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January 11, 2016

Ladies and Gentlemen:

You have asked me for my legal opinion, as a specialist in securities law, as to whether certain disclosures that were set forth in prospectuses and prospectus supplements filed by the Republic of Peru (“**Peru**”) with the Securities and Exchange Commission (“**SEC**”) in 2014 and 2015 contained material misstatements, or omitted to state other material facts necessary to be stated in order to make these statements not misleading, with the result that the federal securities laws of the United States might thereby be violated.<sup>1</sup> As you are aware, “materiality” is “a mixed question of law and fact,”<sup>2</sup> and the trier of the fact—whether a judge or a jury—has substantial discretion. Nonetheless, in my judgment, the disclosures that Peru has made (and the necessary disclosures that it has omitted to state) seriously mislead and fail to adequately inform reasonable investors with respect to both the quality of Peru’s debt securities and the ability of investors to enforce their legal rights in Peru with respect to its debt securities. Thus, under the traditional standards for materiality,<sup>3</sup> these statements are materially misleading and, as a result, the prospectuses not only fail minimum SEC disclosure standards, but also subject Peru to civil liability, both in private actions by bond purchasers and actions brought by the SEC, which could

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<sup>1</sup> I have reviewed the following registration statements and prospectus supplements, which Peru filed with the SEC during 2014 and 2015: (1) Pre-Effective Amendment No. 1, dated July 22, 2014, to Registration Statement No. 333-196690; (2) Prospectus Supplement, dated October 30, 2014, to above Registration Statement; (3) Prospective Supplement, dated March 19, 2015, to Prospectus, dated October 30, 2014; (4) Preliminary Prospectus Supplement, dated August 18, 2015, to Registration Statement No. 333-205678; (5) Prospectus Supplement, dated August 18, 2015, to Registration Statement No. 333-205678; (6) Prospectus Supplement, dated October 27, 2015, to Registration Statement No. 333-205678.

<sup>2</sup> See TSC Indus. v. Northway, 426 U.S. 438, 450 (1976).

<sup>3</sup> *Id.* at 449 (“an omitted fact is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote”).

seek an injunction or take administrative steps to halt trading in these bonds. These misleading disclosures primarily relate to its past and ongoing treatment of Peru's Bonos Agrarios or land bonds (the "**Land Bonds**"), which have now been in default for over 20 years.

## I. Background

In 1969, after nationalizing numerous private enterprises, the military government of Peru headed by General Juan Velasco Alvarado instituted an agrarian "reform" program under which it confiscated numerous properties from landowners in exchange for long-term Land Bonds issued by Peru.<sup>4</sup> Some 23 million acres of rural land were seized, and as compensation (which the Peruvian constitution required), the government issued the Land Bonds, which carried a four to six percent annual interest rate over a 20 to 30 year term and were guaranteed by Peru without reservation.<sup>5</sup>

During the 1980s and 1990s, the Peruvian economy experienced hyperinflation, and Peru twice changed its currency. The combined impact of inflation and currency devaluation was to trivialize the cost to Peru of making payments on its Land Bonds. Nonetheless, even though the cost to Peru of servicing its Land Bonds would have been modest, Peru began defaulting on the Land Bonds in the late 1980s and stopped making payments altogether not later than 1992. No payment has been made on the Land Bonds since 1992 at the latest.<sup>6</sup>

In 2001, Peru's Constitutional Tribunal ruled that the Land Bonds were valid debt obligations and that Peru was required to make payments on them sufficient also to compensate their holders both for hyperinflation and currency changes.<sup>7</sup> Under Peru's 1984 Civil Code, a consumer price index (or "**CPI**") methodology had been established to update the amount owed on debt obligations, by applying Peru's monthly consumer price index to the original face amount of the applicable debt obligation and adding compounded interest on an annual basis at the interest provided in such applicable debt obligation.<sup>8</sup>

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<sup>4</sup> This action was taken pursuant to the Land Reform Act, Peru Decree Law No. 17716, Article 175, available at <http://peru.justia.com/federales/decretos-leyes/17716-jun-24-1969/gdoc/>.

<sup>5</sup> Id.

<sup>6</sup> The bank through which coupon payments were made, the Agrarian Bank (*Banco de Fomento Agrario*), was liquidated by the Peruvian government on May 6, 1992. See Peru Decree Law No. 25478 (May 6, 1992), available at <http://docs.peru.justia.com/federales/decretos-leyes/25478-may-6-1992.pdf>. See also, Constitutional Tribunal of the Republic of Peru, Case No. 022-1996-PI/TC (Mar. 15, 2001), Sec. 2, Para. 5; Sec. 3, Para. 4, available at <http://www.tc.gob.pe/jurisprudencia/2001/00022-1996-AI.html>. See also, Constitutional Tribunal of the Republic of Peru, Decision issued in file No. 022-1996-PI/TC of July 16, 2013, Para. 18, 19, 25, available at <http://www.tc.gob.pe/jurisprudencia/2013/00022-1996-AI%20Resolucion.pdf>.

<sup>7</sup> Constitutional Tribunal of the Republic of Peru, Case No. 022-1996-PI/TC (March 15, 2001), available at <http://www.tc.gob.pe/jurisprudencia/2001/00022-1996-AI.html>.

<sup>8</sup> See Resolution by the Sup. Ct. of Justice of March 13, 2012 in Case N° 4385-2010, Foundation 4, available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Corte-Suprema-Resolución-del-13-de-marzo-de-2012.pdf>. See also, Valuation Expert Report N° 456-2-CVL-2008 in same case, available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Informe-de-Tasacion-456-2-CVL-2008-Economista-Carlos-Adolfo-Venegas-Lizama-caso-Augusto-Durand.pdf>. See also 9th Civil Court of Lima, Exp.

Despite the existence of the CPI methodology which could have been applied with relative ease to the Land Bonds, a long, protracted and still continuing struggle began between Peru's judicial system, which was committed to the protection of basic property rights under the constitution of Peru, and Peru's shifting political leadership, which has resisted significant payments to certain holders of the Land Bonds. For a time, Peru's courts and its Congress reaffirmed the use of the CPI methodology in a series of actions over the next decade. In 2006, Peru's Congress undertook a study, which recognized that Peru was obligated to pay the Land Bonds at a fair and updated value, and quantified their adjusted value at that time under Peru's standard CPI methodology at 10,025,618,044 *Nuevos Soles* (or approximately \$3,455,000,000).<sup>9</sup> Legislation providing for payment of the Land Bonds was approved by the Permanent Committee of Peru's Congress in 2011.<sup>10</sup> However, this legislation was criticized by persons associated with the political party of then-President-elect Ollanta Humala, who characterized the legislation as a fiscal "time bomb."<sup>11</sup> As a result, the legislation was never signed, and President Humala remains in office to date.

The current cost of paying off the Land Bonds at an updated price reflecting the CPI methodology is uncertain (and Peru has made no official estimate since the time of the above 2006 study). Estimates in the press have ranged widely between \$1 and \$8 billion.<sup>12</sup> In February 2015, a former Minister of Economy and Finance for Peru, Ismael Benavides, estimated that the cost would be \$5.1 billion;<sup>13</sup> more recently, Standard and Poor's placed the same cost at a maximum of \$4.1 billion.<sup>14</sup> In a report regarding the Land Bonds, Moody's

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34632-1997-Civil, available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/9o-Juzgado-Lima-Exp.-34632-1997.pdf>. See also, Constitutional Tribunal of the Republic of Peru, Case No. 0041-2004-AI/TC, of November 11, 2004, Foundation 53. Available at <http://bonosagrarios.pe/wp-content/uploads/2015/03/TC-Exp.-0041-2004-Sentencia-del-11-de-noviembre-de-2004.pdf>.

<sup>9</sup> Opinion issued on Draft Laws No. 7440/2002-CR, No. 8988/2003-CR, No. 10599/2003-CR, No. 11459/2004 – CR, and No. 11971/2004 – CR, available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Dictamen-Comision-Agraria-de-mayo-2005.pdf>.

<sup>10</sup> See Patricia Velez and Terry Wade, "Peru's Congress approves bill to pay land bonds," Reuters (July 19, 2011), <http://www.reuters.com/article/us-peru-bonds-idUSTRE76I46Y20110719>.

<sup>11</sup> "Garcia vetará la ley de pago de la deuda agraria," Infobae (July 20, 2011), <http://www.infobae.com/2011/07/20/1029644-garcia-vetara-la-ley-pago-la-deuda-agraria>.

<sup>12</sup> See Mitra Taj & Marco Acquino, "Peru's land-reform debt payout could be minimal, bondholders say," Reuters (July 17, 2013), <http://www.reuters.com/article/peru-economy-bondholders-idUSL1N0FN1RU20130717>. See also John Quigley & Veronica Navarro Espinosa, "Payday Looms on Dictator's Defaulted Bonds in Peru: Andes Credit," Bloomberg (July 17, 2013), <http://www.bloomberg.com/news/articles/2013-07-17/payday-looms-on-dictator-s-defaulted-bonds-in-peru-andes-credit>.

<sup>13</sup> See Dr. Ismael Benavides, Dr. Cesar Peñaranda, and Professor Carlos Adrianzen, "On the Costs and Benefits of Restructuring the Selective Default of the Peruvian Land Debt: Fiscal and macroeconomic implications of honoring the debt associated with the land reform bonds," (Feb. 17, 2015), available at [http://perubonds.org/wp-content/uploads/resources/benavides\\_expert\\_report\\_english.pdf](http://perubonds.org/wp-content/uploads/resources/benavides_expert_report_english.pdf). Dr. Benavides, was Minister of Economy and Finance from 2010-2011.

<sup>14</sup> See Standard & Poor's, Supplementary Analysis: Republic of Peru, Sept. 30, 2015, at 12, <http://www.alacrastore.com/s-and-p-credit-research/Supplementary-Analysis-Republic-of-Peru-1458085>.

echoed the \$5.1 billion estimate provided by Minister Benavides, and also estimated that the current “dollarization” method proposed by the Peruvian government would result in only a \$500 million liability.<sup>15</sup> Although Peru’s ability to pay amounts in this range is not in doubt, this cost, if paid in cash, could be significant to Peru, could significantly impact Peru’s budget over several years,<sup>16</sup> and predictably will provoke much political controversy, particularly in an election year (Peru will hold a presidential election in 2016).

In this light, the critical issue becomes not the ability of Peru to pay its bondholders, but its political willingness to do so.<sup>17</sup> This latter uncertainty is material to investors deciding whether to purchase the debt securities that Peru is currently issuing because, simply put, the past is prologue. A nation willing to renounce past unqualified commitments may do so again in the future, particularly if economic conditions deteriorate (as they may in Peru for reasons later noted). Particularly ominous for prospective investors is that Peru’s refusal to honor its Land Bonds has been disguised behind a thin façade of legality and has not been candidly acknowledged by Peru. Possibly Peru may believe it can escape the full consequences of default. In any event, rather than acknowledge the truth, Peru has employed euphemisms that deny it is still in default by asserting that a procedure has been implemented to update the valuation of the Land Bonds. That procedure is, however, an illusory compromise that economically frustrates the claims of the holders of the Land Bonds. Here, it is useful to review briefly the events over the last five years. When in 2011 Peru’s Constitutional Tribunal was asked to enforce its earlier 2001 decision that the Land Bonds were valid obligations of Peru, that Tribunal did order Peru’s government in 2013 to pay the Land Bonds (a technical victory for investors),<sup>18</sup> but it changed its method of calculating the updated amount, no longer requiring use of the CPI methodology that had been affirmed twice by Peru’s Supreme Court and used for multiple judgments.<sup>19</sup> Ruling that the former CPI methodology would “cause severe impacts in the Republic’s budget” that would potentially make the repayment of the debt “unfeasible” (a

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<sup>15</sup> See Government of Peru, FAQs on Peru’s Bonos de la Deuda Agraria, Moody’s Investors Service, Dec. 18, 2015, available at <https://www.moodys.com/credit-ratings/Peru-Government-of-credit-rating-601500>. Notably, Moody’s did not provide any source or other support for the \$500 million estimate, which conflicts dramatically with an analysis provided by Deloitte (Peru), calculating the value using the dollarization method to be no greater than \$12 to \$24 million. See *infra* note 30.

<sup>16</sup> Peru, of course, could seek to restructure the liability by offering to exchange Land Bonds for performing bonds such as the bonds recently offered under Peru’s prospectuses filed with the SEC, in which case there would not be a significant impact to the budget. See note 13.

<sup>17</sup> Whatever formula is used to convert the Land Bonds to present value, the amount is well within Peru’s financial ability to pay. See note 13. See also Moody’s Investors Service, *supra* note 15.

<sup>18</sup> See Constitutional Tribunal of the Republic of Peru, Decision issued in file No. 022-1996-PI/TC of July 16, 2013, foundations 17-19, available at <http://www.tc.gob.pe/jurisprudencia/2013/00022-1996-AI%20Resolucion.pdf>.

<sup>19</sup> See e.g., Supreme Court, Constitutional and Social Law Chamber, CAS N° 1002-2005 of July 12, 2006, Section 5, available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Corte-Suprema-Casacion-1002-2005-del-12-de-julio-de-2006.pdf>; See also, Supreme Court, Constitutional and Social Law Chamber, CAS N° 1958-2009 of Jan. 26, 2010, Section 4, available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Corte-Suprema-Casacion-1958-2009-del-26-de-enero-de-2010.pdf>.

conclusion reached without any hearing or evidence on this point),<sup>20</sup> the Tribunal directed that an alternative “dollarization” methodology be used that would convert the face amount of the Land Bonds into U.S. dollars as of the date of issuance, using a parity exchange rate, and then further convert the U.S. dollar number into *Nuevos Soles* at the present time. The bottom line result was functionally equivalent to a repudiation of the Land Bonds, but it was masked by a cover story that described Peru’s actions as simply a technical change in the procedures for updating the Land Bonds.

Revealingly, a criminal investigation is now underway as to how this decision was actually reached. In late 2015, a senior Peruvian Justice on the Constitutional Tribunal filed a criminal complaint alleging that an original majority opinion that he signed (and that would have updated the bonds using CPI) was doctored using white out and falsely transformed into his alleged dissenting opinion.<sup>21</sup> In December, 2015, the Court Secretary to the Constitutional Tribunal was criminally charged by Lima prosecutors for falsification of court documents with regard to this decision.<sup>22</sup> On January 6, 2016, a Peruvian judge denied the Court Secretary’s request to dismiss the action and ruled that the criminal proceeding will continue.<sup>23</sup> News

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<sup>20</sup> July 2013 Constitutional Tribunal decision, *supra* note 18, at Para. 25.

<sup>21</sup> Criminal Complaint filed by former Constitutional Tribunal Justice Carlos Mesía before the 12<sup>th</sup> Criminal Prosecutor of Lima (Sept. 2015) available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Carlos-Mesia-Solicito-incorporacion-como-agraviado-23-October-2015.pdf>; see also, “Peruvian judge files complaint over bond ruling,” *Financial Times* (Oct. 27, 2015), <http://www.ft.com/fastft/2015/10/27/peruvian-judge-files-complaint-over-bond-ruling>. See also Christopher Sabatini, “Peru’s test on respect for rule of law,” *Miami Herald* (Oct. 7, 2015), <http://www.miamiherald.com/opinion/op-ed/article38141850.html>. For a graphic description and numerous photographs of the doctored pages in the July 16, 2013 Constitutional Tribunal Ruling, see Forensic Expert Report N° 12439-12454/2015 prepared by experts José Luís Carrión Cabrera and Felix Roger Escajadillo Cabrera of the Institute of Legal Medicine and Forensic Sciences (Aug. 14, 2015), available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Informe-Pericial-Instituto-de-Medicina-Legal-y-Ciencias-Forenses-Agosto-2015.pdf>.

<sup>22</sup> Charges were brought on November 23, 2015 against Oscar Arturo Diaz Munoz, CT Court Secretary, for “Falsification of Documents in prejudice of the State and of Carlos Mesia Ramirez,” available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Cargos-criminales-contra-Oscar-Diaz-119-2015.pdf>. See “Egan-Jones Affirms Three Ratings on Peruvian Sovereign Debt Based Upon Criminal Charges Related to Peruvian Land Bonds,” *PR Newswire*, Dec. 10, 2015 (stating that Egan-Jones had reviewed the “official criminal complaint”), available at <http://www.prnewswire.com/news-releases/egan-jones-affirms-three-ratings-on-peruvian-sovereign-debt-based-upon-new-criminal-charges-related-to-peruvian-land-bonds-300191008.html>. See also “Ministerio Público denuncia adulteración de resolución del TC sobre bonos de la deuda agraria,” *Gestión* (Dec. 8, 2015), available at <http://gestion.pe/politica/ministerio-publico-denuncia-adulteracion-resolucion-tc-sobre-bonos-deuda-agraria-2150594>; Panamericana Televisión report on its show *Las Cosas Como Son*, available at <http://panamericana.pe/lascosascomoson/locales/196344-bonos-agrarios-escandalo-corrupcion-tribunal-constitucional> and <https://www.youtube.com/watch?v=igOWg2DSHeA&feature=youtu.be> (Dec. 13, 2015), as well as <http://panamericana.pe/lascosascomoson/locales/196771-nuevos-documentos-comprueban-escandalosos-casos-corrupcion-tc> and <https://www.youtube.com/watch?v=eR6pg-RKOYI> (Dec. 20, 2015).

<sup>23</sup> See “PJ investiga a relator del TC por falsificación de documentos,” *El Comercio*, (Jan. 7, 2016), <http://elcomercio.pe/politica/justicia/pj-investiga-relator-tc-falsificacion-documentos-noticia-1869235>.

reports have further stated that Lima prosecutors believe that four of the six justices on the Constitutional Court initially approved a decision that updated the Land Bonds using the CPI methodology.<sup>24</sup> Two justices actually signed that decision. However, before the official release of that decision, the draft decision was allegedly altered with white out, and new language was inserted to make that decision appear to be only a dissenting decision by one the two justices that had originally signed it. These developments are still continuing, and it is premature to predict the ultimate resolution of any criminal charges. Nonetheless, because of these developments, the credit rating agencies are now starkly divided as to how to rate Peru's current debt, with one credit rating agency giving Peru a sub-investment grade rating.<sup>25</sup> That rating agency expressed its doubts clearly and concisely:

The confirmation by prosecutors that a final ruling of Peru's highest constitutional court was illegally tampered affirms our serious concern over character in the Peruvian government... This is additionally troubling as this was a significant ruling that adversely affected bondholder rights in connection with a significant sovereign obligation.<sup>26</sup>

Even Moody's, which does not rate the Land Bonds or appear to seriously weigh the ongoing default as a major factor in their rating analysis,<sup>27</sup> recently noted that the Land Bonds are an "unpaid liability of Peru."<sup>28</sup> Put bluntly, although other sovereign issuers have defaulted, I am aware of no instance in which they have done so in quite this lurid, covert and seemingly unlawful fashion. These developments raise the strong possibility that the judicial process in Peru is subject to political pressure and manipulation, at least when legal decisions are politically controversial. Given these issues, investors in the current debt offerings that Peru has registered with the SEC need considerably more detailed disclosures.

Suspicious as this judicial decision was, its implementation by Peru's executive branch raised even more questions. Pursuant to the revised 2013 decision by the Constitutional Tribunal, Peru's Finance Ministry, in January 2014, issued a special directive—widely known as the "Supreme Decree"—which specified a precise dollarization formula to implement the Constitutional Tribunal's decision, along with a detailed procedure that claimants were required

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See also "Juzgarán a ex relator del TC por adulterar fallo sobre bonos," La Republica (Jan. 7, 2016), <http://larepublica.pe/imprensa/politica/731697-juzgaran-ex-relator-del-tc-por-adulterar-fallo-sobre-bonos>.

<sup>24</sup> See sources cited supra at note 22.

<sup>25</sup> Egan-Jones gave Peru a sub-investment grade D rating as of November 17, 2015 on the Land Bonds and a sub-investment BB and BB- rating for its foreign and local currency bonds, respectively. See <https://www.egan-jones.com/public/press/egan-jones-rates-peru-bonds.aspx>. Moody's has maintained an A3 rating. See Mark Melin, "Fraud Charges in Peru Surround Two Very Different Bond Ratings," ValueWalk (Dec. 10, 2015), <http://www.valuewalk.com/2015/12/peru-debt-rating/>.

<sup>26</sup> See PR Newswire supra note 22 (quoting Sean Egan, founder of Egan-Jones Ratings Company).

<sup>27</sup> Despite the default, Moody's currently rates Peru's bonds A3, which is the same rating as countries like Mexico, Malaysia and Lithuania, none of whom have an ongoing default.

<sup>28</sup> Moody's Investors Service, supra note 15.

to follow.<sup>29</sup> Under the parity exchange ratio set forth in the Supreme Decree, if we assume the value of the Land Bonds to be \$5.1 billion under the CPI Methodology (as former Minister Benavides estimated in 2015), that value would decline by over 99.5 % to no more than \$12 to \$24 million under this “dollarization” method.<sup>30</sup> Even worse for the holders of the Land Bonds, the Supreme Decree also provides that (i) no payment need be made to any bondholder for up to seven years, (ii) the Finance Ministry has discretion to choose the payment method (e.g., new bonds or tax credits), (iii) the Finance Ministry may prioritize payments so that creditors who purchased Land Bonds on the secondary market are paid last (or not at all if the Ministry decides that Peru cannot afford the cost), and (iv) holders of the Land Bonds are required to waive their legal rights at the inception of the process before they have the ability to estimate what compensation (if any) that they will receive.<sup>31</sup> Not surprisingly, many bondholders have declined to participate in the process or waive their rights.<sup>32</sup> The prospects for payment on the Land Bonds in the near future remain dim, as the current Finance Minister has not requested any budgetary allocation for such a payment on the Land Bonds in 2016.<sup>33</sup>

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<sup>29</sup> See Supreme Decree No. 17-2014-EF (Jan. 18, 2014), articles 6.1 and 6.2, available at <http://bonosagrarios.pe/wp-content/uploads/2015/03/Decreto-Supremo-017-2014-EF.pdf>, subsequently revised by Supreme Decree No. 19-2014-EF (Jan. 21, 2014), available at <http://bonosagrarios.pe/wp-content/uploads/2015/03/Decreto-Supremo-019-2014-EF.pdf>.

<sup>30</sup> See Deloitte (Peru), “Comparative Analysis of Supreme Decree #017-2014-EF and #019-2014-EF and Economic Value of Land Expropriated During Peruvian Agrarian Reform,” March 2015, cited in the Brief filed by the Asociación de Bonistas de la Deuda Agraria del Perú (ABDA) with the Constitutional Tribunal, March 16, 2015, p. 5, available at <http://bonosagrarios.pe/wp-content/uploads/2015/03/Peticion-de-ABDA.pdf>. See also, “An Analysis of the Formulas for Calculating the Redemption Value of Land Reform Bonds in Peru” by Ivan Alonso and Italo Muñoz (Feb. 2015) (concluding that “on purely mathematical grounds, the [Supreme Decrees] formula is untenable[.]” as it fails the “basic test” “that both sides of the equation be expressed in the same units,” and further confirming that the formula contained in the Supreme Decrees “is inadequate to establish the original dollar value of the bonds, both on economic and mathematical grounds” and that the application of this formula would “substantially underestimate the original value of the bonds”), available at [http://perubonds.org/wp-content/uploads/resources/alonzo\\_and\\_munoz\\_analysis.pdf](http://perubonds.org/wp-content/uploads/resources/alonzo_and_munoz_analysis.pdf).

<sup>31</sup> See Supreme Decree, supra note 29, at articles 17-19 and Final Additional Provisions.

<sup>32</sup> A number of bondholders, including Gramercy and ABDA, an organization consisting of at least 342 bondholders, have been highly critical of, and have vigorously opposed, the government’s actions with respect to the Land Bonds. See Robin Wigglesworth & Andres Schipani, “Hedge fund pressures Peru to pay back 40-year-old debt,” *Financial Times* (Oct. 7, 2015), <http://www.ft.com/intl/cms/s/0/db360686-6ba5-11e5-aca9-d87542bf8673.html#axzz3qdfi8zah>. See also Andres Schipani & Robin Wigglesworth, *Hedge fund threatens Peru over debts to former landowners*, *Financial Times* (Oct. 9, 2015), <http://www.ft.com/cms/s/0/87b557e8-6e96-11e5-8171-ba1968cf791a.html#axzz3qdfi8zah>. More than 100 additional bondholders have also endorsed ABDA’s petition before the Constitutional Tribunal demanding the annulment of the Supreme Decrees, see Appendix C to ABDA’s Brief of March 2015, available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Apendice-C-Lista-de-Bonistas-que-suscriben-el-pedido-de-ABDA.pdf>. See also, Special Report by AmericaTV’s Cuarto Poder on the pernicious effects of the Supreme Decrees over the value of the bonds, titled “The Land Reform Bonds Shredder” (April 27, 2015), available at <https://www.youtube.com/watch?v=ZGQ0enmWzK8>.

<sup>33</sup> On November 10, 2015, Peru’s Finance Minister, Alonso Segura, advised Peru’s Budget Commission that there would be no payments on the Land Bonds in 2016. See “MEF: bonos de la deuda agraria se

Although this treatment of bond holders is little short of confiscatory, its particular relevance for those buying the bonds that Peru has recently marketed in the U.S. and Europe is that it reveals a deep-seated hostility to foreign investors, particularly those who acquire Peru's bonds in the secondary market. Thus, if Peru were to encounter economic difficulties in the future, it might again be prepared to discriminate against foreign and secondary market investors.

Peru's troubled history with its Land Bonds is clearly material to investors who are today considering whether to buy its new debt securities, but Peru has been conspicuously silent about disclosing this history. Indeed, the only explicit discussion of the Land Bonds in any of the prospectuses filed by Peru in 2014 and 2015 is the following highly selective and incomplete statement that is buried in a discussion of the history of Peru's economy:

In 1968, the military government headed by General Juan Velasco Alvarado nationalized numerous private enterprises and conducted a campaign against foreign participation in the Peruvian economy. In 1969, the Velasco administration enacted the *Ley de Reforma Agraria*, or the Agrarian Reform Law, which confiscated large estates from wealthy owners in exchange for long-term bonds issued by Peru, turning the estates into cooperatives run by the former workers of the estates, and adopted high tariffs to shield local industry and manufacturing from foreign competition. *During 2010, there was an increase in the volume of administrative and judicial claims filed against Peru in connection with the payment of amounts due in respect of the bonds issued by Peru pursuant to the Agrarian Reform Law. In accordance with a resolution issued by the Peruvian Constitutional Court in 2013, the executive branch enacted a by-law regulating an administrative procedure through which the debt corresponding to the Agrarian bonds can be brought to present value.*<sup>34</sup>

Minimal as this disclosure is, nothing similar to it appears anywhere in the other prospectuses filed by Peru with the SEC in 2014 and 2015. Even the above disclosure is factually inaccurate, because it ignores that the "administrative procedure" does not bring the "debt corresponding to the Agrarian Bonds" to "present value," but rather largely eradicates it. Thus, it will not end the "increase in the volume of administrative and judicial claims" that it

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pagarán después del 2016," *Gestión* (Nov. 10, 2015), <http://gestion.pe/economia/mef-bonos-deuda-agraia-se-pagaran-despues-2016-2147982>.

<sup>34</sup> See Prospectus Supplement, filed by Republic of Peru, on March 19, 2015, at p. 24, available at <http://www.sec.gov/Archives/edgar/data/77694/000119312515099415/d890012d424b4.htm>.

acknowledges. Above all, Peru's prospectuses duck the critical fact that Peru is and remains in default on the Land Bonds for a period now exceeding 20 years.

## II. An Overview of The Key Omissions and Misstatements

Most failures of disclosure can be characterized as both omissions and misstatements. What is more critical is the facts that have been distorted. Here, the basic disclosure failures include:

1. Peru Defaulted On a Large Debt and Has Remained in Default for Over 20 Years. The foregoing disclosure in a "History and Background" section seeks to characterize Peru's default as if it were a negotiated workout that has been resolved through an "administrative procedure" that restores the Land Bonds to their "present value." But in fact no resolution has been achieved or is in prospect. Moreover, Peru seems to be in denial over its default, ignoring it in other recent prospectuses filed by Peru with the SEC (i.e., there is no mention of these same facts in the October 28, 2015 or the August 18, 2015 prospectuses).

The fact of a default on a major debt obligation overshadows virtually any other fact about a sovereign issuer, including the status of its economy. As Sean Egan, the founder of Egan-Jones Rating Company, Inc., said as recently as November 17, 2015 about Peru and its debt:

In this case, you have evidence the obligor has the ability to pay yet not the willingness to pay all of their obligations on time and in full...We've been rating bonds since 1995 and we have seen a lot...This is the far end of the spectrum because there has been an acknowledgement that this is a valid obligation that is being ignored.<sup>35</sup>

In short, it matters little if a nation is financially capable of meeting its debt obligations if it has chosen not to do so. That appears to be the choice that Peru has made to date.

2. Peru Has Covered Up Its Failure to Pay With A Transparent Disguise That An Administrative Resolution Has Ended Its Default. Bad as a continuing default is, an even worse signal for investors is that a sovereign issuer covers it up. The Supreme Decree in 2014 that asks debt holders to waive all rights before they learn if they are to be compensated at all and subordinates some holders to others at the discretion of the government amounts to such a cover-up. It is less a compromise than an aggressive attempt to coerce investors into acquiescence. Nor has it worked, as few debt holders have accepted this offer. As controversy grows over the status of the Land Bonds and criminal charges of falsification of judicial records in connection therewith await trial, this continuing negative publicity seems likely to impact the newer debt securities that Peru is now selling.<sup>36</sup>

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<sup>35</sup> See Mark Mellin, supra note 25 (quoting Sean Egan).

<sup>36</sup> See sources cited supra at notes 21 and 22.

Peru's disingenuousness in this respect contrasts sharply with the greater candor shown by Argentina, which has recognized that it is in default and that numerous adverse consequences may befall it as a result. Following its default, Argentina disclosed bluntly:

Argentina's default on its public indebtedness has prompted creditors to file a number of lawsuits in the several countries, many of which have resulted in judgments against Argentina, and the possibility of continued litigation and additional judgment could have a material impact on Argentina's public finances and or about to pay our public debt.<sup>37</sup>

Argentina then listed these various judgments, lawsuits, and arbitration actions, and concluded with the warning:

We can offer no assurance that the Government will prevail in the remaining ICSID claims or in the enforcement proceedings. Rulings against the Government in these and future proceedings could result in the execution, attachment or injunction of assets of Argentina, or assets alleged by the claimants to be property of Argentina...and could have a material adverse effect on public finances, the market price of our securities, and our ability to service our debt.<sup>38</sup>

All these adverse consequences also loom for Peru, which has failed to disclose them.

3. The Integrity of Peru's Judicial System and the Enforceability of Legal Claims Against Peru Have Been Cast Into Severe Doubt by the Pressure Placed by the Government on the Constitutional Court. Although Argentina has also defaulted, the integrity of its judicial system has not been similarly compromised. The fabrication of a judicial decision is a bizarre and unprecedented event that may tarnish Peru's reputation as a responsible, commercially sophisticated nation for some time. Moreover, it raises the prospect that the executive branch in Peru will continue to compel its judiciary to rationalize a de facto renunciation of Peru's debt (or at least that owed to some classes of investors). This is an independent risk for investors in Peru's debt that is quite distinct from Peru's ability to pay.

4. Peru Appears Prepared to Discriminate Against Foreign Creditors and Creditors Who Purchased in the Secondary Market. Under the Supreme Decree, Peru claims the right to prioritize payments retroactively, effectively subordinating some holders to others. In particular, it has revealed a hostility to those buying its bonds in the secondary market. If full and fair disclosure were made in this respect, it would chill the willingness of investors to buy Peruvian debt in the secondary market. In turn, this would predictably dry up the secondary market. It would also demonstrate to investors who purchased (or will purchase) bonds in the primary offering that they would not have access to buyers in any secondary market (except possibly at

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<sup>37</sup> See Republic of Argentina, Prospectus Supplement, dated April 28, 2010, at p. 11, available at [http://www.sec.gov/Archives/edgar/data/914021/000090342310000252/roa-424b5\\_0428.htm](http://www.sec.gov/Archives/edgar/data/914021/000090342310000252/roa-424b5_0428.htm).

<sup>38</sup> Id. at p. 11.

very steep discounts). But no such disclosure has been made by Peru. Worse yet, Peru faces serious economic problems and a Presidential election in the near future.

In its most recent 18-K, Peru describes the commencement of its last external default as follows:

The debt crisis throughout Latin America, which started in 1982, resulted in a growing unwillingness of foreign commercial banks to lend to Peru. At the same time, a sharp decrease in the export prices of mining products and the 1982 – 1983 *El Niño* phenomenon led to a deterioration in Peru's balance of payments and fiscal accounts, which made it difficult for Peru to service its debt. Faced with an unsustainable debt burden, the Government suspended payment on its external commercial bank debt in 1984. By the end of 1984, Peru had failed to make scheduled payments of U.S.\$1.0 billion in principal and interest on its commercial bank debt.<sup>39</sup>

This chain of events is eerily similar to the current situation in Peru. Latin America is in the midst of a potential mini-debt crisis, with Argentina currently in default on its external debt and Venezuela and Brazil both appearing to be subject to severe economic and political strain. In addition, commodity prices have fallen substantially around the globe,<sup>40</sup> in part as China has reduced its purchases.<sup>41</sup> Peru's economy is essentially commodity-driven<sup>42</sup> and, as Peru noted in its 18-K, "a sharp decrease in commodity prices may adversely affect Peru's economy."<sup>43</sup> Peru is also threatened by a particularly severe "El Niño" this year, which could greatly reduce agricultural production.<sup>44</sup> As a result, Peru has begun to experience a deterioration in its balance of payments and fiscal accounts.<sup>45</sup>

In a depressed economy, payment of the Land Bonds would be more difficult and might become more politically contentious. All this implies that fuller disclosure is necessary as to the

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<sup>39</sup> Republic of Peru, 18-K (Aug. 8, 2015), p. D-114, available at <http://www.sec.gov/Archives/edgar/data/77694/000119312515294043/d17928dex99d.htm>.

<sup>40</sup> See Bloomberg, <http://www.bloomberg.com/markets/commodities>.

<sup>41</sup> See General Administration of Customs, People's Republic of China, <http://english.customs.gov.cn/newsroom/statisticsdetail/f78db55a-9c8f-4147-a714-3e5403563622>.

<sup>42</sup> See Central Bank of Peru, <http://www.bcrp.gob.pe/statistics.html>.

<sup>43</sup> See Republic of Peru 18-K, supra note 39, at p. D-6.

<sup>44</sup> See Peru: Weathering Turbulence, Institute of International Finance (Nov. 10, 2015). See also Paul Cashin, Kamiar Mohaddes and Mehdi Raissi, Fair Weather or Foul? The Macroeconomic Effects of El Niño, IMF Working Paper WP/15/89 (April 2015), available at <https://www.imf.org/external/pubs/ft/wp/2015/wp1589.pdf>.

<sup>45</sup> See Central Bank of Peru, supra note 42.

steps that have been taken (formal and informal) by Peru to evade its contractual commitments and the intentions of its political leaders with regard to the Land Bonds. Further, Peru's lack of disclosure may be a principal reason why some credit rating agencies have not reduced their ratings on Peru's sovereign debt. That is, they are conveniently ignoring the growing cloud over Peruvian credit, but would be compelled to face reality if Peru candidly disclosed the material facts.

5. Peru Has Described Its Debt History In Material Misstatements That Falsely Gloss Over Its Default and Deny That a "Dispute" Even Exists. In perhaps the clearest example of a misstatement, Peru has described its debt history in its prospectuses in terms that are diametrically inconsistent with the actual facts:

*Since the Brady restructuring in 1997, Peru has, except as described below, timely serviced its external debt without default.*

Upon completion of the Brady restructuring, Peru ceased paying principal and interest to lenders who did not participate in the restructuring. These lenders included Elliot Associates, L.P., a private investment firm that acquired U.S \$20.0 million in debt issued by Peru. Elliot Associates obtained a U.S \$55.7 million judgment against Peru for non-payment of interest and an attachment of Peru's funds held at Chase Manhattan Bank of New York that Peru had allocated for interest payments on its Brady Bonds. As a result of the attachment, on September 7, 2000, Peru failed to make a required interest payment of U.S \$80.0 million on the Brady Bonds, even though it had deposited the requisite amount in its account at Chase Manhattan Bank of New York.

On September 26, 2000, Elliot Associates obtained an injunction against the Euroclear System clearing agency that prevented it from receiving or distributing funds provided by Peru to pay interest on the Brady Bonds. The Elliot Associates litigation was settled following the issuance of the injunction against the Euroclear System, and Peru made interest payments on the Brady Bonds on October 4, 2000, within the applicable 30-day grace period. Peru has made all of its debt payments to Elliot Associates in accordance with the terms of the settlement.

Other creditors also failed to participate in the Brady restructuring for reasons that included failure to provide the required documentation and failure to

identify the actual holder of the debt to be exchanged. Since the Brady Bond restructuring, Peru has been in default on payments to these creditors. As of December 31, 2011, there were no further scheduled amortizations or interest payments on these debts. None of these creditors has submitted claims against Peru for overdue amounts.

*As of the date of this prospectus, Peru is unaware of any other claims filed against it, in Peru or abroad, for overdue debt payments and Peru is not involved in any disputes with its internal or external creditors.*<sup>46</sup>

Here, Peru's statements appear to be categorically false. Under this description, the unpaid holders of Peru's Land Bonds have seemingly vanished in the eyes of Peru because they have not "submitted claims against Peru for overdue amounts." In fact, the government of Peru is quite aware of numerous lawsuits and "claims" filed in Peru. In fact, Peru has, on multiple occasions, formally acknowledged that these claims exist.<sup>47</sup> Moody's has also publicly noted that these disputes exist and are ongoing.<sup>48</sup> Peru also must know that it is very much involved in a "dispute" with external creditors, again including Gramercy. One cannot help but conclude that these misstatements are intentional.

### III. Liability and Remedies

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<sup>46</sup> See Republic of Peru, Prospectus Supplement, dated October 27, 2015 at p. 1.

<sup>47</sup> Peru has disclosed through responses to public information requests the existence of at least 400 local judicial proceedings against either the Ministry of Economy and Finance or the Ministry of Agriculture and Irrigation deriving from the non-payment of the land reform debt. See Memorandum N° 522-2014-EF-52.04 dated 9 December 2014 listing at least 350 trials in Peruvian courts, including in *Lima, Lampayaque, La Libertad, Chiclayo, Pisco, Ica, Cajamarca, Abancay* and *Piura*, available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Memo-No-552-2014-EF52-9.12.2014.pdf>; Memorandum 1379-2005-MINAGRI-OGA dated 17 September, 2015, providing a list of 47 trials in which final decisions have been issued but for which Peru has not paid the judgment, available at <http://bonosagrarios.pe/wp-content/uploads/2016/01/Memo1379-2015.pdf>. See also Robin Wigglesworth & Andres Schipani (Oct. 7, 2015), supra note 32; Andres Schipani & Robin Wigglesworth (Oct. 9, 2015), supra note 32; Paul Kilby & Davide Scigliuzzo, "Peru will stick to local law in debt dispute: Finance Minister," Reuters (Oct. 11, 2015), <http://www.reuters.com/article/2015/10/11/peru-bonds-gramercy-idUSL1N12A0J220151011>; Javier Parker & Javier Priale, "MEF: "De no haber implementado programas sociales habría aumentado la pobreza," Gestión (Oct. 13, 2015), (Alonso Segura indicated that some bondholders will file lawsuits against Peru because they are not content with the compensation afforded to them), available at <http://gestion.pe/economia/no-implementado-programas-sociales-habria-aumentado-pobreza-2145309>.

<sup>48</sup> See Moody's Investors Service supra note 15.

To establish liability in a private civil action, a private plaintiff in a securities lawsuit under U.S. federal law is normally required to plead and prove scienter—that is, an intent to defraud, which can be demonstrated by showing a severe recklessness or indifference to the truth or accuracy of the defendant’s public statements.<sup>49</sup> From my distant vantage point, I lack sufficient information to opine as a matter of law that all of Peru’s misstatements and omissions with regard to the Land Bonds were made with scienter (as opposed to only gross negligence). Although some of these misstatements or omissions do seem intentional, this point ultimately matters little with respect to Peru’s recent sales in 2014 and 2015 of the bonds that it registered with the SEC, for two reasons:

First, both Sections 11 and 12(a)(2) of the Securities Act of 1933 apply to registered sales of securities, and neither requires the plaintiff to prove scienter or even negligence.<sup>50</sup> Indeed, Peru, as the issuer of these bonds, would be strictly liable under Section 11, and under Section 12(a)(2), it would only have a hard-to-establish due diligence defense. All that the plaintiff must prove to make out a prima facie case is the materiality of the misstatement or omission, which issue has been discussed above.

Second, the SEC can, itself, sue for a material misstatement or omission with respect to Peru’s offerings in 2014 and 2015 under Section 17(a)(2) and (3) of the Securities Act of 1933,<sup>51</sup> and these provisions do not require it to prove scienter. All that must be shown by the SEC is the materiality of the misstatement or omission. In addition, the SEC is authorized under Section 8(d) of the Securities Act of 1933 to enter a “stop order” that suspends the effectiveness of a registration statement.<sup>52</sup> The entry of such a “stop order” would effectively prevent many brokers or dealers from trading the bonds registered under the registration statement that has been suspended by the “stop order.”<sup>53</sup> Alternatively, the Commission could bring a cease-and-desist proceeding against an issuer that has made a material misstatement or omission in a registration statement (or otherwise violated the federal securities laws), and this proceeding could impose monetary penalties on an issuer or require disgorgement and future compliance with the securities laws.<sup>54</sup> Again, the SEC would not be required to prove scienter in any such proceeding, as it could rely on Section 17(a)(2) and (3) of the Securities Act of 1933.

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<sup>49</sup> Under Rule 10b-5, which is the principal antifraud remedy under the federal securities laws, the plaintiff must allege scienter. See Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

<sup>50</sup> Under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, the issuer is strictly liable if there is a material misstatement. Under Section 12(a)(2), 15 U.S.C. § 77l, the issuer has an affirmative defense requiring it to prove that it was adequately diligent in its review of the statements made in the registration statement.

<sup>51</sup> Section 17(a)(2) and (3) of the Securities Act of 1933, 15 U.S.C. §77q(a)(2) and (3).

<sup>52</sup> See Section 8(d) of the Securities Act of 1933, 15 U.S.C. §77h(d).

<sup>53</sup> Underwriters and dealers would violate Section 5 of the Securities Act of 1933 if there were not an effective registration statement for a public offering of securities, as they could not avail themselves of the exemption in Section 4(a)(1) of the Securities Act of 1933, 15 U.S.C. §77d(a)(1). Brokers who filled unsolicited orders to buy or sell might still be able to use the exemption in Section 4(a)(4) of the Securities Act of 1933, 15 U.S.C. §77d(a)(4).

<sup>54</sup> See Section 8A of the Securities Act of 1933, 15 U.S.C. 77h-1.

#### IV. Conclusion

The bottom line is that the SEC has a number of remedies available to it. In deciding whether to exercise these remedies, the SEC might look to a variety of equitable factors. One such factor that should be given special weight is whether trading is occurring in the security as to which the misstatements or omissions were made. Here, Peru has issued several classes of its bonds in 2014 and 2015 in the U.S. and Europe. Although bonds do not trade with the frequency of equity securities, they do trade (especially in over-the-counter “screen trading” with the original underwriters and dealers in the initial offering usually serving as the market maker).<sup>55</sup> Such secondary trading is likely to be among investors having various levels of knowledge of the material facts relating to the status of the Land Bonds and their potential impact on Peru’s other debt offerings—that is, some investors will be informed, some not. Put more simply, the playing field is not level, and this is a factor that would normally be considered (and in the past has been considered) by the SEC in determining whether to exercise its powers.

Of course, it is also possible that the SEC might be reluctant to sue or take action against a sovereign nation, particularly one on friendly terms with the United States. Under some circumstances, such reluctance might be prudent. But the instant circumstances involve special and highly unusual factors, including (1) a potentially massive political scandal, (2) sharp disagreements among the credit rating agencies as to Peru’s creditworthiness, (3) the unique case of an issuer that can pay, but will not pay, its debt, which indebtedness its own courts have held to be valid under local law, (4) wide differences in the knowledge that informed and uninformed investors possess about Peru’s debt securities and the current investigation, and (5) the likelihood that Peru will continue to avail itself of US capital markets in the future. In such a context, it would be an unfortunate departure from past precedents for the SEC to tolerate Peru’s continuing failure to disclose either its refusal to honor the Land Bonds or the highly suspicious, even bizarre circumstances surrounding the judicial decision permitting Peru to depart from its CPI methodology. In an environment where (i) even the credit rating agencies cannot agree, (ii) Peru’s more recent debt securities are actively trading, and (iii) Peru is reasonably likely to issue new debt in 2016, the SEC needs either to take action to ensure that investors are informed—or to halt trading.<sup>56</sup>

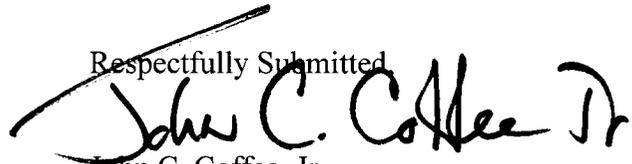
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<sup>55</sup> According to one independent trading platform, during the six-month period ending January 8, 2016, there were over 700 trades involving Peru’s 2.750% Euro-denominated bonds due 2026, 4.125% U.S. Dollar-denominated bonds due 2027, and 5.625% U.S. Dollar-denominated bonds due 2050, with total volume of approximately \$500 million..

<sup>56</sup> See Law N° 30374, providing Peru the right to issue up to \$2.25 billion in external bond debt in fiscal year 2016, available at [http://www.mef.gob.pe/index.php?option=com\\_content&view=article&id=2327&Itemid=101158&lang=es](http://www.mef.gob.pe/index.php?option=com_content&view=article&id=2327&Itemid=101158&lang=es). Also available at [http://bonosagrarios.pe/wp-content/uploads/2016/01/Ley\\_30374-6.12.2015.pdf](http://bonosagrarios.pe/wp-content/uploads/2016/01/Ley_30374-6.12.2015.pdf).

See also, EM Debt: Technicals Monitor, Deutsche Bank Markets Research (Dec. 9, 2015), p. 5.

Respectfully Submitted

A handwritten signature in black ink that reads "John C. Coffee Jr". The signature is written in a cursive style with a large, sweeping initial "J".

John C. Coffee, Jr.  
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