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Argentina and Holdouts: It Takes Two to Tango

By Luis A. Arana Tagle

ARGENTINA is just over 24 hours from incurring in default, and there is little hope that this will be avoided. How did this come about, and what are the issues at stake?

NML CAPITAL, LTD., Aurelius Capital Master, Ltd., and several other plaintiffs, brought an action against Argentina in a Federal court in New York, and obtained judgment in 2003. In that action, U.S. District Judge Thomas Griesa ordered that whenever Argentina pays on its restructured bonds (i.e., the securities issued in its 2005 or 2010 exchange offers), Argentina must also make a “ratable payment” to the plaintiffs (who hold defaulted bonds not exchanged under the 2005 and 2010 offers). The Argentine Government attempted to challenge that order, but on June 16, 2014, the U.S. Supreme Court declined to hear Argentina’s appeal.

Thus, Judge Griesa’s ratable payment order became effective. This meant that Argentina would not be able to make a US\$ 539 million interest payment due to some of its restructured debt holders on June 30. The plaintiff’s position seemed to have gained momentum, and there was much speculation on whether the Argentine Government would change its long stance of not holding any discussions with the plaintiffs. The answer came on Friday, June 20, when President Cristina Fernández de Kirchner publicly announced that Argentina would negotiate with the holdouts. The following Monday, June 23, the Argentine Government requested Judge Griesa “to order measures suitable to enable discussions with the plaintiffs to take place”. On that same day, Judge Griesa appointed Daniel Pollack as special master to preside over the negotiations between Argentina and the holdout funds.

However, prospects of productive discussions started to blur, when on June 26 the Argentine Government deposited in Bank of New York the US\$ 539 million due on June 30. Axel Kicillof (Argentina’s Economy Minister) stated that complying with a court order could not exempt Argentina from fulfilling its obligations; “Argentina will meet its obligations and honour its debts”. However, on the following day Judge Griesa declared the attempted payment illegal, and ordered Bank of New York to return the funds to the Argentine Government.

As a result of this, on June 30 Argentina was unable to make the interest payment then due. Under the terms of the relevant bonds, Argentina has a grace period of thirty more days to make the payment, or else the country will be deemed to be in default.

On July 7, Mr Kicillof met with Daniel Pollack. According to the Argentine Ministry of Economy, Mr Kicilloff made representations to Mr Pollack about the restructuring of Argentina’s sovereign debt, the need to reinstate a stay on Judge Griesa’s order, and Argentina’s will to continue discussions with an aim to secure fair, equitable and legal conditions, which requires contemplating the interests of all the bondholders.

Nevertheless, nothing much seems to have happened since that meeting. Apparently, and despite President Fernández de Kirchner’s June 20 statement, the Argentine Government chose not to engage in any direct discussions with the plaintiffs. Rather, it sought (and obtained) a resolution by the Organization of American States in support of the Argentine Government’s position. Also, taking advantage of a BRICS summit being held in Brazil to discuss the creation of a new development bank, in mid-July President Cristina Fernández de Kirchner attended that summit to request immediate fresh funds. According to leading morning papers, this request was met with a polite “maybe; let’s talk again in two

years-time”.

Furthermore, over the last month the Argentine Government has more than once requested Judge Griesa a stay on its ratable payments order, all such requests being denied. On hearing the last request, on July 22, Judge Griesa ordered both sides to negotiate “promptly and continuously” with Special Master Daniel Pollack until a “settlement is reached”.

In explaining the actions (or lack thereof) taken by the Argentine Government during the past months, some columnists have pointed out that Argentine senior officials believe that they cannot enter into any discussion with the holdouts because of the following legal reasons:

The RUFO clause. Under a Rights Upon Future Offers (the “RUFO” clause”) included in its restructured bonds, if Argentina offered the holdouts a better deal than the one given to the bondholders who accepted the 2005 and 2010 debt exchanges, the latter bondholders would be entitled to the improved terms. The plaintiffs have contested this as a real obstacle for reaching a deal, arguing that the RUFO clause only precludes Argentina from “voluntarily” offering better terms to the holdouts. Given that Judge Griesa has ordered Argentina to pay the holdouts, an extrajudicial settlement could be interpreted as involuntary. In any event, the effects of the RUFO clause will expire on December 31, 2014.

The other holdouts. The claims of the plaintiffs in the litigation being heard by Judge Griesa total approximately US\$ 1.3 billion. If these claims were to be paid in full, other holdouts not included in the litigation could request a similar treatment. According to the Argentine Government, the claims of those latter holdouts would amount to US\$ 15 billion.

The cross-default clauses. Strictly speaking, the default that is anticipated to take place tomorrow is in respect of an interest payment on Argentina’s dollar-denominated securities due in 2033. However, terms of other bonds have cross-default clauses, under which holders of other securities issued by Argentina would be entitled to deem their own bonds as defaulted, its payment terms accelerated, and to immediately claim the entire balance owed to them under their bonds. However, claiming such an immediate payment would be subject to holders of at least 25 percent of that debt making the demand. Also, Argentina would still have 60 days to cure the breach under the 2033 bonds and thus decelerate the other securities. According to an article published today in bloomberg.com, the value of claims that could arise under these provisions has been estimated at US\$ 29 billion, almost the amount of Argentina’s Central Bank reserves.

Although the default seems inevitable, Jorge Capitanich, the Argentine Chief of Ministers’ Cabinet, has played down its possible consequences. This view will be tested against the markets on Thursday of this week. One clear result of a default, though, will be to set back Argentina’s efforts of the last years to reinsert itself back in the international financial markets.

If the default materialises, the next weeks will show if the Argentine Government has any plans (and willingness) to hold discussions with the plaintiffs to revert the situation, or to pursue any alternative path.

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