Vulture funds, creditors and sovereign debtors : how to find a balance?

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Introduction

The actions of so-called 'vulture' funds in relation with sovereign debt has attracted much attention recently. The director of the African Legal Support Facility, an organization set up by the African Development Bank, has recently stressed its commitment to "completely wreck vulture funds activities" in Africa.[1] The independent expert on foreign debt appointed by the UN Human Rights Council has noted that "vulture funds erode the gains from debt relief for poor countries and jeopardize the fulfillment of these countries' human rights obligations".[2] The former prime minister of the United Kingdom referred to 'vulture funds' as being "perverse".[3] These statements are part of a series of public outcries denouncing the actions of 'vulture' funds.[4]

Pushed in part by this clamor and drawing on the (perceived) need to safeguard multilateral debt reduction efforts, national initiatives have been undertaken in recent years which aim to limit the rights of sovereign debt creditors. These initiatives are part of a larger debate on the orderly resolution of sovereign debt difficulties. Recent events of default by sovereign issuers have led the international community to consider a range of new measures, going from the structural solution to a lighter, contractual approach. One of the main themes in these discussions has been the need to strike a different balance between the sovereign debtor and his creditors. The position of the latter has not been helped by a series of well-publicized actions by individual creditors, who have been said to damage sovereign debtors and their attempts at restructuring debt in general.

The purpose of this paper is to question the merits of recent actions undertaken by individual States to limit creditors' rights, and in particular the rights of so-called 'vulture funds'. In order to do so, the paper will first review some of these actions and briefly sketch the context in which they were taken (Part I). It will then inquire what justifications exist for the limitations brought to creditors' rights, in the hope of offering an answer to the question whether the nickname of 'vulture' is warranted or whether it would be wiser to speak of plain 'creditor activism' (Part II).[5]

1 Press Release ALSF, 9 November 2010, available at *www.afdb.org/en/news-events/article/alsf-takes-measures-to-fight-vulture-funds-in-africa-7434*.

2 Report of the 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, UN Human Rights Council, 29 April 2010, A/HRC/14/21, at p. 12, § 33.

3 Gordon Brown is quoted as saying that "We particularly condemn the perversity where vulture funds purchase debt at a reduced price and make a profit from suing the debtor country to recover the full amount owed - a morally outrageous outcome." (Gordon Brown, at that time Chancellor of the Exchequer in the UK Government, speech at the United Nations General Assembly Special Session on Children on May 10, 2002 - "Financing A World Fit for Children").

4 See most notably the outcry which followed the 'victory' of Donegal International in its quest against Zambia to recover on USD 55 million in Zambian obligations that Donegal had purchased at a steep discount from Romania in 1999. See "Zambia Pays 'Vulture Fund' $15m", BBC, Apr. 24, 2007, *http://news.bbc.co.uk/1/hi/business/6589287.stm*.

5 As in Laura Alfaro, "Creditor Activism in Sovereign Debt: "Vulture" Tactics or Market Backbone," Harvard Business School Case Study N9-706-057, April 20, 2006.

Part I. The 'war' on creditors : a review of initiatives aiming at limiting sovereign bondholders' rights

Sovereign debt has been at the center of recent attention, in part due to the European sovereign debt crisis. It is likely that the current discussions on the European Stability Mechanism, will lead to curtailing some of rights of creditors. The focus on the position of private creditors is not unique. The rights of these creditors have indeed been one of the main concerns in recent years in discussion around sovereign debt.

In order to understand why the rights of creditors in general and those of a specific category of creditors, which have been dubbed the 'vulture funds', have in particular received close attention, it is necessary to recall some of the main features of creditor's litigation against sovereign states (*section 1*). Instead of offering an exhaustive review of creditors' action, the focus will be on the changing strategies used by creditors. It is against this background that we will proceed to review some recent initiatives undertaken to limit creditors' rights (*section 2*).

Section 1 – the creditors in action

Litigation by private creditors against a sovereign in default is not an entirely new phenomenon. Until the 1970's however, few creditors acted against sovereign debtors. There were certainly legal reasons for this – among which the fact that the legal framework in place was not creditor friendly, with a strong doctrine of sovereign immunity and reluctance by the courts to interfere in sovereign debt disputes.[6]

The main reason, however, explaining why very few, if any, actions were undertaken by individual creditors in case of sovereign default, may be found in the practice of sovereign debt at that time.[7] If one leaves aside lending by international organizations and states,[8] the bulk of the lending was done until the 1980's by banks, acting in syndicate.[9] Syndicated loan

6 On enforcement practice and tactics before WWII, which involved so-called 'gunboat diplomacy', see K. J. Mitchener and M. D. Weidenmier, “Supersanctions and Sovereign Debt Repayment”, NBER Working Paper No. 11472 and J. Basdevant, « L'action coercitive anglo-germano-italienne contre le Vénézuela », *Rev. gén. dr. int. public*, 1904, 362-458. See also L. Alfaro, N. Maurer and F. Ahmed, “Gunboats and Vultures : Market Reactions to the 'Enforcement' of Sovereign Debts”, Working Paper (available at www.crei.cat/activities/sc_conferences/32/Papers/Maurer.pdf). Alfaro & Co review (at pp. 7-12) extensively the various military interventions by European countries and the US in South America in the early 1900's

7 On the structure of foreign debts until the 1960s, see G. van Hecke, *Problèmes juridiques des emprunts internationaux*, 2nd ed., Brill, Leyden, 1964, 3-6.

8 Which is by essence not conducive to litigation in case of default. The international community has on the contrary set up specific forum to deal with sovereign defaults. The most notable institution is the Paris Club (*www.cludeparis.org*), which was set up in 1956 to help resolve developing and emerging countries' debt problems.

9 The situation was different until the second world war. Bonds issued by sovereigns in the 1920's and 1930's were largely held by private investors. Defaults were not uncommon. This has given rise to some high profile litigation (see most notably the ruling of the Permanent Court of International Justice in the Case concerning the payment of various Serbian loans issued in France and the case concerning the payment in gold of the

contracts were the norm.[10] Such syndicated loan agreements included mechanisms which discouraged individual actions. Many of the loans included a sharing clause – according to which all the members of the syndicate were forced to share any payments obtained through litigation or settlement, with the remaining members of the syndicate.[11]

Further, the practice was that in case of default, the banks would mandate representatives to form a Bank Advisory Committee, entrusted to discuss with the sovereign.[12] This was not compulsory, but one could imagine that in the closed world of banking, going alone was not done... Porzecanski describes this as "the days when a relatively small syndicate of commercial banks could gather quickly in New York or London, spurred into action by urgent telephone calls from their supervisory authorities, to deal with whatever financial emergency had erupted in some distant corner of the world".[13] Finally, there was, at least in the US, a strong regulatory incentive not to declare a default.[14]

The situation changed starting in the 1980's with the creation of a secondary market in securitized loans. This led to the creation of a diverse and unmanageable community of creditors with disparate agendas.[15]

In this new landscape, creditors could also count on some major legal victories, which made litigation against sovereign debtor less unlikely. A first major inroad touched upon the doctrine of sovereign immunity. As is well known, courts started to look with more reservation at sovereign immunity pleas. In major financial centers, legislation was adopted which restricted considerably the scope of the immunity enjoyed by foreign sovereigns. In 1992, the US Supreme Court determined in the case of *Republic of Argentina v. Weltover*,[16]

Brazilian federal loans issued in France, Series A Nr. 20/21 (July 12th, 1929)). In general on the history of these loans see Erika Jorgensen and Jeffrey Sachs, "Default and Renegotiation of Latin American Foreign Bonds in Interwar Period", in *The International Debt Crisis in Historical Perspective*, B. Eichengreen & P.H. Lindert (eds), 1989.

10 See *e.g.* the one which was at the basis of the famous Allied Bank dispute before US courts : 39 banks which had lended money to Costa Rica : *Allied Bank International v Banco Credito Agricola de Cartago* 566 F. Sup. 1400 (SNDY 1983).

11 These mechanisms also led to "pressure from like-minded fellow creditors that helped constrain impulsive or short-sighted behavior", as the US government noted in the 1990's : Statement of Interest of the United States of America in Opposition to the First Amended Complaint, *CIBC Bank and Trust Co (Cayman) Ltd. v. Banco Central do Brazil* 886 F. Supp. 1105 (SDNY 1995).

12 This practice had already been widely used in restructuring before the second World War, see Jill E. Fisch & Caroline M. Gentile, "Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring", 53 Emory L. J. (2004), (1047), 1055-1058.

13 A. C. Porzecansky, "From Rogue Creditors to Rogue Debtors : Implications of Argentina's Default", *Chicago J. Intl L.*, 2005, 312.

14 US banks declaring a default on non-performing loans were required to write off the loan from their books, which would have forced many of them to bankruptcy see Jill E. Fisch & Caroline M. Gentile, "Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring", 53 *Emory L. J.* (2004), (1047), 1061-62.

15 See Philip J. Power, Note, "Sovereign Debt: The Rise of the Secondary Market and its Implications for Future Restructurings", *Fordham L. Rev.*, 1996, 64(6): 2701–2772.

16 504 U.S. 607. This case concerned special instruments ('*Bonods*') issued by Argentina in relation to a foreign exchange insurance program under which it assumed the risk of currency depreciation in cross-border transactions. At one point, Argentina unilaterally decided to extend the time for repayment of these instruments. Argentina sought to have proceedings brought before a Federal District Court dismissed on the ground that the court lacked jurisdiction. The US District Court for the Southern District of New York held

that issuing sovereign bonds could be deemed to constitute a commercial activity under the FSIA. This opened the way for creditors to sue defaulting sovereigns in the U.S.[17] [18]

In another development, courts restricted the use of the non-statutory Act of State doctrine, which had previously been used as a shield by foreign sovereigns.[19] While courts first accepted to refrain from reviewing or questioning actions by foreign states, in order not to become entangled in international affairs more properly left to the political branches of government,[20] they later accepted that the act of state doctrine did not bar creditors from bringing proceedings against sovereign debtors. This was justified on a legal technical basis. Courts noted that while only acts performed within the territory of the foreign sovereign debtor deserved deference under the act of state doctrine, most sovereign debt was too closely connected with the United States, notably because it was payable in US dollars and included a choice for US courts.[21] Behind this reasoning, courts were certainly also sensitive to the fact

that the court had jurisdiction because the issuance of the debt instruments was a "a commercial activity" that have "a direct effect in the United States." Noting that "...when a foreign government acts, not as regulator of a market, but in the manner of a private player within it, the foreign sovereign's actions are "commercial" within the meaning of the FSIA...", Justice Scalia explained that "there is … nothing distinctive about the state's assumption of debt (other than perhaps its purpose) that would cause it always to be classified as *jure imperii*...". The Court concluded that the issuance of the 'Bonods' was analogous to a private commercial transaction. Remarkably, the Court stressed that the purpose of the activity in which the foreign sovereign is engaged, is irrelevant (504 U.S. at 617).

17 See on this development, G. R. Delaume, "Sovereign immunity and public debt", *Festschrift in Honor of J. Gold*, Werner F. Ebke (eds.), Heidelberg, Recht & Wirtschaft 1990, at pp. 471 ff. In the United Kingdom, section 3(3)(b) of the 1978 *State Immunities Act* provides that « (b) any loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction or of any other financial obligation » constitue a « commercial transaction » for which a State does not enjoy immunity.

18 In Belgium, courts have accepted that sovereign debtors cannot claim sovereign immunity in matters of sovereign debt. This was explicitly decided by the Court of First Instance of Brussels in a dispute between the Democratic Republic of Congo and Red Mountain Finance (Ruling of the Brussels Court of First Instance, 6 March 2001, *Democratic Republic of Congo v. Red Mountain Finance*, reproduced in J. Wouters and M. Vidal, *Cases van internationaal recht*, Intersentia, 2005, 544-546). The case did not concern directly the issue of immunity. Rather, the court had to decide whether a judgment issued by an English court against the Republic, could be enforced in Belgium on the basis of the Brussels I Regulation. The court noted that the claim was based on a Refinancing Credit Agreement signed in March 1980 by the Republic and its Central Bank. Although the Agreement included a waiver of immunity, the Court went further and decided that the credit agreements did no significantly differ from a loan agreement which a bank could sign with a private business or individual. According to the Court, the Republic could therefore not claim any immunity for disputes relating to the agreement.

19 In *Underhill v. Hernandez*, 168 U.S. 250 (1897), Chief Justice Fuller wrote that "Every sovereign state is bound to respect the independence of every other state, and the courts of one country will not sit in judgment on the acts of another done within its own terrutory (at p. 252). See for a recent application *Nocula v. UGS Corp*. 520 F.3d 719 (7th Cir. 2008) (the Court held that the "decision of a foreign sovereign to exercise its police power through the enforcement of its criminal laws plainly qualifies as an act of state." *Id.* at 728.

20 In litigation involving debts issued by banks owned by Costa Rica which had defaulted on their obligations as a consequence of exchange controls imposed by the Costa Rica Central Bank, prohibiting the servicing of obligations to foreign creditors, a district court relied on the act of state doctrine to dismiss the claim issued by the agent for a syndicate of thirty-nine commercial banks holding the debt. The court held that the act of state doctrine precluded US courts from inquiring into the validity of acts of foreign government done in its own territory (*Allied Bank International v. Banco Credito Agricola de Cartago* 566 F. Supp 1440 at p. 1444 (SDNY 1983)).

21 *Allied Bank II*, 757 F.2d 516 at 521-523 (2nd Cir. 1985). On the peculiarities of this case, which was submitted twice to the Second Court, see Jill E. Fisch & Caroline M. Gentile, "Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring", 53 *Emory L. J.* (2004), (1047), 1082-84.

that defaulting on debtors payable in international jurisdictions is not considered to be a sovereign act worthy of judicial deference.

In another important development for sovereign creditors, courts also found that the champerty defense, which prohibits litigating on a claim purchased exclusively for the purpose of instituting court proceedings,[22] did not prevent creditors from claiming payment from a sovereign in case of default even when the debt was bought on the secondary market.[23] [24]

Comity remained a potential obstacle to private creditors' litigation in US courts, albeit not a strong one. The *Allied Bank* litigation once again illustrates the evolution of courts. In its first decision in this case, the Second Circuit agreed that comity should benefit the defaulting sovereign.[25] This decision was certainly influenced in substance by the position of the US government, which had indicated its support for Costa Rica's attempt to restructure its debts. In another decision in the same case, the same court of appeals reversed, however, rejecting the argument that comity should bar the suit.[26] According to the Court, "[t]he Costa Rican government's unilateral attempt to repudiate private, commercial obligations is inconsistent with the orderly resolution of international debt problems".[27] In granting the creditors' motion for summary judgment, the Court added that Costa Rica's decision was "... contrary to the interests of the United States".[28] In later cases, however, the doctrine of comity has been used against creditors.[29] At most, the doctrine of comity is therefore a volatile argument, which is "unreliable" as a defense for both the debtor and the creditors.[30]

22 The Champerty doctrine can be found in most state laws, see *e.g.* section 489 of the New York Judiciary Law which prohibits the purchase of a claim with the intent and purpose of bringing action or proceedings on the claim.

23 See *Elliott Associates LP v The Republic of Peru* 194 F.3d 63 (2d Cir. 1998). In first instance, the district court had held tat the champerty doctrine barred claims brought by the creditor against Peru (12 F. Supp. 2d 328 (S.D.N.Y. 1998). In reversing this decision, the Second Circuit Court adopted a narrow reading of the champerty defense, holding that this defense did not apply if the creditor intended, when purchasing the debt, to be paid in full and only to resort to litigation in the absence of payment.

24 It was reported that the New York legislature modified its law to eliminate the champerty defense for any dispute relating to debt exceeding USD 500.000 and this following a request made by distressed debt investors – see J. I. Blackman and R. Mukhi, "The Evolution of Modern Sovereign Debt Litigation : Vultures, Alter Egos and Other Legal Fauna", *Law & Contemp. Problems*, 2010, vol. 73, (47), 54.

25 *Allied Bank I*, 733 F.2d 23 (2nd Cir. 1984).

26 *Allied Bank II*, 757 F.2d 516 (2nd Cir. 1985).

27 757 F.2d 516 at 522.

28 The difference between the Court's position in 1984 and 1985 can be explained by the *amicus brief* submitted by the Justice Department when the Court agreed to rehear the case. The Department explained that it only wished to encourage the cooperative restructuring of sovereign debt if the foreign sovereign did not call into question the validity and enforceability of the original obligations, something which Costa Rica had not done. In the same line, the New York Clearing House Association also filed an *amicus curiae* brief urging the court to enforce the rights of commercial banks on sovereign debt.

29 In a case, which pitted the central bank of Brazil against a private creditor who had acquired, at large discounts, more than USD 1 billion of a special Brazilian debt, the US government filed a 'Statement of Interest" urging the court to reject the claim by the creditors to accelerate the debt because of concern that "a judgment in favor of the [creditors] would encourage creditors to use the courts to gain unfair concessionsthe from sovereign debtors" (Statement of Interest of the United States of America in Opposition to the First Amended Complaint, *CIBS Bank and Trust Co (Cayman) Ltd. v. Banco Central do Brazil* 886 F. Supp. 1105 (SDNY 1995)).

30 As underlined by Sturzenegger & Zetelmayer. As these authors explain, "comity considerations seem to have

All in all, the substantial increase in the number of secondary creditors of sovereign debt [31] and changes in the legal framework laid the foundations for increased creditor activism.[32]

Instead of attempting to charter all instances of creditor litigation, most of which has been extensively documented,[33] we will highlight three novel strategies of such creditor litigation. These strategies have been selected because they illustrate the rapidly changing tactics used by creditors seeking to obtain payment.[34] Gone are indeed the days when creditors limited themselves to attaching – or attempting to attach - assets belonging directly to the sovereign debtor or its instrumentalities. While creditors still attempt to attach assets of central banks,[35] the rise of creditor litigation over the last twenty years has also brought extensive creativity to the field of assets tracing and spawned new forms of creditor litigation. This can be illustrated by reference to three recent cases of sovereign default. It will not come as a surprise that all three instances relate to judgment enforcement, the most crucial stage in dealing with a sovereign debtor.

boiled down to a court assessment on whether the debtor's actions could be viewed as broadly justified in light of US policies on how international debt crises ought to be resolved". See also on this theme Christopher C. Wheeler and Amir Attaran, "Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation", Stanford J. of Int'l Law 2003, vol. 39, 253 ff.

31 In a statement issued in a case, the US government noted the "dramatic increase in the number of secondary market purchasers of sovereign debt", which had altered the relationship between creditors and sovereign debtors : Statement of Interest of the United States of America in Opposition to the First Amended Complaint, *CIBS Bank and Trust Co (Cayman) Ltd. v. Banco Central do Brazil* 886 F. Supp. 1105 (SDNY 1995).

32 Another development worth mentioning is the rather narrow approach taken by courts when dealing with a defense based on Article VIII section 2b of the IMF Articles of Agreement. Certain sovereign debtors have indeed attempted to justify their defaults by pointing to limitations they had themselves imposed on payments to foreign creditors, which made honoring an "exchange contract" impossible – in *Libra Bank Ltd. v. Banco National de Costa Rica* (570 F. Sup. 870 (SDNY 1983)), a district court rejected this argument, noting that the restrictions imposed by Costa Rica were not consistent with the IMF agreement.

33 The best documented sources can be found on the website of EMTA at *www.emta.org/cases.aspx*.

34 There are many other instances of recent creditor litigation, see *e.g.* against China the individual proceedings brought in US courts by individual bondholders : *Marvin L. Morris, Jr. v. The People's Republic of China and Gloria Bolanos Pons and Aitor Rodriguez Soria v. The People's Republic of China* (documents available at *www.globalsecuritieswatch.org/creditorlawsuits.html*).
Other recent cases include *Turkmani v. Republic of Bolivia*, 193 F. Supp. 2d 165 (D.D.C. 2002); *Hirshon v. Republic of Bolivia*, 979 F. Supp. 908 (D.D.C. 1997).

35 This is what Red Mountain Finance did in Belgium, attempting to attach the assets of the Central Bank of the Democratic Republic of Congo – see the ruling of the Brussels Court of First Instance, 6 March 2001, *Democratic Republic of Congo v. Red Mountain Finance*, reproduced in J. Wouters and M. Vidal, *Cases van internationaal recht*, Intersentia, 2005, 544-546. At the same time, this creditor also went directly after the Republic, seeking and sometimes obtaining summary judgments. This was the case in May 2001, the US District Court for the Central District of California entered an order enjoining Congo and its central bank from making or authorizing payments with respect to its external debt without making a "proportionate payment" to Red Mountain Finance, the creditor (*Red Mountain Fin., Inc. v. Democratic Republic of Congo and Nat'l Bank of Congo*, Case No. CV 00-0164 R (C.D. Cal. May 29, 2001), unpublished, reported by L. C. Buchheit and J. S. Pam, "The Hunt for Pari Passu", *IFLR*, February 2004, (20), 22 and by C. G. Berry and K. H. Blake, "'Pari Passu' Means What Now?', *New York L.J.*, 6 March 2006).

A. Peru : targeting the payment flows

A first well known example of a novel and bold action by creditors, which has been both extensively documented and also decried, relate to the attempt by Elliott Associates Ltd. to seize money which was about to be distributed through the Euroclear system, to holders of bonds issued by Peru.

The case started when Elliott Associates acquired, at a large discount, debt guaranteed by the Peruvian government.[36] This acquisition occurred shortly before Peru's 1996 Brady deal.[37] Faced with a refusal by Peru to pay, Elliott initiated proceedings in New York.[38] Its request for a pre-judgment attachment was at first denied, the court finding that the attachment would have jeopardized the Brady restructuring.[39] In 1999, however, Elliott managed to obtain a pre-judgment attachment against Peruvian assets used for commercial purposes in the U.S.[40] In June 2000, Elliott was awarded a US$57 million judgment against Peru.

When it came to enforcing this ruling, Elliott turned to what was at that time a novel tactic. Instead of seeking to attach assets directly owned by Peru, it targeted payment flows from Peru to its creditors. Elliott was aware that Peru was obliged to make a payment in September 2000 to holders of the external bonds Peru had issued to restructure its old bank debt ("*Brady Bonds*"). That payment was to flow through the Chase Manhattan Bank, in its capacity as the fiscal agent for the Brady Bonds, and would eventually be credited to bondholder accounts maintained with the Euroclear System in Belgium and the Depository Trust Company ("*DTC*") in the United States.

In an effort to intercept the Brady Bond payment, Elliott applied and obtained on 26 September 2000,[41] from the Court of Appeals in Brussels (8th Chamber), which reversed a

36 Elliott apparently acquired bonds (issued by the Central Bank of Peru) for a face value of USD 20 million, at a discount of 50 %.

37 See generally on the Brady plan, R. P. BUCKLEY, *International Financial System. Policy and Regulation*, Wolters Kluwer, 2009, at p. 39-54.

38 Elliott first accelerated the debt. The total amount sought by Elliott was in excess of USD 55 million.

39 In another case, another creditor of Peru (Pravin Bank Associates) has also requested summary judgment against Banco Popular del Peru. In a first decision, the United States District Court for the Southern District of New York granted a six-month stay to allow the orderly completion of Banco Popular's Peruvian liquidation proceedings (see *Pravin Banker Assocs., Ltd. v. Banco Popular del Peru*, 165 B.R. 379 (S.D.N.Y.1994) ("Pravin I "). The same court granted an additional stay of two months later on, in order to facilitate Peru's ongoing negotiations with the Bank Advisory Committee under the Brady Plan (See *Pravin Banker Assocs., Ltd. v. Banco Popular del Peru*, 1995 WL 102840 (S.D.N.Y. Mar. 8, 1995) ("Pravin II"). After the end of the two months period, the court finally granted Pravin's motion for summary judgment, thereby allowing enforcement of the debt (See *Pravin Banker Assocs. Ltd. v. Banco Popular del Peru*, 895 F.Supp. 660 (S.D.N.Y. August 24, 1995) ("Pravin III "). In January 1996, judgment was entered for Pravin for an amount in excess of USD 2 million (See *Pravin Banker Assocs. Ltd. v. Banco Popular del Peru*, 912 F.Supp. 77 (S.D.N.Y.1996) ("Pravin IV "). The Court of Appeal for the second circuit refused to dismiss or stay the proceedings until the completion of the negotiations. It also refused to stay the proceedings or the execution of the judgment during the course of the Brady negotiations : *Pravin Banker Associates, Ltd. v Banco Popular del Peru and the Republic of Peru*, 109 F.3d 850 (2d Cir. 1997).

40 *Elliott Associates LP v. Banco de la Nacion and the Republic of Peru*, 194 F.3d 363 (2d Cir 1999).

41 Court of Appeal of Brussels (8th Chamber), 26 September 2000, General Docket n° 2000/QR/92, unpublished.

previous ruling from the Commercial Court,[42] a restraining order against Euroclear with respect to funds Peru was going to transfer through its paying agent.[43]

In order to substantiate its claim, Elliott made a novel argument based on the *pari passu* clause included in the bond documentation. The *pari passu* clause, which is a standard fixture in the legal documentation of bonds,[44] had until then gone mostly unnoticed. According to Elliott, this clause properly construed imposed on the sovereign debtor to treat all the bondholders with equal care and attention. Drawing on the affidavit submitted,[45] Elliott argued that under the *pari passu* clause, a sovereign debtor making payments to one class of bondholders, should be making comparable payments to other classes of bondholders.

Siding with the interpretation suggested by Elliott, the Court of Appeals approve the 'ratable payment' argument it had advanced and held that under the *pari passu* clause, the borrower should pay creditors on a ratable basis.. The Court held that "[i]t also appears from the basic agreement that governs the repayment of the foreign debt of Peru that the various creditors benefit from a *pari passu* clause that in effect provides that the debt must be repaid *pro rata* among all creditors. This seems to lead to the conclusion that, upon an interest payment, no creditor can be deprived of its proportionate share".[46]

The order enjoined Euroclear, for reasons of "absolute necessity", to instruct its Cash Correspondents "not to have any amounts credited to their accounts that originate from the Republic of Peru or Banco de la Nacion, including amounts designed to pay interest under the Brady bonds" and, in case such funds had already been received, "to instruct such Cash Correspondents to block such funds" and also "not to take any action that would result in such funds being distributed in any manner within the Euroclear system".[47]

Faced with the prospect of defaulting on its Brady Bonds, Peru apparently settled the case in order to avoid further damage. The ruling, which was never appealed, unleashed a flow of comments and served as catalyst for further litigation.[48]

B. The Congo : creditors vs. creditors

Another interesting case relates to the debt of the Republic of Congo (Brazzaville), which has also been targeted by creditors in recent years. Litigation was spawned in various jurisdictions

42 President of the Commercial Court of Brussels (unpublished opinion of 22nd Sept. 2006). The President denied the motion for lack of urgency.

43 The order was formally directed at Morgan Trust, who at the time operated the Euroclear system. Elliott had first obtained the exequatur of the US judgment ordering Peru to satisfy its obligations under the bonds.

44 E.g. « *The obligations of the Borrower hereunder rank at least pari passu with all its other unsecured obligations* ».

45 In particular a legal opinion submitted by Professor Andreas Lowenfeld, a reputable law professor with the New York University School of Law.

46 Opinion of the 8th Chamber of the Court of Appeal of Brussels at p. 3, as reported by L. C. Buchheit and J. S. Pam, "The Hunt for Pari Passu", *Intl. Fin. L. Rev.*, 2004, (20-26), 22.

47 The peculiar nature of the restraining order, which stayed clear from attaching assets, can be explained by the specific protection afforded under Belgian law to assets and cash held in the Euroclear system. See hereunder for more details.

48 See *infra* (Part II – section 1) on the current outlook of targeting payment flows.

in order to collect debts owed by the Republic.[49]

The case of Congo is interesting because creditors holding Congo debt resolutely went after non-traditional assets.[50] Instead of attempting to obtain payment on assets owned by the States, some creditors went after receivables owned to the State. This novel tactic was used by creditors, such as FG Hemisphere and Af-Cap, who attempted to attach and garnish royalty and tax obligations owed to Congo by companies involved in oil production projects in the country.[51] [52]

More notably, creditors launched attacks on other creditors. Inter-creditors litigation was a novel development in the field of sovereign debt. The argument made by the creditors was that funds were transferred by other creditors to the common sovereign debtor and that this violated the obligation of the debtor towards the creditor.

49 The case of Congo is also interesting in that private creditors attempted to uncover evidence of corruption and misappropriation of public funds by Congo's government officials, in particular the president, in an effort to demonstrate that this sovereign debtor did not deserve the deference traditionally granted to foreign sovereigns. In their efforts, private creditors seem to have passed much information to NGO's such as Transparency International. See the account by Sebastian Mallaby, “A Corrupt French Connection”, *Washington Post*, 13 March 2006.

50 It is also worth mentioning because it is in a dispute concerning Congo that the US courts have refined their approach to the commercial-activity exception to enforcement immunity enjoyed by foreign sovereign, placing much emphasis on how and for what purposes the assets of the foreign sovereign are used – see *Connecticut Bank of Commerce v. Republic of Congo*, 309 F.3d 240 (5th Cir.) and *Walker International Holdings Ltd. v Republic of Congo*, 395 F.3d 229 (5th Cir. 2004).

51 *Af-Cap, Inc. v. Republic of Congo*, 383 F.3d 361 (5th Cir. 2004) (the dispute focused on tax revenue and royalties to be paid to the sovereign debtor. The court had to decide whether these amounts constituted “commercial activity” and were hence subject to attachment because it was transferred to another creditor. The court found that payments by Texas oil companies were “used for a commercial activity” because they had been used by Congo to repay commercial debt located in the United States; garnishment was possible because the garnishee oil companies were located in the United States. The Court therefore held that the tax and royalty obligations were not protected by sovereign immunity). In Appeal, the Court dissolved the garnishment order, see *Af-Cap, Inc. v. The Republic of Congo et al.*, 462 F.3d 417 (2006) (5th Cir. 2006).
The same creditor also attempted to attach obligations owed to Congo by ChevronTexaco (*Af-Cap, Inc. v. Chevron Overseas (Congo) Ltd.*, 475 F.3d 1080 (9th Cir. 2007). The Court of Appeals dissolved the garnishments and liens after it found that ChevronTexaco’s obligations to Congo were not used for a commercial activity in the United States, upholding the narrow reading of the commercial activity-exception which had already been accepted by the 2nd and the 5th Circuit.
See also in the same vein *FG Hemisphere Associates v. République du Congo*, 455 F.3d 575 (5th Cir. 2006), another case in which the Fifth Circuit Court denied attempt by a judgment creditor of the Congo to satisfy its claim by executing upon the Congo’s right to receive royalty oil from petroleum exploration projects in the Congo. See also *Connecticut Bank of Commerce v. The Republic of Congo*, 309 F.3d 240 (5th Cir. 2002).
In all these cases, one of the issues was whether garnishment was possible. This required that the garnished property should be located in the United States. The determination was made difficult, at least in the case brought by FG Hemisphere, because the garnishees, who had been located in the United States when the proceedings were initiated, later reorganized their operations outside the United States and hence had no presence in the US. The court found that the determination of whether property is in the United States should be made at the time when the creditors attempt to garnish, not at the time suit was brought.

52 In another case, a creditor attempted to attach payments which two American airline companies were scheduled to make to Nicaragua for taxes collected and paid for flights to Managua (*LNC Investments, Inc. v. Republic of Nicaragua*, 2000 WL 745550 (S.D.N.Y. June 8, 2000). The Court dismissed the attachment because the taxes collected by the airline companies were immune under the FSIA.

This is how a creditor, Kensington, went after a French bank which had provided new money to Congo under loan agreements.[53] The Republic managed to repay what it owed to the bank, while it did not meet its payment obligations under the loan agreements in which the creditor had purchased an interest. The creditor brought proceedings in a state court in New York, seeking an order that the bank should pay it the USD 150 million owed by Congo. In addition, the creditor sought also treble damages. The claim was predicated on a violation of the *pari passu* clause included in the 1984 loan agreement on which the sovereign had defaulted. The creditor alleged that the fact that the bank had accepted payment under its loan agreement, while at the same time Congo remained in default under the older agreements, tortiously interfered with the creditor's rights under the *pari passu* clause. An initial case was dismissed on the ground of *forum non conveniens*.[54] In 2005, the creditor made a new claim before a federal court, this time based on the RICO (Racketeer Influenced and Corrupt Organizations) Act, alleging that SNPC, its former president (Mr Itoua) and the French bank had entered into oil trading operations and related financial arrangements which fraudulently prevented the creditor from obtaining payment of its claims against Congo.[55] [56]

The same French bank was also attacked by another creditor in France. This time, the tool used was something close to 'procedural harassment'. According to news reports, FG Hemisphere instructed its bailiff to make at least 30 attachments on the assets of the French bank. The purpose was apparently to cause the bank fails to comply with formal and substantial requirements applicable in case of third party garnishment. The creditor also attempted to obtain an order forcing the bank to disclose documents related to its dealings with Congo's national oil company, SNPC – apparently in order to buttress its liability claim against the bank.[57]

53 *Kensington International, Ltd. v. BNP Paribas S.A.*, Case No. 03602569 (Sup. Ct. N.Y. Co. 2003, unpublished opinion). The case is reported by L. C. Buchheit and J. S. Pam, "The Hunt for Pari Passu", *IFLR*, February 2004, (20), 22. The same creditor went after the Republic of Congo before the courts of England, see *Kensington International, Ltd. v. Republic of Congo*, 2002 Case No. 1088 (Commercial Ct. April 16, 2003), aff'd 2003 EWCA Civ. 709 (C.A. May 13, 2003).

54 Case No. 03602569 (Sup. Ct. N.Y. Co. 2003). The proceedings were brought against the French bank, but also against the national oil company of Congo and its former president.

55 In first instance, the US District Court for the Southern District of New York (Preska J.) denied SNPC's motions to dismiss the claim, holding that SNPC did not enjoy immunity under the FSIA and that the court had personal jurisdiction to hear the case (*Kensington, Int'l, Ltd. v. Société Nationale des Pétroles du Congo*, No. 05 Civ. 5101 (LAP) 2006 WL 846351 (S.D.N.Y. Mar. 31, 2006) (as reported by A. Feibelman, "Equitable subordination, fraudulent transfer and sovereign debt", 2007 *Law & Contemporary Problems*, vol. 70:171, at p. 190). In appeal, the Second Circuit found that Kensington's RICO action could not be heard because the commercial activity on which it was premised (i.e. the prepayment agreements concluded between the oil company and the bank), did not present a sufficient nexus with the United States and was not "based upon" any conduct by the defendants that either took place in the United States or caused a direct effect in the United States. Hence the commercial activities exception of the FSIA was inapplicable to SNPC : *Kensington Int'l Ltd. v. Itoua*, 505 F.3d 147, 156 (2d Cir. 2007).

56 It has been said that the proceedings brought against the French bank were "absurd" and that the creditor probably speculated on the general climate of "francophobia" in the United States (Report by Bernard Carayon, "A armes égales", Report to the French Prime Minister, sept. 2006, at p. 18 [available at *www.ladocumentationfrancaise.fr*]).

57 In first instance, the creditor obtained an injunction ordering the bank to disclose certain documents. The injunction was vacated by the Court of Appeal of Paris, which held that such an order would violate the duty of secrecy resting upon banks under French law (Court of Appeal of Paris, 14th Chamber, 1st of October 2004, N° 04/14118, *SA BNP Paribas v Société FG Hemisphere Associates*, Juris-data n° 2004-269749).

C. Argentina : a war of many battles

The Argentine default is the largest recent sovereign default.[58] The default of December 2001 covered more than USD 85 billion of debts, represented by more than 150 separate bond issues.[59]

It also attracts attention in that the sovereign debtor adopted a very aggressive stance vis-à-vis its creditors. It is therefore no wonder that these creditors massively went to courts. Reports indicate that more than 140 proceedings were launched by creditors.[60] The Argentine case is interesting in that creditors explored novel avenues to obtain judgment and payment. There were the classic proceedings in New York – with creditors first trying to obtain a judgment ordering Argentina to pay. The attempt by EML only stands out in this respect because of the amount involved. EML obtained a judgment against the Republic of Argentina for the amount in excess of USD 700 million.[61] Enforcing the judgment proved more difficult. Many attempts were fruitless.[62] Creditors have, however, not stopped their search and continue to make attempts to have their claims satisfied.[63]

58 See *ad generalia*, S. Schlemmer-Schulte, "Sovereign Debt: the Argentine Bonds Case", in *Frieden in Freiheit. Festschrift für Michael Bothe zum 70. Geburtstag*, A. Fischer-Lescano (ed.), Baden-Baden, Nomos, 2008, pp. 973 ff.

59 See for more details Rodrigo Olivares-Caminal, "Sovereign Bonds : a Critical Analysis of Argentina's Debt Exchance Offer", *J. Banking Regulation* (2008) 10 28-45.

60 EMTA Report Club de Paris : EMTA Preliminary Analysis of Creditor Litigation in the Non-HIPC Sovereign Debt Restructuring Context, May 2009, available at *www.clubdeparis.org*.

61 See *EM Ltd. v. The Republic of Argentina,* 382 F.2d 291 (2004). In first instance, the District Court for the Southern District of New York had awarded a summary judgment to EM in the amount of USD 724,801,662.56 : see *EM Ltd. v. Republic of Argentina,* 2003 WL 22120745 (S.D.N.Y. Sept. 12, 2003), amended by *EM Ltd. v. Republic of Argentina,* 2003 WL 22454934 (S.D.N.Y. Oct. 27, 2003). See also *NML Capital, Ltd. v. The Republic of Argentina*, 03 Civ. 8845 (TPG) USDC S.D. New York (May 11, 2006) and the proceedings brought by Lightwater : *Lightwater Corporation Ltd. v. Republic of Argentina No. 02* Civ. 3804, 2003 WL 1878420 (SDNY Apr. 14 2003) (granting summary judgment to the plaintiffs in respect of one bond issue and rejecting the sovereign's request for a stay of litigation to negotiate with creditors) and *Applestein v. Republic of Argentina*, No. 02 Civ. 1773, 2003 WL 1990206 (S.D.N.Y. Apr. 29, 2003).

62 Panizza & Co indicate that attempts were made "to attach the representation office of the province of Buenos Aires in New York, diplomatic facilities, U.S. accounts of Correo Argentino S.A. (the re-nationalized postal service), and— most significantly—USD 105 million in reserves held by the Central Bank of Argentina in New York". (U. Panizza, F. Sturzenegger, and J. Zettelmeyer, "The Economics and Law of Sovereign Debt and Default", 2009 *Journal of Economic Literature*, 47(3), 651-698, at p. 18). See *e.g. Michelle Colella et al. v. Republic of Argentina* 2007 WL 1545204 (N.D. Cal. May 29, 2007) (attempt to attach the Argentinian presidential airplane – the court held that as the airplane was used to transport the president of Argentina, it was immune).

63 In a recent attempt, a creditor attempted to attach assets held by the Argentine social security system ('*Administración Nacional de Seguridad Social*'), which had been nationalized by Argentina. A district court first allowed the creditor to attach a substantial amount held by the social security system in New York as part of a fund to meet pension obligations, holding that the waiver by Argentina of its sovereign immunity in bond documentation also applied in this case (*Aurelius Capital Partners. LP v. The Republic of Argentina*, 07-CIV-2715 (TPG) (S.D.N.Y. 2008)). The Second Circuit reversed and vacated the attachment, holding that the funds were immune under the FSIA, without resolving the parties' dispute about whether the Social Security Administration was a separate agency or instrumentality of Argentina (see *Aurelius Capital Partner, LP v. Republic of Argentina*, 584 F.3d 120 (2d Cir. 2009), *cert. denied* 130 S. Ct. 1691 (2010)). See also a further attempt by Aurelius to enforce against Argentina, this time on social security funds maintained in Argentina :

In one sophisticated attempt, some creditors went after the assets held by the Central Bank of Argentina at the Federal Reserve Bank of New York, which had been earmarked by Argentina to repay its IFM debt.[64] Although a district court first issued multiple *ex parte* orders of attachment and restraining orders directed to property of Argentina, including property held through the Central bank, the attachments and restraining orders were later vacated by the same district court.[65]

The Second Circuit agreed with the district court that funds allocated by Argentina for the early repayment of the IMF were immune from attachment, upholding the narrow interpretation of the 'used for' commercial-activity exception of the FSIA which had been pioneered by the 5th Circuit. It also held that the ability of the Republic to exercise some control over its central bank, did not mean that the ownership of the funds deposited with the Federal Reserve had changed to the Republic.[66] The Court further relied on the fact that the funds were likely to benefit from sovereign immunity, as the relationship between the IMF and Argentina was one “peculiar to sovereigns”.[67]

The same creditors also targeted the major exchange operation devised by Argentina to restructure its debt. The so-called *Cavalla* exchange was massive : it aimed to exchange the old, defaulted debt for new bonds, issued with a substantial discount. A majority of creditors tendered its 'old' bonds in.[68] Among the creditors who did not respond positively to the offer for exchange, some attempted to attach a number of the tendered 'old' bonds on which Argentina had defaulted. The creditors, argued that these bonds, which had been turned in by bondholders who had accepted the exchange and entrusted with the Bank of New York, which was in charge of carrying the exchange, were the property of the Republic of Argentina. The creditors justified this claim by reference to the fact that although Argentina did not yet have control over the bonds, it was entitled to received the bonds once the exchange was completed.

The creativity of creditors did not pay off : after issuing an *ex parte* attachment, the district court dissolved it.[69] In another case, a creditor sought to attach collateral which Argentina held with the New York Federal Reserve Bank as part of its Brady plan.[70] The motion for

Aurelius Capital Partners, LP v. Republic of Argentina 2010 WL 768874 (S.D.N.Y. Mar. 5, 2010).

64 *EM Ltd. v. Republic of Argentina*, 473 F.3d 463 (2d Cir. 2007) (cert. denied, 128 S. Ct. 109 (2007)).

65 *EM Ltd. v. Republic of Argentina*, Nos. 03 Civ. 2507, 03 Civ. 8845, 05 Civ. 2434, Order Vacating Attachments and Restraining Notices (S.D.N.Y. Jan. 24, 2006).

66 The Second Circuit Court noted that “To conclude otherwise would be to allow creditors of a foreign state to attach all of the assets of the state’s central bank any time the foreign state issues directives affecting the central bank’s reserves.” 473 F.3d 463, 475, § 34.

67 473 F.3d 463, 482-483. *Certiorari* was denied in this case – 552 U.S. 818 (2007).

68 76 % of the creditors accepted the invitation to trade in old bonds for newly issued bonds.

69 In appeal, the Second Circuit affirmed the ruling of the district court denying the attachment, noting that the district court's order was within its reasonable discretion. The Court also noted that “If these attachments [and restraints] are still in effect, we throw into doubt, to say the least, the conclusion of the exchange offer.” : *EM Ltd v. The Republic of Argentina*, 131 Fed. Appx. 745 (2d Cir. 2005). See the comments of B. Maiden, « Argentina ruling calls halt to holdout litigation » (2005) *Int'l Financial L. Rev. 6*.

70 *Capital Ventures Intl v. Republic of Argentina*, 443 F.3d 214 (2d Cir. 2006). In 1992, Argentina negotiated the restructuring of a large part of its commercial debt using the Brady scheme : it exchanged old unsecured bonds for new bonds (the 'Brady Bonds'), which were secured by collateral owned by Argentina and held in

attachment was denied by the district court, which found that the attachment would be moot because there was no property interest attachable. The court was also concerned that the attachment might disrupt the marketplace during Argentina's exchange offer.[71]

While other creditors also attempted to target the exchange operation,[72] another avenue was explored. It involved using the class action mechanism. A first attempt to constitute a class was rejected by the courts on the ground that the class was not sufficiently defined.[73] Subsequently the court certified a greatly reduced class.[74] Other courts also certified classes of plaintiffs in litigation brought against Argentina.[75] This led to novel questions relating among others to the possibility to certify a class while accepting that damages may have to be ascertained on an individual basis.

Finally, some individual creditors undertook actions against Argentina using the investment protection mechanism offered by ICSID. Several proceedings were brought by individual

New York (so-called 'Brady collateral', which consisted of US Treasury and German bonds).

71 In appeal, the Second Circuit reversed and allowed the attachment, holding that there was no risk of creating any confusion since the exchange offer had been carried out. The Second Circuit court also noted that while much of the collateral the creditor sought to attach had been used to pay the tendering bondholders, the creditor still had a right to attach the remaining collateral held in New York. The creditor also attempted to obtain a judgment on the merits against Argentina, see *Capital Ventures Intl v. Republic of Argentina*, 280 Fed Appx. 14 (2d Cir. 2008) and *Capital Ventures Intl. v. Republic of Argentina*, 552 F.3d 289 (2d Cir. Jan. 13, 2009) (in this ruling, the Second Circuit Court addressed the issue of the scope of the sovereign immunity waiver inserted by Argentina in the documentation of German bonds it had issued. The Court found that to be "explicit" as required by the FSIA, a waiver of sovereign immunity need not contain a reference to the United States or a specific jurisdiction in the US, as Argentina had argued. A waiver of immunity in "any court" is sufficient according to the Court).

72 See *Rabbi Jacob Joseph School v. Province of Mendoza*, 425 F.3d 207 (2d. Cir. 2005) (a school, which held bonds issued by the Province of Mendoza, attempted to prevent the Province from accepting Argentina's offer to exchange existing bonds for new ones). The same province was involved in similar litigation initiated by another creditor : *Greylock Global Opportunity Master Fund Limited and Greylock Global Distressed Debt Master Fund Ltd. v. Province of Mendoza*, 2004 WL 2290900 (S.D.N.Y.); *Greylock Global Opportunity Master Fund Ltd. v. Province of Mendoza,* 2004 WL 2515351 (S.D.N.Y.); *Greylock Global Opportunity Master Fund Ltd. v. Province of Mendoza* 2006 WL 140576 (2d. Cir. Jan. 18, 2006).

73 *HW Urban v. Argentina*, N 02 Civ 5699 (TPG) (SDNY). One of the issues discussed by the court was whether the class should include citizens of the Republic of Argentina. See. W. Debevoise et D. Orta, « The Class Action Threat to Sovereign Workouts », (2003) *Intl. Financial L Rev*., 41 and B. Maiden, « Class action threat recedes as Argentina completes debt swap », 24 *Int'l Fin. L. Rev.* 6 (2005).

74 See *H.W. Urban GmbH v. Republic of Argentina*, No. 02 Civ. 5699, 2004 WL 307293 (S.D.N.Y. Feb. 17, 2004) (certifying a class of creditors suing the sovereign). In the same proceedings, see *H.W. Urban GmbH Individually and on Behalf of All Others Similarly Situated v. Republic of Argentina* 02 Civ. 5699 (TPG) USDC S.D. New York (March 11, 2004) (bringing some small changes to the class) and *H.W. Urban GmbH, individually and on behalf of All Others Similarly Situated v. The Republic of Argentina*, 02 Civ. 5699 (TPG) USDC SDNY (March 9, 2006) – granting in part summary judgment as sought by the plaintiffs.

75 See most notably *Seijas v. Republic of Argentina*, 606 F.3d 53 (2d Cir. 2010) – the Court for the Second Circuit affirmed the District Court's decision which had certified a class of plaintiffs suing Argentina over the defaulted bonds. It, however, reversed the district court's method of calculating damages, holding that calculating the aggregate damages could lead to damage inflation. The Court therefore preferred individualized relief as opposed to aggregate, class-wide relief. After the District Court had entered a USD 2.2. billion judgment against Argentina, the plaintiffs attempted to attach the assets of Aerolineas Argentinas, an Argentina airline company which had been nationalized in 2008. The district court held, however, that the the company was not the alter ego of Argentina and therefore denied the plaintiffs' motion to turn over the airline's US assets.

bondholders before arbitration tribunals under the ICSID mechanism against Argentina. These proceedings are currently underway.[76] They offer a new challenge to the ICSID mechanism, not the least because of the number of individual investors who participate in the proceedings.[77]

After this brief survey of the rapidly changing landscape of sovereign debt litigation, it is now time to review the actions undertaken at various levels to curtail the activities of sovereign debt creditors.

76 In the case of *Giovanna a Beccara et al. v. Argentina* (ICSID Case No. ARB/07/5), several procedural orders have already been issued. In the case of *Giordano Alpi and others v. Argentine Republic* (ICSID Case No. ARB/08/9), which was filed in July 2008, the arbitral tribunal has likewise issued several orders on procedural issues such as production of documents. In the case of *Giovanni Alemanni and others v. Argentine Republic* (ICSID Case No. ARB/07/8), the proceedings were suspended in May 2010 pursuant to the parties' agreement.

77 See in general, the comments by M. M. Waibel, « Opening Pandora's Box : Sovereign Bonds in International Arbitration », *Am. J. Intl L.*, 2007, 711-759; Karen Halverson Cross, « Arbitration as a Means of Resolving Sovereign Debt Disputes », *Am Rev Intl Arbitration* 2006, 335-382 and W. Burke-White, « The Argentine Financial Crisis: State Liability under BITs and the Legitimacy of the ICSID System” in *The Backlash against Investment Arbitration*, M. Waibel (ed.), Kluwer, 2010.

SECTION 2 – SOVEREIGN DEBTORS FIGHT BACK : TARGETING THE 'VULTURES'

In recent years the activities of sovereign debt creditors have attracted much attention. The radical changes in the structure of sovereign debt holding has made it more difficult to restructure such debt in case of difficulty. Further, it seems that sovereign debt litigation is on the rise. As a result, various calls have been made to curtail the freedom of individual bondholders and creditors of sovereign.

Some of these initiatives aimed at the rights and actions of individual creditors in general, without distinguishing between various categories of investors. As on previous occasions where sovereign debt was discussed,[78] a first initiative suggested the creation of an institutional mechanism to deal with sovereign debt restructuring, which would achieve something close to corporate debt restructuring. As is well known, the idea of creating an international mechanism for restructuring sovereign debt launched by Ms Kruger, did not produce any results.[79]

The other avenue proved more fruitful : instead of creating an international 'tribunal' for sovereign debt disputes, many States have followed the idea of adapting the contractual documentation of their sovereign issues to facilitate restructuring. The introduction of collective action clauses in the legal documentation of sovereign bond issues has been extensively documented and discussed.[80]

Our focus is on initiatives of another nature, which aim specifically at creditors deemed to be less worthy of protection, often referred to as 'vulture funds'. Although a widely accepted definition of vulture funds is hard to craft,[81] this phrase is usually used in connection with investment funds which have bough sovereign debt on the secondary market for a fraction of its face value.

Pushed in part by a very active civil society, some countries have examined the possibility of

78 It has been reported that even Adam Smith had indicated the need to create a bankruptcy regime for States analogous to that applicable to corporate debtors – see the references in J. I. BLACKMAN and R. MUKHI, “The Evolution of Modern Sovereign Debt Litigation : Vultures, Alter Egos and Other Legal Fauna”, *Law & Contemp. Problems*, 2010, vol. 73, (47), 48, note 6. On the evolution of ideas in this field, see KENNETH ROGOFF and JEROMIN ZETTELMEYER, “Bankruptcy Procedures for Sovereigns : A History of Ideas 1976-2001”, IMF Staff Papers, vol. 49/3, 2002.

79 See ANNE O. KRUGER, “A New Approach to Sovereign Debt Restructuring Process”, IMF, April 2002 and IMF, *The Design of the Sovereign Debt Restructuring Mechanism – Further Considerations*, Nov. 2002. The IMF had undertaken work on the topic well before 2002, see in particular its 'Note on an International Debt Adjustment Facility for Sovereign Debtors', EBS/95/90, May 1995 and the paper 'Orderly and Effective Insolvency Procedures, Key issues', 1999. See on this initiative ad generalia M. DABROWSKI, A. FISCH, K. GABRIEL and C. LIENKAMP (eds.), *Die Diskussion um ein Insolvenzrecht für Staaten. Bewertungen eines Lösungsvorschlages zur Überwindung der Internationalen Schuldenkrise*, 2003, Duncker & Humblot, 303 p. and CH. PAULUS, “Some Thoughts on an Insolvency Procedure for Countries, *Am. J. Comp. L.* 2002, vol. 50, 531 ff. and SEAN HAGAN, “Designing a Legal Framework to Restructure Sovereign Debt”, *Georgetown J. Intl. L.*, 2005, vol. 36, 299 ff.

80 See hereinafter Part II – section 1 for more details.

81 See the attempt in the US bill discussed hereinafter : according to section 3.2, the term 'vulture creditor' means “ any person who directly or indirectly acquires defaulted sovereign debt at a discount to the face value of the obligation so acquired...”.

introducing specific legislation curtailing the rights of such sovereign creditors. As of now, only individual States seem to have undertaken action. Although some of the initiatives discussed at national level to curtail the actions of so-called vulture funds, were not (yet) adopted, it is worth also reviewing them one by one in order to identify their key features.

A. Two aborted attempts : France and the United States

1. A first attempt in France

A first country where the actions of 'vulture' funds was put on the agenda is France. In August 2007, a bill was introduced in Parliament, whose aim it was to "*lutter contre l'action des fonds financiers dits 'fonds vautours*'".[82]

This text was modeled on the French version of the Champerty Act : while Article 1699 of the French Civil Code gives the debtor of a 'litigious' [83] right the possibility to be released from the debt by reimbursing the assignee for the actual price of the assignment, together with the expenses, fair costs and interests,[84] the proposed legislation would grant the French judge discretionary power to order or refuse to order payment of a debt owed to a creditor of a foreign sovereign.[85] This discretion, quite unusual for the French tradition, was only curtailed by the need for the court to take into account the "measure in which the foreign sovereign has been helped by public sources, the efforts undertaken by other creditors and the possibilities of the debtor".[86]

Going even further, the same text provided that courts should deny any request to order payment of sovereign debt - whether the request is put directly for a French court or made on the occasion of a request for enforcement of a foreign judgment - when it appeared that the debt was acquired by a party "speculating on possible litigation which could be introduced against the debtor, and not so much taking into account the market value of the debt".[87]

82 It had already been introduced in June 2006 (bill nr. 3214).

83 According to Art. 1700 of the Code, "*La chose est censée litigieuse dès qu'il y a procès et contestation sur le fond du droit*" (translation : " A matter is deemed litigious as soon as there is a case and controversy as to the merits of the right").

84 Art. 1699 reads as follows : A person against whom a litigious right has been assigned may have himself released by the assignee by reimbursing him for the actual price of the assignment with the expenses and fair costs, and with interest from the day when the assignee has paid the price of the assignment made to him / "*Celui contre lequel on a cédé un droit litigieux peut s'en faire tenir quitte par le cessionnaire, en lui remboursant le prix réel de la cession avec les frais et loyaux coûts, et avec les intérêts à compter du jour où le cessionnaire a payé le prix de la cession à lui faite*".

85 Unlike in the regime of Article 1699, the discretionay power granted to the court would apply even when the underlying debt is not 'litigious'.

86 The bill would introduce an art. 1701-1 in the Civil Code, reading as follows : "*Lorsque le cessionnaire d'une créance née à raison d'une activité autre qu'industrielle et commerciale sur un État souverain ou l'un de ses établissements publics bénéficiant, sous quelque forme que ce soit, y compris d'abandon ou de différé de paiement, d'une aide financière consentie par l'État, l'un de ses établissements publics, ou toute institution internationale à laquelle appartient la France, en poursuit le recouvrement devant un tribunal français, le juge ne fait droit à la demande que dans la limite qu'il estime satisfaisante compte tenu de l'aide consentie par la collectivité publique, des efforts des autres créanciers, et des facultés du débiteur. Les dispositions ci-dessus sont applicables devant toute juridiction.*"

87 "*Il ne peut être prononcé aucune condamnation ni donné aucun effet en France à un jugement étranger*

This Bill, which was justified by the need to prevent actions of 'holdout creditors' undermining the efforts of the French State in helping poor countries by canceling their debt, has never been taken up by Parliament.[88]

2. The US Congress and vulture funds

In June 2009, draft legislation was also introduced in the United States Congress targeting sovereign debt creditors.[89] The Bill, which is known as the 'Stop Vulture Funds-Bill',[90] is an attempt to limit the possibility for creditors of defaulted sovereign debt, to collect through litigation and seizure of assets payment of defaulted debt in amounts which exceed the amount paid to acquire the debt.

In order to do so, the bill first makes it “unlawful” for all citizens and corporations established in the United States to engage in “sovereign debt profiteering”, a prohibition which is made hard by fines. Sovereign debt “profiteering” is defined in the bill as the action of seeking the payment of a sovereign debt for a total which exceeds the amount paid by the creditor to acquire interest in the defaulted sovereign debt.[91]

Further and more significantly, the bill also short-circuits any attempt by sovereign debt creditor to obtain a judgment from US courts. These courts are indeed prevented from issuing judgment or allowing attachment “a purpose of which would be furthering sovereign debt profiteering”.[92] In order to give more teeth to this prohibition, the proposed legislation requires extensive disclosure from creditors seeking a judgment against a sovereign debtor. A

prononcé contre un débiteur visé à l'alinéa précédent ni procédé à aucune voie d'exécution lorsqu'il apparaît au vu des circonstances que l'acquisition de la créance procède d'une spéculation sur les procédures susceptibles d'être intentées contre le cédé et les tiers et non sur la valeur de marché de la créance et son évolution”.

88 The topic is from time to time taken up in parliamentary discussions, without any practical effect – see *e.g.* the discussions following the presentation of a special report on the effectiveness of development aid by Ms Henriette Martinez (Commission des affaires étrangères, Compte-rendu, 4 November 2009, Nr. 14). See also the question raised by Ms. Christine Taubira, Nr. 63227 (published in the *Official Journal* of 13 April 2010, at p. 4206).

89 Bill nr. HR 2932, introduced by Congresswoman Maxine Waters on 18 June 2009.

90 The full title reads : “To prevent speculation and profiteering in the defaulted debt of certain poor countries, and for other purposes”. The acronym 'Vulture Funds' is defined as “Stop Very Unscrupulous Loan Transfers from Underprivileged Countries to Rich, Exploitive Funds” (Section 1 – 'Short Title').

91 According to Section 3-4, “The term ‘‘sovereign debt profiteering'' means any act by a vulture creditor seeking, directly or indirectly, the payment of part or all of defaulted sovereign debt of a qualified poor country, in an amount that exceeds the total amount paid by the vulture creditor to acquire the interest of the vulture creditor in the defaulted sovereign debt (excluding any amount paid for attorneys' fees or other fees and costs associated with collection), plus 6 percent simple interest per year on the total amount, calculated from the date the defaulted sovereign debt was so acquired, but the term does not include the purchase or sale of such a debt, or the acceptance of a payment in satisfaction of the debt obligation, without threat of, or recourse to, litigation.”

92 Section 5 of the bill is entitled “Prohibition on Use of Courts of the United States to Further Sovereign Debt Profiteering”. It reads as follows : “A court in or of the United States may not issue a summons, subpoena, writ, judgment, attachment, or execution, in aid of a claim under any theory of law or equity a purpose of which would be furthering sovereign debt profiteering”.

key requirement is that the creditor must file an affidavit under oath including a "statement of the total amount paid by all persons, directly or indirectly holding an interest in the claim against the foreign state, to acquire the interest, including the date the interest was acquired and the identity of any person from whom the interest was acquired".[93]

The bill was never discussed or adopted by Congress.

B. The English strike : the Debt Relief (Developing Countries) Act 2010

In England, a first limited attempt to interfere in the relations between sovereign debt creditors and debtors was made in May 2009, when a bill was presented in Parliament the aim of which was to restrict the possibility to attach funds earmarked for developing countries.[94] The *Developing Country Debt (Restriction of Recovery) Bill*, which was in part prompted by the outcry which followed the decision of the English Court in *Donegal International Ltd. v. Republic of Zambia*,[95] focused on the recovery of the defaulted sovereign debt of developing countries.

Specifically, the Bill aimed to limit the maximum recoverable amount to that initially paid for the debt, plus interest or charges. It introduced reporting requirements, with institutions requiring UK courts' permission before recovery proceedings for defaulted debt can begin. It would finally require a vulture fund to declare payments or gifts given by it or its colleagues to the developing country's Government. This Bill was dropped by its sponsor MP.

Another Bill was introduced in September 2010. Its aims were similar, i.e. target holders of sovereign distressed debt. It proceeded, however, differently to achieve this aim. The Bill, which was discussed and accepted by Parliament and became law in April 2010, focuses on countries eligible (or potentially eligible) under the Heavily Indebted Poor Countries Initiative (the 'HIPCI').[96] The thrust of the act is that it prevents creditors from recovering an amount in

93 This language is part of Section 5(b) entitled "Disclosures Required in Actions Involving Collection of Sovereign Debt". The same section requires other disclosures from the sovereign creditor. The latter should for example provide a statement that "written notice of the claim against the foreign state has been provided to the Department of Treasury" (section 5(b) (1). As in the proposed legislation in the UK, the Bill also requires that the creditor provides information on the identity of the persons who are behind the creditors (section 5(b)(3)(A)) and on the total amount paid by the creditor in order to acquire the interest in the sovereign debt (section 5(b)(3)(B)).

94 The *Developing Country Debt (Restriction of Recovery) Bill* was introduced in the House of Commons by Sally Keeble MP on 6 May 2009.

95 *Donegal v Zambia*, [2007] EWHC 197 (Comm.). This involved a dispute between Donegal, a company incorporated in the British Virgin Islands, against Zambia, following the acquisition by Donegal of debt which originally arose from a US$ 15 million loan made in 1979 by Romania to Zambia to cover the puchase of agricultural equipment. Zambia had defaulted on this loan. The debt was bought for less than 20 % of its face value. After litigation was initiated by Donegal against Zambia, parties reached a settlement under which Zambia greed to pay US$ 15 million and additional interest payments. Following Zambia's failure to meet its obligations under this settlement agreement, Donegal instituted proceedings in England. Although it found that some provisions of the settlement agreement could be void, the High Court ordered Zambia to pay US$ 15 million. For more details on this case, see the account of Adesegun Akin-Olugbade, "The Donegal Case and the African Legal Support Facility", in *International Monetary and Financial Law. The Global Crisis*, M. Giovanoli and D. Devos (eds.), OUP, 2010.

96 The HIPC Initiative is an initiative based on proportionate burden sharing, aiming at reducing the debt of the

excess of the amount which would be consisted with the Initiative. In order to do so, the Act reduces the amount recoverable on a debt, taking into account the relief which the foreign sovereign is or would be entitled under the Initiative.[97] This is by far the most sophisticated attempt thus far to target specifically vulture funds. The Act, which does not apply to debt incurred after it becomes effective,[98] is noteworthy because it includes provisions which aim to foster negotiated settlements.[99] It carefully defines the sovereign debt which benefits from the privileged treatment - excluding for example debt which has been incurred to pay for goods and services.[100]

The Act was adopted after a public consultation.[101] It was heavily debated in Parliament, with strong lobbying notably from the Jubilee Campaign [102] and from London's financial sector. During discussions in Parliament, a sunset clause was added to the bill, to the effect that the bill would only remain in force for a year, unless renewed. This was apparently part of a compromise between parties involved.[103]

C. The Belgian strike against vulture funds

In Belgium, Parliament became concerned about the activity of 'vulture funds' in 2007. During that year, the Senate adopted a non binding resolution calling for limitation to be brought to the activities of 'vulture funds'.[104] The main concern behind the resolution was the fact that holdout creditors could circumvent multilateral efforts geared towards reduction or cancellation of debts of very poor countries.[105] More specifically, the senators were concerned that money earmarked by the government for development aid projects, mainly in the

poorest countries. See L. F. GUDER, *The Administration of Debt Relief by the International Financial Institutions. A Legal Reconstruction of the HIPIC Initiative*, Springer, 2009, 358 p.

97 The Act defines with great precision the "relevant proportion", i.e. the reduction in the amount of a debtor's obligations. This reduction is derived from the reduction achieved under the Initiative. Section 4 subsection 3 contains a rule for countries which have not yet reached the so-called 'Decision Point' under the Initiative. For those countries, the Act requires a reduction of 33 % to be applied.

98 See section 1(1)(3) – definition of a 'qualifying debt'. See also the caveat in section 1(4).

99 A sovereign debt creditor which has reached an agreement with a debtor to reduce the latter's debt, will undergo a more limited reduction of his interest. The reduction will be calculated not on the amount of the debt outstanding, as reduced by the agreement between parties, but on the facial value of the debt (section (3), subsections (3) and (4)).

100 Section 2 (3) (a) provides that "Debt" does not include "a liability to pay for goods or services that arose on the delivery of the goods or the provision of services".

101 See HM Treasury, Ensuring effective debt relief for poor countries : a consultation on legislation, July 2009 (available at *www.hm-treasury.gov.uk/consult_debt_relief.htm*).

102 See *www.jubileedebtcampaign.org.uk/?lid=2893*.

103 The Act is due to expire on 8 June 2011. It is unclear whether it will be renewed or replaced by more permanent legislation. The Coalition Agreement signed in May 2010 by the new English government led by Mr David Cameron indicated that "We will review what action can be taken against 'vulture funds'". (at p. 22)

104 Proposal "*visant à limiter l'impact des 'fonds vautours" sur l'allégement de la dette des pays du tiers monde*", Senate, Nr. 4-244, introduced on 5 October 2007 by Mr. Paul Wille. Another proposal with the same title was introduced on 18 April 2007 (Senate, Nr. 3-2414).

105 The Resolution noted that : "*Ce qui gêne principalement les auteurs de la présente proposition dans ce jugement, c'est qu'il mette en évidence le fait que certains créanciers privés véreux contournent les conventions internationales conclues en matière d'allégement de la dette alors que les gouvernements occidentaux oeuvrent enfin à l'allégement et à la remise des dettes*".

DRCongo, had been seized by creditors, thereby putting these projects on hold.[106] The resolution mainly called the Belgian government to adopt measures to avoid that holdout creditors could benefit from debt cancellation or restructuring in favor of HIPIC countries.[107] During the discussions in the Senate, it was already accepted that Parliament should go further and introduce specific legislation.[108]

A bill was introduced early in 2008. It differed from the French proposal in that it was much more focused. The Act, adopted on 6 April 2008 [109] introduces a specific provision in the Act of 25 May 1999 which organizes a legal framework for the development aid cooperation of Belgium. The new provision reads as follows : "the funds and assets which are earmarked for international cooperation as well as the funds and assets earmarked for public development aid, other than those of the international cooperation, cannot be attached nor assigned".[110] Another provision covered loans made by Belgium to foreign countries and institutions. It reputed such loans as unattachable and unassignable.[111]

Although the Bill was introduced following attempts by a hedge fund to seize money promised by Belgium to a developing country, it appears that the bill also followed attempts by private creditors to attach these amounts.

During the discussions, a proposal was made to sharpen the law. One MP suggested to make impossible for the National Export Credit Insurance Office to sell or transfer receivables when the debtor is a 'developing country'.[112] This amendment was, however, not adopted.

The law, which only attracted few commentary,[113] did not solve all issues as it only applied for court proceedings introduced after its entry into force. The Minister of Finance as confirmed that even after the law was adopted, several disputes were still pending concerning amounts

106During the discussions in the Senate Commission, reference was made to attachment by creditors of a loan granted by Belgium to Congo Brazzaville, which could not go through due to the attachment.

107The resolution called the government to "*mettre tout en œuvre pour éviter que les bénéfices des rééchelonnements de dette et/ou des programmes de remise de dette instaurés au profit des « pays pauvres très endettés » (PPTE), tels que définis par le FMI et la Banque mondiale, en raison tant des accords bilatéraux que des conventions internationales, ne puissent tomber dans l'escarcelle des fonds vautours, notamment en prévoyant les clauses nécessaires pour pouvoir épuiser toutes les possibilités existantes sur le plan international et juridique*".

108Report of the Commission of Foreign Affairs and Defence by Ms Zhiren, nr. 4-244/3, 15 January 2008, at p. 12-13.

109Act of 6 April 2008 "*visant à empêcher la saisie ou la cession des fonds publics destinés à la coopération internationale, notamment par la technique des fonds vautours*" (published in the *Moniteur belge*, on 16 May 2008).

110Article 11bis reads as follows : "*Les sommes et les biens destinés à la coopération internationale belge ainsi que les sommes et les biens destinés à l'aide publique belge au développement - autres que ceux relevant de la coopération internationale belge - sont insaisissables et incessibles*."

111"*Les montants des prêts consentis en application de l'alinéa 1er sont insaisissables et incessibles*".

112The amendment read as follows : "*Lorsque ces opérations concernent des créances sur des pays en voie de développement, conformément à la définition et à l'extension accordée par ce concept par le programme des Nations unies pour le Développement, ces créances ne sont pas cessibles. » (Doc. Parl.*, Senate,15 January 2008, nr. 4-482/2)

113See mainly A. HANSEBOUT, "De wet van 6 april 2008: over onbeslagbaarheid en aasgierfondsen", *Rechtskundig Weekblad*. 2008, 595-597.

earmarked for development aid.[114]

The initiatives undertaken by States which have been reviewed so far, lack the power and incisiveness of concerted, negotiated initiatives.[115] It may be that other countries will follow suit and also adopt measures. Certainly, if the United States which remains a prime forum for defaulted sovereign debts litigation, were to adopt measures, such as the ones which were introduced before Congress, this would have a tremendous impact – even though experience has shown that when it comes to enforcing judgments obtained in the US, sovereign debt creditors were almost always forced to look for assets outside the United States. Hence, measures adopted by individual States will not have the same force as a truly coordinated intervention.

Until now, the international community has not moved towards adopting stringent measures aimed at taming the so-called 'vulture funds'. The only initiatives which have been undertaken at the multilateral level are non binding resolutions – such as the Resolution adopted by the Paris Club in May 2007, in which the Club expressed its concern about the action of litigating creditors, noting that they 'free ride' on the debt cancellation granted by other creditors and thus divert resources from poverty reduction expenditures in the debtor country.[116] At most, these declarations will raise awareness of the issue among the countries concerned, which may therefore refrain from selling debts they owe to distressed-debts ventures.[117] On the regional level, one should also note that legal debt clinics have been set up, with a view to

114Parliamentary question nr. 4-728 of 23 April 2009 of Mr Paul Wille, Senate of Belgium.

115An additional question which is raised by the national interventions, relates to their scope of application. It may indeed be wondered what consequences, if any, the various national legislations will have outside their home jurisdictions. In so far as the legislation prohibits or otherwise impose limitations to courts seized of a claim made by a sovereign creditor, it is submitted that such limitations may only have effect for the jurisdiction concerned. Even though some countries are prepared to give effect to foreign mandatory rules, it seems quite unlikely that a court outside England will reduce the claim filed by a sovereign creditor as imposed by Debt Relief Act. In fact, it is quite likely that this Act does not seek to have any effect outside the UK. The fact that the Debt Relief Act is said to operate even if the debt is subject to the law of another country (section 3(9) of the Act), does not change this result. Likewise, it is unlikely that when seized of a request to authorize an attachment, a court located outside Belgium will give any effect to the special status of assets earmarked for cooperation under the Belgian Act. To rule otherwise, would be to give effect to what is in essence a very political decision by Belgium. See on these various issues, submission by Jonathan Nash, QC and Peter Ratcliffe, HM Treasury consultation, 'Ensuring effective debt relief for poor countries', February 2010, at § 15-26).

116In furtherance of this resolution, Paris Club creditors have confirmed that they are committed to avoid selling their claims on HIPCs to other creditors who do not intend to provide debt relief under the HIPC initiative (more details available at *www.clubdeparis.org/sections/themes-strategiques/2009-8217-action-du-club*). See further the declaration by the Member State of the European Union, which have pledge to take action to "deter aggressive litigation by distressed-debts funds" and agreed not to sell claims on HIPCs to creditors who are not willing to provide debt relief – Council of Europe, conclusions of the 2870th External Relations Council Meeting, 26 and 27 May 2008 – 'Speeding Up Progress Towards the Millenium Development Goals', at § 41 - *http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/gena/10688.pdf*.

117As has been done by the Finance Ministers of the Commonwealth following their meeting in October 2008 – see the Commonwealth Finance Ministers Meeting Communiqué 2008 at § 13, where it is stated that the Ministers "[r]ecognised the importance of Commonwealth creditors leading by example by providing full HIPC relief and not selling claims onto other creditors" (*www.thecommonwealth.org/document/184212/commonwealth_finance_ministers_meeting_communiq.htm*).

provide advice to countries facing litigation by creditors.[118]

It is now time to wonder whether the international community should indeed move in to rein so-called 'vulture funds'.

* * *

118See the so-called 'African Legal Support Facility' which was set up by the Inter-African Development Bank to provide technical legal assistance to indebted countries faced with claims made by so-called vulture funds. According to Article 1 of the Agreement by the members of the Bank, the Facility aims to "To provide legal advice and services to African countries in creditor litigation" and to "provide technical legal assistance to African countries to strengthen their legal expertise and negotiating capacity in matters pertaining to debt management and litigation". The Commonwealth also established a 'Legal Debt Clinic' in sept. 2006 – *www.thecommonwealth.org/Internal/140503/157583/legal_debt_clinic*. The IDA Debt Reduction Facility has also adapted its policy in April : it no longer considers eligible for buy-back debts sold to commercial creditors after the HIPC decision-point reference date, in order to prevent 'vulture' funds to tender these claims to the Facility.

Part II. Sovereign debtors and creditors : an appraisal

The rise of sovereign creditor litigation and the advent of so-called 'vulture funds' which has been documented in the previous section, could be shrugged off as the logical consequence of the modernization by States of their debt management : the insistence on liquidity, the creation of secondary markets and the dissemination of sovereign debts explain to a large extent the increased role of individual creditors. Complaints by sovereign debtors have, however, been heard, in part thanks to the continued efforts of the civil society and in particular the debt relief movement. It must be said that the case of 'rogue' creditors is a difficult one to make. One does not need, indeed, to be a pr-maverick to present actions by these creditors in the well known format of the 'good' and the 'bad' – with the latter using vehicles incorporated in exotic jurisdictions to acquire sovereign debts at large discounts and often hiding the name of the investors behind the vehicle.[119]

The apparent obviousness of the arguments against creditor litigation should not prevent, however, a close examination of the various initiatives adopted recently to curtail individual bondholders' rights. After all, such limitations entail a significant breach of a fundamental principle of contract law, i.e. that contracts should be enforced and debt paid. Breaching this fundamental principle requires sound justification, as it modifies the equilibrium between the parties.

In order to inquire whether such limitations are necessary and justified, one should take into account the many interests at stake : those of the bondholders, of the sovereign States, or more generally wider welfare considerations. In a first section we will examine the impact of creditor litigation, in particular in the light of recent developments. We will then turn to international legal standards, in particular those protecting property rights, to offer an appraisal of the legislation recently adopted in Belgium and the United Kingdom.

Section 1 – The case against limiting creditors' rights : from a significant obstacle to a significant nuisance

At first sight, the fight between a sovereign debtor in default and private investors does not seem balanced. Here is a poor or very poor country trying to allocate its meager resources among its population in need, faced with a savvy investor who has bought debt on the secondary market at a heavy discount in the hope of achieving a extraordinary return rate with the help of the best lawyers in town, using tactics which have been characterized as “legal harassment”.[120] What could be wrong with a few national measures clipping the wings of those 'vultures'?

119In an early case, a US court dismissed a claim brought by a sovereign debt creditor because of the failure by the fund to disclose the identity of its principal – see *Water Street Bank & Trust Ltd. v. Republic of Panama* 1995 WL 51160 (S.D.N.Y. Feb. 8, 1995).

120U. Panizza, F. Sturzenegger, and J. Zettelmeyer, “The Economics and Law of Sovereign Debt and Default”, 2009 *Journal of Economic Literature*, 47(3), 651-698, at p. 25.

This picture is, however, by far too sketchy. A close examination reveals that it is difficult to identify David from Goliath in the fight between private investor and sovereign debtor. One should in particular question the picture of almighty private creditors whose aggressive litigation may derail the orderly restructuring of sovereign debt.

In order to understand the relative weight of creditor litigation, one should start from a brief review of the economics of sovereign debt. The right of creditor to seek judgment against a debtor in case of default and to collect, is an essential part of the modern thinking on enforcement of contractual promises. In classic economic literature, enforcement rights have indeed been seen as a deterrent of opportunistic defaults by debtors, alongside with other remedies.

Classic theory indeed goes that sovereign debtors may be checked by two major tools : creditors litigation, whereby creditors attempt to enforce contractual rights, and market access.[121] The latter idea presumes that if a sovereign defaults, it may find it difficult to regain access to primary capital markets in order to obtain 'new' money.[122] The limitations imposed to

121 Among the other possible reasons why sovereigns pay their debts, the use of force (so-called 'gunboat diplomacy') only has historical value – see J. BASDEVANT, « L'action coercitive anglo-germano-italienne contre le Vénézuela », *Rev. gén. dr. int. public*, 1904, 362-458. Other explanatory models include the fear of capital flight and associated output losses, which may be so severe that it triggers a sovereign to pay its debts – see P. GAIA, S. HAYES & H. S. SHIN, « Crisis costs and debtor discipline : the efficacy of public policy in sovereign debt crises », *J. Intl Economics*, 2004, vol. 62, 245-262.

122 This is the 'reputational sanction', whose role has been stressed by Eaton and Gersovitz in their seminal paper (J. EATON and M. GERSOVITZ, "Debt with Potential Repudiation : Theoretical and Empirical Analysis", *Rev. Economic Studies*, 1981, vol. 48(2), 289-309). Commentators have since long demonstrated that the analysis of Eaton and Gersovitz suffered from certain flaws. Eaton and Gersovitz started for example from the assumption that a sovereign debtor could be excluded permanently from financial markets, an assumption which ignored the benefits which both the sovereign debtor and potential creditors could derive from providing the debtor with new money, even after a default. As noted by Panizza & Co., "a lending equilibrium sustained by the threat of a permanent embargo on future lending is not renegotiation-proof, in the sense that after a default both parties potentially benefit from reaching a new agreement involving positive lending" (U. PANIZZA, F. STURZENEGGER, and J. ZETTELMEYER, "The Economics and Law of Sovereign Debt and Default", 2009 *Journal of Economic Literature*, 47(3), 651-698). Studies have further shown that the threat of barring access to financial markets has proven a weak one. This is in the first place because a sovereign debtor could find other means to respond to the needs it cannot satisfy by calling on the financial markets. A sovereign could for example purchase insurance or invest a portion of its wealth abroad so that it can be used in difficult times (for more details on these solutions, see the analysis by U. PANIZZA, F. STURZENEGGER, and J. ZETTELMEYER, "The Economics and Law of Sovereign Debt and Default", 2009 *Journal of Economic Literature*, 47(3), 651-698). Practice has further shown that sovereign debtors can count on international organizations such as the IMF in case of need. Finally, sovereigns which have defaulted, appear not to have been denied the possibility to access the markets and the interest rate penalties are minimal (see L. ALFARO and F. KANCZUK, "Sovereign Debt as a Contingent Claim: A Quantitative Approach," *J. Intl. Econ.* 65, no. 2 (2005): 297-314 – this study shows that the interest rate penalties imposed following default are not substantial enough to cause sovereigns to repay their obligations. It also finds that additional output costs of defaulting in line with are necessary to sustain the debt levels observed in emerging markets even in a model of contingent services). It seems that the traditional weapon or sanction which could be used by creditors, i.e. deny sovereign debtors access to financial markets in case of default, is not being used. There are several examples of sovereign debtors paying very low post-swap sovereign spreads in secondary markets for its existing debts. Another major assumption of the sovereign debt market is that the market itself is a constraint, since sovereign debtors fear market exclusion and will not default lightly in order to avoid losing access to new money. This has been proved wrong in several instances. For a thorough review of the literature on the

sovereign creditors primarily concern the first element, that of litigation. The focus will therefore be on litigation as element of debtors' discipline.

A review of recent literature teaches that the classic picture of creditors' rights as necessary to balance (opportunistic) defaults by sovereign debtors should be nuanced.[123] Recent research related to the role played and influence exercised by creditors in case of sovereign defaults, has demonstrated that the threat of enforcement by individual creditors may be one factor in the decision making process of a sovereign facing difficulties. It will, however, not act as a powerful deterrent against repudiation of debt by the sovereign. Creditors cannot in other words *prevent* such repudiation. Other factors will in any case have much more impact than creditor's reactions. One can refer to reputation loss,[124] loss of output, capital flight, etc. It follows that limiting creditors' rights will not necessarily increase the risk of opportunistic default by sovereign since the creditors' rights can only remotely be compared to 'checks and balances'.

If creditors cannot exercise sufficient influence to prevent default, will they be able to exercise any influence to elicit a better restructuring offer when a default has occurred? If one focuses not so much on the possibility to prevent a default but on what happens *after* a sovereign has defaulted, it seems that the role of creditors should not be overestimated. According to Sturzenegger and Zettlemeyer, holdout creditors cannot exercise such pressure that they pose a systemic obstacle to debt restructuring.[125] In its report on collective action clauses, the G-10 working group noted likewise that “disruptive legal action against sovereigns has historically not been a major barrier to restructurings...”.[126]

It follows that even though creditors' action has received a lot of attention, the role played by creditors in debt restructuring is limited. When a sovereign defaults and contemplates a restructuring of its debts, creditors may exercise some pressure on the process, without derailing it. The main lesson which can be drawn from economic theory is in fact that contract law focuses too narrowly on individual enforcement rights. Individual enforcement will solely benefit the creditor who is acting. At the same time, it will reduce the 'pie' available to all creditors. Linked to this collective action problem, actions by individual creditors also raise a free ridership issue.[127]

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objections to the threat of exclusion from financial markets, see U. PANIZZA, F. STURZENEGGER, and J. ZETTELMEYER, “The Economics and Law of Sovereign Debt and Default”, 2009 *Journal of Economic Literature*, 47(3), 651-698.

123A first point of contention relate to the concept itself of opportunistic default. Economists indeed seem to agree that the problem of so-called opportunistic default should not be exaggerated. There are many reasons why a sovereign could default on its debt. It will be rare that pure opportunism plays a key role in such a high stake decision. Although the recent default of Ecuador in 2008 probably comes close to the ideal concept of opportunistic default - see

124See above.

125F. STURZENEGGER & J. ZETTELMEYER, “Has the Legal Threat to Sovereign Debt Restructuring Become Real?”, Business School Working Papers, 2006. See also ARTURO C. PORZECANCKI, “From Rogue Creditors to Rogue Debtors : Implications of Argentina's Default”, *Chicago J. Intl. L.*, 2005, vol. 6, 311 at p. 314.

126See the Report of the G-10 Working Group on Contractual Clauses, Sept. 2002, at p. 6.

127An argument to that effect was made by the US government, which file an *amicus curiae* brief in the case between Darts and Central Bank of Brazil. In its brief, the government urged the court to reject the creditor's claim for acceleration of the principal on the ground that holdouts which have purchased debt in the secondary market should not be allowed to free ride on a debt restructuring agreed by a majority of creditors

At the very least, what this general review suggests is that the weight of creditors' threat should not be overestimated. Creditors will not be able to prevent a default and their influence on the restructuring process is limited. This conclusion is confirmed by two recent trends which affect the legal regime of sovereign debt restructuring. The international community has indeed adopted in recent years a new framework for sovereign debt issues, which will significantly curtail the rights creditors may assert in case of restructuring (A). In addition, other legal evolutions will in the future limit the ability of creditors to weigh on a restructuring process (B).

A. Collective action clauses as limitation on the impact of individual creditors

Traditional sovereign debt issues were characterized by two notable features, which largely contributed to the increased creditor activism, including court action. The first feature was the fact that bonds issues granted each individual investor the right to sue for its share of a missed payment. The second related to the exacting standard imposed on the sovereign debtor for amendment of the payment terms of the bonds and loans. It was not uncommon that such amendment was only possible with the consent of every bondholder.[128] These features helped maximize the influence sovereign creditors could exercise in case of default.

Starting in 2003, sovereign issuers introduced significant changes to the legal documentation of their international sovereign bond issues.[129] These changes are known as 'collective action clauses'. They have been discussed for quite some time. The use of collective action clauses has been heavily promoted by international authorities, in particular the G10.[130] The EU Member States also collectively committed in November 2003 to introduce such clauses in their bond issues.[131]

Since then, collective action clauses have become more and more common in new sovereign issues. A privileged witness of sovereign bonds has noted that “collective action clauses in New York bonds for sovereign issuers have become the documentary norm”.[132] Close analysis

(Statement of Interest of the United States of America in Opposition to the First Amended Complaint, *CIBC Bank and Trust Co. Ltd. vs. Banco Central do Brazil* 886 F. Supp. 1105 (S.D.N.Y. 1995)).

128 On these two features, see L. C. Buchheit and G. Mitu Gulati, “Sovereign Bonds and the Collective Will”, *Emory L. J.*, 2002, vol. 51, 1317 at pp. 1331.

129 Mexico was reportedly the first major issuer to introduce such collective action clauses in a bond issue.

130 See the Report of the G-10 Working Group on Contractual Clauses, Sept. 2002, available at *www.bis.org/publ/gten08.htm*.

131 See the press release issued after the 2537th Council meeting - Economic and Financial Affairs on 4 November 2003, in which the Ministers “reiterated their commitment to include Collective Action Clauses in all their international sovereign bond issues” (Press release 13689/03). More recently, the member of the Euro-zone have decided that standardized and identical collective action clauses will be included in the terms and conditions of all new Euro area government bonds starting in June 2013 – see the conclusions of the Heads of State or Government of the Euro Area of 11 March 2011, at p. 14. The Member States contemplate supermajority clauses and aggregation clauses, allowing all debt securities issued by a Member State to be considered together in negotiations.

132 L. Buchheit, “Supermajority control wins out”, *Intl. Fin. L. Rev.*, 2007, 26/5, 21. Häseler notes “the almost universal adoption of collection action clauses in new sovereign bond issues beginning in 2003” (S. Häseler, Individual Enforcement Rights in International Sovereign Bonds, p. 1).

of market practice has shown that the shares of sovereign bonds issues including CAC's increased to almost 90 % between 2003 and 2007.[133]

One of the major innovations introduced by collective action clauses is the incorporation in bond documentation of a majority restructuring or amendment provision, allowing the sovereign debtor to modify some elements of the bonds by obtaining approval of a qualified majority. This allows a qualified majority of bondholders, typically 75%, to amend the some of the of the bond – for example, the payment terms, extension of maturity, interest-rate cut and possibly a 'haircut'. An individual creditor may hold out and not agree to the change proposed by a sovereign debtor. The amendment will nonetheless be binding on all bondholders, even those who have not accepted the amendment. Hence, the prospect of individual action by dissenting bondholders is made less attractive. By the same token, restructuring a bond issue is made easier because individual creditors have less possibility to block out a restructuring.

Another important feature of collective action clauses are majority enforcement provisions. A good example of a clause of this type is a clause requiring a specific majority, for example 25 % of outstanding bondholders, to vote for acceleration of the bond issue. In the same line, sovereign issuers may also consider including a clause which concentrates the power to initiate litigation against the sovereign debtor with a representative of the bondholders acting upon instruction of say 25 % of the bondholders.

Collective action clauses may not be the miracle solution they have been praised to be [134] – especially since it appears that they did not help to reduce spreads.[135] These clauses do not for instance prevent holdout litigation by individual creditors before the restructuring is completed and becomes effective. The creditors have possibility to launch attacks on sovereign *before* the restructuring is closed down. This is especially the case when the sovereign decides to use a trustee instead of a fiscal agent, as is apparently the tradition for bonds issued under the laws of New York. Under these laws, it is apparently common that the

133See in particular the study of M. H. BRADLEY, J. D. COX and M. GULATI, “The Market Reaction to Legal Shocks and their Antidotes : Lessons from the Sovereign Debt Market”, (2008). Duke Law School Faculty Scholarship Series - paper 120 (available at *http://lsr.nellco.org/duke_fs/120*). See also M. GULATI and A. GELPERN, ANNA, "Innovation after the Revolution: Foreign Sovereign Bond Contracts Since 2003" 4 *Capital Markets Law Journal* 85-103 (2009) – showing that the adoption of collective action clauses in sovereign bonds, while it brought the New York and the London markets for sovereign debt closer, did not lead to the emergence of new boilerplate documentation. No standard has apparently yet emerged from the shift caused by the introduction of collective action clauses.

134The debate is still open. Consider and compare the views of ANNA GELPERN and MITU GULATI (“Public Symbol in Private Contract : a Case Study”, in *Washington University L. Rev.*, 2006, vol. 84 at 1627 ff – arguing that the introduction of collective action clauses is “unimportant” and merely a “mix of symbolic gesture and political maneuver designed to achieve goals apart from solving the technical problems” linked with sovereign debt restructuring) and FRANK ELDERSON and MARINO PERASSI, “Collective Action Clauses in Sovereign Foreign Bonds : Towards a More Harmonised Approach”, *Euredia*, 2003, at pp. 239-264 (who argue that the incorporation in foreign debt instruments of collective action clauses is “a useful and necessary contribution to the smooth resolution of sovereign debt crises” - at p. 241).

135Bradley & Co (M. H. BRADLEY, J. D. COX and M. GULATI, “The Market Reaction to Legal Shocks and their Antidotes : Lessons from the Sovereign Debt Market”, *Journal of Legal Studies*, 2010, vol. 39, 289-324) have shown that CACs had no impact on the pricing of sovereign debt. See also BARRY EICHENGREEN and ASOKA MODY, “Do Collective Action Clauses Raise Borrowing Costs?”, Economic Journal, 2004, vol. 114, 247-264.

trust indenture reserves to each individual bondholder the right to sue for its share of payment not made on a regularly-scheduled due date.[136] Some sovereign bonds recently issued have, however, broken up with this tradition. New York law bonds issued by Granada and Belize have granted the trustee all enforcement powers, as has always been the practice under English law bonds.[137]

Further, collective action clauses can replicate corporate restructuring only to a certain extent. One major remaining difficulty is that a sovereign may have many different bonds issued, with different terms and clauses. It is difficult, albeit not impossible, to consolidate collective action clauses across several issues.

Finally, even though collective action clauses have become very popular among sovereign issuers, there remain a great number of past issues which lack such clauses.[138] According to Häseler, bonds issued in the German market under German law, fail to incorporate CAC's.[139] CAC's are indeed prelavent in bonds governed by the laws of NY and England. Many sovereigns keep issuing bonds subject to local law, without the benefit of collective action clauses.[140]

Collective action clauses will therefore provide a solution for future defaults, while leaving a "period of transition" where restructuring remains difficult in the absence of the benefit provided by such clauses.[141]

Even taking into account these various caveats, the significant limitation imposed by the CAC's on the bondholders' rights make it, or will make it in the future, more difficult to carry holdout litigation. They contribute to reduce the influence bondholders may exercise in case of default of the sovereign.

The case of Belize shows that collective action clauses have the intended effects : in 2006, Belize indicated that it wanted to restructure its external debt. Among the bonds issued concerned, there were two New York law bonds : one issued in 2003 including a CAC and one with documentation that did not include any CAC. The bond issued with a CAC required the approval of 85% of the bondholders to allow a modification of the payment terms. The

136M. Buchheit has explained that this feature was inspired by US practice in respect of corporate bonds, but that it was carried over "as a matter of drafting inertia" to sovereign bonds (L. BUCHHEIT, "Supermajority control wins out", *Intl. Fin. L. Rev.*, 2007, 26/5, 21).

137L. BUCHHEIT, "Supermajority control wins out", *Intl. Fin. L. Rev.*, 2007, 26/5, 21.

138It has been suggested that in case a sovereign has issued some 'old' debt, without the benefit of CAC's, the sovereign debtor could adopt a law which replicates the effects of CAC's for all bond issues, but on the basis of a national law (L. C. BUCHHEIT & M. GULATI, "Restructuring a nation's debt", *Int'l. Fin. L. Rev.*, 2010, 29/5, (46-49), 48-49 – who discuss the impact such law could have and whether it would be accepted by major international financial institutions).

139S. HÄSELER, "Individual Enforcement Rights in International Sovereign Bonds", p. 3 – who reports that the adoption of CAC's has been met by resistance due to obstacles under German law in particular regarding the possibility to amend bond provisions with a qualified majority.

140This is apparently the case of Greece. According to Buchheit, "More than 90% of Greek bonds are governed by local law" (L. C. BUCHHEIT & M. GULATI, "Restructuring a nation's debt", *Int'l. Fin. L. Rev.*, 2010, 29/5, (46-49), 46).

141M. MILLER & D. THOMAS, "Sovereign Debt restructuring : the Judge, the vultures and creditors rights", 2006, p. 18.

change sought by Belize was classic : Belize sought to modify the payment terms of the existing bonds to match those of the new bonds issued in the exchange offer. According to the reports, Belize obtained the approval of the required supermajority. The non-participants were left with old bonds whose payment terms had been modified.[142]

It may therefore be expected that the shift to bonds including CAC's will make it more and more difficult for individual creditors to exercise any pressure on sovereign debtors. As Miller and Thomas have explained, "[w]ith CACs [...] the issue of recalcitrant holdouts should disappear. Subject to the necessary majority for a swap, the holdouts will be impelled to accept the same terms. They cannot hold out for better".[143]

This first trend contributes to downplay the importance of individual bondholders and their litigation tactics. It is confirmed by other recent trends which concern various litigation devices used in the past by sovereign creditors.

B. The chess game between sovereign creditors and debtors

The adoption and spread of CAC's in future bond issues will lead to a significant decrease of individual creditors' rights. It may therefore be expected that litigation by holdout creditors will decrease. It is impossible, however, to exclude such litigation altogether.

There are very few players in the game of sovereign debt litigation. These players are highly sophisticated investors with access to vast resources. It is therefore not surprising that in many instances, counsels for the private investors have advanced unprecedented arguments or used novel devices. In some instances, these argument and devices have proven effective and led, if not to actual recovery, at least to reasonable prospects in this direction.

As in all chess games, players, however, learn from their mistakes. After a first momentary lapse when faced for the first time with the creative device used by creditors, States have indeed reacted to the new legal strategies used by creditors in obtaining judgments against sovereign debtors and in trying to collect on them. In doing so, States have attempted to close the 'loopholes' used by creditors in order to pressure sovereign debtors in paying. Hence, even though creditors (and most notably their counsels), have used enormous creativity to find new targets and devise new litigation strategies, the room for effective recovery has not increased. On the contrary, the review of the most well known devices will show that this room has effectively been reduced.

1. The Lure of *Pari Passu*

As already explained, in the infamous decision of the Brussels Court of Appeals, Elliott obtained a very broad reading of the *pari passu* clause.[144] In a bold and radical interpretation

142See the explanations of Lee C. Buchheit, "Supermajority wins out", *Int'l Fin. L. Rev.*, 2007, vol. 26, at p. 21.

143M. Miller & D. Thomas, "Sovereign Debt restructuring : the Judge, the vultures and creditors rights", 2006, p. 17.

144A typical *pari passu* clause reads as follows : "The obligations of the Guarantor hereunder do rank and will of the clause, the court found that the borrower should pay creditors on a ratable basis.[145] As Hal as noted, "this 2000 decision was the high watermark of creditor rights, albeit in a case decided by a Belgian rather than a U.S. Court."[146]

While it was unanimously decried by commentators, who expressed surprise at the interpretation accepted by the Court of Appeal,[147] the decision of the Court of Appeal was seen as a blessing by the community of sovereign debt creditors which had until then not paid much attention to the *pari passu* clause. It is not surprising that other creditors rushed to benefit from the broad reading given by the Brussels Court of Appeal to the *pari passu* clause – which has been termed a "devastating enforcement device".[148]

The first results seemed positive for the creditors. A court in California, hearing a claim in 2001 by a judgment creditor of the Democratic Republic of Congo seeking specific performance by Congo to the *pari passu* clause included in a 1980 credit agreement with the Republic, refused the request for specific performance. It did, however, enjoin the debtor from making any payments in respect of its external debt without making a "proportionate payment" to the creditor, thereby lending some weight to the *pari passu* clause.[149] To come to that ruling, the court was sensitive to Congo's responsibility to aid the enforcement of judgements (that is, 'procedural' *pari passu*). The ruling of the court in fact produces similar effect to that of the Court of Appeal of Brussels, even though it falls short from enforcing directly the *pari passu* clause in the sense given to it by the Court of Brussels.

Soon, however, the tide began to turn. In separate cases, courts in Belgium and in England imposed severe limitations on the possibility for a creditor to block payments to other

rank at least pari passu in priority of payment with all other External Indebtedness of the Guarantor, and interest thereon."

145Opinion of the 8th Chamber of the Court of Appeal of Brussels at p. 3, as reported by L. C. Buchheit and J. S. Pam, "The Hunt for Pari Passu", *Intl. Fin. L. Rev.*, 2004, (20-26), 22.

146Paper Washington Legal Foundation at p. 10.

147.The criticism were not limited to the 'usual suspects', i.e. lawyers and commentators from the United States and England involved in sovereign debt litigation. See e.g. Philip R. Wood, « *Pari Passu* Clauses – What Do They Mean ? », (2003) 18 JIBFL 371; Lee C. Buchheit & J. S. Pam, « The *Pari Passu* Clause in Sovereign Debt Instrument » (2004) 53 Emory L. J. 869 ff ;W. W. Bratton, « Pari Passu and a Distressed Sovereign's Rational Choices », (2004) 53 Emory L.J. 823. Commentators in France also expressed surprise at the interpretation accepted by the Court – see *e.g.* G. Affaki, « Du bon sens des mots et du bon sens : de la bonne interprétation de la clause *pari passu* », in *Libre droit. Mélanges en l'honneur de Philippe Le Tourneau*, Dalloz, 2007 and G. Affaki and J. Stoufflet, « Chronique de droit bancaire international », *Banque & Droit*, 2005, 81-90. It is in fact a rare event that a court decision attracts that much criticism. In Belgium, comments were limited to a factual account of the Court's decision - see. I. Peeters & A. Zenner, « Tegenwerpelijkheid van samenloopvermijdende contractuele waarborgmechanismen », *R.W.*, 2004-2005, (481) at pp. 489-490. See also the Report drawn up by the Financial Markets Law Committee and Bank of England, « Analysis of the Role, Use and the Meaning of Pari Passu Clauses in Sovereign Debt Obligations as a Matter of English Law », March 2005 (available at *www.fmlc.org*).

148J. I. Blackman and R. Mukhi, "The Evolution of Modern Sovereign Debt Litigation : Vultures, Alter Egos and Other Legal Fauna", *Law & Contemp. Problems*, 2010, vol. 73, (47), 55.

149*Red Mountain Fin., Inc. v. Democratic Republic of Congo and Nat'l Bank of Congo*, Case No. CV 00-0164 R (C.D. Cal. May 29, 2001), unpublished, as reported by L. C. Buchheit and J. S. Pam, "The Hunt for Pari Passu", *IFLR*, February 2004, (20), 22. It appears that the Democratic Republic of Congo later agreed an out-of-court settlement with Red Mountain Finance after the ruling of the Californian court (as reported by J. I. Blackman and R. Mukhi, "The Evolution of Modern Sovereign Debt Litigation : Vultures, Alter Egos and Other Legal Fauna", *Law & Contemp. Problems*, 2010, vol. 73, (47), 56).

creditors using the *pari passu* clause.[150]

The English case, which went unreported, also concerned the Republic of Congo.[151] A creditor attempted to compel Congo to specific performance of the alleged payment obligation. While it declined to issue the relief sought on equitable grounds,[152] the English court apparently "expressed strong reservations about the plaintiff's *pari passu* arguments".[153] The court apparently indicated that it found the precedent of Elliott "unpersuasive".[154]

The case in Belgium concerned bonds issued in 1980 by a sovereign debtor, Nicaragua, and held by LNC.[155] LNC had refused the offer made by Nicaragua in the 1990's, to exchange the 1980 bonds for new ones representing 8% of the value of the old ones. However, more than 80% of the bondholders accepted the offer. LNC initiated various proceedings to attempt to recover the amount owed by Nicaragua. LNC obtained a judgment from a court in New York, ordering Nicaragua to pay more than USD 80 million.[156] LNC also obtained a ruling by the English High Court in February 2001, ordering Nicaragua to pay the same amount.

Inspired by the example of Elliott, LNC Investments attempted to attach money circulating through the Euroclear system and meant to cover interest payments to holders of bonds issued in 1990 by Nicaragua.[157] At first, LNC attempted to attach money in the hands of the government's paying agent, Deutsche Bank AG, in London. In July 2003 it obtained leave to attach funds transiting through Deutsche Bank AG in London. This proved fruitless, as it later transpired that the funds were channeled through Deutsche Bank's establishment in New York. LNC requested then, *ex parte*, an injunction from a court in Brussels, which would prevent Euroclear to disburse the money to the holders of Nicaragua's indemnification bonds. The injunction was granted *ex parte*.[158] Nicaragua sought to have the injunction withdrawn.[159]

The Commercial Court of Brussels first refused to withdraw the injunction which had been served to Euroclear. The Court found that the behavior of Nicaragua, which had

150In a case concerning corporate and not sovereign debt, another court in New York was also concerned with a *pari passu* clause. Its ruling apparently endorsed an interpretation of the *pari passu* clause merely ensuring equal treatment of creditors in case of insolvency (*Nacional Financiera SNC v The Chase Manhattan Bank, NA* 2003 WL 1878415(SDNY), as reported by C. G. Berry and K. H. Blake, "'Pari Passu' Means What Now?', *New York L.J.*, 6 March 2006).

151*Kensington v Republic of Congo*, Commercial Court 2002, N° 1088, 16 April 2003 (Justice Tomlinson) – unreported opinion, as summarized by C. G. Berry and K. H. Blake, "'Pari Passu' Means What Now?', *New York L.J.*, 6 March 2006. See in the same dispute, *Kensington International v. Republic of Congo* [2007] EWCA 1128, [2006] EWHC 1848, [2005] EWHC 2684.

152Among other the fact that the creditor had failed to identify who it was and how much it had paid for its debt.

153C. G. Berry and K. H. Blake, "'Pari Passu' Means What Now?', *New York L.J.*, 6 March 2006.

154Idem.

155LNC was a subsidiary of Leucadia National Corporation. It had acquired its interest in the debt from two commercial banks in 1986.

156See *LNC Investments, Inc. v. The Republic of Nicaragua,* 1999 WL 92603 (S.D.N.Y. Feb. 19, 1999); *LNC Investments, Inc. v. The Republic of Nicaragua,* 115 F. Supp. 2D 358 (S.D.N.Y. April 26, 2000), *affirmed sub nom LNC Investment, Inc. v. Banco Central de Nicaragua*, 228 F.3d 423 (2d. Cir. 2000).

157These were so-called 'indemnification bonds' (*Bonos de Pago por Indemnization*) issued in order to compensate the victims of expropriation under the rule of the Sandinistas.

158Unpublished ruling of 25 July 2003 by the Vice-President of the Commercial Court in Brussels (R.R. 101/03).

159Its request was followed by a similar request made by Euroclear.

systematically neglected to make any payment on the money owed to LNC, while at the same time servicing new debt, was a violation of the *pari passu* clause.[160] The Court specifically referred to the *pari passu* clause and endorsed the interpretation which had been given by the Court of Appeal in the Elliott case.[161]

In appeal, however, the ruling was overturned.[162] The Court of Appeals held that Euroclear was a third party to the contractual relationships between Nicaragua and LNC. LNC could therefore not require that Euroclear be made liable for the performance of the contract. In so far as LNC had claimed that Euroclear was liable for third party breach (‘*tierce complicité*’) of the *pari passu* clause, the Court of Appeals found that, even though Euroclear could not ignore the fact that Nicaragua made payments through its system, there was no third party liability. Liability could only arise if Nicaragua made payments on the 1990 bonds without making equivalent payments on the 1980 bonds or other debts. The mere fact that Nicaragua was using the Euroclear system to make payments, did not as such demonstrate that Nicaragua violated its contractual obligation under the pari passu agreement.

The Court went further and noted that another element was missing, which was necessary in order to make a case of third party liability. The court noted that a third party could only be liable if, when entering into an agreement with one of the parties, it was aware that it lended its hands to the breach of contract. Euroclear could, however, not have been aware of the fact that Nicaragua was only servicing its 1990 bonds and neglecting the 1980 bonds, when it first contracted with the Republic of Nicaragua to allow the latter to make payments through its system. Hence, Euroclear was not aware that Nicaragua would be violating the *pari passu* obligations. The Court noted that ruling otherwise and accepting that Euroclear should have been aware of the dealings of Nicaragua, would impose a severe burden on Euroclear, which would be required to guarantee that the Republic of Nicaragua respects and assume its contractual obligations towards LNC.[163]

160See ruling of the Commercial Court of Brussels, 11 September 2003, opinion unpublished, case R.K. 204/03. The ruling did not have any effect because Nicaragua apparently refrained from making any payment and hence, no money was injected in the Euroclear system.

161Once the injunction had been served on Euroclear and Nicaragua, Euroclear informed all the participants holding bonds that it would be unable to make the payment scheduled. This forced Nicaragua to promise all holders of bonds that it would pay late interests on the money owed, for fear that the participants would call on the various acceleration clauses and claim payment of the whole capital.

162Brussels Court of Appeals, (9th Chamber), 19 March 2004, N° 2003/KR/334 and 2004/1831, opinion unpublished, *Republic of Nicaragua v. LNC Investments LLC and N.V. Euroclear Bank*.

163The Court's dictum reads as follows : “*La responsabilité d’un tiers pour le préjudice qu’une partie à un contrat subit du fait de l’inexécution fautive du contrat par le débiteur, peut être engagée lorsque le tiers, même sans avoir l’intention de nuire, prête son concours en connaissance de cause à la violation du contrat. Il n’est nullement établi à suffisance de droit qu’en offrant ses services pour assurer via le système Euroclear, le paiement des intérêts dus sur les ‘Obligations d’indemnisation’, admises dans le système Euroclear depuis l’année 2000, ou le paiement d’autres dettes extérieures de la République du Nicaragua, Euroclear se rendrait coupable de tierce complicité fautive à la violation des clauses pari passu telles qu’elles sont intérpretées par LNC. Le respect des clauses pari passu, telle qu’elles sont interprétées par LNC, impose à la République du Nicaragua, lorsqu’elle affecte des fonds au remboursement de sa dette extérieure, de payer simultanément et au marc le franc, tous les créanciers pouvant revendiquer le bénéfice de ladite clause. Le seul fait que la République du Nicaragua exécute ses obligations résultants des ‘Obligations d’indemnisation’, en transférant via la système Euroclear des fonds destinés à payer les intérêts venus à échéance, ne peut en aucune manière constituer par lui-même la preuve d’une violation contractuelle par la République du Nicaragu de l’obligation contractuelle dont LNC se prévaut. La preuve*

With this ruling, it appears that the Court of Appeal, without overturning directly the previously accepted interpretation of the *pari passu* clause,[164] has in effect blocked all attempts to use this interpretation.[165]

Arguably, the evolution of case law in Belgium and England is only a nail in the coffin of the novel and broad reading of the *pari passu* clause adopted in Elliott and not a final blow.[166] A definitive ruling in the interpretation of this type of clause will in fact prove illusory. The matter of the interpretation of *pari passu* clauses cannot be settled in general as much will depend on the drafting of the clause concerned. The language of one clause may support an interpretation incompatible with language used in another clause. However, the unrelenting criticism voiced against the Brussels interpretation in Elliott and the Nicaragua ruling strongly suggest that the *pari passu* route is closed.[167]

2. The Road to Payment Flows Blocked

In Elliott, the creditor also succeeded in attaching payment flows. As happened with the broad reading of the *pari passu* clause, sovereign debt creditors have since then jumped on this novel tactic and attempted to target various payment flows.

This requires, however more resources and expertise, as locating and identifying future payment flows is a time consuming and difficult exercise. The Nicaragua case is a good demonstration : at first, the creditor (LNC) targeted the government's paying agent, entrusted with making payments to holders of the indemnification bonds. The agent was a commercial bank. LNC obtained an attachment in London. It then appeared that the funds would be channeled not through the London branch of the paying agent, but through the New York branch. The attachment therefore proved fruitless.

LNC next turned to Euroclear, the Brussels based settlement specialist, through which

de l'inexécution ne peut en effet être rapportée qu'à l'aide d'autres éléments permettant de constater que la République du Nicaragua resterait en défaut d'affecter des fonds au remboursement de ses autres dettes extérieures de manière à ce que tous les créanciers pouvant revendiquer le bénéfice des clauses pari passu soient remboursés. Or, pour qu'il y ait tierce complicité, il faut qu'au moment où il conclut la convention avec le débiteur, le tiers soit conscient qu'il prête son concours à l'inexécution fautive par son cocontractant d'une obligation contractuelle. Le tiers n'engage pas sa responsabilité lorsqu'il ne peut acquérir la connaissance de l'obligation violée et de la violation, qu'en exigeant de son cocontractant avant de s'engager, qu'il lui révèle les obligations contractuelles qui pèsent sur lui et qu'il lui rapporte en outre la preuve de leur exécution. Le principe de la relativité des contrats s'oppose à toute mesure qui ferait des tiers les garants de l'exécution des contrats. » (at pp. 17-18, § 22)

164It is noteworthy that the Court of Appeal noted in its ruling that the interpretation of the *pari passu* clause advocated by LNC, was "seriously questioned" - at p. 16, § 21.

165An appeal before the Supreme Court (Court of Cassation) was introduced on 22 June 2004 by LNC Investments, N° C 04.029 F. The Supreme Court, however, did not rule on the dispute.

166A US judge has declined to rule on the issue of the interpretation of the *pari passu* clause – Judge Griesa in *Applestein v. Republic of Argentina and Province of Buenos Aires*, 2010 US Dist. LEXIS 14083 (S.D.N.Y. Jan. 15, 2004).

167Blackman has noted that "the … *pari passu* strategy seems to have receded from the forefront of creditor enforcement strategies" (J. I. BLACKMAN and R. MUKHI, "The Evolution of Modern Sovereign Debt Litigation : Vultures, Alter Egos and Other Legal Fauna", *Law & Contemp. Problems*, 2010, vol. 73, (47), 57).

payments would be made to the bonds holders. LNC knew that Nicaragua was required to make payments twice a year (on the 1st of February and on the 1st of August). It obtained an injunction in Belgium at the end of July, a couple of days before the payments were to be made. However, this injunction did not bring any results at first, as Nicaragua had delayed its payment until 17th of September 2003.[168]

More importantly, legal restrictions imposed in various countries have made the attachment of payment flows more and more difficult. To take the example of payments made through the Euroclear system, the creditors will face very substantial obstacles when attempting to attach any payment flow running through the system.

Even before the Elliott ruling, the assets and funds transiting through the Euroclear already benefited from a strong protection. The legal position of assets held in the Euroclear system is defined by Royal Decree no. 62 of 10 November 1967 promoting the circulation of the securities.[169] The analysis is different depending on whether the attachment concerns a *cash account* or a s*ecurities Clearance Account*.

As far as the securities account are concerned, article 11 of Royal Decree n° 62 prohibits any attachment on securities account.[170] Cash accounts in the Euroclear system are, moreover, protected by Article 9 of the Law of 28 April 1999 on settlement finality in payment and securities settlement systems.[171] Under this provision, each settlement account concerning cash with an operator of the system (i.e. Euroclear Bank) or with a settlement organisation of a system shall not be subject to attachment, receivership or blocking, in any way, by a participant (other than the operator or the settlement organisation), a counterparty or a third party.[172] This provision grants immunity to cash held within the Euroclear system. Although

168This information is taken from the ruling of the Commercial Court of Brussels, 11 September 2003, opinion unpublished, case R.K. 204/03.

169The "Royal Decree no. 62", originally drafted in 1967 and most recently amended by the Law of 2 August 2002 and coordinated by the Royal Decree of 27 January 2004.

170According to Article 11 :"It is not allowed to carry out an attachment on securities current accounts opened in the books of the [clearing organisation]. [Moreover, no attachment on securities deposited with the clearing organisation shall be admitted].

The same applies, by virtue of Article 10 of the Law of 2 January 1991 for accounts held within the settlement system operated by the Belgian National Bank for government debt securities.

The provisions of Royal Decree n° 62 are directly applicable to CIK, the primary settlement system in Belgium. By Royal Decree of 22 August 2002, Euroclear Bank has been recognised as a "Central Security Depositary" in the sense of Article 1(1) of Royal Decree n° 62. This means that securities accounts held within the Euroclear system benefit since August 2002 altogether from the protection granted by Royal Decree n° 62 and, hence cannot be attached.

It is also worth noting that most securities will not be held directly by their direct owner. The Euroclear system works through 'Participants'. The Participants are mostly financial institutions. It may be that a sovereign debtor holds its securities in the Euroclear system through one or more Participants. Serving a writ of attachment directly to Euroclear will therefore not only be ineffective in that securities account cannot be attached but furthermore, Euroclear may reply that it holds no securities for the sovereign debtor since Euroclear does not know, and cannot know, who the final owner is of securities held by one Participant. In the *Indosuez* case, the circumstances were optimal, since the attachment was made on the securities account of the Reserve Bank of Russia, which apparently was a direct participant in the Euroclear system.

171*M.B.*, 01-06-1999, entrée en vigueur le 11-06-1999.

172Article 9 read as follows (as it was in force when the Elliott case was decided) : "« *Tout compte de règlement sur espèces auprès d'un organisme gestionnaire ou d'un agent de règlement d'un système ne peut être saisi,* the Finality law has been adopted pursuant to the Finality Directive,[173] Article 9 was not part of the European Directive but was introduced by the Belgian legislator at its own initiative.[174]

In order to sidestep the legal protection afforded to the Euroclear system and more in general to all clearing and settlements systems by the Finality Directive, Elliott framed its claim for relief very narrowly when it attempted to attach payment flows initiated by Peru. Elliott attempted to block funds that were to transit through the Euroclear system and were meant to be paid out to new bondholders. What it requested from the court was not an attachment. Elliott requested an injunction barring Euroclear from making payments. Although the injunction sought by Elliott had in fact the same consequences as an attachment, the Court found that this injunction did not violate the protection granted by the Royal Decree nr. 62 and the finality law.[175]

In the meantime, however, as has been reported elsewhere,[176] the 'loophole' found by Elliott Associates has been closed. The Belgian legislator has intervened and made it impossible to attach, block or paralyze assets and funds held in the Euroclear system.[177] A new provision

mis sous séquestre ou bloqué d'une manière quelconque par un participant (autre que l'organisme gestionnaire ou l'agent de règlement), une contrepartie ou un tiers. ».

173Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems.

174Article 9 shields part of the debtor's assets from attachment by creditor. In a case where a Dutch creditor had attempted to attach the cash account of a Russian financial intermediary, it has been argued that Article 9 violated basic principles of equality and was also in contradiction with European law : Court of Appeal of Brussels, 23 December 2002, in the matter of *Indosuez International Finance BV v. National Reserve Bank*, unpublished opinion, case nr. 2000/AR/2658. The dispute arose out of currency-exchange contracts entered into between IIF and NRB, with a view to protect the former against a devaluation of the ruble. When the ruble declined, NRB became indebted to IIF for more than USD 100 million. It is that amount that IIF attempted to recover with its attachment. The Court of Appeals, however, refused to consider that Article 9 amounted to a violation of the principle of equality among creditors. It also refused to refer a preliminary question to the European Court of Justice or to the Belgian Constitutional Court. Interestingly, the Court of Appeals also held that Article 9 was a general measure and could not be restricted to 'abusive' attachments. Hence, the Court refused to examine whether the attachment was abusive or not. In this case, see also the ruling by an English court : *Indosuez International Finance BV v National Reserve Bank* [2002] EWHC 774 (Comm).

175Likewise, in the Nicaragua case, the Commercial Court (ruling of the Commercial Court of Brussels, 11 September 2003, opinion unpublished, case R.K. 204/03, at p. 18) found that the injunction made to Euroclear did not violate the legal protection. Specifically, the Court found that "*en l'espèce, les mesures sollicitées par LNC ne constituent en aucune manière de la part de LNC (I) ni une saisie-arrêt sur un compte courant d'instruments financiers ouvert dans les livres d'Euroclear (article 9 de l'Arrêté royal [nr? 62], (ii) ni une saisie de sommes payées à Euroclear Bank en tant qu'organisme de liquidation (article 10 bis de l'Arrêt Royal [nr. 62] par la République du Nicaragua, ou pour son compte, en tant qu'émetteurs d'instruments financiers, (iii) ni une mesure de saisie ou de blocage d'un compte de règlement du système Euroclear (article 9 de la loi [Finality Law]". The Court went further : "... les mesures ordonnées par l'ordonnance n'ont en aucune manière entraîné le blocage des comptes de Deutsche Bank, ni d'aucun autre participant au système Euroclear. Le maintien de ces mesures ... n'empêchera dès lors pas non plus ni la continuation du bon fonctionnement de ces comptes, ni le bon fonctionnement global du système ou la liquidation des opérations traitées par celui-ci, à l'exception des transactions visées par l'ordonnance*".

176See the comments of G. Affaki and J. Stoufflet, « Chronique de droit bancaire international », *Banque & Droit*, 2005, 81 ff.

177The change was part of a modification which primarily aimed to implement in Belgium the twin directives 2001/17 and 2001/24 on insolvency of insurance undertakings and banks. Article 27 of the Bill was, however, clearly not inspired by these directives, but by the *Elliott* case. See the Explanatory Statement by the Government, which was filed together with the bill : Doc. Parl., *Chambre*, Session 51, 1157/01, 25 May adopted shortly after the *Elliott* saga has broadened even more the protection enjoyed by cash accounts held in the Euroclear system. The new text prevents a judgment creditor from obtaining a court order that would preclude Euroclear from channeling payments from a sovereign debtor to its bondholders.[178]

With this new development, targeting payment flows has become more difficult for sovereign debt creditors. This may explain why creditors considered with renewed attention other strategies, such as attaching central bank assets.

3. The Fortress around Central Bank Assets

Finally, a word should be said about the attempts by creditors to enforce their claims on central bank assets. Sovereign creditors have long targeted assets of state entities, such as central banks. Litigation against central banks is in fact a classic tool of international creditors.

Creditors have faced an uphill battle in this war. Central banks can indeed rely on two potent arguments to fend off attacks by creditors : in the first place, a central bank may argue that it is a separate entity, whose assets are independent from that of the state itself. Before reaching the assets held by central banks, creditors must therefore show that there are convincing reasons to disregard the independent legal status of the bank. Even if a creditor succeeds in demonstrating that the corporate veil should be pierced and that the central bank should hence be held liable for the engagement of the State, it remains that central bank assets benefit in many legal systems from a specific immunity.[179]

The first obstacle has proven difficult for creditors to bypass. In many instances, courts have not been satisfied that the presumption of independent legal status should be overturned. In a case brought against Nicaragua, a US District Court held that the central bank was only responsible for its own debts, not for the debts of the sovereign. Creditors could therefore only

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2004, at pp. 63-64.

178 This result was achieved through an amendment of Article 9 of the Settlement Finality Law. The change was effected by Article 15 of the Act of 19 November 2004 (published in the *Official Gazette* of 28 December 2004). The modified text would read as follows (the additional language is in bold): "Every settlement account concerning cash with an operator of the system (i.e. Euroclear Bank) or with a settlement organization of a system *as well as every transfer order of monies through a credit institution operating under Belgian or foreign law that must be transferred to such a settlement account concerning cash*, shall not be subject to attachment, receivership or blocking in any way, by a participant (other than the operator or the settlement organization), a counterparty or a third party". The French text reads as follows : "*Tout compte de règlement sur espèces auprès d'un organisme gestionnaire ou d'un agent de règlement d'un système, (, de même que tout transfert de sommes, via un établissement de crédit de droit belge ou étranger, à porter à un tel compte de règlement sur espèces,) ne peut être saisi, mis sous séquestre ou bloqué d'une manière quelconque par un participant (autre que l'organisme gestionnaire ou l'agent de règlement), une contrepartie ou un tiers*."

179On the immunity enjoyed by central banks in general, see CH. PROCTOR, "Central Banks and Sovereign Immunity," *Butterworths J. Int'l. Banking and Financial L.*, vol.15, issue 3, pp.70-78 (2000); L. PAUL LEE, "Central Banks and Sovereign Immunity," *Columbia J. Transnational L.*, vol. 41/2, pp.327-396 (2003) and BERND KRAUSKOPF and CHRISTINE STEVEN, "Immunität ausländischer Zentralbanken im deutschen Recht," *Wertpapier-Mitteilungen*, vol. 6, pp.269-279 (2000).

attach assets held in the name of the central bank that actually belong to the sovereign.[180] In a case involving Argentina which has already been mentioned, the Second Circuit Court likewise rejected an attempt by creditor to attach an account of Argentina's central bank held at the Federal Reserve Bank of New York, even though the creditors had argued that Argentina had a direct ownership interest in the reserves held by the central bank.[181]

Recently, creditors seemed to have updated heir intelligence on management by central banks of their reserves and of the States' funds. They have also benefited from a larger recognition by courts of the doctrine of 'alter ego'.[182]

In the United States, creditors managed to secure an important victory when the US District Court of New York issued a declaratory judgment that the Argentina central bank was the alter ego of its parent state.[183] The court justified its ruling by reference to actions undertaken by Argentina to control the activities of the central bank and its use of central bank resources to pay its own debts.[184]

In the meantime, debtors have reportedly moved some of their assets to Switzerland, where

180 *LNC Investments, Inc. v. Republic of Nicaragua*, 115 F. Supp. 2d 358 (S.D.N.Y. 2000), aff'd 228 F.3d 423 (2d Cir. 2000).

181 *EM Ltd. v. Republic of Argentina*, 473 F.3d 463 (2d Cir. 2007). In rejecting the request, the Second Circuit noted that the ability of the Republic to exercise some control over its central bank, did not mean that the ownership of the funds deposited with the Federal Reserve had changed to Argentina. The Second Circuit Court added that "To conclude otherwise would be to allow creditors of a foreign state to attach all of the assets of the state's central bank any time the foreign state issues directives affecting the central bank's reserves." 473 F.3d 463, at 475. The Court further refused to accept that Argentina's ability and willingness to control the central bank could entail a "transfer of property rights sufficient to give the Republic an attachable interest in the [reserves] (473 F.3d 463, at 479).

182 See in France, the decision of the Supreme Court (Cour de cassation) in the case of *Société Nationale des Hydrocarbures v. Winslow B&T*, 14 November 2007, Jurisdata Nr. 2007-041371. The Court held that the national oil company could be held liable for judgments against the State of Cameroon. In order to find that the company "does not have a substantial functional independence and does not enjoy a legal and factual autonomy in respect of the State", the Court noted that Cameroon held 100 % of its share capital, that the company was created to manage Cameroon's oil interests, that it was controlled by the president of Cameroon. The Court also referred to the fact that the board of the company was composed of representatives of the president and that it was Cameroon which had imposed to the oil company how it was to perform under its contract with Winslow. Hence, a creditor of Cameroon was entitled to seize a debt owed by Winslow to the oil company. In Switzerland too the Supreme Court recently loosened the requirements to pierce the veil between a State and a company or an agency. In a ruling of 15 August 2007 (*Automated Air Traffic Control v. Commission de surveillance des offices des poursuites et des faillites du canton de Genève*, 134 ATF III 122), the Swiss Federal Tribunal ruled in the famous *Noga* saga that the creditor could seize tolls collected on behalf of the Russian authority for air control, held by IATA (International Air Transport Association). Based upon an examination of the statutes of the corporation, which mentioned inter alia that its assets belonged to the Russian Federation, the Court found that the Russian corporation "*peut ainsi revêtir l'apparence d'une émanation de l'Etat russe*" (ATF 134 III 122 at p. 127).

183 *EM Ltd. and NML Capital Ltd. v. Banco Central de la Republica Argentina* No. 03 CIV 2507 (TPG) (S.D.N.Y April 7, 2010). The decision has been appealed. A ruling by the U.S. Court of Appeals for the Second Circuit is now expected.

184 Since it determined that the central bank of Argentina was an alter ego of the State, the district court concluded that the specific protection of central bank assets in the FSIA (section 1611(b)(1)) did not apply. In the proceedings before the Circuit Court, the Federal Reserve Bank of New York and the US Department of Justice have filed *amicus curiae* briefs urging the court to rule that a central bank's relative degree of independence from its parent government is irrelevant for purposes of Section 1611(b)(1) analysis.

the Bank of International Settlements is established.[185] They count on the very stringent legal framework protecting assets held by the BIS.[186]

The increased importance of the doctrine of alter ego and the heightened focus of creditors on central bank assets have put a spotlight on the legal status of central bank assets. In some countries, where no statutory protection existed for assets held by foreign central banks, legislators recently intervened to adopt such protection. This happened in Spain,[187] France [188] Slovenia [189] and in Belgium recently.[190] China also adopted specific legislation aiming to protect central bank assets.[191]

185It has been reported that the BIS has emerged as a competitor for the Federal Reserve Board of New York as safe haven for exchange reserves of foreign central banks : "Note : Too Sovereign to be Sued : Immunity of Central Banks in Times of Financial Crisis", *Harvard L. Rev.*, vol. 124, (550), 569-570 and Arturo C. Porzecancki, "From Rogue Creditors to Rogue Debtors : Implications of Argentina's Default", *Chicago J. Intl. L.*, 2005, vol. 6, 311 at p. 327.

186 Article 10 of the Constituent Charter of the BIS provides that: "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." Additional protection is afforded in the Headquarters Agreement signed between the BIS and the Swiss government on February 10, 1987 (Agreement between the Swiss Federal Council and the Bank for International Settlements to determine the Bank's legal status in Switzerland, of 10 February 1987, as amended, available at *www.bis.org/about/headquart-en.pdf*).

187See the Act 22/2005 of 18 November 2005 which modifies the 13/1994 Act on the *Banco de Espana* and incorporates a Seventh additional provision to this law. According to this new provision, in the absence of treaty provisions otherwise, "No court or administrative authority may issue an attachment order or process an execution order against goods and property rights belonging, possessed or managed by the Banco de España, when they are physically subject to the exercise of public functions or the exercise of administrative powers". The new provision adds that "The same rules shall apply to the goods and property rights belonging, possessed or managed by foreign states or central banks in which foreign reserves are invested, and to those belonging, possessed or managed by the Bank for International Settlements".

188 See the Act No. 2005-842 of 26 July 2005 which revised Article L153-1 of the 'Code monétaire et financier', which extends immunity to "[...] assets of whatever kind, including exchange reserve assets, which foreign central banks or foreign monetary authorities hold or manage for their own account or on behalf of the foreign state that govern them".

189As explained by K. van Raemdonck, "Immunities of Central Bank Assets : Towards Greater Legal Certainty?", *Euredia*, 2006, (357), 359-360.

190Act of 24 July 2008 amending the Code of Civil Procedure with a view to grant enforcement immunity to assets of foreign central banks and international monetary authorities (published in the *Official Gazette* of 14th Aug. 2008). The Act introduced an Article 1412*quate*r in the Code. The adoption of this legislation was mentioned in Switzerland as an incentive to update Swiss law in relation to immunity of central bank assets (see *Message concernant l'approbation et la mise en oeuvre de la Convention de l'ONU sur les immunités juridictionnelles des Etats et de leurs biens*, February 2009, No. 09.024) – even though the Swiss Act on Debt Enforcement and Bankruptcy was amended in 1994 to include specific language protecting the assets belonging to "*une banque centrale étrangère qui sont affectés à des tâches leur incombant comme détenteurs de la puissance publique...*" (see art. 92-1-11 of the Law of 11 April 1889, as amended).

191See the 2005 Law on Judicial Immunity from Measures of Constraint for the Property of Foreign Central Banks. According to Zhu, the main purpose behind the adoption of the Act was to "eliminate the misgivings of foreign central banks" in relation to the status of assets they held in Hong Kong (Lijiang Zhu, "State Immunity from Measures of Constraints for the Property of Foreign Central Banks : the Chinese Perspective", 6 *Chinese J. Intl. L.*, 2007, 67 at p. 73). In Japan, it has been argued recently that specific legislation should be adopted with a view to protect assets of foreign central banks – see Takehiro Nobumori, "Recent Development of Sovereign Immunity Law in Japan from a Comparative Perspective of Central Banks", 125 *Banking L.J.* 885.

In other countries, where such legislation already existed,[192] the focus has been lately on tying up loose ends in order to ensure an effective protection for central bank assets. In the United States, where the FSIA contains specific language affording some protection to central bank assets, voices have been heard recently arguing that courts should move towards a stricter reading of the immunity granted by the FSIA.[193]

All in all, professional sovereign debt holders face significant obstacles when trying to collect from sovereign debtors. As one commentator has put it, the case law and practice of sovereign debt litigation "has begun to resemble a chess match : a move by a vulture is blocked or countered, and a new move or theory comes into vogue as another avenue to try to increase the changes of recovery".[194]

192 This is the case in the *United States*, where central bank assets are protected under § 1611 of the FSIA, which immunizes property of a foreign central bank "held for its own account" - this provision was applied by the Second Circuit Court in *EM Ltd. v. Republic of Argentina*, 473 F.3d 463 (2d Cir. 2007). In *Australia*, see FSIA section 32, read together with section 35(1). In the *United Kingdom*, see section 14(4) of the Foreign Sovereign Immunity Act, which provides that a central bank's property shall not be considered as property in use or intended for use for commercial purposes – this provision was recently considered in *AIG Capital Partners Inc. et al. v. Kazakhstan* [2005] EWHC 2239 (Comm). In *Canada*, see section 12(4) of the 1982 State Immunity Act. The privileged position of central banks in London and in the US can probably be explained by the concern of both countries to keep London and NY as investment centers for foreign reserves by foreign States' central banks (see the Australia Law Reform Commission Report No; 24 on 'Foreign State Immunity, at § 132 (1984)). For other Commonwealth countries whose law is modeled on the English Act, see HAZEL FOX, *The Law of State Immunity*, 2nd ed., OUP, 2008, 472.

193 See "Note : Too Sovereign to be Sued : Immunity of Central Banks in Times of Financial Crisis", *Harvard L. Rev.*, vol. 124, (550), 569-570.

194 J. I. BLACKMAN and R. MUKHI, "The Evolution of Modern Sovereign Debt Litigation : Vultures, Alter Egos and Other Legal Fauna", *Law & Contemp. Problems*, 2010, vol. 73, (47), 61.

SECTION 2 – LIMITATIONS OF CREDITORS' RIGHTS ASSESSED : A 'FAIR BALANCE'?

A. The perils of moral judgment

The preceding section has shown that the power of creditors in general and of vulture funds in particular should not be overestimated. In practice, sovereign creditors will in most cases be able to obtain a judgment on the merits ordering the sovereign to pay. They will be helped by the widespread existence in sovereign bond issues of waiver of sovereign immunity.[195] Creditors seeking to obtain a judgment in the courts in New York and in England, the two jurisdictions of choice in sovereign bond issues, will not face much resistance on the merits. In fact, courts have no other choice than to grant the claim, mostly in summary judgments.[196]

The impact of actions by individual creditors deserve, however, a realistic appraisal. We have seen that recent developments have limited the overall impact of creditor litigation. This is further evidenced by Häseler's demonstration that the markets almost took no notice of the *Elliott* case, which has been described as a major event in creditors' rights litigation.[197] According to Häseler, the analysis of sovereign bond index returns shows that the *Elliott* case had no noticeable impact. This may be explained by various factors, which are discounted in Häseler's analysis. One possible explanation, which should be taken into account seriously, is that for the creditors at large, the actions of single creditors are so far off, so remote, that the majority of creditors feel unconcerned by the action.[198]

Going further, one may note that even if they succeed in obtaining a judgment, creditors will face substantive hurdles when trying to collect the money owed to them.[199] In some rare cases,

195 This is perfectly valid and accepted practice : see section 1605(a)(1) of the FSIA, which provides an exception to sovereign immunity when “the foreign state has waived its immunity either explicitly or by implication.” For other references to waiver in the FSIA, see sections 1610(a)-(c), § 1610(d) and § 1611(b)(1). When Argentina defaulted in 2001, the US federal courts found that Argentina was not immune from suit and that the creditors were entitled to be paid. For example, the Second Circuit decided, in *EM Ltd. v. The Republic of Argentina, 382 F.2d 291* (2004), that Argentina was required to pay the plaintiff bondholder $740 million on defaulted debt. See section 22 of the 1994 Fiscal Agency Agreement dated October 19, 1994, which governed the bond indebtedness on which a New York court granted a summary judgment in *Lightwater Corporation Ltd. v. Republic of Argentina*, 2003 WL 1878420 (S.D.N.Y. 14 Apr. 2003). Section 22 of the 1994 FAA states that the Republic waives sovereign immunity and consents to jurisdiction in any state or federal court in the borough of Manhattan in the City of New York.

196 At most, courts have in some cases stayed the judgment in order to win some time, with a view not to disrupt the ongoing restructuring. This is what some US courts have done, using their discretion and ordering a temporary stay. This is what a court in New York did in the case *Pravin Banker vs. Banco Popular del Peru*, in which the court stayed Pravin’s claims for full repayment by Peru on two occasions to avoid a disruption to the ongoing Brady deal negotiations. See MARCUS MILLER & DANIA THOMAS, 'Sovereign Debt Restructuring : the Judge, the Vulture and Creditor Rights', Discussion Paper - University of Warwick, Department of Economics, August 2006.

197 See above Part I, section I, under A.

198 S. HÄSELER, “Individual Enforcement Rights in International Sovereign Bonds” MPRA Paper, Nov. 2008. See also SÖNKE HÄSELER, “Trustees versus Fiscal Agents and Default Risk in International Sovereign Bonds”, German Working Papers in Law and Economics: 2010(1). On the same issue, consider also the research of Alfaro & Co : L. ALFARO, N. MAURER and F. AHMED, “Gunboats and Vultures : Market Reaction to the 'Enforcement' of Sovereign Debt”, Rutgers Working Paper.

199 When looking at the difficulty of creditors to collect what is owed to them, one cannot but make the link with

the sovereign debtor will have waived its immunity of enforcement.[200] In most cases, creditors will have to maneuver around the enforcement immunity enjoyed by the sovereign debtor. Even when targeting assets outside the sovereign's jurisdiction, the exercise is difficult. Most sovereigns own few assets in foreign jurisdictions. Direct assets such as immovables are not only almost always subject to immunity. Their value is also often insufficient to satisfy the claims made by private creditors.

This explains why creditors have targeted other assets such as money, mainly the foreign currency accounts opened by the sovereign's central bank. In addition, payment flows and payments to be made to creditors and future income streams have been targeted, with creditors able to enjoy a few victories, notably in Belgium.

In most cases, these efforts have, however, proved futile. As noted by Sturzenegger & Zettelmeyer, "creditors have in general been relatively unsuccessful in devising legal strategies that have allowed them to obtain payment from defaulting nations".[201] We have seen that recent changes in national legislations have made it more difficult for creditors to replay the same song.

Ultimately, the greatest part of the victories enjoyed by private creditors may, however, not directly result from a court judgment, but from a settlement reached with the sovereign debtor. Most sovereign creditors who have enjoyed success, have done so after pressuring a sovereign debtor in making a settlement, *e.g*. by attaching important payment money.[202]

Even if sovereign debtors are arguably more vulnerable now than a hundred years ago, mainly because of the advent of the doctrine of limited immunity, sovereign debt litigation is therefore more a nuisance than an obstacle for sovereign debtors. It is therefore no surprise that a decrease has been reported in the number and intensity of creditor litigation.[203]

the enforcement of ICSID awards and awards rendered in furtherance of BIT's. See on this theme, IAN A. LAIRD and ALAN ALEXANDROFF, "Compliance and Enforcement", in *The Oxford Handbook of International Investment Law*, P. MUCHLINSKI et al. (eds.), OUP, 2008, at pp. 1171-1187.

200 See *Af-Cap Inc. v. Chevron Overseas (Congo) Ltd.*, 475 F.3d 1080 (9th Cir. 2007) - the Ninth Circuit notes the Republic of Congo's contractual waiver of immunity from execution.

201 F. STURZENEGGER & J. ZETTELMEYER, "Has the Legal Threat to Sovereign Debt Restructuring Become Real?". Prof. Hal also concludes in the same sense : he writes that "The bottom line is that while creditors have been able to obtain judgments that sovereign defaulters must repay their debt, they have been unable — with a few notable exceptions — to attach assets in satisfaction of their judgments" (HAL S. SCOTT, "Sovereign Debt Default : Cry for the United States, not Argentina", Working Paper Washington Legal Foundation No. 140, Sept. 2006 at p. 17).

202 This is particularly the case for *Elliott Associates*, *e.g*. in its dealings with Panama : Elliott first obtained judgments covering the full claims (even though it had acquired the debt at a substantial discount), but then forced Panama to settle because it made attachments which could have proven seriously prejudicial for Panama. Elliott attached US assets of a national telecommunications company which Panama was about to sell to the market. It also made attachments which would have interfered with a new bond issue in New York. Likewise in the Peru case, Elliott forced Peru to settle through attachments in Belgium (above).

203 See the conclusion reached by EMTA in 2009 : "In recent years, the trend … has been that creditors have found it increasingly difficult to enforce debt claims against sovereigns" (EMTA Preliminary Analysis of Creditor Litigation in the Non-HIPC Sovereign Debt Restructuring Context, June 2009, at p. 3). See also the EMTA response to Debt Relief Consultation : "Litigation against HIPCs is already rare and becoming rarer, and would not appear to pose a significant threat to future debt relief initiatives." (submission by EMTA, HM Treasury consultation, 'Ensuring effective debt relief for poor countries', February 2010, at p. 5). See also the

If one should not overestimate the power of creditors in general and of vulture funds in particular, it does not mean that sovereign debt litigation is irrelevant.[204] Notwithstanding recent evolutions, which have decreased the effects which creditor litigation could have on sovereign defaults, it is indubitable that actions by creditors may have adverse effects on the sovereign debtor. Actions by creditors may force debtors to incur significant costs, in particular legal fees associated with defending claims. Further, substantial time must be devoted to managing actions undertake by creditors.[205]

The case of the Democratic Republic of Congo perfectly illustrates what a sovereign creditor must do in order to obtain payment of its debts and what the sovereign debtor will endure if it does not pay. The DRC has been dragged in court in various jurisdiction by a venture fund, FG Hemisphere, which has spawned a number of proceedings against the Republic, for a period of time extending over many years. It seems that FG Hemisphere's claim goes back to a credit agreement entered in 1980 by the DRC (then Republic of Zaire) and its state-owned electric company *Société Nationale d'Électricité* ('SNEL') with Energoinvest, an engineering company established in the formed Yugoslavia, to finance the construction of an electric power transmission facility in Zaire. After the DRC had failed to repay what it owed under this agreement, Energoinvest obtained two arbitration awards against the DRC.[206] Energoinvest then assigned its rights in the award to FG Hemisphere, a company that identifies itself as "financial advisor and investor specializing in sovereign debt obligations in emerging markets".[207] The dispute led to proceedings in many different countries, with FG Hemisphere Associates claiming more than USD 100 million.

2009 Status of Implementation for the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI), under the umbrella of the IMF and the IDA (Sept. 15, 2009), at p. 19, § 24). The Report nonetheless indicates that "While recent developments are encouraging, the threat of new litigation remains" (at § 25).

204 Porzecanski has argued that attempts by private creditors to obtain payment by litigation when a sovereign debtor defaults, is a "fruitless endeavor" (Arturo C. Porzecanski, "From Rogue Creditors to Rogue Debtors : Implications of Argentina's Default", *Chicago J. Intl. L.*, 2005, vol. 6, 311 at p. 326). In his view, the few victories obtained by private creditors are "pyrrhic victories" ("When Bad Things Happen to Good Sovereign Debt Contracts : the Case of Ecuador", MPRA Working Paper, February 2010, at p.17). He also writes that "rogue sovereign debtors, rather than rogue private creditors are the ones that pose the greatest threat to the integrity and efficiency of the international financial architecture" (Arturo C. Porzecanski, "From Rogue Creditors to Rogue Debtors : Implications of Argentina's Default", *Chicago J. Intl. L.*, 2005, vol. 6, 311 at p. 331).

205 The very relative importance of court action and the weakness of the creditors, does not mean that courts do not have any role to play in sovereign debt restructuring. The example of Argentina and the treatment of his restructuring by US courts, shows that courts may have some influence on restructuring. As Miller and Thomas have argued (M. Miller & D. Thomas, "Sovereign Debt restructuring : the Judge, the vultures and creditors rights", 2006), courts may exert some influence notably by balancing the rights of the creditors and the interest of a successful restructuring. In the Argentinian case, judge Griesa apparently carefully calibrated his interventions in order to nudge the debtor to make an offer while preserving the creditors' rights. This is most apparent in the first ruling given by judge Griesa, in which he granted summary judgments in favor of the creditors, while staying the enforcement (*EM Ltd. v. The Republic of Argentina* 2003 WL 22120745 (S.D.N.Y. Sept. 12, 2003). Whatever truth there is in this analysis, it remains that creditors have as such very little impact on sovereign restructuring.

206 For an amount of USD 37 million.

207 An account of the factual background of the dispute may be found in the Annual Report of the Belgian Supreme Court ('Cour de cassation' / 'Hof van Cassatie'), 2008, at pp. 62-63.

In its quest to collect the judgment, FG Hemisphere attempted to attach money owned by a mining company to the DRC, seeking authorization to do so in Belgium where the company had a branch.[208] In the United States, FG Hemisphere sought to lay its hands on two properties owned by the Democratic Republic of Congo and located in Washington DC.[209] In Hong Kong, Hemisphere attempted to intercept a payment of USD 104 million due to the DRC from a Chinese company owned by the central government of the People's Republic of China. The money was part of a global sum promised to the DRC by the Chinese company in connection with an infrastructure project in the DRC.[210] The DRC sought to set aside court orders permitting interception of that payment, mainly on grounds of sovereign immunity.[211] It appears that FG Hemisphere also filed proceedings in Jersey,[212] the Bahamas, Australia [213] and

208See Supreme Court, 26 Sept. 2008, *FG Hemisphere v Gécamines*, published in *R.G.A.B.*, 2010, at p. 1203, with comments by A. HANSEBOUT. The Court refused to allow the attachment, holding that no attachment could be made in Belgium since the receivable was not located there, but in the DRC where the mining company had its main establishment.

209The dwellings were occupied by DRC diplomatic officials by virtue of their official capacities until the mid-1990s. FG Hemisphere attempted to obtain writs of execution against the two properties. At first, the Republic did not appear in court. The District Court consequently entered default judgments against the Republic (in sept. 2004 and January 2005) and it issued writs of execution against the properties. A few months later, the Republic sought permission to have the execution orders quashed, on the ground that the properties were immune from execution. The District Court refused to grant such permission, in view of the Republic's negligence to appear in court. In May 2006, the Court of Appeal granted the permission, on the basis that the DRC's failure to respond earlier was due to "excusable neglect" (*FG Hemisphere Associates, LLC v. The Democratic Republic of Congo*, 447 F.3d 835 (DC Circuit 2006)). Other proceedings followed, among other concerning discovery requests made by FG Hemisphere which sought information on the location of the DRC's assets. In March 2009, the District Court for the District of Columbia held the DRC in contempt of court because it had failed to comply with previous discovery orders (*FG Hemisphere Associates, LLC v Democratic Republic of Congo and Société Nationale d'Electricité (SNEL)*, 603 F. Sup. 2D 1(2009) (District Court, District of Columbia).

210See *FG Hemisphere Associates LLC v Democratic Republic of the Congo (No 2)*, [2010 2 HKLRD 1148 (5 May 2010) and *FG Hemisphere Associates LLC v Democratic Republic of the Congo*, [2010] 2 HKLRD 66 (10 Feb. 2010). Specifically, the money FG Hemisphere sought to attach consisted of 'entry fees', which were due to be paid by a consortium of PRC enterprises to the DRC as part of a development project under a co-operation agreement singed by the DRC and the PRC. The project contemplated the setting up of a joint venture company which was to develop local infrastructure in the DRC in return for the right to exploit certain mineral resources over the life of the project. On the decisions of the Hong Kong courts, see NICHOLAS PENGELLEY, 'Waiver of Sovereign Immunity from Execution: Arbitration is Not Enough' (2009) 26 *J. Int'l Arbitration* pp. 859–872

211After adopting the doctrine of restrictive immunity, which it found was part of customary international law, the Hong Kong Court of Appeal held that the Republic's participation in an arbitration proceedings was not in itself sufficient to constitute waiver of immunity from execution enjoyed by it as a sovereign State. The Court therefore remitted the case to the Court of First Instance for re-examination of the issue whether the entry fees payable to the DRC were commercial in nature.

212See MICHAEL J. KAVANAGH, "Congo, US-Controlled Venture Lose $ 100 Million Vulture Claim", Bloomberg 3 Nov. 2010 – reporting that the Royal Court in Jersey in the Channel Islands ordered a joint venture operating one of the biggest mines in Congo (GTL) to pay all amounts to due to one of the joint venture partners (the company Gécamines, which the court found to be "an organ of the state") to FG Hemisphere in order to satisfy its debt. The judgment is under appeal.

213In December 2010, the New South Wales Supreme Court ruled that FG Hemisphere's claims could be pursued in Australia.

South Africa.[214] [215]

Certainly, sovereign debt litigation is not much ado about nothing. For sovereign creditors, the consequences of being dragged to court by private creditors can be dire – in particular because those creditors with sufficient resources to initiate proceedings against sovereign debtors, will not hesitate to launch multiple proceedings, in several countries and to make use of the full scale of remedies and tools offered by civil procedure.

Besides the annoyance and the steep costs of being dragged to court, creditor action can, if it succeeds, divert funds which, at least for the poorest countries, could also be allocated to other goals. It does not take much imagination to picture the contrast between the profits which sovereign creditors could make when collecting on a debt bought at a steep discount on the secondary market and the immense needs of the population of some sovereign debtors.

This type of moral argument has precisely been used to pressure governments to act.[216] The case has been made by militants in the debt forgiveness and repudiation movement – Jubilee 2000, CADTM, Eurodad, and Latindadd, which have been very vocal in arguing that the actions of 'vulture funds' should be curtailed. They have been helped by the sovereign creditors themselves, the most aggressive of which being secretive hedge funds based in exotic jurisdictions, who purchase heavily discounted claims on the secondary market and launch aggressive litigation campaigns against very poor countries.

The balance of morality is, however, difficult to establish. Identifying the 'good and the 'bad' is less straightforward if one remembers that sovereign defaults are declared by the debtor himself. This is a rare case of a debtor who by its own initiative, can refuse to pay its debts, without being immediately subject to a legally organized restructuring procedure and while remaining in principle in full possession of all its assets. The sovereign debtor's assets may indeed not be taken away. Even when a default is declared, these assets enjoy in principle some form of immunity, making it more difficult for the creditors to obtain payment. Even taking into account the recent limitations to sovereign immunity, sovereign debtors still enjoy considerable advantages, when compared with corporate debtors.

What is more, the battle between sovereign debtors and creditors does not always resemble the case of the impoverished widow unable to pay the heating bill in wintertime. Without going as far as calling some sovereign debtors 'rogue debtors',[217] it is clear that some

214 In 2008, a South African court ruled that FG Hemisphere could seize payments for Congolese electricity sold to South Africa. See the Report of the 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, UN Human Rights Council, 29 April 2010, A/HRC/14/21, at p. 8, § 19.

215This is not the only instance where the DRC has faced a with a creditor. Kensington has also proven a very tenacious creditor. See the account of the many proceedings between Congo and Kensington in MICHAEL D. GOLDHABER, “Vulture Culture - Kensington International litigated around the world to collect on bad debt from the Congo Republic”, *The American Lawyer* ,September 1, 2008.

216See recently the Op-Ed by RENAUD VIVIEN, “Nouvelle victoire d’un fonds vautour contre la RDC, que fait la Belgique?”, published in *Le Soir* (a daily published in Belgium), 20 December 2010.

217As Porzecanski does – Mr. Porzecanski has been very vocal in making a case against sovereign debtors in several recent publications - see ARTURO C. PORZECANSKI, “When Bad Things Happen to Good Sovereign Debt Contracts : the Case of Ecuador”, MPRA Paper N 20857 February 2010 and “From Rogue Creditors to Rogue Debtors : Implications of Argentina’s Default”, *Chicago J. Intl. L.*, 2005, vol. 6, 311-332.

sovereign debtors have adopted tactics which make full use of all possibilities offered by the law and the market structure.[218] This is particularly evident when one contemplates the latest restructuring by Ecuador in 2008. Not only did Ecuador's default by all appearances come very close was to a case of opportunistic default. Ecuador also played the full scale of available means in order to conduct the restructuring.[219] The plight of Argentina, assailed by court proceedings in many forms, has already been mentioned. One should, however, not forget that Argentina took a very aggressive stance when it defaulted on its debt in 2001. Argentina indeed refused to engage in any dialogue with its creditors while steadfastly pursuing its goal of setting up its massive exchange operation.

The picture is even more blurred on the moral ground if one considers who are the creditors holding sovereign debt. Not all creditors are highly specialized investment boutiques set up to prey on distressed sovereign debt. Even if one only takes into account those creditors who have launched litigation against sovereign debtors, it has been shown that at least some of these are in fact the original creditors who have done business with the State in the first place.[220]

The market for sovereign debt is in fact very diverse. How should one recognize and identify those creditors whose behavior is so repugnant that they must be punished? 'Rogue' creditors have attracted the ire of many, from national Parliaments to civil society involved in debt reduction. The focus of the public debate is mostly on the 'fat' rewards that distressed debt funds have (supposedly) reaped from collecting on sovereign debts they have bought for a penny the pound. It is submitted that one should not start from the assumption that one will recognize a 'vulture' fund when one sees is, as Justice Stewart so famously wrote in relation to “adult movies”.[221] One should, on the contrary, take into account the growing heterogeneity of holders of sovereign debt.[222]

218Some sovereign creditors have gone further and denounced acts of corruption and personal enrichment committed by government officials of debtor countries. This has made for an unlikely alliance between NGO's fighting for transparency of government and combating corruption and counsel for sovereign creditors. See the submission by Dechert LLP, HM Treasury consultation, 'Ensuring effective debt relief for poor countries', February 2010, at §§ 79-87 - with examples drawn from Chad and the Republic of Congo) and the account of a battle between Kensington and officials of the Congo Republic in Robert Friedman, “Judge : Vulture fund leaked documents to human rights group”, August 21, 2007, *http://features.blogs.fortune.cnn.com/category/privacy/*.

219For more details, see Lee C. Buchheit and G. Mitu, “The Coroner's inquest”, *Intl. Financial L. Rev.*, 2009, vol. 27, at pp. 22-25.

220See the submission EMTA, HM Treasury consultation, 'Ensuring effective debt relief for poor countries', February 2010, at p. 6 – the figures demonstrate that of all creditors bringing litigation against sovereign debtors, a substantial portion are 'trade creditors' and 'original lenders”.

221“I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description ["hard-core pornography"]; and perhaps I could never succeed in intelligibly doing so. But **I know it when I see it**, and the motion picture involved in this case is not that. [Emphasis added.] ” (Justice Potter Stewart, concurring opinion in *Jacobellis v. Ohio* 378 U.S. 184 (1964), regarding possible obscenity in *The Lovers*.)

222In the Nicaragua case, a court in Belgium refused to accept that LNC was a “vulture fund”, as claimed by the State of Nicaragua. The Court noted that “*LNC est une respectable société d'investissements détenue à 100% par la société Leucadia National Corporation. Leucadia est une société côtée en bourse à New York dont les actifs cumulés s'élèvent à plus de USD 1 milliard et qui exerce diverses activités au travers de ses filiales telles que la promotion immobilière, la fourniture de services financiers, de services de télécommunication etc., et qui, en effet, contrairement à ce qu'affirme la République du Nicaragua, n'est nullement un fond*

In the case of Argentina, the largest restructuring in recent years, reports suggest that there were many thousands of creditors in various jurisdictions. Looking at these creditors, one can distinguish the institutional investors (commercial banks and investment banks), from the small, retail investors who could be scattered all over the world. If one looks more closely, even these categories could be refined if one takes into account the method of acquisition. Some of these investors may have bough Argentinian paper first hand, when it was issued. Other may have bought it on the secondary market. And looking at the latter category, some creditors may have bought papers at a substantial discount. Among those, some may have made an investment, hoping to be repaid in full at face value. Other, who may have bought when the default was forthcoming, may have sought to make a profit in case of restructuring, hoping that the 'haircut' would be smaller than the discount they obtained. Finally, other may have decided that the bonds would be held even in case of restructuring, by holding out and seeking additional payments.[223]

Sovereign creditors are not all out for quick and easy 'windfall' on distressed sovereign debt.[224] Furthermore, one should not forget that behind the actual sovereign creditors, claims made against sovereign debtors on account of unpaid sovereign bonds can find support in one of the most fundamental tenets of modern legal systems, i.e. the principle of sanctity of contracts. Indeed, the enforceability of valid contracts is a general principle which is also in the interests of the common welfare. In this sense, limitations imposed on the creditors' rights necessarily also erode the principle that contractual claims should be upheld.[225]

Ultimately, courts may not best placed to make moral judgments, especially when the waters are muddled. It is submitted that those judgments should in the first place be left to legislators – who are better placed to redraw the lines of the law if morality insists on doing so. When it comes to the perils of so-called 'vulture funds', some legislators have already taken the

vautour "spécalisé dans le rachat de créances de débiteurs insolvables dans le but de réaliser des plus-values considérables" - see ruling of the Commercial Court of Brussels, 11 September 2003, opinion unpublished, case R.K. 204/03, at p. 9.

223 It is not unrealistic to assume that an investment fund can pursue a two-layered strategy, buying debt first and foremost to obtain a nice pay-out (if the sovereign debtor pays, even with a haircut) and considering holding out or resorting to litigation only as subsidiary options.

224 In fact, not only are not all sovereign creditors driven by the same motives. On top of this, the actions undertaken by individual creditors may be seen as prejudicial to the interests of the creditors at large Buchheit rightly noted in this respect that the attempts by well-known holdout creditors such as Elliott Fund and the like, may have prompted the community of sovereign debt creditors at large to reconsider their position on the benefits which may be derived from litigation. Buchheit recalled the "first rule of Sherwood Forest : when he takes from someone else, he is Robin Hood; when he takes from you, he is a brigand" (L. Buchheit, "Supermajority control wins out", *Intl. Fin. L. Rev.*, 2007, 26/5, 21).

225 The US government made reference to the principle of the sanctity of contracts in various *amicus curiae* briefs filed in creditor litigation. In *Allied Bank Int'l*, the government is on the record as saying that "the United States has a strong interest in ensuring the enforceability of valid debts under the principles of contract law, and in particular, the continuing enforceability of foreign debts owed to United States lenders." - See *Allied Bank Int'l. II*, 757 F.2d 516 at 522-22 (2nd Cir. 1985). The US government attempted to balance this principle with its concern to encourage participation in voluntary debt resolution procedures. To that end, the government explained that "although the United States advocates negotiations to effect debt reduction and continued lending to defaulting foreign sovereigns, it maintains that creditor participation in such negotiations should be on a strictly voluntary basis. It also requires that debts remain enforceable throughout the negotiations" See *Allied Bank Int'l II*, 757 F.2d at 519.

initiative. The various laws reviewed earlier are clearly premised on moral judgments. Instead of submitting these laws to yet another test of 'morality', which by essence rests on fragile assumptions, it is submitted that more would be learned if these legislations were reviewed on the basis of a key fundamental right, i.e. the right to property. This seems to be a valid alternative to moral judgment – as fundamental rights are the expression of higher values.

B. Limitations of creditors' rights and the taking of property

Belgium and the United Kingdom seem so far to be the only jurisdictions where legislation was enacted limiting the rights of private creditors seeking to collect from sovereign debtors. The two legislations are quite different. The Belgian version of the 'Anti-Vulture Act' is a very narrow one, as it is confined to making attachments of some assets impossible. It only seeks to protect funds earmarked for development aid. Whatever one thinks about partnerships between rich and poor countries and the efficiency of development aid, it remains a fundamental gesture of solidarity whose existence it is difficult to call in question.

The English version of the Act goes much further : it targets not so much the possibility for creditors to collect their dues, but the very source of creditors' rights by making it impossible to obtain a title. At the same time, the Act is very focused, as it only applies hen the sovereign debtor which has been found to meet the requirements of the HIPC Initiative. The operation of the Act is further limited by a series of requirements and caveats.

What both legislations have in common, is that they do not specifically target certain categories of creditors.[226] In contrast with the French attempt, which sought to extend the reach of the champerty statute by targeting creditors who have bought sovereign debt with a view to speculate on possible litigation,[227] both the English and the Belgian Act do not distinguish between creditors on the basis of their (presumed) intention.[228] To take the example of the Belgian Act, the prohibition on attaching certain assets it introduces, is applicable to all creditors, whatever their status. *Bona fide* creditors – whatever this concept may mean in the context of sovereign creditors - are therefore barred from attaching these

226The same can be said of Collective Action Clauses, which apply to all creditors holding a particular issue of sovereign debt.

227The first part of the Bill put to the French Parliament did not make such a distinction and was deemed to be applicable to any creditor of a foreign sovereign.

228It is submitted that the approach adopted by the French legislator is bound to create additional litigation. It may indeed prove very difficult to ascertain what was the intention of the holder of sovereign debt when it acquired the debt. The Bill which was submitted to the US Congress introduced a more objective criteria, as it defined the concept of '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” (section 3.1.). The only exclusion is that selected public bodies are not deemed to act as 'vulture funds' even though they may have purchased sovereign debt at a discount. The definition excludes 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). The Bill purported to prohibit 'sovereign debt profiteering', which was defined as the activity of such 'vulture creditor' seeking payment of a defaulted sovereign debt in an amount that exceeds the total amount paid by the vulture creditor to acquire the debt (section 3.4). It is submitted that this very broad provision could have an adverse impact on the secondary market of sovereign debt as it would touch any investor buying sovereign debt for less than its nominal value.

assets, as are vulture funds.[229]

If the measures adopted or considered for adoption by various States, do not follow the same model, they all have in common that they impose more or less radical limitations to the contractual rights acquired by the creditor. It is therefore legitimate to inquire whether these limitations comply with the protection of private property rights. *Brevitatis causae*, the inquiry will be limited to the protection afforded by Article 1 of the 1st Protocol to the European Convention on Human Rights.[230]

Here is no doubt that the protection afforded by this provision may be called upon by holders of sovereign debt. All claims held by sovereign creditors indeed enjoy protection under Article 1 of the 1st Protocol.[231] The ECHR has adopted a rather wide reading of the concept of 'possessions'. Shares and the benefit of a legal claim have been deemed to fall within the scope of protection of that provision.[232] So have contractual rights. The Court has in fact already accepted that an assignment of debt is capable of amounting to a 'possession' in the sense of Article 1 Protocol 1.[233] In addition it is not contested that a enforceable judgment against a State constitutes a property right in the sense of Article 1.[234] When a sovereign creditor has obtained a judgment against its debtor following the latter's default, there is therefore no doubt that Article 1 comes into play.[235]

It is not enough, however, to conclude that the creditor's contractual right or judgment debt qualifies as 'possessions'. One should also examine to what extent this right or debt is protected under Article 1, Protocol 1. In particular, one should ask whether under this provision the creditor's property right extends only to the market value of the claim, or at least to the value paid by the creditor when acquiring the debt, or if it extends to the nominal value, which may be much higher. Certainly, when issuing proceedings in court against the sovereign debtor, the creditor will seek a judgment for the full nominal value. On the other

229 See the criticism of this aspect by A. Hansebout, “De wet van 6 April 2008 : over onbeslagbaarheid en aasgierfondsen”, *Rechtskundig Weekblad*, 2008, at p. 597.

230 It does not seem useful to apply the same analysis to the Collective Action Clauses which have been previously mentioned. CAC's are indeed *ex ante* limitations, which are well known to the market and which each investor may carefully weigh before deciding to invest. The market indeed has ample resources to put a price on these limitations.

231 This was acknowledged by the Treasury in its Explanatory Notes to the Debt Relief (Developing Countries) Bill, at p. 9, § 42.

232 See *e.g. Bramelid and Malmstrom v Sweden* (1982) 29 DR 64 (EComHR) and *National Provincial Building Society v UK* (1977) 25 EHRR 127 (ECtHR).

233 In the case *Aleksey Nosov v Russia*, decision as to the admissibility of 20 October 2005, application No. 30877/02 (the 1st section of the Court declared an application inadmissible after noting that the judgment debt had been assigned to the applicant after it had already been quashed by Russian courts).

234 See *e.g. Burdov v. Russia* (2004) 38 EHRR 639 (ECtHR 7 May 2002) and the Stran Greek Refineries case, which concerned arbitral awards which had been annuled by a Greek court (*Stran Greek Refineries and Stratis Andreadis v Greece*, Series A No 301-B, (1994) 19 EHRR 293 (ECtHR 9 Dec. 1994).

235 The fact that the sovereign creditor may have experience difficulties, even substantial and extending over a long period of time, in collecting what is due to him under the judgment, cannot be used to argue that the claim has ceased to constitute possessions in the sense of Article 1, Protocol 1. The European Court has only accepted that property rights constituting possessions cease to do so if they have long been impossible to exercise effectively in cases dealing with the aftermath of the second World War (see *e.g. Wolf-Ulrich von Maltzan et al. v. Germany*, (2005) 42 EHRR 93 (Grand Chamber, 2nd March 2005). The Court will not come to such a conclusion if the rights not able to be exercised have had a 'continuing legal basis'.

hand, it is very unlikely that a secondary creditor (who bought the debt on the secondary market) will have paid the full nominal value. Most creditors on the secondary market will have acquired the debt at a discount knowing that it would be difficult to collect anything from the sovereign debtor.

There does not seem to be any good reason to argue that the protection enjoyed by the creditor under Article 1 Protocol 1 is limited to a claim to obtain from the State what the creditor paid on the market when acquiring the debt. There does not seem to be any room under the case law of the Court for a distinction between market value, acquisition value and nominal value. It may even be doubted whether whether a distinction could be made between the claim, which would amount to possessions and the creditor's hope to recover the full value of the debt, which could be seen as 'legitimate expectations'. The concept of 'legitimate expectations' under Article 1 is, indeed, a difficult one to apply.[236] At the end of the day, under the common law of contract, a creditor is entitled to full recover of his claim. Hence, we should proceed based on the assumption that the creditor enjoys under Article 1 full protection for his sovereign debt.[237]

A first step in the analysis is to inquire under which rule the limitation brought by the legislator falls. As is well known, the Court has distinguished three rules in Article 1 : the first one confers a general right to peacefully enjoy one's property. The Court has added to this general rule two specific principles, i.e. the right not to be deprived of property and the right of a State to control the use of property.[238]

While it seems clear that the limitations imposed by the Belgian Act only amounts to regulation of property rights,[239] the nature of the 'interference' brought by the UK Debt Relief Act with private property of sovereign creditors is subject to debate. In its Explanatory Note, the Treasury explained that the debt reduction which private creditors would undergo as a result of the operation of the law would more likely be a 'control of use' than a 'deprivation' of possessions.[240] This was challenged by representatives of the sovereign creditors who argued, during the consultation which was launched prior to the adoption of the law, that as the creditors would lose a substantial part of their debts, the act would result in a *de facto* deprivation.[241]

Looking at the English legislation, one could hesitate as to the proper characterization of the

236As the European Court itself seemed to have acknowledged in Kopecky (*Kopecky v Slovakia*, (2004) 41 EHRR 944 (Grand Chamber, at para. 48)). See in general P. Popelier, "Legitimate Expectations and the Law-Maker in the Case Law of the European Court of Human Rights", 1 *European Human Rights Law Review* 2006, 10-24 and L. Wildhaber, "The Protection of Legitimate Expectations in European Human Rights Law", in *Economic Law and Justice in Times of Globalisation: Festschrift Carl Baudenbacher*, M. Monti et al. (eds.), 2007, Nomos, 253 ff.

237The difference between the nominal and the market value of the claim could, however, become relevant when assessing whether the taking of property strikes a fair balance between the public interest and the private interest of the creditor (see *infra*).

238See the seminal judgment of the court in *Sporrong and Lönnroth v Sweden* Series A No 52 (1983) 5 EHRR 35 (ECtHR 23 Sept. 1982).

239'Control of use' to use the language of the Convention.

240Explanatory Notes, Debt Relief (Developing Countries) Bill, 2010, at p. 9, para 42.

241See *e.g.* the comments made by Dechert LLP in submission by Dechert LLP, HM Treasury consultation, 'Ensuring effective debt relief for poor countries', February 2010, at p. 13, § 45.

legislative intervention. If one considers the net effect of the English Act, it is not unreasonable to accept that the creditor is deprived of at least part of its property. To be sure, the operation of the Debt Relief (Developing Countries) Act does not amount to formal expropriation, since there is no formal transfer of ownership. Nevertheless, the prohibition imposed to courts to render a judgment for the full value of the claim render the creditor's title to its claim effectively useless, at least for the part for which no title may be obtained. In that sense, there is deprivation of property, even though the formal title to the sovereign debt continues to rest with the creditor. The European Court has long made clear that Article 1 also applies to *de facto* expropriation.[242] The adverse impact on the title to claim is undeniable. In effect, this impact amounts to the extinction of part of the legal rights enjoyed by the creditor, at least before the courts in England. What is a claim indeed worth if the legislator provides that it cannot be enforced in court?

In any case, the question of the proper characterization of the Debt Relief Act does not seem decisive. Indeed, the European Court has itself blurred the line between deprivation, control of use [243] and the general rule barring interference with the peaceful enjoyment of possessions.[244] Noting the Court's disinclination to specify the relevant rule into which an interference falls to be considered, it may be accepted that "the identification of the type of interference is less important to the outcome of a case than is the process involved in the application of the 'fair balance' test".[245]

Once it is accepted that the Debt Relief Act leads to deprivation of property enjoyed by sovereign creditors, it must be asked whether this deprivation can be justified under Article 1 of Protocol 1.[246] There is no doubt that the measure is in accordance with the conditions provided for by national law. The Debt Relief Act makes very detailed provisions. It has been adopted after a public debate during which representatives of sovereign creditors intervened at

242*Sporrong and Lönnroth v Sweden* Series A No 52 (1983) 5 EHRR 35, at § 63 (ECtHR 23 Sept. 1982).

243Most famously in its judgment in the *Pye* case, where the Court held that the operation of the English law rule whereby property of registered land could pass on to those who occupy the land for a long period (the so-called 'adverse possession'), should be investigated on the basis that it amounts not to deprivation but to control over the use of property (*JA Pye (Oxford) Ltd. and JA Pye (Oxford) Land Ltd. v. UK* (2008) 46 EHRR 1083 (ECtHR – 30 August 2007). See in general the comments by M. PELLONPAA, "Reflections on the notion of 'deprivation of possessions' in Article 1 of the First Protocol of the European Convention on Human Rights", in P. MAHONEY et al. (eds.), *Protecting Human Rights : the European Perspective. Studies in Memory of Rolv Ryssdal*, Carl Heymanns, 2000, 1087 ff.

244In the context of the Debt Relief Act, the judgment of the Court in the Stran Greek Refineries is relevant : in that case, the Court decided that a legislation which declared void and unenforceable an arbitral award which had been issued by an arbitral tribunal in favor of the applicant, was an interference with the general rule of Article 1, rather than a *de facto* deprivation (*Stran Greek Refineries and Stratis Andreadis v. Greece*, Series A, No. 301-B (1994) 19 EHRR 293 (ECtHR 9 Dec. 1994), at § 66 and 67).

245As noted by D. HARRIS, M. O'BOYLE et al. in *Harris, O'Boyle and Warbric Law of the European Convention on Human Rights*, 2nd ed., OUP, 2009, at p. 668.

246There does not seem to be any doubt that the prohibition of attachment of certain assets introduced by the Belgian Act is Convention compliant. The limitation imposed by the Act is at most a very limited threat to creditors and should not bother them too much. Given the very narrow scope of the legislation, which seeks to protect only designated amounts, it is submitted that it is very unlikely that the legislation would be run afoul of Article 1 Protocol 1.

length.[247] The Debt Relief Act does not leave much room for discretion to courts.[248] It must therefore be accepted that the Act is sufficiently precise and foreseeable legal basis. This is even more so since the business model of many of the creditors targeted already incorporate the need to seek sophisticated legal advice. As far as primary creditors are concerned, it does not seem unreasonable to expect that a company dealing with a sovereign counterpart will seek specialist advice .[249]

Can it be said that the deprivation of the sovereign creditor's property is in the interest of the public? The Debt Relief Act seeks to protect the process of debt relief undertaken under the HIPC Initiative and guarantee that the affected sovereign debtors will be able to freely access the amounts freed up by the process. This goal is not peculiar to the United Kingdom. In fact the goal of poverty alleviation through debt forgiveness and debt reduction is shared by the international community at large, as is demonstrated by the HIPC initiative itself, which enjoys the support of many states and international organizations. This makes it a very strong aim to which the restriction may be linked.[250] It may well be that the United Kingdom will not directly benefit from the Debt Relief Act. In effect, with this legislation, the United Kingdom is seeking to further the interests of other, less privileged nations. This does not seem to be an impediment to the existence of a public interest.

Could the existence of such a legitimate aim be questioned by pointing to the doubts as to the effectiveness of the debt reduction scheme? Some sovereign creditors have attempted to shed some doubt as to the effectiveness of the Debt Relief Act, by pointing out that it was not certain that HIPC countries will use all the proceeds from debt reduction or forgiveness for poverty reduction measures, especially since money is fungible.[251] It is true that questions may be raised as to the final benefits of the debt forgiveness program. Although the HIPC initiative rests upon a very detailed scheme in which the accuracy of claims is tested, it is difficult, if not impossible to pretend that all amounts forgiven will necessarily and directly be used for poverty reduction purposes. The same applies, in general, for the effectiveness of development aid.

However, once the international community has decided that certain countries deserve, on account of their very difficult situation, debt forgiveness, and has adopted measures which are

247See the various submissions published in Ensuring Effective Debt Relief for Poor Countries : Consultation Responses Received, February 2010.

248During the consultation process, the Treasury contemplated the idea of granting the court some discretion to grant more relief if it is found to be just and equitable to do so, see question 9 in HM Treasury, Ensuring effective debt relief for poor countries : a consultation on legislation, July 2009, at p. 27.

249The Court has taken into account the possibility for the victim of an interference to seek and obtain information about the law, in deciding whether the law was accessible and foreseeable.

250This was recognized by Jonathan Nash, QC and Peter Ratcliffe (both of 3 Verulam's Building) in their response to the consultation on the Debt Relief Act (submission by Jonathan Nash, QC and Peter Ratcliffe, HM Treasury consultation, 'Ensuring effective debt relief for poor countries', February 2010, at § 11).

251In its response to the UK government's consultation, EMTA stated that “We also question the assumption in the Legislative Proposal that amounts not paid to litigating creditors would necessarily be devoted to development and poverty reduction” (submission by EMTA, HM Treasury consultation, 'Ensuring effective debt relief for poor countries', February 2010, at p. 7, note 29). Dechert went further : it stated that “the notion that whatever debt relief would be deliverable would translate into poverty reduction is naïve in the extreme...” (submission by Dechert LLP, HM Treasury consultation, 'Ensuring effective debt relief for poor countries', February 2010, at § 103.1).

necessary to reach this goal, it is difficult to see how this political decision may be questioned under Article 1 Protocol 1. The practice of the European Court has indeed been to start from a presumption that a national measure is in the public interest.[252] The Court's scrutiny is therefore very limited. The Court will apparently only intervene in the most egregious cases, where the taking of property, far from aiming to enhance social justice, amounts to an arbitrary confiscation. There is therefore a real prospect that courts will respect the United Kingdom's judgment as to what is "in the public interest".[253]

Once it is accepted that the Debt Relief Act effectively seeks to further what amounts to a public interest, it must be asked whether this legislation strikes a 'fair balance' between this interest and the private property interests at stake, held by sovereign creditors. As in most cases, this proves the most difficult part of the inquiry. Does the Debt Relief Act go beyond what is necessary to secure the interest it seeks to guarantee?

At first sight, the lack of any compensation in the legislative scheme for sovereign creditors appears difficult to reconcile with the protection afforded by Article 1 Protocol 1. Under the Act, a sovereign creditor will find itself unable to avail itself of at least part of his claim and this without being compensated. Under accepted practice, this lack of compensation deserves a close scrutiny. The Court has indeed stated that the need for a 'fair balance' between the public and private interests requires some measure of compensation. In the absence of compensation, the Court is only prepared to accept that a taking of property is Convention compliant in the most exceptional cases.[254]

Some elements must, however, be borne in mind before concluding to a violation of Article 1, Protocol 1 due to the absence of any compensation. The first one relates to the size of the expropriation : when the mechanism of the Debt Relief (Developing Countries) Act is applied, how should one calculate the size of the deprivation suffered by the sovereign creditor? The creditor's claim is reduced to the amount in line with the HIPCI.[255] This could lead to a

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252 The ECtHR indeed grants a wide margin of appreciation to States when it reviews their actions under Article 1 Protocol 1. See *e.g. James v United Kingdom*, Series A No 98 (1986) 8 EHRR 123 at § 46 (ECtHR 21 Feb. 1986) and more recently, *Broniowski v Poland* (2005) 40 EHRR 495 (ECtHR 22 June 2004) at § 149 – where the Court noted that "the notion of 'public interest' is necessarily extensive. In particular, the decision to enact laws expropriating property or affording publcly funded compensation for expropriated property will commonly involve considerations of political, economic and social issues. The Court has declared that, finding it natural that the margin of appreciation available to the legislature in implementing social and economic policies should be a wide one, it will respect the legislature's judgment as to what is 'in the public interest' unless that judgment is manifestly without reasonable foundation".

253 As noted, "it is difficult to find a case in which the Court has not recognized the policy preferences of a State as providing a legitimate goal" (Robin C. White and C. Ovey, *The European Convention on Human Rights*, 5th ed., OUP, 2010, at pp. 492-493). See also D. Harris, M. O'Boyle et al. in *Harris, O'Boyle and Warbric Law of the European Convention on Human Rights*, 2nd ed., OUP, 2009, at p. 667 - "The Court leaves it to the state to identify the community interest; claims made by the state will seldom be reviewed" and at p. 668 - "... it will be presumed that the interference has a legitimate aim... It is difficult to imagine circumstances in which the Court would dispute the purpose alleged by the government or contest its assertion that the measure had a legitimate aim".

254 *Lithgow v United Kingdom*, Series A No. 102 (1986) 8 EHRR 329, at para. 120 and more recently *Papastavrou et al. v. Greece*, (2003) 40 EHRR 361, at § 37 (18 April 2003) (absence of any compensation under national law).

255 Under the Act, this is done by calculating a so-called "relevant proportion", which according to section 4(2) is achieved by looking at "the amount the debt would be if it were reduced in accordance" with the HIPCI.

significant reduction in the value of the claim when compared to the nominal value of the claim. However, when compared with the actual (secondary) market value of the sovereign debt, the deprivation could certainly be of a lesser magnitude, as debts of HIPCI countries trade at levels much lower than their nominal level. The UK government referred to this in order to justify the legislation.[256] Certainly, if it appears that the reduction applied to the sovereign debt is only minimal given the real market value of the debt,[257] the lack of any compensation will be viewed with less distaste.[258]

Further, account should probably also be taken of the weight of the public interest at stake. Far from attempting to further its own, national interest, the United Kingdom is in fact vying for the poorest countries on the planet. There is strong reason to believe that this is a formidable public interest, which deserves some additional deference. The Court has in the past indicated that it will take into account the intensity of the public interest when determining whether the compensation granted to the owner is sufficient to guarantee a 'fair balance'. In *Scordino*, the Court noted in that respect that "[l]egitimate objectives in the "public interest", such as those pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value".[259] The Court seems to use 'sliding scale', which balances the scope of degree of importance of the public interest, against the property right and the compensation offered.[260]

Section 5(3) of the Act directs courts to issue a judgment only for the "relevant proportion".

256 Explanatory Notes, Debt Relief (Developing Countries) Bill, 2010, at p. 9, para 42. The Treasury explained that "the current market value of those debts is likely to be much lower than their face value... HIPC debts currently trade at or slightly below the levels to which they would be reduced under the provisions of this Bill".

257 The current market value of the debt at the time the Debt Relief Act is applied seems to be a better benchmark to appreciate whether the fair balance has been breached than the amount actually paid by the creditor to acquire the debt on the secondary market.

258 When deciding whether the compensation foreseen by the State has maintained a 'fair balance' between the public interest and the property interest, the European Court seems to expect that the compensation will be related to the market value of the assets concerned – see *e.g. Pincova and Pinc v. Czech Republic*, (ECtHR, 5 Nov. 2002), at § 53; *Scordino v. Italy (I)*, (ECtHr - GC, 29 March 2006), at §§ 99-103 and *Lallement v France*, (ECtHR, 11 April 2002) at § 23. See also *Holy Monasteries v Greece*, Series A No. 301-A, (1995) 20 EHRR 1, at § 71 where the Court made a reference to the "full market value" of the property. In applying Article 50 of the Convention, the Court also refers to the market value of the asset in case of violation of Article 1 Protocol 1 : see *e.g. Hentrich v. France*, Series A 296-A (1994) 18 EHRR 440 at § 71 – the Court noted that "the calculation of pecuniary damage must be based on the current market value of the land".

259 *Scordino v. Italy (I)*, (ECtHr - GC, 29 March 2006), at §§ 97 ff. See also *Urbarska Obec Trencianske Biskupice v Slovakia*, (2009) 48 EHRR 1139 (ECtHR 27 Nov. 2007) at § 126.

260 This has been particularly apparent in cases where the Court was called upon to rule in matters relating to 'post-transition' economies or measures adopted in the framework of sweeping nationalization programs – see *The former King of Greece et al. v. Greece* (ECtHR-GC, 28 November 2002) at § 87 (the Court held that less than full compensation may be necessary where property is taken for the purposes of "such fundamental changes of a country's constitutional system as the transition from monarchy to republic"); *Kopecky v. Slovakia* ECHR 2004-IX (ECtHR-GC) at § 35 (The Court recognizes that the State has a wide margin of appreciation when enacting laws in the context of a change of political and economic regime); *Broniowski v Poland* (2005) 40 EHRR 495 (ECtHR 22 June 2004) at § 182 (likewise in the context of the country's transition towards a democratic regime); *Wolf-Ulrich von Maltzan et al. v. Germany*, (2005) 42 EHRR 93 (Grand Chamber, 2nd March 2005), § 77. Compare with *Scordino v. Italy (I)*, (ECtHr - GC, 29 March 2006), at § 102 (in that case, the Court held that the expropriation "was neither carried out as part of a process of economic, social or political reform nor linked to any other specific circumstances". The Court added that it did "not discern any legitimate objective "in the public interest" capable of justifying less than reimbursement of the market value".

The transitional character of the Debt Relief Act, which is subject to a sunset clause and only pertains to the 'historical' stock of HIPC's debts, also speaks in its favor.[261]

Finally, the Court also seems to take into account, when assessing whether a fair balance has been guaranteed, the circumstances in which the property was acquired. In cases dealing with restitution of property acquired during the communist regime, the Court has taken due account of the fact that some property had been acquired “in good faith”.[262] In *Jahn v Germany*, the Court held that deprivation of property without any compensation did not upset the fair balance to be struck between the public and private interest, in part because of the manner in which the applicants had acquired the property, which would give them a windfall.[263] The windfall resulted in that case from very specific circumstances which existed shortly before the German reunification. What matters is that the Court was plainly of the opinion that private property deserve less protection when acquired in circumstances not typical of a private economy, i.e. against payment of proper consideration.[264] In the case of sovereign debt acquired at a fraction of its nominal value on secondary market, it it clear that the return enjoyed by the creditor, if he succeeds in collecting the nominal value, would vastly exceed the normal return expected from most investments. This is even more so since the Court also takes into account, in considering the proportionality of a State action, the element of risk inherent in a commercial venture.[265]

In view of all these elements, it may ultimately be argued that the public interest in guaranteeing that the objectives of the HIPPC may be reached, outweigh the requirement for the protection of individual property rights.[266] Under the Debt Relief Act, sovereign creditors bear a burden which is in other words not excessive, in particular given that a substantial part of the cost of the policy is also incurred by States. The conclusion that the Debt Relief Act is Convention compliant,[267] is further reinforced when considering the Debt Relief Act as a whole. It is striking indeed that the Act has been carefully drafted and includes many caveats and safety-valves which all contribute to reduce its impact on the sovereign debt market – such as the fact that it excludes its application when the sovereign debt is a liability to pay for

261 In several instances where it dealt with rent control cases, the Court has taken into account the fact that the intererence was limited in time – see *e.g. Hutten-Czapska v. Poland*, (ECtHR, 22 February 2005), at § 176.

262 *Pincova and Pinc v. Czech Republic*, (ECtHR, 5 Nov. 2002), at § 59.

263 *Jahn at al. v. Germany*, 42 EHRR 1084 (ECtHR-GC, 30 June 2005) at § 116-c.

264 For other cases to that effect, see *Zvolsky and Zvolska v. Czech Republic* (ECtHR, 12 Nov. 2002) at § 72 and *The former King of Greece et al. v. Greece* (ECtHR-GC, 28 November 2002) at §§ 83 ff.

265 *Pine Valley Developments Ltd. and others v Ireland*, Series A No 222, (1992) 14 EHRR 319 (ECtHR 29 November 1991) at § 59 – the Court refers to the fact that the applicants “... were engaged on a commercial venture which, by its very nature, involved an element of risk...”

266 Compare with *Al-Kishtaini v Shansal* [2001] All ER (D) 295 – where the Court of Appeal found that the application of English rules giving effect to sanctions adopted by the UN, which led the freezing of assets belonging to Iraq and its nationals, was justified because the public interest in securing compliance with sanctions imposed by the UN outweighed the protection of individual property rights.

267 Arguably other difficult issues arise in relation to the Debt Relief Act - such as the fact that it applies retrospectively to debts already incurred and to judgments already issued. In order to justify the retrospective effect of the Act, the UK government would have, under the standards established by the Court in *Scordino*, to demonstrate that the considerations which justify the legislative intervention, amount to an “obvious and compelling general interest” required to justify the retrospective effect (*Scordino v. Italy (I)*, (ECtHr - GC, 29 March 2006), at § 132). See on this aspect the explanations of the Treasury in Explanatory Notes, Debt Relief (Developing Countries) Bill, 2010, at p. 9, para 43-44.

goods or services or is a short term debt, that its application is limited to debts of countries to which the HIPC Initiative applies or countries which are eligible for this initiative and that it excludes its application to purely internal debts. Far from being a blunt and radical measure, the law appears indeed very well balanced.

By way of conclusion

The last word on sovereign debt litigation has not been said. Activism by creditors may not be spreading. The highly specialized investments funds seeking high returns in this niche market will, however, certainly continue to occupy lawyers and courts alike in many jurisdictions. In the meantime, the civil society and the debt relief movement will continue to press for more legislation to tame the 'vultures'.

Ultimately, the case for special regulation of 'vulture funds' is not a particularly strong one. It rests on a political decision to consider with more favor the plight of sovereign debtors than the position of creditors rather than on the economics of sovereign debt and sovereign debt litigation. If legislators chose to intervene, they would be well inspired to consider the English experience carefully. The compromise between the sanctity of contracts and the right to private property on the one hand and the wish to encourage those countries engaged in the difficult process of debt alleviation, is a difficult one to make. The Debt Relief (Developing Countries) Act seems to make the best out of all these concerns. It therefore deserves to be extended beyond the initial trial year.

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