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Sovereign Debt Restructuring: Destabilizing Action of Litigations

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Abstract

In the contemporary international financial order, litigations risks have increased manifold as the creditor group has become more dispersed. Litigation has become a potent creditor weapon ever since sovereign debt has transmuted to tradable bonds displacing traditional relationship-driven bank loans (Gelpern, 2005: 5). The rise of the secondary market for distressed debt bonds adds to the delirium. A parallel dilution of the shield of sovereign immunity further weakens a sovereign against litigating creditors.

In the absence of a legal framework to restructure sovereign debt, negotiation between an indebted sovereign and its creditors is expected to lead to rescheduling of external debt. As there is no standardized process of reorganization, negotiation is primarily premised on voluntary participation amongst the concerned parties and good will. Often the terms of restructuring may not be acceptable to some creditors. Dissatisfied creditors hold out of the restructuring agreement to obtain better terms. Besides arbitration, litigation is one of the legal processes that creditors cannot adopt to resolve dispute with a sovereign debtor. Litigations top the list of factors that add complexity to the process of restructuring sovereign debt. Often sovereign debt bonds are governed by multiple jurisdictions. Litigious creditors speculate the possibility of getting a favorable judgment in a particular jurisdiction and file a claim accordingly.

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