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Role played by the Legislative and Judicial Powers in the Sovereign Debt Restructuring of the Republic of Argentina.

By Ricardo W. Beller[1] ***May 11, 2015***

Introduction

As of December 2001 Argentina suffered one of the worst economic, political and social crises of its history. Among many effects of this crisis, Argentina devalued its currency, restricted transfers of funds to and from Argentina, and defaulted payment of most of its public debt, including its sovereign bonds for a principal amount outstanding at such time of approximately USD 92 billion (the "Old Bonds").

Argentina managed to restructure 93% of its defaulted Old Bonds by means of two debt exchanges implemented in 2005 and 2010. The sovereign bonds issued in the 2005 and 2010 exchanges (the "Exchange Bonds") had similar economic terms and implied a "haircut" of approximately 70% to 75% of the debt exchanged.

The remaining 7% of Old Bonds that were not tendered for exchange in 2005 and 2010 are held mostly by distress funds who are litigating against Argentina claiming full payment of the amounts owed under the same.

One of the most notable judicial cases is *"NML Capital, Ltd. et al vs. Republic of Argentina"*, in which the plaintiffs obtained a favorable ruling regarding the interpretation of the "*pari passu*" clause from the Southern District Court of New York Judge Thomas P Griesa ("Judge Griesa"), which was affirmed by the United States Court of Appeals for the Second Circuit. Such ruling restricts the Republic of Argentina from making any payment to the holders of the Exchange Bonds if it has not made previously or concurrently a "ratable payment" to the plaintiffs holding the Old Bonds.[2] After these judgments became effective, Argentina attempted to make interest

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[2] See decisions in re: "*NML Capital, Ltd. et al vs. Republic of Argentina"* of the United States District Court for the Southern District of New York Judge Griesa dated February 23, 2012 and December 21, 2012, and of the United States District Court of Appeals for the Second Circuit dated October 26, 2012

payments to holders of the "Exchange Bonds" without complying with the "ratable payment" ordered by the courts. As a result of the enforcement of these judgments, to date most of the holders of the Exchange Bonds have not collected the interest installments that became due as of June 30, 2014 and thereafter.

We would like to focus specifically on the role that each of the Legislative and Judicial Powers of the Republic of Argentina have played in this sovereign debt restructuring beginning in December 2001 when the crisis exploded and the default of the sovereign debt was declared.

Please note that it would be very pretentious of us to try and cover all the angles of analysis this might entail. We will just aim to describe here certain events that highlight the interaction of the Executive with the Legislative and Judicial Powers when facing the Argentine sovereign bond default.

Three Powers, One Sovereign

When analyzing the role played by each of the three powers regarding the Argentine sovereign debt restructuring, we conclude that they have acted consistently as a united front.

As it is in charge of the administration of the State, which includes its finances, the Executive Power leads the debt restructuring process. Considering the division of powers provided by the National Constitution, it is not necessarily guaranteed that the Legislative and Judicial Powers will accompany the Executive Power in this process.

This is an important feature to bear in mind when considering negotiations with the creditors, especially the litigious "holdouts". The Executive Power would be in a weaker position if it knows it is under the threat of an adverse ruling of an Argentine court favoring the creditors, or if it could be held to be acting beyond the scope of powers granted to it by Congress.

Even when 93% of the Old Bonds were tendered in the 2005 and 2010 exchanges, the Republic of Argentina is unable to *cramdown* the exchange terms on the 7% of holdouts. This is because the Old Bonds do not include a collective action clause (CAC), and there is no sovereign insolvency procedure that applies to sovereign debt restructurings. If Argentina were not a sovereign but a private corporation in most jurisdictions of the World with such an overwhelming majority of 93% consent it would be able to impose the exchange terms on the holdout minority.

This inability of Argentina to force the exchange terms on the holdouts to a certain extent has been compensated by the fact that the three powers have been consistent in resolving that the only acceptable alternative to restructure the Old Bonds is by means

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and August 23, 2013. The United States Supreme Court denied the petition for a writ of certiorari to review these rulings on October 7, 2013 and on June 16, 2014.

of tendering them in the 2005 and 2010 exchanges, or in a later exchange under similar terms.

We therefore analyze below certain legislative acts and judicial decisions that evidence this consistency of the three powers when dealing with the sovereign debt restructuring that commenced in 2002.

The Emergency Law

The first law the Argentine Congress passed to deal with the crisis was the Public Emergency and Reform of the Exchange System Law 25,561 (the "Emergency Law")[3]. The Emergency Law declared the social, economic, administrative, financial and exchange public emergency, delegating specific extraordinary powers to the Executive Branch until December 10, 2003.[4] The Emergency Law was later successively extended by Congress, the most recent extension being until December 31, 2015.[5]

The Emergency Law created the framework for a major reordering of the Argentine economy. It provided, among other matters, the devaluation of the Argentine Peso (the Peso had been pegged to the dollar for more than 10 years), the conversion to Pesos of foreign currency bank deposits and debts in general (which has become known as "pesification"), and the renegotiation of all the contracts of the State with public utility companies.

Among the powers delegated to the Executive Branch, the Emergency Law included all those that may be needed "to create conditions that will favor a sustained economic growth, consistent with the rescheduling of public debt."[6]

Finally, the Emergency Law declared that its provisions should be considered of "public order". It provided that no person could allege against it the existence of any irrevocably vested rights, and any other provision inconsistent with its terms was thereby abrogated.[7]

As we shall see below, this declaration of "public order" would later prove to be very relevant in the resolution of the claims filed by sovereign bond holders before the Argentine courts.

The Lock Law

The second law that we shall mention is Law N° 26,017, also known as the "Lock Law" ("Ley Cerrojo" in Spanish).[8]

[3] Published in the Official Gazzette on January 6, 2002.
[4] Emergency Law, Article 1.
[5] Law 26,896, published in the Official Gazzette on October 22, 2013.
[6] Emergency Law, Article 1, subsection 3.
[7] Emergency Law, Article 19.
[8] Law 26,017 published in the Official Gazzette on February 11, 2005.

The Lock Law was enacted as an incentive for holders of the Old Bonds to accept the 2005 exchange. It would actually be more accurately defined as a deterrent to avoid bondholders becoming holdouts.

The Lock Law provided that:

(i) The Executive Power was not allowed to reopen any exchange after the closing of the 2005 exchange.[9] A new exchange would require a new law to be passed by Congress. As no payments were being made under the Old Bonds, those holders that did not enter into the 2005 exchange were subject to uncertainty as to how long it might eventually take till they would have another similar opportunity.

(ii) The Executive Power was prohibited from entering into any kind of judicial, extrajudicial or private settlement regarding the Old Bonds that were not tendered in the 2005 exchange.[10] Therefore the only chance the holdouts would have to collect their credit would be through the enforcement of a judicial sentence, without the alternative of settling any judicial claim. As we have seen that would not be a simple task either.

By means of Law N° 26,547 (the "First Suspension Law")[11], the effects of the Lock Law were suspended in 2010 to allow the second tender offer and debt exchange to be implemented. The Lock Law was suspended until the earlier of December 31, 2010 or the date the Executive Power declared the 2010 exchange offer to be finalized.[12] This First Suspension Law also provided that the terms offered in the 2010 exchange could not be better than those offered in the 2005 exchange[13], and that any holder of Old Bonds that wished to participate in the exchange needed to resign to any claims it may have against the Republic of Argentina in connection to the tendered bonds.[14]

The effects of the Lock Law were finally suspended a second time by Law Nº 26,886 (the "Second Suspension Law").[15] Congress ordered the reopening of the exchange aimed at the 7% of holdouts that had not tendered their Old Bonds in the prior two exchanges.

The bill that proposed this law was filed five days after the Court of Appeals for the Second Circuit of New York affirmed Judge Griesa's interpretation of the *pari passu* clause which ordered Argentina to make ratable payments to the plaintiffs if a payment was made under the Exchange Bonds.

The Republic of Argentina intended to show good will by offering holdouts to tender their Old Bonds in exchange for bonds issued in similar terms as the Exchange Bonds, which were at the time performing bonds that were being paid. In this respect, the

[9] Lock Law, Article 2.
[10] Lock Law, Article 3.
[11] Law 26,547, published in the Official Gazzette on December 10, 2009.
[12] Law 26,547, Article 1.
[13] Law 26,547, Article 3.
[14] Law 26,547, Article 5.
[15] Published in the Official Gazzette on September 23, 2013.

Executive Power is restricted from offering better terms to the holdouts than those offered in the 2010 exchange.[16]

The main two differences between the First Suspension Law and the Second Suspension Law are that: (i) the authority delegated to the Executive Power to offer an exchange is left open for an indefinite period, and (ii) the restrictions to the Executive Power to enter into a judicial, extrajudicial or private settlement with holders of the Old Bonds imposed by the Lock Law are suspended.[17]

Therefore, the two main deterrents under the Lock Law (which were, (i) the restriction to exchange bonds once the 2005 and 2010 tender offer periods closed, and (ii) the restriction to settle any claims of holdouts) are currently suspended until Congress passes a new law providing otherwise.

The 2005 and 2010 exchanges could be considered highly successful. The 2005 exchange was accepted by 76% of the holders of Old Bonds, percentage which was increased to a total of 93% of the holders of Old Bonds in the 2010 exchange.

Argentina had no "carrots" to offer in these exchanges. Tendering bondholders were required to accept a significant haircut of approximately 70% to 75%. The only benefit of tendering was that they would receive Exchange Bonds which the Republic of Argentina was committed to pay, as opposed to the Old Bonds which it was and continues to be committed not to pay.

Therefore the "sticks" provided under the Lock Law and the First Suspension Law described above may have played an important role in the success of the 2005 and 2010 exchanges.

Judicial Precedents

Argentina does not have significant assets abroad, and those that it does have are mostly protected by sovereign immunity. This has been evidenced by numerous failures of the holdouts who have attempted to attach Argentine assets abroad.

Argentina does have assets located in its territory that could be attached. But an attachment of these assets would necessarily need to be resolved by an Argentine court. In this respect, the Argentine courts have played a crucial role in blocking attempts of the holdouts claiming full payment under terms other than those offered in the 2005 and 2010 exchanges.

The Argentine courts have consistently and historically ruled against holders of sovereign bonds who have filed individual claims against the Republic of Argentina. This has occurred in cases where the creditors filed a claim directly before the Argentine Courts, as well as in those cases in which a claim was filed before a foreign

[16] Law 26,886, Article 2.
[17] Law 26,886, Article 7.

court, and the resulting foreign judgment was later filed before the Argentine Courts to obtain execution (proceeding known as "*exequatur*").

As a general rule, the Courts have found that when the Republic of Argentina is in an emergency situation in which it cannot pay its financial obligations, such emergency implies that the "public order" would be affected if an individual judgment ordering payment is issued by the Argentine courts. In this respect, a need to comply with "public order" overrides the individual rights of sovereign debt creditors, and the Republic of Argentina is considered to be entitled to reschedule its debt payments in accordance with the government's actual payment capacity taking into consideration its need to provide essential public services and supply basic public needs.

The Claren case

In *Claren* the plaintiffs initially filed a claim before Judge Griesa in the Southern District of New York, and later filed an exequatur proceeding before the Argentine Courts seeking recognition of the New York Court judgment that ordered the Republic of Argentina to pay amounts due under the defaulted Bonex 2017 sovereign bonds held by plaintiff.

The exequatur was rejected by the Argentine Courts in all three instances: first instance in March 2, 2010[18], Court of Appeals in December 30, 2010[19] and finally by the Argentine Supreme Court on March 6, 2014.[20]

In order for an exequatur to proceed, the Argentine Court needs to verify that several requirements have been complied with.[21] One of these requirements is that the foreign judgment does not violate the Argentine "public order" The Argentine courts found that Judge Griesa's judgment violated the public order principles provided by the Emergency Law and subsequent measures adopted by the Argentine Government to restructure the Old Bonds.

The Supreme Court used several of the arguments proposed by the Attorney General (who also opined the exequatur should be rejected), including the following:

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[18] In re: *"Claren Corporation c. Estado Nacional -Arts. 517/518 Cód. Procesal Civ. y Com. exequátur- s/ varios"*; ruling of *Juzgado Nacional de 1a Instancia en lo Contencioso Administrativo Federal Nro. 9* dated March 2, 2010, published in La Ley Online AR/JUR/6159/2010.

[19] *"Claren Corporation c. Estado Nacional -Arts. 517/518 Cód. Procesal Civ. y Com. exequátur- s/ varios"*; ruling of *Cámara Nacional de Apelaciones en lo Contencioso Administrativo Federal, sala V*, dated December 30, 2010, published in La Ley Online AR/JUR/96745/2010.

[20] *"Claren Corporation c. Estado Nacional -Arts. 517/518 Cód. Procesal Civ. y Com. exequátur- s/ varios"*; Supreme Court judgement dated March 6, 2014, published in El Derecho Constitucional 2014-48; La Ley 2014-C, 342 - La Ley Online AR/JUR/765/2014.

[21] Article 517 of the National Civil and Commercial Procedure Code.

(a) the Bonex 2017 bonds held by the plaintiffs were included among the Old Bonds to be restructured in accordance to the emergency laws and resolutions passed by the Argentine Government;

(b) granting the exequatur would violate public order since it would allow plaintiffs, by means of an individual action brought before a foreign court, to circumvent the restructuring process put in place by the Argentine government through the relevant emergency rules passed by the competent authorities;

(c) the consent given by the Republic of Argentina to submit to the jurisdiction of the courts of New York does not exclude the subsequent foreign judgment from being scrutinized by the Argentine courts to determine compliance of public order principles; and

(d) the control of public order principles must be made at the time an exequatur is brought before an Argentine court as a condition precedent to the recognition of the foreign judgment and may not be postponed to the time of enforcement of such judgment.

The Supreme Court made a broad construction of the powers of the Argentine Government to take exceptional measures in times of grave crises that could limit, suspend or restructure debt payments in accordance with the government's actual payment capacity, the provision of essential public services and the fulfillment of basic public duties. From that perspective, the Supreme Court affirmed that the rules passed by the competent authorities in accordance with the Argentine Constitution and by means of which the Argentine government exercises the above powers, are part of the Argentine public order; consequently, a foreign judgment which is contrary to that public order must not be recognized.

The Supreme Court ruled that the above conclusion is in line with Supreme Court precedents *Brunicardi* and *Galli*, which we comment below.

Claren was followed by the "*Crostelli"* case[22], in which the Supreme Court passed judgement rejecting plaintiff's exequatur procedure in similar terms and grounded its ruling by remitting to *Claren*.

The Galli Case

The plaintiffs in *Galli*[23] were holders of sovereign bonds denominated in United States Dollars that were "pesified" by virtue of Decree 471/2002. Under the provisions of Decree 471/2002, any sovereign bonds governed only by Argentine law denominated in

22 In re: "*Crostelli, Fernando y otros c. EN - M. Economía (arts. 517/518 CPCC exequátur) (BNNY) s/ varios*"; Supreme Court judgment dated November 11,2014, published in La Ley April 06, 2015 - La Ley Online AR/JUR/57132/2014.

23 *"Galli, Hugo Gabriel y otro c/ PEN - ley 25.561 - dtos. 1570/01 y 214/02 s/ amparo sobre ley 25.561"*; Supreme Court ruling of April 5, 2005, published in "Fallos" 328:690.

United States Dollars or another foreign currency were automatically and mandatorily converted to Pesos at a rate of Pesos 1,4 per US dollar or its equivalent in foreign currency.[24] Needless to say, this conversion implied a significant "haircut" to holders.

The plaintiff filed a claim demanding a declaration of unconstitutionality of the provisions of Decree No 471/2002. The First Instance Court and the Court of Appeals ruled in favor of the plaintiffs claim. The Supreme Court, however, overturned such decisions and ruled that Decree 471/2002 was not unconstitutional, rejecting the plaintiffs claim.

The Supreme Court considered that the economic situation immediately prior to Decree No 471/2002 was even more serious than the one that justified the solution in *Brunicardi*, and that, for this reason, these dramatic measures are justified. In addition, the Court followed the doctrine set down in *Brunicardi* by concluding that "international law (*ius gentium)* exists that would free a State from international liability for wholly or partly suspending or modifying payment of external debt, in cases in which it is forced to do so for reasons of financial necessity that cannot be postponed".

Galli was latter reaffirmed by the "*Sacchi*" case dated June 8, 2010, which is grounded by remitting to *Galli*.[25]

The Brunicardi Case[26]

Brunicardi is a Supreme Court precedent which was passed prior to the 2001 crisis (actually, on December 10, 1996). We mention it here because in *Claren* and in *Galli* the Supreme Court makes a cross reference to it as a relevant precedent, and therefore its principles were reaffirmed by these latter cases.

In *Brunicardi* the plaintiffs claimed that a decree and resolutions that unilaterally modified the payment conditions of sovereign bonds called "BONODs" should be declared unconstitutional,[27] and the plaintiffs should therefore be paid under the original terms of such bonds.

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[24] Decree 471, Article 1 provided that "The obligations of the National, Provincial and Municipal Sectors outstanding on February 3rd 2002 denominated in United States Dollars or another foreign currency which are governed only by Argentine law shall be converted to Pesos 1,40 per each United States Dollar or its equivalent in another foreign currency and shall be adjusted by the "*Coeficiente de Estabilización de Referencia (CER)*" (an official index that measures inflation).

[25] *"Secchi, Gonzalo c/ PEN - ley 25.561 - dtos.1570/01 214/02 471/02 (Nación) s/ amparo"*; Supreme Cout judgment dated June 8, 2010, published in http://servicios.csjn.gov.ar/confal/ConsultaCompletaFallos.do?method=verDocumentos&id=685372

[26] "*Brunicardi, Adriano C. c/ Estado Nacional (BCRA.) s/ cobro"*; Supreme Court judgement dated December 10, 1996 published in "Fallos" 319:2886"

[27] The BONODs had been issued under the provisions of Decrees 1334/82 and 1603/82.

The BONODs had been issued by the Argentine Government in 1982 as a consequence of the exchange insurance ("*seguro de cambio*") in effect in prior years. In view of the significant devaluation of the Argentine currency during that period, Argentina had transformed private debt into public debt and modified the terms for payments of the BONODs' amortization of principal.

The Supreme Court ruled that the decrees and resolutions that modified the payment schedule of the BONODs were constitutional and valid[28], and ruled against the plaintiff.

The Supreme Court found that the modification of the payment terms were reasonable and therefore constitutional. Its decision was grounded on many factors: first, the gravity of the general economic situation and the need to avoid default of the public sector; second, the "sovereign" nature of the act ("*acto soberano*") of issuing the BONODs; and third, the reasonableness of the modification, which, in the Supreme Court's understanding, did not entail a confiscatory act nor violate the constitutional right to property, since it only deferred compliance which would be carried out in terms and conditions deemed compatible with collective interest.

Final Comment

As Argentina is a republic in which the Legislative, Executive and Judicial Powers each play different roles in accordance to the provisions of the National Constitution, it could not be assured in advance that these powers would act as a consistent front. From the examples we have analyzed here (which as we stated above are only a few illustrative examples) we conclude that in the Argentine sovereign debt restructuring that began in 2002 these three powers have acted consistently to the benefit of the Republic of Argentina as a sovereign negotiating with its creditors.

[28] Executive Power Decree 772/86 and Resolutions of the Ministry of Economy 450/86 and 65/87