Information Clearinghouse: Market Implications of US Judicial Decisions

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The 1976 Foreign Sovereign Immunities Act

Can Private Actors Hold a State Accountable for Broken Commercial Contracts ?

Yes.

- US Domestic Courts a Clear Option since 1976

- Substantial Connection to the US

- For Sovereign Debt :
    - Governing Jurisdiction : New York Law
    - United States District Court for the Southern District of New York

Do US Court Rulings Matter ?
What Impact Does a Court Ruling Have on the Debt Market ?

A Ruling in Favor of the Plaintiff (Creditor), Increases Investor Confidence to Reinvest in a Country After a Contract is Broken.

- Implication :

    - Lower Borrowing Costs

    - Higher Prices, Lower Interest Rates, Lower Bond Spreads

Why Bonds Under a Foreign Jurisdiction ?

- Original Sin
    - Inability of a Developing Country to Issue Bonds in their Own Currency
    - Higher Interest Rates Due to Increased Risk

- Currency vs. Law
    - Underlying Law Matters More than Currency
    - Foreign Jurisdiction as Dispute Location Ties Hands of Government
    - Cannot Unilaterally Change Terms of Contract
        - Unless Contract Lists Domestic Law as Governing Jurisdiction

Preference for New York Law

- Mismatches
  - Rarely Occur
  - Argentina Unhappy with Rulings Against Them
    - Issued 6 bonds in USD - 3 Under Domestic Law

- Investors Prefer Contracts that List New York Law as Governing Jurisdiction
  - Allows Them to Use the FSIA if Needed

Table – Argentina - Starting Price for New York Law & Domestic Law

Start Date	Coupon	Price	Maturity Length	Type
2020-09-04	4.25	51.300	18	New York Law
2020-09-15	4.25	45.409	18	Argentina Domestic Law
2020-09-04	3.625	45.938	15	New York Law
2020-09-16	3.625	38.118	15	Argentina Domestic Law
2020-09-04	3.5	44.563	21	New York Law
2020-09-14	3.5	41.000	21	Argentina Domestic Law

Activation of New York Law & the FSIA

- NY Law Jurisdiction Bonds
    - May Fetch Higher at Issuance, but Not Immune to Price Fluctuations
- Underlying Law - Important to Attract Investors
- During Crisis/Contract Repudiation - Judicial Ruling Matters
- Ruling in Favor of Creditor Signals :
    - FSIA is Not Window Dressing Legislation
    - Decrease Investors' Risk Perception
- With a Creditor Win, Expectation Created
    - FSIA will be There to Protect their Assets
    - Provide Property Rights Protection in the Future for that Defendant Country

H1 : Judicial Rulings Against Sovereign States are Associated with Higher Bond Prices on their New York Law-Governed Debt Instruments.

Enforcement

- Bond Prospectus
  - Boilerplate Template - All Similar To Each Other
  - General Sovereignty Statement - Cannot Seize Assets Within Borders

- Judges Cannot Enforce Rulings For Creditors

- Rulings - Send a Signal to All Investors
  - Blockade Countries (Schumacher, Trebesch, and Enderlein, 2021)
  - Current and Future Debt Holders - Pay Attention

- FSIA - External Backstop when Domestic Institutions are Weak
    - Creates International Consequences for Property Rights Violations

- Repeat Behavior - Contracts

- Domestic Institutions Still Matter

- Heuristics (Brooks, Cunha, and Mosley, 2015 ; Biglaiser and Staats, 2012)
    - Independent Courts

- Independent Court
    - More Likely to Follow Rulings and Opinions From the SDNY
    - Independent Courts More Likely to Recognize Foreign Judgments
    - Shared Legal Principles about Judicial Review
    - Common Understanding of Rule of Law
    - Less Political Interference in Recognition Process

- Institutional Self-Interest
    - Accepting FSIA Rulings Reinforces Domestic Judicial Independence
    - Strengthens Courts' Role in Economic Governance
    - Creates Precedent for Judicial Review of Executive Actions

H2 : Among Countries That Are Ruled Against, Impact of a Ruling More Pronounced for Democracies.

- Price$_t$ - Rolling 30 Day Mean (Δ Price)
  - Daily from Jan. 1st 1993 - March 8th 2024
  - Refinitiv
  - Address Mean Reversion Dynamics
  - Fewer NA's
  - Highlighting Immediate Deviations from Recent Price Trends

Sovereign Debt Litigation - Variable

- Treatment Variable : Creditor Win
  - "1" if Plaintiff Won and "0" Otherwise

- Placebo Treatment Variable : Defendant Win
  - "1" if Defendant Won and "0" Otherwise

- Start Court
  - "1" when the Case Started and "0" Otherwise

- Public Access to Court Electronic Records (PACER)
  - Coverage : 1976 - March 2022

Additional Variables

- Regime Type
  - Liberal Democracy Index from the Varieties of Democracy data set

- Restructure
  - "1" Debt Restructuring Occurred and "0" otherwise
  - Cruces & Trebesch (2013)

- Default Amount
  - $\frac{Arrears}{Debt\ Due}$
  - World Bank's Debtor Reporting System

- Government Involvement In Violence
  - UCDP Country-Year Dataset on Organized Violence

- IMF Involvement
  - "1" if the Defendant was Participating in an IMF Program and "0" Otherwise
  - Kentikelenis & Stubbs (2023)

- And Standard Economic Control Variables

- Judicial Assignment Influences Outcomes
    - Even in International Commercial Contract Suits
- Judicial Assignment is Quasi-Random
    - Assignment by Lot
        - Managed by the Clerk of the Court
        - Random Assignment Among Available Judges via Computer
    - Overseen by Assignment Committee
        - Two Judges with One Year Term + Chief Judge with 7 Year Term
- Instrumental Variable

▶ Assignment Variation

With OLS :

- Creditor Win$_{t-1}$×Regime Type$_{t-1}$ → Positive Direction (+)

With IV :

- Creditor Win (+)

	Δ Price	
	(1)	(2) EU Placebo
Start Court$_{t-1}$	0.0430	0.4645*
	(0.0805)	(0.2031)
Regime Type$_{t-1}$	-10.36**	2.487
	(3.500)	(2.025)
Defendant Win$_{t-1}$	-0.3773**	-1.247***
	(0.0909)	(0.1544)
Creditor Win$_{t-1}$	16.94***	-9.201
	(2.754)	(14.53)
Creditor Win$_{t-1} \times$ Regime Type$_{t-1}$	26.72***	14.32
	(4.525)	(23.23)
Observations	409,325	409,325
Year Fixed Effects	✓	✓
Maturity Fixed Effects	✓	✓
Judge Fixed Effects	✓	✓

▸ Robustness Check

	Δ Price (1)	Δ Price$_{t-1}$ (2)	Δ Price$_{t-2}$ (3)
Creditor Win	2.802***	4.835***	6.482***
	(0.1719)	(0.1865)	(0.1807)
Regime Type$_{t-1}$	-0.1071	-0.0918	-0.1492
	(0.6870)	(0.7145)	(0.6939)
F-test (1st stage)	40.5 ***	40.0***	40.8***
Wu-Hausman	14.8***	39.0***	60.1***
Year Fixed Effects	✓	✓	✓
Maturity Fixed Effects	✓	✓	✓

▸ TWFE   ▸ IV - EU

Bayesian Structural Time Series : Causal Impact

- **Variable Selection**
  - Keeps variables that improve predictions. Excludes those that do not help
  - Shrinks unimportant coefficients to zero

- **Counterfactual Prediction**
  - What Would Have Happened Without Intervention

- **BSTS Causal Impact :**
  - Can work with as little as one control series
  - Handles missing data naturally
  - Does not require perfect pre-intervention fit
  - Can incorporate multiple predictors easily

- **Synthetic Control :**
  - Requires multiple control units
  - Needs complete data for all units
  - Relies heavily on pre-intervention fit quality
  - More sensitive to missing data

- Absolute Effect : Observed Data - Counterfactual

- Relative Effect : Percentage Change Attributable to Intervention

- Cumulative Effect : Total Effect Over the Post-Intervention Period
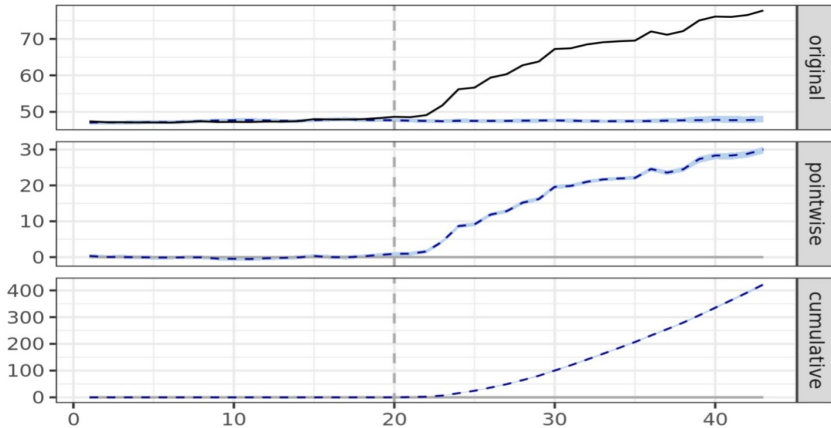
Creditor Win

	ARG$_{2014}$	BRA$_{1999}$	ECU$_{1999}$
Actual	65.94	49	47.67
Prediction (s.d.)	47.58 (0.11)	49 (0.15)	46.01 (0.87)
95% CI	[47.39, 47.82]	[48, 49]	[44.48, 47.52]
Absolute effect (s.d.)	18.36 (0.11)	0.43 (0.15)	1.67 (0.87)
95% CI	[18.12, 18.55]	[0.13, 0.73]	[0.16, 3.19]
Relative effect (s.d.)	38.6% (0.31%)	0.89% (0.31%)	3.6% (1.97%)
95% CI	[37.9%, 39.15%]	[0.27%, 1.5%]	[0.3%, 7.18%]
p-value	0.0010***	0.005***	0.0175**
Causal Prob.	99.9%	99.5%	98.3%

▶ Defendant Win

	IRQ_{2017}	VEN_{2020}
Actual	89.94	73.50
Prediction (s.d.)	86.75 (0.91)	73.45 (0.07)
95% CI	[85.17, 89.16]	[73.34, 73.59]
Absolute effect (s.d.)	3.19 (0.91)	0.04 (0.07)
95% CI	[0.77, 4.77]	[-0.10, 0.16]
Relative effect (s.d.)	3.7% (1.08%)	0.1% (0.09%)
95% CI	[0.9%, 5.60%]	[-0.1%, 0.22%]
p-value	0.0080***	0.2070
Causal Prob.	99.2%	79.3%
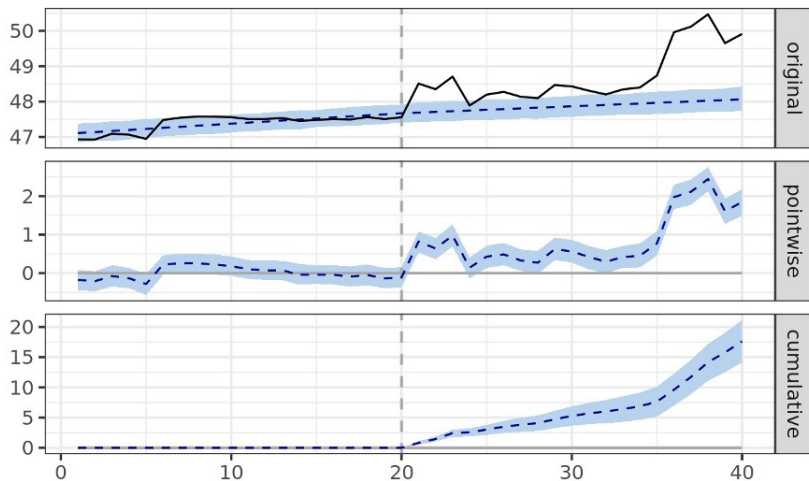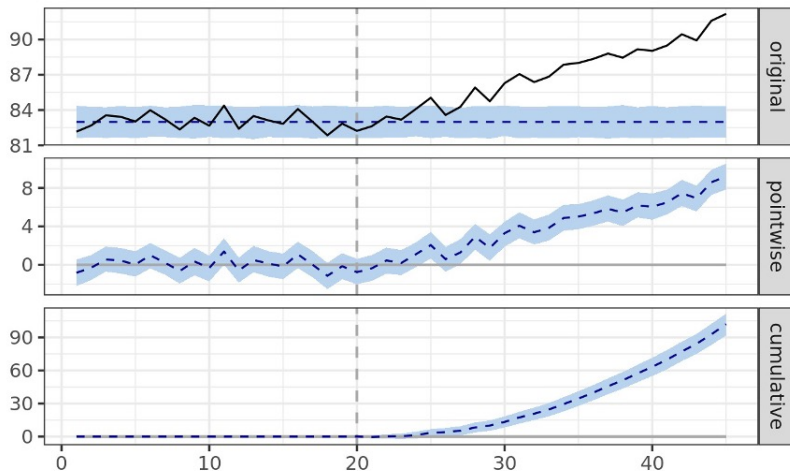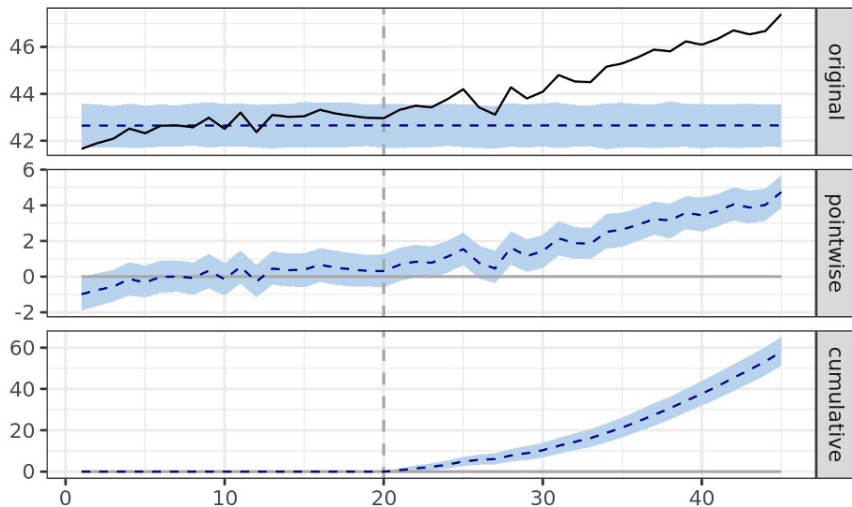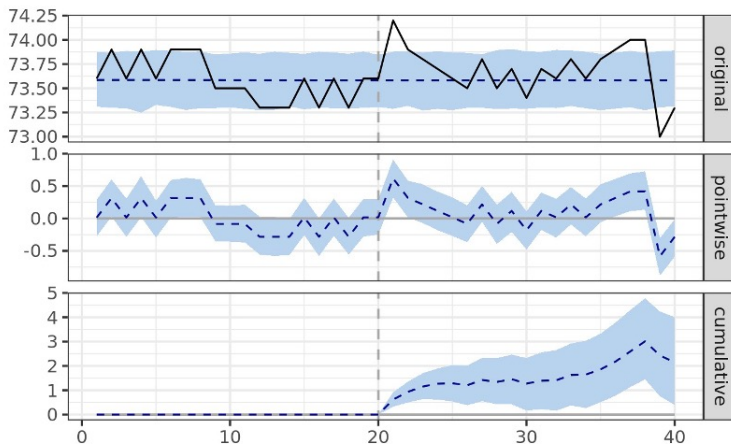
What Impact, if any, does a Court Ruling have on the Debt Market ?

- A Ruling in Favor of the Creditor :
    - Lowers the Perceived Risk by an Investor
    - Lowers Borrowing Costs

Thank You !

- Sovereign Debt with US Connection - SDNY
    - No Court Shopping Within United States

- Selection into Court
    - Behavior and Decisions by the State and the Creditor
    - Creditors Only Bring Cases they Think they will Win
        - Defendants Winning more often than Expected
        - Selection Process is Biased Against this Finding

▶ FSIA

BSTS

- Models time series as a sum of different components (hence "structural")
- Updates beliefs about parameters using observed data (Bayesian aspect)
- Regression component
    - Incorporates effects of predictor variables
    - Can include contemporaneous or lagged relationships

$$Y_t = \mu_t + x_t\beta + S_t + e_t, \quad e_t \sim N(0, \sigma_e^2)$$

- Y_t is our observed value at time t
- μ_t represents the local level (trend) component at time t
- $x_t\beta$ is our regression component where :
    - x_t is our vector of predictors at time t
    - β is our vector of coefficients
- S_t captures the seasonal component
- e_t is our error term which follows a normal distribution :
    - Mean of 0
    - Variance of σ_e^2

$$\mu_{t+1} = \mu_t + v_t, \quad v_t \sim N(0, \sigma_v^2)$$

- μ_{t+1} is our local level at the next time point
- μ_t is our current local level
- v_t is the state error term which follows a normal distribution :
    - Mean of 0
    - Variance of σ_v^2

- 63 Unique Judges Total
    - 34 Nominated by Presidents from Democratic Party

Highest Number of Judicial Assignments to a Default Case

Judge Name	Number of Unique Countries Assigned To	Republican Nominated?
Denise L. Cote	5	No
Loretta A. Preska	5	Yes
Robert W. Sweet	7	No

▶ Judicial Assignment

Investor Reaction - Full Sample, OLS Results

	Δ Price	
	(1)	(2) EU Placebo
Start Court$_{t-1}$	0.5712	0.5484**
	(0.3915)	(0.2113)
Defendant Win$_{t-1}$	-0.3165**	-0.8978***
	(0.1193)	(0.0666)
Creditor Win$_{t-1}$	2.199	4.097
	(1.676)	(14.08)
Regime Type$_{t-1}$	-0.2847**	-0.7002*
	(0.1100)	(0.3513)
Judge Party$_{t-1}$	7.548	4.401
	(6.397)	(4.102)
Creditor Win$_{t-1}$ $\times$ Regime Type$_{t-1}$ $\times$ Judge Party$_{t-1}$	41.88***	6.139
	(7.014)	(11.51)
Observations	2,435,521	2,435,521
Year Fixed Effects	✓	✓
Maturity Fixed Effects	✓	✓

▸ OLS Main

Table 1: The Data By Judicial Characteristics - A Selection of Cases

Docket Number	Country	Start Year	Judge	Party	President
1:84-cv-08101-JSM	Nigeria	1984	John S. Martin	Republican	George H.W. Bush
1:90-cv-06639-DNE	Liberia	1990	David N. Edelstein	Democrat	Harry Truman
1:86-cv-09935-MJL	Bolivia	1986	Mary Johnson Lowe	Democrat	Jimmy Carter
1:90-cv-03651-RPP	Peru	1990	Robert P. Patterson	Republican	Herbert Hoover
1:94-cv-04733-BSJ	Brazil	1994	Barbara S. Jones	Democrat	Bill Clinton
1:96-cv-06360-JFK-RLE	Nicaragua	1996	John F. Keenan	Republican	Ronald Reagan
1:96-cv-06586-MGC	Iraq	1996	Miriam Goldman Cedarbaum	Republican	Ronald Reagan
1:14-cv-09844-KBF	Ecuador	2014	Katherine B. Forrest	Democrat	Barack Obama
1:15-cv-00725-RJS	Ecuador	2015	Richard J. Sullivan	Republican	George W. Bush
1:08-cv-00164-LAP	Argentina	2008	Thomas P. Griesa	Republican	Richard Nixon
1:15-cv-05551-DAB	Peru	2015	Deborah A. Batts	Democrat	Bill Clinton
1:14-cv-08242-LAP	Argentina	2014	Loretta A. Preska	Republican	George H.W. Bush

What Role Do National Courts Play ?

- (1) Validity of the Investor Claims
- (2) Socially Acceptable to Hold a State Accountable
- (3) Rulings Send a Signal to Other Sovereign Debt Investors

Argentina US Dollar Denominated Bond Prices
Time Series Plot for Argentina with Smoothed Trend

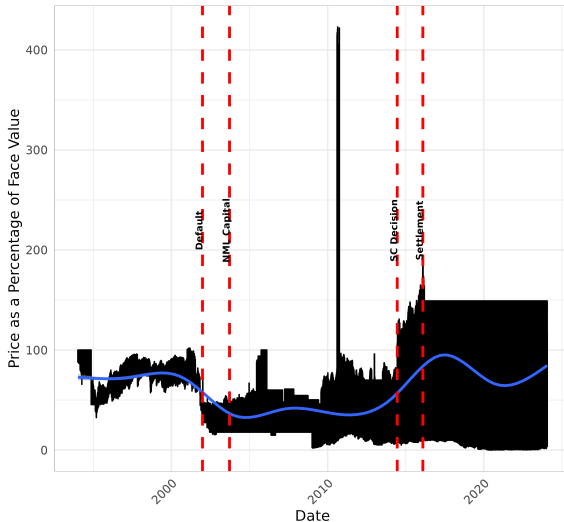Table 6: TWFE - First NML Ruling, All Currencies

	(1) All Bonds	(2) All Bonds:90 Days
Treatment	7.740***	8.673***
	(0.063)	(0.117)
N	18320	4490
R²	0.564	0.580
Ticker fixed effects	•	•
Day fixed effects	•	•

- Bonds in all currencies were included in this analysis. Models 1 and 2 include all bonds that have a maturity of 7 or greater.

- Date Range for Model 1: 2001-04-18 until 2004-04-21.

- Date Range for Model 2: 2002-12-05 until 2003-08-23.

▸ IV

Table 9: TWFE - Supreme Court Ruling, All Currencies

	(1) 90 Days	(2) 60 Days	(3) 30 Days
Treatment	0.686**	0.801*	0.751**
	(0.210)	(0.309)	(0.276)
N	5418	4147	2844
R²	0.093	0.110	0.091
Ticker fixed effects	•	•	•
Day fixed effects	•	•	•

Date Range for Model 1: 2014-02-09 until 2014-07-30.

Date Range for Model 2:2014-03-23 until 2014-07-30.

Date Range for Model 3: 2014-05-04 until 2014-07-30.

Bonds in all currencies and with maturities 7 or greater were included in this analysis.

▸ IV

Table 13: TWFE - Argentine Settlement, All Currencies

	(1) 90 Day	(2) 60 Day	(3) 30 Day
Treatment	-0.470*	-1.033*	-1.021*
	(0.230)	(0.500)	(0.505)
N	8984	5803	2821
R^2	0.074	0.078	0.098
Ticker fixed effects	•	•	•
Day fixed effects	•	•	•

Date Range for Model 1: 2015-10-15 until 2016-07-07.

Date Range for Model 2: 2015-12-01 until 2016-05-21.

Date Range for Model 3: 2016-01-14 until 2016-04-09.

Bonds issued in all currencies and with maturities 7 or greater were

included in this analysis.

▸ IV

Literature

Primarily Focused On the Usage and Impact of :

- International Courts and Tribunals
    - International Criminal Court
    - International Court of Justice
    - WTO's Dispute Settlement Body

- International Arbitration
    - International Center for the Settlement of Investment Disputes
    - Ad Hoc Arbitration Under the UN Commission on International Trade Law (UNCITRAL)

Less Focus On :

- National Courts
    - Problem Because
        - Many International Commercial Issues are Only Seen in the US
        - After Getting a Ruling Elsewhere, Investors will then go to the US because they view it as a "stronger enforcer"

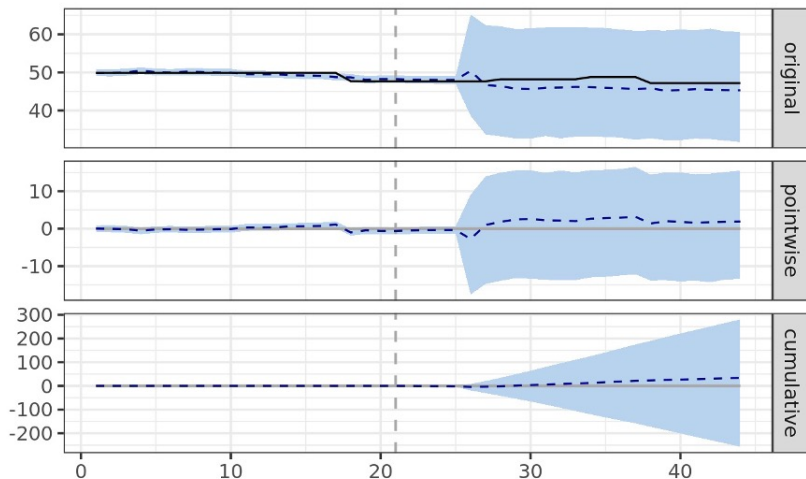**Defendant Win**

▶ Creditor Win

Defendant Win - Results

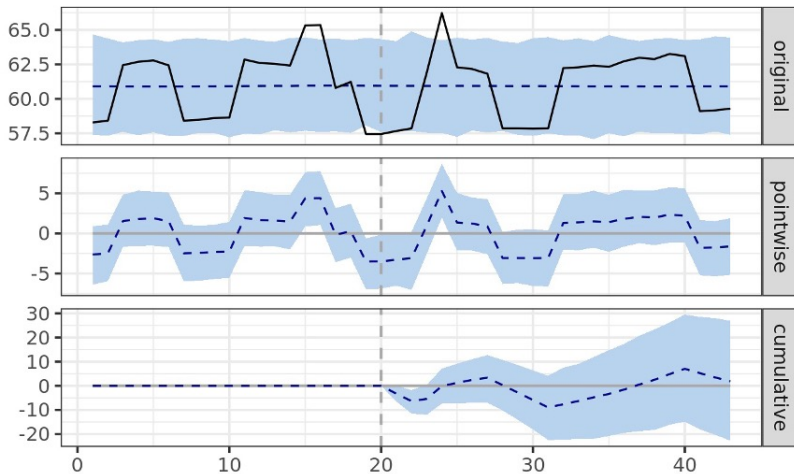|	BRA_{1996}	ECU_{2000}	ECU_{2015}
Actual	50.89	47.86	61.00
Prediction (s.d.)	51.73 (0.32)	46.39 (5.69)	60.92 (0.56)
95% CI	[51.09, 52.37]	[35.65, 59.05]	[59.83, 61.99]
Absolute effect (s.d.)	-0.84 (0.32)	1.47 (5.69)	0.08 (0.56)
95% CI	[-1.47, -0.20]	[-11.18, 12.21]	[-0.99, 1.17]
Relative effect (s.d.)	-1.6% (0.60%)	4.7% (12.85%)	0.1% (0.92%)
95% CI	[-2.8%, -0.39%]	[-18.9%, 34.25%]	[-1.6%, 1.96%]
p-value	0.0051***	0.3620	0.4379
Causal Prob.	99.5%	63.8%	56.2%

	IRQ$_{2008}$	PER$_{2009}$	VEN$_{2006}$
Actual	71.84	127.08	96.62
Prediction (s.d.)	74.30 (0.07)	127.10 (5.93)	96.58 (0.15)
95% CI	[74.15, 74.39]	[114.16, 140.16]	[96.32, 96.92]
Absolute effect (s.d.)	-2.45 (0.07)	-0.02 (5.93)	0.04 (0.15)
95% CI	[-2.55, -2.31]	[-13.08, 12.91]	[-0.29, 0.30]
Relative effect (s.d.)	-3.3% (0.09%)	0.2% (4.76%)	0.0% (0.15%)
95% CI	[-3.4%, -3.12%]	[-9.3%, 11.31%]	[-0.3%, 0.32%]
p-value	0.0011***	0.3994	0.3290
Causal Prob.	99.9%	60.1%	67.1%
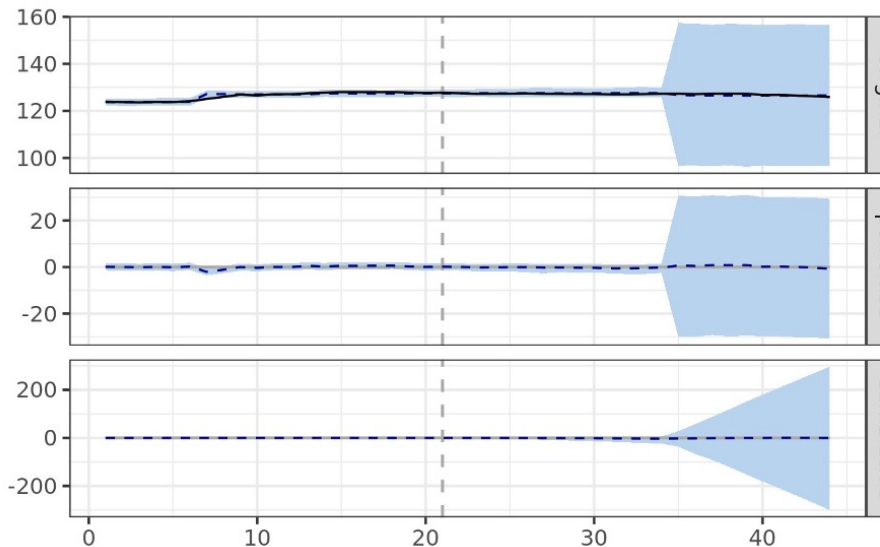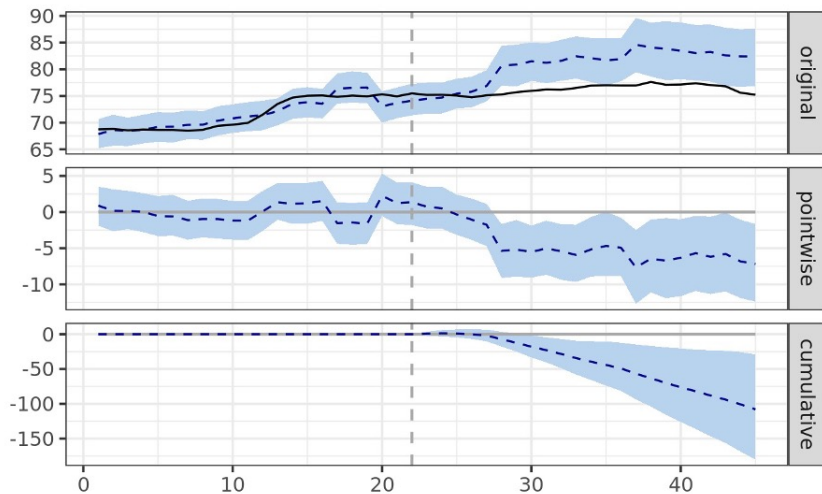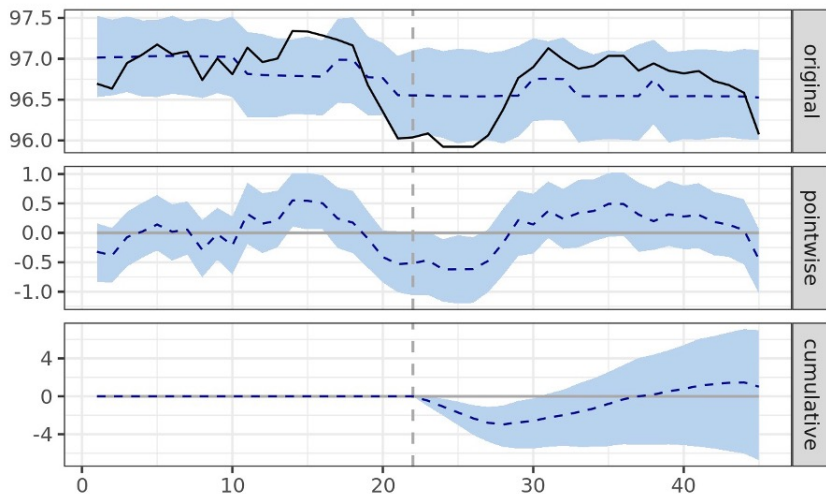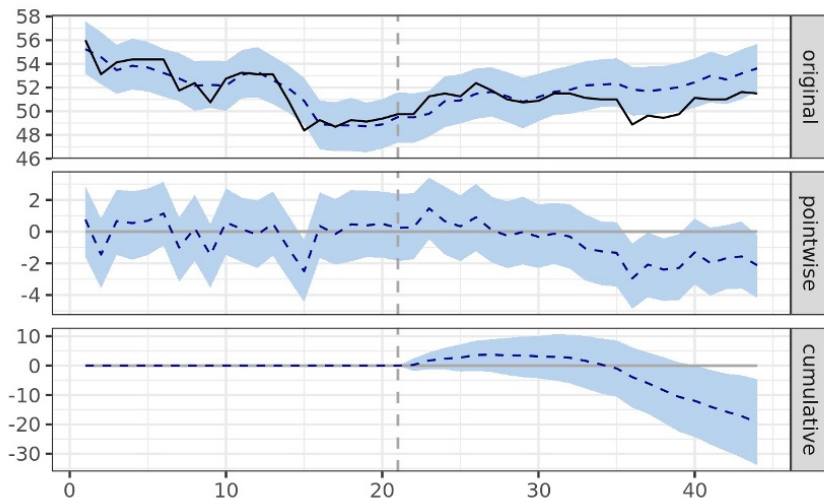
Plaintiff Win

	Δ Price (1)	Δ Price$_{t-1}$ (2)	Δ Price$_{t-2}$ (3)
Creditor Win	0.9928	2.003	3.823
	(0.7955)	(1.089)	(2.320)
Regime Type$_{t-1}$	-12.68**	-18.46**	-14.24**
	(4.384)	(6.087)	(4.809)
F-test (1st stage)	48.8 ***	48.2***	48.1***
Wu-Hausman	7.06***	19.9***	38.6***
Year Fixed Effects	✓	✓	✓
Maturity Fixed effects	✓	✓	✓

▸ IV