



EVERYTHING MATTERS

Tactical Considerations in Vulture Fund Litigation

Defence of litigation against sovereign debtors

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Tactical Considerations

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Tactical Considerations

Tactical considerations in litigation for sovereign debtors (1)

- What is the claimant trying to achieve?
 - an enforceable judgment in a jurisdiction that will focus only on the legal issues regarding the underlying debt;
 - the enforcement of the judgment against the sovereign defendant's assets, worldwide.

Tactical considerations in litigation for sovereign debtors (2)

- What is the claimant likely to do to achieve its objectives?
 - forum shop;
 - look for assets outside the defendant State's borders.

Tactical considerations in litigation for sovereign debtors (3)

- What can a State do to protect itself in advance?
 - Audit sovereign assets held out of country:
 - can they be frozen by a court order?
 - can they be attached by enforcement of a judgment/arbitral award?
 - is attachment a necessary risk?
 - Where possible, assets held overseas should be repatriated or restructured.

Tactical considerations in litigation for sovereign debtors (4)

- Sovereign debt litigation raises complex issues and requires expert handling.
- Claimants instruct the best advisors in the world -- including law firms and asset search firms.
- States must also instruct the best advisors, and at the earliest possible stage, to avoid being disadvantaged.

Tactical considerations in litigation for sovereign debtors (5)

- The best possible result for a claimant is a default judgment
 - At the enforcement stage, courts won't be concerned with the merits of the State's position.
 - State officials must not sit on letters of claim or legal proceedings.
 - Deadlines in litigation are tight and real. Failure to meet them will have severe consequences.
 - States must not assume overturning a default judgment will be easy.

Tactical considerations in litigation for sovereign debtors (6)

- Don't assume the claimant is right and can do what it threatens.
 - It may be bluffing.
 - It may be wrong on the facts.
 - It may be wrong on the law.
 - It may have acted in a forum where the courts do not have jurisdiction.
- Early analysis and legal advice can address these issues.

Tactical considerations in litigation for sovereign debtors (7)

- Vulture funds are serial litigators who are constantly seeking to improve the quality of their debt.
 - They can catch States off guard, causing mistakes and generating legal and strategic advantages.
 - States often concede jurisdiction unnecessarily.
 - States should not make admissions or concessions in relation to the funds' acquisition of the debt, or its quality.

Tactical considerations in litigation for sovereign debtors (8)

- States should instruct their lawyers to conduct a full investigation of the debt and its assignment.
 - Only by uncovering the true factual position can they establish whether there is a defence.
 - Lawyers must establish if the assignment tainted with illegality or corruption.
 - Further information/evidence may be available from the claimant that might substantiate corrupt payments -- e.g. evidence of all payments made in connection with the assignment of the debt.
 - It is important, if sensitive, to establish if there has been bribery or improper use of confidential information.

Tactical considerations in litigation for sovereign debtors (9)

- Is the claimant subject to the Foreign Corrupt Payments Act ("FCPA") or other relevant legislation?
 - Can the results of a factual investigation be used to the State's advantage?
 - Can the media be persuaded to assist the State?

Case Study

Donegal International Limited

VS

(1) The Republic of Zambia

(2) Mofed Limited

- 1979 – Romanian tractor debt; \$15 million
- 1998 – face value \$29m
- Dec 1998 – Zambia agrees to buy back for \$3.6m
- Jan 1999 – Romania assigns to Donegal - a BVI SPV for less (\$3.2m)
- Why was Romania prepared to accept a lower figure from Donegal's principals?
- Thereafter:
 - Donegal seeks repayment from Zambia
 - Zambia refuses

- 2002 – Donegal persuades BVI court to take jurisdiction over its legal claim for repayment of the debt because of alleged corruption in Romania and Zambia
- Donegal threatens summary judgment for \$45 million, prior to proper service of the proceedings on Zambia (which never happened)
- 2003 – Zambia enters settlement agreement without taking independent legal advice on its terms or on the broader issues
 - what advice might have been given?

The terms of the settlement agreement

- Zambia accepted English law
- Zambia accepted English courts' jurisdiction and waived sovereign immunity
- Zambia agreed to pay \$15.9m (1/3 of face value of debt) in 36 instalments
- On default of any instalment, Donegal was entitled to judgment for the full amount of the debt with interest both before and after judgment at 8% pa, compounding quarterly

- Zambia paid two instalments (\$2.4 million)
- Change of President - Task Force on Corruption set up
- Zambia stopped paying, pending investigation of assignment of debt
- March 2005 Donegal obtained and served without notice freezing order on specific commercial assets of Zambia and Mofed Limited in London
 - properties
 - bank accounts
- No substantive relief sought against Mofed, a UK trading company (wholly owned by Minister of Finance)

- Donegal claimed \$55.5 million damages for breach of the Settlement Agreement. Zambia's former lawyer's advised there was no defence.
- DLA Piper took over Zambia's defence on the proceedings and investigated thoroughly.
- There was a 3 week trial and further week of legal submissions. Zambia's witnesses included former Ministers and General Counsel of the IMF.
- Zambia disputed validity and enforceability of the Settlement Agreement
 - tainted with illegality and corruption
 - improper use of confidential information
 - bribery
 - issues of lack of authority, misrepresentation and mistake

- Zambia's allegations of bribery not upheld, **but** Donegal held to have improperly sought and obtained confidential government information in relation to debt
- Donegal's witnesses held to have been thoroughly dishonest
- Freezing order discharged due to misleading evidence
- Judge upheld Zambia's defence that payment provisions of settlement agreement were unenforceable because they were penal
- Consequence: at separate quantum hearing, Donegal awarded judgment for \$15.7 million instead of \$55.5 million. No appeal

Penalty clauses are unenforceable under English law.
Test – a genuine pre-estimate of loss, or extravagant and unconscionable?

In the present case:

- Donegal would be entitled to 3x the settlement sum
- Interest increased from 6% to 8%
- Compounded interest with quarterly rests
- Compounded interest entitlement ran from date of agreement, not breach
- Had Zambia paid 35 instalments on time and defaulted on the final payment, Donegal could have claimed judgment for \$29 million

Freezing Orders

- Initial pre judgment order was discharged for dishonesty
- Post judgment freezing order granted re the same limited assets, but restricted in time to 28 days
- Worldwide freezing order over Mofed's assets refused because of Donegal's dishonesty
- Extension of freezing order to capture proceeds of main corruption proceedings against former President Chiluba not pursued – and eventually withdrawn

- Zambia paid interim costs award within 14 days and US\$5 million of judgment sum
- Donegal nevertheless secured ex parte orders as follows:
 - interim charging orders over commercial properties of Mofed Limited and Zambia
 - interim charging order over shares in Mofed Limited
 - third party debt order over all funds held by Mofed's bankers

- Donegal attended court on the hand down of judgment in Zambia's successful anti-corruption proceedings
- Zambia had paid money into court as security for the Defendant's costs, which was due to be paid back to Zambia
- The judge in the anti-corruption proceedings granted Zambia an injunction, preventing Donegal from seeking to attach the security money

- Zambia argued that Donegal was massively oversecured. Enforcement proceedings were settled after negotiation.
- Donegal's security was limited to a final charging order over a single property
- The security money was paid out to Zambia
- Donegal agreed to pay its own costs of enforcement
- Zambia has now paid the judgment debt in full and the charging order has been discharged.