Collective Action Clauses Before they Had Airplanes

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December 2012
Modern Sovereign debt debate

• Classic papers by Eaton and Gersowitz (1981), Bulow and Rogoff (1989a and b), and “critique” by Kletzer and Wright (2001) and subsequent papers by Wright
• Revolve around the problem of free riding (how bad?), and punishment (by whom?)
• Restrictive conditions limiting creditor’s competition help explain sovereign debt (Kletzer and Wright 2001)
Pragmatic approach (history based) by Eichengreen and Portes

- Eichengreen and Portes:
  - Compare historically relevant cases of bondholder cooperation/competition
  - Draw inferences
  - Study of CFB (Value of bondholder cooperation in CFB)
  - Superiority of CFB over other arrangements
  - Case of pre-1933 CFB world
- Modern proposal of Collective Actions Clauses
  - Limit risk of hold out creditor hampering orderly restructuring
  - Some suggest too soft
- Modern debate opposes (Eichengreen and Portes’) market-based proposals to “statutory” approach (international bankruptcy procedures, etc.)
  - But recent cases of vulture funds (Dart, Elliot Associates)
  - Complex issues involving attitude of courts toward sovereign default (back in the 19th century, so-called “privileged exemption of the sovereign”)
My reservations towards the CFB-fixer-of-collective-action-problems story

• Coase’s lighthouses=>History is more complex
• This story was that which the CFB wanted people to tell
• Empirical evidence (cross-section unclear; Time series unclear)
• My own joint research=> Flandreau et al. “gatekeeping hypothesis”
• Market operated in an efficient way: confusion between an argument about efficiency and argument about coercion
My story: Outline

• Evidence against bondholder competition (pre-1868, interlocking committees)
• Importance of Stock Exchange (regulation in 1827, punishing defaulters)
• In practice, the regulation creates reward for majority, disallows hold out bondholders.
• Bondholder Committees get organized very early on to capture the Exchange veto point.
• Evidence on CFB perhaps more supportive of statutory approach
The Veto Point

• The “Spanish Committee” of 1827
  – Spain in default
  – Attempted Securitization of existing book debt
  – “establish a system of credit most destructive to their interest”

• The Portuguese test of 1831
  – Complex default story
  – Attempt by exile government to issue new debt with British banker (Maberly)
  – Met by David Salomons
The value of a listing

• LSE grants quotation and settlement:
  – Pricing service
  – Contract enforcement service (forward contracts disallowed under British Law)

• Evidence that borrowers were prepared to pay something
  – Case of Austrian loan not listed (1870):
  – Austrian minister of finance asks to be heard, pleads with committee etc.
  – Hungary picks up the bill (1871)

• Evidence on effects of not listing
  – Identification problem (you would want to have a country having securities listed and others not listed)
  – Case of Venezuela’s stay decision (1862)
Work of the Committee

• Greece 1833
  – Seyd: case where the Exchange surrendered to political pressure
  – Greece is in default, new loan issued with guarantee of powers
  – Underwriting by Rothschilds
  – Obstruction by Stock Exchange (despite pressure, probably by R. and British Gvt.)
⇒ Application is turned down
Case Studies, Cont’d

• Venezuela 1862
  – Agreement with bondholders
  – Application by Barings
  – Obstruction by individual bondholder (Richard Thornton)
  – Hearing (John Field Chairman of relevant Committee)
  – Decision to stay until paperwork is in order
=> Committee recognizes a majority when it sees one 9de facto CAC)
Case Studies, end

• Austria 1869-70
  – Starts just before creation of CFB
  – Anglo-Austrian bondholders
  – Get represented by CFB
  – Apply and succeed in blocking issue
  – Then Gerstenberg plays a trick on the Exchange
=> Nothing new in the resulting arrangement of 1868, only a “claim” by CFB promoters
Organizing the Capture of the Veto Point: Ricardos

• Samson and Jacob ("Jack") Ricardo, Exchange members
• Issue their own Portuguese Regency Loan 1831
• Succeed in subsequent restructuring/access to the market
Interlocking Committees

• Early creation of Committees (1827-1830)
• Creation of “Federating Structures”: Spanish American Bondholders (1836)
• Looking at period 1845-1868:
  – John Diston Powles: Greece, Peru, Venezuela, Mexico, Colombia, Buenos Aires and Spanish American Committee
  – Haslewood: Greece, Peru, Argentina, Ecuador, Spanish American
  – Etc.
Conclusions

• Role of LSE Rules (Statutory mechanisms?)
• Logic of the veto point: Reputation (explaining why it is enforced)
• Majority clauses: Keep the power with the Exchange
• Encourages creation of groups -- and helps keep them together ? (by disenfranchising minority)
• Mystery of the coming to being of the CFB:
  – A pure artifact of propaganda?
  – Something else?