

10 REASONS WHY *NML v. ARGENTINA* MATTERS

TO ALL

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After a severe economic, political and social crisis, Argentina was forced to default on its debt in 2001. Under a new government, Argentina successfully restructured almost 93% of its debt and has serviced that restructured debt ever since. However, a small minority of bondholders have not yet agreed to the terms accepted by the overwhelming majority of creditors who participated in Argentina's exchange offers because they seek privileged and unwarranted conditions. Some of these holdouts are suing Argentina before U.S. courts and are determined to disrupt the flow of payments to the creditors who participated in Argentina's exchange offers.

Sovereigns, multilateral institutions like the IMF, and experts have all stated that the consequences of this case go well beyond Argentina and the plaintiffs. The future of all sovereign debt restructurings is at stake.

Chronology

2001

Sovereign debt default.
Public debt as a percentage of GDP reached 166% in 2002.

2003

President Nestor Kirchner takes office. Negotiations begin with creditors of 152 different bonds series issued in 7 currencies under several jurisdictions.

2005

First debt swap: Argentina restructures its debt with 76.1% of creditors.

2010

Second debt swap: Under the Presidency of Cristina Fernández de Kirchner, Argentina makes a second offer under the same terms of the 2005 debt swap. Including both swaps, Argentina restructures its debt with almost 93% of its creditors; 7% of creditors decided to hold out.

2013

Argentina suspends the Lock Law (designed to ensure that holdouts would not be treated better than exchange bondholders) indefinitely, once again allowing the holdouts to accept an exchange offer under the same terms that approximately 93% of defaulted debt holders accepted. Argentina's public debt as a percentage of GDP stands at 44%.

1 What is the case NML v Argentina about?

- There is no sovereign bankruptcy regime. Unlike private companies, sovereigns cannot declare bankruptcy when their debts become unsustainable. When a company files for bankruptcy and reaches an agreement with a certain threshold of its creditors, no minority creditor can block the debt restructuring process, much less threaten to deprive those creditors who negotiated in good faith of property that belongs to them.
- Sovereign financial crises have been a regular feature of modern international finance. In the last fifteen years alone, significant financial crises have been experienced by a long list of widely varied countries, both developing and developed economies.
- Argentina followed established international practice by voluntarily restructuring its debt under the principle of inter-creditor equity, which requires that all similarly-situated holders of defaulted debt be treated equally. However, current court rulings are threatening to turn both inter-creditor equity and established principles of sovereignty on their head.
- A minority of professional litigants is attempting to obtain privileged conditions, consecrating inequality amongst bondholders. The case will determine whether a minority of debt profiteers will be able to secure a new weapon that would empower hold-out creditors around the world to threaten the flow of payments to bondholders who accept debt restructurings, which in turn would render such restructurings virtually impossible in the future. What bondholder would participate in a debt restructuring if they knew that the flow of payments to them could be disrupted by a minority of holdouts through litigation?

2 Why are these plaintiffs known as “vulture funds” and what is their claim?

- Led by NML Capital Ltd., a Cayman Islands hedge fund, plaintiffs in this case are primarily “vulture funds” that represent a small proportion of the 7% of holdouts. “Vulture funds” exploit the absence of a sovereign bankruptcy regime and seek windfall profits by buying distressed debt at steep discounts, then suing to enforce its original terms while ignoring any restructuring efforts and harassing good-faith creditors in the process. In fact, in the Argentine case, a significant part of the plaintiffs’ holdings was purchased many years after the default occurred at pennies on the dollar.
- Plaintiffs have continuously rejected the restructuring terms accepted by the overwhelming majority of Argentina’s creditors because they seek privileged conditions (payment in full of original nominal amounts plus interests). These litigants not only sued Argentina before U.S. courts, but are insisting that Argentina be forced not to pay the other 93% of creditors holding restructured debt unless they are paid in full based on a novel and counterintuitive reading of a boilerplate provision, the *pari passu* clause.
- As shown by public registries, the litigants have spent millions of dollars in lobbying and PR campaigns against Argentina. These campaigns utilize false and outright misleading information.
- “Vulture funds” often use aggressive and bad faith tactics to reach their goals. They follow a strategy of legal harassment, abusing the legal systems around the world. Argentina was forced to litigate in the courts of France, the United States, Belgium and Switzerland in order to stop “vulture funds” from seizing diplomatic and military bank accounts and other property protected by international law such as the reserves from Argentina’s Central Bank held at the Federal Reserve Bank of New York (FRBNY) and the Acquarius SAC.D Satellite in California (part of an Argentine-US project with NASA), among many others.
- The most recent and notorious example was the seizure of the Argentine naval vessel “ARA Libertad” in the Port of Tema, Ghana, by NML, which was released by a unanimous ruling of the United Nations International Tribunal of the Law of the Sea.

3 What is Argentina's position?

- Argentina has never repudiated its debt and is committed to treating all bondholders equally, including these litigants.
- In 2001, Argentina's indisputable inability to pay its sovereign debt forced it to defer payments on approximately US\$80 billion in bonds. Since 2003 a new government has implemented a successful debt management strategy under the premise that it was necessary to resume economic growth in order to be able to service debt. After two highly successful restructuring processes in 2005 and 2010, Argentina restructured its debt with almost 93% of its creditors. The debt swap was based on the country's effective payment capacity. The participants received new, performing debt instruments that Argentina has consistently and timely serviced ever since.
- In September 2013, Argentina suspended indefinitely its Lock Law (which was designed to ensure that holdouts would not be treated better than exchange bondholders), once again allowing holdouts to accept an exchange offer under the same terms accepted by approximately 93% of defaulted debt holders.
- Argentina remains committed to finding a solution for all bondholders following the principle of inter-creditor equity.

4 What has the U.S. stated about this case in its *amicus* briefs before New York courts?

- The U.S. has submitted two *amicus* briefs in support of Argentina's position.
- In its briefs the U.S. has warned about the systemic consequences of this case and its impact on U.S. interests in the following terms:
 - "Voluntary sovereign debt restructuring will become substantially more difficult, if not impossible, if holdout creditors are allowed to use novel interpretations of boilerplate bond provisions to interfere with the performance of a restructuring plan accepted by most creditors and to dramatically tilt the incentives away from consensual, negotiated restructuring in the first place."ⁱ
 - "Notwithstanding recent developments in sovereign debt contracts that promote collective action by creditors, the district court's interpretation of the *pari passu* provision could enable a single creditor to thwart the implementation of an internationally supported restructuring plan, and thereby undermine the decades of effort the United States has expended to encourage a system of cooperative resolution of sovereign debt crises. Allowing creditors recourse to such an enforcement mechanism would have adverse consequences on the prospects for voluntary sovereign debt restructuring, on the stability of international financial markets, and on the repayment of loans extended by international financial institutions ("IFIs")."ⁱⁱ
 - "Because the district court's interpretation of the *pari passu* clause disrupts settled expectations concerning the scope and effect of boilerplate language contained in many sovereign debt instruments, it is contrary to U.S. policy interests."ⁱⁱⁱ
 - "In addition, the decision could harm U.S. interests in promoting issuers' use of New York law and preserving New York as a global financial jurisdiction."^{iv}
 - "The decision could encourage issuers to issue debt in non-U.S. currencies in order to avoid the U.S. payments system, causing a detrimental effect on the systemic role of the U.S. dollar."^v

5 What did the New York courts rule?

- Based on an outlier and deeply flawed interpretation, U.S. courts have concluded so far that Argentina breached the *pari passu* clause. This radically new judicial interpretation implies that a sovereign cannot pay creditors who have accepted an exchange offer unless holdouts from the exchange offer are paid in full, effectively granting privileged conditions to holdout creditors. This counterintuitive interpretation of a boilerplate provision upsets settled financial market expectations and threatens all future sovereign debt restructurings.
- The courts have also ruled that Argentina must pay the full amount of the judgment (US\$1.33 billion corresponding to principal plus interest) to the plaintiffs whenever it services the restructured debt. Thus, the plaintiffs were granted a remedy that would allow them to disrupt the flow of payments to the 93% of bondholders who participated in the restructurings.
- The court stayed (suspended) the enforcement of its decision pending a petition for a writ of certiorari before the U.S. Supreme Court. On February 18th, 2014, Argentina asked the U.S. Supreme Court to review these rulings (case “Republic of Argentina vs. NML Capital LTD” Docket N° 13-990).

6 Why is Argentina’s case not unique?

- The *pari passu* clause in Argentina’s bonds is a standard clause that appears in virtually all modern sovereign bonds often with materially identical language.^{vi}
- The courts’ rulings in the case will therefore have consequences for almost every sovereign that issued international debt over the past 30 years. As eloquently stated by a panel of economic experts, “[...] recent rulings in New York may give creditors the first broadly replicable remedy against sovereign debtors since the days of gunboat diplomacy a century ago.”^{vii}

7 What are the IMF’s and the international community’s views on this case?

- The International Monetary Fund (IMF) has warned about the rulings’ consequences for the international financial system. In a document approved by its Board of Directors, the IMF stated that:
 - “[...] ongoing litigation against Argentina could have pervasive implications for future sovereign debt restructurings by increasing leverage of holdout creditors.”
 - “[...] the Argentine decisions, if upheld, would likely give holdout creditors greater leverage and make the debt restructuring process more complicated for two reasons. First, by allowing holdouts to interrupt the flow of payments to creditors who have participated in the restructuring, the decisions would likely discourage creditors from participating in a voluntary restructuring. Second, by offering holdouts a mechanism to extract recovery outside a voluntary debt exchange, the decisions would increase the risk that holdouts will multiply and creditors who are otherwise inclined to agree to a restructuring may be less likely to do so due to inter-creditor equity concerns.”^{viii}
- In addition to the opinion of the IMF and to the *amicus* briefs presented by the U.S. Government, the Republic of France has also submitted an *amicus* brief before U.S. courts. International experts and organizations including the G77 plus China, Nobel Laureate Joseph Stiglitz, Professor Nouriel Roubini, former Finance Minister of Colombia, José Antonio Ocampo and Jubilee USA Network, among many others, have also supported Argentina’s position underscoring the potential negative implications of this case for the global financial system.^{ix} In addition, the Community of Latin American and Caribbean States (CELAC; comprised of the 33 countries in the region), recently highlighted the importance of guarantying orderly debt restructuring processes.

8 Why are the court's decisions at odds with the U.S. Foreign Sovereign Immunities Act (FSIA)?

- The plaintiffs are not only threatening to disrupt inter-creditor equity but are also meddling with sovereign assets that are specifically protected under U.S. law. According to the U.S. Foreign Sovereign Immunities Act (FSIA), foreign State property is immune from attachment, arrest and execution except if it is located in the United States and being used for commercial activity in the United States. State property located outside the United States lies beyond the reach of a U.S. court's enforcement authority.
- These court's decisions run contrary to the text, structure, history and purpose of the FSIA: they coerce a foreign State into paying money damages with immune assets located outside the United States.
- The court rulings not only purport to exercise jurisdiction over foreign State property, but also have the effect of dictating to a sovereign State its sovereign debt policy within its own territory, with obvious potential for creating tensions in foreign relations.

9 Why can't Collective Action Clauses (CACs) solve the problem?

- While the plaintiffs have insisted that Collective Action Clauses (CACs) would solve any holdout problems, experts have clearly stated that this is false. Even when bonds contain CACs, a small minority of holdouts can still block an entire debt restructuring process.
- First, many sovereign bonds around the world do not have CACs. The most conservative estimates show that the outstanding stock of bonds without CACs amount to between US\$329 billion and US\$593 billion.
- Second, CACs in most international bonds do not prevent hold-out creditors from buying up blocking positions in single series of bonds, effectively preventing any debt restructuring of that series. Indeed, recent evidence from Greece's debt restructuring shows that "[...] of thirty-six bonds governed by foreign (English) law containing collective action clauses that were eligible to participate in the debt exchange, only seventeen bonds were able to be successfully restructured using collective action clauses. [...] Hold-out creditors prevented the operation of the collective action clauses in the remaining bonds, amounting to approximately EUR 6.5 billion in un-restructured claims, or thirty percent of the total value of bonds governed by foreign law."^x

10 How are the rights of bondholders affected?

- These court rulings threaten to disrupt the flow of payments to the close to 93% of bondholders who accepted Argentina's debt restructuring offer and have been collecting payments ever since. Holders of this debt include many U.S. taxpayers such as institutional investors, teachers associations, pension funds and universities. Therefore, the rulings inequitably prioritize the interests of a group of private litigants holding a small fraction of the Argentina's total debt over those of the overwhelming majority of Argentina's bondholders.
- The current rulings also negatively affect other third parties such as transfer or paying agents, including those located outside the United States.

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- i. Brief for the United States of America as *amicus curiae* in support of reversal (April 4, 2012). This brief was filed before the United States Court of Appeals for the Second Circuit (New York) in the case NML vs. Republic of Argentina, case 12-105.
 - ii. Brief for the United States of America as *amicus curiae* in support of reversal (April 4, 2012). This brief was filed before the United States Court of Appeals for the Second Circuit (New York) in the case NML vs. Republic of Argentina, case 12-105.
 - iii. Brief for the United States of America as *amicus curiae* in support of reversal (April 4, 2012). This brief was filed before the United States Court of Appeals for the Second Circuit (New York) in the case NML vs. Republic of Argentina, case 12-105.
 - iv. Brief for the United States of America as *amicus curiae* in support of the Republic of Argentina's petition for panel rehearing and rehearing en banc (December 28, 2012). This brief was filed before the United States Court of Appeals for the Second Circuit (New York) in the case NML vs. Republic of Argentina, case 12-105.
 - v. Brief for the United States of America as *amicus curiae* in support of the Republic of Argentina's petition for panel rehearing and rehearing en banc (December 28, 2012). This brief was filed before the United States Court of Appeals for the Second Circuit (New York) in the case NML vs. Republic of Argentina, case 12-105.
 - vi. Weidemaier, M., Scott, R. and Gulati, M. (2013), Origin Myths, Contracts, and the Hunt for *Pari Passu*. *Law & Social Inquiry*, 38: 72-105. doi: 10.1111/j.1747-4469.2012.01313.x
 - vii. "Revisiting Sovereign Bankruptcy", Committee on International Economic Policy and Reform, "Chapter 3: Argentina and the Rebirth of the Holdout Problem", Brookings Institution, October 2013.
 - viii. Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework, International Monetary Fund—IMF—(April 26, 2013)
 - ix. See "The Systemic Consequences of Argentina's Sovereign Debt Case. What Experts are Saying", www.embassyofargentina.us, November 2013, Embassy of Argentina (Washington DC).
 - x. Brief for the Republic of France as *amicus curiae* in support of the Republic of Argentina's petition for a writ of certiorari (July 26, 2013). This brief was filed before the Supreme Court of the United States in the case Republic of Argentina v. NML (Docket Number 12-1494)

More publications

SOVEREIGN DEBT RESTRUCTURINGS: THE CASE OF ARGENTINA AND LATEST DEVELOPMENTS

Key Remarks

Briefing at the
United States Congress,
Washington, D.C.

JULY 22, 2013

Top international experts discuss policy and systemic implications of sovereign debt restructurings and the interpretation of the *pari passu* clause with a focus on the case of Argentina.



THE SYSTEMIC CONSEQUENCES OF ARGENTINA'S SOVEREIGN DEBT CASE

WHAT EXPERTS ARE SAYING

"... ongoing litigation against Argentina could have pervasive implications for future sovereign debt restructurings."

International Monetary Fund
(IMF) 5/23/2013

"This case is not only about the named plaintiffs and Argentina. To the contrary, the Court of Appeals' decision, if upheld, will have a global impact [...]"

Brief for the Republic of France as amicus curiae in support of the Republic of Argentina's petition for a Writ of Certiorari
7/26/2013

"A recent decision by a US appeals court threatens to upend global sovereign debt markets. It may even lead to the US no longer being viewed as a good place to issue sovereign debt."

Joseph E. Stiglitz
Nobel Laureate in economics
Project Syndicate - 9/4/2013

"These consequences would be felt by debtor nations, creditors, the United States, and the international economy as a whole."

Brief for amicus curiae Professor Anne Krueger in support of the Republic of Argentina and reversal - 1/4/2013

"The recent court rulings [...] have very serious consequences that go far beyond Argentina. They have potential implications for the restructuring of official and private claims on Greece and for the entire global architecture of orderly sovereign debt restructurings, as pragmatically developed over the past decade."

Nouriel Roubini
Roubini Global Economics, 1/12/2012



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