ALERT MEMORANDUM

Creditor Files SDNY Lawsuit Against Sri Lanka In Connection With Its Sovereign Debt Default, Asserting Breach Of Contract And Pari Passu Claims

June 30, 2022

On June 21, 2022, plaintiff Hamilton Reserve Bank Ltd. brought claims against Sri Lanka in the federal district court for the Southern District of New York in connection with Sri Lanka's default on its 5.875% bonds due July 25, 2022.[1] The first claim is for non-payment of approximately $258 million in principal and interest on the bonds. While these amounts are not scheduled to come due until next month, the plaintiff claims to have accelerated the bonds in light of Sri Lanka's declaration of a payment moratorium and its cross-default on other bond series. This implicates various issues regarding the contractual requirements for acceleration and institution of suit to enforce payment obligations.

The remaining claims in the lawsuit are for a declaratory judgment and an injunction related to the bonds' so-called *pari passu* clause. Also referred to as "equal treatment" provisions, *pari passu* clauses in sovereign debt contracts have been the subject of a great deal of past sovereign debt litigation. Here, the plaintiff recycles arguments that have been rejected by New York courts in many of those past cases, by claiming that Sri Lanka's proposal to restructure some of its external debt while continuing to make payment on other debt—held largely by domestic entities—would violate the equal treatment required by the *pari passu* clause.

The lawsuit's timing is somewhat unusual, as it was filed before the IMF has completed its staff-level review and before even preliminary negotiations among Sri Lanka and its creditors have taken place. The plaintiff purports to have served Sri Lanka with the lawsuit on June 23, 2022 and accordingly Sri Lanka's response to the complaint is due on August 22, 2022.

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[1] *Hamilton Reserve Bank Ltd. v. The Democratic Socialist Republic of Sri Lanka*, 22-cv-5199 (DLC) (S.D.N.Y.)

The lawsuit seeks $257,539,331.25, comprised of $250,190,000 in principal and $7,349,331.25 in interest, plus additional interest continuing to accrue. Although the bonds do not mature until July 25, 2022, the plaintiff claims to have accelerated the bonds on June 21, 2022 pursuant to Section 5.1 of the Indenture. That provision allows holders of not less than 25% in aggregate outstanding principal amount to declare the principal amount of the entire series and all accrued interest to be immediately due and payable by written notice to the Trustee following the occurrence of certain enumerated "events of default."

The plaintiff points to two such events of default here, *i.e.*, Sri Lanka's (i) declaration of a general moratorium on principal and interest payments in April 2022 and (ii) its cross-default on other bond series (5.75% Bonds due April 18, 2023 and 6.75% Bonds due April 18, 2028) based on missed interest payments on April 18, 2022 and expiration of the 30-day grace period. The written notice of acceleration to the Trustee is included as an exhibit to the complaint.

The lawsuit raises a number of threshold questions. For one, Section 5.7 of the Indenture contains a no-action clause, which provides that a Holder cannot bring suit unless certain enumerated conditions are satisfied including that Holders of at least 25% of aggregate outstanding principal have made a written request to the Trustee to institute proceedings in its own name and have provided reasonable indemnity, and the Trustee has failed to bring suit for at least 30 days. The plaintiff does not allege that it has complied with these conditions.

There is an exception to the no-action clause in Section 5.8 of the Indenture, which allows a Holder to sue for the payment of principal and interest on the "Stated Maturities" for such payment. Here, the "Stated Maturities" for the principal and interest installments are July 25, 2022, and the suit was initiated over a month in advance of that date. Moreover, the plaintiff does not allege that it has been authorized to act on behalf of the registered "Holder" of the bonds.

The lawsuit also includes claims for purported violation of the so-called *pari passu* clause contained in Section 3.1 of the Indenture. In support of these claims, the plaintiff principally cites announcements that the Sri Lanka Development Bonds, USD-denominated bonds largely held domestically, will be excluded from the debt standstill and future debt restructuring. According to the plaintiff, such action would violate the *pari passu* clause because "Sri Lanka cannot pay any Bond holders—or pay any other External Indebtedness (i.e., debt issued in any currency other than Sri Lanka's)—without also making a ratable payment at the same time to Plaintiff." Compl. ¶ 33.

However, the U.S. Court of Appeals for the Second Circuit has repeatedly held that mere payment to one creditor and not another does not constitute a *pari passu* violation, without other circumstances demonstrating that the sovereign is a "uniquely recalcitrant debtor." *See Bugliotti v. Republic of Argentina*, 952 F.3d 410, 415 (2d Cir. 2020); *Bison Bee LLC v. Republic of Argentina*, 778 F. App'x 72, 73 (2d Cir. 2019) ("[W]e have not held that a sovereign debtor breaches its pari passu clause every time it pays one creditor and not another, or even every time it enacts a law disparately affecting a creditor's rights.") (quoting *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230, 247 (2d Cir. 2013)).[2] Here, the plaintiff appears to be trying to re-argue this issue, without including the types of allegations regarding unique recalcitrance that have been required to find a *pari passu* violation in other cases.

The case has been assigned to Judge Denise Cote and an initial conference has been scheduled for August 26, 2022.

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[2] *See also Exp.-Imp. Bank of the Republic of China v. Grenada*, No. 13 CIV. 1450 HB, 2013 WL 4414875, at *4 (S.D.N.Y. Aug. 19, 2013) (denying *pari passu* relief where the pleadings "establish[ed] only that Grenada may have made payments to other external bond holders" while stating that it will not pay claims of the type at issue "unless resources become available to do so").