

# **VULTURE FUNDS AND DEBT RELIEF**

## **THE IMMORAL TACTICS OF VULTURE FUNDS: THE CASE OF ZAMBIA**

### **“WHAT THEY ARE AND WHAT YOU CAN DO ABOUT IT”**

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

A ‘Vulture Fund’ is a financial organization that specializes in buying securities which can be in form of company shares, industries, and debts in distressed economic environments. These securities could be high-yield bonds/shares in or near default and debts where debtors are struggling to pay. The goal of the vulture fund is to make profit by buying cheap debts of struggling companies and recently, heavily indebted third world countries facing debt repayment difficulties. These organizations work like circling vultures that patiently wait to pick up the remains of a rapidly weakening debtor and later claim huge interest repayments through litigation. According to Jubilee - UK, currently, there are at least 40 lawsuits by ‘Vulture Funds’ against poor countries.

#### **2. WHICH VULTURE FUND IS CURRENTLY SUING ZAMBIA?**

Donegal International Limited, an incorporated company by Debt Advisory International LLC (DAI) of Washington area of the US is the Vulture Fund suing Zambia. It was registered in the British Virgin Island (BVI) on the 18<sup>th</sup> of December 1997. Donegal is owned and run by Mr. Michael Sheehan, a citizen of the United States. Donegal's major asset is its claim of over US\$55 million against Zambia.

#### **3. WHY IS JUBILEE-ZAMBIA AND ITS PARTNERS OPPOSED TO THIS CLAIM?**

- We feel it is immoral for Donegal to ask for a profit of several millions dollars (US\$ 55 million) over and above the price (US\$ 3.3 million) it paid for the debt from Romania.
- We feel debt repayments to Donegal International will upset Zambia's fiscal stability and ability to deliver public services. Our position is that Zambia cannot afford to lose millions of dollars as the country needs to address pressing poverty and development problems, which require immediate financial resources.
- We also feel and agree with Judge Smith of the London court that Mr. Sheehan and his agents did not act very honestly in the acquisition of this debt. As Jubilee movements, we are convinced that the purchase of the debt undermines and erodes the full intended benefits from debt relief arrangements initiated through the Highly Indebted Poor Country Initiative (HIPC) and the Multi-lateral Debt Relief Initiative (MDRI).

#### **4. WHAT'S THE BACKGROUND TO THIS DEBT?**

Following a credit agreement between Zambia and Romania dated 17<sup>th</sup> April 1979, which Zambia failed to honour, Zambia became indebted to Romania. Romania had provided a credit facility amounting to US\$15 million with a 5.5% yearly interest, to acquire agricultural equipment, vehicles, spare parts, and technical assistance. According to an agreement signed between Romania and Zambia dated 4<sup>th</sup> August 1985, Zambia was required only to pay US\$5.5 million by instalments spread over 8 years. From 1992 to the end of 1998, Zambia on several occasions discussed with Romania a 40% debt reduction that would have enabled a debt conversion process, where Zambia would pay back the debt through exports and investments in Zambia.

In 1998, an agreement between Zambia and Romania was signed where Zambia agreed to buy this debt at 12 cents for each dollar owed. Under this agreement, Zambia would only pay US\$3, 5 million. Zambia was given up to 31<sup>st</sup> January 1999 to confirm this offer after which Romania would have the liberty of selling the debt. On the 19<sup>th</sup> of January 1999, 12 Days before Zambia's deadline for this debt repayment arrangement to Romania was due, Donegal International bought this debt for US\$3.2 million from the Romanian government. Consequently, the Romanian government breached their word with Zambia.

The Zambian government later acknowledged this debt transfer and its obligation to start servicing the debt to Donegal on February 12, 1999. A settlement agreement was signed on the 1<sup>st</sup> of April 2003 between Zambia (signed by the then Minister of Finance and National Planning, Mr. Emmanuel Kasonde) and Donegal (signed by Donegal Chief Executive Officer, Mr. Michael Sheehan). In this agreement, Zambia committed itself to pay back 33% of the principal amount of the debt in the total amount of US\$14.8 million in 36 monthly instalments to Donegal. Each instalment was estimated at US\$1.1million.

Upon noticing some irregularities in terms of the prior handling of the debt, Zambia's Attorney General ordered the debt service payments to Donegal to be stopped. This resulted in freezing of Zambia's assets in the United Kingdom particularly the British Virgin Islands. The payments were stopped after the Zambian government diligently paid three instalments amounting to US\$3.4 million. In 2005, Donegal initiated a court action in London, UK against Zambia asking for a debt payment of US\$55 million (US\$42.3 million plus interests).

## **5. IS THIS LEGAL? AND IS ZAMBIA BLAMELESS?**

- **YES!** It is completely legal. Buying such a debt is legal despite all contextual factors in this case.

Vulture Funds have drawn on the "Parri Passu law" which is a Latin term upon which the UK bankruptcy law is based. This principle requires that all credits "should be treated on equal terms without discrimination", despite concessions made by other credit owners.

Donegal followed all the legal procedures when acquiring the debt. Donegal is a commercial debt collector whose key aim is profit.

**NO!** Zambia is not blameless. The Zambian government has ignored calls previously made by anti-debt campaigners under Jubilee-Zambia since 2003 to increase transparency and accountability regarding the way in which the government negotiates and acquires foreign loans. Jubilee-Zambia has long called for an increase in the parliamentary authority in the acquisition of loans. At the time Donegal bought the debt, the Zambian government was also negotiating to buy back the debt at a discount. Although Romania offered to sell the debt at a discounted rate of 12 cents per dollar owed (totalling about US\$3.5 million); the Zambian government did not follow up on the deal expeditiously. Zambian authorities also signed the settlement agreement in 2003 with Donegal.

### **➤ CAN THIS HAPPEN AGAIN?**

**YES!** If the way Zambia contracts loans continues to be centralised in the hands of the Minister of Finance and National Planning without consultation and approval of parliament and monitoring of loan agreements by the citizens through civic organisations.

## **6. WHAT'S WRONG WITH THE ZAMBIAN EXTERNAL DEBT CONTRACTION AND MANAGEMENT SYSTEM?**

The Donegal case demonstrates transparency and accountability inadequacies in the constitutional and regulatory provisions for loan contraction and debt management in Zambia.

**Highlights of Transparency deficits demonstrated in the case of the Donegal debt**

× ***Excessive powers of Minister and Ministry of Finance and National Planning in Loan Matters***

In Zambia, negotiation of the terms and conditions of new debts, settlement and restructuring of old loans is the prime mandate of the Ministry and Minister of Finance and National Planning (MoFNP), with marginal participation of the Attorney General. Thus, the MoFNP have excess powers in matters that relate to debt management, which are subject to abuse and/or corruption. In relation to Donegal, the Minister of Finance and National Planning within his constitutional authority negotiated this loan, renegotiated it and further signed the acknowledgement letter recognising Donegal International as the new owner of the debt. This was done without oversight of parliament.

× ***Weak Institutional Mechanisms for Early warning***

Parliament has constitutional authority to approve the annual national budget some of which is financed by loans. However, parliament is not empowered to sanction all loans. If parliament was involved in the contraction and monitoring of loan performance, irregularities as evident in the Donegal case could have been detected ahead of time. Most parliamentarians are not informed of the details of Zambia's commitments made through foreign loan acquisition.

The regulatory powers of the Attorney General (A.G) on foreign loan agreements are primarily limited to providing advice on the legalities of the agreements. The law does not give the AG explicit authority to evaluate the economic, social and human rights implications of loan agreements.

× ***Lack of Public Access to Loan Agreements and there Consequences.***

Lack of public access to loan agreements encourages a climate that breeds corruption. Judge Smith in the Donegal judgement held that Donegal and its local agents improperly sought and obtained confidential state information from public officials in the Government and the Bank of Zambia which should not have been disclosed to them. He described this as "an unlawful or immoral act deliberately to seek out such information from public officials".

Zambian witnesses contended in their evidence to the London court that the behaviour of a number of senior Government officials could be deemed as corrupt and against the interests of the Zambian public.

There is normally scanty information on public loans that is made available through the press after agreements have been signed, while detailed commitments remain concealed from the public.

If parliament and the public were informed about the debt Zambia owed the Romanian government, they mostly likely could have asked,

- i. Why Government had not asked/pressured for the Romania debt to be treated on comparable terms as other Paris Club debts that were falling under the HIPC Debt relief arrangement;
- ii. Why Government had not acted quickly on the offer of the discounted rate from Romania;
- iii. For details of the negotiations between the GRZ and the Romanian government and, between GRZ and Donegal.

***7. BUT WASN'T ZAMBIA'S EXTERNAL DEBT DUE FOR CANCELLATION AFTER THE HIPC PROCESS?***

**YES!** Zambia reached the HIPC completion point in April 2005. This meant that Zambia would benefit from debt relief from a range of its creditors under such an initiative. In 1999, Zambia signed an agreement with ten creditors, including the UK and the US, seeking settlement of debts on similar terms even with countries not participating in the HIPC debt relief initiative. That is why Zambia was negotiating with Romania over this debt before Donegal bought it. Donegal is, however, seeking treatment considerably more favourable than other creditors, despite the fact that they knew before buying the debt that Zambia's debt was deemed

unsustainable and Zambia would hence qualify for debt relief under the HIPC program. When Donegal sued Zambia in March 2005, Zambia had already started implementing conditionalities under the HIPC program and was only a month from reaching the HIPC completion point.

## **7. WHAT'S WRONG WITH THE INTERNATIONAL MECHANISMS FOR MONITORING AND RESOLVING SOVEREIGN DEBT PROBLEMS?**

A number of weaknesses in the international debt resolution system exist which imply that Zambia and other poor countries cannot be protected from the prey of Vulture Funds. Despite the international consensus that debts of poor countries such as Zambia should be cancelled due to their un-sustainability, the HIPC debt resolution scheme was too weak in ensuring and protecting expected benefits. This is primarily because the HIPC program was voluntary and not mandatory for creditors. Secondly the HIPC program, was one sided in that, while the HIPC process forced impoverished countries to spend years meeting harsh and undemocratic economic policy conditions set by the rich world, creditors were only expected to act in good faith in providing debt cancellation.

- **The HIPC Debt Resolution Mechanism Was Voluntary For Creditors**

The creditors (debt forgivers) were not bound by HIPC to give debt relief but only required to act voluntarily, while debtors on the other hand had to comply with a lot of conditionalities, creditors just had to act in good faith (such as the good will as demonstrated by the UK, Japan, German and others in the case of Zambia). Creditors such as Donegal and Romania on their part unlike these creditors choose not to act in good faith. Romania sold the debt to Donegal and Donegal has asked for full payment plus interest on the discounted debt. Because the international debt resolution mechanism is largely determined by the conditions set by each creditor, countries such as Zambia become targets and victims of Vulture Funds such as Donegal.

- **The HIPC Process was one-sided hence, unfair to HIPC countries**

It is important to note that although creditors under HIPC are not obliged to cancel debts, HIPC debtors are asked to promise NOT to pay more to some creditors than others. That is, the richest countries in the world offer HIPC countries cancellation of at least 90% of the debts owed directly to them but only ON CONDITION that debtors seek 'comparable' treatment from other creditors. This means that Zambia was torn apart between this key condition asked for in the HIPC formula and the claims and conditions of Romanian/Donegal debt.

The international debt resolution system is so unfair because while debtor countries were forced to comply with conditionalities in the HIPC deal and meet contradicting creditor terms, they were not protected by the international debt and financial system.

- **International corruption**

The national and international system permitted unbridled opportunities for abuse and corruption initiated by a foreign agent, Donegal International. "From the time of entering and procuring the debt to the time of settling of signing the agreement, there is a consistent pattern of irregularity, corruption, and fraud, which cannot be ignored." Said: George Kunda, the Zambian Justice Minister

There is, therefore, urgent need for a fair and common standard on international debt resolution mechanism that addresses the weaknesses of the HIPC formula. A mechanism that ensures bound commitment by both debtors and creditors and guides resolution of debt defaults that does not leave the debtor and its citizens vulnerable to the powers of the creditor.

## **8. WHAT ARE JUBILEE CAMPAIGNERS PROMOTING?**

- ✓ Economic justice that goes beyond debt cancellation, that focuses on unveiling the root causes of the past debt burden and campaign for their elimination.

- ✓ Installation of a stronger, transparent and responsible loan contraction and debt management system in Zambia and in similar low income countries that will have increased parliamentary authority on future loans and increased public access to loan agreements. Further, a law should be enacted that empowers parliament to scrutinise and approve new loans and get regular reports on loan performance and associated risks. The law should explicitly empower the Attorney General to veto loan agreements that might have negative social, economic and human rights consequences. The public should have the right to access full information on loan and aid agreements. These changes are vital in ensuring that future loans are acquired responsibly, are productive and can repay themselves.
- ✓ Independent audits of all past loans as basis for lesson drawing and further strengthening of loan contraction and debt management systems.
- ✓ Responsible lending and clear accountability framework that lender countries and other creditors need to abide by. This includes supervision by their parliaments.
- ✓ A fair international debt resolution framework which protects poor borrowing countries from vulture practises of lenders and ensures shared debtor and creditor responsibility. An international debt resolution mechanism that is fair, with terms defined by both creditor and debtor countries.

## **9. ACTION**

### **WHAT JUBILEE AND OTHERS ARE DOING?**

- Jubilee -Zambia, Jubilee -UK, Jubilee -USA have done some research on the case
- Jubilee -Zambia, Jubilee-UK, Jubilee-USA have spearheaded a media and email campaign to discourage Donegal from getting the money from Zambia
- Jubilee UK is doing research on vultures in other countries with a goal to curb their negative behaviour
- Jubilee - Zambia and Jubilee - UK have been conversing and lobbying parliamentarians and key government offices.

### **WHAT ACTION IS NEEDED NOW!**

- Join the Jubilee campaigners in asking Mr Michael Sheehan of Donegal International Limited to return the money to Zambia.
- Log on to [www.jubileedebtcampaign.org.uk/vultures](http://www.jubileedebtcampaign.org.uk/vultures) or [www.jctr.org.zm/jubileezambiavulture](http://www.jctr.org.zm/jubileezambiavulture) campaign and send the emails to stop the Vulture Funds.
- Contact your member of parliament to raise these concerns
- Write to the President Levy Mwanawasa and encourage him to close the loop holes in loan contraction and debt management in Zambia.
- Write to the donors to ask them to support these reforms in Zambia, in their countries and at international levels.
- For international supporters, ask your elected officials to promote a fairer and transparent international debt resolution mechanism
- More needs to be done, join Jubilee-Zambia, Jubilee UK, Jubilee USA in creating more awareness on this key debt issue.

For more information contact:

JUBILEE-ZAMBIA

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