EURODAD DEBT WEDNESDAYS

Sovereign Default

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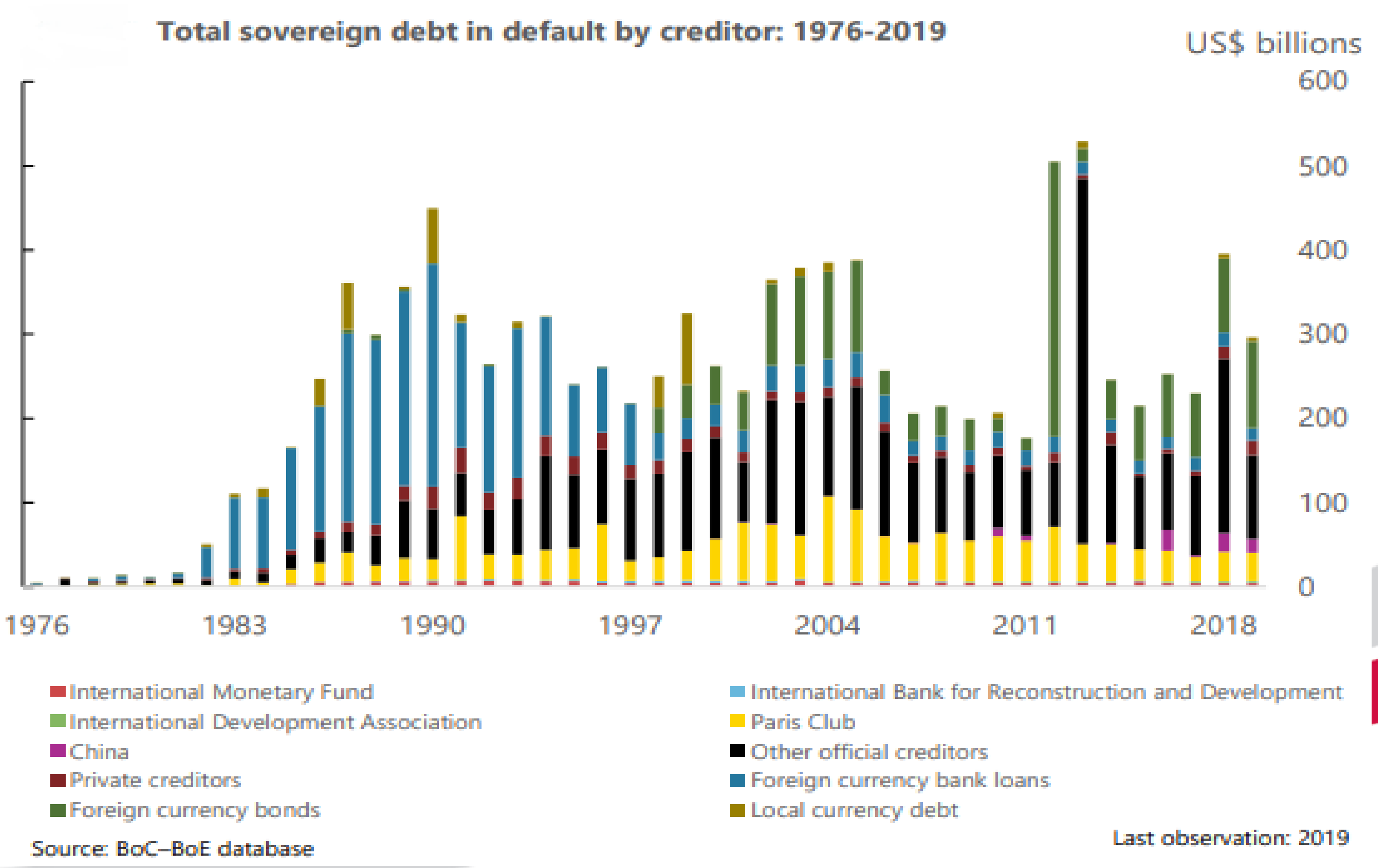
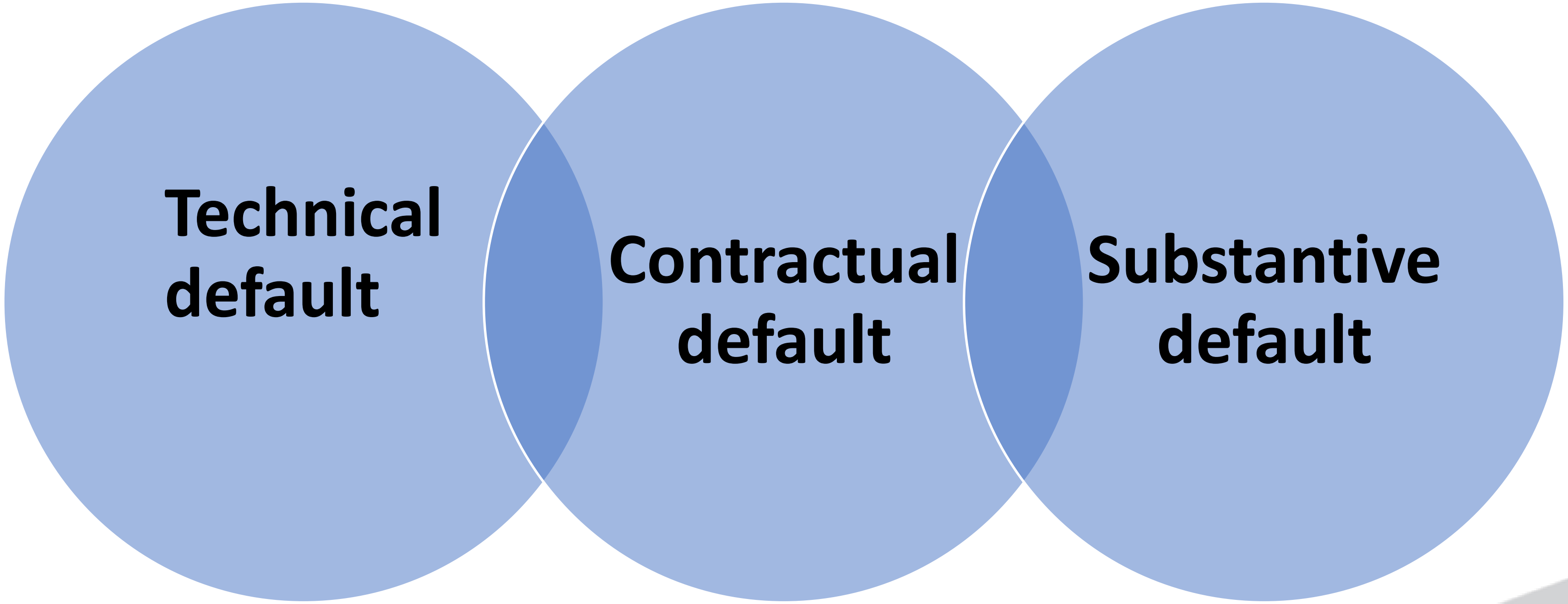
Sovereign defaults: a recurring theme



Defining sovereign default: 3 approaches



Source: Ams et al., 2019

Technical Default

- Not a legal term – relatively little importance in practice
- Any contractual Event of Default (EoD) in *foreign law* debt that is <u>not</u> also a default under influential third-party definitions (e.g. rating agencies, ISDA)
  - Equivalent in *official or domestic law* debt instruments
- Examples:
  - Administrative errors
  - Certain minor covenant defaults

Contractual Default I

- Contractual Event of Default (EoD) = breach of a legal promise
- Several types of EoDs, e.g.:
  - Payment default
    - Failure to pay interest/coupon or principal – typical grace period of 30 days (Lebanon, 2020)
  - Repudiation
    - For instance, debt declared as illegitimate by sovereign issuer (Ecuador, 2008)
  - Cross default
    - Default under one debt instrument triggers default of other instruments
  - Moratorium
    - Temporary suspension of payment (Argentina, 2001)

Contractual Default II

- EoD under foreign law (NY & English law) bond contract has several legal implications
  - Usually allows for acceleration of *principal* payments (25% of creditors required)
  - Creditors may also trigger cross-default clause & cross-acceleration
  - Reverse acceleration (“cure of default”) requires 50% creditor consent
- Usually *no* EoD definition in domestic law instruments
  - Sovereign can ex-post change contractual terms (including EoD)
  - Substantive default (next slide) becomes more important

Substantive Default

- Defaults under third-party documentation (e.g. rating agencies, ISDA) but *not* in contract
  - May trigger financial/reputational consequences, but *no* legal remedies
  - As soon as contract is breached (e.g. by missed payments), it becomes a contractual default
- Examples:
  - Distressed debt exchange (Belize, 2007)
  - Restructuring with local law (Greece, 2012)
  - Restructuring using CACs (Ecuador, 2020)

(Legal) consequences of default I

- Creditors have several (hypothetical) *channels for debt enforcement*:
  - Foreign courts (foreign law debt, usually NY or English courts)
  - Domestic courts (local law debt)
  - International Center for the Settlement of Investment Disputes (ICSID)
- Sovereign debtors have certain, albeit weak defenses against repayment, e.g.:
  - Act of State
  - Prescription
  - Champerty
  - Odious debt
  - Capacity to repay

(Legal) consequences of default II

- Enforcement of sovereign debt difficult, though not impossible:
  - 1. Sovereign Immunity from suit
    - Sovereigns usually immune under international law
    - BUT, nowadays waived under foreign law debt or for commercial transactions
  - 2. Sovereign immunity from enforcement
    - Waiver usually narrower than for adjudicative immunity
    - Attachment/seizure limited to *commercially-used* assets located *abroad*
  - 3. Contempt of court (equitable injunction against sovereign *or* 3rd party)
    - Forces 3rd parties (e.g. fiscal agent, trustee) to halt all payments
    - Successfully used by creditors against Argentina (*NML* case)
    - NY law standard: “uniquely recalcitrant” debtor

Countries rarely default, given the legal, reputational, and financial implications…

A Hedge Fund Has Physically Taken Control Of A Ship Belonging To Argentina's Navy

Joe Weisenthal Oct 4, 2012, 5:28 AM

Europe's Debt Crisis

Greece avoids default … for now

by Ben Rooney @ben_rooney

August 17, 2012: 10:22 AM ET

Guatemala Pays Debt to Teco Energy

After Guatemala paid off its debt to Teco Energy, the $15.75 million embargo was lifted, resources that the country had allocated for interest payments from some Eurobond holders.

Wednesday, November 25, 2020

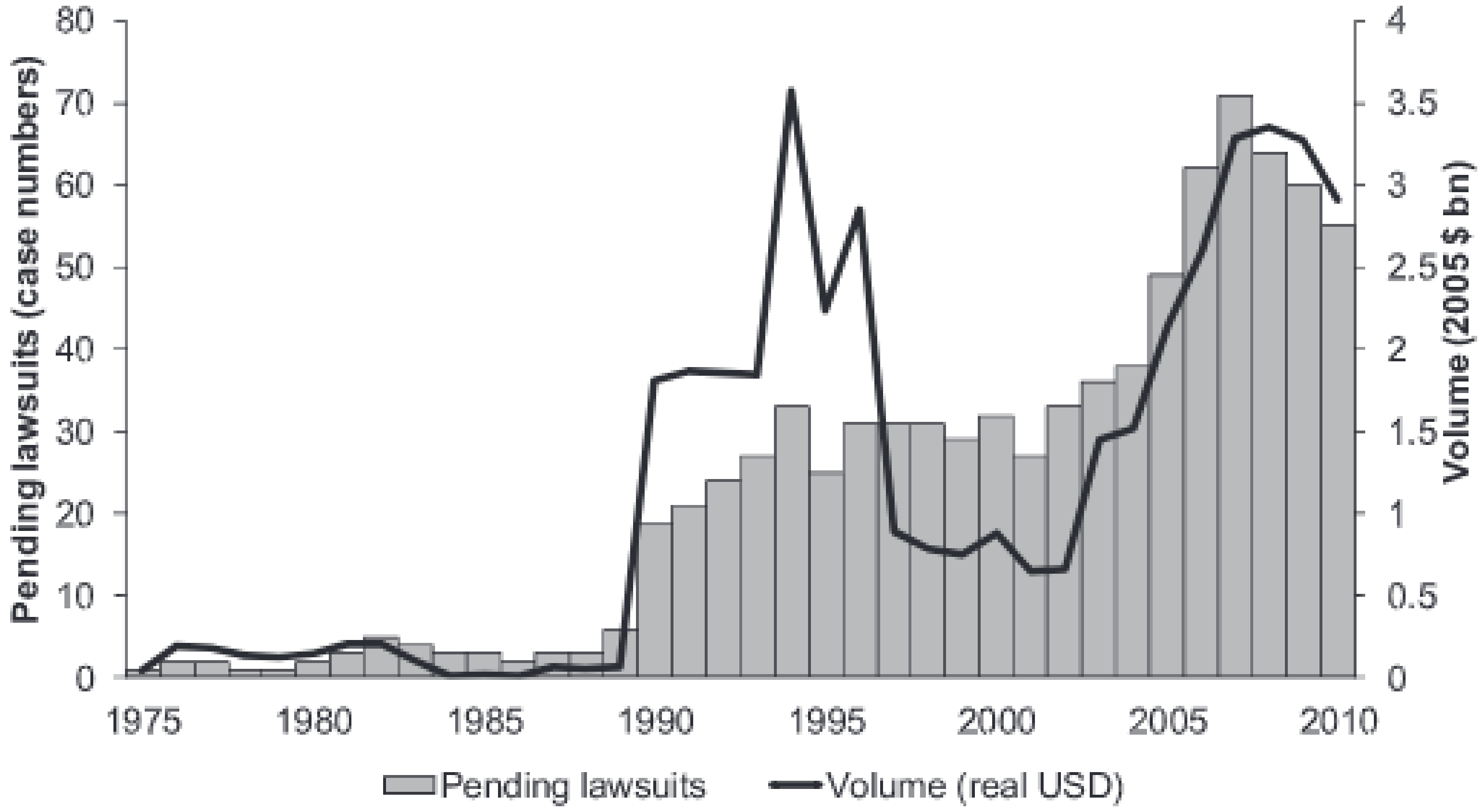
Argentine Leader's Plane Grounded By Credit Holders

January 10, 2013 · 3:00 PM ET

BUSINESS NEWS AUGUST 4, 2020 / 3:20 AM / UPDATED 8 MONTHS AGO

Argentina strikes $65 billion debt deal to avert hard default

…but sovereign debt litigation is here to stay



Source: Schumacher et al., 2021

Recommended literature:

- Ali Abbas, Alex Pienkowski, Kenneth Rogoff, *Sovereign Debt: A Guide for Economists and Practitioners* (OUP, 2019)
- Hayk Kupelyants, *Sovereign Defaults Before Domestic Courts* (OUP, 2018)