

SDNY Stays Lawsuit Against Sri Lanka to Allow Debt Restructuring to Proceed

November 21, 2023

On November 1, 2023, the federal district court for the Southern District of New York granted Sri Lanka's request for a six-month stay of proceedings in a lawsuit related to Sri Lanka's 2022 sovereign debt default.¹ Plaintiff Hamilton Reserve Bank filed the lawsuit in June 2022, before IMF staff-level review and preliminary negotiations with creditors had taken place.

The district court's recent stay decision comes after the United States, France, and the United Kingdom filed statements in the case in support of Sri Lanka's request for a stay in light of its ongoing debt restructuring process. In accordance with the stay, the district court denied Hamilton Reserve Bank's pending motion for summary judgment without prejudice, meaning the motion can be renewed after the stay is lifted.

In its ruling, the district court considered dual U.S. policy interests in encouraging IMF foreign debt resolution procedures and ensuring the enforceability of debt contracts. In the past, some courts balancing these interests have allowed judgment entry but stayed judgment enforcement. Here, consistent with the statement submitted by the United States, the district court found these interests were best served through a stay of judgment entry proceedings.

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¹ *Hamilton Rsrv. Bank Ltd. v. Democratic Socialist Republic of Sri Lanka*, 22CV5199 (DLC), 2023 WL 7180683 (S.D.N.Y. Nov. 1, 2023).
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Background

In June 2022, plaintiff Hamilton Reserve Bank Ltd. filed a lawsuit against Sri Lanka related to its default on its 5.875% bonds due July 25, 2022. It brought claims for (i) non-payment of approximately \$258 million in principal and interest on the bonds; (ii) a declaratory judgment; and (iii) an injunction related to the bonds' *pari passu* ("equal treatment") clause.

As summarized in our prior [Alert Memorandum](#), the lawsuit was filed before the IMF had completed its staff-level review and before even preliminary negotiations among Sri Lanka and its creditors had taken place, which is unusual timing for such a case. The lawsuit also raised various threshold questions, including that Hamilton Reserve Bank had not alleged it was authorized to act on behalf of the registered "Holder" of the bonds and that its *pari passu* claim was based on recycled arguments that have been rejected by New York courts.

Hamilton Reserve Bank filed an amended complaint in October 2022, dropping its declaratory judgment and *pari passu* claims and alleging that it had received authorization from the registered "Holder." Sri Lanka moved to dismiss, arguing that the authorization was insufficient based on the contractual terms. The district court denied Sri Lanka's motion in a March 2023 ruling.

After the parties engaged in discovery regarding ownership of the bonds, Hamilton Reserve Bank filed a motion for summary judgment (seeking a money judgment on its bond claims). In July 2023, Sri Lanka moved for a six-month stay, as it "hopes to implement restructuring agreements" by the end of 2023.²

In the briefing, Hamilton Reserve Bank noted that neither the U.S. government nor any other creditor of Sri Lanka had joined Sri Lanka's stay request. Following this, France and the United Kingdom (as members of the Paris Club) and the United States all filed submissions arguing that a stay would best

facilitate an orderly process for restructuring Sri Lanka's debt with official sector and private creditors.

The District Court's Ruling

On November 1, 2023, the district court granted a stay until February 29, 2024, holding that "a judgment for Hamilton would likely threaten the complex debt negotiations and, hence, the successful economic rehabilitation of Sri Lanka" because it would "provide an incentiv[e] to other bondholders to engage in line-jumping litigation and deter commercial creditors from participating in the restructuring negotiations."³ This could "threaten Sri Lanka's progress towards the[] IMF targets, its economic recovery, and the well-being of its citizenry."⁴

The district court noted that the stay was of a limited duration. Prejudice to Hamilton Reserve Bank was mitigated by the pre-judgment interest applicable to a future judgment. And judicial economy also supported a stay, to prevent a "rush-to-the-courthouse" by other private creditors seeking "to secure priority."⁵

The district court disagreed with Hamilton Reserve Bank that a stay would be a "radical departure" from "four decades of U.S. policy."⁶ Like other courts that have considered similar stay requests, the district court cited the dual U.S. policy interests in (i) encouraging "IMF foreign debt resolution procedures" and (ii) ensuring "enforceability of valid debts under the principles of contract law."⁷

The district court found that these interests are best balanced by affording sovereigns "a limited opportunity to achieve a consensual resolution before judgments are entered or enforced against their debts."⁸ By contrast, some courts applying this framework have granted limited stays of judgment enforcement without staying judgment entry. Accordingly, this ruling potentially provides helpful precedent for sovereigns in future debt litigation cases.

² *Id.* at *3.

³ *Id.* at *4.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at *5.

⁷ *Id.* (citing *Pravin Bankers Assocs., Ltd. v. Banco Popular Del Peru*, 109 F.3d 850, 855 (2d Cir. 1997)).

⁸ *Id.*