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UPDATE ON ARGENTINA SOVEREIGN DEBT DEFAULT

Background

During the 1990s, Argentina began issuing a number of debt securities which were purchased both directly from Argentina, and on the secondary market. After Argentina defaulted on these securities in late 2000 due to its currency crisis, it declared a "temporary moratorium" on principal and interest payments. In 2005 and 2010, Argentina proposed various restructurings of the debt, offering new bonds which paid less than 30 cents for each dollar owed in default, and by 2010, 93% of the original bondholders had agreed to a bond exchange. The remaining 7% "hold-out" investors repeatedly refused to participate in the bond exchanges, despite Argentina warning that one of the risks of not participating was that existing defaulted bonds that were not exchanged could remain in default indefinitely. The plaintiffs (who had in large part acquired the debts on the secondary market) sued Argentina on the defaulted bonds in 2009-2011, alleging breach of contract and seeking injunctive relief.

Recent procedural history

On October 26, 2012, the 2nd Circuit US Court of Appeals upheld a ruling that Argentina could not service the bonds it issued in the 2005 and 2010 debt restructurings unless it also paid the hold-out investors. In its decision, the Court asked Judge Griesa, the judge responsible for the case, to determine precisely how much Argentina would have to pay the hold-out investors in order to stay current on its performing obligations.

In a decision on November 21, 2012, Judge Griesa found in favour of the hold-out investors, and found that Argentina could not fulfil one of its obligations—paying what it owes to the holders of its restructured debt, which is the next interest installment—unless it fulfilled the other as well: paying what it owes to the hold-outs, which is their full $1.3 billion claim, representing the face value of the defaulted bonds plus a decade of past due interest. Argentina was already due to make a payment of $3 billion on previously restructured debt on December 15; and Judge Griesa's order meant it also must pay the $1.3 billion by that time or fall into default on all of its debt. This was because it meant that if Argentina stuck to its position of not paying the holdouts, it would also be barred from paying investors who participated in the debt exchanges in 2005 and 2010.

Both Argentina and bondholders who took part in the exchanges filed appeals against Judge Griesa's order. The 2nd Circuit Court of Appeals granted the emergency stay, and agreed to hear the appeal on February 27, 2013. An emergency motion by the holdout investors requesting that Argentina put up a security deposit of $250 million by December 10, 2012, or that the court expedite the case so that it can be resolved before December 31, 2012, was denied. The US Government has filed a brief in support of the Argentinian case, on the grounds that a decision against Argentina could cause damage to US foreign relations and the US dollar.

Observations

The aggressive litigation in this case is likely to continue, pending some negotiated compromise between the parties. Argentina has described the hold-out investors as "vulture funds" (because they acquired the debt at a discount with the apparent intention of pursuing full face value claims). The hold-out investors have also attempted to seize Argentine assets worldwide – including an Argentine Navy frigate which the Ghanian government have refused to detain, pursuant to a decision by the International Tribunal for the Law of the Sea.

Previously, Argentina has said that it would be willing to reopen the bonds swap agreed in 2005 and 2010, and invite the hold-out investors to participate. Such a move would be conditioned on the agreement of the Argentine Congress to lift the 'lock-law' which currently prevents any further negotiations with the hold-out investors. However, the hold-out investors have already rejected the terms of the bonds swap twice, and until the legal requirement not to offer better terms runs out on December 31, 2014, Argentina is unable to offer better terms than were offered and accepted by other investors in 2005 and 2010.

The case raised important questions as to Sovereign Debt, acquisition of such debt by investment vehicles (sometimes called "vulture funds"), and the vexed issue as to how a situation of "State insolvency" can be addressed in an internationally acceptable and legally consistent manner, in the event this happens.

8th January 2013