Background

The public sector has expressed concern over what is considered aggressive litigation by some private creditors, especially in the context of debt relief operations for low-income countries. The Paris Club creditors and private sector participants have exchanged views on the role of the private sector in debt restructurings and debt relief. Some in the official sector believe that most commercial creditors have not provided their share of debt relief to HIPCs, and creditor litigation is on the rise.

The IIF and EMTA, in leveraging their extensive membership networks, have pursued cooperative action with the private sector, while promoting dialogue with multilaterals that will ultimately benefit creditor participation in the debt relief programs. A joint study researched and published by IIF/EMTA aims to enhance understanding of the issue and offers a broader perspective.

The IIF assesses private sector involvement in low-income countries, while EMTA focuses its work on private sector involvement in market-access countries. The issues surrounding low-income countries center on countries benefitting from debt relief initiatives, in the context of the 2008 World Bank/IMF survey of commercial creditor lawsuits against HIPCs: seven HIPC completion point countries reportedly facing lawsuits by commercial creditors and three interim-HIPC countries facing similar legal processes. Importantly, the IIF study calls attention to examples where commercial creditors provided full debt relief.
Creditor Litigation in Low-Income Countries Benefiting from the Enhanced-HIPC and MDRI

June 2009

Preliminary Analysis

Creditor Participation in the Enhanced HIPC Initiative

The HIPC initiative - launched in 1996 – and its successors, the Enhanced HIPC Initiative and MDRI, have brought nominal debt relief of about $44 billion to a group of 20 countries with completion point status. Commercial creditors have forgiven $6.6 billion of debt, twice the originally expected amount. The implementation of technical aspects of the Initiative has allowed faster, deeper and broader debt relief and has strengthened the links between debt relief, poverty reduction, and socio-economic policies.

Participation of non-Paris Club official bilateral and commercial creditors is crucial to the successful implementation of the initiative. One particular concern has been the legal action taken by some private creditors against countries in the process of securing potential benefit from formal debt relief programs. Since 2002, the IMF and the World Bank have monitored creditor litigation against HIPC countries.

In recognition of the challenges involved in garnishing and tracking information relative to active litigation cases, the IMF/IDA survey on commercial creditor participation and litigation provides a systematic tool to collect information on creditor legal action. The survey findings are summarized annually in their report to the Development Committee on The Enhanced HIPC Initiative and MDRI--Status of Implementation.

---

1 Questions may be directed to Edgar Luna-Mendoza at the Institute of International Finance (IIF) (elunamendoza@iif.com)
2 In April 2002, the Development Committee (DC) - a forum of the WB and the IMF that facilitates intergovernmental consensus-building on development issues - encouraged the IMF and the WB to explore issues related to creditor participation in the HIPC initiative.
3 The survey initially covered only post-decision-point HIPC; by 2008 it was extended to all HIPC s. An initially reticent response rate has gradually improved over the years, representing four out of five countries in the latest survey. The World Bank confirmed they are currently working on the 2009 survey edition to be presented to the Development Committee during its annual meeting in Istanbul in October 2009.
Litigation in Low-Income Countries by Commercial Creditors

The public sector has expressed concern over what is considered aggressive litigation by some private creditors. This note provides a preliminary assessment of creditor litigation against low-income countries. The IIF staff has compiled information on the experience with such litigation, and sought feedback from market participants, legal and financial advisors, and multilateral institutions. Further credit is due to the contribution of Elliott Management Association, which has been of particular value as they have coordinated information from a number of financial and legal institutions involved in developments between creditors and debtors. An update and close assessment by creditor composition of remaining distressed debt activity on a per-country basis is attached as Appendix A.

The present review of litigation in low-income countries aims at broadening overall understanding of the nature of litigation in these countries and identifies the incidence of the most controversial cases. The discussion with the Paris Club is expected to promote an exchange of views between creditors and borrowing countries, drawing special attention to elements that maximize chances of broad creditor participation and encourage burden-sharing between creditors and debtors. Appendix C supplies a table comparing the scope of debt reduction among creditors in selected Decision Point HIPC countries.

The report focuses on the experiences of low-income countries pending litigation as reported in the latest IDA/IMF survey. Pending cases in countries benefiting from debt relief define the scope of this assessment: seven HIPC completion point countries reportedly facing lawsuits by commercial creditors and three interim-HIPC countries facing similar legal processes. General conclusions are drawn from selected cases; instances characterized by cooperation within the debt relief framework are underscored.

Preliminary Assessment

- The cases of the Republic of Congo, Nicaragua, Cameroon and Liberia illustrate examples of cooperative agreements between low-income countries and commercial creditors, including recalcitrant creditors. A per-country assessment is provided by Appendix B.
- Good faith negotiations in cases where a sovereign seeks debt relief from its commercial creditors is an essential element for an outcome likely to limit legal action against the sovereign.
- Recent cases show that recalcitrant creditors are willing to participate in a negotiation process if the debtor is prepared to negotiate on mutually acceptable terms.
- Cooperative agreements performed in good faith among affected parties resulted in an agreement considered fair by the parties involved.
- Most of the suits brought by distressed debt funds as identified by the 2008 HIPC Initiative and MDRI Status of Implementation have been settled. The number of commercial creditor lawsuits in low-income countries is declining. Out of the 47
commercial creditor lawsuits reported in the 2008 IMF/IDA Status of Implementation, 21 cases remain ongoing.\(^4\)

- However, the vast majority of remaining lawsuits have been brought by **trade creditors, not distressed debt funds**. Out of the 21 ongoing legal cases, we identify remaining cases by distressed debt funds in the Democratic Republic of Congo (2) and Liberia (1).
- The amount of litigious claims in many of these cases is such a small percentage of the country’s GDP that enforcement would have no substantial impact on debt sustainability.
- Holdout creditors are usually subject to criticism. But the possibility of litigation is an essential element for the smooth functioning of capital markets, including sovereign debt markets. It acts as a deterrent to help minimize the occurrence of opportunistic default and the pursuit of unreasonable restructuring terms by sovereigns.
- Modifications that have been made to the IDA Debt Reduction Facility (DRF) address issues that have arisen in the past, such as uneven treatment of commercial creditors, low participation and the consequent need for second buybacks to achieve significant debt relief.\(^5\)
- Private sector participants encourage debtor countries to initiate dialogue with creditor committees at an early stage and consider good faith negotiations as a high priority.
- Modifications to the DRF in 2004 are consistent with the principles of transparency, fair treatment, and close debtor-creditor cooperation to increase creditor participation.

\(^4\) The IIF Study focused on Completion Point, and Interim HIPC.s.

\(^5\) These modifications include a broader definition of debt used in the pricing of future buybacks, and the requirement of sovereign debtors and their advisors to negotiate the best possible deal in terms of participation and pricing.
Appendix A

Commercial Creditor Suits against HIPC

Update and Assessment of Remaining Cases

This note provides an update of commercial creditor lawsuits against HIPC as reported by the 2008 IMF/IDA Status of Implementation on the HIPC and MDRI initiatives. The IIF staff has sought feedback from market participants, legal and financial advisors, and multilateral institutions as needed.

It is observed that most of the suits brought by distressed debt funds have been settled, and instances of litigation are tapering off. Remaining cases by distressed debt funds are identified in the Democratic Republic of Congo (2) and Liberia (1). One case by a distressed fund may exist in Sudan.

The remaining cases have been brought by private creditors, state-owned enterprises from non Paris Club creditors and by trade creditors, with this last group representing the majority of the cases in court.

<table>
<thead>
<tr>
<th>Country</th>
<th>2008 IDA/IMF*</th>
<th>2009 Update*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cameroon</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>Congo, Democratic Republic</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Congo, Republic of</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Guyana</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Honduras</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Liberia</td>
<td>10</td>
<td>1</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Uganda</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Zambia</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>47</strong></td>
<td><strong>21</strong></td>
</tr>
</tbody>
</table>

* Per the latest joint IDA/IMF Heavily Indebted Poor Countries Initiative and Multilateral Debt Relief Initiative-Status of Implementation, released in September 2008.

* From research compiled by IIF staff. Number represents ongoing cases and unsettled cases where judgment has been awarded.

---

6 The remaining lawsuits represent trade creditors. All distressed debt funds were recently settled.
7 One outstanding case was brought by a state-owned enterprise; the second is not a distressed-debt fund.
8 The remaining creditor is a pharmaceutical company and remains in litigation.
9 Commercial creditors settled for 3 cents on the dollar in Liberia’s buyback of $1.2 billion in commercial debt in 2009. One distressed debt fund is holding out for a sum of approximately $20 million.
10 The five creditors holding out are not distressed funds.
11 The two remaining creditors are defense contractors, not distressed funds.
12 Four trade creditors await settlement. The fifth case in court was brought by a non-Paris Club bilateral lender.
Appendix B

Enhanced HIPC Initiative
Commercial Creditor Participation and Status of Legal Claims against Selected Low-Income Countries

1. Liberia

In mid-April 2009, Liberia took a big step toward restoring relations with the international community by reaching an agreement in which its commercial creditors agreed to accept about three cents on the dollar, paying off $1.2 billion in foreign debt, including principal and interest arrears.

The country has made significant progress in a gradual normalization of relations with the international community, including private sector creditors. By the end-June 2007, Liberia’s external debt is estimated to have reached $4.7 billion, above 800 percent of estimated GDP and over 3,000 percent of exports of goods and services. Bilateral and multilateral creditors held 65.9 percent of Liberia’s external claims whereas commercial creditors held 33.3 percent.

Long-standing arrears to the World Bank and African Development Bank were cleared in December 2007 and to the IMF in March 2008. In April 2008, the authorities also agreed on a comprehensive rescheduling of outstanding obligations to Paris Club creditors with the cancelation of $254 million of Liberia’s debt under Cologne terms.13

After a difficult start, Liberia engaged in **good faith negotiations with commercial creditors**. Outreach efforts to private creditors proved successful when Liberia achieved a high participation rate in its ambitious debt relief strategy, meeting the expectations by the enhanced HIPC initiative14. In addition to providing exceptional debt relief, the debt buy back operation will limit future confrontation with commercial creditors. Some of these creditors had taken legal action against Liberia in order to be protected against the statute of limitation. Moreover, the deal with commercial creditors settles **most of the outstanding judgments contributing to the country’s ambitious goal to achieve debt sustainability**.

The country’s remaining debt of $1.7 billion is owed mainly to official creditors, expected to be forgiven once the country reaches completion point under the HIPC initiative, anticipated in end-2009/early-2010. The country’s debt burden has been reduced by more than $3 billion since the new government took office in January 2006.

---

13 The stock of debt owed to Paris Club creditors as of 1st January 2008 was estimated to be more than $1.5 billion in nominal terms, of which more than 97 percent consisted of arrears and late interest.

14 The reduction of Liberia’s NPV of debt-to-exports ratio to 150 percent implied a common reduction factor (CRF) of 90.5 percent, one of the largest CRF thus far under the HIPC Initiative.
In June 2009, the IMF concluded a positive second review of the country’s Poverty Reduction and Growth Facility (PRGF).

The 2008 HIPC Initiative and MDRI Status of Implementation identifies Liberia as the country facing the highest number of commercial creditor lawsuits. Following the successful debt buyback operation, it is reported that only one commercial-debt holdout remains unsettled.

2. Nicaragua

Second Buyback Operation

Nicaragua closed a first Debt Reduction Facility (DRF) sponsored buy-back in 1995, when it extinguished US$1.1 billion in commercial debt principal, plus associated interest, at a price of 8 cents per dollar of eligible principal. The 1995 operation was not a comprehensive buy-back of the assessed eligible debt principal since it only extinguished about 81 percent of eligible debt.

Following the 1995 buy-back, several hold-out creditors and/or their assignees litigated against the Government of Nicaragua. Between 1996 and 2003, three of these filed lawsuits in the United States District Court for the Southern District of New York, the United Kingdom Commercial Court and the Commercial Court of Brussels, securing judgments against Nicaragua for an overall amount of US$275 million. Since 1996, Nicaragua has been subject to a total of nine lawsuits by commercial creditors.

Nicaragua reached its completion point in the HIPC initiative in January 2004, thus opening the door for further debt relief from commercial creditors and the Paris Club. After reaching completion point, Nicaragua also qualified for debt relief under the Multilateral Debt Relief Initiative (MDRI), and received MDRI debt relief from the IMF in January 2006, from the International Development Association (IDA) in July 2006, and from the Inter-American Development Bank (IADB) in November 2006.

The government hired legal advisors in January 2005 (Lazard Frères as financial advisor, and Cleary Gottlieb Steen & Hamilton as legal advisor) using funds received from a DRF grant approved by the IDA. On July 31, 2007 the Board of IDA approved a grant of up to US$61.0 million from the DRF for a new commercial debt reduction operation to support the Government of Nicaragua in its efforts to reduce its remaining external commercial debt arrears.

The actions of both debtor and creditors were based on good faith negotiations. The Buyback II was characterized by cooperation and dialogue with a committee (the Nicaragua International Creditors Association, chaired by Hans Humes of Greylock Capital) representing 75 percent of total hold-outs, including all judgment creditors. Several meetings involving Nicaragua, its advisors and the committee took place in New York and Washington prior to the launch of the Cash Tender Offer.
On October 10, 2007, the Government of Nicaragua invited all creditors holding external commercial arrears to participate in the Cash Tender Offer operation organized with the support of the DRF. Pricing of the Cash Tender Offer was elaborated on the basis of the Enhanced HIPC Initiative Decision Point and Completion Point Documents for Nicaragua dated respectively December 7, 2000 and January 6, 2004, which set the common reduction factor for all creditors to 73 percent. As a consequence, eligible creditors were given the option to tender their claims on the basis of a price of 8 percent of Principal (Option 1), or 4 ½ percent of Principal plus associated Interest and penalties (Option 2).15

| The Cash Tender Offer expired on October 31, 2007 with more than 99 percent of the Eligible Debt owned by hold-out financial institutions (including all judgment creditors) being tendered. |

3. Congo-Brazzaville

Progress in macroeconomic stabilization supported by debt relief from multilateral donors in the 90s suffered a serious setback after the resumption of harsh civil conflict, leading to accumulation of arrears. Emerging from a severe conflict situation, Congo-Brazzaville has made significant progress in implementing macroeconomic, financial and structural reforms. Despite efforts in securing macroeconomic stability, the country is still afflicted by consequences of civil unrest.

At the end of 2006, total external debt of Congo-Brazzaville is estimated to have been $6.5 billion, approximately 75 percent of GDP. The share of claims owed to commercial creditors represents approximately 50 percent of total external public debt. In March 2006, under the enhanced HIPC initiative the country qualified for debt relief, providing the basis for negotiations with commercial creditors. Almost simultaneously, the Paris Club agreed in principle to provide financing relief under Cologne Terms to those maturities falling due from March 09, 2006 up to September 30, 2007, provided the country met the fiscal and monetary targets set out for it under a new three-year PRGF-supported program with the IMF. The country benefited from the cancellation of nearly $1.7 billion and rescheduling of about $1.3 billion in the context of the Paris Club agreement. The March 2006 agreement with the Paris Club followed a debt relief package agreed by its members on Naples terms in 2004.

Following the decision point under the enhanced IMF/World Bank HIPC Initiative in March 2006, authorities started discussions with a creditor committee to negotiate the settlement of arrears on terms comparable to those under an enhanced IMF/World Bank HIPC Initiative. The consultation process moved forward and a code

---

15 The common reduction factor is applied after Naples Terms Debt Relief of 67 percent. Thus the common reduction factor of 73 percent is applied to the residual 33 percent.
of conduct signed between participant creditors and authorities established the details for the disclosure of confidential information.

On June 29, 2007, discussions led to an agreement in principle on the restructuring of the Congolese external debt, known as London Club debt, which amounted to $2,284 U.S. million dollars as of June 30, 2006, including $1,967 U.S million dollars of interest arrears accumulated since 1984. **Close cooperation of the creditor committee with the IMF and the Paris Club facilitated reaching terms of the debt exchange offer considered as fair on both sides.** Authorities expect to disburse the first payment on the Eurobonds in an amount equal to 5 percent of principal on the closing date of the issuance, scheduled to take place before the end of 2007.

This offer is the result of intensive negotiations with a creditor committee that was clearly representative of affected creditors. Prior to the negotiations, a complete reconciliation of claims, including interest arrears with private creditors, lead to a clear understanding for both sides of the extent of commercial liabilities. Such a process was a key element of the design by multilateral institutions of the country’s PRGF-supported program and in particular the “common debt reduction factor.”

---

**The 2008 Status of Implementation of the HIPC Initiative and MDRI identifies eight lawsuits against Congo-Brazzaville. Following the successful debt restructuring, no outstanding distressed debt fund suits remain against the country.**

---

4. **Cameroon**

In the early 1980s Cameroon was one of Africa's economic success stories. However, the economic and policy weaknesses were exposed in 1985, when severe terms of trade shock combined with an over-valued exchange rate, fiscal crisis, and economic mismanagement. In January 1994, the CFA franc was devalued, a prolonged economic stagnation and rapid accumulation of public debt ensued.

Cameroon holds the seventh biggest oil reserves in Africa, and the second highest reserves of natural gas behind Mozambique. Economic growth has picked up since 1994 due to the devaluation of the CFA franc and successful implementation of structural reforms. Poor infrastructure, electricity deficits, a weak investment climate and poor governance hinder the country’s economic performance. Cameroon has sub-Saharan Africa’s second biggest hydro-power resources, but capacity is currently barely utilized.

Cameroon has long benefited from HIPC and MDRI debt relief programs. Wide-ranging economic reform programs have been implemented in the context of three IMF PRGF arrangement (1997-2000), (2000-2004), (2005-2009), an IDA structural adjustment credit (SAC III), and technical assistance. The most recent comprehensive poverty reduction strategy was adopted in 2003. In April 2006, the country reached the completion point under the Enhanced HIPC Initiative and became eligible for further debt relief from the IMF, IDA, and the African Development Fund (AfDF) under the
Multilateral Debt Relief Initiative (MDRI). While waiting for a new PRSP on which the next CAS in preparation (FY10-12) will be based, IDA and IFC have prepared an Interim Strategy Note (ISN) for FY07-08 that extends the FY04-06 CAS for two years.

Under the HIPC initiative, Cameroon’s bilateral creditors have provided debt relief of US$874 million in NPV terms (69 percent). Cameroon reached the decision point under the enhanced HIPC Initiative in October 2000. The IMF approved a PRGF of $144 million for Cameroon in December 2000. The Paris Club followed with a first debt reduction agreement in January 2001 under Cologne terms ($1300 million of debt treated, of which $900 million to be canceled, $400 million being rescheduled.) London Club negotiations for Cameroon were concluded in May 2002 at a significant discount to the original amount, which was in line with the comparable treatment provision articulated by the Paris Club.

On mid-June 2006, Paris Club creditors agreed to substantially reduce Cameroon's stock of debt after the completion point under the enhanced initiative for the enhanced HIPC initiative on April 28, 2006. Paris Club creditors agreed to cancel their share of the effort in the framework of the enhanced HIPC Initiative, representing $921 million in nominal terms.

The World Bank is making available to Cameroon highly concessional financing under its IDA Debt Reduction Facility to buy back the eligible commercial bank debt at a price of 14.5 percent of its principal amount. The buyback relates solely to the outstanding principal amount of bank and non-bank debt, whether in arrears or falling due in the future, owed or guaranteed by Cameroon. Upon settlement of the buyback, contractual and default interest accrued and/or unpaid on such principal amount will be forgiven in full. The buyback has not yet taken place, but IDA funds are being collected in order to implement it soon.

**Relations with Commercial Creditors and Lawsuits**

Despite progress in addressing relations with commercial creditors, some arrears with private external creditors remain to be addressed. The country reported up to twenty-two cases of commercial creditors holding nearly $240 million in claims (2003), of which $78 million correspond to debt on principal as of August 2003, did not accept to participate in the debt buy-back. Some of these commercial creditors had pursued legal recourse through litigation and seizure of Cameroon’s assets abroad.

---

16 The cut off date is defined when a debtor country first meets with Paris Club creditors. The cut-off date is designed to protect credits granted by Paris Club creditors after this date. It is not changed in subsequent Paris Club treatments. In accordance with Paris Club rules, credits granted after this cut off date are in principle not subject to rescheduling or cancellation.
Two private financial institutions not participating in the debt buy-back held nearly $106 million in claims (2008), of which $24 million correspond to original debt reported to be in arbitration. These two cases have been settled out of court. Distressed debt fund creditors as reported by the IMF/IDA 2008 Enhanced HIPC Initiative and MDRI Status of Implementation report have all settled with Cameroon.
### Appendix C

**Debt Burden-Sharing in select Decision Point HIPC**s\(^ {17} \)

<table>
<thead>
<tr>
<th>Country</th>
<th>Decision Point, Enhanced HIPC</th>
<th>Total, US$ millions</th>
<th>Multilateral</th>
<th>Bilateral</th>
<th>Commercial</th>
<th>Common Reduction Factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cameroon</td>
<td>May-06</td>
<td>1260</td>
<td>25.71%</td>
<td>69.37%</td>
<td>4.92%</td>
<td>26.9</td>
</tr>
<tr>
<td>Congo, Democratic</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Republic</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Congo, Republic of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ethiopia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guyana</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Honduras</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liberia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nicaragua</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sierra Leone</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zambia</td>
<td>Dec-00</td>
<td>2499</td>
<td>53.26%</td>
<td>45.82%</td>
<td>0.92%</td>
<td>62.6</td>
</tr>
</tbody>
</table>

As illustrated by the information in the table above, commercial claims represent a small fraction of total net present value of debt in each of the cases above with the exception of the Republic of Congo. Bilateral and multilateral creditors hold the largest stake in debt relief and restructuring. In the vast majority of cases, commercial creditors provided their share of debt relief in the context of the enhanced HIPC initiative.

\(^ {17} \) Data as provided in respective country’s Decision Point Document.