

SUBMISSION

to

**The Chief Minister's Department, States of Jersey,
on the consultation concerning promotion of
debt relief for poorer countries**

by

DR CEPHAS LUMINA, PhD

United Nations Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights

C/o Office of the United Nations High Commissioner for Human Rights
United Nations Office at Geneva
CH -1211 Geneva 10
SWITZERLAND

Tel: +41 (0)22 917 91 76
Fax: +41 (0)22 917 90 06
E-mail: ieforeigndebt@ohchr.org

8 December 2011

INTRODUCTION

1. This submission is from Dr Cephas Lumina, the United Nations Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights (“Independent Expert on foreign debt and human rights”).
2. The mandate of the Independent Expert on foreign debt and human rights is one of the “special procedures” of the United Nations Human Rights Council – mechanisms established by the former Commission on Human Rights and assumed by the Human Rights Council to address either thematic human rights issues throughout the world (“thematic mandates”) or the whole range of human rights issues in a specific country (“country mandates”).¹
3. The special procedures are independent experts appointed by the Human Rights Council to, inter alia, undertake studies, receive communications alleging violations of human rights falling within their respective mandates, conduct official visits to countries and report annually to the Human Rights Council and/or the General Assembly on their studies or country missions. Reports to the Council and General Assembly contain recommendations addressed to States and other relevant stakeholders that are designed to improve the realization of human rights.
4. I was appointed by the Human Rights Council as its Independent Expert on foreign debt and human rights in March 2008 for a renewable term of three years by resolution 7/4. My mandate was extended in April 2011 by the Council for a further three years by its resolution 16/14.
5. In my role as Independent Expert, I undertake studies and country missions and present annual thematic and country mission reports to the

Human Rights Council and annual progress reports to the General Assembly. Since my appointment in 2008, I have submitted a total of 9 thematic and country mission reports to the Council and General Assembly. I have also carried out official visits to Norway, Ecuador, Australia, Solomon Islands, Vietnam and the Democratic Republic of Congo. In addition, I have participated in a number of international events related to my mandate, including the Follow-Up to the International Conference on Financing for Development in Doha in 2008.

6. I have also delivered lectures on the issue of vulture funds, most recently at Monash University in Australia and at Lubumbashi University in the Democratic Republic of Congo.
7. In my report to the Human Rights Council in 2010 (A/HRC/14/21), I analysed the impact of vulture funds on debt relief and human rights in countries that have benefitted from international debt relief efforts. This submission draws upon that report.
8. I make this submission in my capacity as the UN Independent Expert on foreign debt and human rights.

VULTURE FUNDS, DEBT RELIEF AND DEVELOPMENT

9. According to the World Bank and International Monetary Fund, international debt relief efforts under the Heavily Indebted Poor Countries' and Multilateral Debt Relief Initiatives have helped significantly reduce the external debt burden of Heavily Indebted Poor Countries (HIPC) and contributed to creating the fiscal space necessary for poverty-reducing expenditure and development in these countries. Countries that have benefitted from debt relief have increased average spending on health and

¹ For more information on the mandate of the Independent Expert on foreign debt and human rights, see <http://www.ohchr.org/EN/Issues/Development/IEDebt/Pages/IEDebtIndex.aspx>

education and now spend on average six times more on these basic services than they do on debt service.

10. From a human rights viewpoint, reduced debt burdens and increased fiscal capacity have contributed to the creation of the conditions necessary for the realization of human rights, particularly economic, social and cultural rights, in some HIPCs. Some of the human rights impacts of debt relief include the abolition of primary school fees in Ghana, Malawi, Uganda, the United Republic of Tanzania and Zambia, resulting in increased school enrolments in these countries; abolition of user fees for health care in Zambia, thereby making basic health care available to millions of Zambians living in rural areas; and improvement of health care in Mauritania and the Plurinational State of Bolivia.
11. However, as the Green Paper notes, the voluntary nature of international debt relief efforts has provided opportunities for vulture funds to purchase the defaulted debt of HIPCs (particularly those that have benefitted from debt relief), refuse to participate in debt relief efforts and aggressively pursue payment exorbitant amounts consisting of the debt, interest and legal costs.
12. The African Development Bank (AfDB) has reported that vulture funds have averaged recovery rates of approximately 3 to 20 times their investment, equivalent to returns of 300 to 2000 per cent – “probably the highest in the distressed debt market.”² Apart from the United Kingdom’s Debt Relief (Developing Countries) Act 2010, there are no laws that limit the amount of interest or profit that vulture funds can recover through litigation. Further, there are no regulatory frameworks that require disclosure of the amount that such funds paid to purchase the debt on which they seek an exorbitant return.

² See African Development Bank (AfDB), “Vulture funds in the sovereign debt context,” available from www.afdb.org/en/topics-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context.

13. Vulture fund litigation and associated activities not only dilute the impact of debt relief by reducing the resources available to the targeted debtor countries to finance development and reduce poverty, they also undermine the capacity of these countries to create the conditions necessary for the realization of human rights, particularly economic, social and cultural rights. Funds that are earmarked for or should otherwise be spent on poverty reduction and provision of basic social services such as health and education, are diverted to settling the substantial claims of vulture funds.
14. It has been estimated that the average potential impact of vulture fund litigation against HIPCs amounts to 18 per cent of spending on health care and education, 59 per cent of debt repayments, and 5 per cent of budget revenue. In 2008, the World Bank and IMF estimated that the potential impact of court awards in favour of vulture funds varied from less than 0.5 per cent to 49 per cent of the debtor country's GDP.
15. Vulture fund litigation can also be lengthy and costly for HIPCs, thereby diverting scarce resources and attention from pressing development, social and human rights issues. According to the AfDB, vulture funds "grind down poor countries in cycles of litigation" and many lawsuits typically take 3 to 10 years to settle.³ An example in this regard, is the litigation instituted by FG Hemisphere against the Democratic Republic of Congo – the world's second poorest country - in multiple jurisdictions including Jersey, Australia, Hong Kong, South Africa and USA.
16. It is notable that both the World Bank and IMF have recognized that litigation by commercial creditors has been an "impediment to the delivery of full debt relief to HIPCs."⁴ Similarly, the European Commission has acknowledged that cases of aggressive litigation by commercial creditors have diluted some of the benefits of debt relief.

³ Ibid.

⁴ IDA and IMF, "Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – status of implementation" (2009), para. 24.

17. A perusal of the case law involving vulture funds suggests that some (if not many) of the debts were purchased in very questionable circumstances (see A/HCR/14/21).

Concerns over proposed legislative controls on vulture funds

18. Some have expressed opposition to legislative proposals to curb vulture fund activity based on the concerns, inter alia, that legislative controls offer minimal benefits to the beneficiary countries, they have adverse consequences for the secondary debt market and may limit access to credit for the intended beneficiary countries.⁵ I have addressed these concerns in my report to the Human Rights Council (A/HRC/14/21, paras. 54 to 66). In order to avoid rendering this submission prolix, I will not repeat the contents of my report in this regard. Nevertheless, I wish to reiterate my conclusion that there is no empirical evidence to support these concerns. Indeed, the benefits of legislative control significantly outweigh the absence of control and leaving the issue to be addressed by the markets.
19. As I noted in my report to the Human Rights Council aforementioned, current initiatives to address the unethical activities of vulture funds are inadequate. Consequently, robust action is required particularly at the national level (in the form of legislation) to curb the activities of vulture funds.

SPECIFIC COMMENTS

20. In this context, I wish to raise the following matters under questions 1, 2, 3, 4, 6 and 8 of the Green Paper.

⁵ See, for example, the submissions of (a) EMTA and (b) Africa Fighting Malaria, International Policy Network, Free Market Foundation of Southern Africa and Imani Ghana, in United

Question 1: Should Jersey enact legislation equivalent to the UK Debt Relief (Developing Countries) Act 2010 to help curb the ability of vulture funds to pursue sovereign debt through the Jersey courts?

- (a) With respect to the general intent of the consultation, I recommend that the Government of Jersey should enact legislation to limit practices that could undermine international debt relief efforts. Such legislation should be similar to but broader in scope than the United Kingdom's Debt Relief (Developing Countries) Act 2010 for the reasons set out herein.
- (b) Further, as I observed my report to the Human Rights Council, there are compelling public interest grounds for reducing the recoverability of debts and judgments by vulture funds, namely, that the proposed legislation would promote fairness among creditors and promote the development of HIPC's and other beneficiary countries.

Question 2: Are there any unique aspects of Jersey's political, commercial or financial profile which are not present in the UK and which would require specific attention?

As I understand it, Jersey is, unlike the United Kingdom, a banking secrecy jurisdiction. Consequently, any proposed legislation should include provisions requiring full disclosure of the amount of the debt, the circumstances in which the debt that a vulture fund seeks to recover was acquired and details of the creditors.

Question 3: Should the maximum recovery percentage be pegged to the Common Reduction Factor or utilise a different benchmarking

Kingdom, *Ensuring Effective Debt Relief for Poor Countries: Consultation Responses Received* (2010). See also my report to the Human Rights Council (A/HRC/14/21), paras. 54 to 66.

criteria (e.g. amount paid for any sovereign debt purchased on the secondary market)?

I recommend that the maximum recovery percentage should be pegged to the Common Reduction Factor or the amount paid for any sovereign debt on the secondary market, whichever is the lesser.

Question 4: Should any other parameters (e.g. the list of countries which benefit, the application of the Act to original commercial creditors as well as ‘vulture funds’ etc) other be broader or narrower than the UK Act and, if so, in what particular respect?

- (a) The proposed legislation should not be limited to HIPCs but should cover a broader group of poor countries (particularly those eligible for concessional borrowing from the International Development Association) and have debt burdens that undermine their development prospects.
- (b) In addition, the legislation should apply to all commercial creditors (including original creditors) that refuse to participate in debt relief efforts or refuse to negotiate any restructuring of the debt owed by poor countries that have repayment difficulties due to circumstances beyond their control.

Question 6: What reputational impact is UK-equivalent legislation likely to have on Jersey?

- (a) It is unlikely that the proposed legislation will have a negative reputational impact on Jersey. In my view, one of the benefits of such legislation would be the promotion of transparency, predictability and efficiency in the functioning of the secondary debt market.

- (b) The legislation would also promote equitable burden sharing among creditors i.e. address the problem of “free-riding”.

Question 8: Other than the case of Hemisphere v DRC, what evidence exists of foreign vulture funds or commercial creditors using or aspiring to use Jersey as a jurisdiction to institute or continue litigation against HIPCs for the recovery of sovereign debt?

Vulture funds tend to be secretive, both in terms of their ownership and operations. Often, they are established to pursue a single debt (for example, Donegal International Ltd which was incorporated with the sole aim of pursuing a debt owed by Zambia to Romania). For this reason, it is difficult to state with any degree of certainty that there are or they will be or will not be any vulture funds or other commercial creditors aspiring to use the Jersey courts to pursue sovereign debt claims against HIPCs. Nevertheless, as the *Hemisphere v DRC* case in the New South Wales Supreme Court in 2010 suggests, vulture funds are quite resourceful in identifying jurisdictions that they consider creditor-friendly. It is therefore best to guard against this eventuality by putting in place legislation that can curb their unethical behaviour.

CONCLUSION

21. In the light of the foregoing and with respect to the general intent of the consultation, I wish to make the following recommendations:

- (a) Jersey should enact legislation, as a matter of urgency, to limit practices (particularly, vulture fund litigation) that could undermine debt relief efforts. Such legislation should be similar to but broader in scope than the United Kingdom’s Debt Relief (Developing Countries) Act 2010 as outlined above.

- (b) The debt covered by the legislation should extend beyond that eligible for relief under the HIPC Initiative.
 - (c) Qualifying debt should not be limited to HIPC eligibility criteria as at the commencement of the legislation but should apply to debts owed by HIPCs and other qualifying countries after the commencement of the legislation.
 - (d) The legislation should apply with retrospective effect.
 - (e) The proposed legislation should limit the amount of qualifying debt and associated costs (including interest) recoverable by a commercial creditor to the Common Reduction Factor or the amount paid for the debt on the secondary market, whichever is the lesser.
 - (f) Where there is evidence of illegality (e.g. corruption or bribery of foreign officials) in the acquisition or purchase of the debt obligation, the purchaser or assignee should not be able to recover any amount.
 - (g) Qualifying debt should include debt governed by foreign law as well as the law of Jersey.
22. Should you require further information concerning this submission, please feel free to contact me through **Mr Boris-Ephrem Tchoumavi**, Human Rights Officer, Office of the United Nations High Commissioner for Human Rights, telephone: +41 (0)22 917 91 76, facsimile: +41 (0)22 917 90 06, e-mail: betchoumavi@ohchr.org or ieforeigndebt@ohchr.org

SIGNED: DR CEPHAS LUMINA

**UNITED NATIONS INDEPENDENT EXPERT ON FOREIGN DEBT
AND HUMAN RIGHTS**