

Insight: Capital Markets

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The UK Debt Relief (Developing Countries) 2010 Act: Causes and Effects

The UK Debt Relief (Developing Countries) Act came into effect on 8 June 2010. Although colloquially referred to as the "Vulture Funds Act," the legislation has ramifications for all commercial creditors of the 40 sovereigns the Act identifies.¹

How does the Act affect creditors' claims on existing sovereign debt? The Act puts in place a cap on the amount that commercial creditors may recover on the historically-incurred debt of the 40 countries qualifying for the World Bank and IMF Highly Indebted Poor Countries Initiative ("HIPC"). Under HIPC, public creditors (multilateral institutions and sovereign lenders) have been subject to a formula that reduces the amount that they can recover on the debts of HIPC countries. The amount of this reduction is anywhere between 67% and 90% of the original value of the obligations, depending on calculations determined on a country-by-country basis. Under the Act, commercial creditors enforcing their claims in UK courts will now automatically be subject to these same formulaic write-downs.

What types of activities are targeted by the Act? The legislation stemmed from recent litigation by creditors against Zambia and Liberia in English courts. In each case, with Zambia and Liberia already in default on their debt, hedge funds acquired a portion of the sovereign debt of each country for a fraction of its face value, then subsequently sued in UK courts for enforcement of the full amount (including accrued interest). Both cases raised a public outcry at the prospect of privately-controlled hedge funds profiting at the expense of some of the world's poorest countries.

As the Act prohibits private creditors from collecting more than the limited amount set by the HIPC formula, it also diminishes any incentive such creditors may have had to hold out or abstain from any restructuring process that a HIPC country undertakes. In the past, some commercial creditors have opted not to participate in debt restructurings in an attempt to gain a higher amount through litigation than they would under the terms of the restructuring.

What debt is affected under the Act? The Act applies to any existing external public debt of the countries identified by the World Bank and IMF as HIPC-eligible or potentially HIPC-eligible. The Act also sets out criteria for determining the eligibility of different obligations, including short-term debt and refinanced and restructured debt. Additionally, the Act applies to any current or future court judgments or arbitral awards obtained with respect to the payment of HIPC countries' debt, if at any point the creditors attempt to enforce such judgments in UK courts.

¹ The list of sovereigns whose debt is affected by change in law can be accessed on the HIPC IMF Factsheet <http://www.imf.org/external/np/exr/facts/hipc.htm>



For more information please contact:

Gavin McLean

Partner

+ 44 20 7532 1431
gmclean@whitecase.com

Francis Fitzherbert-Brockholes

Partner

+ 44 20 7532 1400
ffitzherbert-brockholes@whitecase.com

Anna Dupont

Associate

+ 44 20 7532 1417
adupont@whitecase.com

White & Case LLP
5 Old Broad Street
London EC2N 1DW
Tel: + 44 20 7532 1000
Fax: + 44 20 7532 1001

The Act does **not** affect any debt incurred by any HIPC country **after** 8 June 2010, the date the Act became law. Crucially, the UK Government felt that, in the absence of similar legislation in other major financial jurisdictions (notably New York), a forward-looking application of the law, covering future indebtedness, would chill the degree to which sovereign lenders and creditors would choose English law to govern future debts.

Other relevant features of the Act. Notably, the Act explicitly aims to maintain an incentive for commercial creditors to participate in restructuring processes vis-à-vis HIPC countries. It does so by specifying that, in the event of a default and a resultant enforcement action on restructured debt, the HIPC-formula write-downs will apply to the original amount of the debt, and not to the restructured lower amount.

The Act also contains an exception explicitly excluding the otherwise-eligible debts of any HIPC country which does not affirmatively offer to repay its commercial creditors under the HIPC formula. This exception was created to incentivise sovereign debtors' participation in debt settlement and restructuring negotiations with creditors. In this way, creditors are not forced to recover exclusively through litigation.

The Act contains a "sunset clause", which provides for its expiration on 8 June 2011, one year after its entry into force. However, it is widely expected that, despite the intervening change of UK government, more permanent legislation will be enacted in its place.

Legislation in other jurisdictions. The UK is the first country to pass this type of legislation. While important to the restructuring of HIPC debt in its own right, it is anticipated that the passage of the Act will also put pressure on other lawmakers to do the same. Indeed, the US Senate has already commenced the lawmaking process on a similar bill that would affect debts incurred and enforced under US law (including, crucially, New York law). We understand that a similar law is also under consideration in Belgium. The UK Act is a step forward in the long-running efforts of the international financial community to resolve the debt crisis for developing countries. White & Case will continue to monitor these legislative processes and their potential impact for our clients.