**Hedge Fund Challenges Peru on Land Bonds**

Tactics are similar to those used in Argentina, Greece and Iceland

By

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A Connecticut hedge fund is waging a campaign to make Peru pay off land bonds it defaulted on two decades ago, echoing financial firms’ tactics in recent years in Argentina, Greece and Iceland.

About a decade ago, Gramercy Funds Management LLC began buying agrarian bonds held mostly by Peruvians who received them when their family farms were expropriated by the government in the 1960s. Gramercy bought about 20% of the bonds at a fraction of their face value and now says it is owed more than $1 billion, according to people familiar with the matter.

The government disputes that figure, and successive administrations have ignored Peruvian court orders to pay up. At issue is how to adjust bondholder claims for decades of inflation and missed interest payments, with bondholders saying they are owed about $5 billion and the government calculating a far lower sum. Peru stopped paying on the bonds by 1992 in the aftermath of the Latin American debt crisis.

When Peru passed a decree in January 2014 to pay less than 10% of what bondholders say they are owed, Gramercy sent an executive to Lima to push for a settlement. He received a three-word answer from a government official, according to a person briefed on the matter: “Make us care.”

Gramercy, with $6 billion under management, responded by hiring lobbying firm Podesta Group to sway U.S legislators to support bondholders, joining local bondholder groups and waging a media campaign at the International Monetary Fund’s October meetings in Lima.

Now, the firm has obtained a legal opinion accusing Peru of violating U.S. securities regulations in an effort to spur the U.S. Securities and Exchange Commission to sanction Peru. A spokeswoman for the SEC declined to comment.

Peru is subject to SEC regulation because it borrows in global markets by issuing bonds governed by New York law, an option it likely prefers to keep open at a time when a global plunge in commodities prices has caused budget deficits.

It’s not unusual for hedge funds to squeeze cash-strapped governments to pay defaulted bonds. [Paul Singer](http://topics.wsj.com/person/S/Paul-Singer/1093)’s Elliott Associates used that strategy to force Peru to repay bonds in 2000 and has been fighting a similar action against Argentina since 2004.

This fight is different because Peru is in strong financial shape—its single-A credit rating ranks it above Ireland and Italy—and because most of the bondholders demanding repayment are locals.

“We haven’t lost hope of getting paid,” said 72-year-old Ed Aedo, who said his family is owed as much as $8 million on bonds his late father received in exchange for his alpaca ranch almost five decades ago. “Even if we don’t enjoy it ourselves, we will see our children enjoy it,” said Mr. Aedo, who has spent about $15,000 in expenses on the fight.

International attention is unlikely to push Peru to pay under the rule of President Ollanta Humala but could work after he is replaced in general elections this year, Mr. Aedo said.

So far, buyers of Peru’s international bonds see Gramercy’s campaign as little more than a sideshow. A 10-year bond the country issued in October traded this week at a yield of 2.4%, about the same as bonds of blue-chip corporations like [Johnson & Johnson](http://quotes.wsj.com/JNJ).

“We quite like Peru,” said Koon Chow, a senior macro and foreign exchange strategist at Union Bancaire Privée, citing Peru’s economic growth, tight fiscal policy and substantial reserves. He said the country has the money to pay any judgment if a new government decides to do so.

When hedge funds buy defaulted sovereign debt, they typically buy international bonds so they can fight the countries in U.S. or European courts, hampering the debtors’ access to global markets. But the land bonds are governed by Peruvian law.

Gramercy hired Columbia Law School professor John Coffee to provide a legal opinion on Peru’s disclosures to investors. According to Mr. Coffee, Peru violated the Securities Act of 1933 in October when it issued a €1.1 billion ($1.2 billion) bond, telling investors in offering documents that the country was “not involved in any disputes with its internal or external creditors.”

Land bondholders have filed at least 450 lawsuits seeking payment from the government, according to a document provided by Peru’s Ministry of Economy and Finance to Gramercy’s lawyers.

Peru “is diligent in its management of debt issuances and disclosures,” a government official said.

Debate has dragged on about how much is owed on the bonds because they are denominated in a now-defunct currency Peru used before several bouts of hyperinflation. Peru contends it is willing to repay bondholders in compliance with a July 2013 ruling by the country’s highest court valuing claims at no more than $24 million, according to Mr. Coffee.

A scandal over the 2013 court decision erupted last summer after one of the judges involved said the ruling itself had been falsified using whiteout and that he was barred from posting his dissenting opinion on the matter. A public prosecutor is now conducting a criminal investigation of the ruling.

*—Carolyn Cui and Ryan Dube contributed to this article.*