110, at 20–21.

[187] Richard Tren & Jasson Urbach, *Debt Forgiveness: Does it Help the Poor?*, THE AFRICAN EXECUTIVE, Oct. 21–28, 2009, http://www.africanexecutive.com/modules/magazine/articles.php?article=4722&magazine=252.

[188] MICHAEL PETTIS, THE VOLATILITY MACHINE: EMERGING ECONOMIES AND THE THREAT OF FINANCIAL COLLAPSE 166 (2001).

[189] *Id.*

In public market contexts, trading in distressed debt can facilitate identification of arbitrage opportunities in mispriced securities, leading to a more rational pricing of debt.[190] Secondary markets may influence primary markets, thereby creating incentives for more rational pricing in primary debt markets as well, in turn encouraging greater and more efficient lending.[191]

The current U.K. consultation suggests that the narrow scope of new legislation would limit any negative impact on liquidity; it would only apply to HIPC debts contracted before the proposed legislation comes into force and international agreement would be needed for a measure that applied to new lending. However, such an argument can be used to support the opposite proposition; because there is such a small group of countries concerned, the drastic step of modifying numerous international contracts with one sweeping blow is not called for. Even a limited post-contractual modification of creditor and debtor rights could undermine confidence in sovereign lending; if creditor rights are curtailed now, why could they not be altered again in the future? Thus, even though the actual funds affected might be small, the additional uncertainty could still undermine the increased liquidity and supply of credit to borrower countries.

The emphasis on the restricted scope of the legislation further undermines the justification for an ex post abrogation of creditor rights because of the resulting mismatch between the stated objective and the legislation's scope. Although the purported goal is to prevent litigation by vulture funds against poor countries, the legislation

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[190] Olufunmilayo B. Arewa, *Vultures, Hyenas, and African Debt: Private Equity and Zambia*, 29 NW. J. INT'L L. & BUS. 643, 666 – 67 (2009).

[191] *Id.* at 667. *See also* Jeffery W. Gunther & Anna Zhang, *Hedge Fund Investors More Rational than Rash*, 2 ECON. LETTER 1 (2007), *available at* http://www.dallasfed.org/research/eclett/2007/el0708.html (noting that "[b]y seeking arbitrage opportunities associated with misaligned prices and exploiting them through short sales, derivatives and other leveraged trading strategies, hedge funds promote price discovery, resulting in more efficient markets and lower capital costs.").

restricts the activity of any party that seeks to litigate its claims after purchasing sovereign debt on the secondary market.[192] Any proposal directed at secondary market debt ignores the role of dissatisfied official creditors in sovereign debt litigation. Non-Paris Club official creditors (for example Burundi and Iraq) have sought to recover on their claims through official actions.[193] In fact, available data suggests that most active litigation has been due to action by original creditors.[194]

Thus, this rule would not eliminate most of the remaining debt litigation. Instead, the result could be a rise in interest rates to countries without commensurate benefits. Creditors take calculated risks which are reflected by loan pricing and governments benefit from favorable interest rates relative to private borrowers because of the presumption that "countries cannot go bankrupt." Even if such legislation would only apply to a limited amount of debt, it would nevertheless be a retroactive cap on the amount available through litigation of sovereign bonds. Such changes could erode the confidence of even well-intentioned investors in the efficacy of their legal remedies, potentially prompting the private market to withdraw from unsecured lending to emerging market sovereigns.

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[192] H.R. 2932 §3(1) defines a vulture creditor as "any person who directly or indirectly acquires defaulted sovereign debt at a discount to the face value of the obligation so acquired, except that the term does not include the Government of the United States or any agency of the Government of the United States, any foreign state, or any international financial institution (as defined in section 1701(c)(2) of the International Financial Institutions Act)."

[193] DINESH DODHIA, POST-HIPC DEBT SUSTAINABILITY AND COMMONWEALTH HIPCS 10 (2003).

[194] The IIF identifies that most legal cases identified by the 2008 IDA/IMF Status of Implementation of the HIPC Initiative are brought by trade creditors, with different incentives than traditional private-sector creditors. Institute of International Finance, *Creditor Litigation in Low-Income Countries Benefiting from the Enhanced – HIPC and MDRI* 4 (June 2009), *available at* http://www.clubdeparis.org/sections/communication/evenements/rencontre-avec-secteur/secteurprive2009/rencontre-avec-secteur/document-iif-emta/downloadFile/file/IIF-EMTA_Study_on_Creditor_Litigation_against_Sovereigns.pdf?nocache=1265362021.63.

B. The Value of Distressed Debt Investors

Even if the proposals could successfully eliminate all vulture fund actions, it is unclear if such action is desirable. In attempting to prevent vulture activity, the proposals ignore the important role vultures play in the sovereign debt market. In spite of the harm caused by vulture litigation, their position as one of the few parties willing to purchase distressed debt and then potentially hold sovereign debtors accountable through litigation offers important benefits that would disappear if the legislative caps were adopted. The most significant benefits brought by vulture creditors are discussed below.

1. Checks on Opportunistic Defaults and Coercive Restructuring Offers

Holdout creditors help maintain the viability of sovereign debt markets by serving as a check on opportunistic defaults and unreasonable restructuring terms. Vulture funds operate free of the political and public pressures that can prevent other creditors from litigating against debtor nations.[195] While this lack of accountability is responsible for many of the problems associated with vulture funds, their role as a constant background threat is vital in a market where other constraints on opportunistic default are inadequate.

Reputational harm caused by default has proven insufficient in deterring opportunistic defaults.[196] Although the empirical evidence is mixed, many studies indicate that ability to borrow is not significantly influenced by a sovereign debtor's reputation for repayment. Because new lending is usually available if future prospects are good,

[195] *See* Bosco, *supra note* 5, at 54 (stating that "they inflict pain on countries that default, which most large institutional investors aren't willing to do").

[196] *See* Scott, *supra* note 84, at 1 (arguing that "the only effective remedy against sovereign overborrowing is to allow creditors to enforce their contract rights effectively against sovereigns in default. Any well functioning debt market depends on strong creditor rights").

deterrence of overborrowing and then default is also not particularly strong.[197] Without the threat of litigation, a sovereign debtor may choose to default on its obligations to its creditors rather than to make the internal financial sacrifices needed to make the required payments on its debt.[198]

Once a debtor country has accepted the loss of reputation that inevitably accompanies a default, there may be a little incentive to negotiate a restructuring deal in a timely manner if the country has no immediate need for additional capital from the financial markets. Because there is no standard liquidation or reorganization process for countries in default, the process is dependent upon such a series of negotiations between the sovereign debtor and its creditors to devise a debt restructuring plan. Though IMF's "lending into arrears" policy requires the debtor to negotiate with the creditors in good faith, this requirement is not compelling for countries that do not depend on IMF loans.[199] One of the main objectives of the Group of Ten model collective action clauses was "to foster early dialogue, coordination, and communication among creditors and a sovereign caught up in a sovereign debt problem"; however, engagement

[197] There are numerous sources in economic literature finding that defaults do not seem to influence future access of sovereigns to capital markets. *See, e.g.*, BARRY EICHENGREEN & PETER H. LINDERT, THE INTERNATIONAL DEBT CRISIS IN HISTORICAL PERSPECTIVE —1 - 10 (1989); R. Gaston Gelos, Ratna Sahay & Guido Sandleris, *Sovereign Borrowing by Developing Countries: What Determines Market Access?*, (IMF Working Paper, Paper No.04/211, 2004), *available at* http://ssrn.com/abstract =879046.

[198] *See* Scott *supra* note 84 at 10 (noting that it does not appear that Argentina paid a substantial economic price for its default, and that after default there is no evidence that foreign direct investment was negatively affected and GDP substantially increased).

[199] Lee C. Buchheit & Rosa M. Lastra, *Lending into Arrears—A Policy Adrift*, 41 INT'L LAW. 939, 940 (2007) (defining IMF policy regarding lending to states in default to private creditors). *See also* Scott, *supra* note 84, at 2 ("the government has fostered Argentina's claim that it can defy the West with impunity, by offering poor restructuring terms, and walking away from $20 billion in debt still in default—with interest now $30 billion").

provisions, which could have brought the promise of timely consultations with the debtor, were generally not adopted. The threat of litigation may therefore, at least in some situations, be the most effective means to force the debtor countries to negotiate with creditors.[200]

While there has been debate over whether sovereigns default due to an inability to pay or a lack of willingness to do so, recent events have demonstrated that opportunistic defaults do occur. In Buenos Aires, the government's decision to default was greeted as a declaration of financial independence.[201] The 2008 default by Ecuador was motivated by domestic politics, not financial necessity. Ecuador demanded that its external commercial creditors write off most of their claims (65 percent), without even attempting to argue that such extraordinary debt relief was warranted by financial distress.[202]

2. Exposing Corruption

Vulture funds have also served as checks against corruption. Litigation against Congo is an oft-cited example of this claim. In the case of Congo, money was owed to the vulture fund Elliott Associates. In the course of its attempt to seize Congo assets, specifically shipments of Congolese oil,

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[200] *See* Häseler, *supra* note 13, at 12–13.

[201] *See* Clifford Kraus, *Argentine Leader Declares Default on Billions in Debt*, N.Y. TIMES, Dec. 24, 2001, at A1. The parliament gave then-President Adolfo Rodríguez Saá a standing ovation when he announced the plan to default and promised to use the money saved to create jobs and fortify social programs instead. *See also* James M. Roberts, *Averting Disaster in Argentina: The Case For Economic Freedom*, THE HERITAGE FOUNDATION, at 6, Oct. 3, 2008, *available at* http://www.heritage.org/research/latinamerica/bg2191.cfm. (quoting asset manager Hans Humes that "Argentina is just trying to bully people into accepting an unacceptable offer.").

[202] G. Mitu Gulati & Lee C. Buchheit, *The Coroner's Inquest*, 28 INT'L FIN. L. REV. 22 (Sept. 2009) (analyzing the opportunistic default of Ecuador and noting that it was the first time in modern history that a sovereign debtor had demanded that its external commercial creditors write off most of its claims without advancing a plausible argument that financial distress warranted such extraordinary debt relief).

Elliott's team of private detectives and forensic accountants uncovered corruption in the Congo that otherwise would have continued unreported.[203] Armed with court-approved powers to subpoena witnesses and with search warrants, the Elliott team discovered that the Brazzaville government had established a network of sham companies and bogus executives in the hope of concealing their oil transactions, implicating members of government such as the president and his son.[204] In identifying the middlemen who facilitate corrupt payments and tracing the money trail from British oil traders to luxury boutiques in Paris, Elliott has probably done more than any other national or corporate entity to expose corruption in Africa.[205]

Congo is not the only example of corruption in debtor nations. In Zambia, a group of Zambian policymakers and businessmen got together to buy a debt owed by the Bank of Zambia to Kuwait, using a front company called Camdex in the Cayman Islands, and then launched a lawsuit against their own government.[206] This deceit became apparent through the litigation against Zambia by Donegal.[207]

Organizations that fight corruption, such as Global Witness and the Publish What You Pay Coalition, have acknowledged the work of vulture investors in exposing in court the corrupt networks of government officials, providing a much-needed check on mineral-rich states. Such groups also agree that when nations win debt relief without becoming more accountable, they will simply repeat old mistakes and end up deep in debt once again.[208] At present, vulture lawsuits may be one of the only means of holding

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[203] Tony Allen-Mills, *'Vultures' Expose Corruption*, TIMES ONLINE, June 15, 2008, http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article4138445.ece.

[204] *Id.*

[205] *Id.*

[206] *See* GUEYE ET AL., *supra* note 110.

[207] *Id.*

[208] Lydia Polgreen, *Unlikely Ally Against Congo Republic Graft*, N.Y. TIMES, Dec. 10, 2007, at A1, *available at* http://www.nytimes.com/2007/12/10/world/africa/10congo.html?_r=1.

these undemocratic, opaque countries accountable for how they spend their money.[209]

B. Vulture Litigation—A Strategy in Decline

As discussed above, vulture funds play a vital role in the sovereign debt market. A secondary market for debt is a fundamental feature of sovereign borrowing and lending. When creditors can sell their debts on the secondary market, they assume less risk in lending to sovereigns, and creditors are therefore more likely to provide the capital sovereigns require.[210] The sweeping change in the rights associated with numerous bonds connecting countries around the world must have an extremely compelling justification and should only be done as a last resort.

While it is undeniable that vulture funds do pose problems as well, this section argues that legislation is not necessary, as *Elliott v. Peru* appears to have been the "high watermark" for creditor rights.[211] Data indicates a recent decline in the level of vulture litigation. This trend should continue as a result of the increasingly effective techniques developed to assist sovereign debtors in deterring and defending against vulture activity.[212]

1. Trends in Available Quantitative Data

Recent reports acknowledge a significant decrease in creditor litigation against HIPC countries. As of September 2008, 54 cases had been filed against HIPCs, of which 33 were then active.[213] As of September 2009, there were only

[209] *Id.*

[210] African Development Bank Group, *Vulture Funds in the Sovereign Debt Context*, http://www.afdb.org/en/topics-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/.

[211] Scott, *supra* note 86, at 10.

[212] *See* EMTA REPORT, *supra* note 105 ("A number of changes to the international EM markets in recent years may mean that fewer of these types of creditor suits are on the horizon.").

[213] 2009 STATUS REPORT, *supra* note 108, at 14 n.32.

14 active lawsuits.[214] It could be argued that there are only ten instances of litigation against HIPCs, as the report included four cases in Sudan, a country that is not currently a part of the HIPC Initiative, but is instead a potential future HIPC participant.

Trade creditors, not vulture funds, are responsible for the majority of the remaining lawsuits. Out of the 21 ongoing legal cases, a recent IIF report identifies only three remaining cases by vulture funds: two against the Democratic Republic of Congo ("DRC") and one against Liberia.[215] This clear decrease in vulture activity suggests that legislation is not needed at this time.

2. Increasing Strength of Contractual Defenses

Although the IDA status report recognizes the recent decrease in vulture litigation, it ominously notes that "the threat of new litigation remains" and cites examples of new lawsuits filed in the DRC, Sierra Leone, Sudan and Zambia.[216] While a recent decline in litigation is not a guarantee of low levels of litigation in the future, this decline would be consistent with the increasing use of innovative pro-debtor contract provisions.

In the past decade, the contractual provisions discussed in Part II have helped to decrease the probability of vulture fund litigation.[217] While all of the tools discussed above have limitations, they will nevertheless become more effective over time. For example, although the benefits of a trust structure cannot apply retroactively to outstanding debt, debtors may utilize this arrangement going forward and eliminate the more egregious types of vulture litigation.

Another recent innovative step demonstrates the potential of these provisions to develop and become more useful over time. In the 2007 Belize debt exchange, the

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214 *Id.*

215 Institute of International Finance, *supra* note 194, at 4.

216 2009 STATUS REPORT, *supra* note 108, at 20.

217 *See supra* Part II.A (discussing exit consents, collective action clauses, and trust structures).

collective action clause was coupled with an exit consent with Belize debt.[218] Holders of Belize 2015 bonds voted under the collective action clause to reducing the payment terms on the bond in the certain knowledge that they would not be affected by that vote because they were tendering their bonds to the Government of Belize anyway.[219] The only parties affected would be the holdouts, who were basically forced into the offer because the exit consents substantially reduced the value of the outstanding bonds owned by the holdouts, essentially forcing these dissenting parties into accepting the offer anyway. This combination of the CACs and exit consents now strengthens exchange offers by allowing for payment terms in addition to non-payment terms to be altered. It is unsurprising that in the case of Belize, the exchange process culminated in a high acceptance ratio of 97% as of the final deadline for exchange and was then able to force 1.3% of non-complying or non-responding creditors to accept the terms of the exchange.[220]

3. Limitations on Recovery in Practice

While vulture judgments have claimed media headlines and provoked international outcry from activists and politicians, the large judgments may overdramatize the actual impact of the funds. In spite of the size of vulture fund victories in court, it is unclear to what degree vultures have been able to recover on their judgments in practice. Success by vulture funds has been the exception and not the norm.[221]

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[218] *See* Press Release, Government of Belize, Belize 2015 Notes Amended (Feb. 5, 2007), *available at* http://www.hispanicbusiness.com /news/news_print.asp?id=54913.

[219] *Id.*

[220] RICHARD SEGAL, BELIZE AND ECUADOR: SOVEREIGN DEBT RESTRUCTURING IN THE NEW FINANCIAL WORLD 9 (Feb. 2007), *available at* http://www.un.org/esa/ffd/events/2007debtworkshop/richard%20segal.pdf.

[221] As noted by one specialist in sovereign debt, "[s]uing a sovereign is so damn hard—being a holdout is hard, not smart." Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L.R. 1627, 1693 (2007).

In recent years, creditors have found it increasingly difficult to enforce debt claims against sovereigns despite their successes in court. Section 1611(b)(1) of the FSIA provides that central bank property "held for its own account" shall be immune from attachment unless the bank has waived immunity "in aid of execution."[222] The ability of creditors to attach or garnish flows of payments for goods has also not met with much success. Section 1610(a) of the FSIA provides that the "property in the United States" of a foreign state, "used for a commercial activity in the United States," shall not be immune from attachment if a foreign state has waived sovereign immunity.[223] The difficulties with meeting these criteria have been a focus of extensive litigation by creditors of the Congo.[224] The mere possibility that central bank accounts in the United States and elsewhere might be attachable has led sovereigns, including Argentina, to hold these accounts at the Bank for International Settlements (BIS), where they will be immune from attachment.[225]

Thus, while obtaining a favorable judgment has been comparatively and increasingly easy, the effectiveness of the legal remedy is limited by the availability of assets that belong to the debtor, that are situated within the relevant

[222] 28 U.S.C. § 1611(b)(1) (2006).

[223] 28 U.S.C. § 1610(a) (2006).

[224] *See, e.g.*, Connecticut Bank of Commerce v. The Republic of the Congo, 309 F.3d 240 (2002); Af-Cap Inc. v. Republic of the Congo (*Af-Cap*), 383 F.3d 361 (2004); FG Hemisphere Associates v. Republic of the Congo (*FG Hemisphere*), *appeal docketed*, Nos. 04-20965 and 05-20042 (July 10, 2006).

[225] Article 10 of the Constituent Charter of the BIS provides: "The Bank, its property and assets and all deposits entrusted to it shall be immune in time of peace and in time of war from any measure such as expropriation, requisition, seizure, confiscation, prohibition, or restrictions of gold or currency export or import, and any other similar measures." Convention Respecting the Bank for International Settlements, Jan. 20, 1930, 104 L.N.T.S. 441. The Convention includes the Constituent Charter of the Bank on International Settlements (104 L.N.T.S. 441) and the Statutes of the Bank for International Settlements (104 L.N.T.S. 448). Argentina moved over $2 billion of its reserves to the BIS before and after its default. Scott, *supra* note 84 at 12.

jurisdiction (usually New York State), and that can be attached to satisfy the claim.[226] Despite the billions of dollars at stake in Argentina lawsuits, foreign creditors who refused to take part in Argentina's debt restructuring and sued abroad have not yet collected any money.[227] Statistics available for non-HIPC countries indicate that the amounts recovered by litigating creditors were almost insignificant when compared to the overall amounts restructured even when creditors were successful in obtaining recoveries.[228]

The difficulty associated with attachment of assets has led many holdout creditors to agree to out of court settlements. These settlements have generally been an effective way for debtors to reduce the amounts due to around 75 percent of the original claim. In some cases settlements have also allowed payments to be spread over 1-2 years, reducing the immediate budgetary burden.[229]

C. Alternative Means of Assisting HIPC Countries

Now is the time for caution, not sweeping legislation. As more poor countries turn to the international capital markets as a source of funding, it is not the time to pass legislation that might dampen creditor interest or adversely impact pricing and interest rates.[230] Below are examples of

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[226] *Cf.* Häseler, *supra* note 13, at 6-7.

[227] To date, 140 cases have been brought against Argentina in multiple jurisdictions including the United States (New York), Italy, Germany and Japan. In the Southern District of New York, about 130 plaintiffs have brought claims against Argentina, and several class actions have been filed. To date, a number of judgments have been awarded in favor of creditors (over $8.3 billion in the New York courts), but there have been no recoveries. *See* EMTA Report, *supra* note 105.

[228] Examples include Brazil ($77 million out of $47 billion), Peru ($56.3 million out of $10.6 billion), and Panama ($71 million out of $3.9 billion). *Id.*

[229] *Id.*

[230] Kenya, Tanzania, Uganda, Zambia and Nigeria have reportedly expressed interest in issuing international bonds, though these plans have been delayed due to the recent financial crisis. Deutsche Bank Research, *African Frontier Capital Markets: More Than A Flash in the Pan*, July 31,

preferable means of assisting HIPC countries facing litigation. These choices offer more flexible remedies that can be tailored to specific situations, which is superior to broad legislative reform.

1. "Bailing Out" Targeted HIPC Countries

Instead of legislation aimed at all HIPC countries, creditors can help settle the few remaining vulture lawsuits left. Early engagement with commercial creditors, including through DRF operations, has increased willingness to settle and has helped reduce the number of outstanding litigation cases against HIPCs from 33 to 14 cases between 2008 and 2009.[231] The success of Nicaragua and Liberia in their debt buy-backs are particularly noteworthy, as both involved agreements with commercial creditors.[232]

The approach taken in the case of Liberia's successful 2009 buyback model, where a majority of the debt was paid off with the assistance of international financial institutions and creditor nations after a series of negotiations. Including other multilaterals (such as the Caribbean Development Bank, East African and West African Development Banks, and PTA Bank) in the MDRI could increase funds provided to HIPCs significantly and these partners could potentially help with any lawsuits that might arise in the future as well.[233]

2009, *available at* http://www.dbresearch.com/PROD/DBR_MOBILE_EN-PROD/PROD0000000000244808.pdf.

[231] 2009 STATUS REPORT, *supra* note 108, at 14.

[232] In December 2007, the government of Nicaragua and its creditors agreed to a cash buy-back of more than US $1.3 billion of the country's commercial external debt at 4.5 cents on the dollar, funded by US $61 million from the World Bank's Debt Reduction Facility (DRF). All four of the commercial financial institutions holding court judgments against the country accepted the terms of the buyout. The final closing temporarily freed Nicaragua of old law suits. *See* 2008 STATUS REPORT, *supra* note 107, at 31. For a discussion of Liberia, *see supra* Part II.D.

[233] *See* DEVELOPMENT FINANCE INTERNATIONAL, ENHANCING ACTIONS AND INFORMATION EXCHANGE ON CREDITOR PARTICIPATION AND LITIGATION RELATING TO HIPC DEBT RELIEF (2009). "All major multilateral creditors are either fully participating in HIPC, or have indicated their intention to

Such an approach is reasonable when considered alongside the U.K. Impact Assessment, which provides the most recent quantitative estimates for the potential costs and benefits of legislation aimed at HIPC countries. The calculations are based on creditor litigation statistics from the 2008 World Bank and IMF Status Implementation Report. If a cap were to be passed in the U.K., potential benefits to HIPC countries are estimated to be, at most, £44.2 million per annum over 6 years.[234] This number likely overestimates the benefit to HIPC participants. As stated earlier, the amount of litigation in question has substantially decreased from thirty-three active cases to about fourteen even when Sudan is included as an HIPC country, and, of these, only a few cases have been brought by vultures.[235] These numbers also do not consider potential increases in interest rates and restriction of credit, which would reduce the net benefit to HIPC countries.

While purchasers of sovereign debt in the secondary market may eventually pursue litigation against debtors, these creditors may in some cases be more willing to restructure on terms favorable to the debtor because they paid so little to acquire the debt.[236] In fact, some distressed debt funds enter the market, not with the primary goal of litigating, but to benefit from a later restructuring.[237]

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participate. The latest BWI Status Report states that the four largest creditors (IMF, World Bank, AfDB and IADB), representing 85.7% of multilateral relief due, are delivering fully on their assistance under both HIPC and MDRI. It should be noted, however, that only these four major multilateral institutions have been funded to deliver on MDRI relief." *Id.*

234 H.M. Treasury Consultation, *supra* note 110, at 3 (Appendix A).

235 *Id.*

236 *See* Felix Salmon, *Collective Indecision*, EUROMONEY, Nov. 1, 2002, *available at* http://www.euromoney.com/Print.aspx?ArticleID=1002887 "[B]ondholders are not like banks holding syndicated loans . . . . A hedge fund that bought at 25 [cents on the dollar] yesterday might be very happy with a work-out that would be worth 35 [cents on the dollar] next week; a retail investor who bought at par seven years ago would probably reject such an offer as out of hand." *Id.*

237 Donegal's lawsuit against Zambia serves as another example of a vulture fund only resorting to litigation once other methods of repayment

Given the low potential benefit provided by the legislation, ex post interference with contract hardly seems warranted. Settling select disputes would also reward those countries that have demonstrated good faith and efforts to reform, whereas legislation will reward both well-meaning and uncooperative debtors alike.

2. Potential Use of Judicial and Executive Intervention

Both the executive and judicial branches still have the means to prevent vulture activity that they deem to be extremely harmful. In the few instances where creditors brought suit prior to the conclusion of an ongoing, productive restructuring, it appears the courts did heed concerns raised by debtors that permitting enforcement actions at such a sensitive time could disrupt the restructuring. For example, in *Pravin Banker*, the court granted a stay when it noted there were ongoing meetings between the different public and private sector parties and that the IMF was assisting Peru in the process.[238]

The courts have also tended to be responsive to the concerns expressed by the U.S. government in instances in which the U.S. has submitted an *amicus curiae* brief.[239] In *CIBC Bank and Trust (Cayman) v. Banco do Brasil*, the U.S. government submitted an *amicus curiae* brief opposing the acceleration of Brazil's debt because it had the potential to

had failed. Donegal spent many years in negotiation with Zambia before it initiated legal proceedings. *See* DANIEL ZAVALA, DONEGAL INT'L LTD., ZAMBIAN DEBT PROJECT 3 (2007), http://r0.unctad.org/dmfas/docs/DMconf07_papers/zavala3.pdf.

[238] *See* Pravin Banker Assocs, Ltd. v. Banco Popular del Peru, 165 B.R. 379, 387 (S.D.N.Y. 1994) (granting a stay of litigation against the Peruvian bank and noting the ongoing negotiations between various parties to accomplish the orderly liquidation and restructuring of the debt).

[239] *See, e.g.,* Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516, 520 (2d Cir. 1985) (reversing its decision in light of the government's amicus).

upset the restructuring.[240] It also noted that because CIBC's debt had been purchased through the secondary market, it might not necessarily desire a successful restructuring.[241] In the end, the court upheld Brazil's move to block acceleration of the debt.[242]

Intervention in specific cases allows for more narrowly tailored solutions. The viability of the litigation remedy may be preserved while tools remain available to fight creditors in the occasional case that interferes with a restructuring process or is truly repugnant to U.S. policy.[243]

3. Odious Debt Doctrine

One major criticism of the litigation in the HIPC context is that countries such as Liberia incur their debts while under tyrannical or corrupt regimes and receive virtually no benefits from the loans.[244] Under the public international law, this situation might qualify as an "odious debt" and therefore be an exception to the standard requirement that governments inherit the debts of their predecessors.[245] Odious debt scholarship at present proposes numerous potential solutions to address debt incurred in an unjust

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[240] 886 F. Supp. 1105, 1108 (S.D.N.Y. 1995). *See also* EMTA REPORT, *supra* note 105, at 6.

[241] *See* EMTA REPORT, *supra* note 105, at 6.

[242] 886 F. Supp. at 1117.

[243] *See also* Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253, 254 (2003) (arguing that, in the context of sovereign debt and vulture fund litigation, comity might be used in two ways: to stay collection actions during the restructuring process and to frustrate attempts to derail any completed restructuring agreement).

[244] *See* JUBILEE USA NETWORK, FACT SHEET: LIBERIA'S DEBT (Oct. 2006), http://www.jubileeusa.org/fileadmin/user_upload/Resources/Liberia_2006.pdf (stating that Liberia's debt was illegitimate and should be cancelled because it did not benefit the Liberian people). *Cf.* Desmond Tutu, Editorial, *Debt Cancellation a Victory for the World*, BALTIMORE SUN, May 7, 2008, at 13A (noting that many African countries are burdened by debt that originated from corrupt regimes that never benefited the people).

[245] *See* Lee C. Buchheit, G. Mitu Gulati, & Robert B. Thompson, *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201, 1203 (2007).

manner.[246] While the doctrine is controversial and not well-defined at present, it might be of use in the context of HIPC countries and onerous debt going forward. The new United Nations effort announced in early 2010 to create legitimate debt guidelines is particular reason to be optimistic on this front.[247]

V. CONCLUSION

The proposed benefits of limiting available recovery in sovereign debt litigation are far outweighed by the costs. The limited savings for sovereign borrowers would be offset by the adverse impact on future lending to poor countries.

It is also unclear if vultures should be regulated at a national level. These funds thus play a necessary, albeit unlikable, role in the international financial markets. They create secondary markets for less aggressive investors and check the behavior of recalcitrant sovereigns when creditor countries and large institutional investors are unwilling to do so. Vulture funds have been accurately described as the "avenging angels of the debt market."[248] They not only add value, but are necessary for the market to work effectively.[249]

Vulture litigation can certainly be costly, forcing heavily indebted countries to forfeit millions in debt relief. Even when the debtors can successfully avoid attachment and garnishment of assets, such defensive maneuvers impose costs as well. However, the diversity in sovereign debt restructurings and complexity of the market cautions against imposing such wide-ranging remedies on an issue that varies wildly on a case-by-case basis.

Such a drastic step may simply be unnecessary because direct enforcement of sovereign debt is the exception and not

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[246] Arewa, *supra* note 85, at 663.

[247] *See* Jonathan Lynn, *UN Seeks to Draw up Legitimate Debt Rules in Crisis Fallout*, BALKANS.COM BUS. NEWS, Feb. 15, 2010, http://www.balkans.com/interview-view_new.php?id=47660.

[248] Bosco, *supra* note 5, at 54.

[249] *Id.* (quoting Professor Mitu Gulati of Duke Law School).

the rule.[250] Vulture litigation against HIPC countries appears to be on the decline, a proposition that is supported by recent statistics as well as the decreasing viability of the strategy.

Reforms to improve the efficiency of the international financial market are welcome. However, changes in the complicated world of sovereign debt should come through the cooperation of the public and private sector to encourage wiser investment and to offer a method of market stabilization when events reduce the likelihood of sovereign debt repayment.

[250] *See* Panizza et al., *supra* note 38, at 659.