

NEWSLETTER

EAST-WEST DEBT



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Season's Greetings !

As the days turn shorter and holidays are rapidly approaching, we are happy to present you with the latest issue of our newsletter. Use the holidays to reflect on your performance and forge ahead for better ones in 2011. Teamwork is the key to success and teamwork is exactly what our company stands for. So let us be your partner and assist you by offering creative solutions for your claims portfolio.

May 2011 be a fantastic year for all of you!



The team of East-West Debt

The Air Cargo Cartel takes a flight to Europe

In the United States, major airlines already paid compensation for participating in a huge air cargo cartel. In Europe however, companies still await sanctioning by the European Commission. Between 2000 and 2006, over 40 major airlines, involved in air cargo, conspired together to introduce surcharges for shipping, which were claimed to be a result of increasing fuel costs. In fact these surcharges had no relation whatsoever to the increased fuel expenses. In 2006 after extensive investigation, the United States began to file lawsuits against the airlines involved.



In the United States, several airlines have pleaded guilty or agreed to do so in the department's long-running probe into price-fixing in air cargo. The airlines have paid more than \$1.6 billion in criminal fines, and four executives have been sentenced to prison. Major airlines caught up in the probe include British Airways, Korean Air Lines, Qantas Airways, Japan Airlines, Cathay Pacific Airways, KLM, Air France, EL AL Israel Airlines, Nippon Cargo Airlines, American Airlines and SAS.

SAS Cargo will pay \$13.9 million to settle class-action lawsuits over price-fixing in international air freight transport. SAS will also pay \$500,000 in "notice costs" and agreed to "provide substantial cooperation" in ongoing lawsuits. The settlement with SAS Cargo is subject to the approval of the court in the United States. SAS earlier paid a \$52 million fine after pleading

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guilty to criminal charges in the United States, where the investigation into alleged antitrust violations on surcharges and other fees has produced more than \$1 billion in fines.

American Airlines agreed to give evidence against other carriers and pays \$5 million to a group of freight shippers to settle a New York class-action lawsuit over its role in a global price-fixing cartel. As part of the agreement, American Airlines will provide witnesses, documents and electronic data to help shippers in similar cases in Canada, Australia, South Korea and other countries.

Air France KLM also paid fines of \$87 million to settle civil damages as compensation for their part in the air freight cartel. The payment was a result of a settlement between Air France, KLM and Martinair and several parties in the United States. Nonetheless damages which occurred in Europe, have not been compensated for. Following sanctions in the United States, the European Commission has begun investigations in 2007 concerning the violation of EU rules on restrictive business

practices. So far the airlines involved have not been fined yet.

An expected result will enable injured parties to regain 10% of total air freight during the air cargo cartel policy of fuel surcharges and additional fees incurred. It is highly recommendable that companies, who have been damaged by these illicit handlings during 2000 and 2006, seek recovery or a refund from the airlines. Litigation will be necessary for parties in Europe that have suffered losses due to illegally charged costs, whether direct or indirect. These lawsuits are to compensate the billions of euros which were unfairly charged to European shipping companies.

However some claimants do not wish to participate in a lengthy legislative process to seek collective redress of damages suffered due to the air cargo cartel. East-West Debt is offering to purchase the claims of companies, who suffered from the illegal surcharges implemented by the Air cargo cartel and bear the expenses required by the recovery process. Please contact us for more information.

Iraq: a new era now invasion is officially over?

After seven years the occupation of Iraq by the United States is officially over. On Tuesday the 30th of August 2010 President Obama announced the official end of combat operations in Iraq in a nationwide address. Since the start of the conflict in March 2003 around 200.000 U.S. troops were deployed to Iraq. This number has been brought down to just 50.000 U.S. troops that will remain in the country. The remaining troops will no longer be permitted to set out on combat missions unless on specific request by the local Iraqi forces. The invasion of Iraq in March 2003 kicked off a new era in both Iraq and the Middle East Region. Whether the official end of the Iraq conflict may have a similar effect remains to be seen, particularly as U.S. presence will be continued in the country.

Following a security agreement between the United States and Iraq, all U.S. forces must have left Iraq by the end of 2011. However the Obama administration has no intention of abandoning Iraq and has assembled a diplomatic corps to assist in stabilizing both the

country's government and its economy over the coming years. One of the United States' main concerns is that the Iraqi people need to solve their own political crises by



means of their own leaders, as well as the improvement of the nation's security. Although general elections were held six months ago, the Iraqi politicians still haven't decided on a government and a prime minister, while its parliament is not meeting.

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Petroleum

American petroleum companies presumed to have had the inside track to oil concessions, but the situation appears to be completely different. In fact they have been largely outmanoeuvred by a spate of foreign firms including BP, China National Petroleum, Total of France, and Russia's Lukoil.

During its initial assessment in 2004, the International Monetary Fund (IMF) positively predicted oil production in Iraq to double in five years while the country's ministry of oil was expecting to at least triple its production levels. Those years have passed all too quickly. As reported by the ministry of oil, the average crude production in Iraq this year was 2.4 million barrels per day (bpd), similar to the levels reported in February 2003. The harsh reality is oil production in Iraq has not improved in over a decade. In addition, neither has electricity production. The ministry now plans to increase production to 6 million bpd in the next four years and double once more in a decade. Though hardly a realistic plan, this would make Iraq a leading producer in the Gulf. It is not difficult to see where the problem lies, the output expansion deadlines do not allow enough time to build the pipelines, ports and other facilities needed to transport enormous amounts of oil.

Outstanding debts

In 2010, Iraq signed bilateral debt restructuring agreements with each of the 18 members of the Paris Club. These agreements settle more than \$51.1 billion of debts from the Saddam era outstanding to Paris Club countries.

In 2003 a study was conducted by the IMF on the debts owed by Iraq to non-Paris Club countries. The study showed Iraq owed debt to 55 countries worldwide. In 2005, Iraq approached the countries involved and settled \$19.5 billion in debt with all but thirteen. Currently, the Iraqi government is actively working to resolve its outstanding debts with these countries. The United Arab Emirates has cancelled 100% of the debts owed by Iraq and Morocco is likely to do the same. China has also agreed to cancel 80% of debts owed by Iraq and has entered into a trade agreement in 2009 valued at \$3.8 billion.

Iraq has made great strides to resolve outstanding debts owed to non-governmental creditors. The companies



that still have claims from the Saddam era have been contacted and 13,000 individual claims valued over \$20.9 billion have been resolved. These claims have been agreed upon to be settled by either a cash payment or in the form of bonds with a face value of 20% of the old debt. The Iraqi Government has assured its commitment to settle all debts and claims inherited from the former regime, and to continue to deal with them until all have been cleared.

The struggle to secure a stable government and secure the local economy is essential to keep Iraq from becoming a socioeconomic vacuum in the Middle East. Although violence in the country is lessening there remains the trouble with insurgents attacking the petroleum infrastructure. These attacks are causing the most important industry in Iraq to be under productive. This with the debt reconciliation programs is the tightrope the Iraqi government is walking. Should the petroleum industry produce at a less than satisfactory level, the question is where the funds needed to repay the outstanding debts will come from or will Iraq be forced into default.

Are you still holding overdue receivables on Iraq?

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Is Venezuela ready to implode?

At first glance Venezuela, the largest oil producing nation of South America, would seem to be able to avoid a massive economic disaster. However recent actions by Hugo Chávez's socialist government are showing signs of a breakdown.



Hugo Chávez

Since 2006, Hugo Chávez, who holds an almost dictatorship position, has implemented a nationalization policy for most Venezuela's major industries, much to the dismay of foreign owners.

Oil, telecommunication and publications, cement and banking sectors have been nationalized or partially

nationalized, although in some industries minor stakes by foreign investors have been allowed. While these actions have provided Venezuela with a huge shift in domestic income, it has come at a price as it has alienated foreign investment.

2010 has not been a banner year for the country. Venezuela's economy, the only South American country to remain in recession, continued to shrink for a fifth quarter in the April-to-June period. This is mainly seen as a result of tightened restrictions on currency trading and electricity shortages, which throttled industrial output. Venezuela's GDP shrank 1.9% in the second quarter after contracting 5.2% in the first.

To counteract this decline, Venezuela has planned to issue \$3 billion in bonds in the near future for the state run oil company, Petroleos de Venezuela SA, following a sale of \$1.04 billion in bonds due in 2014. The sale of \$2 billion, earlier this year in the local market, was needed to meet the demand for foreign currency in the domestic market. The bond market is a key source for businesses to obtain dollars to pay for imports because the currency-exchange system is controlled by the government and only a limited amount of dollars is made available at official exchange rates.

While the offering of bonds will bring in much needed foreign currencies, the local bond market is being stifled by a new law excluding private brokerages from trading the local Bolivar currency or public sector dollar-denominated debt. This law will allow private brokerage firms to only trade in local equities and securities issued by the private sector.

The only notable silver lining to Venezuela's economic woes is the increased trade namely with China. Venezuela received \$20 Billion credit line, the largest loan from China, to advance development projects in return for future oil shipments. Petroleos de Venezuela SA and China National Petroleum Corp have signed a \$16.3 billion joint venture agreement for a project that will supply Chinese refineries 1 million barrels of oil a day.

Nationalization continues

In August 2010, the Chávez government has voted to nationalize one of Venezuela's top insurance companies, Seguros La Previsora. The company had been closed since December 2009 due to suspicions of illegal activities. The government raided the company after the suspicions were aroused and as a result discovered documents of an illegal nature. Banco Confederado, along with several other banks, was closed at the same time due to alleged unexplained funds and capitalization problems. Chávez has been increasing the government's role in the banking sector, saying repeatedly



that he is battling "parasitic bourgeoisie". Other recent nationalizations have included the expropriation of a group of iron, aluminium and transportation companies in Venezuela's mining region.

Challenging the world

Chávez, since his coming to power, has persisted that the problems of Venezuela have been the effects of foreign concerns and the "Bourgeoisie". Chávez has moved increasingly into a protectionist stance against most of the Western world. The rhetoric of the socialist government has challenged the United States and other world powers. While Chávez has controlled in his country in the same manner as Castro has in Cuba, he has had the strength due to Venezuela's massive oil production abilities. Oil is still a weapon that Chávez is using to the best of his abilities.

In 2009, Venezuela signed an agreement to supply 20,000 barrels of gasoline per day to Iran, although the shipments have not begun. Simultaneously the Western powers were contemplating energy sanctions against Iran due to the Iranian nuclear program. There have been discussions of increased cooperation with the Iranian energy sector while continuing the standoff with the West by ignoring possible sanctions against Iran.

September 2010 elections

Elections were held on the 26th of September 2010 in which the opposition parties, united in the Coalition for Democratic Unity (MUD), made a substantial gain in congress although both sides claimed victory. The opposition overturned the two-thirds majority of the United Socialist Party of Venezuela (SPUV) and loosened the dominant grip the Chávezists had on the country.

Violence on the home front

In Venezuela, there were over 16,000 deaths from violence in 2009. Venezuelans have had to deal with such grim statistics for years. Wealthy Venezuelans have been forced to live behind walls or hire foreign security experts to educate them as how to avoid the killings and kidnappings which are plaguing the country. The opposition has expressed concern that the violence has been low on the list of government's priorities.

A photograph on the front-page in Venezuela's leading independent newspaper, El Nacional, depicts a dozen homicide victims scattered about the city's largest morgue. The photograph as well as the reaction of the government shocked the nation. A court ordered ban on the publishing of violent images has been seen as a break from the usual socialist values government.

Since Chávez took office in 1999, homicide figures doubled as an estimated 119,000 killings occurred so far. Even though the government has stopped publicly publishing their own figures as to the number of murders, human rights groups have stated that the numbers are very likely to be far more. The deaths are mostly contributed to drug violence, however a great portion are children hit by stray bullets.

When Chávez came into power, he established many social policies that were welcomed by the majority of the Venezuelans. His government's domestic and foreign policies of avoidance or ignoring the consequences these policies may promote may just be his downfall. The government's strives for social equality, had early successes, however, the economic troubles remain and are growing due to Venezuela's recession, even without the help of the nationalization of most of the industries of Venezuela.

The limiting of foreign investment and the declining number of trading partners, due to Venezuela's increasing isolation politics from the West, have been a major factor in the country's inability to rise out of their recession. Venezuela's economic woes may just swing popular opinion enough to topple Chávez's hold over the country. Even though the SPUV managed to maintain the majority in the National Assembly in the recent elections, Chávez's position will even still become more precarious.



Economic indicators of a Sovereign Debt Crisis



While historical and statistical data over a long period show an almost clear picture to economic trends, economists, creditors, investors and governments very often are unable to use such data, as it is thought not to be relevant to the conditions today. Sovereign debt crises, while the extent and severity have varied, have been cyclic in nature and followed trends, which are generally only noticeable in hindsight.

However, there are indicators that may be of use and although not always concise, the following three conditions have either been present or have had an effect on nations defaulting on sovereign debts.

Large capital inflows and high debt crisis risk

Since 1800, the risk of a debt crisis has almost always been preceded by a large inflow of capital. With the inflow of foreign capital, a crash of local currency and an increase in inflation is often followed by default. This has been seen time and time again.

Domestic Debt

Contrary to contemporary opinion, domestic debt has always constituted a significant part of government debt in most countries, including established economies and emerging markets. The amount of domestic debt owed usually affects the amount of external debt owed, due to the fact that creditors take into account the country's ability to repay its domestic debts and thus repay its external debts.

Inflation and the relationship between domestic and external debt

A remarkable correlation can be observed between countries in default at one point and countries experiencing high inflation. There is a faulty belief that

countries regard domestic debt as less important than external debt. The probability of default depends more on the total debt a country holds rather than only external debt.

Sovereign Debt troubles in Greece

Capital inflow

The total foreign capital inflow increased by 147.8% in 2008, marking a 40.5% rise from 2007 and equalled a total of €18.1 billion for the period of 2006 to 2008. Simultaneously, Greece began to attract public attention when the new government announced that the actual budget deficit was likely to be 12.7% of GDP, as a result of both the financial crisis as well as the government's uncontrollable spending over the years. Eventually Greece did not manage to avert the financial crisis, even though its EU membership still enabled them to borrow effortlessly in the bond markets at considerably low rates.

Domestic Debt

The rapidly increasing government deficit at 12.7% of the GDP and escalating public debt at 113% of GDP resulted in rising borrowing cost, where Greece's 10-year government-bond spreads over the German bunds expanded to 312 basis points in 29 March, 2009. Panic spread across investors with fears that Greece might need a bailout, in case it fails to refinance its €20 billion in loans that have been maturing in April and May 2010.

Inflation and external debt

Greece's unmanageable spending in the public sector, such as higher pay and more jobs also resulted in the bloated budget deficit. In February 2010, Greece's Prime Minister George Papandreou announced increased taxes, budget cuts and public sector salary freeze to reduce deficit to 8.7% by 2010. Instead of deflation,

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the Greek inflation rate has escalated to 3.9% in March 2010, in comparison to a low of 0.5% in June 2009. Greece's external debt soared in the second quarter of 2009, signalling the economy's lack of competitiveness and its susceptibility to international money markets and their troubles. According to figures published by the Central Bank of Greece, the entire external debt, both in the private and public sector, surmounted 391.1 billion Euros or 163% of the gross domestic product, in the second quarter of the year. This shows an increase of 16 percent in comparison to the same period a year earlier, amounting to 53.8 billion Euros.

Debt crisis are not sudden shocks to economies but rather the result of different symptoms, which may have been present well before any definitive sign of a possible crisis becomes visible.

Result

On 23 April 2010, the Greek government requested that the EU/IMF bailout package would be activated. The initial size of the loan package was €45 billion and its first instalments covered €8.5 billion of Greek bonds that became due for repayment. On 27 April 2010, the Greek debt rating was decreased to BB+ by Standard & Poor's amidst fears of default by the Greek government. The yield of the Greek two-year bond reached 15.3% in the secondary market. Standard & Poor's estimated that in the event of default investors

would lose 30–50% of their money. Stock markets worldwide and the Euro currency declined in response to this announcement.

Another country which has experienced similar conditions is Ireland. The Irish case is somewhat different as the country did not experience a major rise in inflation. Capital inflows have been made available through bond issues at a high level since 2006. At the same time housing prices rose over 200% with about 90% of the housing purchases made through mortgages, increasing the strain on local banks. The housing market crash in 2008, severely affected the liquidity ratio of the banks, rendering them on brink of collapse. In order to prevent the impending break down, additional external loans were given and consequently Ireland's gross external debt reached 811% of GDP, which is the highest in the world. With continuing difficulties, public debt is expected to further rise to 113% of GDP in 2012 and the estimated cost of the banking rescue has been raised to €90 billion or 58% of GDP.

While variations of the actual conditions occur, the movement to default or the emergence of a sovereign debt crisis can be seen in advance. Debt crisis are not sudden shocks to economies but rather the result of different symptoms, which may have been present well before any definitive sign of a possible crisis becomes visible. By using such indicators, creditors or investors have the ability to prepare their strategy for when or if a crisis should occur.

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Iran and China: trading partners under strain by sanctions



The United Nations has imposed tough sanctions on Iran. Even though Japan was the latest country to join the sanctions, the U.S. Treasury department has found that many Iranian banks are still operating within the borders of one of the oldest allies of the United States. Germany has recently taken moves to close many of the banks operating within its borders, although it remains Iran's largest trading partner. On June 30 2010, the Treasury department confirmed that four out of five Iranian owned banks were operating in Germany.

China, as a major non-Western economy, is a likely trading partner for Iran. In spite of the economic sanctions imposed on Iran, China remains prepared to do business, but the relationship between the two countries has not always been a smooth one. So far, Chinese petroleum industry equipment presented one of the few ways to bypass the numerous United Nations and unilateral sanctions imposed on Iran because of its uranium-enrichment program. Beijing's decision to support a fourth round of United Nations sanctions in early June 2010, obliging it to apply tougher conditions to trade and financial transactions with Iran, has clearly peeved officials in Tehran. But it is not likely to have a major impact on the economic relationship that is significant to both countries. Beijing's backing for the latest UN resolution to impose further sanctions on Iran was hardly unexpected, as the Chinese have voted in favor of all previous Security Council resolutions.

The influx of cheap Chinese-made goods has almost eliminated the ability of Iranian companies to compete and the exports to China mainly consist of crude oil rather than manufactured goods. To counteract the criticisms from Iranian businesses for the Chinese dominance of the local Iranian market, China has

decreased the number of Chinese companies permitted to export to Iran from 20,000 to 1,000. Last year, Beijing emerged as Tehran's most important trading partner since Iranian crude oil accounts for one-third of imports for the energy-hungry Chinese economy. The Iranian-Chinese Chamber of Commerce estimates that bilateral trade will continue to boom in 2011 and will show a 50% year-on-year increase in monetary terms.

Iranian Government officials have proposed that to bypass the financial structures created by sanctions, crude oil exports could be remunerated for in Yuan rather than strong currency, or used as payment in kind for Chinese investment projects and key import items like refined fuel and machinery.

Overspending

In a recent disclosure, Iranian President, Mahmoud Ahmadinejad, stated that Iran is running a staggering \$140 billion debt, according to figures released by the regime's Central Bank. \$60 billion alone is owed to Iran's Central and domestic banks. This comes as a surprise considering the government has spent \$256 billion in petroleum revenues.

While the Central Bank of Iran has refused to release data regarding the debt, budget and government expenditures, it has come to light that the government owed \$55.4 billion in February 2010 to the regime's banks. Other domestic debts owed by the government are \$21 billion to social services, \$4.5 to the Armed Forces, \$6 billion to water and electricity contractors and \$1 billion dollars for each of the Transportation and Oil Ministries.

With increased pressure from the West and facing difficulties with its largest trading partner, Iran has found itself with an ever expanding dilemma of how to solve its domestic and foreign affairs. The ruling government has a firm grip over the country, with support from the majority of the populace as well as Iran's Supreme Leader Ayatollah Ali Khamenei, but this is possible to change. The increase in the financial burden being placed on Iranian workers and businesses may just accomplish what the West has been unable to do with sanctions, which is topple the current regime and leaving the Iranian people to clean up the mess.



Pakistan, in the wake of the flood

Pakistan is in the midst of its worst natural disaster in the country's history. The Indus River, which flows through the center of Pakistan on a North-South course dividing the country in two, has flooded, due to an unusually heavy monsoon season, to the extent that has never been seen before. The flood has displaced an estimated 20 million people, destroyed billions of dollars of crops and killed millions of livestock. The disaster continues as the food stock have been destroyed causing a large portion of the population to be nearing starvation levels. Diseases, such as cholera, diarrhea and malaria have already become present in the area.

Although devastating, this catastrophe is unique as it did not happen suddenly. The recent devastating earthquakes or the 2004 tsunami caused almost immediate destruction, whereas the floods began well before any damage occurred. On July 29, unusually heavy monsoon rains caused flash floods and landslides in north-western Pakistan and Pakistan-administered Kashmir. These areas are generally avoided by the military as well as government officials due to the tension between Pakistan and India. The rain continued causing the flood to make its way into the Indus valley, where the threat of major destruction became visible.

President Asif Ali Zardari and his government were slow to react. This was highly criticized, especially when Zardari kept to his planned trip to Europe. This trip, which included a visit to his chateau in Northern

France, increased the criticism of his reaction to the disaster as well as bringing his corruption to the forefront of concerns at home and abroad.

There has been a great call for aid for those displaced by the floods and most developed nations have agreed to send aid. In 2009 the United States approved an aid package worth \$7.5 billion. This relief was meant to deepen ties with the Pakistan and to combat militants in the country, however only \$50 million has been diverted to aid survivors of the floods. An additional \$200 million has been pledged for flood assistance. The Organization of the Islamic Conference, the 57 member group of Muslim countries, has pledged \$1.5 billion in cash and supplies for relief efforts. Nevertheless Yousuf Raza Gilani, Pakistan's prime minister, has criticized contributions made to foreign NGOs involved in relief efforts, instead of the Pakistani government, stating that nearly 80% of the donations would be wasted. Reason behind this criticism concerning relief payments, is the belief that NGO's consume much of the money received for their internal organizations.

Pakistan has many other problems, beside the devastating floods. External debts have experienced an increase of \$1.304 billion between April and June of 2010. Comparing Pakistan's debt in March 2010 at \$54.32 billion, to the total debt at the end of June 2010 at \$55.63 billion, shows a rise of 2.4% in just





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three months. This incline occurred prior to the floods, which are sure to see a large increase by the end of the year. In the past two years, the foreign debt rose 28%, showing a dangerous trend that Pakistan has been experiencing.

According to the Paris Club, the following countries are holding Pakistani debt, these include: Austria \$60 million, Belgium \$31million, Canada \$516 million, Finland \$6 million, France \$2.011 billion, Germany \$1.660 billion, Italy \$98 million, Japan \$7.011 billion, Korea \$471 million, Netherlands \$106 million, Norway \$19 million, Russia \$120 million, Spain \$79 million, Sweden \$151 million, Switzerland \$103 million, United Kingdom \$9 million, United States \$1.507 billion.

The non-Paris Club countries are holding debts from Pakistan totalling \$2.5 billion, with the most being held by China at \$1.76 billion. The total debt owed to the International Monetary Fund (IMF) has reached \$8.07 billion.

In response to the outstanding debt and the assured fact that Pakistan will be hard pressed to repay, the

Isolated North Korea seeking a way to pay off their immense debts

The isolated and nuclear armed state of North Korea has recently shown indications that they beginning to manage their immense outstanding debts. Although North Korea is highly secretive of its economic data, it is estimated that their outstanding debts are close to \$12 billion and nearly two thirds of this estimated total is owed to former communist states. The South Korean government has given respect to the Kim Jong-Il regime in Pyongyang by refraining from officially announcing the debts of North Korea, which they chose not to disclose themselves.

In 2008, a member of the Grand National party suggested the debt owed to South Korea, \$920 million, could be paid off by offering mineral rights to South Korea. In the past, Czechoslovakia, a former communist nation, had been a major supplier of heavy machinery, trucks and trams to North Korea. In 2010,

IMF and the World Bank have offered to issue new loans and debt relief to Pakistan, while restructuring has been discussed. The new issuance, while enabling Pakistan to repay debts and interest on those debts, will not give much relief to the country. Pakistan is in need of cash to support the relief effort and combat the slide into greater indebtedness, by increasing trade. Economists have stated that the interest payments on Pakistan's current debt consumes about one third of their budget revenues.

While there is a worldwide call for aid to the survivors of the floods and those who have lost shelter and livelihoods, Pakistan's severe financial problems have come to light. The ever increasing debt, loss of trade due to the insurgency groups and corruption at the highest level of the government have made debt relief or restructuring a long hard battle. With an expected \$70 billion debt by 2015, Pakistan has two disasters to contend with and the government must deal with one and the other.



North Korea endeavored to make a payment towards the accumulated \$10 million debt owed to what is now the Czech Republic by offering ginseng in return. While non-cash trade and settlement of debt has been common among socialist countries, Czech officials did not look upon this offer of ginseng very fa-

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vorably. Consequently Prague has continued further discussions to facilitate the receipt of either a cash payment or commodities from North Korea. While attempting to solve their debt problems, North Korea, like Pakistan, has been hit with flash floods. In response, South Korea pledged \$8.4 billion to help the victims of the flooding, the first aid offer since the sinking of a South Korean naval ship in March 2010. Earlier in 2010, South Korea had frozen all government funds for North Korea just before an international investigation confirmed that the ship had been struck by a torpedo. Chinese state-run news agency Xinhua reported that the new aid offer is "a means to defuse tension on the divided peninsula."

North Korea may have few alternatives but to accept the financial aid from Seoul, as a recent trip of Kim Jong-il to China, in order to bid for support, reaped less than was expected. The disappointing reaction of China, the food shortages and financial setback caused by the floods may become another setback to the anticipated succession of Kim Jong-il by his youngest son Kim Jong-un. Kim Jong-il suffered a stroke last year and recent footage has been a testimony of his frail condition. The succession is eminent since Kim Jong-un was elevated to the post of four-star general even though he has no military experience.

The six-party talks with North Korea over its nuclear program have stalled as the United States and Japan, members of the talks, have appeared unwilling to return to the bargaining table, due to North Korea's behavior. In August 2010, the United States enacted new sanctions, as the administration believed that stronger sanctions were needed in response to the sinking of the South Korean warship in March.

The release of an American activist, which was accomplished by a trip to North Korea by former U.S. President Jimmy Carter, seemed to raise speculation that the tensions between North Korea and the United States were beginning to thaw. This was seen as not to be the case as the new sanctions were enacted. The new sanctions target people and companies involved with selling arms and luxury goods to North Korea and facilitating the country's authorities with money laundering, counterfeiting and narcotics trafficking. The entities mentioned included Office 39



of the Korean Workers' Party, which aids top North Korean administrators through "illicit economic activities and managing the leadership's slush funds," according to a fact sheet from the U.S. Treasury Department.

The sanctions intend to freeze any of those targets' U.S. assets, and render it illegal for American companies to do business with such firms. The freezing of assets goes beyond the United Nation's penalties for trading in illegal commodities, including luxury goods and conventional arms.

North Korea has opened talks with South Korea for the possibility of another cross border reunion of families that were separated during the Korean War. In principal the two countries remain at war since their three-year conflict ended in a ceasefire in 1953 and no peace treaty was signed. Millions of families were displaced during the war and the last Red Cross brokered reunion took place in 2009. The offer may ease tensions that have increased during joint military exercises by the United States and South Korea.

With the transition of leadership approaching, the actions of North Korea have not expressed any sense of security, something the West and North Korea's neighbors have been anxious of. Natural disasters, the sanctioning of trade and persistent pressure on North Korea to dismantle its nuclear arsenal have placed the country in a difficult situation. Now, without the strong support from China, the country is hard pressed to continue its standoff with the West. It can almost be said that North Korea has only two choices; to discontinue its isolation or to collapse.





The conflict in production of documents from abroad

The continuing trend of globalization and the steady expansion of multinational corporations increases the likelihood that businesses will have to respond to an adversarial proceeding in the United States that requires the collection, review and possible production of materials located abroad. For attorneys used to practising under the Federal Rules of Civil Procedure (FRCP), this may seem like a clear enough task. However, multinational corporations dealing with information located in jurisdictions outside the United States must also be mindful of data privacy laws and other requirements in the foreign jurisdictions. In fact, there is a seemingly irresolvable conflict between broad U.S.-based discovery rules and EU member states' privacy and data protection directives. This article looks at some recent developments that show that the conflict is not close to being resolved.

U.S. Approach to Discovery

In the United States, the Federal Rules of Civil Procedure dictate that parties to pending or reasonably anticipated litigation must collect, preserve and produce all relevant records within their possession or control, including any records existing in electronic format. This obligation can extend to foreign subsidiaries or affiliates of the companies involved in the litigation, and courts can order persons subject to their jurisdiction to produce evidence even if the information is not located in the United States. Failure to comply with these disclosure requirements can result in sanctions in a civil suit (even dismissal or a judgment) and may even constitute a criminal offence in the case of a federal investigation.

The Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters provides a standard procedure for making requests for information abroad through issuing "letters of request" or "letters rogatory." Under this procedure, a U.S. court seeks judicial assistance by way of "letter of request" sent to the central authority in the jurisdiction where the information is located, identifying the documents sought with specificity. The letters are then executed by a local court in that jurisdiction, should the data request be found reasonable.

Unfortunately for U.S. practitioners, because the foreign court is the one to determine whether the



discovery request is reasonable, and because foreign courts generally believe that the practice of U.S.-style pretrial discovery is a wasteful fishing expedition, this process does not result in the mandatory production of all the information sought. Furthermore, the process can be bureaucratic and lengthy, and only applies to countries that are parties to the Hague Convention.

More than 20 years ago, the U.S. courts were called on to decide whether the Hague Convention was the exclusive means for a party to litigation in the federal courts to obtain evidence located outside the United States. In *Societe Nationale Industrielle Aerospatiale et al, v. District Court for the Southern District of Iowa*⁽¹⁾, the U.S. Supreme Court held that the procedures afforded by the Hague Convention are but "one method of seeking evidence [abroad] that a court may elect to deploy." As a result, especially as it related to a party to a lawsuit, the practice was not to follow the Hague Convention.

Foreign Law Restrictions

Unlike in the United States, in the EU and in other foreign countries, protection of personal data is considered a fundamental human right. These jurisdictions have adopted data privacy laws in an attempt to restrict cross-border discovery of information intended for disclosure in foreign jurisdictions. Violations of the data privacy laws can lead to private rights of action by affected individuals, or criminal penalties for persons who authorized violative activities (including their corporate officers or outside counsel).



An overview of the policy on data privacy within Europe can be found in EU Directive 95/46/EC. The EU Directive is intended to protect the fundamental rights and freedoms and the right to privacy with respect to personal data. By its own terms, the EU Directive dictates that "[the Member States shall provide that the transfer to a third country of personal data which are undergoing processing or are intended for processing after transfer may take place only if...the third country in question ensures an adequate level of protection." See EU Data Protection Directive 95/46/EC (1995) Art. 25 (1).

Under the EU Directive, "personal data" encompasses a wide variety of information including such mundane information as names and positions of employees within a company, and their titles ("any information relating to an identified or identifiable natural person.") There is also a further sub-category of "sensitive" personal data receiving even greater protection—such as racial or ethnic origin, political opinions, religious beliefs, criminal matters and the like.

The EU Directive defines "processing" as "any operation or set of operations" performed on "personal data," including any retention, preservation, or archiving of data for a litigation hold; inconveniently for U.S. litigators, this covers virtually any and every action that would be done in the United States during discovery. Violations in EU member countries are punishable by fines ranging from less than 100,000 Euros to an unlimited amount⁽²⁾, and may result in jail terms in some countries including Sweden and Switzerland. Other sanctions include public reprimand, which is used as a method of generating negative publicity against violating companies in the UK, France, and Belgium.

Further complicating the issue of transnational discovery are the "Blocking Statutes" adopted by foreign jurisdictions, which restrict the collection, handling, and transfer of any personally identifiable information about individuals. Indeed, while U.S. civil procedure rules and government obligations might require that an organization retain certain data for litigation or investigation purposes, a foreign blocking statute might require that the same data be destroyed in order to protect individuals' privacy once the personal data has served the original purpose for which it was collected.

Article 7 of the EU Directive allows for "processing" of data to comply with legal obligations, and Article 26 of the directive allows transfer of data to non-EU countries to defend legal claims under six exceptions (consent, contract, legal obligation, vital interests of data subject, public interest or "legitimate interests"). One would think that these provisions would permit compliance with discovery demands made in U.S. litigation, but that is not the case.

Article 29 of the EU Directive creates independent data protection authorities to supervise compliance efforts pertaining to data protection, and the heads of each office meet as a group and provide advisory opinions. This group, the Data Protection Working Party, has issued multiple advisory opinions specifically stating that U.S. litigation requests do not qualify as "legal" or "legitimate" obligations.⁽³⁾ Most recently, in February 2009, the Data Protection Working Party decided that "consent" was not deemed to be a reliable basis for transfer of personal data, and that the obligations created by the Federal Rules of Civil Procedure do not qualify as a "legal obligation." The Data Protection Working Party recommended restricting disclosure to anonymised or pseudonymised data after filtering by a "reliable third party based in the EU."

The Conflict Intensifies

Parties with data in an EU country that are asked to disclose private data in a U.S. litigation are placed on the horns of a dilemma—run the risk of violating their jurisdiction's privacy laws if they disclose, or being sanctioned in the U.S. if they refuse to do so. Yet there does not seem to be any movement on either side of





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the Atlantic to resolve this conflict.

Despite EU law, U.S. courts continue to follow Societe Nationale and refuse to use the Hague Convention's letter procedures in all instances involving the transfer of discovery materials from Europe. This has led to attorney sanctions in Europe. For example, in *Strauss v. Credit Lyonnais, S.A.*,⁽⁴⁾ the Eastern District of New York ordered defendant Credit Lyonnais to produce documents without resorting to the Hague Convention's letters of request, acknowledging that pursuing information through the Hague Convention could be costly, uncertain and time-consuming. The court also noted that the defendant presented little evidence that France enforced the privacy laws that the company complained discovery would supposedly violate.

Credit Lyonnais' French outside counsel approached one of the company's former directors for a statement, but did not go through the Hague Convention's letters rogatory or letter of request procedures. Counsel was subsequently criminally prosecuted and fined. The French Supreme Court upheld the criminal conviction of the French attorney, as well as the 10,000 Euro fine.⁽⁵⁾

Despite France's calling the Eastern District of New York's bluff on the issue of lack of enforcement of the data privacy restrictions, each side has only become more entrenched over the last 12 months. In July 2009, the French data protection authority, Commis-

sion Nationale de l'Information et des Libertes (CNIL) confirmed that all U.S. discovery requests for the transfer to the United States of personal data located in France, or subject to the protections of France's data protection laws, must be made through the Hague Convention.

Moreover, even for requests coming under the Hague Convention, French data protection laws still apply if "personal data" is included. French data protection laws require: limitations on scope, notice to data subject, right of data subject to object, security over personal data, and data protection either by corporate rules, safe harbor principles, or by protective order. Further, the party seeking to transfer the information may need authorization of CNIL prior to transferring the documents.

Notwithstanding these explicit instructions from CNIL, U.S. courts have not changed course. None of the district court decisions considering blocking statutes in France or other countries with similar regimes ordered them to use the Hague Convention after the July 2009 Recommendations. For example, in *In re: Global Power Equip. Group Inc.*,⁽⁶⁾ the claimant, a Dutch entity, argued that the Hague Convention applied to discovery of information possessed by its French affiliate. The court held that, under Societe Nationale, the claimant could not shield documents from discovery by storing them with a French affiliate, as the Hague Convention procedures are optional and the claimant had not demonstrated hardship. The court cited to *Strauss* and distinguished *In re Christopher X*, stating that it was not clear that the sanctioned attorney in that case was "pursuing discovery in a manner that was ordered or approved by a U.S. court."

Similarly, in *Accessdata Corp. v. Alste Techs.GmbH*,⁽⁷⁾ the U.S. District Court in Utah rejected a German defendant's argument that the Hague Convention applied, calling it unnecessary where the suit did not involve a foreign state as a party or a sovereign with a "coordinate interest in the litigation" or where the costs of transporting documents or witnesses is not high. Obviously, the simplest way to avoid such conflicts would be to agree before discovery to conduct all discovery of documents with international sources through the procedures of the Hague Convention. But U.S. parties are not likely to agree to a time-con-

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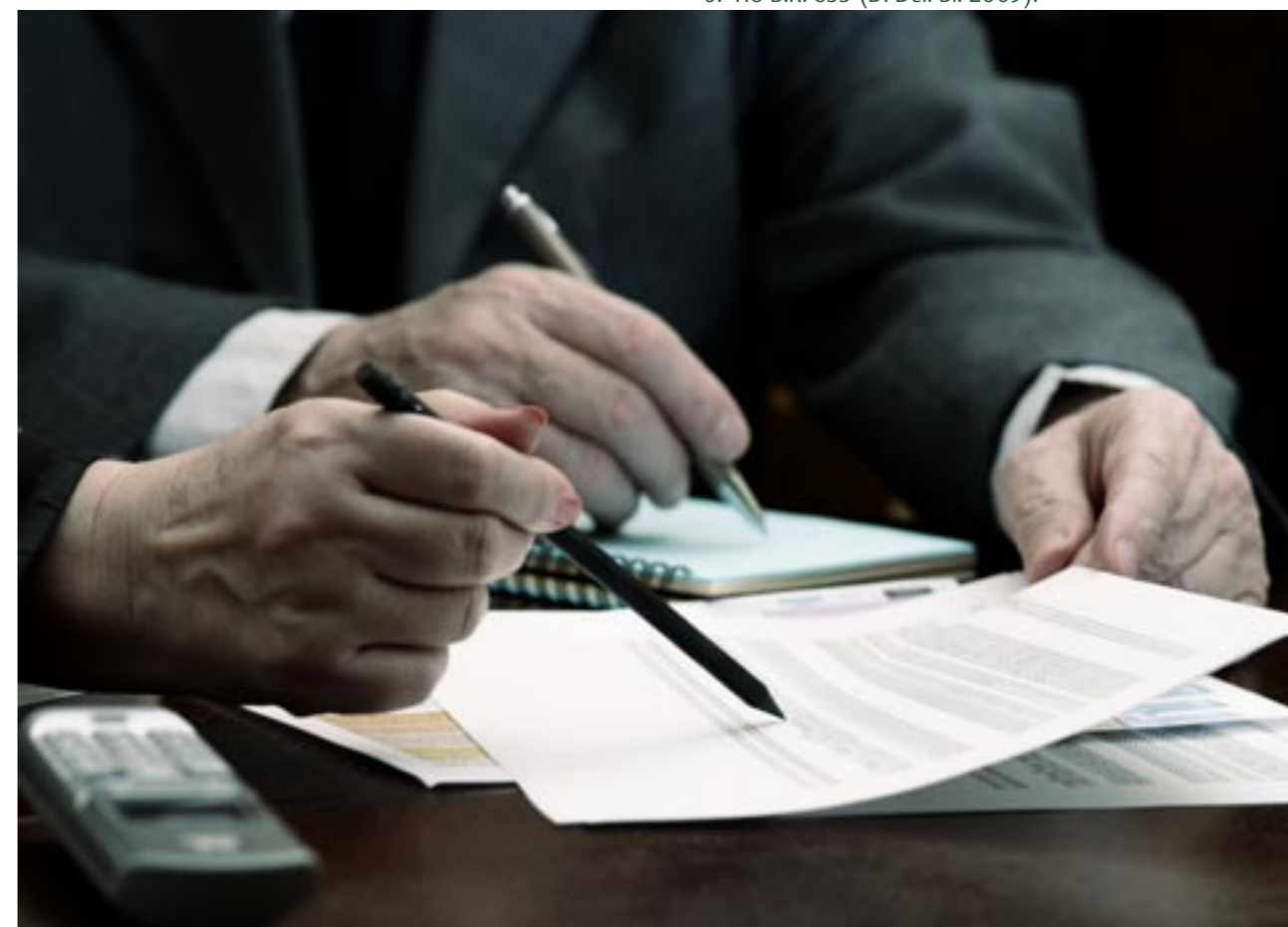
suming procedure that will not yield all the discovery they are seeking. Thus, decades after Societe Nationale and the first of the Blocking Statutes, the U.S. and foreign countries are actually moving further apart, rather than finding solutions to this intractable problem.

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Notes

1. 482 U.S. 522, 541 (1987).
2. The largest fines have been levied against companies that were not engaged in litigation. For example, Spain imposed a one-million Euro fine against a company that inadequately protected personal data from Internet hackers and a 420,000- Euro fine against a company that disclosed clients' personal data for marketing purposes. However, lesser fines have been handed out in litigation-related cases.
3. February 2006: opined that SOX whistle blowing provisions in the United States are not a "legitimate interest" for "processing" of personal information. November 2005: opined that US discovery obligations do not qualify under the exceptions to processing and transferring personal data. February 2009: issued a decision relating to pretrial discovery further restricting transfer of data to the U.S.
4. 242 F.R.D. 199 (EDNY 2007).
5. In re *Advocat "Christopher X,"* No. 07-83228 (Cour de Cassation Dec. 12, 2007).
6. 418 B.R. 833 (D. Del. Br. 2009).

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