In Brief: Recent Rulings on Sovereign Debt Restructurings

November/December 2012

Mark G. Douglas

On October 26, 2012, the Court of Appeals for the Second Circuit, in a ruling that may impact sovereign debt restructurings, upheld a lower-court order enjoining Argentina from making payments on restructured defaulted debt without making comparable payments to bondholders who did not participate in the restructurings. On November 21, the U.S. District Court for the Southern District of New York ordered Argentina to pay nonparticipating bondholders $1.3 billion in past-due obligations no later than December 15, 2012.

In 1994, Argentina began issuing bonds with a governing instrument that contained a "*pari passu*," or "equal treatment," clause, providing that the bonds would constitute "direct, unconditional, unsecured and unsubordinated obligations of the Republic . . . [ranking] at all times . . . pari passu without any preference among themselves" and that "[t]he payment obligations of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness."

Following a 2001 default on the bonds, Argentina offered bondholders new exchange bonds in 2005 and again in 2010. Argentina continued to make payments to holders of the exchange bonds, but pursuant to a "temporary moratorium" renewed each year since December 2001, it has not made payments to bondholders who did not participate in the exchange. The old bondholders sued Argentina in federal district court in New York (the old bond instrument being governed by New York law) to collect $1.33 billion in unpaid principal and interest. In February

2012, the district court, holding that Argentina's conduct violated the *pari passu* clause, enjoined further payments to exchange bondholders without corresponding payments to old bondholders.

The Second Circuit Court of Appeals upheld that ruling in *NML Capital, Ltd. v. Republic of Argentina*, 2012 BL 283459 (2d Cir. Oct. 26, 2012). The court was careful to predicate its ruling on the totality of Argentina's conduct, which included enacting unusual legislation rendering the defaulted bonds (and judgments obtained on them) unenforceable in Argentina. Even so, broadly speaking, the decision reflects judicial dissatisfaction with a sovereign debtor that for many years has flouted judgments entered by U.S. courts, notwithstanding the debtor's possession of resources sufficient to pay such judgments in whole or in part. It is expected that Argentina will seek to appeal the ruling to the U.S. Supreme Court. The full text of the opinion can be accessed at http://law.justia.com/cases/federal/appellate-courts/ca2/12-105/12-105-2012-10-26.html (web sites herein last visited November 30, 2012).

The Second Circuit remanded the case to the district court for the purpose of clarifying how the injunction was to operate. On November 21, 2012, U.S. district court judge Thomas Griesa did just that, ordering Argentina to pay holders of the original defaulted bonds in full—approximately $1.33 billion—on December 15, when interest payments are due to holders of Argentina's restructured debt. "It is hardly an injustice to have legal rulings which, at long last, mean that Argentina must pay the debts which it owes," Judge Griesa concluded. "After 10 years of litigation, this is a just result." If Argentina refuses to pay, the judge noted, the Bank of New York, which processes Argentina's bond payments, will also find itself in violation should it decline to withhold payments to other bondholders. Argentina's Economy Minister, Hernán

Lorenzino, announced at a news conference on November 22 that Argentina will appeal the ruling.

Argentina received at least a temporary reprieve of its obligation to make payments to old bondholders pursuant to Judge Griesa's order on November 28, 2012, when the Second Circuit Court of Appeals stayed the ruling until it has an opportunity to hear the merits of Argentina's appeal, which has been scheduled for argument on February 27, 2013. The emergency stay quelled investor fears of a default by Argentina on December 15, when some $3.3 billion in debt repayments are due. On December 4, 2012, the Second Circuit denied an emergency motion by old bondholders to modify the stay by requiring Argentina to post $250 million in security in order to maintain it.