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Argentina, the vultures and the debt

- Argentina's 2001 default on its sovereign debt was one of the largest in financial history. Its impact on orderly debt restructuring practices persists, particularly as a result of the dispute pitting Argentina against its "holdout" creditors, also known as "vulture funds".
- The "NML Capital v. Argentina" case has entered its final phase, as the Argentine government filed a petition with the Supreme Court of the United States in February 2014 to review earlier rulings in favour of the vulture funds. On 16 June 2014, the Supreme Court declined this request.
- France has intervened in the case, filing a brief as a "friend of the court" (*Amicus Curiae*), alongside other countries (Brazil, Mexico and the United States, at an earlier stage of the proceedings), as well as economists and researchers. France's brief alerted the Supreme Court to the adverse impact that upholding the lower courts' decisions would have on the practice of orderly sovereign debt restructuring.
- The crux of the dispute lies in the interpretation of a boilerplate clause in bond contracts called *pari passu* from the Latin for "on an equal footing". The legal meaning of this clause had never been called into question until vulture funds started suing defaulting countries in the late 1990s. The usual interpretation concerns seniority rankings of creditors in the eyes of the law, but vulture funds are now citing the language of this clause to demand "ratable" payment (which has a specific meaning in American courts) from Argentina each time it makes a repayment to the bondholders who exchanged their defaulted bonds for securities with discounted face values. In practical terms, this means that, if Argentina wishes to honour the payments owed to the exchange bondholders, it must also pay $1.33 billion to NML Capital.
- There is more at stake in this case than Argentina and the *pari passu* clause alone. It could affect the future of sovereign debt restructuring, since participation of the greatest possible number of bondholders in exchange offers is critical for bringing excessive debts down to more sustainable levels.
- Sovereign debt market stakeholders have started to discuss the most efficient ways to enhance the legal security of bond contract clauses and the capacity to implement restructuring deals, using such means as collective action clauses (CACs).

Argentine sovereign bond spreads, 2012-2014

Source: JP Morgan.

MINISTÈRE DES FINANCES ET DES COMPTES PUBLICS

MINISTÈRE DE L'ÉCONOMIE DE L'INDUSTRIE ET DU NUMÉRIQUE

1. The crisis in Argentina, from the 2001 default to the 2005 and 2010 restructurings

Between 1991 and 2000, Argentina ran up huge current account deficits, leading to the end of the peso's fixed parity against the dollar in June 2001. The ensuing capital flight and withdrawals of bank deposits, combined with unpopular economic measures, led to the government's resignation and to a devaluation of the Argentine peso.

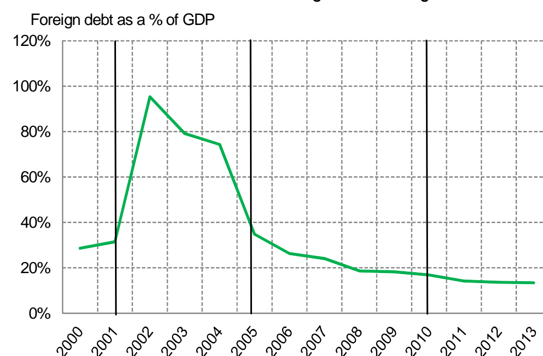
In the midst of an economic and financial crisis, Argentina announced a moratorium on public foreign debt on 23 December **2001**[1], triggering the largest sovereign default to date, involving unprecedented amounts ($94 billion) and numbers of creditors (more than 700,000). It was also the most complex default, because of the number of jurisdictions involved[2] and the geographical distribution of the creditors[3].

In 2002, Argentina began the long process of restructuring its debt. The first milestone came on 14 January **2005**, with an exchange offer that was accepted by 76.15% of bondholders[4]. A further exchange offer with comparable terms to the 2005 offer was made available from 3 May to 22 June **2010**, bringing the total proportion of restructured debt to 92.6%.

The size of the proposed discount (approximately 70% of the net present value) led some bondholders to reject the 2005 making them "holdout" creditors. These holdouts owned a total of $19.5 billion of the debt, with Italian retail investors, who formed Task Force Argentina[5], accounting for 29%, non-litigating creditors accounting for another 47%, and litigating creditors for 24%. The latter are also collectively referred to as "vulture funds" because of their business model, which consists in buying over-indebted countries' bonds at a deep discount and then going to court to obtain full repayment[6]. When the Argentine government made a comparable exchange offer in 2010, all of the non-litigating creditors and 77% of the Italian retail investors took up the offer. This left the holdouts with $6.2 billion in unexchanged bonds at the end of 2010, or $11.2 billion, including interest and penalties. The larger part of this debt ($4.5 billion)[7] was held by litigating creditors and, more specifically, the Elliot Associates fund and its subsidiary, NML Capital.

Debt restructurings allowed Argentina to reduce the amount of its foreign debt substantially (see Chart 1).

Chart 1: Argentina's foreign debt, 2000-2014



Source: Buenos Aires Regional Economic Department, IMF.

2. The role of holdout bondholders and vulture funds

Vulture funds, such as NML Capital, the subsidiary of Elliot Capital, do not always take legal action. Only 29 of the 180 sovereign debt restructurings the occurred between 1976 and 2010 resulted in lawsuits[8].This strategy can nonetheless be very lucrative for investors who can afford to be patient, or when the holdouts' share of the aggregate debt is fairly small. In the latter case, history has shown that their debtors are more inclined to settle out of court[9] .

In 2011, NML Capital and other litigating creditors filed a suit against Argentina before the New York courts, since the restructured bonds had been issued under New York law. The proceedings and, more specifically, the attachment orders placed on Argentina's assets in the United States, greatly increased the pressure on Argentina and compromised its return to the bond markets. This pressure also drove up yields on Argentine bonds being traded on the markets, as shown in Chart 2.

(1) Technically, the default occurred in January 2002, since Argentina had 30 days to resume payments. The government officially announced the default on 25 April 2002.

(2) At the time, the laws of eight jurisdictions applied to Argentina's debt, including New York (51% of the nominal debt), the United Kingdom (18%) and Germany (17%).

(3) Up to 40% of the foreign debt was owned by Argentine creditors. The remaining 60% was shared by at least nine countries (Germany, Italy, Japan, Luxembourg, Netherlands, Switzerland, United Kingdom, United States, France).

(4) Several exchange options were offered: **1. "par bonds"** with no reduction in the face value, a maturity of 35 years, including a 25-year grace period, and incremental coupon payments, starting with a small amount; **2. "quasi-par bonds"**, denominated in pesos only, with a 31% reduction of the face value, a 42-year maturity, including a 32-year grace period, capitalisation of interest for the first 10 years and interest payments starting in the 10th year with a coupon rate of 3.31%; and **3. "discount bonds"** with a 66.3% reduction in the face value, a 30-year maturity, including a 20-year grace period and a coupon rate of 8.28%. A GDP warrant was also introduced to increase coupon payments whenever real GDP growth exceeds 3.22%.

(5) According to the Securities and Exchange Commission, 18-K Form, Annual Report of the Republic of Argentina, September 2011.

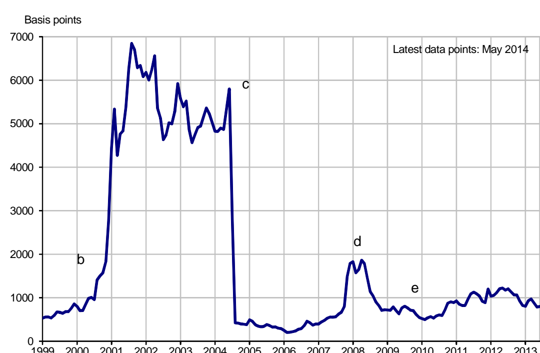
(6) The vulture funds' operating methods were described in detail by Anne Krueger, the Deputy Managing Director of the IMF, in her speech, International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring (available from http://www.imf.org/external/np/speeches/2001/112601.htm). The fund that sued Peru (see footnote 14) was Elliott Associates, the same fund that sued Argentina in this case, acting through its subsidiary NML Capital.

(7) Retail Italian investors represented by Task Force Argentina still owned $1.1 billion at the end of 2010, after an exchange of $3.2 million of their bonds in mid-2010. See also Hornbeck, J. F. (2013), "Argentina's Defaulted Sovereign Debt: Dealing with the Holdouts," February.

(8) Schumacher, J., C. Trebesch and H. Enderlein (2012), "Sovereign Defaults in Court: The Rise of Creditor Litigation 1976-2010," *Working Paper* (16 December).

(9) Miller and Thomas, (2007), "Sovereign Debt Restructuring: the Judge, the Vultures and Creditor Rights."

Chart 2: Argentine and EMBIa spreads[a]



Source: JP Morgan.

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a. The Emerging Market Bond Index is published by JP Morgan. It tracks the prices of sovereign dollar bonds issued by a selection of emerging countries that includes Argentina. The prices are expressed as spreads meaning the difference between the yield of a given bond and that of a "risk-free" American bond.

b. Argentina's default on its foreign debt.
c. First exchange offer.
d. 2008 farm crisis.
e. Second exchange offer.
f. 7 December 2011: first decision of the New York Court.
g. Nationalisation of the YPF oil company.
h. 26 October 2012: decision upheld by the Court of Appeals.
i. 23 August 2013: final decision of the Court of Appeals.
j. March-May 2014: Paris Club invitation and agreement.
k. 16 June 2014: Supreme Court's rejection of the petition.
l. 31 July 2014: Argentina declared in selective default.

Some litigating creditors even managed to freeze Argentine Central Bank assets worth $105 million at the Federal Reserve Bank of New York[10]. In this case, with international repercussions, Elliot relied on a new interpretation of a boilerplate clause of sovereign bond contracts include the Argentine bond contracts. This is the *pari passu* clause, which had been invoked in a similar case involving the Peruvian government[11]. The Argentine bond contract contains the most commonly used wording of the clause:

"The securities will constitute [...] direct, unconditional, unsecured and unsubordinated obligations of [X] and shall at all times rank pari passu without any preference among themselves. ***The payment obligations of [X] under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness****"*

The first issue in the dispute is the interpretation of this clause. The task of the American judge was to determine whether it implied an obligation to pay exchange bondholders and holdouts in an equivalent manner.

The interpretation given by Elliott's lawyers is that the *pari passu* clause prohibits the debtor from paying one group of bondholders, without making simultaneous *prorata* payments to the other groups based on the amount of debt they hold. More specifically, this interpretation would require *(i)* either repayment to holdouts at par, meaning at the original face value of the holdouts' bonds, even though the exchange bondholders would only be repaid 30% of the original face value; *(ii)* or no repayment of any private-sector bondholders.

Despite the intrinsically ambivalent nature of the clause, this interpretation is broadly considered to be incorrect in academic literature[12], because it is contrary to market practice. For several decades, market practice deemed that the *pari passu* clause does not entail any obligation for the debtor to make *ratable payments*; it is merely intended to prevent debtors from altering the seniority rankings of their creditors through lel changes.

(10) These funds were to be used to meet the repayments on the restructured sovereign bonds. The freeze was ultimately lifted when Argentina won its case on appeal at the Supreme Court in June 2012. The Court found that the Central Bank of Argentina's funds deposited with the Federal Reserve Bank of New York enjoyed immunity. On a more anecdotal note, NML Capital had an Argentine navy frigate seized in Ghana and held for 78 days. The ship was only released after a decision from the International Tribunal for the Law of the Sea.

(11) Mitu Gulati and Kenneth N. Klee, (2001), "Sovereign Piracy," UCLA School of Law Research Paper 01-7. In October 1995, Peru launched a restructuring offer for loans guaranteed by the two banks: *Banco de la Nacion and Banco Popular del Peru*. Four months later, the Elliott Associates fund purchased loans from two international banks with a face value of $20.7 million, paying the market price of $11.4 million. Elliott Associates then rejected the exchange offer and sued Peru in the New York courts seeking full repayment of the loans. The court found in Elliot Associates' favour in June 2000, awarding the fund $55.7 million. Armed with this ruling, Elliot Associates obtained a restraining order from a Brussels court to prevent Peru from paying the bondholders who had accepted the exchange by blocking the fund transfers that were to be made through the Euroclear clearinghouse. Faced with the risk of default, Peru finally opted to settle with Elliott Associates, thus ending the suit. In subsequent cases, the Belgian court has reviewed the interpretation put forward by Elliot Associates: see Republic of Nicaragua v. LNC Investments LLC, General Docket No. 2003/KR/334 (Ct. App. Brussels, 9th Chamber, March 19, 2004).

(12) For a discussion of the counter-intuitive and ambivalent nature of the *pari passu* clause, see Mitu Gulati G. and Kenneth N. Klee, (2001), "Sovereign Piracy," 56 Bus. Law. 635, 637, 640.

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In its case against Argentina, Elliott's subsidiary NML Capital was obviously building on the precedent set in its successful suit against Peru in 2000 (see footnote 11), and was advocating for the New York courts to accept the same interpretation of the *pari passu* clause. It has prevailed at every stage in the proceedings (New York District Court and Court of Appeals of the Second Circuit: see timeline below), and the Supreme Court of the United States upheld these favourable decisions when it declined to review the case on 16 June 2014.

Box 1: **Timeline of NML Capital v. the Republic of Argentina**[a]

- **12 July 2011:** NML Capital (along with other funds, such as Aurelius Capital, ACP Master, LLC, Blue Angel Capital and Olifant) petitioned the New York District Court to rule that Argentina, by paying exchange bondholders and refusing to pay the holdouts, was violating the *pari passu* clause in the bond contracts and to issue an order enjoining Argentina to repay all of its creditors.
- **7 December 2011**: The New York District Court ruled that Argentina violated the "equal treatment" provision by refusing to honour the bonds held by NML while paying the exchange bondholders.
- **23 February 2012**: The New York District Court ordered Argentina to make a "ratable payment"[b]), of $1.33 billion to its creditors based on a broad interpretation of the *pari passu* clause that differs from the usual one.
- **26 October 2012**: The Court of Appeals for the Second Circuit confirmed the order of 23 February 2012, while asking for clarification on two technical issues (how the payments to holdouts are calculated and the status of intermediary bank[c]).
- **26 June 2013**: Argentina filed its first petition, or *writ of certiorari* with the Supreme Court. The Republic of Argentina claimed that the Court of Appeals' ruling of 26 October 2012 was not consistent with the provisions of the Foreign Sovereign Immunity Act (FSIA) or with the American rule of civil procedure governing injunctions.
- **26 July 2013**: France filed a first *Amicus Curiae* brief with the Supreme Court of the United States.
- **23 August 2013**: The Court of Appeals rendered its final decision on the payment formula and the intermediary banks, thus confirming its October 2012 decision and enjoining all agents acting indirectly on behalf of the Republic of Argentina to refrain from any transaction that would violate this principle.
- **7 October 2013**: The Supreme Court announced that it would not hear the petition filed by Argentina in June and that, consequently, the *Amici Curiae* briefs would not be considered. This decision might have been taken to avoid hearing the same case twice, pending a second petition for certiorari from Argentina, based on the now final decision of the Court of Appeals. Even though the Supreme Court does not provide any official explanations for its decisions, the Court of Appeals decision on 23 August seems to accredit this interpretation, indicating that apparently "*Argentina filed a petition for certiorari in this matter on June 24, 2013, notwithstanding that, as of that date, no final order had yet issued in this case*."
- **18 February 2014**: Argentina filed a new petition for certiorari with the Supreme Court following the Court of Appeals' final decision dated 23 August 2013. This time around, the petition relied heavily on the interpretation of the *pari passu* clause to support Argentina's case.
- **24 March 2014**: France filed a second Amicus Curiae brief with the Supreme Court on the basis of Argentina's new petition for certiorari. Briefs were also filed by the governments of Mexico and Brazil[d], the European clearinghouse Euroclear, and Joseph Stiglitz, a Nobel laureate for economics.
- **16 June 2014**: The Supreme Court of the United States declined to hear the petitions of the Argentine government, thus ending the suspensory effect of Argentina's appeal. The earlier decisions of the American courts immediately became enforceable. However, their exact impact would not be known for several weeks, since Argentina's next payment to the exchange bondholders was scheduled for 30 June 2014, with a 30-day grace period. Judge Griesa of the New York District Court appointed a "Special Master" on 23 June 2014 to intermediate between the parties regarding implementation of the Court's decision..
- **31 July 2014**: End of the grace period. A payment of $539 million initially intended for the exchange bondholders and held in accounts at the Bank of New York Mellon was frozen. Argentina was deemed to be in selective default. Negotiations with the holdouts have not yet made it possible to reach a compromise solution.

a. See Buchheit, L. and Pam, J.S. (2004), "The *Pari Passu* Clause in Sovereign Debt Instruments", *Emory Law Journal*, vol. 53, as well as Gulati, M. and Scott, R. (2012), The 3½ Minute Transaction: Boilerplate and the Limits of Contract Design, *University of Chicago Press*.

b. According to the Court of Appeals for the Second Circuit, a "ratable payment" would mean that Argentina pays 100% of the amount owed to the holdouts if it pays the exchange bondholders 100% of a payment owed to them, even if the payment corresponds only to a coupon payment or a fraction of the principal amount. See the United States Court of Appeals for the Second Circuit, 12-105(L) / NML Capital, Ltd. v. Republic of Argentina, p. 7: "In its opinion, the district court first explained that its "ratable payment" requirement meant that whenever Argentina pays a percentage of what is due on the Exchange Bonds, it must pay plaintiffs the same percentage of what is then due on the FAA Bonds. Under the express terms of the FAA, as negotiated and agreed to by Argentina, the amount currently due on the FAA Bonds, as a consequence of its default, is the outstanding principal and accrued interest. Thus, as the district court explained, if Argentina pays Exchange Bondholders 100% of what has come due on their bonds at a given time, it must also pay plaintiffs 100% of the roughly $1.33 billion of principal and accrued interest that they are currently due."

c. The New York District Court stipulated on 21 November 2012 that the entire amount owed to the holdouts had to be repaid and that its decision was binding on all intermediary banks, including the Bank of New York, which is Argentina's fiscal agent.

d. Brazil and Mexico highlighted the risks that the Court of Appeals' decision raised with respect to their sovereignty, since they, like Argentina, are very vulnerable to decisions by American courts. Brazil and Mexico, along with France, also reminded the court that they had operated on the financial markets for many years on the basis of the usual interpretation of the *pari passu* clause, and that a new interpretation could destabilise them in their dealings with private-sector creditors. Finally, France, Brazil and Mexico argued that CACs, contrary to what was advanced in the court's decision, are not a remedy to holdout situations.

3. France's intervention and the systemic implications of the case

3.1 Steps taken by France

France decided to file an Amicus Curiae brief on 24 March 2014, alongside Argentina's latest petition *writ of certiorari*. A person that is not a party to a dispute may be allowed to file such a brief in order to provide the court with insight into a matter where the third party is deemed to be competent. France's brief highlighted the systemic risks raised by the New York court's decision. In particular, it focused on the implications for orderly debt restructuring practices if the Supreme Court were to uphold the lower court's decision, as it eventually did on 16 June 2014. The United States had already filed two Amicus Curiae briefs with the Court of Appeals in April 2012 and on 28 December 2012 in support of an *en banc* rehearing (rehearing a case in the presence of the entire bench of judges). France's brief was not specifically related to the case of Argentina but rather was motivated by France's desire to maintain international financial stability and by its role within the Paris Club, even though it is important to note that the brief was filed in France's name alone and not on behalf of the Paris Club.

France's position has not changed from the one set out in its brief. France:

(i) underlines the impact of the ruling by the Court of Appeal for the Second Circuit on the overall mechanism for restructuring sovereign debt.

(ii) points out that, as a sovereign creditor, France feels the decision is likely to jeopardise its own claims, insofar as suits filed by holdouts could prevent it from receiving the repayments owed to it following debt restructuring.

(iii) notes that collective action causes (CACs) on their own are not enough to prevent this type of situation from arising for new bonds, as shown in the case of Greece[13], especially if the ruling applies in a jurisdiction as "universal" as New York for bond issues.

Box 2: Paris Club: the hub for coordinating bilateral official-sector creditors and restructuring sovereign debt

The Paris Club is an informal group of creditors. The French Directorate General of the Treasury acts as the Club's Secretariat and the Director General of the French Treasury as the Club's Chairman. In its nearly 60 years of existence, the Paris Club has reached 430 sovereign debt-restructuring agreements with 90 countries involving debts totalling more than $580 billion.

Although the Paris Club has not taken a position in the dispute between Argentina and the holdouts, it is fully aware of the need to make debt restructuring practices more effective, more inclusive and more transparent.

With this in mind, the Club prefers to promote a flexible approach based on frank and open dialogue between official-sector creditors and debtors as well as private stakeholders. It holds monthly meetings for members to discuss debtors' economic and financial situations.

The Club is a forum that provides creditors with major leverage for collecting their claims and an opportunity to share information with other creditors and international financial institutions. It also contributes to the general debate about sovereign debt restructuring mechanisms. Agreements reached through the Paris Club also enable debtors to avoid long periods of default and arrears, opening up new sources of private and public financing for the countries that have restructured their debt. In this way, the Club contributes to the ultimate goal of sustainable and shared economic development.

In an international financial environment that has seen the rise of new creditors and new financing procedures[a], the Paris Club is a focal point for coordination between creditors from both the private and public sectors. The Club's pivotal role is highlighted during major annual events, such as the meeting that the Club organises jointly with the International Institute of Finance (the 14th such meeting was held in Paris on 25 June 2014), or the Paris Forum of Sovereign Creditors, which was held for the second time on 20 November 2014 and organised jointly with the Australian Presidency of the G20.

Alongside the creditors usually involved in the Club's work, events of this nature enabled many emerging creditors, such as Saudi Arabia, South Africa, India, Indonesia, Qatar and Turkey, to take part in the Club's activities in 2013 and 2014. Several debtor countries, including Senegal, Mozambique, Seychelles and Tanzania, also attended. On these occasion, the IMF hailed the Paris Club's increasing openness to a growing number of representatives. This opening was also well received in academic circles, where there is greater emphasis than ever on the need for flexible coordination between bilateral official-sector creditors, in full respect of each country's sovereignty. These efforts are already paying off; the Central Bank of China and Brazil have been attending the monthly Paris Club meetings as ad hoc participants since December 2013. In a similar vein, the State of Israel, which had been an ad hoc member of the Club alongside Brazil and South Korea, was officially named the 20th permanent member of the Paris Club on 24 June 2014.

a. The share of private-sector financing in international disbursements has risen from approximately 2% at the end of the 1990s to 10% today.

(13) The CACs included in certain Greek bonds issued under foreign law did not prevent bondholders from becoming holdouts, since the qualified majority required to impose the terms of a restructuring deal on them was not achieved.

3.2 Systemic implications of the Court of Appeals' decision

On 26 October 2012, the interpretation of the *pari passu* clause by the Court of Appeal for the Second Circuit led it to rule that Argentina had breached the clause by repaying the exchange bonds without making a "ratable payment" to the holdouts. The Supreme Court of the United States has since declined to review this decision.

The main direct risk generated by this decision is the significant harm caused to Argentina's image despite all of the country's efforts , acknowledged by the IMF itself[14] to normalise its situation in relation to international debt markets. There is also reason to fear that the selective default announced in July 2014 could cause foreign investors to shun Argentina, with the risk of jeopardising the situation of its balance of payments and its already stretched reserves of only $28 billion, which do not even cover four months of imports of goods and services.

Enforcing the Court's decision would also strengthen the holdouts' position, thereby greatly reducing the incentives for creditors to take part in orderly debt restructurings. Precisely, the key to bringing excessive debt back to sustainable levels is to involve the greatest number of creditors and have them share the efforts more evenly. Anna Gelpern maintains that the remedy ordered by the New York Court and upheld by the Court of Appeals for the Second Circuit in August 2013 may actually maximise the collateral damage to Argentina's financial intermediaries[15] without affecting Argentina itself. Thus, she qualifies this decision as "partial, arbitrary and inequitable"[16].

In response to the alleged systemic implications of their decision, the Second Circuit Judges stated that only contracts under New York law were concerned and that CACs in future bond contracts would prevent a similar situation from occurring in the future. This argument does not hold up[17], even if all bond contracts were to include a CAC. There are two reasons for this. First of all, not all sovereign debt can be covered by CACs, especially debt not issued in bond form. Secondly, not all CACs contain aggregation clauses that make it possible for a super-majority measured on an aggregated basis, to make changes to a whole series of bonds, instead of each individual issuance (see Box 3). The IMF estimates that some 20% of the $900 billion in bonds under foreign law currently in circulation worldwide with several years of residual maturity do not contain CACs. Furthermore, even if the American courts' decisions apply only to bond contracts subject to New York law, which alone account for $100 billion in bonds without CACs, the interpretation of the *pari passu* clause could still create a precedent in other jurisdictions. This could, for example, apply to the bond issuances made under British law that are still owned by the holdouts who rejected the exchange offer made by Greece in March 2012.

Box 3: Collective Action Clauses in sovereign bond issues

Over the last decade, collective action clauses, or "CACs," have become the principal means to reduce uncertainty regarding sovereign debt restructurings. These clauses are contractual provisions in the legal documentation of bonds that allow a qualified majority of bondholders (generally ranging from 66.7% to 75%) to modify the bond's terms, including its face value, interest rate or repayment schedule.

The change then applies to a given bond series (identified by an ISIN, defined by its face value, interest rate, issue date and repayment date) and is legally binding for all of the bondholders, even if a minority rejects it. In theory, however, a holdout could be exempt from the change if it held a sufficient blocking minority. Apart from Argentina's default in 2001, the recommendation in the *Report of the G10 Working Group on Contractual Clauses* of 26 September 2002 helped promote a wider use of CACs: "*The Working Group recommends the inclusion of a majority amendment clause permitting amendments of payment terms with the approval of a supermajority of bondholders.*"

The recent decision by euro area countries to include CACs in their sovereign bonds issued under domestic law as of 1 January 2013 marked a further step in strengthening the contractual procedures for sovereign debt restructurings, since it introduced aggregation mechanisms into CACs on an unprecedented scale. The aggregation mechanism requires an aggregated tally of the votes of all of the bondholders affected by the restructuring in addition to the "classic" tallies of votes of the holders of individual series, which contributes to avoiding the creation of blocking minorities.

(14) http://en.mercopress.com/2014/05/31/imf-and-argentina-paris-club-deal-we-hope-they-continue-that-process

(15) In its decision of 23 August 2013, the Court of Appeals for the Second Circuit, in addition to enjoining Argentina to pay its bondholders "equitably," prohibited all agents acting indirectly on its behalf from carrying out any transaction that infringes this principle. The decision specifically names Euroclear, DTS and Bank of New York. Unlike other "intermediary" banks whose role is limited to making automated funds transfers, Euroclear is specifically named in the Court of Appeals' decision in its capacity as a clearing system operator. The judge seems to rule out any objection based on extraterritoriality on the strength of Federal Rule 65, which states that federal injunctions apply to entities that "participate in applying American law". Therefore, the Court's decision would apply to entities that are not subject to American law themselves, but merely assist Argentina, which is subject to American law in this case.

(16) Gelpern, A., (2013), "Sovereign Damage Control," Peterson Institute for International Economics, *Policy Brief*, Number PB13-12.

(17) Gelpern, A. (2012), "Sovereign Restructuring after NML v. Argentina: CACs Don't Make *Pari Passu* Go Away," May.

Furthermore, the comparability of treatment clause in the Paris Club Agreed Minutes requires debtor countries to obtain comparable debt relief terms from their other creditors, including private-sector creditors. The upholding of the court's decision reinforces the holdouts' position and may make it difficult to enforce this Paris Club principale in the future. Consequently, it would be much more complicated for debtor countries to obtain comparable treatment from their private-sector creditors and the burden would not be shared fairly by all of the creditors.

4. Implications for international sovereign debt restructuring practices

NML v. Argentina, in addition to the theoretical debate surrounding the interpretation of the *pari passu* clause, has already had a very real impact on international sovereign debt restructuring practices. When the Supreme Court declined to hear Argentina's petition on 16 June 2014, it further amplified the international impact of the injunction issued by the New York Court. The rejection of the petition means that the systemic risks described above are now likely to occur, starting with the threat to established sovereign debt restructuring mechanisms.

One example of the risk of copycat suits brought by holdout creditors against heavily indebted countries is the suit that Taiwan filed before a New York court in March 2013 for breach of the *pari passu* clause in the contracts for its loans to Grenada. Other countries that could be affected by the Court of Appeals' decision in various ways have started to change their laws and contractual provisions to guard against any knock-on effects. Belgium, which played a leading role in the case of Elliott Associates v. Peru, was one of the first countries to take legislative measures to guard against vulture funds' suits in the future[18]. Several bond issuers, including Belize in 2013, and Greece and Ecuador in 2014, opted to modify the *pari passu* clause in their international bond issues by eliminating any mention of payment requirements, or by providing an interpretation that guards against lawsuits by holdouts.

In light of Argentina's case, academics increasingly see debt restructuring as a step that can be facilitated once prior reforms aimed at consolidating the country's macroeconomic situation and fiscal consolidation policies have failed, rather than something to be avoided at all costs. This once again raises the question of how this can be achieved. In a framework paper published in May 2013[19], the IMF put forward several ideas for discussion, such as strengthening CACs through the introduction of aggregation clauses[20], or requiring creditors, including commercial creditors, to agree to maturity extensions when countries encounter liquidity crises. Several recent articles[21] call for a re-assessment of the Sovereign Debt Restructuring Mechanism, a concept also raised by the IMF following Argentina's 2001 default. However, the authors refrain from proposing the same mechanism as in 2001, insofar as it encountered strong opposition, particularly from public-sector creditors who attach great value to their sovereignty. Instead of this rigid statutory approach, which implies setting up a supranational power, the authors often prefer closer coordination between creditors, which is key to the stability and effectiveness of sovereign debt restructurings[22]. They also prefer a "contractual" approach based primarily on the widespread use of the CACs described by the IMF in sovereign bonds. These CACs are supposed to prevent holdout situations and facilitate restructurings. As we noted, however, Argentina's case suggests that CACs alone may not be enough to prevent abusive suits by certain creditors insofar as *(i)* they are not yet universally used and it is estimated that it will take around ten years to run down the current stock of outstanding bonds without CACs; and *(ii)* the protection they provide is incomplete if they do not include aggregation mechanisms, as is still often the case, which means that determined creditors with ample resources can still obtain blocking minorities.

Some sovereign defaults, if they are not dealt with comprehensively, can undermine the very foundations of an economy for many years. The case of Argentina and its dispute with the holdouts playing out in the American courts is a case in point. Its repercussions are much greater than the specifics of the actual case; they affect the actual process of sovereign debt restructuring, which will remain inevitable for countries that end up in unsustainable situations. Regardless of how it is resolved, this case has also highlighted several key issues, including the fundamental matter of strengthening the contractual approach to debt resolution and fostering greater coordination between sovereign creditors. All of the stakeholders in the international financial system will focus on these issues for years to come. The Paris Club, in keeping with its traditional role as a pivotal player for sovereign creditors, will have its full say in the coming debates. Argentina and the Paris Club reached a historic agreement on 29 May 2014 defining the procedures for clearing up Argentina's debts to sovereign creditors in the Paris Club that have been in default since 2002. This agreement is testimony, if any is needed, to the effectiveness of dialogue and good faith negotiations in resolving the most complex sovereign defaults.

Geoffroy CAILLOUX

(18) The Act of 28 April 1999 was amended in November 2004 in light of the holdouts' suit against Nicaragua to stipulate (emphasis added) that "Any cash settlement account held with an operator or cash settlement agent of a system, **as well as any cash transfer through a Belgian or foreign institution to be credited to such cash settlement account**, cannot be attached, sequestered or blocked in any manner whatsoever by a participant, counterparty or third party, other than the operator or settlement agent of the system."

(19) IMF, (2013), "Sovereign Debt Restructuring: Recent Developments and Implications for the Fund's Legal and Policy Framework," May.

(20) This is in contrast to current CACs in that it would require approval of the new terms at an aggregate level only and not on a series-by-series basis.

(21) Bucheit, L., A. Gelpern, M. Gulati, U. Panizza, B. Weder di Mauro and J. Zettelmeyer, (2013), "Revisiting Sovereign Bankruptcy," Brookings Institution, Committee on International Economic Policy and Reform, October.

(22) Gitlin, R. and B. Brett House, (2013), "The Sovereign Debt Forum: Expanding our tool kit for handling sovereign crises," CIGI Policy Brief No. 28, August.

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