

The Roots of Argentina's Holdout Litigation

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The voluminous litigation involving the Republic of Argentina, mainly as defendant before the federal courts of the United States, captured the attention of many fixed-income intermediaries and investors during 2002-2016. However, as time passed, a new generation of investment bankers, traders, and institutional investors has come on the scene without much knowledge of the context which gave rise to that long-running litigation. This article revisits the historical facts and provides appropriate context, because the sheer size of the government's 2001 default, the largest-ever up to that point, does not explain the scale of Argentina-related litigation that followed. Instead, its true origins are to be found in the unusually coercive and aggressive way that the authorities in that country went about defaulting on, and attempting to restructure, their sovereign debt obligations. It was a major deviation from best practices as understood and settled in the early 2000s, which codified how economic policy adjustments are to be made in a way that limits damage to the business climate, minimizes holdout investors, preserves access to the international capital markets, and promotes rapid and sustainable economic growth, that was at the roots of the epic Argentina litigation.

BACKGROUND

During most of recorded history, private lenders and investors did not have the necessary legal rights to demand, never mind the legal mechanisms to compel, payment from foreign states. Sovereigns accepted that their counterparts could not be held accountable in their domestic courts under what came to be known as the doctrine of "absolute" sovereign immunity. Faced with an event of default, and lacking any legal remedies, private creditors would accept non-payment or else new payment terms decided unilaterally by foreign states. Alternatively, they would band together to limit a sovereign debtor's access to new capital, thereby gaining some leverage to discuss a settlement.¹ Or else they would pressure their own governments to take up their cause and negotiate on their behalf, which if they did would lead to retaliation against the deadbeat sovereign through the imposition of trade sanctions, or in the extreme, military intervention for the purpose of collecting on unpaid debts – "gunboat diplomacy."

After the end of World War II, governments increasingly sought ways to minimize being dragged into cross-border payments disputes involving their private sectors, and also means to start holding accountable the growing number of state-owned enterprises, including Soviet firms,

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¹ The most institutionalized, powerful, and celebrated such creditor association was the British Corporation of Foreign Bondholders (CFB), established in London in 1868. By approving or withholding access to the London financial market, it was able to negotiate with the governments of Argentina, Brazil, Greece, Mexico, Peru, Spain, Portugal, and Turkey, among others. CFB-type organization were eventually set up in France and Belgium (1898), Switzerland (1912), Germany (1927), and the United States (1933). The CFB and its counterpart organizations in other countries remained active until the 1950s, when most of the sovereign defaults of the 1930s were settled. Federico Sturzenegger & Jeromin Zettelmeyer, *Debt Defaults and Lessons from a Decade of Crises* 11 (2007).

whose legal immunity gave them an unfair advantage over private companies in the West.² In 1952, the U.S. Department of State adopted what is nowadays referred to as the “restrictive” theory of foreign sovereign immunity, under which foreign states are entitled to immunity from suit for their sovereign (public) acts but not for their commercial activities – the classic distinction between acts *jure imperii* and acts *jure gestionis*. The State Department retained for itself initial responsibility to decide questions of sovereign immunity using the new immunity framework, but the policy’s application left a great deal to be desired, because Foggy Bottom did not always issue an opinion on misbehaving sovereigns, or else it was conflicted by foreign-policy considerations.³ Moreover, the property of foreign states continued to be absolutely immune from execution to satisfy any judgments obtained through the U.S. courts.

The restrictive theory of sovereign immunity was codified into U.S. law through the Foreign Sovereign Immunities Act (FSIA) of 1976, and shortly thereafter, the United Kingdom passed a similar law, the State Immunity Act of 1978. Many other countries have since followed in their footsteps, or else their courts have expressly accepted the concept of restrictive (or relative) sovereign immunity – one that the Council of Europe had already adopted via the European Convention on State Immunity of 1972, which became effective in 1976.⁴

The FSIA was passed to provide a statutory framework for resolving issues of sovereign immunity through the judicial branch without reliance on the State Department. The law established the general rule that foreign government property is immune, but setting out exceptions (28 U.S.C. 1330, 1602-1611) under which U.S. courts may exercise jurisdiction over a foreign state (e.g., when it has waived its immunity or engaged in commercial activities) and may subject foreign state assets to attachment, arrest or execution. It was passage of the FSIA and its equivalents elsewhere which gave rise to the first cases of litigation against sovereign debtors in the 1980s, including commercial banks seeking to collect on their defaulted loans to governments or their entities.

A comprehensive study of litigation against sovereigns during the period 1976-2010, focused on foreign commercial banks or institutional investors with claims related to loan or bond contracts, identified 120 instances of legal actions against a total of 25 defaulting sovereigns.⁵ Interestingly, 102 of them (85 percent) comprised cases filed in the United States, mostly in the Southern District of New York, suggestive of the dominance of New York law as a venue for contract-writing and of the federal courts based in Manhattan for contract-dispute resolution. Only 30 out of 180 sovereign defaults in 68 countries, or less than one-fifth of total, engendered any litigation at all – half of them a single lawsuit – suggesting that most defaults and ensuing debt restructurings were accepted by the parties involved.

Most relevant to this article, Argentina alone accounted for one-third of the case universe, with 41 commercial-creditor lawsuits filed – and all of them following just one of its four defaults during the 1976-2010 period: the one that took place in December 2001-January 2002. According

² Mark B. Feldman, *The United States Foreign Sovereign Immunities Act of 1976 in Perspective: A Founder’s View*, 35 Int’l & Comp. L.Q. 302 (1986).

³ *Id.* at 303-04.

⁴ Alice de Jonge, *Transnational Corporations and International Law: Accountability in the Global Business Environment*, 112 (2011).

⁵ Julian Schumacher, Christoph Trebesch & Henrik Enderlein, *Sovereign Defaults in Court*, draft, May 6, 2014, available at <https://sites.google.com/site/christoph-trebesch/research/SovereignDefaultsinCourt.pdf?attredirects=0> Lawsuits filed by retail investors were excluded, as were multiple suits (in different jurisdictions) by the same creditor, and disputes over procurement bills or unpaid checks.

to the study, no other country or default has ever attracted anywhere near as much litigation. Argentina's prominence in this arena is particularly evident given the number of lawsuits and class actions filed also by retail investors, as discussed below, which the study excluded from consideration.

At first glance, the scale of Argentina-related litigation might be explained by the sheer size of the government's 2001 default. At the time, it was the largest in history, involving potentially \$145 billion in public indebtedness, although it soon became clear that the default would apply to less than \$95 billion in obligations largely to non-resident bondholders, and to a lesser extent to official creditors such as trade-finance banks (e.g., the U.S. Export-Import Bank) and foreign-aid agencies.⁶ In early 2012, however, Greece's own default set a new world record with a restructuring involving approximately \$265 billion (more precisely, €196 billion) of obligations to domestic and foreign bondholders.⁷ The gigantic Greek default attracted not a single lawsuit, nonetheless, even though in the days before the restructuring a "wave of potential litigation" reportedly was a threat.⁸ This was the case despite the fact that the Greek restructuring imposed even heavier losses on bondholders than did the Argentine restructuring, something which could have prompted the proverbial runs to the courthouse.⁹

There are factors other than default size that provide the best explanation for the origins of the Argentina litigation, and they relate to the unilateral, coercive and aggressive way the authorities in that country went about managing, defaulting and restructuring their debt obligations.

DEPARTURES FROM BEST PRACTICE

Argentina's behavior during 2002-2015, as detailed below, strayed very far from best practice as settled already in the early 2000s, by which time plenty of experience had been accumulated from a multitude of sovereigns having encountered debt-servicing difficulties in the 1980s and 1990s. Indeed, it was partly out of concern that Argentina's wayward behavior would set an undesirable precedent that the "Principles for Stable Capital Flows and Fair Debt Restructuring" were conceived. They constitute a voluntary code of conduct between sovereign debt issuers and their private-sector creditors that was agreed in the early 2000s, encouraged by the G20 Ministerial Meeting of 2002, and welcomed by the same body in Berlin two years later.¹⁰ Best practices in the

⁶ Most resident bondholders had already been subject to a restructuring in November 2001. The official bilateral creditors mentioned were owed less than \$5 billion as of end-2001, see Argentina Ministerio de Economía y Producción, Secretaría de Hacienda, *Boletín Fiscal 4to Trim. 2001*, available at <http://www.mecon.gov.ar/onp/html/boletin/4totrim01/pdf/fisc25.pdf>

⁷ Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, *The Greek Debt Restructuring: An Autopsy*, 28 *Econ. Pol.* 513 (2013).

⁸ Sarah White & Tommy Wilkes, *Hedge funds prepare legal battle with Greece*, Reuters, Jan. 24, 2012, available at <http://www.reuters.com/article/2012/01/24/greece-hedge-funds-idUSL5E8CN0OR20120124>

⁹ According to rating-agency Moody's, Argentina's restructuring in 2005 imposed losses of 71 percent, and Greece's in 2012 entailed losses of 76 percent, as measured by average issuer-weighted prices of sovereign bonds the day before the close of their respective distressed-debt exchanges. Moody's Investors Service, *Investor Losses in Modern-Era Sovereign Bond Restructurings*, Aug. 7, 2012, available at <http://av.r.ftdata.co.uk/files/2012/09/Sovereign-Default-Series-Investor-Losses-in-Modern-Era-Sovereign-Bond-Restructurings.pdf>

¹⁰ Institute of International Finance, "Principles for Stable Capital Flows and Fair Debt Restructuring," *Report on Implementation by The Principles Consultative Group* 33 (Oct. 2014), available at <https://www.iif.com/file/6573/download?token=sVzJwuyF> The seed of the Principles was planted in 2001 when Jean-Claude Trichet, then Governor of the Banque de France, floated the idea of devising a code of conduct on sovereign debt restructuring, to be embraced by the public as well as the private sector, see Raymond Ritter, *Transnational Governance in Global Finance: The Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets*, 11 *Int'l Studies Persp.* 225 (2010).

early 2000s are also distilled in an informative book published in 2003, which explained how sovereign debt restructurings had been handled during the 1980s and 1990s by the official and private sectors.¹¹ It is on the basis of these two sources, plus directly relevant personal experience,¹² that the following table has been prepared.

Table 1: Argentina’s Behavior Relative to Best Practice in Sovereign Debt Management

	<u>Best Practice</u>	<u>Argentina</u>
Engage in a regular dialogue with creditors on key economic and financial policies.	Yes	No
Consult with creditors on how to forestall debt-service problems before defaulting.	Yes	No
If a debt restructuring becomes inevitable, enter into timely, good-faith negotiations.	Yes	No
Stop incurring debt when already burdened by too much debt.	Yes	No
Seek debt relief appropriate to the nature of the liquidity or solvency problem.	Yes	No
Recognize interest arrears, and treat them preferentially versus past-due principal.	Yes	No
Seek the financial support and endorsement of multilateral agencies.	Yes	No
Make a good-will, up-front cash payment – especially when circumstances permit.	Yes	No
Aim for 100% creditor participation, in order to minimize a holdout problem.	Yes	No

Starting in 2001, as economic and financial problems worsened, communications with Argentina’s lenders and investors broke down just when they should have intensified. The International Monetary Fund (IMF) became Argentina’s single-largest creditor in 2001, with net disbursements of nearly \$9 billion that year which brought the Fund’s exposure to a peak of \$14 billion.¹³ The authorities took numerous economic measures in 2001 to kick-start the economy, eliminate the fiscal deficit and restore investor confidence under extraordinary powers granted by the Argentine congress, but most of them were announced or adopted without prior consultation

¹¹ Lex Rieffel, *Restructuring Sovereign Debt: The Case for Ad Hoc Machinery*, 95 (2003).

¹² This author was a senior international economist for various Wall Street firms from 1977 through 2005, and was directly involved in several sovereign debt restructurings during his tenure, see <http://www.american.edu/sis/faculty/aporzeca.cfm>

¹³ The IMF provided five successive financing arrangements to Argentina during 1991-2001. From early 2000 onward, the IMF-supported programs attempted to address the country’s worsening recession and, increasingly, the government’s inability to access the international capital markets through the provision of substantial funds. IMF Independent Evaluation Office, *The IMF and Argentina, 1991-2001* 9 (2004).

with the IMF – never mind with private creditors.¹⁴ The measures backfired, engendering capital flight, social protests and political instability, which in turn provoked the resignation of President Fernando de la Rúa on December 20, 2001.

There followed two chaotic weeks in late December during which a default on the public-sector debt was announced by Acting President Adolfo Rodríguez Saá. The venue was his inaugural address to the legislature right after his swearing-in, and the justification provided for the moratorium was to redirect debt-service funds to an emergency jobs program and an increase in social spending – a decision greeted by the assembled legislators with a standing ovation.¹⁵ The default was confirmed in early January 2002 by President Eduardo Duhalde, who had been elected by the Legislative Assembly to serve through 2003. There followed a raft of additional economic measures which likewise were undertaken without consulting the IMF, and which not only failed to stabilize the economic situation but complicated the eventual resolution of the financial crisis.¹⁶ In sum, Argentina neither maintained a dialogue with its creditors about its key economic and financial policies, nor did it consult with them on how to forestall a default.

In terms of engaging in timely, good-faith negotiations with its creditors, there was none of that. In February 2002, the then Economy Minister issued a first press release, explaining that the government was “devoting every effort to formulate and implement the various elements of its new economic program” and that it was preparing “plans for a proper basis for engaging in a fruitful dialogue with Argentina’s external creditors.”¹⁷ It was followed in April by a second communication stating that while Argentina was committed to a dialogue with its bondholders, the government had concluded “that it [is] preferable to initiate such a dialogue once greater certainty has been achieved.”¹⁸ Other such press releases followed, yet despite the formation of several bondholder groups ready to meet and negotiate, and the filing of the first lawsuits against Argentina,¹⁹ no dialogue was initiated in 2002 or 2003 – never mind a negotiation process. The following is how a recent IMF retrospective summarized the post-default situation:

“[T]he authorities were expected to negotiate with creditor committees that were judged to be representative and formed in a timely manner. Although there were over thirty creditors’ committees, the Fund assessed that the Global Committee of Argentina Bondholders (GCAB) represented about one-half of Argentina’s external private debt, and was therefore representative for the purposes of [our] policy. In the end, however, no constructive dialogue was observed and the authorities presented a non-negotiated offer, which eventually led to a restructuring of eligible debt and past-due interest of about two-fifths of total debt, more than three years after the default.”²⁰

¹⁴ *Id.*, 46-47, 60-61.

¹⁵ Asamblea Legislativa, República Argentina, Versión Taquigráfica, Sesión 22/23 de diciembre de 2001, available at <http://www.l.hcdn.gov.ar/dependencias/dip/documentos/asuncion/22.12.01.RodriguezSaa.pdf>

¹⁶ Christina Daseking, Atish Ghosh, Timothy Lane, & Alun Thomas, *Lessons from the Crisis in Argentina* 38 (IMF Occasional Paper #236, 2004).

¹⁷ Argentina Ministry of the Economy and Infrastructure, *Press Release*, Feb. 8, 2002, available at <http://www.emta.org/WorkArea/DownloadAsset.aspx?id=3214>

¹⁸ Argentina Secretary of Finance, Letter to Bondholders, Apr. 10, 2002, available at <http://www.emta.org/WorkArea/DownloadAsset.aspx?id=3248>

¹⁹ For example, an attachment order was issued on July 19, 2002 by a court in Rome against the Republic of Argentina on behalf of a group of individual Italian bondholders. Argentina Ministry of the Economy and Infrastructure, *Press Release*, July 29, 2002, available at <http://www.emta.org/WorkArea/DownloadAsset.aspx?id=3246>

²⁰ IMF, *Sovereign Debt Restructuring: Recent Developments and Implications for the Fund’s Legal and Policy Framework*, Apr.

It has also been good practice for sovereigns claiming to be over-indebted to stop accumulating new liabilities, but the authorities in Argentina did just the opposite. Especially damaging was the government's announcement in February 2002 that banks' assets and liabilities would be subject to an asymmetric conversion from U.S. dollars into Argentine pesos. Their existing stock of dollar-denominated assets and liabilities would be forcibly converted at the pre-existing, one-to-one exchange rate in the case of loans to the private sector but at a different, 1.4-to-one rate for loans to the government and for dollar deposits, which henceforth were also indexed to inflation.²¹ The measure was intended to cushion firms and households with foreign-currency denominated debt to banks, by shifting the cost of the devaluation to the banking industry. However, since the banks could not possibly cope and most were rendered insolvent as a result, the burden was ultimately shifted to taxpayers and to the government's creditors, because banks had to be reimbursed for their losses through "compensation bonds" issued by the government.²² Other policy decisions which added to the central government's debt burden were the takeover of liabilities incurred by provincial governments in prior years and the issuance of still more bonds to settle previously contingent liabilities with pensioners, civil servants, victims of human rights abuses, and others.²³

Perhaps the one decision on Argentina's part that grated on investors the most was the authorities' demand for massive debt forgiveness despite the fact that, by the time a take-it-or-leave-it restructuring plan was put to them in early 2005, the economy had substantially recovered.²⁴ In general, governments seek debt relief appropriate to the magnitude and nature of their liquidity or solvency problem, and their calculations are usually vetted by multilateral institutions like the IMF and the World Bank. That way, bondholders have some assurance that the losses (in market parlance, the "haircut") they are asked to take are in accordance with the sovereign's present and potential ability to pay. The irony is that if Argentina had sought major debt relief in 2002, soon after the default and when the economy was in a depression, it probably would have been received with greater sympathy.

However, by waiting for three excruciatingly long years to put its restructuring plan forward, giving time for an intervening commodity export boom to power a vigorous economic recovery which substantially replenished Argentina's coffers, the authorities undermined their case. For example, the government's tax revenues had already doubled between 2002 and 2004 measured in dollars, and the country's official international reserves had recovered similarly, from under \$10 billion in early 2003 to over \$20 billion by early 2005.²⁵ And yet, the forecasting model used by Argentina's economic team to plead poverty to its creditors was never updated to reflect the strong economic rebound underway. It was also loaded with excessively pessimistic assumptions as to what the future would bring in terms of crucial variables such as exports and tax revenues. During 2006-2012, the economy ended up growing twice as fast as the government's forecasts vintage

26, 2013, 36, available at <https://www.imf.org/external/np/pp/eng/2013/042613.pdf>

²¹ *Se pesifican todas las deudas uno a uno*, La Nación, 3 Feb. 2002, available at <http://www.lanacion.com.ar/371402-se-pesifican-todas-las-deudas-uno-a-uno>; Sturzenegger & Zettelmeyer, *supra* note 1, at 182-186.

²² Daseking, et al., *supra* note 16, at 38.

²³ Arturo C. Porzecanski, *From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default*, 6 Chi. J. Int'l L. 318 (2005).

²⁴ For example, according to a monthly index of seasonally-adjusted economic activity, Argentina had returned to its pre-crisis high by March 2005. Ministerio de Economía y Finanzas Públicas, Dirección Nacional de Política Macroeconómica, *Nivel de Actividad: Cuadro 1.4*, available at http://www.mecon.gov.ar/download/infoeco/actividad_ied.xls

²⁵ Arturo C. Porzecanski, *Don't Cry for Rogue Debtor Argentina*, The Financial Times, June 12, 2014, available at <http://blogs.ft.com/beyond-brics/2014/06/12/guest-post-dont-cry-for-rogue-debtor-argentina/>

late 2004, with actual export earnings and tax revenues outperforming the gloomy official assumptions by even greater multiples.²⁶ Therefore, by early 2005, Argentina was positioned to justify only a modest amount of debt and debt-service relief from its creditors – and quite a few of them knew it.²⁷ Therefore, the impression conveyed by the authorities was that Argentina was suffering from a case of unwillingness more than inability to pay.

Argentina's debt-restructuring proposal of early 2005 departed from best, or even customary, practice in several other ways. While other sovereigns in financial trouble, including Argentina itself in the past, had actively sought to avoid an event of default or had moved promptly to cure any default, in this case the government dragged its feet for more than three years and, adding insult to injury, largely refused to recognize the interest arrears that its own delay had generated.²⁸ Contrary to other restructurings before, including those of Argentina previously, the 2005 plan was not accompanied by the usual reassuring endorsement – never mind backed with financial support – from the IMF, World Bank, or even a regional development agency like the Inter-American Development Bank.²⁹ And in another break from tradition, Argentina's 2005 restructuring failed to include an upfront payment to clear a portion of interest or principal arrears, a common "sweetener" to ensure success which the country could afford.³⁰

THE HOLDOUT PROBLEM

With the benefit of hindsight, probably the most self-defeating departure from convention was Argentina's decision not to aim for 100 percent participation of its bondholders in the debt restructuring, or even to set a high bar (e.g., 85 or 90 percent approval) for the transaction to go forth, in order to prevent a holdout problem. In fact, when launching the debt restructuring proposal, Economy Minister Roberto Lavagna went so far as to state that the government would regard any participation rate above 50 percent as having effectively cured the country's default.³¹ The clear implication was that even if nearly half of all bondholders failed to accept the terms of the punishing debt restructuring, they would and could be ignored. To ensure the message was heard loud and clear, three weeks into the transaction, the government sent a draft law to the legislature forbidding the Executive from reopening the transaction in the future, and engaging in any dealings with bondholders arising from any court order or otherwise, without prior approval

²⁶ *Id.*

²⁷ *Grinding Them Down: Brutal Tactics May Pay Off – For Now*, *The Economist*, 13 Jan. 2005, available at <http://www.economist.com/node/3564904> ("Many bondholders are furious. They say Argentina, whose economy is growing strongly, could pay more;"); see also Andrew J. Barden, *UBS, an Adviser to Argentina, Tells Clients Debt Offer Is Low*, *Bloomberg News*, 21 Jan. 2005, available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aUVIh1osg14&refer=news_index (quoting Zurich-based Oussama Himani, head of emerging market research at UBS Wealth Management, as having published that "Argentina's offer to repay bondholders 25 cents per dollar of defaulted debt is below the country's capacity to pay").

²⁸ Argentina refused to pay the interest arrears accumulated in 2002 and 2003, whether calculated at contractual or lower interest rates – until that time, the only government to have taken this stance with bondholders. Sturzenegger & Zettelmeyer, *supra* note 1, at 190.

²⁹ Porzecanski, *supra* note 23, at 325; Sturzenegger & Zettelmeyer, *supra* note 1, at 196.

³⁰ Porzecanski, *supra* note 23, at 325.

³¹ *Lavagna dijo que 'con el 50% de aceptación' se saldría del default*, *La Nación*, 12 Jan. 2005, available at <http://www.lanacion.com.ar/670384-lavagna-dijo-que-con-el-50-de-aceptacion-se-saldria-del-default>; and Annabella Quiroga, *Lavagna lanzó el canje y reiteró que no habrá una nueva oferta*, *Clarín*, 13 Jan. 2005, available at <http://edant.clarin.com/diario/2005/01/13/elpais/p-00301.htm>

by the legislature.³² This infamous “Lock (or Cram-Down) Law” was passed within one week. The law thus complemented Argentina’s warnings in the deal’s prospectus, and in all presentations in the major capitals, that any existing defaulted bonds that were eligible to be restructured but were not tendered would remain in default indefinitely – because the government had no intention of ever resuming payments on those bonds.³³

A recent scholarly study of sovereign defaults, which provides the first comprehensive and systematic assessment of debtor-government behavior during financial crises, puts the above observations into comparative context.³⁴ The authors developed an objective index of government coerciveness, capturing confrontational debtor policies vis-à-vis private external creditors in times of debt distress, drawing on criteria suggested by the IMF and the Institute of International Finance, one of the main contributors to the aforementioned Principles. Their sample includes just over 100 restructurings involving commercial banks and bondholders, whether domestic or foreign, during the 1980-2007 period – the universe of sovereign default and restructuring relevant to private-sector lenders and investors. The following is the study’s most pertinent result:

“The well-known case of Argentina from 2001 to 2005 displays an exceptional degree of coerciveness, as the government officially declares a default, sticks to the proclaimed moratorium by stopping all payments to its bondholders for four years, freezes foreign assets, and rejects any meaningful negotiations.”³⁵

Argentina’s choice to defy convention and rely heavily on a “stick” rather than “carrot” approach to creditor participation in its debt restructuring was a risky strategy. The 2005 restructuring was accepted by a mere 76 percent of total bondholders (namely, the owners of \$62.3 billion of defaulted bonds out of a target universe of \$81.8 billion), far below the 95 percent average degree of creditor participation registered in 34 sovereign bond restructurings from 1997 through early 2013.³⁶ On the one hand, the transaction succeeded in erasing \$27 billion of principal owed and in achieving also significant concessions in terms of greatly extended maturities, drastically lower coupons, and forgiveness of 2002-03 past-due interest payments incorporated into the \$35.3 billion of new bonds issued – all in all, a “haircut” to participating bondholders of at least 70 percent. On the other hand, Argentina created for itself a holdout constituency without precedent: the owners of nearly \$20 billion in defaulted bonds accruing contractual interest from December 2001 at high coupons and high penalty rates on any arrears. The holdouts featured mostly foreign investors whose participation rate in the restructuring was much lower (an estimated 63 percent) than among Argentine investors (around 95 percent).³⁷ These holdouts included institutional and retail investors from all around the world.

³² The law (Law No. 26,017, adopted on 9 Feb. 2005) also mandated the government to do everything in its power to delist all bonds not tendered into the exchange, and to unilaterally exchange all bonds tied up in litigation against Argentina into new Par bonds denominated in pesos and maturing in 2038. *Argentina, Addendum to Prospectus Supplement dated January 10, 2005*, Feb. 4, 2005, available at http://www.mecon.gov.ar/finanzas/sfinan/english/download/addendum_feb_4.pdf

³³ Republic of Argentina, *Prospectus Supplement* (to Prospectus Dated Dec. 27, 2004) Filed Pursuant to Rule 424(b)(5), Jan. 10, 2005, S-29, available at <http://www.sec.gov/Archives/edgar/data/914021/000095012305000302/y04567e424b5.htm>

³⁴ Henrik Enderlein, Christoph Trebesch & Laura von Daniels, *Sovereign Debt Disputes: A Database on Government Coerciveness during Debt Crises*, 31 J. Int’l Mon. & Fin. 250 (2012). The index consists of 9 sub-indicators grouped into two broad categories capturing payment and negotiation behaviors (including patterns and rhetoric employed).

³⁵ *Id.*, 261.

³⁶ Moody’s Investors Service, *The Role of Holdout Creditors and CACs in Sovereign Debt Restructurings*, Apr. 10, 2013, 32-33, available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_150162

³⁷ Sturzenegger & Zettelmeyer, *supra* note 1, at 192-193.

Evidently, while the threat of indefinite non-payment for holdouts helped to persuade some bondholders to capitulate and accept the harsh terms on offer, it also motivated others to spurn the deal and either file suit or else await better treatment on the part of some future government. And investors who had purchased any of the numerous bonds that Argentina had issued under New York State law according to a Fiscal Agency Agreement (FAA) structure certainly had strong legal rights: as was typical of indentures up until the early 2000s, the 1994 FAA contained provisions to protect purchasers of its bonds from subordination, and provided that a holder's right to receive payment of principal and interest on their respective due dates could not be impaired without their consent.³⁸ In the past decade, in contrast, the typical bond indentures used by sovereign borrowers, whether in New York or in Europe, have come to include collective-action clauses enabling a qualified majority of bondholders (typically, 75 percent) to approve payment and other modifications in a vote that binds the minority of dissenting bondholders.

Given that by the time the debt restructuring deal was being formulated the authorities in Argentina knew that a number of investors had already taken the path of litigation, it is surprising that they nevertheless decided to persevere with such a confrontational approach. In the prospectus presenting the debt restructuring offer filed with the Securities and Exchange Commission (SEC) in January 2005, it was disclosed as follows:

“Bondholders have initiated numerous lawsuits against Argentina in the United States, Italy and Germany based on the Government's default on its public debt obligations. In the United States, approximately 39 suits, including one suit certified as a class action and 14 suits purporting to be class actions, have been filed since March 2002, and judgment has been entered against the Government in seven cases in a total amount of approximately \$740 million. In Italy the total amount claimed in bondholder proceedings against the government is €64 million plus interest, while in Germany the total amount claimed is €58 million plus interest. We can give no assurance that further litigation will not result in even more substantial judgments granted against the Government. Present or future litigation could result in the attachment or injunction of assets of Argentina that the Government intends for other uses, and could have a material adverse effect on public finances and on the market price of new securities we issue in an exchange offer.”³⁹

In a lengthy insider's account of the transaction by one of its leading architects, the then Finance Secretary of Argentina Guillermo Nielsen, published in March 2006, a year after the transaction closed, he spent more than 5,000 words describing everything that transpired behind closed doors in the run-up to the landmark debt restructuring.⁴⁰ Surprisingly, the words “holdout” or “litigation” never even came up in Nielsen's narrative. Apparently, the Argentine authorities and their financial and legal advisors – mainly Barclays Capital and Cleary, Gottlieb, respectively – must have been persuaded that achieving large-scale debt relief, even if by highly confrontational means, was a goal worthy of the risk of generating a major holdout problem – possibly because as

³⁸ David J. Johnson Jr., *Some Lessons for Distressed Debt Participants from the Argentina-NML Dispute*, July 3, 2014, available at <http://www.omm.com/fcwsite/abc.aspx?url=newsroom%2fopenPDF.aspx%3fpub%3d1495>

³⁹ Republic of Argentina, *Prospectus Supplement*, *supra* note 31, at 27.

⁴⁰ *Inside Argentina's Financial Crisis*, 37 *Euromoney* 64 (2006).

of that date investor litigation had not caused major headaches for Argentina.⁴¹ Private creditors, after all, faced serious difficulties in executing judgments and collecting assets from Argentina.

In the years following the 2005 debt restructuring, Argentina's economy, tax revenues and export earnings continued to outperform all expectations (except during the global financial crisis, from mid-2008 through mid-2009), greatly enhancing the country's ability to service its debts – including its remaining defaulted obligations. However, despite this improvement in creditworthiness and some intervening changes in political leadership,⁴² the government maintained an unyielding attitude toward investor holdouts.

As time passed and it became evident that, whether they litigated or not, holdout investors would neither collect nor get better terms from an intransigent Argentina, most of them gradually came to accept the idea that recovering something was better than nothing. Therefore, upon advice from its leading banks (mainly Barclays Capital, again), in late 2009 the government requested the Argentine congress to temporarily suspend the “Lock Law,” so that the debt-restructuring window could be opened anew to bondholders who had rejected the 2005 transaction.⁴³ Tenders of defaulted bonds were accepted during May-September and again in December of 2010 on slightly worse exchange terms than those applied in 2005.⁴⁴ The result was that approximately two-thirds of the holdouts accepted the conditions, such that about \$12.4 billion of defaulted principal was tendered in exchange for new bonds. Consequently, the bondholder participation rate in Argentina's restructuring increased from the initial 76 percent to over 92 percent of the universe of defaulted bonds – in other words, the reopening had greatly reduced the holdout universe from 24 percent to just over 7 percent of the original bonds, or an estimated \$6 billion plus accrued interest and penalty interest.⁴⁵

The dramatic reduction in the universe of holdouts had mixed consequences. On the one hand, fewer holdouts meant that in 2010 Argentina came closer to achieving its original restructuring objectives – over 92 percent of its 2001 defaulted, bonded debt had been put through the wringer and was now performing – and to normalizing its relations with the international investor community.⁴⁶ On the other hand, after spurning two opportunities to take their losses and conform, the remaining holdouts now constituted a committed, hard core of disgruntled investors who were

⁴¹ The government at the time, and since then, has not returned to the international capital markets, such that lack of access evidently has not been viewed as a problem worth solving by settling with holdout creditors.

⁴² President Néstor Kirchner was in office from May 25, 2003 until Dec. 10, 2007, and he was succeeded by his wife Cristina Fernández de Kirchner.

⁴³ Later that year, Argentina started informal conversations with member countries of the so-called Paris Club, a gathering of representatives from official trade-finance and foreign-aid agencies, because its obligations to them had remained in default since end-2001. However, it was not until May 2014 that Argentina finally agreed to pay 100 percent of the principal and interest payments it owed its official bilateral creditors, albeit on a 5-year installment plan, and the government made its first payment on July 30, 2014, as scheduled. See *The Paris Club and the Argentine Republic agree to a resumption of payments and to clearance of all arrears*, May 29, 2014, available at

<http://www.clubdeparis.org/sections/communication/communiqués/argentine/switchLanguage/en>

⁴⁴ In 2005, past-due interest for 2014 was paid in cash; in 2010, past-due interest since 2003 was paid with bonds.

⁴⁵ Argentina Ministry of the Economy and Public Finance, *Debt Report*, Sep. 30, 2010, available at http://www.mecon.gob.ar/finanzas/sfinan/english/download/informe_deuda_publica_30-09-10_english.pdf, and Dec. 31, 2010, available at http://www.mecon.gob.ar/finanzas/sfinan/english/download/informe_deuda_publica_31-12-10_ingles.pdf

⁴⁶ A reflection of this progress is that in the wake of the successful 2010 reopening, Fitch Ratings upgraded Argentina's long-term, foreign-currency rating to 'B' from 'RD' (Restricted Default), see Fitch Ratings, *Fitch Lifts Argentina out of Default to 'B'; Outlook Stable*, July 12, 2010, available at https://www.fitchratings.com/creditedesk/press_releases/detail.cfm?pr_id=599659; and Standard & Poor's followed with an upgrade of its long-term, foreign- and local-currency credit ratings on Argentina to 'B' from 'B-', see Standard & Poor's, *Ratings on Republic of Argentina Raised to 'B'*, Sep. 10, 2010, available at <http://www.emta.org/WorkArea/DownloadAsset.aspx?id=6127>

seemingly determined to litigate against Argentina until the bitter end. An illustration of the latter aspect is that in Argentina's Form 18-K Annual Report filed with the SEC in 2011, the authorities had to devote about 4,400 words to describe the litigation challenges they faced in the United States, Europe, and Japan, versus fewer than 200 words devoted to the subject in the aforementioned filing in 2005.

In particular, the 2011 filing detailed litigation in the United States involving over 150 individual lawsuits, on which judgments had been entered in almost 110 cases for nearly \$5.9 billion of past-due principal and interest; 18 class-action suits representing groups of retail investors, of which 13 had been certified; and multiple attempts to attach Argentine commercial and other property in the United States. In Germany, nearly 650 legal proceedings had been initiated against Argentina by bondholders, and more than 460 judgments had been rendered against it, for some €240 million in principal plus interest. The government also had to contend with ongoing litigation in Belgium, France, Italy, Japan and Switzerland.⁴⁷ It is some of this litigation that would come to haunt Argentina in 2013-14, precipitating a renewed default on the new bonds issued in 2005 and 2010.

CONCLUSION

In sum, it is our contention that the origins of Argentina's litigation epic are to be found in the country's aberrant behavior both at home and abroad, starting in 2001 even ahead of the actual default. For ideological reasons, successive governments in Buenos Aires refused to follow the well-worn playbook of how economic policy adjustments are to be made in a way that limits damage to the business climate, minimizes holdout investors, preserves access to the international capital markets, and promotes rapid and sustainable economic growth. They chose quite deliberately to sacrifice the strategic, portfolio, and other investors who entered into Argentina during the 1990s and helped to catapult the country into the modern era – and did so in accordance with a nationalist and populist ideology which held that the income and wealth of investors ought to be redistributed mainly to urban consumers, via energy and other subsidies and artificially low prices for public utilities. The costs were enormous legal expenses, a besmirched national reputation, discouraged domestic and foreign investment, a mountain of unpaid claims (especially past-due interest and penalty interest), and limited, intermittent access to the international capital markets. Argentina's self-defeating path during 2001-2015 is one that other countries would we well advised to avoid.

⁴⁷ Republic of Argentina, *Form 18-K Annual Report* (filed with the U.S. SEC), Sep. 30, 2011, 181-188, available at http://www.sec.gov/Archives/edgar/data/914021/000090342311000486/roa-18k_0928.htm