EMTA Preliminary Analysis of Creditor Litigation in the Non-HIPC Sovereign Debt Restructuring Context

In connection with this study, EMTA has briefly reviewed the sovereign debt restructurings of over 50 non-HIPC countries since the early 1980s (a number of which have defaulted and/or restructured more than once). The purpose of the review was to identify, to the extent possible, within this universe of non-HIPC restructurings, (i) those instances in which sovereigns have been sued by their creditors (including the identity of such creditors); (ii) the judgments obtained and amounts recovered by these creditors; and (iii) factors or circumstances that may have made litigation and/or recovery more or less likely in these cases.

In our analysis, we specifically did not look at litigation against sovereigns in any other recovery situations, including, but not limited to (i) claims against countries that were not brought in the context of a sovereign debt default, (ii) claims arising from a foreign direct investment, but later assigned or sold to a litigating creditor; or (iii) claims against HIPC countries.

With respect to methodology, EMTA attempted to define the known universe of sovereign debt restructurings, the value of overall debt restructured (not always an exact science), relevant terms of the restructuring (where possible), and overall participation in the debt rescheduling process. We then attempted to identify and analyze, in the context of each restructuring, related litigation by non-participating creditors. In the analysis of litigation, we reviewed available literature and published court decisions, and attempted to interview market participants who were involved in some of the cases. Nevertheless, while some useful information was found to be freely available, this was not always the case, for a variety of reasons. For example, claims may have been dismissed at early stages of litigation and then settled out of court, and therefore not widely publicized. Other cases may not have been published (in particular binding arbitral awards that are subject to confidentiality), and others brought outside the United States in jurisdictions in which we did not research. Our attempts to obtain information from knowledgeable market participants did not always prove successful. As a result, while we believe that most instances of such creditor litigation have been identified (at least the better known cases), further research in this area may be warranted. Certainly the instances identified could be subjected to more detailed analysis.

Preliminary Conclusions

- Since the early 1980s, at least 59 non-HIPC countries have defaulted on and/or restructured their sovereign debt[1] (some countries have defaulted

[1] See EMTA Chart: Overview of Non-HIPC Sovereign Defaults/Restructurings (Draft 6/16/09).

and/or restructured their debt more than once). The aggregate debt restructured by these countries exceeds US$ 600 billion.[2]

- From this universe, we have identified nine non-HIPC countries[3] that have been subject to litigation by one or more of their creditors.[4] Excluding claims against Argentina arising from its 2001 bond default, to the best of our knowledge, these legal actions were brought with respect to debt totalling about US $ 1.5 billion[5] and have resulted in recoveries (either through legal enforcement or settlement) totalling about US$ 230 million[6].

- With the exception of Argentina, which defaulted on its international bonds in December 2001, the other cases known to us and referred to above all arose out of defaults on foreign currency bank debt or trade finance paper dating from the 1980s and 1990s. In one case (Allied), the claim was asserted by the original bank lender. In the other cases, the litigating creditor purchased the debt on the secondary market.

- Against these nine debtor countries, creditor plaintiffs have been successful in asserting their claims and obtaining judgments in U.S. courts (primarily the federal courts in New York) under basic principles of contract law (including waivers of sovereign immunity). Despite these judgments, actual recoveries appear to have been challenging in many cases. The time lag between obtaining favourable judgment and recovering on the judgment (usually through settlement) has varied from less than one year, to several years, but all cases involved numerous additional attachment and enforcement actions in various jurisdictions.[7] This review did not attempt to ascertain the related costs of enforcing any

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2 See EMTA Chart. Restructuring amounts are extremely difficult to nail down and we were not able to obtain any amounts for a number of countries. This total, therefore, is very approximate.

3 See EMTA Case Summaries (Discussion Draft 6/16/09). We have found reference to other cases against non-HIPC countries, for example, a suggestion that Vietnam was also subject to litigation or the threat of litigation at some point in the past by Elliott Associates, but we have not been able to confirm this, or other potential disputes against other countries.

4 One plaintiff – Elliott Associates – shows up in three of these cases, Water Street Bank & Trust Ltd also appears in three, and the Dart plaintiff is present in two. For more information on the cases, see Case Summaries.

5 This figure is based upon face amounts of debt claims litigated to the extent we were able to determine, and excludes claims for accrued and/or compound interest. Incidentally, the Dart holding of MYDFA amounted to about US$1.4 billion of the total amount of debt litigated of US$ 1.5 billion. (See in Case Summaries.)

6 The total amount of recoveries on the litigated debt includes awards of accrued and/or compound interest. The amount of debt litigated and recovered in the *Allied* case is not known, and so are not included in these totals.

7 We did not review the multitude of attachment and enforcement actions accompanying the judgments.

of these claims and was unable to make any assessment of the "profitability" of the use of litigation as an investment strategy.

- While we do not have sufficient information on the different factors in each case, it appears that in three of these cases the litigating creditor recovered what appears to be a substantial amount, if measured against what was paid for the debt instrument in the secondary market, or against what other creditors who voluntarily exchanged their debt in the restructuring received, despite all of the plaintiffs being awarded favourable judgments (see, in particular, *CIBC v. Brazil*, *Elliott v. Peru* and *Elliott v. Panama*).[8]

- The amounts recovered by litigating creditors as compared to the overall amounts restructured did not appear to be significantly large (about .262% overall[9]), even in the instances where creditors obtained substantial recoveries (Brazil .163% ($77 million out of $47 billion[10]); Peru .531% ($56.3 million out of $10.6 billion) and Panama 1.8% ($71 million out of $3.9 billion)).[11]

- In recent years, the trend (perhaps largely exemplified by the experience of Argentina's creditors) has been that creditors have found it increasingly difficult to enforce debt claims against sovereigns. Whether this is due to market factors (such as characteristics of bonds (including how they have typically been restructured)), the particular strategies followed by the debtor countries to shield their assets from legal claims, or the evolution of the law of sovereign immunity, is not clear, and was not the focus of this study.

- In the few instances where creditors brought suit prior to the conclusion of the relevant restructuring, most notably, *Pravin Banker*,[12] it appears the courts did heed concerns raised by debtors that permitting enforcement actions at such a sensitive time could disrupt the restructuring. Therefore,

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8 *The Economics and Law of Sovereign Debt and Default*, Ugo Panizza, Federico Sturzenegger, and Jeromin Zettelmeyer, November 2008, (reviewed draft to be Forthcoming: Journal of Economic Literature).

9 Includes restructured amounts in the cases involving Brazil ($47B), Bulgaria ($8B), Ecuador ($7B), Panama ($3.9B), Peru ($10.6) and Poland ($11B). Excludes restructured amounts for Argentina (there have been no recoveries to date) and Costa Rica (we do not have numbers from the 1981 refinancing). Excludes any amounts that Weston may have obtained from Ecuador, or Pravin Banker from Peru due to lack of sufficient information.

10 We are using the 1994 Brady rescheduling amount for purposes of analyzing the CIBC recovery on its hold-out position of its MYDFA debt. The recovered amount excludes the principle amount of the MYDFA that was retained and later securitized.

11 See Case Summaries.

12 Pravin Banker's first action against Peru was filed in 1993.

in this and other cases,[13] the courts delayed enforcement actions to give debtors time to complete the restructuring. However, it was clarified in *Pravin Banker* that debtors could not avoid enforcement actions indefinitely as the court ultimately affirmed the principle in U.S. law that sovereign debt restructurings are voluntary, and contracts should remain enforceable throughout the pendency of the restructuring. [14]

- One possible interpretation of the available information is that much of the creditor litigation of the mid-1990s was opportunistic in nature – knowledgeable plaintiffs were able to pursue a tested legal strategy within a specific set of facts at a specific time. A number of changes to the international EM markets in recent years may mean that fewer of these types of creditor suits are on the horizon. For example, in a market now dominated by bond issuance, the use of exit consents to change the terms of old bonds (by subordinating them or otherwise weakening creditor protections) and the increasing use of collective action clauses (CACs) to bind minority shareholders in new bond issuances may have an effect on the future likelihood of creditor litigation.

- While it is difficult to make the argument that more "cooperative" debtors would have avoided some of the creditor litigation identified in this report due to what appears to have been its opportunistic nature, the recent case of Argentina, in contrast to the many other defaults or reschedulings that have occurred since 2001 that have not resulted in any litigation, suggests that debtor behaviour may influence the likelihood that it will become subject to legal actions.

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[13] Elliott brought a pre-judgment attachment suit against Peru prior to the completion of the Peruvian restructuring, which the court did not permit. See Case Summaries.

[14] In *Pravin Banker*, Peru argued that permitting its enforcement action prior to the completion of its restructuring could "result in a creditor stampede to find and attach Peruvian assets, and such a stampede would, in turn disrupt Peru's structural reform." The court heeded this concern by enjoining Pravin's enforcement action for six months to give Peru time to complete the restructuring, but then permitted Pravin's action. *Pravin Banker Associates v. Banco Popular Del Peru*, 109 F.3d 850 (2nd Circuit 1997).