

# NATIONAL ANTI-VULTURE FUNDS LEGISLATION: BELGIUM'S TURN

Lucas Wozny\*

*Sovereign distressed debt investors can create holdout problems during sovereign restructurings. Scholars have suggested a wide-range of normative solutions to alleviate these holdout problems, including ad hoc deals, the creation of a multilateral international sovereign bankruptcy framework, the insertion of collective-action clauses into bonds, the expansion of judicial discretion, and the return of the doctrines of comity and sovereign immunity. However, national legislatures have increasingly begun to exhibit a preference for adopting national legislative solutions to this issue. In 2015, Belgium passed the broadest Anti-Vulture Funds Law to date, which is significant because the law impacts the Euroclear payment system. While this law has received high praise from the United Nations and from other nations also considering passing similar legislation, a careful analysis demonstrates it is not sensitive to the benefits that vulture funds bring, such as providing incentives to sovereigns to form more efficient capital structures, providing a moral hazard counterbalance, serving as liquidity-providers on the secondary distressed-debt market, and providing information to the market. If adopted by other*

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\* J.D. Candidate, 2018, Columbia Law School; B.A., 2014, Yale University. I extend my deepest gratitude to Professor Robert Jackson, Jr. for his enthusiasm, support, constant guidance, and helpful comments. I also thank my alma mater, Regis High School, for teaching me at an early age about good scholarship and for motivating me to embark on a lifelong journey in attempting to produce it. Finally, and most importantly, I thank my mother, Margaret Wozny, whose selflessness and generosity inspires me daily and whose story drives my passion for the law. Without the immeasurable, lifelong sacrifices Mom made for my education and for me, none of this would be possible.

*nations, Belgium's law can eliminate the secondary distressed debt market by blocking liquidity-providers from the market. As a result, national legislatures should avoid using Belgium's law as model law, but rather, enact legislation that enhances active settlement discussions without compromising the bargaining power or rights of either the sovereign or the vulture funds.*

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## I. INTRODUCTION

Scholars have long commented on the ability of sovereign distressed debt investors to create holdout problems during sovereign restructurings.<sup>1</sup> Many have suggested a wide range of normative solutions to alleviate these holdout problems, including ad hoc deals, the creation of a multilateral international sovereign bankruptcy framework, the insertion of collective-action clauses into bonds, the expansion of judicial discretion, and the return of the doctrines of comity and sovereign immunity.<sup>2</sup> Between 2008 and 2016, however, national legislatures increasingly began to exhibit a preference for adopting national legislative solutions in favor of these other suggestions.<sup>3</sup>

Unfortunately, scholarship on the efficacy of these national legislations remains scarce, and none exists on Belgium’s Anti-Vulture Funds Law, which passed in the Belgian Federal Parliament on July 12, 2015.<sup>4</sup> Like earlier

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<sup>1</sup> See *infra* Section II.C.1.

<sup>2</sup> See *infra* Section III.A.

<sup>3</sup> *Id.*

<sup>4</sup> Loi relative à la lutte contre les activités des fonds vauteurs [Anti-Vulture Funds Law] of July 12, 2015, MONITEUR BELGE [M.B.] [Official Gazette of Belgium] Sept. 11, 2015, 57357. For an English translation by the author, see *infra* Appendix A.

national pieces of legislation, Belgium's Anti-Vulture Funds Law seeks to prohibit distressed debt investors who acquired the sovereign debt of poor countries from collecting fully on their investment.<sup>5</sup> Belgium's law in particular merits analysis both for its structure and its influence on the global community. The law's scope is broad<sup>6</sup> and impacts the Euroclear payment system, which is based in Belgium.<sup>7</sup> Moreover, a UN human rights report has hailed the law as model legislation,<sup>8</sup> and other nations have debated following its example.<sup>9</sup> As such, determining the relative strengths and weaknesses of the Belgian Anti-Vulture Funds Law will shed light on past regulations and inform the discussion on a

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<sup>5</sup> *Id.*

<sup>6</sup> See JACQUES RICHELLE, STRELIA, BELGIAN 2015 ANTI-VULTURE FUNDS LAW 1 (2016), [https://www.strelia.com/sites/strelia.com/files/strelia\\_-\\_belgian\\_2015\\_anti-vulture\\_funds\\_law.pdf](https://www.strelia.com/sites/strelia.com/files/strelia_-_belgian_2015_anti-vulture_funds_law.pdf) [<https://perma.cc/K5F7-SLXK>].

<sup>7</sup> See *id.* Euroclear is a Brussels-based clearinghouse that processes cross-border and domestic securities transactions. See About, EUROCLEAR, <https://www.euroclear.com/en/about.html> [<https://perma.cc/ZDT2-LBF2>] (last visited June 4, 2017).

<sup>8</sup> See HUMAN RIGHTS COUNCIL, REPORT OF THE HUMAN RIGHTS COUNCIL ADVISORY COMMITTEE ON THE ACTIVITIES OF VULTURE FUNDS AND THE IMPACT ON HUMAN RIGHTS 11–12 (July 20, 2016), [http://www.ohchr.org/Documents/HRBodies/HRCouncil/AdvisoryCom/Sessi on17/A\\_HRC\\_33\\_54.docx](http://www.ohchr.org/Documents/HRBodies/HRCouncil/AdvisoryCom/Sessi on17/A_HRC_33_54.docx) [<https://perma.cc/M3JA-82WJ>] (“[I]t is evident that more national laws are needed to tackle this problem effectively”); see also Renaud Vivien, *UNCTAD Organizes a Side-Event of the Second Committee on Sovereign Debt Restructurings*, CADTM: COMMITTEE FOR THE ABOLITION OF ILLEGITIMATE DEBT (Oct. 27, 2017), <http://www.cadtm.org/UNCTAD-organizes-a-side-event-of> [<https://perma.cc/JBW7-YM2R>].

<sup>9</sup> For example, the French legislature is currently debating anti-vulture funds legislation. See *infra* Section III.G; see also Adrien Paredes-Vanheule, *France to Restrict Vulture Funds' Claims*, INVESTMENT EUROPE (June 3, 2016), <http://www.investmenteurope.net/regions/france/france-restrict-vulture-funds-claims/> [<https://perma.cc/V9AT-WXFD>]. See generally *Projet de Loi Relatif à la Transparence, à la Lutte Contre la Corruption et à la Modernisation de la Vie Économique*, ESPACE PRESSE (Dec. 12, 2016), [https://www.senat.fr/espace\\_presse/actualites/201606/le\\_senat\\_examine\\_la\\_loi\\_sapin\\_2.html](https://www.senat.fr/espace_presse/actualites/201606/le_senat_examine_la_loi_sapin_2.html) [<https://perma.cc/W23V-CXNA>].

large swath of the potential upcoming regulations in this area.

While this Note acknowledges that national legislative solutions may not be the optimal solution to alleviate problems with sovereign distressed debt, their increasing prevalence indicates they have become the practical policy solution for many nations.<sup>10</sup> This Note analyzes the Belgian Anti-Vulture Funds Law and queries both whether it provides efficient solutions to problems that vulture funds cause and whether it inhibits the positive functions they serve. This Note argues that the Belgian Anti-Vulture Funds Law is not sensitive to the benefits vulture funds bring, and if adopted by other nations, can eliminate the secondary distressed debt market by blocking liquidity-providers from the market. Such an answer inherently requires a weighting and balancing assessment of the value created by vulture funds solving a collective action problem on the one hand and the value lost or gained by vulture funds' net effect on the cost of borrowing on the other.

Part II of this Note provides an overview of what vulture funds are, their business model, and how they positively and adversely impact the market. Specifically, Part II examines how vulture funds serve as a moral hazard counterbalance, provide liquidity on the secondary distressed debt market, provide information to the market, and encourage sovereign states to adopt more efficient capital structures. Likewise, Part II also explores the holdout problems vulture funds introduce into voluntary sovereign restructuring proceedings, which can be amplified if vulture funds are

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<sup>10</sup> Some scholars question whether the optimal solution requires any sort of regulation, or whether non-regulation itself is the best choice. These arguments tend to point out that there are only three outstanding vulture fund cases in litigation right now, and the creation of legislation governing such a small number of instances is exorbitantly costly. See, e.g., Elizabeth Broomfield, Note, *Subduing the Vultures: Assessing Government Caps on Recovery in Sovereign Debt Litigation*, 2010 COLUM. BUS. L. REV. 473, 517. While this Note recognizes the scholarly debate over whether any regulation is necessary, engaging in the debate goes beyond the scope of this Note.

empty creditors that are trading odious debt. Part III identifies and analyzes national legislation already enacted in the United Kingdom, Jersey, and Belgium, and summarizes the proposed legislations in the Isle of Man, Australia, the United States, and France. Part IV considers the Belgian law in the context of the benefits and costs of vulture funds identified in Part II. Part V offers concluding remarks.

## II. BACKGROUND ON BENEFITS OF AND PROBLEMS WITH VULTURE FUNDS

### A. What are Vulture Funds?

“Vulture funds” are hedge funds or private equity funds that specialize in distressed debt investing or forced sale assets.<sup>11</sup> Their business model is to buy the debt of insolvent or struggling sovereigns at bargain prices from original

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<sup>11</sup> Peter Moles & Nicholas Terry, *The Handbook of International Financial Terms*, OXFORD REFERENCE (2005), <http://www.oxfordreference.com/view/10.1093/acref/9780198294818.001.0001/acref-9780198294818-e-8301?rskey=PSeUUF&result=1> [https://perma.cc/RD6Q-CAS7]. Debt is generally considered distressed when its yield to maturity is more than 1000 basis points above the risk-free rate of return and receives a CCC rating from Moody's. INVESTING IN DISTRESSED SECURITIES, BARCLAYHEDGE, <http://www.barclayhedge.com/research/educational-articles/hedge-fund-strategy-definition/hedge-fund-strategy-distressed-securities.html> [https://perma.cc/8XAM-FEDS] (last visited June 4, 2017). Distressed securities are sometimes defined as “securities issued by entities that are already in default, under bankruptcy protection, or in distress and heading towards such a condition.” MERCER, HIGH YIELD AND DISTRESSED DEBT 10 n.2 (2016), <https://www.mercer.com/content/dam/mercer/attachments/global/investments/high-yield-and-distressed-debt-mercer-april-2016.pdf> [https://perma.cc/MQK4-WFQK]. The pejorative public moniker has been reserved for funds that invest in sovereign, as opposed to corporate, distressed debt. Hedge funds known as vulture funds commonly invest in both corporate and sovereign distressed debt. Following the common parlance and to avoid confusion, the term “vulture fund” as used in this Note will refer exclusively to sovereign distressed debt funds and “vulture fund investments” will refer to investments in sovereign distressed debt here on out.

creditors and seek to receive the full payment of the debt,<sup>12</sup> sometimes through aggressive and extensive litigation that the sovereign cannot afford.<sup>13</sup> Thus, public opinion often labels these funds and their tactics predatory and immoral<sup>14</sup> because they swoop in, like vultures, to profit off the carcass

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<sup>12</sup> See *Distressed Debt*, OAKTREE CAPITAL MANAGEMENT, <https://www.oaktreecapital.com/strategies/distressed-debt> [<https://perma.cc/U4WK-XUZ3>] (last visited June 4, 2017) (Oaktree Capital receives significantly higher returns than initial investment by returning companies to financial viability through restructuring).

<sup>13</sup> See Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253, 254 n.3 (2003). The International Monetary Fund ("IMF") estimates that there have been only 112 sovereign debt litigations since 1982, of which the number of successful litigations has been quite small. Furthermore, even when a creditor won a judgment, it still had to find assets to execute the judgment, and many sovereign assets continue to be protected by sovereign immunity protections. See MONETARY AND CAPITAL MARKETS DEPARTMENT, IMF, A SURVEY EXPERIENCES WITH EMERGING MARKET SOVEREIGN DEBT RESTRUCTURINGS 11, 13 (June 5, 2012), <https://www.imf.org/external/np/pp/eng/2012/060512.pdf> [<https://perma.cc/4CVH-PYZJ>]. Vulture funds managers have indicated sensitivity to the moniker, and some have tried to reclaim their fund's identity as more phoenix than vulture. For example, Wilbur Ross, owner of WL Ross & Corp. said in an interview, "The one term I don't like to be called is a 'vulture.' Because to me, a vulture is a kind of asset-stripper that eats dead flesh off the bones of a dead creature. Our bird should be the phoenix, the bird that reinvents itself, recreates itself from its ashes. And that's much closer to what it is that we really do." Wilbur Ross, *I Am American Business*, CNBC (2012), <http://www.cnbc.com/id/100000729#> [<https://perma.cc/TS89-KVLS>].

<sup>14</sup> See *End the Vulture Culture*, JUBILEE DEBT CAMPAIGN <http://jubileedebt.org.uk/campaigns/stop-vulture-funds> [<https://perma.cc/N48A-GJD9>] (last visited June 4, 2017); see, e.g., Martin Guzman, *Wall Street's Worst Vulture Hedge Funds Are Making a Killing by Undermining the Global Economy*, QUARTZ (June 17, 2016), <https://qz.com/707165/wall-streets-vulture-hedge-funds-are-making-a-killing-by-undermining-the-global-economy/> [<https://perma.cc/S9QU-9XZF>]; *Argentina Edges Closer to Settling with Predatory Vulture Funds*, TELESUR (Mar. 30, 2016), <http://www.telesurtv.net/english/news/Argentina-Edges-Closer-to-Settling-with-Predatory-Vulture-Funds-20160330-0030.html> [<https://perma.cc/8S9T-ZV7Z>].

and at the expense of economic development in the sovereign state.<sup>15</sup>

Many investors engage in this highly specialized form of investing. One study calculated that as of June 2016, private distressed debt fund managers held \$63.3 billion in available capital, up from \$28.2 billion in December 2006.<sup>16</sup> Scholars have estimated the distressed debt market at more than 200 financial institutions investing between \$350–400 billion in U.S. distressed debt and substantially more outside of it,<sup>17</sup> and North American distressed debt investors have indicated they expect to invest even more capital next year.<sup>18</sup>

Estimates of distressed sovereign debt are less clear. The amount of sovereign debt in default peaked in 1990 at \$335 billion.<sup>19</sup> In 2003, about \$125 billion of emerging markets sovereign debt traded at distressed levels.<sup>20</sup> It is not clear

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<sup>15</sup> See generally, Diana B. Henriques, *The Vulture Game*, N.Y. TIMES (July 19, 1992), <http://www.nytimes.com/1992/07/19/magazine/the-vulture-game.html?pagewanted=all> [<https://perma.cc/WK8T-JG5Q>] (explaining that the term “vulture” comes from the analogy that these investors “get rich by feeding on the carcasses” of insolvent debtors).

<sup>16</sup> PREQIN, PREQIN QUATERLY UPDATE: PRIVATE DEBT: Q2 2016 7 (2016), <https://www.preqin.com/docs/quarterly/pd/Preqin-Quarterly-Private-Debt-Update-Q2-2016.pdf> [<https://perma.cc/DW5Q-5MW4>].

<sup>17</sup> Testimony from Edward L. Altman, Testimony before the ABI Chapter 11 Reform Commission 2 (Oct. 17, 2012), [http://commission.abi.org/sites/default/files/statements/17oct2012/Testimony\\_ABI\\_2012\\_Conference.pdf](http://commission.abi.org/sites/default/files/statements/17oct2012/Testimony_ABI_2012_Conference.pdf) [<https://perma.cc/B99U-KAKS>].

<sup>18</sup> CORTLAND INVESTMENT SERVICING, NORTH AMERICAN DISTRESSED DEBT MARKET OUTLOOK 2016, at 5 (Feb. 23, 2016), [http://mergermarketgroup.com/wp-content/uploads/2016/02/DW-North-American-Distressed-Debt-2016\\_Final\\_LR.pdf](http://mergermarketgroup.com/wp-content/uploads/2016/02/DW-North-American-Distressed-Debt-2016_Final_LR.pdf) [<https://perma.cc/X5XM-5FFM>].

<sup>19</sup> Ricardo Correa & Horacio Sapriza, *Sovereign Debt Crises* (Bd. Governors Fed. Reserve Sys., International Finance Discussion Papers No. 1104, 2014), <https://www.federalreserve.gov/pubs/ifdp/2014/1104/ifdp1104.pdf> [<https://perma.cc/T6FV-4223>].

<sup>20</sup> Manmohan Singh, *Recovery Rates from Distressed Debt—Empirical Evidence from Chapter 11 Filings, International Litigation, and Recent Sovereign Debt Restructurings* 3 (IMF Working Paper No. WP/03/161, 2003), <https://www.imf.org/external/pubs/ft/wp/2003/wp03161.pdf> [<https://perma.cc/FZP4-5MG5>].

what percentage of that amount was held by vulture funds and what amount was held by other investors, such as other sovereigns. Regardless of the exact present amount, it is clear that any national or international regulation of vulture funds would affect an enormous amount of capital.

## B. Benefits Brought by Vulture Funds

Any evaluation of the efficacy of national anti-vulture fund legislation first requires an understanding of the benefits and harms of vulture funds. Because public sentiment and media coverage present an overwhelmingly negative image of vulture funds,<sup>21</sup> it is particularly important for policymakers to consider evidence that vulture funds do make markets more efficient. If the advantages of vulture funds are significant enough, national legislative action that broadly bans vulture funds may be costly. This section argues that vulture funds create numerous *ex ante* benefits. First, they provide incentives for corporations and sovereign states to promote more efficient capital structures. Second, they serve as a moral hazard counterbalance. Third, they provide liquidity on the secondary distressed debt market. And fourth, they serve as information-providers. These functions are highly valuable and result in a more efficient market.

### 1. More Efficient Capital Structures

Vulture funds confer to the sovereign distressed debt market many of the same benefits that corporate distressed debt investors bring to the corporate distressed debt markets. For example, corporate distressed shareholders can sometimes obtain financial leverage more cheaply themselves than the corporation, such as when the corporation is already over-levered and might go bankrupt. In such situations, the efficient choice by the managers would be to issue a dividend or buy back stocks. If the

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<sup>21</sup> See *supra* note 14 and accompanying text.

corporation's creditors have no bargaining power or are not paying attention, the probability and costs to the corporation of financial distress may decrease,<sup>22</sup> incentivizing managers to inefficiently issue additional debt. Sophisticated distressed debt investors, however, pay attention and provide an incentive for managers to consider properly the efficiency of issuing corporate debt.

Similarly, vulture funds provide incentives that promote efficient capital structures and responsible financial behavior by sovereigns. Regardless of who the other market actors are, sovereigns always desire to raise money for investments in health, education, infrastructure, or development. To do this, the sovereign can take foreign-currency denominated debt or issue domestic-currency claims.<sup>23</sup> The optimal capital structure seeks an equilibrium between inflation costs and expected default costs that arise from the proportion of debt incurred versus currency issued.<sup>24</sup> Vulture funds raise the expected costs of default. Their absence lowers such costs. Thus, without these sophisticated activist investors who seek to collect on their claims, the optimal ratio between debt incurred and currency

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<sup>22</sup> See generally RICHARD A. BREALEY, STEWART C. MYERS & FRANKLIN ALLEN, *PRINCIPLES OF CORPORATE FINANCE* 455–72 (11th ed. 2014).

<sup>23</sup> See Patrick Bolton & Haizhou Huang, *The Capital Structure of Nations* 2 (Columbia Business School Research Paper No. 16-44, 2016), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2787982](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2787982) [<https://perma.cc/Q9VH-LRRD>]. While corporate finance scholars have explored what constitutes an efficient capital structure for corporations, Bolton is the first to explore what such a structure would look like in the sovereign-context. Bolton's insight is that the "fiat money of a nation and other money-like debt claims may be seen as a close equivalent to the common stock of a corporation." *Id.* Generally, this static trade-off theory is advanced for corporations, and pits the tax advantages of debt against expected costs of financial distress. Because debt has no tax advantages for nations, nations would never use debt under this theory. Thus, the more relevant corporate finance theory for nations is the pecking order theory, which states nations should fund their investments first with internal funds such as tax revenues, then with debt, and finally with equity (fiat money). *Id.* at 1–3.

<sup>24</sup> *Id.* at 1–8.

issued would inefficiently promote debt, over-borrowing, and perhaps even encourage default. This is because “[i]f realized output [from the investment] is too low relative to the nation’s debt burden then the nation prefers to default on its debt obligations even if it incurs a deadweight output loss as a result of the default.”<sup>25</sup> Moreover, default is even more desirable if the sovereign’s bondholders do not reside within the sovereign itself because the sovereign will not have to bear all the costs of default.<sup>26</sup>

Historical examples of sovereigns using irresponsible capital structures that are unchecked by or immune from the sovereigns’ collectors date back to at least the sixteenth century. For example, Spain did not have locally-held debts and became a serial defaulter in the late sixteenth and seventeenth centuries, suspending payments to creditors nine times in one hundred years.<sup>27</sup> In the nineteenth century, Latin American republics discovered that it was “relatively painless to default when a substantial proportion of bondholders were foreign . . . [and] the first great Latin American debt crisis happened [between] 1826–9, when Peru, Colombia, Chile, Mexico, Guatemala and Argentina all defaulted on loans issued in London just a few years before.”<sup>28</sup>

Some have argued that reputational harm and increasingly limited access to global capital markets may

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<sup>25</sup> *Id.* at 6.

<sup>26</sup> See generally NIALL FERGUSON, *THE ASCENT OF MONEY: A FINANCIAL HISTORY OF THE WORLD* 99 (2008). In this scenario, the defaulting sovereign would not bear all the costs because the sovereign in which the bondholders reside would be partially responsible for the economic externalities of the defaulting sovereign’s default. On the other hand, of course, if the bondholders had resided in the defaulting sovereign, the defaulting sovereign would not only have to deal with its own financial position but also with that of its own citizens.

<sup>27</sup> *Id.* at 74. Payments were suspended in the following years: 1557, 1560, 1575, 1596, 1607, 1627, 1647, 1652, and 1662. *Id.*

<sup>28</sup> *Id.* at 98.

discourage sovereigns from defaulting.<sup>29</sup> However, reputational harm is an inadequate constraint. First, reputational harm from default has not sufficiently deterred opportunistic defaults historically.<sup>30</sup> Second, sovereigns that serially default may disregard any marginal harm an additional default might cause. Furthermore, increasingly limited access to the global capital market might not properly incentivize a sovereign where the costs of domestic inflation outweigh the higher costs of raising debt on a limited capital market. Such a sovereign will try to raise money but will avoid doing this by issuing currency. The sovereign will also be risk-tolerant of deleterious consequences that might arise from default, like limited access to the global capital markets, because the alternative is always more expensive. Sophisticated vulture funds, however, can raise the costs of default exorbitantly by holding out, thereby adjusting this equation and perhaps properly realigning the sovereign's incentives.<sup>31</sup>

Finally, another *ex ante* benefit provided by vulture funds on sovereign capital structures is preventing inefficient restructurings altogether. Scholars scrutinize the holdout and free-rider problems brought by vulture funds during the restructuring.<sup>32</sup> By starting the analysis at the time of the bankruptcy, however, one potentially overlooks the fact that some sovereign restructurings may never have occurred because of the vulture funds' deterrent-effect. An International Monetary Fund ("IMF") article indicates that there were only 14 lawsuits by vulture funds against sovereigns of Heavily Indebted Poor Countries (HIPC) in 2008, down from 33 in 2007.<sup>33</sup> These relatively low numbers

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<sup>29</sup> Molly Ryan, Note, *Sovereign Bankruptcy: Why Now and Why Not In the IMF*, 82 *FORDHAM L. REV.* 2473, 2486–87 (2014).

<sup>30</sup> Broomfield, *supra* note 10, at 514; *see also supra* notes 26–27 and accompanying text.

<sup>31</sup> *See infra* note 61 and accompanying text.

<sup>32</sup> *See infra* Section II.C.1.

<sup>33</sup> INT'L DEV. ASS'N & IMF, HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE AND MULTILATERAL DEBT RELIEF INITIATIVE (MDRI)—STATUS OF

might be explained by *ex ante* deterrent effects. If countries know *ex ante* that a sophisticated creditor may litigate its claims and potentially hold out from the restructuring, thereby locking the sovereign out of the global capital market, this might alone promote more efficient capital structures.

## 2. Moral Hazard Counterbalance

Vulture funds' actions may resolve another market problem by positively serving as a moral hazard counterbalance with respect to sovereign default. Moral hazard refers to any situation in which one party makes decisions about how much risk to take while another party bears the cost of that decision.<sup>34</sup> The classic example is a too-big-to-fail bank that takes unwarranted risks because it knows or expects a bailout to prevent the consequences of its risk-taking from affecting the global economy. Sovereign states that expect a bailout in the form of debt relief from the IMF or other sources also suffer from problems of moral hazard. The moral hazard of default stalks markets and burdens every contract with unnecessary uncertainty, which raises the cost of capital.<sup>35</sup> Even financially responsible sovereigns will suffer higher borrowing costs simply if they choose to raise debt, regardless of whether or not the sovereign had a low risk of default.<sup>36</sup>

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IMPLEMENTATION 20 (Sept. 14, 2010),  
<http://www.imf.org/external/np/pp/eng/2010/091410.pdf>  
[<https://perma.cc/ZA8U-CX7U>].

<sup>34</sup> See PAUL KRUGMAN, RETURN TO DEPRESSION ECONOMICS AND THE CRISIS OF 2008, at 63 (2009).

<sup>35</sup> Review and Outlook, *Decade of Moral Hazard*, WALL ST. J. (Sept. 25, 1998, 12:01 AM) <http://www.wsj.com/articles/SB906674661676514000> [<https://perma.cc/9TA4-WQLS>].

<sup>36</sup> Robin Moroney, *The Debate Over Vulture Funds*, WALL ST. J.: THE INFORMED READER (June 19, 2007, 5:03 PM), <http://blogs.wsj.com/informedreader/2007/06/19/vulture-funds-do-some-good-work/> [<https://perma.cc/CX6J-AJ6S>].

Vulture funds counter the moral hazard of default by vigorously pursuing their claims against sovereigns, even going so far as to block sovereigns out of capital markets. Knowing *ex ante* that vulture funds will litigate their claims and cause significant damage to the sovereign and its citizens changes the incentive structure and behavior of the sovereign.<sup>37</sup> Without vulture funds, for example, sovereigns may implement reckless fiscal policies that are dependent upon an expectation of some bailout in the form of debt relief from the IMF. But knowing that vulture funds will litigate their claims and potentially recover such a bailout, or prevent the feasibility of such a bailout, sovereigns may exercise restraint and implement long-term solutions. Therefore, the *ex ante* incentives vulture funds create by functioning properly generate a moral hazard counterbalance that prevents the cost of borrowing from rising unnecessarily, which allows sovereigns to invest in development more cheaply.

### 3. Liquidity-Providers on the Secondary Distressed Debt Market

Vulture funds also serve as an important source of liquidity on the secondary market for distressed sovereign debt,<sup>38</sup> which developed during the late 1980s and early 1990s due to an international debt crisis.<sup>39</sup> This crisis was rooted in the late 1970s and early 1980s when banks lent unprecedented amounts of money to Latin American nations.<sup>40</sup> Believing that sovereigns were experiencing only a temporary liquidity crunch, these banks then rescheduled these loans at least four times during the 1980s as

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<sup>37</sup> *See id.*

<sup>38</sup> *Id.*

<sup>39</sup> *See* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1064–65 (2004).

<sup>40</sup> *See* Phillip J. Power, *Sovereign Debt: The Rise of the Secondary Market and Its Implications for Future Restructurings*, 64 FORDHAM L. REV. 2701, 2707 (1996).

sovereigns failed to pay the interest.<sup>41</sup> By the late 1980s, the banks realized that the sovereigns would never be able to repay their debt fully.<sup>42</sup> However, the banks could not afford to write off the losses because they lacked sufficient reserves to cover their losses.<sup>43</sup> To avoid financial ruin and to reduce their exposure, banks sold sovereign debt at significantly discounted prices.<sup>44</sup> The market actors who bought the banks' sovereign debt and helped prevent their failure were the vulture funds.<sup>45</sup> Without a sophisticated market actor for whom the claims had higher value than for the banks, the international debt crisis may have amplified. The flexibility afforded by vulture funds to financial institutions and to other sovereign states continues to this day. Indeed, the continued utility of vulture funds as liquidity-providers on the secondary distressed sovereign debt market should be carefully considered before any policies are implemented.

Even in markets where a fragmented creditor structure already existed before the entrance of vulture funds, vulture funds still provide liquidity for distressed debt.<sup>46</sup> The original creditors may not have the financial backing to defend their legal rights in the bond. Without a distressed debt market, they may lose their entire investment, and the sovereign would automatically receive a windfall.<sup>47</sup> Because of their sophistication and ability to litigate, vulture funds value distressed debt more than individuals do, and the prices vulture funds pay creditors may be higher than creditors

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<sup>41</sup> *Id.* at 2713–14.

<sup>42</sup> *Id.* at 2715–16.

<sup>43</sup> *Id.* at 2710–11.

<sup>44</sup> Fisch & Gentile, *supra* note 39, at 1067; *see also* Power, *supra* note 40, at 2716.

<sup>45</sup> Power, *supra* note 40, at 2702.

<sup>46</sup> Fisch & Gentile, *supra* note 39, at 1047 (“Holdout creditors also provide value independent of the restructuring process by increasing liquidity in the market for sovereign debt, especially distressed debt.”).

<sup>47</sup> Felix Salmon, *In Defense of Vulture Funds*, FELIX SALMON (Feb. 24, 2007), <http://www.felixsalmon.com/2007/02/in-defense-of-vulture-funds/> [<https://perma.cc/7ZHE-WNBR>].

expect to recover.<sup>48</sup> This makes individual creditors willing sellers and vultures willing buyers of distressed debt, allowing “investors in a country to make back some of their investments at times of crisis.”<sup>49</sup> Vulture funds allow bondholders expecting no recovery to receive a “non-negligible recovery value on their defaulted paper.”<sup>50</sup>

Holdout vulture funds help maintain the viability of sovereign debt markets by providing a check on opportunistic defaults and coercive restructuring offers.<sup>51</sup> By holding corrupt and irresponsible sovereigns accountable, vulture funds enable the distressed debt market to work more efficiently.<sup>52</sup>

#### 4. Information-Providers

Vulture funds also help financial markets operate more efficiently by providing information that would otherwise go unnoticed. Individual creditors with small claims lack the means or incentives to conduct their own independent research on a sovereign’s capital structure and spending habits prior to their investment. After their investment, individual creditors might find this type of analysis particularly inefficient because their position and options will not be affected by the news. If the sovereign does not default, these fragmented creditors’ claims will not suffer. If the sovereign does default, such creditors often lack adequate resources to litigate their rights.<sup>53</sup>

By contrast, sophisticated institutional distressed debt investors, like vulture funds, invest huge amounts in distressed debt and wield massive litigation coffers and

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<sup>48</sup> See generally *id.*

<sup>49</sup> See Moroney, *supra* note 36.

<sup>50</sup> See Salmon, *supra* note 47.

<sup>51</sup> Broomfield, *supra* note 10, at 514.

<sup>52</sup> See generally David Bosco, *The Debt Frenzy*, FOREIGN POL’Y (June 11, 2007), <http://foreignpolicy.com/2009/10/13/the-debt-frenzy/> [<https://perma.cc/K6WS-UN8R>]; see also *supra* Section II.B.1.

<sup>53</sup> See *supra* Section II.B.3.

experience holding sovereigns accountable. Because of their sizable positions, vulture funds have an incentive to conduct extensive pre-investment research to determine that they are acquiring debt that can actually be repaid.<sup>54</sup> Even after the initial investment, vulture funds remain committed to investigating the sovereign's spending patterns, locating all seizable assets, and valuing the expected payoff. Thus, unlike the individual creditors, vulture funds have the financial means to litigate their claims in exchange for higher returns.

In conducting their research, vulture funds provide valuable information to investors by signaling which claims are recoverable and which are not. Their departure from a market might also signal the strength of the sovereign's economy.<sup>55</sup> Vulture funds may also expose clandestine corruption in sovereigns that abuse international debt relief efforts for their personal benefit. Elliott Associates' team of private detectives and forensic accountants, for example, discovered massive corruption by the Brazzaville-Congo government that included spending more than £112,000 total by Denis Christel Sassou-Nguesso, the son of the previous dictator of Brazzaville, including £1,600 at Escada, £3,700 at Christian Lacroix, £4,000 at Ermenegildo Zegna, and £3,200 at Louis Vuitton.<sup>56</sup> Vulture funds also uncovered that Sassou-Nguesso illicitly purchased multiple flats in downtown Paris totaling £3.6 million and ran up a hotel bill of £169,000—£100,000 of which was paid in cash—during a recent visit to the United Nations, all while repeatedly claiming his country lacked any resources to repay its

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<sup>54</sup> See Tony Allen-Mills, *Hedge Funds Lift the Lid on African Deception*, ALEXANDER'S GAS & OIL CONNECTIONS (June 15, 2008, 2:00 AM), <http://www.gasandoil.com/news/africa/67c4ba36f57496c01738bf41816f68e6> [<https://perma.cc/WCR5-KQVB>].

<sup>55</sup> See Fernando Barciela, *Vulture Funds Leave Spain in Search of Fresh Game*, THE CORNER (Aug. 17, 2016), <http://thecorner.eu/spain-economy/vulture-funds-leave-spain-in-search-of-fresh-game/57062/> [<https://perma.cc/3H95-2UR6>] (interpreting vulture funds' departure from Spain as an indication of Spain's road to recovery).

<sup>56</sup> See Allen-Mills, *supra* note 54.

debts.<sup>57</sup> Furthermore, vulture funds determined that Brazzaville-Congo “had established a network of sham companies and bogus executives” to conceal oil transactions that implicated both the president and his son.<sup>58</sup> Finally, vulture funds identified the middlemen who facilitated corrupt payments and traced the money trail from British oil traders to luxury boutiques in Paris.<sup>59</sup> In doing so, Elliott arguably did more to expose corruption in Africa than any other organization.<sup>60</sup>

### C. How the Uniqueness of Sovereign Debt Introduces Potential Inefficiencies

Based on these salutary effects, it is not a foregone conclusion that vulture funds should be targeted by specific regulations. However, legislatures that regulate vulture funds are not just responding to public outcry; their decisions are also founded upon legitimate concerns about market inefficiencies created by vulture funds. Many of these concerns arise from the uniqueness of sovereign debt. For example, both sovereign states and corporations issue debt to finance ongoing expenses and new capital projects. But if corporations over-borrow and need to restructure, bankruptcy codes create a mandatory process for their creditors to prevent collective action and holdout problems. If a sovereign state gets into a financial debacle, however, no global bankruptcy code exists to standardize the legal process for its restructuring. Thus, a sovereign’s ability to restructure its obligations depends upon the voluntary participation of its creditors.

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<sup>57</sup> *Id.*

<sup>58</sup> Broomfield, *supra* note 10, at 517.

<sup>59</sup> *See* Allen-Mills, *supra* note 54.

<sup>60</sup> Broomfield, *supra* note 10, at 517.

## 1. Holdout Problem

Vulture funds have strong incentives to refuse to participate in the sovereign debt restructuring. First, vulture funds understand that by withholding their consent, they will disrupt the restructuring and prevent the sovereign state from accessing international capital markets to obtain the financing necessary for development.<sup>61</sup> As a result, these

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<sup>61</sup> Argentina was locked out of the capital markets for 15 years while it publicly fought with approximately 200 holdout vultures, or about only 7% of the creditors. See Julie Wernau, *Argentina's Debt Drama: How We Got Here*, WALL ST. J.: MONEYBEAT (Feb. 29, 2016, 5:55 PM); <http://blogs.wsj.com/moneybeat/2016/02/29/argentinas-debt-drama-how-we-got-here/> [<https://perma.cc/9FYY-QMPY>]. Immediately after negotiations, Argentina sold \$16.5 billion in debt, of which \$7.1 billion will be invested directly in construction of roads, ports, and other public infrastructure. Andres D'Alessandro & Chris Kraul, *Argentina Pays Off 'Holdout' Bondholders, Elevating Hopes for Economy*, L.A. TIMES (Apr. 23, 2016, 3:00 AM), <http://www.latimes.com/world/mexico-americas/la-fg-argentina-economy-20160424-story.html> [<https://perma.cc/8GP6-EAB9>]. This indicates a certain level of demand and need in the Argentinian economy to access capital markets. Indeed, Alfonso Prat-Gay, Argentina's new finance minister, estimated that the 15-year litigation and lock-out of capital markets meant "\$120bn worth of savings that did not save, and investments that did not come" and that Argentina lost 2 million jobs. John Authers, *Oh What a Circus, Oh What a Show, Drama Not Over for Argentina*, FIN. TIMES: THE LONG VIEW (Apr. 15, 2016), <https://www.ft.com/content/57e3131c-030a-11e6-99cb-83242733f755>. Moreover, while Argentina was locked out of capital markets, "the administration . . . finance[d] its fiscal deficit by printing money, which has continued to stoke inflation and inflationary expectations." David Francis, *After 15 Years, Argentina Agrees to Pay Back U.S. Creditors*, FOREIGN POLY: THE CABLE (Mar. 31, 2016, 11:37 AM), <http://foreignpolicy.com/2016/03/31/after-15-years-argentina-agrees-to-pay-back-u-s-creditors/> [<https://perma.cc/UNE7-7GRC>]. Other empirical studies indicate that debt restructuring decreases GDP growth after default. FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISIS 51–52 (2006), for example, finds GDP grows at -0.6% because of debt restructuring due to default. Guido Sandleris approximates the impact at -1.5%. Guido Sandleris, *The Costs of Sovereign Defaults: Theory and Empirical Evidence* 16–17 (Escuela de Negocios, Universidad Torcuato Di Tella, Working

profit-maximizing funds gain significant leverage to seek full repayment of the principal on their bond plus interest. Second, to the extent vulture funds buy the distressed debt after negotiations have already reached their final stages with other non-vulture fund creditors, they will hold out to seek even higher returns than the amount upon which the non-vulture fund creditors had just agreed to compensate for the transaction costs and risk undertaken.<sup>62</sup> Furthermore, the tactics of a small handful of vulture funds can create this same holdout incentive in other creditors. Bondholders may become less willing to negotiate if they believe vulture funds will receive higher benefits and may hold out themselves, free-riding on the resources of the vulture funds to litigate further. The result might be a Pareto inefficient negotiation and restructuring.<sup>63</sup> In fact, such tactics inherently prevent sovereigns from accomplishing the fundamental goal of restructuring. If everyone knows that a holdout can obtain full repayment, everyone will want that holdout and no one will want to restructure, especially if the transaction costs will be covered by the capital-rich vulture funds.<sup>64</sup> Thus, holdouts are a source of market inefficiency.<sup>65</sup> Vulture

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Paper 02/2012), <https://ideas.repec.org/p/udt/wpbsdt/2012-02.html> [<https://perma.cc/J2MX-F8UJ>].

<sup>62</sup> This happened in Argentina when the country defaulted on the bonds in 2001 and started debt restructuring in 2005. In 2008, more than three years after negotiations with creditors had already begun, Elliott Management, a vulture fund, purchased a substantial amount of Argentina debt on the secondary distressed debt market. See Arthur Phillips & Jake Johnston, *Argentina vs. the Vultures: What You Need to Know*, CTR. FOR ECON. AND POL'Y RES.: THE AM. BLOG (Apr. 2, 2013), <http://cepr.net/blogs/the-americas-blog/argentina-vs-the-vultures-what-you-need-to-know> [<https://perma.cc/WKM6-7FSN>].

<sup>63</sup> Pareto efficiency refers to the economic state of allocating resources such that no single party's situation can be improved without worsening some other party's situation.

<sup>64</sup> See STURZENEGGER & ZETTELMEYER, *supra* note 61, at 64.

<sup>65</sup> See JOANNA DREGER, BRUGES EUR. ECON. POL'Y, WHY IS SOVEREIGN DEBT RESTRUCTURING A CHALLENGE? THE CASE FOR GREECE 7 (2012), [https://www.coleurope.eu/system/files\\_force/research-paper/beep24.pdf?download=1](https://www.coleurope.eu/system/files_force/research-paper/beep24.pdf?download=1) [<https://perma.cc/XW5M-YNQR>].

holdouts raise the costs of litigation, incentivize standby creditors to similarly hold out, and postpone the sovereign's decision to restructure unsustainable debt, leading to avoidable higher costs.<sup>66</sup>

In addition to creating the issues during the restructuring identified above, holdout vulture funds can create incentives for the sovereign that lead to an inefficient economic policy and the moral hazard problem.<sup>67</sup> If a sovereign nation knows that any of its surplus output will immediately go into the pockets of holdout vulture funds, it may fail to exert sufficient policy effort to run an effective economy.<sup>68</sup> Specifically, the sovereign would be disincentivized from enacting reforms required to regain the ability to repay its debt.<sup>69</sup> Second, this adjustment inefficiency may represent a moral hazard if the sovereign is too significant to fail and can expect to be bailed out by lending institutions hoping to prevent a wider economic downturn.<sup>70</sup> In such cases, the sovereign's taxpayers bear the burden of these costs brought on by holdout vulture funds.<sup>71</sup>

## 2. Empty Creditor Hypothesis

These holdout problems are potentially amplified if vulture funds are "empty creditors." The empty creditor problem arises when a debtholder has obtained insurance in

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<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 7–8.

<sup>68</sup> See Andrew G. Haldane, Andrew Penalver, Victoria Saporta & Hyun Song Shin, *Analytics of Sovereign Debt Restructuring* 23 (Bank of England, Working Paper No. 203, 2003), <http://www.bankofengland.co.uk/archive/Documents/historicpubs/workingpapers/2003/wp203.pdf> [<https://perma.cc/J74V-F54V>].

<sup>69</sup> See Dreger, *supra* note 65, at 7–8.

<sup>70</sup> *Id.*

<sup>71</sup> John A.E. Pottow, *Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign-Debt Restructurings*, 49 *TEX. INT'L L. J.* 221, 222, 225 (2014).

the form of a credit default swap (“CDS”)<sup>72</sup> against default but otherwise retains control rights in and outside of bankruptcy.<sup>73</sup> Under limited circumstances, CDS contracts can lead to powerful *ex ante* market benefits<sup>74</sup> and do not

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<sup>72</sup> The mechanics of a CDS must be understood to understand the empty creditor problem. In a CDS,

the protection seller agrees to make a payment to the protection buyer in a credit (default) event on a prespecified reference asset. In exchange for this promised payment, the protection seller receives a periodic premium payment from the buyer. The credit event may be the bankruptcy filing of the debtor, non-payment of the debt, and, in some CDS contracts, debt restructuring or a credit-rating downgrade. In most cases the default payment is given by the difference between the face value of the debt due and the recovery value, which is either estimated from market prices over a prespecified period after default has occurred (typically 30 days), or based on a CDS settlement auction. Settlement of the contract can be a simple cash payment, or it may involve the exchange of the defaulted bond for cash.

Patrick Bolton & Martin Oehmke, *Credit Default Swaps and the Empty Creditor Problem*, 24 REV. FIN. STUD. 2617, 2618 (2011).

<sup>73</sup> See *id.* at 2617. For a discussion about the specific rights enjoyed by creditors that might lead to the empty creditor problem, see Yesha Yadav, *Empty Creditors and Sovereign Debt: What Now?*, 9 CAP. MKTS. L.J. 103, 113 (2014) (“[S]overeign debt instruments generally give lenders a handful of powers that constrain sovereign behaviour. For example, lenders can stipulate negative pledge and *pari-passu* clauses to constrain sovereign borrowing capacity. They can accelerate repayment on debt where an event of default occurs such as when a sovereign breaches a negative pledge. This acceleration might trigger a cross-default across all debts owing to the lender. Invariably, the exercise of such creditor rights can place stress on a sovereign borrower, diminishing reputational standing and making it more difficult for the borrower to access capital markets.”).

<sup>74</sup> See Bolton & Oehmke, *supra* note 72, at 2619, 2622. For example, creditors with CDS may have a stronger bargaining power than creditors without CDS, which offsets the necessary risk premium in the cost of borrowing. Because of the existence of CDS creditors, firms are able to “increase their debt capacity. This means that in the presence of CDS, more positive net present value projects can receive financing *ex ante*. Also, projects that can be financed in the absence of CDS may get more

lead to gains from trade if the parties involved are risk-neutral.<sup>75</sup> However, in the context of a sovereign restructuring,<sup>76</sup> holding a CDS while holding a claim against the sovereign separates the creditor's control rights from her cash-flow rights and might create creditors who over-insure to over-cover their downside risk.<sup>77</sup> This type of creditor either lacks an interest in the efficient continuation of the debtor or gains an incentive to intentionally push the debtor through an inefficient restructuring.<sup>78</sup> In short, if creditors are insured through CDS, they stand to lose less in default and therefore are less forgiving in debt renegotiations.<sup>79</sup>

In the case of holdout vulture funds, the ability of a creditor to profit on CDS and be made whole on the value of the debt by encouraging debtors to file for bankruptcy<sup>80</sup> is

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efficient financing, as the presence of CDS lowers the borrower's incentive to inefficiently renegotiate down payments for strategic reasons." *Id.*

<sup>75</sup> See *id.* at 2622.

<sup>76</sup> The sovereign CDS market is about 20% the size of the overall CDS market. See Yadav, *supra* note 73, at 103, n.1.

<sup>77</sup> See Yadav, *supra* note 73, at 103. The entire CDS market was calculated to be approximately \$24 trillion in notional value in June 2013. *Id.* at 109. For a discussion on the emergence of the CDS market and its impact on sovereign debt, see *id.* at 109–14.

<sup>78</sup> See Bolton & Oehmke, *supra* note 72, at 2617; see also Henry T.C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 153 U. PA. L. REV. 625, 731–32 (2008) (offering legal analysis of the empty creditor hypothesis); IMF, A SURVEY OF EXPERIENCES WITH EMERGING MARKET SOVEREIGN DEBT RESTRUCTURINGS 16 (2012), <https://www.imf.org/external/np/pp/eng/2012/060512.pdf> [<https://perma.cc/5UJL-2GAM>] (“There is a view that CDS holders who also own the underlying bond would have an incentive not to participate in a pre-default debt exchange offer but would prefer to force a default that constitutes a credit event.”).

<sup>79</sup> See Bolton & Oehmke, *supra* note 72, at 2618; see also Yadav, *supra* note 73, at 104 (Protection sellers, i.e. the sell side on the CDS, assume the economic risk of the debtor's distress and acquire incentives to promote debt discipline. Thus, these sellers robustly monitor debtors and reign in irresponsible lenders.).

<sup>80</sup> *Is the 'Empty Creditor' Theory Itself Empty?*, N.Y. TIMES: DEALBOOK (Dec. 21, 2009, 4:54 AM), <https://dealbook.nytimes.com/2009/12/21/is-the-empty-creditor-theory-just-empty/> [<https://perma.cc/4QHH-8NVK>].

doubly problematic. First, empty creditor vulture funds holding CDS have an additional incentive to hold out from the negotiation past the market efficient point.<sup>81</sup> Second, one can imagine a scenario—though one that is impossible to verify—in which vulture funds receive full or approximately full repayment and interest on their claim but continue holding out because their CDS recovery might be still greater. In such situations, there might be no vulture fund to “make whole.”

Scholars continue to debate to what extent empty creditors damage markets. Some research certainly criticizes the empty creditors hypothesis in the sovereign debt context both generally and as they apply to vulture funds.<sup>82</sup> These arguments contend that CDS-holding vulture funds, for example, face a very uncertain process and have no guarantee that their actions to push the sovereign state will be successful.<sup>83</sup> Moreover, vulture funds do not always get the full payment. Sometimes, vulture funds may insure only against partial repayment and receive only partial repayment.

While the likelihood of empty creditor vulture funds exploiting this imbalance is probably small, it does happen.

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<sup>81</sup> Yadav, *supra* note 73, at 113 (“Empty creditors can also harbour perverse incentives regarding sovereign restructuring. They may be less willing to engage in a voluntary restructuring plan even where such a workout is beneficial for all parties as informal solutions are unlikely to trigger repayment on CDS.”).

<sup>82</sup> See generally *id.* at 114–15 (reputational concerns, including in the form of increased regulation, constrain empty creditors). But vulture funds have hardly changed their behavior as their reputations tank and national regulations increase; if anything, the sovereign relents because of reputational concerns. See Ryan, *supra* note 29, at 2488 (“Much of the academic literature on sovereign debt emphasizes this fact and assumes that creditors have little or no legal recourse against defaulting sovereigns and that the sovereign debt market only works at all because of various nonlegal mechanisms (including reputational concerns and political pressures).”); see also David Mengle, *The Empty Creditor Hypothesis*, ISDA RESEARCH NOTES, Nov. 3, 2009, at 1, 4–13 (questions the plausibility of the empty creditor hypothesis on logical, not empirical grounds).

<sup>83</sup> Yadav, *supra* note 73, at 104.

For example, in March 2012, CDS repayments were triggered in Greece's restructuring.<sup>84</sup> In 2014, about \$1 billion of CDS on Argentina were triggered when the nation failed to pay its debt.<sup>85</sup> Elliot Management Corp., one of the vulture fund holdouts, was rumored to hold a substantial CDS portfolio related to the restructuring.<sup>86</sup>

### 3. Odious Debt

When vulture funds trade the distressed sovereign debt of impoverished states, they may exacerbate another market inefficiency that exists only in the sovereign context. Corporations, unlike sovereign states, can liquidate themselves and cease to exist as a legal entity if it is not feasible to continue existing.<sup>87</sup> Moreover, corporate law restricts the range of corporate governance options, providing a relatively predictable and stable framework. By comparison, a sovereign state's political system is oftentimes much more volatile. Furthermore, not only do regimes change, but entire political systems can change along with them as well. Thus, a newly formed democratic sovereign

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<sup>84</sup> *Id.* at 105.

<sup>85</sup> Matt Levine, *Today's the Day for Argentina and Its Vultures*, BLOOMBERG (July 30, 2014), <https://www.bloomberg.com/view/articles/2014-07-30/today-s-the-day-for-argentina-and-its-vultures> [<https://perma.cc/ZT79-UKSL>].

<sup>86</sup> The payout would be huge for Elliot; however, the mechanics of recovering on CDS for sovereign debt means recovery does not translate neatly in a 1:1 ratio. Rather, only about 70% of the value would be recovered. *Id.* Because recovery is less than 100%, it is unlikely that CDS would be used purely for insurance purposes with respect to sovereign debt. They are much more likely to be used by speculators/vulture funds. Moreover, "[e]ven when insurance is fairly priced and correctly anticipates the creditors' potential value-destroying behavior in renegotiation, creditors have an incentive to over-insure." Bolton & Oehmke *supra* note 72, at 2622. Thus, even if the debt market prices the CDS accounting for the fact that debt might be held by empty creditors, creditors will still over-insure, leading to the same issue.

<sup>87</sup> See, e.g., 11 U.S.C. §§ 701–83 (2012); Insolvency and Bankruptcy Code, No. 31 of 2016, INDIA CODE (2016), vol. 37.

state may inherit the self-serving debts incurred by the preceding dictatorship. This debt, known as odious debt, at best complicates and at worst endangers the new regime's macroeconomic policies.<sup>88</sup>

Odious debt refers to money borrowed by a regime in the name of the state, but then stolen or squandered by the regime's dictator.<sup>89</sup> The conditions sufficient for a debt to be considered odious include: the debt is incurred without the consent of the people, the debt accrues no benefit to the people, and these facts were known by creditors at the time the loan was made.<sup>90</sup> There is no legal designation known as odious debt nor currently any official mechanism or recognized tribunal that could designate certain debt as odious.<sup>91</sup> As such, "odious debt" refers to a doctrine that seeks to excuse these and other illegitimate debts from sovereign debt litigation.

Almost by definition, odious debt is not Pareto efficient, and it is hard to imagine any scenario in which odious debt is Kaldor-Hicks efficient either.<sup>92</sup> Yet, vulture funds do not

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<sup>88</sup> Caroline M. Gentile, *Market for Odious Debt*, 73 LAW & CONTEMP. PROBS. 151, 151 (2010).

<sup>89</sup> Lee C. Buchheit, G. Mitu Gulati & Robert B. Thompson, *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201, 1201 (2007).

<sup>90</sup> See PATRICIA ADAMS, ODIIOUS DEBTS: LOOSE LENDING, CORRUPTION, AND THE THIRD WORLD'S ENVIRONMENTAL LEGACY 165-66 (1991); CTR. FOR INT'L SUSTAINABLE DEV. LAW, *Advancing the Odious Debt Doctrine* 1 (CISDL Working Paper No. COM/RES/ESJ, 2003), [http://cisdl.org/public/docs/pdf/Odious\\_Debt\\_Study.pdf](http://cisdl.org/public/docs/pdf/Odious_Debt_Study.pdf) [<https://perma.cc/VY2S-U7C7>] (odious debt as "contracted against the interest of the population of a state, without its consent and with the full awareness of the creditor"). Gentile traces these principles to the Paris Conference following the War of 1898 and argues the first application of the odious debt doctrine occurred in 1923 by Chief Justice Taft in an arbitration between Great Britain and Costa Rica. See Gentile, *supra* note 88, at 155-56.

<sup>91</sup> See generally Adam Feibelman, *Contract, Priority, and Odious Debt*, 85 N.C.L. REV. 727, 729-30 (2007).

<sup>92</sup> Kaldor-Hicks efficiency refers to the economic state of allocating resources such that at least one party gains resources after all post-reallocation losses are fully compensated.

discriminate against odious debt and trade it if financially profitable to do so.<sup>93</sup> These characteristics make it highly unlikely that vulture funds bring efficiency into the market by trading odious debt. Generally, vulture funds provide *ex ante* incentives for sovereigns to implement better capital structures.<sup>94</sup> The very fact that odious debt is incurred despite an active vulture fund presence in the market evidences that these *ex ante* incentives do not reach all dictatorships. Numerous reasons might explain this phenomenon. Overthrown dictatorships cannot be incentivized to adopt more efficient capital structures because they no longer exist, and generally, still-existing dictatorships cannot be incentivized to forego bad debt for personal gain because their legitimacy does not depend upon citizen satisfaction. Second, because taxpayers bear the burden of any litigation,<sup>95</sup> and the dictator yields all private benefits from the debt, the dictator prefers bad debt. Moreover, reputational harm does not deter dictatorships from incurring debt either because dictatorships do not care about their reputation. Finally, the benefits of vulture funds exposing corruption<sup>96</sup> are limited in the case of dictatorships because such corruption is rarely veiled in disguise and more probable.<sup>97</sup>

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<sup>93</sup> *Vulture Funds and the Threat to Debt Relief in Africa: A Call to Action at the G-8 and Beyond: Hearing Before the Subcomm. on Africa and Global Health of H. Comm. on Foreign Affairs*, 110th Cong. 2 (2007) (statement of Donald M. Payne, Chairman, Subcomm. on Africa and Global Health of H. Comm. on Foreign Affairs) (“vulture funds take advantage of ambiguous international and domestic laws to collect on debts that were acquired by authoritarian regimes and that were not used in the legitimate interest of their people.”).

<sup>94</sup> See *supra* Section II.B.1.

<sup>95</sup> See Pottow, *supra* note 71, at 225–29.

<sup>96</sup> See *supra* Section II.B.4.

<sup>97</sup> See generally William Hallagan, *Corruption in Dictatorships*, 11 ECON. GOVERNMENT 27 (2010). It is possible that the market prices in these biases accordingly when dealing with dictatorships and assumes corruption, thereby eliminating the need for evidence thereof. *But see* VINEETA YADEV & BUMBA MUKHERJEE, *THE POLITICS OF CORRUPTION IN*

In addition to not contributing to a more efficient market, trading odious debt may be positively harmful. For example, vulture funds create a secondary market for odious debt, which may have implications for loans issued by governments that are structured as loans in form but not actually loans in substance.<sup>98</sup> Official lenders may issue grants that appear to be loans and never expect to recover on this loan. If this loan is traded on the secondary market, form may win over substance and the intent of the original issuer will not matter. Furthermore, any capital used to repay distressed odious debt held by vulture funds is capital that cannot be invested in infrastructure and development in the sovereign, which will stifle progress and impact those already devastated by the previous government's use of odious debt. This is especially troubling because much odious debt originates in heavily indebted poor countries ("HIPC").<sup>99</sup> HIPC are a group of 36 countries with high levels of debt and poverty.<sup>100</sup> In 1996, the World Bank and IMF jointly launched the HIPC Initiative, which provided debt-relief in order to free up resources for social spending in these impoverished nations.<sup>101</sup> In many cases, the HIPC Initiative has been highly successful. The World Bank, the African Development Bank, the IMF, the Inter-American

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DICTATORSHIPS (2015) (arguing that dictatorships are not necessarily synonymous with extreme corruption).

<sup>98</sup> Olufunmilayo B. Arewa, *Vultures, Hyenas, and African Debt: Private Equity and Zambia*, 29 NW. J. INT'L L. & BUS. 643, 664 (2009) (explaining that some debt incurred by developing countries is really a grant disguised as a loan).

<sup>99</sup> See generally Michael Kremer & Seema Jayachandran, *Odious Debt: Report*, BROOKINGS INST. (July 15, 2002), <https://www.brookings.edu/research/odious-debt/> [<https://perma.cc/5X7A-HQLU>].

<sup>100</sup> IMF, DEBT RELIEF UNDER THE HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE, <http://www.imf.org/About/Factsheets/Sheets/2016/08/01/16/11/Debt-Relief-Under-the-Heavily-Indebted-Poor-Countries-Initiative?pdf=1> [<https://perma.cc/LH5D-M6G3>] (Apr. 17, 2017).

<sup>101</sup> *Id.* The number of HIPC countries may increase from 36 because there are still three pre-decision-point HIPCs, including Eritrea, Somalia, and Sudan. *Id.*

Development Bank, and All Paris Club creditors have provided their full share of debt relief under the HIPC Initiative,<sup>102</sup> which totals over \$76 billion in debt relief.<sup>103</sup> As a result, HIPC countries increased their poverty-reducing expenditures by more than three percentage points of GDP between 2001 and 2009.<sup>104</sup>

While the HIPC Initiative seeks voluntary support and most organizations have done so, vulture funds have offered the HIPC Initiative limited support.<sup>105</sup> As a result, some have argued that vulture funds free-ride on debt relief and target nations who suddenly have more access to cash because of the HIPC Initiative.<sup>106</sup> In doing so, vulture funds convert the “benefits of international relief into private corporate gain, obstructing the process of securing debt relief for some countries and prohibiting others who have attained debt relief from investing their funds in much needed development.”<sup>107</sup> The World Bank estimates that more than one-third of the countries which have qualified for HIPC debt relief have been targeted by vulture funds with judgments totaling \$1 billion.<sup>108</sup> As a result, the HIPCs have been forced to pay for costly litigation. Such litigation has been said to

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<sup>102</sup> *Id.*

<sup>103</sup> INT’L DEV. ASS’N & IMF, *supra* note 33, at 12.

<sup>104</sup> *Id.* at 11. By reducing expenditures on debt service, sovereign states free up capital to invest in development and infrastructure. See *Vulture Funds and the Threat to Debt Relief in Africa*, *supra* note 93, at 2 (“[I]nstead of servicing millions of dollars in debt annually, these nations could finally begin to service their own people.”).

<sup>105</sup> See IMF, *supra* note 100 (participation from non-Paris Club and multilateral creditors needs to improve).

<sup>106</sup> See *Vulture Funds and the Threat to Debt Relief in Africa*, *supra* note 93, at 16.

<sup>107</sup> *Id.* at 4.

<sup>108</sup> *Id.* at 2, 4 (over 20 HIPC countries have been the target of these funds since 1999); see also *Vulture Funds in the Sovereign Debt Context*, AFRICAN DEVELOPMENT BANK GROUP (last visited June 10, 2017), <http://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/> [<https://perma.cc/4FQD-PL92>].

“undermine international debt relief initiatives or restructuring mechanisms” and has been called “predatory.”<sup>109</sup> As litigation costs rise, HIPC countries miss goals and fail objectives in education and health-related sectors.<sup>110</sup> Indeed, studies estimate that the lawsuits against the HIPC cost these countries the equivalent of 18% of spending on health care and education.<sup>111</sup>

### III. SUMMARY AND ANALYSIS OF NATIONAL ANTI-VULTURE FUND LEGISLATION

#### A. Background to the Growing Trend of Using National Legislation as the Policy Solution to Vulture Funds

These unsavory elements of vulture funds have elicited a public outcry, which has created an increasingly hostile legal environment that burdens vulture funds internationally, potentially inhibiting their roles as market-enforcers, liquidity-providers, and information-providers.<sup>112</sup>

Various methods have been proposed (and used) to constrain vulture funds, including special vulture fund taxes,<sup>113</sup> return of absolute sovereign-immunity rules,<sup>114</sup>

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<sup>109</sup> *Vulture Funds and the Threat to Debt Relief in Africa*, *supra* note 93, at 12.

<sup>110</sup> See IMF, HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE AND MULTILATERAL DEBT RELIEF INITIATIVE (MDRI)—STATISTICAL UPDATE 8 (2014), <https://www.imf.org/external/np/pp/eng/2014/121214.pdf> [<https://perma.cc/V3A8-MNY4>].

<sup>111</sup> *Stop Debt Vultures*, JUBILEE AUSTRALIA (last visited June 12, 2017), <http://www.jubileeaustralia.org/page/work/stop-debt-vultures> [<https://perma.cc/9JHP-HLL9>].

<sup>112</sup> See *supra* Section II.B.

<sup>113</sup> The Irish Department of Finance has recently closed off tax-loopholes that allowed vulture funds to avoid taxes on profits made by buying and selling Irish property. See Charlie Taylor, *Department of Finance Closes Vulture Fund Loophole*, IRISH TIMES (Sept. 6, 2016, 5:16 PM), <http://www.irishtimes.com/business/economy/department-of-finance-closes-vulture-fund-loophole-1.2781681> [<https://perma.cc/MTA8-GAH8>]. In addition, Ireland introduced a new 20% tax on vulture fund profits off the

return of the comity defense,<sup>115</sup> expanding judicial discretion,<sup>116</sup> an international multi-lateral sovereign restructuring framework independent of the IMF,<sup>117</sup> special clauses in bonds that counteract holdouts,<sup>118</sup> and national anti-vulture fund legislation. Scholars have not yet arrived on a consensus over which method is best.<sup>119</sup> Countries, on the other hand, have begun to indicate a preference for national anti-vulture fund legislation.<sup>120</sup> The United Nations Human Rights Council, perhaps sensing this momentum, issued a recommendation dated October 3, 2014 that

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Irish property market. Donal O'Donovan, *New 20pc Tax on Profits Will Hit Vulture Funds and Investors with Irish Property Assets*, INDEPENDENT (Oct. 20, 2016, 3:35 PM), <http://www.independent.ie/business/new-20pc-tax-on-profits-will-hit-vulture-funds-and-investors-with-irish-property-assets-35147317.html> [<https://perma.cc/S6J4-SVT3>].

<sup>114</sup> See generally Jonathan I. Blackmun & Rahul Mukhi, *The Evolution of Modern Sovereign Debt Litigation: Vultures, Alter Egos, and Other Legal Fauna*, 73 LAW & CONTEMP. PROBS. 47 (2010); Kevin Chan, *Beijing OKs UK Ruling Blocking Vulture Fund Suit*, SAN DIEGO UNION TRIB. (Aug. 26, 2011, 4:47 AM), <http://www.sandiegouniontribune.com/sdut-beijing-oks-hk-ruling-blocking-vulture-fund-suit-2011aug26-story.html> [<https://perma.cc/B9R7-NWMC>].

<sup>115</sup> See Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253 (2003).

<sup>116</sup> See Harvey Asiedu-Akrofi, *Banks, Bonds and the American Bench: Exercising Judicial Discretion to Discourage Rogue Sovereign Bond Litigation Claims*, 7 CAMBRIDGE STUDENT L. REV. 42 (2011).

<sup>117</sup> See Ryan, *supra* note 29, at 2515–20.

<sup>118</sup> Among these clauses include collective-action clauses (“CAC”) in bonds, which the IMF endorsed. See YAN LIU, IMF, COLLECTIVE ACTION CLAUSES IN INTERNATIONAL SOVEREIGN BONDS (Aug. 30, 2002), <http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/liu.pdf> [<https://perma.cc/J295-AVMZ>]. Sovereigns may choose to exclude these clauses from their bonds to lower the cost of debt. In doing so, however, they expose themselves to potentially damaging litigation with holdouts. For a comprehensive history of CACs, see W. Mark C. Weidemaier & Mitu Gulati, *A People's History of Collective Action Clauses*, 54 VA. J. INT'L L. 51 (2013).

<sup>119</sup> See *supra* notes 113–118 and accompanying text.

<sup>120</sup> See *infra* Sections III.B–H.

countries adopt national anti-vulture fund legislation.<sup>121</sup> The United Nations Human Rights Council condemned the activity of vulture funds because they (1) paralyze debt restructuring efforts of developing countries; (2) frustrate the sovereign state's right to protect its citizens under international law; (3) increase the debt burden of extreme poverty countries; and (4) diminish the impact of debt relief.<sup>122</sup> The author is sensitive to the distributive justice concerns from which these national legislative acts may arise; national legislative acts may nevertheless not be the optimal choice for dealing with these concerns.

Legislation across countries is not always consistent. Indeed, these national regulations vary widely and shape different regulatory standards for vulture funds. This creates forum shopping between jurisdictions. The remainder of this Part will review the legislative responses of the United Kingdom, Isle of Man, Jersey, Australia, United States, France, and Belgium.

## B. United Kingdom

On April 8, 2010, the United Kingdom Parliament enacted the Debt Relief (Developing Countries) Act<sup>123</sup> ("DRA"), which went into force on June 8, 2010.<sup>124</sup> On May 16, 2011, the United Kingdom took legislative action to make the law permanent.<sup>125</sup> The United Kingdom enacted the DRA in response to a lawsuit brought by vulture funds seeking to

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<sup>121</sup> Human Rights Council Res. 27/30, U.N. Doc. A/HRC/RES/27/30 (Oct. 3, 2014).

<sup>122</sup> *Id.*

<sup>123</sup> Debt Relief (Developing Countries) Act 2010, c. 22 (UK).

<sup>124</sup> *Id.* at § 10.

<sup>125</sup> Debt Relief (Developing Countries) Act 2010 (Permanent Effect) Order 2011 S12011/1336 (UK); *see also* Press Release, Her Majesty's Treasury, Government Acts to Halt Profiteering on Third World Debt Within the UK (May 16, 2011), <https://www.gov.uk/government/news/government-acts-to-halt-profiteering-on-third-world-debt-within-the-uk> [<https://perma.cc/7Z2Y-ZQS6>] [hereinafter Press Release, Her Majesty's Treasury].

recover claims on Zambian and Liberian debt.<sup>126</sup> Prior to passing the law, Parliament sought extensive public consultation on limiting sovereign debt recovery and achieved bipartisan support for the bill as a result.<sup>127</sup>

The HIPC Initiative set a country-by-country debt reduction factor required of all creditors to reduce a sovereign's debt to sustainable levels.<sup>128</sup> Whereas major institutions had already provided their full share of the debt relief, commercial creditors like vulture funds lagged behind.<sup>129</sup> The DRA enhanced the IMF and World Bank's HIPC Initiative<sup>130</sup> by introducing a compulsory reduction of debt that forced private-sector creditors to accept deals agreed under the HIPC Initiative by the international public sector.<sup>131</sup> The DRA sought to accomplish this by restricting the amount commercial creditors could recover on their sovereign debt to 33% for potentially eligible, but not-yet-approved HIPC.<sup>132</sup> For countries that had already been approved, the DRA limited recovery to a small proportion of the sovereign debt consistent with the reduction factor set forth by the HIPC Initiative.<sup>133</sup> Because vulture funds can never recover more than the HIPC Initiative, they have no incentive to engage in prolonged, value-destructive litigation in the United Kingdom's courts. Moreover, because the DRA applies to foreign judgments or arbitration awards on qualifying debt, vulture funds cannot easily shop for more

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<sup>126</sup> See John Muse-Fisher, *Starving the Vultures: NML Capital v. Republic of Argentina and Solutions to the Problem of Distressed-Debt Funds*, 102 CAL. L. REV. 1671, 1696 (2014).

<sup>127</sup> James Bai, *Stop Them Circling: Addressing Vulture Funds in Australian Law*, 35 SYDNEY L. REV. 703, 725 (2013).

<sup>128</sup> Sophie Hughes, Simon James, Andrew Yianni & Deborah Zandstra, *The HIPC Debt Relief Bill: Making Forgiveness Compulsory*, 4 LAW & FIN. MKT. REV. 269, 269 (2010).

<sup>129</sup> See IMF, *supra* note 100.

<sup>130</sup> Debt Relief (Developing Countries) Act 2010, c. 22 § 1(2); see also Press Release, Her Majesty's Treasury, *supra* note 125.

<sup>131</sup> Hughes et al., *supra* note 128, at 269.

<sup>132</sup> Debt Relief (Developing Countries) Act 2010, c. 22 § 4(3).

<sup>133</sup> *Id.* § 4(2).

favorable laws and ask U.K. courts to enforce the judgment.<sup>134</sup>

The DRA reinforces the importance of the HIPC Initiative by binding the Debtor (sovereign state) to the HIPC's terms as well. The DRA does so by excluding from the DRA's scope all sovereign debt that the Debtor did not "make an offer to compromise on comparable Initiative terms."<sup>135</sup> Thus, if the sovereign state does not offer the amount set forth in HIPC Initiative recovery, it may be on the hook for several factors of that amount. This encourages the sovereign to make the creditor an offer to settle. At the very worst, the state must offer the creditor terms comparable to the HIPC Initiative terms, which prevents the HIPCs pointing to the HIPC Initiative threshold as a maximum, negotiating a settlement price below this threshold, and thereby securing a windfall. More importantly, however, because the DRA will not apply to a passive sovereign's debt, the DRA encourages the sovereign nation to actively "make" offers and direct their debt restructuring, rather than free-ride on the debt relief.<sup>136</sup> Finally, the DRA waives HIPCs' sovereign debt issued before the commencement of the DRA and prior to the HIPC decision point.<sup>137</sup> This means HIPCs are required to honor short-term debt incurred after and unrelated to the reason for their designation as an HIPC country.<sup>138</sup> Studies indicate that this law will have a very beneficial impact on HIPC countries. The U.K. Treasury estimated, for example, that the DRA could save poor countries an estimated £145 million in total over six years.<sup>139</sup>

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<sup>134</sup> Bai, *supra* note 127, at 727.

<sup>135</sup> Debt Relief (Developing Countries) Act 2010, c. 22 § 6(1).

<sup>136</sup> Bai, *supra* note 127, at 727.

<sup>137</sup> Debt Relief (Developing Countries) Act 2010, c. 22 § 1(3).

<sup>138</sup> Bai, *supra* note 127, at 726.

<sup>139</sup> See Press Release, Her Majesty's Treasury, *supra* note 125.

### C. Isle of Man

On December 11, 2012, Isle of Man, a self-governing British Crown dependency, signed and enacted the Heavily Indebted Poor Countries (Limitation on Debt Recovery) Act 2012.<sup>140</sup> In form and substance, the Act essentially mirrors the U.K. legislation.

However, the Isle of Man legislation is unique because it preemptively bars vulture funds from exploiting HIPC without any evidence of prior vulture fund activity within the Crown dependency. As such, the Act responds to a problem that was non-existent in its jurisdiction. If legislation in jurisdictions without vulture activity continue to trend this way, anti-vulture funds regulation may amount to a complete ban of vulture funds from the distressed debt market.

### D. Jersey

The United Kingdom's DRA did not cover Jersey, so the Crown dependency of the United Kingdom was broadly regarded as a loophole for recovery. In 2011, New York vulture fund FG Hemisphere used the Jersey courts to sue the Democratic Republic of Congo.<sup>141</sup> In the summer of 2012, the Jersey courts ruled against FG Hemisphere's attempt to sue a state-owned mining company for \$100 million on a \$3 million debt.<sup>142</sup> To unambiguously close the Jersey loophole,

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<sup>140</sup> Heavily Indebted Poor Countries (Limitation on Debt Recovery) Act 2012 (Isle of Man); *see also* Press Release, Cabinet Office, Isle of Man Introduces Legislation to Outlaw Vulture Funds (Dec. 12, 2012), <https://www.gov.im/news/2012/dec/12/isle-of-man-introduces-legislation-to-outlaw-vulture-funds/> [<https://perma.cc/G48X-9KSW>].

<sup>141</sup> Greg Palast, Maggie O'Kane & Chavala Madlena, *Vulture Funds Await Jersey Decision on Poor Countries' Debts*, THE GUARDIAN (Nov. 15, 2011, 6:15 PM), <https://www.theguardian.com/global-development/2011/nov/15/vulture-funds-jersey-decision> [<https://perma.cc/6R4Z-8VFQ>].

<sup>142</sup> *See* Amber Przybysz, *Anti-Vulture Fund Legislation Introduced in Jersey as One Vulture Swoops in on Argentina*, JUBILEE USA NETWORK (Oct. 22, 2012), [http://jubileeusa.typepad.com/blog\\_the\\_debt/2012/10/anti-](http://jubileeusa.typepad.com/blog_the_debt/2012/10/anti-)

however, a debt relief law similar to the U.K. DRA was proposed on October 1, 2012 in Jersey.<sup>143</sup> After an independent expert made an official submission to the government on the need for anti-vulture legislature,<sup>144</sup> Jersey enacted the Debt Relief (Developing Countries) (Jersey) Law 2013, which came into force on March 1, 2013.<sup>145</sup>

It is clear that the Jersey legislature used the DRA as a model for crafting this law. Like the U.K. and Isle of Man laws, the Jersey legislation seeks to support debt relief efforts intended to assist the world's poorest and most heavily indebted countries.<sup>146</sup> The Jersey law adopts the DRA's language almost verbatim in a variety of sections, including qualifying debt with reference to the HIPC Initiative,<sup>147</sup> limiting the amount recoverable by a proportion from the Initiative,<sup>148</sup> extending the law to foreign judgments and arbitrations,<sup>149</sup> and providing exceptions that incentivize the Debtor (sovereign state) to not actively make an offer to compromise the proceedings.<sup>150</sup>

## E. Australia

The initiative to draft anti-vulture fund legislation in Australia arose in similar circumstances as those in

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vulture-fund-legislation-introduced-in-jersey-as-one-vulture-swoops-in-on-argentina-.html [<https://perma.cc/969K-YFUW>].

<sup>143</sup> *Id.*

<sup>144</sup> Cephias Lumina, *Sovereign Debt and Human Rights: The United Nations Approach*, in MAKING SOVEREIGN FINANCING AND HUMAN RIGHTS WORK 263 n.59 (Juan Pablo Bohoslavsky & Jernej Letnar Cernic, eds., 2014).

<sup>145</sup> Debt Relief (Developing Countries) (Jersey) Law 2013; *see also* Press Release, Jersey Government, Debt Relief Law Comes into Force (Mar. 1, 2013), <https://www.gov.je/News/2013/Pages/DebtRelief.aspx> [<https://perma.cc/U5UE-HGZ3>].

<sup>146</sup> Press Release, Jersey Government, *supra* note 145.

<sup>147</sup> Debt Relief (Developing Countries) (Jersey) Law 2013, § 2.

<sup>148</sup> Debt Relief (Developing Countries) (Jersey) Law 2013, §§ 5, 6.

<sup>149</sup> Debt Relief (Developing Countries) (Jersey) Law 2013, § 7.

<sup>150</sup> Debt Relief (Developing Countries) (Jersey) Law 2013, § 8(1)(b).

Jersey.<sup>151</sup> In November 2010, FG Hemisphere pursued a claim against the Democratic Republic of Congo in the NSW Supreme Court in Australia.<sup>152</sup> FG Hemisphere sought and won a judgment forcing the DRC to sell its shares in an Australian mining company operating in Congo for \$30 million.<sup>153</sup> However, in February 2011, the United Nations Independent Expert on Foreign Debt and Human Rights called upon the Government of Australia to pass national legislation that limited vulture funds' ability to use Australian courts to recover claims.<sup>154</sup>

Once again, the DRA model impacted a foreign jurisdiction. On June 25, 2012, the Australian Federation Chamber debated legislative action to protect the HIPC Initiative,<sup>155</sup> and the legislators regarded the DRA as model legislation that Australia should adopt.<sup>156</sup> The Federation Chamber discussed odious debt<sup>157</sup> and the trending response of the international community to vulture funds.<sup>158</sup>

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<sup>151</sup> This same dispute dragged into the Bahamas, South Africa, the United States and Hong Kong. See Bai, *supra* note 127, at 704. Of these jurisdictions, national anti-vulture funds legislation was proposed in every jurisdiction except for Hong Kong. Such legislation was unnecessary in Hong Kong because its courts outright rejected FG Capital Management's claims on the basis of absolute sovereign immunity of the mainland. See Chan, *supra* note 114. Two years after the ruling, there is evidence that calls for regulation appeared in the media, but this never translated into legislation or legislative conversation. See e.g., Andrew Mak, *Time for Hong Kong to Regulate Predatory Vulture Funds*, CHINA DAILY ASIA (Nov. 19, 2013, 7:38 AM), [http://www.chinadailyasia.com/opinion/201311/19/content\\_15099719.html](http://www.chinadailyasia.com/opinion/201311/19/content_15099719.html) [<https://perma.cc/5TY9-D8M3>].

<sup>152</sup> See JUBILEE AUSTL., *supra* note 111.

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

<sup>155</sup> Commonwealth, *Parliamentary Debates*, Federation Chamber, 25 June 2012, 7790 (Anna Burke, Deputy Speaker) (Austl.).

<sup>156</sup> Commonwealth, *Parliamentary Debates*, Federation Chamber, 25 June 2012, 7789 (Hon. Melissa Parke) (Austl.).

<sup>157</sup> Commonwealth, *Parliamentary Debates*, Federation Chamber, 25 June 2012, 7789 (Hon. Andrew Leigh) (Austl.).

<sup>158</sup> *Id.* (discusses the need to see how Hong Kong and China will respond to vulture funds).

However, the legislature has yet to pass any anti-vulture fund legislation.

## F. United States

On August 1, 2008, Congresswoman Maxine Waters (D-CA, 43rd District) introduced the first national anti-vulture funds legislation in the United States.<sup>159</sup> The House of Representatives shelved the bill for committee review. On June 18, 2009, Ms. Waters re-introduced the same bill, titled “Stop Very Unscrupulous Loan Transfers from Underprivileged Countries to Rich, Exploitive Funds Act,” or also known as the “Stop Vulture Funds Act.”<sup>160</sup> Unlike pieces of legislation in other nations that warn of how immoral vulture funds’ actions are, the Stop Vulture Funds Act focuses on deleterious consequences that U.S. vulture funds’ conduct has on the foreign relations of the United States.<sup>161</sup>

The proposed legislation seeks “[t]o prevent speculation and profiteering in the defaulted debt of certain poor countries,”<sup>162</sup> which refers to the HIPC Initiative countries, with some exceptions and additions.<sup>163</sup> The Act does this by imposing a punitive fine on “vulture creditors” equal to the total amount sought through the sovereign debt profiteering<sup>164</sup> and by creating mandatory disclosure requirements that expose vulture creditors to judicial scrutiny.<sup>165</sup> Under the Act, “vulture creditors” refers to any person, except other sovereigns or International Financial

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<sup>159</sup> Stop Vulture Funds Act, H.R. 6769, 110th Cong. (2d Sess. 2008).

<sup>160</sup> Stop Vulture Funds Act, H.R. 2932, 111th Cong. (1st Sess. 2009).

<sup>161</sup> *Id.* § 2(12).

<sup>162</sup> H.R. 2932.

<sup>163</sup> These exceptions include countries that engage in gross violations of human rights, that have excessive expenditures on military operations, those that promote terrorism, or those fail to cooperate with the United States on narcotics matters. H.R. 2932 § 6. The Secretary of Treasury maintains a list of all qualified poor countries, which includes those that borrow from the International Development Association. *Id.* § 6(a)(2).

<sup>164</sup> *Id.* § 4(b).

<sup>165</sup> *Id.* § 5(b).

Institutions,<sup>166</sup> who acquires defaulted sovereign debt of a qualified poor country at a discount to face value.<sup>167</sup>

Both bills were referred to the Committee on the Judiciary and the Committee on Financial Services, but neither has gone to a vote.<sup>168</sup>

### G. France (Proposed Legislation)

On March 30, 2016, the French National Assembly started considering legislative action to promote transparency, anti-corruption, and economic modernization with the “Sapin II Bill.”<sup>169</sup> The proposed Bill attached anti-vulture fund legislation to Article XXIV of the Bill,<sup>170</sup> and functioned similarly to the United Kingdom’s DRA by limiting the claims brought by vulture funds against sovereign states facing default.<sup>171</sup> Additionally, the French law would enlarge judicial discretion and enhance the court’s role in countering vulture funds. It does this by requiring vulture funds to obtain court authorization before commencing any litigation for seizure of debt recovery.<sup>172</sup>

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<sup>166</sup> The definition for “vulture creditors” in H.R. 2932 follows the definition for “vulture creditor” under section 1701(c)(2) of the International Financial Institutions Act. *Id.* § 3(1).

<sup>167</sup> *Id.*

<sup>168</sup> H.R. 2932; see also Stop Vulture Funds Act, H.R. 6796, 110th Cong. (2d Sess. 2008).

<sup>169</sup> Bénédicte Graulle et al., *The Sapin II Bill: A Potential Game-Changer in French Corruption Enforcement*, JONES DAY (May 2016), <http://www.jonesday.com/The-Sapin-II-Bill-A-Potential-Game-Changer-in-French-Corruption-Enforcement-05-05-2016/?RSS=true>.

<sup>170</sup> Fabrice Nodé-Langlois, *L’«amendement Poutine» adopté dans la loi Sapin 2*, LE FIGARO (Oct. 6, 2016, 3:53 PM), <http://www.lefigaro.fr/conjoncture/2016/06/10/20002-20160610ARTFIG00199-1-amendement-poutine-adopte-dans-la-loi-sapin-2.php> [<https://perma.cc/KZW3-ZS89>].

<sup>171</sup> Adrien Paredes-Vanheule, *France to Restrict Vulture Funds’ Claims*, INVESTMENT EUROPE (June 3, 2016), <http://www.investmenteurope.net/regions/france/france-restrict-vulture-funds-claims/> [<https://perma.cc/5RRX-27YM>].

<sup>172</sup> *Id.*

The French legislature appeared to have been motivated by NML Capital's victory over Argentina, by the UN Human Rights Report,<sup>173</sup> and by the Belgian law enacted in September 2015, which is similar to the French draft legislation.<sup>174</sup> However, the Senate adopted a version of this bill on November 3, 2016 with Article XXIV deleted in the final revision.<sup>175</sup>

## H. Belgium's Anti-Vulture Act

### 1. Background

In January 2008, Belgium's Federal Parliament adopted its first legislation to "safeguard Belgian funds disbursed towards development cooperation and debt relief from the actions taken by vulture funds."<sup>176</sup> The law forbade the seizure or transfer of development assistance between parties and prohibited creditors from recovering interest owed to vulture creditors.<sup>177</sup>

On July 12, 2015, the Belgian Federal Parliament passed its second national legislation against vulture funds, known as the Anti-Vulture Funds Law,<sup>178</sup> which became effective on

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<sup>173</sup> Plateforme Dette & Développement, *Loi Sapin 2: L'Assemblée confirme sa volonté de réguler l'action des fonds vautours mais ne leur coupe pas les ailes*, CADTM: COMITÉ POUR L'ABOLITION DES DETTES ILLÉGITIMES (Sept. 30, 2016), <http://www.cadtm.org/Loi-Sapin-2-L-Assemblée-confirme> [<https://perma.cc/2J24-EUH4>].

<sup>174</sup> See Paredes-Vanheule, *supra* note 171.

<sup>175</sup> *Projet de loi relatif à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique*, SÉNAT (Nov. 3, 2016), [https://www.senat.fr/espace\\_presse/actualites/201606/le\\_senat\\_examine\\_la\\_loi\\_sapin\\_2.html](https://www.senat.fr/espace_presse/actualites/201606/le_senat_examine_la_loi_sapin_2.html) (legislative history of the Sapin II Bill).

<sup>176</sup> Bai, *supra* note 127, at 722 (quoting The Chamber of Representatives, *Project de loi visant à empêcher la saisie ou la cession des fonds publics destinés à la coopération internationale, notamment par la technique des fonds vautours* (2008) Belgian Federal Parliament).

<sup>177</sup> *Id.*

<sup>178</sup> *Loi relative à la lutte contre les activités des fonds vauteurs* [Anti-Vulture Funds Law] of July 12, 2015, MONITEUR BELGE [M.B.] [Official Gazette of Belgium] Sept. 11, 2015, 57357.

September 12, 2015.<sup>179</sup> Shortly after passing the Anti-Vulture Funds Law, Belgium's Federal Parliament inserted an act into Article 1412 (collectively, the "Belgian Laws") of the Judicial Code ("Article 1412") that governed seizures of property belonging to foreign countries.<sup>180</sup> Despite separate ratification, the two legislative acts work in tandem with each other to achieve their goals.

## 2. What Does the Legislation Do?

Unlike anti-vulture fund legislation passed in other countries, the Belgian Laws are very short.<sup>181</sup> Article 1412, which fits on one page, announces that sovereign property, including bank accounts, is generally not seizable by creditors.<sup>182</sup> There are three exceptions to this rule: first; where the sovereign state expressly and specifically agrees to the seizability of the property; second, where the property was earmarked specifically for the satisfaction of a demand that is the subject of enforcement or "authentic" private title; and third, if it is established that the property is specifically in use or intended for use by the foreign power, except for public non-commercial services, that the property is located in the country's territory, and there is enforceable or "authentic" private title to the property.<sup>183</sup>

The Anti-Vulture Funds Law, on the other hand, deals specifically with claims rather than sovereign property. The Anti-Vulture Funds Law vanquishes the rights of claimants that pursue an "illegitimate advantage" on sovereign distressed debt.<sup>184</sup> To determine what constitutes an illegitimate advantage, the legislation provides a two-prong

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<sup>179</sup> *Id.*

<sup>180</sup> See CODE JUDICIAIRE/GERECHTELIJK WETBOEK [C.JUD./GER.W.] art.1412 (Belg.), [http://www.etaamb.be/fr/loi-du-23-aout-2015\\_n2015009459.html](http://www.etaamb.be/fr/loi-du-23-aout-2015_n2015009459.html) [<https://perma.cc/5WG5-TS59>].

<sup>181</sup> See Anti-Vulture Funds Law.

<sup>182</sup> C.JUD./GER.W. art.1412 § 1.

<sup>183</sup> *Id.* § 2.

<sup>184</sup> Anti-Vulture Funds Law, art. 2.

test.<sup>185</sup> First, there must be a manifest difference between the purchase price and the face value of the loan, or between the purchase price and the sums actually claimed by the creditor.<sup>186</sup> The second prong requires at least one of the following criteria to also be met: (1) the debtor State is in an actual or imminent state of insolvency; (2) the creditor's headquarters are in a tax haven,<sup>187</sup> (3) the creditor systematically uses legal procedures to recover on its loans; (4) the creditor refused to cooperate with the debtor State; (5) the creditor abused the weakness of the State to negotiate a clearly imbalanced restructuring; or (6) repayment of the amounts claimed by the creditor would have a negative effect on the public finances of the debtor State.<sup>188</sup>

The Belgian Laws have been met with mixed results. Despite the two-prong test, practitioners remain uncertain as to the legislation's scope.<sup>189</sup> Some have criticized the Belgian Laws for their potentially negative impact on Belgium as a financial center.<sup>190</sup> Many others, however, have offered praise. The French legislature, for example, proposed a bill similar to the Belgian Laws in June 2016.<sup>191</sup> The Committee for the Abolition of Illegitimate Debt also considers it model legislation.<sup>192</sup> The United Nations

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<sup>185</sup> *Id.*

<sup>186</sup> *Id.*

<sup>187</sup> "Tax haven" is a rough approximation for a more complex definition outlined in the Anti-Vulture Funds Law, which provides a three-party disjunctive test. Specifically, this test is: are the headquarters on the list of states or non-cooperative jurisdictions established by the Financial Action Task Force ("FATF"), or referred to in Article 307, § 1, paragraph 5, of the Code of income tax of 1992, or that refuses to negotiate and sign an agreement in accordance with OECD standards which provides the automatic exchange of information in tax and banking matters with Belgium. See Anti-Vulture Funds Law, art. 2; see also *infra* Appendix A.

<sup>188</sup> Anti-Vulture Funds Law, art. 2.

<sup>189</sup> See RICHELLE, *supra* note 6, at 3.

<sup>190</sup> *Id.*

<sup>191</sup> See *supra* notes 169–175 and accompanying text.

<sup>192</sup> CNCD, *Intervention du CNCD-11.11.11, CADTM et 11.11.11 koepel van de Vlaamse Noord-Zuidbeweging dans le recours en annulation*

Independent Expert on foreign debt and human rights, Juan Pablo Bohoslavsky, noted the international importance of the Belgian legislation and praised it as the most “comprehensive cover against excessive financial claims by vulture funds.”<sup>193</sup>

### 3. Constitutional Challenge

While political entities have taken to praising the regulation, vulture funds have taken to litigation to protect their rights. On March 2–3, 2016, NML Capital Ltd. (“NML”), a vulture fund incorporated in the Cayman Islands,<sup>194</sup> raised constitutional challenges to the Anti-Vulture Funds Law<sup>195</sup> and Article 1412<sup>196</sup> before the Belgian Constitutional Court. The Article 1412 challenge was met by Yukos Universal Limited,<sup>197</sup> a firm from the Isle of Man.<sup>198</sup>

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*devant la Cour Constitutionnelle du fonds vautour NML Capital Ltd. contre la loi du 12 juillet 2015 relative à la lutte contre les activités des fonds vautours*, CADTM (2016) [http://www.cncd.be/IMG/pdf/factsheet\\_fr.pdf](http://www.cncd.be/IMG/pdf/factsheet_fr.pdf) [<https://perma.cc/9YH3-49NG>].

<sup>193</sup> Press Release, UN Human Rights Office of the High Comm’r, Belgian Legislation Against Vulture Funds Should Be Preserved – UN Rights Expert Urges (June 15, 2016) <http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=20106&LangID=E> [<https://perma.cc/QLN9-UKEG>].

<sup>194</sup> NML Cap. Ltd. v. Republic of Argentina [2011] UKSC 31 2 AC 495, 496, <https://www.supremecourt.uk/cases/docs/uksc-2010-0040-judgment.pdf> [<https://perma.cc/NLB8-LFTJ>].

<sup>195</sup> Cour Constitutionnelle [CC][Constitutional Court] case no. 6371 (FR) (ongoing, no decision reached yet), accessed at <http://www.const-court.be/fr/common/home.html>.

<sup>196</sup> Cour Constitutionnelle [CC][Constitutional Court] case no. 6372 (FR) (ongoing, no decision reached yet), accessed at <http://www.const-court.be/fr/common/home.html>.

<sup>197</sup> Cour Constitutionnelle [CC][Constitutional Court] case no. 6373 (NL) (ongoing, no decision reached yet), accessed at <http://www.const-court.be/fr/common/home.html>. The document mistakenly refers to Yukos Universal Limited as “Ykos Universal Limited.”

<sup>198</sup> Yukos Universal Limited v. Russian Federation (Isle of Man v. RU), PCA Case No. AA227 31 (Perm. Ct. Arb. 2014),

NML presented three arguments in support of its constitutional challenge. First, NML argued that the law breached its property rights.<sup>199</sup> Second, NML proposed the laws wrongfully discriminate between creditors of sovereigns and other creditors and arbitrarily determine some claims to be legitimate while others as illegitimate.<sup>200</sup> Finally, NML submits that these laws violate the inviolability of contracts.<sup>201</sup> After almost a year, this constitutional challenge remains ongoing and unresolved by the Belgian Constitutional Court.

#### IV. RECOMMENDATIONS AND SOLUTIONS

Regulations that restrict the rights of a particular group of creditors should consider the benefits and harms created by that group, and in circumstances where these benefits are extraordinary, the lawmakers should enact legislation that curtails the harms without eliminating the benefits. Specifically, national anti-vulture funds legislation that addresses holdout problems should (1) be mindful that vulture funds create more efficient capital markets;<sup>202</sup> (2) function as a counterbalance to the moral hazard problem posed by sovereigns;<sup>203</sup> (3) provide liquidity on the secondary market for distressed debt;<sup>204</sup> and (4) provide information to the market as corruption-exposers.<sup>205</sup> While the DRA is more sensitive to these benefits, the Belgian Laws are not. If future legislation is adopted by other nations, such regulation might eliminate the secondary distressed debt market by blocking out liquidity-providers.

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<https://www.pcacases.com/web/sendAttach/420>

[<https://perma.cc/YY6X-8ZZT>].

<sup>199</sup> See Vivien, *supra* note 8.

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

<sup>202</sup> See *supra* Section II.B.1.

<sup>203</sup> See *supra* Section II.B.2.

<sup>204</sup> See *supra* Section II.B.3.

<sup>205</sup> See *supra* Section II.B.4.

A. By Eliminating the Ability to Profit on Sovereign Debt Claims, the Belgian Laws Eliminate the Secondary Distressed Debt Market and Expose Sovereigns to Other Inefficiencies

One issue the Belgian Laws address is the incentive for vulture funds to buy claims during the late stages of a negotiation in a sovereign restructuring, which may cause holdouts and further delays.<sup>206</sup> For example, if negotiations are going poorly and creditors believe they will only receive 10% of the loan's purchase price, creditors will be incentivized to sell their claims to vulture funds for 15% of the purchase price. Vulture funds would be willing to pay this premium because their expected return may be higher due to their resources and expertise to litigate their claims. After purchasing these claims, however, vulture funds will not be content to restructure for 15%. Rather, they will seek to maximize gains. Thus, such claims trading may prolong a voluntary sovereign restructuring.

The Belgian Laws address this problem by limiting the creditor's recovery amount to the price paid, thereby eliminating the incentive for the vulture fund to purchase the loan at 15%.<sup>207</sup> Two observations follow. First, claims will not be uniform and will have different values under this mechanism. Generally, the closer to default an investor purchases a sovereign loan, the lower its purchase price and quality, and the less likely a creditor will receive any recovery. Regardless of the expected return the creditor expects, however, all creditors' rights are still the same. Under the Belgian Laws' restriction, however, early purchasers' rights might be more valuable, and as such, early purchasers may receive greater recovery.

The second observation, however, is that regardless of whether the investor purchases early or late, the highest her

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<sup>206</sup> See Phillips & Johnston *supra* note 62 and accompanying text.

<sup>207</sup> Loi relative à la lutte contre les activités des fonds vauteurs [Anti-Vulture Funds Law] of July 12, 2015, MONITEUR BELGE [M.B.] [Official Gazette of Belgium] Sept. 11, 2015, 57357.

return on investment could ever be is the same: zero. By pegging the recovery price to the purchase price, the Belgian Laws vanquish the ability of sovereign distressed debt investors to recover any profit on their investments. No creditor would ever purchase a profitless loan on which she would lose money because of the time value of money. On the one hand, this regulation accomplishes its goal of discouraging distressed debt investors from purchasing odious debt. On the other hand, by eliminating the ability for distressed debt investors to profit, the Belgian Laws eliminate liquidity-providers and essentially shut down the secondary market for sovereign distressed debt.

Eradicating vulture funds from this market wrongly dismisses their benefits and may lead to deleterious consequences. For example, without the ability to make a profit, vulture funds lose the incentive to provide liquidity to suffering banks with distressed sovereign debt on their balance sheets.<sup>208</sup> The mechanism that helped avert an international debt crisis in the 1980s would dissipate.<sup>209</sup> Furthermore, banks would recognize the absence of these liquidity-providers on the market, and the cost of capital would rise. It is true that banks may become more careful in issuing loans. However, this additional diligence would make debt more costly and difficult to raise. Financially distressed countries desperate to finance development, education, and medical services would be disproportionately hurt.

Furthermore, the burden to perform due diligence shifts from being a responsibility shared by both the banks and the sovereign into a unilateral responsibility of the bank. In the absence of vulture fund regulation, the sovereign state shares an incentive to monitor its capital structure.<sup>210</sup> With this elimination of vulture funds, however, financially healthy countries that can still obtain debt from banks will know *ex ante* that no market actor will hold them

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<sup>208</sup> See *supra* notes 38–45 and accompanying text.

<sup>209</sup> *Id.*

<sup>210</sup> See *supra* Section II.B.1.

accountable. The sovereign will be less careful knowing that if it makes a bad decision, at worst, its taxpayers will pay the bill, and at best, the country may be bailed out by debt relief. As such, these financially healthy countries lose the incentive to monitor their capital structure and suffer from a moral hazard problem.

## B. Trading Odious Debt is a Problem; Trading Other Sovereign Debt is Not

The Belgian Laws clearly seek to resolve problems brought by trading odious debt. The Anti-Vulture Funds Law restricts “reimbursement of the amounts claimed by the creditor would have a clearly adverse impact on the public finances of the debtor state and would likely to compromise the socio-economic development of its people.”<sup>211</sup>

However, the Belgian Laws otherwise fail to distinguish between odious debt and other sovereign debt. By trading sovereign debt, vultures may encourage more efficient capital structures.<sup>212</sup> Trading odious debt, however, confers no benefit to the market and is neither Pareto nor Kaldor-Hicks efficient.<sup>213</sup> Legislation that limits vulture funds’ rights should be responsive to this difference.<sup>214</sup> The Belgian Laws, however, broadly restrict the rights of all creditors holding claims with an “illegitimate advantage,” regardless of whether or not the claim arises from an HIPC country or from the United States.<sup>215</sup>

The first prong of the “illegitimate advantage test” looks for a clear difference between the purchase price and face value of the loan, or between the purchase price and the sums claimed by the creditor.<sup>216</sup> First, this may shut down the possibility of collecting accrued interest by the defaulting

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<sup>211</sup> Anti-Vulture Funds Law, art. 2; *see also infra* Appendix A.

<sup>212</sup> *See supra* Section II.B.1.

<sup>213</sup> *See supra* Section II.C.3.

<sup>214</sup> *See supra* Section III.A.

<sup>215</sup> Anti-Vulture Funds Law, art. 2.

<sup>216</sup> *See supra* Section III.H.2; *see also* Anti-Vulture Funds Law, art. 2.

sovereign. Second, this results in a dramatic shift in the bargaining process. While it is unclear how much of a difference is necessary to meet this guideline, any creditor negotiating her rights will be at the mercy of the sovereign in the Belgian jurisdiction. Even without the profit-limiting provision that dismantles the secondary distressed debt market,<sup>217</sup> the uncertainty created by the first-prong of the illegitimate advantage test decreases the value of the loans and makes trading them prohibitively expensive.

### C. The Belgian Legislation's Definition of "Illegitimate Advantage" Wrongly Absorbs Non-Vulture Funds Under Its Reach

The Belgian legislature never explicitly defines a vulture fund and instead uses the two-prong test of the Anti-Vulture Funds Law to restrict the rights of creditors with characteristics of vulture funds. Some of these combinations of characteristics, however, can apply to non-vulture fund creditors. For example, an individual farmer can theoretically pursue significant unpaid interest while the sovereign is insolvent. This meets both the first prong and second prong.<sup>218</sup>

For this reason, the "illegitimate advantage test" may again prove difficult to import to other jurisdictions. To the extent sovereign states seek to borrow from Belgium's legislation, they should be careful to adopt legislation curtailed to the specific conditions of their own markets.

## V. CONCLUSION

The Belgian Laws do not resolve the problems posed by vulture funds in a thoughtful way and other countries should be skeptical in adopting a model that follows the Belgian model. To the extent nations continue deciding to implement national anti-vulture funds regulation, they should limit the

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<sup>217</sup> See *supra* Section IV.B.

<sup>218</sup> See *supra* Section III.H.2.

scope of its application to odious debt to avoid curtailing the entire secondary distressed debt market and to maintain a flexible market approach to market problems. Moreover, rather than applying broadly to all vulture funds, and even individuals that free-ride on vulture funds efforts, such countries should pass legislation, like the DRA, that enhances active settlement discussions without compromising the bargaining power or rights of either the sovereign or the vulture funds. While politicians may continue to praise the comprehensiveness of the Belgian approach to regulating vulture funds, the United Kingdom's approach with the DRA is more sensitive to the costs and benefits of vulture funds.

## APPENDIX A

### Article 1

This Act regulates a matter referred to in Article 74 of the Constitution.

### Article 2

Where a claimant is pursuing an illegitimate advantage by acquiring a loan or debt on a State, its rights in respect of the debtor State will be limited to the price paid to redeem such loan or debt.

Regardless of the law governing the legal relationship between the creditor and the debtor State, no enforceable title can be obtained in Belgium, and no precautionary measures or enforcement may be taken in Belgium at the request of that creditor in connection with a payment to be charged in Belgium, if such payment gives to the creditor an illegitimate advantage as defined by law.

Pursuing an illegitimate advantage exists where there is a manifest disproportion between the purchase price and face value of the loan or receivable, or between the purchase price of the loan or receivable and the sums actually claimed by the creditor.

To constitute an illegitimate advantage, the manifest disproportion referred to in paragraph 2 shall be supplemented by at least one of the following criteria:

- The debtor State was in an actual or imminent state of insolvency at the time of redemption of the loan or receivable;
- The creditor has its headquarters in a State or Territory that is:
  - a) On the list of states or non-cooperative jurisdictions established by the Financial Action Task Force (FATF); or

- b) Referred to in Article 307, § 1, paragraph 5, of the Code of income tax of 1992; or
- c) On the list established by the King that refuses to negotiate and sign an agreement in accordance with OECD standards which provides the automatic exchange of information in tax and banking matters with Belgium from 2015;
- The creditor systematically uses legal procedures for the reimbursement of the loan or loans previously redeemed;
  - The creditor refused to cooperate with the debtor State restructuring debt;
  - The creditor has abused the weak situation of the debtor State to negotiate a clearly imbalanced repayment agreement; or
  - Reimbursement of the amounts claimed by the creditor would have a clearly adverse impact on the public finances of the debtor State and would likely to compromise the socio-economic development of its people.

### Article 3

This Act applies subject to the application of International Treaties, the EU or bilateral treaties.