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# JUBILEE USA NETWORK POLICY BRIEF

# VULTURE FUNDS

## Compromising the Gains of Debt Cancellation

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Debt cancellation provides the chance for impoverished countries to start fresh and allocate additional resources to essential health, education, and other spending. Commitments by the US government and other shareholders at the IMF and World Bank led to the creation of the Heavily Indebted Poor Countries (HIPC) Initiative, which was designed to alleviate impoverished countries of some of their unpayable debts. In 2005, The Multilateral Debt Relief Initiative (MDRI) was established to augment these efforts by canceling more debt.

While the international community was extending debt relief to some impoverished countries, a new form of business emerged, with the purpose of speculating in and profiteering from poor country debt in default. This new business by so-called “vulture funds” comes at the expense of the citizens of these indebted countries — some of the poorest in the world — as well as taxpayers in countries like the US, who have been supporting in part the cost of debt relief. The Jubilee USA Network, along with other groups in the US, the UK and elsewhere, is increasingly monitoring the activity of vulture funds and working to publicize and curtail their activity.

### **WHAT IS A VULTURE FUND?**

‘Vulture fund’ is a name given to a company that seeks to make profit by buying up ‘bad’ debt at a cheap price, then trying to recover the full amount, often by suing through the courts. Such companies often describe themselves as ‘distressed debt funds’. Some target failing companies, but Jubilee USA Network is focused on those that target poor country governments. These vulture fund companies tend to be quite secretive, and many of them are based in tax havens. Some are owned by large, often U.S.-based, financial institutions such as hedge funds. In other cases, there is limited or no information on who owns them. Often companies are set up simply to pursue one debt, then shut down again.

### **HOW DO VULTURE FUNDS OPERATE?**

When an impoverished country has outstanding debt owed to a government or a commercial creditor — that has not been written down or restructured according to HIPC or MDRI terms — there is a chance that a financial organization will seek to buy that debt at reduced prices and seek repayment of the original amount and more. Firms call this capitalizing, but debt campaigners consider this vulture activity. Vulture fund activity has increased in the past 3 years with the provision of debt cancellation as these funds seek to seize on the opportunity of resources being freed up by debt relief. Vulture fund activity has resulted in a large and growing number of lawsuits being brought against HIPC.

### **THE CASE OF DONEGAL V. ZAMBIA**

The most recent, or visible, vulture fund case has been that of Donegal International, Limited suing the government of Zambia — and winning \$15 million. In 1979, Zambia purchased agricultural equipment and services from Romania on credit. Being unable to service this debt, in 1999 Zambia and Romania agreed to liquidate this debt for \$3.28 million. But before Zambia could seal the deal, a vulture swooped in.

Donegal International, Limited is registered in the British Virgin Islands. Its only business is to pursue the Zam-

bian debt. Donegal's sole director is a man called Michael Sheehan, who owns a company called Debt Advisory International, based in Washington DC. He bought this debt value at \$3.28 million and later sued the Zambian government for \$55 million. On April 24th, the British High Court ruled that the government of Zambia would have to pay Donegal some \$15 million. This represents over a third of what Zambia is projected to save in debt relief delivered through HIPC and the MDRI in 2007.

## **A GROWING PROBLEM; A TREMENDOUS SOCIAL COST**

At least 20 Heavily Indebted Poor Countries (HIPC) have been threatened with or have been subject to legal actions by commercial creditors and vulture funds since 1999. The debtor governments have almost always lost. There have been some mixed results and settlements out of court. But the only known case where a debtor government has won in court is a case in Madagascar. When they lose, poor debtor governments have been obliged to pay the original debt, interest and fees accrued since the debt has been in arrears, as well as the legal costs of the plaintiff.

The amounts awarded to plaintiffs have varied from 1 to 6 times the original value of the debt, or \$1 million to \$153 million. The average has been 2.2 times the original value. More than 14 settlements have exceeded \$50 million, a huge sum to pay in one year, especially when compared to other crucial spending needs. Considering these costs comparatively:

- » In Uganda and Sierra Leone lawsuit payments were as high as 35% and 34%, respectively, of total debt service in one year.
- » In Nicaragua, lawsuit cost was some \$425 million in one year, only marginally less than health and education spending combined.
- » In Niger, the government spent more than half of what it spent on health and education combined on lawsuits (US\$76.5 million).
- » In Zambia, health and education expenditure totaled almost US\$303 million, while lawsuits cost almost US\$127 million.

More than two-thirds of the lawsuits brought by vulture funds occur in the US or UK jurisdictions. This is because is in part because these courts are seen as being more creditor-friendly and more efficient. But there are an increasing number of cases being made at the national level, where weaker legal systems get mired in the details of these cases.

## **RECOMMENDATIONS**

For this reason and many more, Jubilee USA Network and our supporters are compelled to tackle these vulture funds. There are several measures that should be taken:

- » President Bush should go to the G8 summit in Germany from June 6 to 8 and push for a commitment for world leaders to address this issue, as it threatens to undermine debt cancellation commitments made by the US and others at the Gleneagles summit in 2005. Examples of the types of commitments that could be made include a call to put in place legal remedies to prevent vulture funds from buying defaulted debt and suing for their repayment, as well as more immediate measures such as providing legal support to poor governments and advice as to how to avoid getting taken to court.
- » U.S. Treasury Secretary Henry Paulson Jr. should support proposals put forward by UK Chancellor Gordon Brown on May 11 when the G8 Finance Ministers meet in Potsdam on May 18 to 19.
- » Legal changes should be made in the United States to disallow this practice in the future.



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