

## Vulture funds

Recently, a Sydney court ruled in favour of NY-based company FG Hemisphere Associates. It buys the debts of desperately poor countries for a pittance and then fronts up to courts all around the world seeking to enforce the full amount of the debt plus interest.

The NSW Supreme Court said the Democratic Republic of Congo must hand over \$30 million. FG Hemisphere Associates is on solid legal ground but what about the ethics?

## **Transcript**

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Damien Carrick: While most people don't know much about vulture funds, they have been flying into Australia and paying our courts a visit.

Late last year, a Sydney court ruled in favour of a New York-based vulture fund, named FG Hemisphere Associates, also known as FG Capital Management.

Vulture funds buy debts owed by desperately poor countries for a pittance, and then front up to courts all around the world, seeking to enforce the full amount of the debt, plus interest.

In November 2010, the New South Wales Supreme Court ruled that the Democratic Republic of Congo must hand over \$30 million.

The sum forms part of a debt incurred in the 1980s by an authoritarian government of what was then called Zaire. According to Bloomberg Businessweek, the original \$37 million loan (which has now ballooned to over \$100 million), was for power transmission lines and a hydro power dam near the home of long-time dictator Mobutu.

Now in pursuing the debt in Australian courts, it seems quite clear that FG Capital Management is on solid legal ground. But what about the ethics?

Cephas Lumina is a United Nations Independent Expert on Foreign Debt and Human Rights. A Zambian national who's based in South Africa, he describes the recent Sydney litigation as 'morally unacceptable'.

Cephas Lumina: This is a case involving a vulture fund called FG Capital Management Limited. It's a US-based vulture fund, or investment fund. The history of the matter is that in the 1980s, the government of Zaire, which is now the DRC, the Democratic Republic of Congo, and its national electricity company entered into credit agreements with a Yugoslav company called Energo Invest to provide electrical infrastructure in the country. Towards the end of the '80s, both the company and the government defaulted on those dates. Energo Invest took the matter to the International Chamber of Commerce, which in 2003 awarded in favour of Energo Invest, one in the amount of just over \$US18 million, the other one in the amount of \$US11 million. Energo Invest then took action in the US courts, seeking to register judgments there.

Damien Carrick: So in other words, they took their International Chamber of Commerce ruling and went to an American court and said, 'Look, we want this judgment order enforced.'

Cephas Lumina: Yes. They succeeded in doing that in 2004 and then Energo Invest sought those dates to FG Capital Management, which at that time was known as FG Hemisphere Associates. And then FG Hemisphere then sought to enforce that particular judgment in various jurisdictions including the Bahamas, the UK and the USA, in South Africa, in Hong Kong and more recently in Australia.

In 2009 they instituted action in the New South Wales Supreme Court. They were essentially seeking to register the two ICC arbitration awards in Australia and I suspect it is because the DRC government has some assets here. In November last year the New South Wales Supreme Court ruled in favour of FG Capital Management, and gave

judgment in the total amount of just over \$US30 million plus the costs of arbitration, the two ICC arbitral awards and the cost of legal representation. So altogether the DRC has to pay something like \$US32 million.

Damien Carrick: And I understand that the assets of the government of the Congo here in Australia, I think it's something like \$30 million worth of shares in an Australian mining company, which I'm not sure if it has operations or not in the Congo, but that is the asset which FG had tried to claw off the government of the Congo, is that right?

Cephas Lumina: That is my understanding. I'm still investigating the matter to gain some clarity as to which Australian mining operation is implicated in this particular case, but certainly the information that I have is that the judgment itself will possibly trigger off the sale of those assets.

Damien Carrick: People listening to this might be saying well what's wrong? If the government incurs a debt, why shouldn't the government be held accountable even if it is 20, 30 years down the track?

Cephas Lumina: Well there are a number of issues here. I think you know, these kinds of cases raise a number of ethical and human rights issues. The debt that we're talking about here was a debt that was incurred a regime that one would say was not one that represented the wishes of the people.

Damien Carrick: We're talking about the Mobutu regime of what was then known as Zaire which was a kleptocracy, I mean he basically ran the country as his own private fiefdom.

Cephas Lumina: Yes, that's correct, I think it's a matter of public notoriety, that particular regime siphoned off a lot of money to the detriment of the people of the country. But the problem here is not so much that the country shouldn't have to pay, but the people of the DRC now should have to pay debts that were extended to a government that was not representative of the wishes of the people.

There are also other issues, you know, since the middle of 1997 I think, the DRC has been involved in conflict that has claimed almost 3.5 million lives. The infrastructure in the country is almost non-existent, it's trying to repute, it has recently gone through a process of debt cancellation, I think just in December last year they completed the HIPC (Highly Indebted Poor Country) process and thereby received some debt forgiveness from the country's various creditors. Nevertheless I think there's still an amount of about \$US3 billion that the DRC still owes. You're talking about a country that has a population of about 66 million people, most of which -- I think about 79% of the population -- living below the poverty line.

Damien Carrick: Cephass Lumina, a United Nations Independent expert on foreign debt and human rights.

FG Hemisphere Associates declined to be interviewed for this program, as did its Australian lawyers, Gilbert and Tobin.

However, a source close to the industry did provide the Law Report with a very different perspective.

The source points out that 'In this case, the hydro-electric infrastructure was actually built. The Congo purchased an asset.

'The Congo is a deeply dysfunctional place. Through regime change and war, at every stage it's been controlled by a small, highly corrupt, self-interested clique.

'So it's not fair to argue that any debt repayments will translate into less money being spent on its impoverished people. Indeed, right now there is a huge scramble for the country's natural resources, and corruption and kickbacks are endemic.'

And the source goes on to say, 'The country's interest is best served by creating an environment where there is rule of law and transparency, and where contracts are honoured.'

Back in Sydney, the government of the Democratic Republic of Congo didn't bother arguing its case at the recent Supreme Court hearing.

And according to Ross Buckley (a professor of International Finance at the University of New South Wales) engaging Australian legal eagles wouldn't have helped to keep the vultures at bay.

He doesn't think the New South Wales Supreme Court had any choice but to find in favour of FG Hemisphere Associates.

Ross Buckley: Well, Damien, all it was really doing was saying that it would enforce an arbitral award that was achieved overseas. So the Sydney court really didn't decide that the Democratic Republic of the Congo's government was liable. What it said was it would enforce in Australia a decision that had been achieved overseas and the Australian court didn't have a whole lot of choice in that I don't think. Because we had these treaty obligations which are important, which make arbitral awards effective around the world. In other words, if you can get an award from an arbitration, you can enforce it in most jurisdictions, which is why that whole dispute resolution process has meaning.

Damien Carrick: What do you think of the decision?

Ross Buckley: Well I think the decision of the Australian court is appropriate. I suspect it probably may well have caused the judge some sleepless nights, because it's not a very pleasant thing to have to do. I think the decision overseas, the arbitral decision, which made the government of the Congo liable, is deeply unfortunate. What's going on in this case is that somebody has bought a whole lot of debt that the Congo owed for the explicit purpose of enforcing that debt and making a whole lot of money on it, because of course when you're dealing with a country that's got a lot of economic problems, its debt often -- and if it can't service its loans -- they're often trading at 20 cents or 30 cents on the dollar, but if you can buy the loans and take them to a court, the court doesn't have a lot of choice but to give you judgment for 100 cents on the dollar.

Damien Carrick: So you're saying that the judge in this case may well have had a few sleepless nights or uneasy moments, but if he had decided not to uphold this order, then where would that leave us in terms of international trade and contractual obligations?

Ross Buckley: Yes, I don't really think it was open to the judge to reach that conclusion, because there's no basis in Australian law at the moment to distinguish between this sort of claim, which is frankly morally repugnant, and a completely legitimate claim. And so if the judge in this case had refused to enforce this claim, he also would have been refusing to uphold all the ones that are completely legitimate.

Damien Carrick: So courts in the past have never, never distinguished between fair claims and, to use your term, morally repugnant claims?

Ross Buckley: They often do, but they need a legal basis for it. And this particular situation, where somebody buys the debt of a developing country at a deep discount with the pure intention of getting recovery for the full amount, the law doesn't recognise that, the law as it stands today doesn't recognise that as a problem, even though I think everybody I think, would accept as totally different. If you're a creditor, you've made the loan and then you're seeking to recover the loan. That's one thing. But if the only way you have the loan is because you've bought it for 20% of its value, to turn around the next week and try and get 100% of its value is just sheer opportunism.

Damien Carrick: Have there been cases in the past where it has been successfully argued that a debt does not need to be repaid? Where there have been kind of literally profound changes in terms of the government, or even the national entity?

Ross Buckley: There have been a few, not many. I think when America won the war with Spain over Cuba, Cuba was saddled with a whole lot of debts the Spanish regime had undertaken and America refused to honour those debts, on the basis that they were not legitimate debts of the Cuban government. And I think there was a case involving Costa Rica where there was a regime change once, and that went to arbitration and the arbitrator came to the same conclusion, that these debts from the old regime didn't have to bind the new regime. But there's not been a lot of instances, and both of those are a

long time ago.

Damien Carrick: If a corporation enters into commerce, or makes a loan to very unrepresentative government, should the taxpayers of that country always be liable for the contract signed by that government, even if it is 20, 30 years down the track, and in the case of, say, Zaire now the Congo, there've been some pretty profound changes, and indeed terrifying war there, a number of regime changes. Should the taxpayers be liable for the debts incurred by a really unrepresentative government, a kleptocracy, back in the 1980s?

Ross Buckley: I think most people would think there's a very large question mark over whether there should be. There is a doctrine that's floating around in international law called 'odious debt', and what that says basically is the taxpayers should be liable if, when the loans were borrowed, they were used for the benefit of the country. So in other words, if an odious dictator borrows money to build a hospital, it's fair enough that the people should service that debt, no matter how long it takes but if the same person borrows money to buy gas, to gas a minority, or to buy weapons to use against his own people, then that debt shouldn't be enforceable. But that doctrine is not law, it's just a very good idea.

Damien Carrick: Do we know the facts in this case? You know, what the money was used for? Here was a contract between a Yugoslav hydroelectric company I think, and the government of the Congo. We don't know who got what money and what was actually provided for in consideration.

Ross Buckley: We don't, and there's typically not a whole lot of transparency about these things. But in a sense, we don't need to know the facts in this case, to know that morally there's a problem with it, because the Congo can't service its debts. All international banks accept that. So all international banks are going without payment or accepting reduced payments. And then one of these vulture funds comes along, and because they're operating on a relatively small scale, they're able to buy up the debt and then seek its full repayment. If the whole banking system sought full repayment of the Congo's debt, the Congo can't do it, so it knows it's not going to get it.

Damien Carrick: Professor Ross Buckley I understand that recently the UK adopted some legislation in this area. What is that legislation?

Ross Buckley: It was introduced in April last year. What it says is if a foreign country is a member of the World Bank's Highly Indebted Poor Country (HIPC) initiative, any claims against that country are limited to the extent that they are prescribed by the World Bank. In other words, if the bank has said 60% of the country's debts are to be cancelled, one can only recover 40 cents on the dollar against that country.

Damien Carrick: And you would say that Australia should adopt similar sorts of legislation?

Ross Buckley: If we don't adopt such legislation, we're really allowing the misuse of our courts. We're allowing them to be forced to enforce claims that are just repugnant, I think. So we need that legislation and we need a rider on it which also says that our courts are not compelled to enforce any arbitral awards that in turn are enforcing debts that would be in violation of the legislation.

Damien Carrick: It's interesting. I understand that as part of its campaign to recover this money, FG, they've done some pretty extraordinary things. I think in 2009 a US court fined the government of the Congo something like \$US80,000 a week for failing to comply with a court order to detail its assets throughout the world and hand over this list to the US court. And ever since then, this fine of \$80,000 a week against this government has been rolling over and getting bigger and bigger and bigger. Is that right?

Cephas Lumina: Yes, this is a huge challenge, and beyond that -- if you'll just allow me to give you two other examples. In 2008 the same company in the US, well they basically got another court judgment which gave them the right or authority for a period of 15 years from the date of the judgment to collect revenues from the DRC's export of electricity to South Africa. That's one example. For a period of 15 years from the date of judgment, all the revenue collected from the sale of electricity by the DRC to South

Africa, goes to this vulture fund. February last year, the Hong Kong Appeals Court authorised the seizure of a portion of entry fees paid by China to the DRC for mineral exploration. These are just two examples.

Damien Carrick: Extraordinary if those payments from South Africa and those payments from China, they are now being siphoned off by this company.

Cephas Lumina: Yes, in fact it's not just the FG Hemisphere. Beyond FG Hemisphere, the other vulture funds, I don't know the precise identity of these vulture funds, most of them you know operate in a lot of secrecy, but what is being claimed from the DRC is I think just over \$US452 million, and we're talking about debts that are substantially less than this, this particular amount. And just to illustrate, the debt that we've been talking about had a face value of about \$30 million, I think that is \$37 million or something like that, but FG Hemisphere's essentially seeking a total of over \$100 million from the DRC government.

Part of the problem is that these vulture funds operate in such a way that they grind down these poor countries in years and years of litigation, and so obviously as the litigation goes on, so the interest on the debt rises, and the costs accumulate.

Damien Carrick: As an African, what is your view of this kind of strategy?

Cephas Lumina: I think it's morally unacceptable. Perhaps some of the courts that I've been looking at this, and I have enormous respect for the independence of the judiciary, but I think one has to ask themselves some questions. The problem is that sovereign states do not have the protection that individuals have at the national level, under insolvency laws. And so there's no clear protection for them. This is what allows these vulture funds to operate with a degree of impunity. And I'll say that it's just unethical. If you look at the average recovery rates of these vulture funds, they are somewhere between three and twenty times their investment. So we're talking about 200% to 3,000%.

Damien Carrick: There have been a couple of other examples that you've written about.

You wrote recently a report for the United Nations and you spoke about a couple of other examples. Can you briefly tell me about two of those? The first one involves the country of Liberia, again a desperately poor conflict-riven country. Tell me briefly about moves by vulture funds to extract funds from that country.

Cephas Lumina: Yes, the Liberian debt is a debt of \$US6.5 million, that arises from a loan that -- well it was a loan of \$US6.5 million that the Liberian government got from a US bank in 1978, and you know, Liberia in November 2009 was ordered to pay just over \$US20 million, that is interest and legal costs. So you can see, it's more than three times what the vulture fund actually paid for -- the two vulture funds involved -- paid for the debt in question.

Damien Carrick: And of course Liberia has a GDP of something like only \$US80 million a year, and this \$US20 million would amount to something like 5% of its annual budget, and I think its health budget is something like \$US15 million a year.

Cephas Lumina: Yes, I mean the debt is, as I say, much more than the education budget. It's just amazing. This is a country that is desperately poor. There is no infrastructure to speak of. Water and sanitation broken down by the years of civil war. Of course there is a democratically elected government in place that is trying its best to fix things, but this sort of money really diminishes the capacity of the government to deliver on its promises to fix things. This is a country that has 85% unemployment. I think more than 90% of the population are illiterate, so this is a real challenge for Liberia.

Damien Carrick: And indeed the government in 1978 is not the same government as now, it's a completely different group of people.

Cephas Lumina: Yes, completely different. I mean of course the changes in government do not relieve the current government of liability for the debt, but the issue really is much more of -- it is a question of morals really. Whether it is ethical to allow these vulture funds to recover those debts in these circumstances.

Damien Carrick: Cephas Lumina, a United Nations Independent Expert on Foreign

Debt and Human Rights. And before him, Ross Buckley, professor of International Finance at the University of New South Wales.

<http://www.abc.net.au/rn/lawreport/stories/2011/3148840.htm#transcript>