

## Creditor Litigation in the Non-HIPC Sovereign Debt Restructuring Context: EMTA Case Summaries<sup>1</sup>

### Argentina

In December 2001, Argentina defaulted on approximately \$86 billion of debt (represented by 152 separate bond issues). 76% of the defaulted debt was exchanged for new bonds in 2005 (at a 70% discount). Of the nearly 24% hold-outs who have not been restructured (and an Argentine law from February 2005 prevents the government from settling with those creditors), most have opted for litigation and/or arbitration.

To date, 140 cases have been brought against Argentina in multiple jurisdictions including the United States (New York), Italy, Germany and Japan. In the Southern District of New York, about 130 plaintiffs have brought claims against Argentina, and several class actions have been filed. Among the various plaintiffs in the New York courts are EM Ltd. (aka Darts), NML Capital (aka Elliott), Aurelius Capital, Macrotecnic, Greylock, GMO, Barboni (class action), and HW Urban GmbH (class action). Task Force Argentina, which represents Italian retail investors, has brought an action against Argentina in the World Bank's International Court for the Settlement of Investment Disputes (ICSID).

To date, a number of judgments have been awarded in favour of creditors (over US\$ 8.3 billion<sup>2</sup> in the New York courts), but there have been no recoveries.

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### Brazil

Brazil (and its majority-owned entity Banco do Brasil) was sued in 1995 by CIBC Bank and Trust Company, a Cayman Islands company belonging to the Dart family.<sup>3</sup> The suit was brought in connection with Brazil's restructuring of its foreign currency bank debt incurred in the 1980's that was eventually the subject of a 1994 refinancing package under the Brady initiative.

In this case, the Dart family through its entity CIBC Bank did not submit its \$1.4 billion portion of the Multi-year Deposit Facility Agreement (the MYDFA), which had been restructured in 1988, under the interim 1992 refinancing package. This debt had been

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<sup>1</sup> We are unable to confirm that this is a complete list of all cases brought against non-HIPC sovereigns in the restructuring context for the reasons set forth in the Preliminary Analysis. We would welcome further input from knowledgeable market participants in order to complete the project.

<sup>2</sup> This information comes from a summary of cases and judgments awarded against Argentina in the New York courts provided to us by a law firm. This figure is rounded and excludes awards in currencies other than U.S. dollars.

<sup>3</sup> *CIBC Bank and Trust (Cayman) v. Banco do Brasil*, 886 F. Supp 105 (S.D.N.Y. 1995).

purchased in the secondary market (although we do not know at what price). Banco do Brasil also kept out \$1.6 billion from the restructuring in order to prevent the Darts from being the only hold-out creditor and accelerating the debt under the MYDFA (the terms of the MYDFA required holders of 50% of the outstanding debt to request acceleration).

CIBC argued that it should be allowed to accelerate its debt according to the terms of the MYDFA because it held nearly 50% of the outstanding debt, and Banco do Brasil's holdings should not count because it was Brazil's alter-ego. The court ruled that the Darts were entitled to past-due interest under the MYDFA, but did not allow it to accelerate.

The U.S. government submitted an *amicus curiae* brief, opposing the acceleration on the grounds that it might upset the restructuring. It also noted that because CIBC had bought the debt in the secondary market, its interests were potentially not aligned with bank lenders in terms of achieving a successful restructuring.

Brazil settled in March 1996 by paying the Darts \$52 million in Eligible Interest Bonds covering past due interest until April 1994 (the settlement date of the Brady deal) and \$25 million in cash covering accrued interest since April 1994.<sup>4</sup>

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## Bulgaria<sup>5</sup>

In June 1994, Bulgaria's Foreign Trade Bank (Bulbank) rescheduled approximately \$8 billion in foreign currency bank debt in a London Club restructuring. One creditor, AI Trade Finance (AITF), a subsidiary of AIG, did not agree to the terms of the restructuring and instead brought suit in [1996].

AITF, which was established in 1987 to participate in the a-forfait and trade finance markets, purchased three Bulbank DM credits (face amount approximately \$12 million<sup>6</sup>) in the secondary market. According to the Managing Director of AITF, the credits were purchased at a relatively high price (apparently from an Austrian bank) close to the time of their origination.<sup>7</sup>

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<sup>4</sup> "Brazil treated the remaining MYDFA as if it had been performing since April of 1994, signaling that it would continue servicing the loan in the future. On that basis, the Darts managed to effectively sell their MYDFA holding by issuing \$1.28 billion in Eurobonds secured by MYDFA debt in October of 1996, at a modest spread over Brazilian sovereign debt with similar payment terms." The market value of this issue was put at approximately \$1.1 billion. *See, 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*), p. 11.

<sup>5</sup> No cases were reviewed in connection with Bulgaria, the account was provided by AI Trade Finance's Managing Director at the time of the suit.

<sup>6</sup> Two credits were DM-denominated, so dollar amounts fluctuated.

<sup>7</sup> "As with much trade finance paper, it is possible that the availability of AITF as a secondary buyer might have been essential to its origination." (Quote from AITF's Managing Director at the time.)

The dispute was subject to arbitration in Stockholm. AITF won its case and was awarded the full amount of its claim in 1998. In the ensuing years, enforcement proceedings were then brought in Germany, Austria and elsewhere to recover. A final settlement amount of \$15 million was paid to AITF in 2000.

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### Costa Rica

In 1981, the government of Costa Rica suspended all external debt payments, including on promissory notes from Costa Rican banks (wholly-owned by the state) owed to a group of 39 creditors represented by Allied Bank International (Allied). In 1982 Costa Rica settled with 38 of the 39 creditors. Fidelity Union was the only hold-out, and Allied, as agent, brought suit on their behalf in the Southern District of New York.<sup>8</sup>

The District Court held that principles of comity required U.S. courts to recognize Costa Rican directives, and therefore found against the plaintiff. However, on appeal the U.S. submitted an *amicus curiae* brief on the side of the creditors in which it clarified its policy with respect to debt relief under the auspices of the IMF. The U.S. stated that the IMF approach ...

*“encourages the cooperative adjustment of international debt problems. The entire strategy is grounded in the understanding that, while parties may agree to renegotiate conditions of payment, the underlying obligations to pay nevertheless remain valid and enforceable. Costa Rica’s attempted unilateral restructuring of private obligations ... was inconsistent with this system of international cooperation and negotiation and thus inconsistent with U.S. policy.”<sup>9</sup>*

The District Court ruling was reversed by the Second Circuit, which further found that the Act of State doctrine did not apply because the situs of the debt at issue (promissory notes denominated in U.S. dollars and governed by New York law) was not Costa Rica, but rather the United States.

As settlement, Fidelity eventually accepted the same pay-out as the other syndicate members.<sup>10</sup>

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### Ecuador

Ecuador was sued at least twice in connection with debt not tendered into its approximately \$7 billion<sup>11</sup> Brady refinancing in 1995. One plaintiff was Weston Cie de

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<sup>8</sup> *Allied Bank Int’l v. Banco Credito Agricola de Cartago*, 757 F.2d 516 (2<sup>nd</sup> Circuit 1985).

<sup>9</sup> *Id.*

<sup>10</sup> Panizza, *et al.*, page 9. We were not able to obtain the amounts in dispute or the amounts restructured and they were not disclosed in the case.

<sup>11</sup> IIF Survey, 2001.

Finance et D'Investissement,<sup>12</sup> a Swiss company engaged in the buying and selling of Latin American sovereign debt, and another plaintiff was Water Street<sup>13</sup>, a hedge fund that brought a number of actions against sovereigns in the 1990's.<sup>14</sup>

Weston. The Weston case in New York district court (in 1993) involved an action to recover \$20,756,959.74 in principal and \$9,587,360.34 in interest from the Republic of Ecuador, the Central Bank and others. In the action, the plaintiff attempted to obtain prejudgment attachment of funds in the name of the Central Bank at four commercial banks in the US. The Central Bank argued that funds belonging to the Central Bank are immune from prejudgment attachment. The Court held that there was no waiver of prejudgment attachment by Ecuador or the Central Bank of funds held for their own account, and clarified that the FSIA makes a distinction between prejudgment attachment and attachment in aid of execution.

In its decision in the Weston case the court was considering only a motion for pre-judgment attachment, and there is no indication whether or not the action was pursued after the motion was denied.

Water Street. We have not been able to review the Water Street case (brought in 1995), but understand that the Ecuador debt at issue was purchased from Lloyds Bank in the secondary market. The case was dismissed for settlement, and the full amount of the claim (\$6 million) was apparently paid.<sup>15</sup>

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## Panama

Panama was sued by at least two plaintiffs on debt that was the subject of its nearly \$4 billion<sup>16</sup> 1996 London Club rescheduling under the Brady Plan. A suit brought by Water St. Bank & Trust Ltd. was dismissed in February 1995 due to Water Street's failure to comply with the Court's order to disclose its principals.<sup>17</sup> Elliott Associates then

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<sup>12</sup> *Weston Cie de Finance et D'Investissement, S.A. v. Ecuador*, 823 F. Supp 1106 (S.D.N.Y., 1993).

<sup>13</sup> *Water Street Bank & Trust Ltd. V Banco Central del Ecuador*, 95 Civ. 5253 (JES) (S.D.N.Y. 1995). (This case was not independently reviewed.)

<sup>14</sup> Water Street was a distressed debt fund set up in the 1990s, which brought cases against several sovereigns including Ivory Coast, Republic of the Congo, Ecuador, Panama, Peru and Poland in courts in New York and London. While it is difficult to obtain accurate information about Water Street, we understand from market sources that all, or nearly all, of the Water Street cases were dismissed for settlement purposes. In the 1990s, Water Street and Elliott Associates shared the same legal counsel. Water Street was liquidated in May 1995.

<sup>15</sup> IMF Working Paper IMFWP/03/161.

<sup>16</sup> IIF Survey, 2001.

<sup>17</sup> *Water St. Bank & Trust Ltd. v. Republic of Panama*, 94 Civ. 2609, 1995 WL 51160 (S.D.N.Y. Feb. 8 1995), as described in *Elliott v. Peru*, 12 F. Supp 2<sup>nd</sup> 328 (S.D.N.Y. 1998).

sued in July 1996 on debt it had purchased in the secondary market in 1995, after declining to participate in the rescheduling.<sup>18</sup>

Elliott. Elliott Associates purchased \$28,750,907.05 face value of syndicated loan debt for around \$17.5 million in the secondary market, in or around October 1995, when Panama was in the process of finalizing its debt restructuring. In July 1996, Elliott sued Panama to recover the face value of the loans and contractual and compounded interest. In October 1997, the NY court found in Elliott's favor in a judgment amount of around \$78 million. In [1998] Panama settled for \$71 million dollars after Elliott was successful in attaching U.S.-based assets of a state-owned telecommunications company that Panama was preparing to privatize.<sup>19</sup>

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### Paraguay

Paraguay was sued in connection with its \$20 million debt restructuring, which concluded in 1993.<sup>20</sup>

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### Peru

Peru was sued by two plaintiffs on debt not tendered into the 1997 London Club rescheduling under the Brady Plan of approximately \$10 billion<sup>21</sup> of debt. One plaintiff was Pravin Banker Associates<sup>22</sup> and the other was Elliott Associates.<sup>23</sup>

Pravin Banker. The debt sued on by Pravin Banker Associates was part of Banco Popular's debt owed to Mellon Bank dating from the 1980's. Pravin bought \$9 million of this debt from Mellon in the secondary market in 1990. It sold on most of this debt almost immediately, but kept \$1,425,000 face amount. The assignment was notified to

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<sup>18</sup> *Elliott Associates, L.P. v. The Republic of Panama*, 975 F. Supp. 332 (S.D.N.Y. 1997). (This case has not been independently reviewed.)

<sup>19</sup> In discussions of *Elliott v. Panama* in *Elliot v. Peru* (1998 and 1999), the court notes that Elliott received settlement from Panama of over \$57 million. The \$71 million settlement number (also put at \$78 million in some publications) appears to be the more oft-cited. See, for example, Panizza, et al., page 13. Note that in IMFWP/03/161, this settlement is attributed to Water Street Bank & Trust Ltd., but we do not believe this is accurate.

<sup>20</sup> This case, *Banque de Gestion Privee-SIB v. La Republica de Paraguay*, 91 Civ. 7952 (MBM) (S.D.N.Y.), was cited in *Elliott*, 1998. (This case was not independently reviewed, and it does not appear again in any of the literature reviewed. We do not know the outcome.)

<sup>21</sup> IIF Survey, 2001. The Peru Brady exchange closed in March 1997. (*Elliott v. Peru*, 1998).

<sup>22</sup> *Pravin Banker Associates v. Banco Popular Del Peru*, 895 F. Supp. 660 (S.D.N.Y. 1995); *aff'd*, *Pravin Banker Associates v. Banco Popular Del Peru*, 109 F.3d 850 (2<sup>nd</sup> Circuit 1997).

<sup>23</sup> *Elliott Associates v Peru*, 12 F. Supp 2<sup>nd</sup> 328 (S.D.N.Y. 1998); Appeal, *Elliott Associates v. Peru*, 193 F 3<sup>rd</sup> (2<sup>nd</sup> Circuit 1999).

Banco Popular, which started and then stopped making interest payments to Pravin, which declared the debt in default and demanded payment.

Banco Popular went into liquidation. Pravin did not join either the liquidation proceedings, or the Brady Plan negotiations, but instead brought the law suit in January 1993.

Peru cross-moved to dismiss or stay arguing that Pravin's actions could result in a creditor stampede to attach Peru's assets and disrupt Peru's structural reform efforts. (Peru also tried to argue that Pravin was not a "financial institution" and therefore not a proper assignee of the debt, but the court disagreed, citing NY law that only express limitations on assignability are enforceable.)

The U.S. District Court for the Southern District of New York at first enjoined enforcement for six months based upon comity to permit Peru to complete the restructuring. However, it later ruled that continuing to extend international comity to Peru's Brady Plan negotiations with its foreign creditors would violate United States policy. The Court of Appeals for the Second Circuit affirmed. In its ruling, the Second Circuit held found that the District Court properly weighed the US's competing interests in:

- a) ensuring the successful, voluntary resolution of past-due foreign sovereign debt and
- b) maintaining the enforceability of contracts under US law.

Therefore, the District Court appropriately concluded that using principles of international comity to defer further the enforceability of Pravin's debt would violate U.S. policy. In October 1995, the Court granted Pravin's motion for summary judgment on enforcement of \$2,083,234.61 plus pre-judgment simple interest from October 26, 1995 until judgment (plus post-judgment interest).

We have not been able to ascertain whether or not Pravin recovered on the judgment, and if so, when or how much.<sup>24</sup>

Elliott. Between January 31, 1996 and March 1, 1996, Elliott purchased debt claims aggregating about US\$20.7 million face amount (plus accrued and unpaid interest) for about US\$11.4 million on the secondary market.

Elliott commenced its action to recover on the claims on October 18, 1996 in the Supreme Court of New York. The case was then removed to District Court for the Southern District of New York in October 1996. In December 1996, Elliott lost its first action for pre-judgment attachment prior to the conclusion of the Brady restructuring on

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<sup>24</sup> In an action in 1998 (*Pravin Banker v. Peru*, 9 F. Supp. 2d 300 (S.D.N.Y. 1998)), Pravin was still attempting to enforce its judgment without success.

the grounds that it might jeopardize the restructuring.<sup>25</sup> The Peru restructuring closed in March 1997.

In a decision dated August 6, 1998, following a bench trial in the Southern District of New York, Elliott was found to have violated New York's anti-champerty statute (Section 489 of the NY Judicial Law), which generally prohibits the purchase of a debt claim "*with the intent and for the purpose of bringing an action or proceeding thereon*", and judgment was entered in favor of Peru.<sup>26</sup> The court also took into consideration facts suggesting that Elliott had been watching the outcome in the Pravin Banker case to determine its litigation strategy.<sup>27</sup>

On appeal, the Second Circuit disagreed, holding that the purchase of a debt with intent to bring a legal action was not champertous where the primary purpose of the legal action was to collect the debt.<sup>28</sup> Elliott obtained a judgment award against Peru in June 2000 for US\$ 55.7 million and set in motion numerous suits to attach assets in New York and various European countries.

Elliott obtained a very high-profile settlement from Peru in late 2000 amounting to \$56.3 million after Elliott threatened to attach \$80 million in interest payments owed to Peru's Brady bondholders to be paid through the Euroclear system in Brussels.<sup>29</sup> In an unusual ruling, a Brussels' magistrate agreed with Elliott's expansive definition of the *pari passu* clause in its bonds to mean that other creditors should not be paid before it. Peru ended up halting payments (and going into technical default on its Brady bonds) to avoid the attachment, and settled with Elliott. The expansive interpretation of the *pari passu* clause has not been given effect in the US courts (or elsewhere), and Belgium has subsequently enacted a law that makes international payment systems like Euroclear immune from similar attachment orders.<sup>30</sup>

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## Poland

Poland was sued by Water Street<sup>31</sup> in 1995 in the Southern District of New York [and in London] in connection with debt not tendered into Poland's 1994 London Club restructuring of approximately \$11 billion in foreign currency bank debt.

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<sup>25</sup> Discussed in *Elliott* (1999).

<sup>26</sup> *Elliott* (1998).

<sup>27</sup> *Elliott* (1998 and 1999).

<sup>28</sup> *Elliott* (1999).

<sup>29</sup> Panizza, *et al.*, page 14.

<sup>30</sup> *Id.*, pages 14-15

<sup>31</sup> *Water Street Bank & Trust Ltd. V. Republic of Poland*, 95 Civ. 0042 (LAP) (S.D.N.Y. 1995). (This case was not independently reviewed.)

The case was dismissed in favor of settlement, and Water Street was paid the full amount of the claim, approximately 5 million Swiss Francs.<sup>32</sup>

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<sup>32</sup> IMF Working Paper WP/03/161.