Collective Action Clauses Before they Had Airplanes

Marc Flandreau, Graduate Institute,

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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
- Series of papers (Eichengreen and Portes 1986, 1989, 2000; Eichengreen and Werley 1988, Portes (2004)
  - 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.)

  $\Rightarrow$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?