



PREYING ON THE POOR

BRIEFING PAPER: VULTURE FUNDS

“IT IS ILLOGICAL TO GRANT DEBT RELIEF TO POOR COUNTRIES WHILE AT THE SAME TIME ALLOWING VULTURE FUNDS TO LITIGATE AGAINST THESE COUNTRIES AND THEREBY DILUTE THE GAINS FROM DEBT RELIEF.”

UNITED NATIONS INDEPENDENT EXPERT ON FOREIGN DEBT AND HUMAN RIGHTS

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JUBILEE
AUSTRALIA

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VULTURE FUNDS - BRIEFING PAPER, JUNE 2011

The insatiable greed of a small number of individuals is undermining international debt relief initiatives. Money that thanks to debt relief, should be going to lifesaving medicines and schooling, is lining the pockets of wealthy investors instead. Without legislation to prevent it, these so called 'vulture funds' are free to profiteer from poor country debts in Australian courts. Last year one did just that in New South Wales.

WHO ARE THE VULTURE FUNDS

Vulture funds, or their more polite title of 'distressed debt funds', are private investment entities (such as hedge funds or private equity firms) that specialise in distressed ('bad') debt. They are often incorporated in tax havens so that their ownership and operations are secret. Distressed debt generally refers to debt which the debtor is having trouble servicing, in other words, that is less likely to be repaid. Owners of such debt may decide to sell it below its face value to make some money while they can, fearing that they will lose more if they continue to hold it. Vulture Funds hover looking for debtors who are in trouble. They buy the debt on the secondary market usually at a steep discount because of the risk that it will not be repaid, and then try to recoup the debt for its full value. Unsurprisingly then, vulture funds make money when economies hit problems - the worse things get for most people, the better the vultures like it.

Although vulture funds have typically preyed on companies in financial difficulty, more recently these investors have received publicity for scavenging off some of the poorest countries in the world. In much the same way as vulture funds deal with corporate debt, they purchase debt owed by less-developed countries, usually heavily indebted poor countries (HIPC), which is at risk of default (i.e. non-payment). Having bought the debt very cheaply due to its high risk, the vulture funds threaten to or actually do sue the debtor country for the full value of the debt, plus interest. Lawsuits are taken out by the funds in national courts considered 'creditor-friendly', such as UK, US, France or Belgium, or in jurisdictions where the debtor country holds some of its foreign assets.

Unlike the legal protection offered to individuals and companies under national insolvency or bankruptcy laws, no international debt court exists to protect sovereign governments from unethical creditor behaviour. This legal vacuum clears the way for international vultures to prey on poor countries that are highly indebted. And since the activities of vulture funds are legal in most places, it is effectively impossible for the debtor governments to avoid making the payments.

In 2007 Vulture Funds hit the UK headlines when Donegal International, an investment firm registered in the tax haven British Virgin Islands, sued Zambia in the British High Court for \$55 million, for a debt it had bought for \$3.3 million. After campaigner pressure and legal support, Donegal was awarded \$15 million - which Zambia had no option but to pay, even though, as pointed out by Presidential Advisor Kalunga-Banda, paying Donegal meant "the treatment, the Medicare, the medicines that would be available to in excess of 100,000 people in the country will not be available."

Between 1998 and 2008, 54 court cases were instituted by Vulture Funds against 12 HIPCs. National income that is earmarked for poverty reduction and basic social service provision is diverted to settling the legal claims of vultures. The law suits are grinding down poor countries, being locked into cycles of litigation that can last up to 10 years.

VULTURE SWOOPS IN AN AUSTRALIAN COURT

The Australian legal system was exploited by a vulture fund for the first time in November 2010. New York investment firm FG Hemisphere filed a case in the NSW Supreme Court as part of its lawsuit against the Democratic Republic of Congo (DRC).

DRC is a country which since 1997 has been involved in conflict that has claimed almost 3.5 million lives, with almost non-existent infrastructure, and almost 80 per cent of its 66 million population living below the poverty line. It has finally completed the long and tough process required to receive HIPC debt relief. DRC's debt was due to be cut by over \$7,000 million, with the IMF, World Bank and African Development Bank agreeing to cancel 100 per cent of pre-2004 debts, and other creditors like the UK committing to do the same.

But a vulture fund had been circling the DRC. Just as it reached HIPC debt relief completion point, FG Hemisphere swooped. In 2004 the firm bought one of the DRC's debts on the secondary debt market for a highly discounted price, from the original creditor Yugoslav company Energoinvest. The original loan, for what turned out to be a failed hydro power project, was contracted during the 1980s by long-time dictator President Mobutu who ruled an authoritarian government when the country was still known as Zaire. Now the new creditor, FG Hemisphere refused to participate in the debt relief scheme, and instead began pursuing repayment of \$100 million for this debt - \$80 million more than the DRC would have been expected to pay for the debt under the HIPC process.

FG Hemisphere scoured the world in search of foreign assets belonging to the DRC. When it found that the government owned shares in an Australian mining company operating in DRC, the firm filed a case in the NSW Supreme Court, and in November 2010 was successful in forcing the DRC government to sell the shares and transfer the \$30 million (plus \$2 million in legal costs and court-imposed fines) to itself.

This is not the first time the DRC has been hit by vulture funds. At the end of 2008 the government paid \$939 million (approximately 9 per cent of the country's GDP) to settle a dispute with another vulture fund.

INTERNATIONAL CONDEMNATION FOR VULTURE FUNDS PREYING ON THE POOR

The actions of vulture funds in profiteering from desperately poor countries, have been condemned by civil society, trade unions, indebted governments, donor governments, the United Nations, and the IMF and World Bank.

"Vulture fund activity erodes the gains from international debt relief efforts at the expense of both the citizens of distressed debtor countries and the taxpayers of countries that have supported international debt relief efforts" (Dr Cephas Lumina, United Nations Independent Expert on Foreign Debt and Human Rights).

"Trade unions call for decisive action on vulture funds which only serve to plunge indebted countries back into deeper debt" (2008, International Trade Union Confederation).

"The role of vulture funds is deplorable. They cannot be allowed to continue to profit from poor countries" (Gareth Thomas, Minister in the UK Department for International Development).

"I'm hoping that...increased attention on this issue may enable the international community to come up with some effective legal remedies that protect countries [like Zambia and Democratic Republic of Congo] from that kind of unfair dealing" (Paul Wolfowitz, former President of the World Bank).

While there have already been multilateral initiatives to discourage vulture funds, such as the Paris Club commitment not to sell claims on HIPC countries to creditors who do not intend to provide debt relief, and the commitment to provide funds or technical legal support to highly indebted poor countries, these initiatives are insufficient to prevent vulture fund activity. They depend on voluntary commitments and ignore the fact that it is entirely legal for vulture funds to pursue their claims in court.

Vulture funds have not been deterred. Aptly summed up by Michael Sheehan of Donegal International: "Our experience and that of others in this business is that you always eventually recover. You have a legal claim. Eventually if you litigate and work hard enough, you will always recover a significant amount to cover your costs."

NATIONAL LEGISLATION TO MAKE VULTURE FUND PROFITEERING ILLEGAL

NGO campaigns have been mounted to put a stop to this unethical behaviour. In May 2008 the Belgian Senate passed a Law which prohibits vulture fund litigation in that country. In 2009 a Stop Vulture Funds bill was launched in the US Congress and Jubilee USA are coordinating continued campaigning to see that Congress turns this into law.

There has been more success in passing legislation in the UK, with the Stop Debt Vultures campaign led by Jubilee Debt Campaign UK resulting in the landmark *Debt Relief (Developing Countries) Act* 2010, which limits the ability of unscrupulous creditors from using UK courts to recover extortionate amounts from poor countries engaged in international debt relief efforts. The landmark law which was due to expire in June 2011 (as a result of a 'sunset clause' in the legislation) was made permanent in April this year with no opposition in the UK. The law has already saved Liberia \$40 million, and successfully kept FG Hemisphere out of UK courts.

As Danny Alexander, the Chief Secretary to the Treasury said: "Today the Government has acted to stop the unjust actions of a few unscrupulous companies having a huge impact upon the futures of some of the poorest countries in the world. This act will make sure that vulture funds will never again be able to exploit the poorest countries in the world within the UK's courts."

The action of the UK government has been strongly commended:

“Bravo! We’ve been waiting for a parliament or an assembly to take this kind of hard decision to be able to bring these funds into reason. Maybe the US Congress...will pick up this gauntlet and will follow the example of Britain and move that - because it’s just so unfair to poor countries.”

(Ellen Johnson Sirleaf, President of Sierra Leone, 2010)

“By limiting the amounts litigating creditors can recover in UK courts, resources provided through debt relief and intended to support development and poverty reduction in the country are not diverted.”

(World Bank and IMF, September 2010)

“The Gleneagles G8 Summit’s decision to extend debt relief to poor African countries gave rise to great hope and expectations that these countries would now be able to channel the relief resources towards meeting the Millennium Development Goals. The activities of vulture funds quash these hopes, directly negate the spirit and intent of the Summit decision, and should not be given legal countenance. I hope the international community joins hands to put an end to these deplorable activities of vulture funds.”

(Benjamin William Mkapa, Former President of Tanzania, 2010)

“The enactment of similar legislation in other countries will ensure that the billions of dollars committed to debt relief for the world’s poorest countries will not be diverted to satisfy the greed of unscrupulous companies.”

(Dr Cephas Lumina, UN Independent Expert on Foreign Debt and Human Rights, 2011)

STOP DEBT VULTURES - AUSTRALIAN CAMPAIGN

Now it is time for Australia to follow suit.

Since 1998 the Australian Government has contributed well over \$100 million to international debt relief initiatives. In the most recent budget it was announced that Australia would contribute another \$106.8 million to finance its share of the Heavily Indebted Poor Countries Initiative (HIPC) and the Multilateral Debt Relief Initiative (MDRI).

As the United Nations Independent Expert on Foreign Debt and Human Rights said, during his mission to Australia in February 2011: “It is illogical to grant debt relief to poor countries while at the same time allowing vulture funds to litigate against these countries and thereby dilute the gains from debt relief.”

In his report to the Human Rights Council of the United Nations General Assembly presented 25 May 2011, Dr Lumina concluded that, as demonstrated by the November 2010 NSW Supreme Court judgement, Australia’s contribution to multilateral debt relief schemes is being undermined by the absence of legislation to prevent these investment funds from using Australian courts to recover exorbitant amounts on debts they purchase at steep discounts:

“Consequently, the Independent Expert calls upon the Government of Australia to bolster its commitment to debt relief by urgently enacting legislation to limit the ability of vulture funds to use Australian courts at the expense of both Australian taxpayers and the citizens of the poor countries for whose benefit it contributes to multilateral debt relief.”

Jubilee Australia invites people to **join in**. Write or visit your MP to express your concern about vulture funds using an Australian court to profiteer, at the expense of both the citizens of the Democratic Republic of Congo and Australian taxpayers who support international debt relief initiatives. Ask your MP to raise this matter with Foreign Minister Kevin Rudd, and urge him to take action.

Email stopthedebtvtures@jubileeaustralia.org for our letter-writing guide.



Jubilee Australia emerged out of the successful international Jubilee 2000 *Drop the Debt* Movement. Today, Jubilee plays a unique role in Australia, digging to the roots of global poverty and injustice, through research-based advocacy exposing and challenging unjust laws and practices that hurt the poor and marginalised and perpetuate long term poverty. Jubilee’s work is driven by relationships of solidarity with civil society groups and networks in the Global South who are at the front line in the struggle against extreme poverty and environmental degradation, and who call for economic transformation and global justice, not just charity.

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