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# Some Lessons for Distressed Debt Participants from the Argentina-NML Dispute

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The continuing saga between the Republic of Argentina and a hold out group of investors led by NML Capital, an affiliate of Elliott Management in New York, in relation to sovereign bonds issued by Argentina is a fascinating display of what can happen when a well-funded creditor is dissatisfied with the settlement offered by a distressed debtor. While the outcomes of these related cases may not actually be important as a matter of precedent beyond the sphere of sovereign debt (and may even be fairly limited even in relation to sovereign issues), the recent events made us pause and reflect on some of the more interesting questions we see in the international corporate distressed debt market.

First, a quick review of the *Argentina-NML* dispute. In 2001, Argentina defaulted on its debt securities issued pursuant to a 1994 Fiscal Agency Agreement that was governed by New York law (the "FAA Bonds"). After Argentina defaulted, it declared a "temporary moratorium" on principal and interest payments on more than US$80 billion of its external debt, including the FAA Bonds. In 2005 and then again 2010, Argentina restructured its external debt by offering new bonds (the "Restructured Bonds") that reduced the principal amount, extended the maturities and generally offered less favorable terms than the defaulted bonds. Certain of the FAA Bondholders, including NML Capital, a hedge fund specializing in distressed debt (collectively, the "Dissenting Bondholders"), did not agree to the exchange, and instead brought a series of collection actions in the U.S. federal district of New York (the "NY Southern District Court").

In those cases, the NY Southern District Court agreed with the Dissenting Bondholders that by making payments on the Restructured Bonds "while failing to make any payments to persons who still held the defaulted" 1994 bonds,

Argentina had violated the *pari passu* provision (called the “Equal Treatment Provision” in the decision) in the FAA. The NY Southern District Court also issued an injunction on "all parties involved, directly or indirectly, in advising upon, preparing, processing, or facilitating any payment on the [Restructured] Bonds", such that the trustee under the Restructured Bonds, Bank of New York Mellon, will be enjoined from making payments on those bonds. The next interest payment was payable on June 30 (but has a 30-day grace period).

Argentina appealed the NY Southern District Court’s decision to the Second Circuit, which affirmed the NY Southern District Court’s decision but stayed the injunction pending Argentina’s appeal to the United States Supreme Court. On June 16, 2014, the Supreme Court denied Argentina’s petitions for *certiorari* in *Argentina v. NML Capital, Ltd.*, No. 13-990, and *Exchange Bondholder Group v. NML Capital, Ltd.*, No. 13-991. By denying Argentina’s petition for review of the Second Circuit’s decisions affirming the NY Southern District Court’s injunction, the Supreme Court has cleared the way for that injunction, forbidding Argentina from paying the Restructured Bondholders unless it also makes payments to the Dissenting Bondholders, to go into effect.

In a related case, *Republic of Argentina v. NML Capital, Ltd.*, No. 12-842, the Supreme Court issued a decision in favor of the Dissenting Bondholders holding that where a creditor obtains a judgment against a foreign sovereign, the Foreign Sovereign Immunities Act (FSIA) does not bar post-judgment discovery of information concerning assets that the sovereign holds outside the United States.

The Dissenting Bondholders apparent strategy has been to create a situation where Argentina is not only adverse to the Dissenting Bondholders, but is also at odds with the Restructured Bondholders who now face the prospect of payment default on their Restructured Bonds.

**What lessons can we take away from this strategy?**

***Read—and Understand—Your Documents.*** While this sounds simple and straight-forward, our experience has been that many market participants are not focused on some of the important differences in terms found in various debt instruments. For example, any indenture qualified under the United States Trust Indenture Act (the “TIA”), and most New York law governed indentures (typically following important portions of the ABA Model Indenture), provide that, subject to some very limited exceptions, a holder’s right to receive

payment of principal and interest on their respective due dates shall not be impaired without the consent of the affected holders. On the other hand, many fiscal agency agreements or trust deeds (pursuant to which English law Eurobonds are typically issued), and even some indentures that are not subject to the TIA (such as Argentina's 2005 and 2010 Restructured Bonds indentures), contain provisions—known as "collective action clauses"—that permit the amendment or modification of *any term* of the debt securities, including the amount of principal and interest to be paid and the dates for payment of such amounts, with the affirmative vote of a specified amount of the debt securities. While collective action clauses generally require a substantial supermajority to effect such fundamental modifications, it is often the case that the supermajority can be obtained at a meeting of holders, counting only those holders actually participating in the meeting. Although there is usually a quorum requirement for the meeting, this is typically lower than the majority required to approve the relevant amendment. As a result, the necessary amount of approving bondholders may be significantly less than a supermajority to make fundamental economic changes to the bond terms. The differences in these terms can have a substantial effect on the leverage holdout bondholders may have in relation to a debtor trying to restructure its debt.

Another example is the no-action clause contained in typical New York law indentures, that limits a holder's right (as distinct from the right of the trustee) to initiate separate legal action against the issuer unless at least a specified minimum principal amount of holders—typically 25% of the outstanding bonds—collectively seek such remedy. An important exception is that holders may individually sue the issuer to receive defaulted interested or principal payments. But importantly, this right is limited to the right to bring suit for payment of a *particular* defaulted payment and not the right to *accelerate* the maturity of the bonds. As a practical matter, when an issuer misses an interest payment, individual bondholders under a NY law indenture will generally not bring a separate legal action, but will rely on the trustee or work with a larger group of bondholders to effect a remedy.

Conversely, debt obligations issued under fiscal agency agreements generally provide that each individual holder has the right to cause its bonds to be accelerated upon the occurrence of an event of default or, at the very least, a payment event of default. This "every man for himself" approach does have the benefit of allowing holders to be more proactive in pursuing remedies upon

an occurrence of an event of default. But the incentive on the part of bondholders to not be left behind may also work against a negotiated restructuring and force an issuer to more quickly turn for protection under applicable insolvency regimes.

***Know Your Place.*** The *pari passu* clause is another term that will no doubt become more of a focus of market participants. While Argentina argued that the meaning of this clause is well settled, this view was rejected by both the NY Southern District Court and the Second Circuit, even though the Second Circuit went to some length to note that the operative provision in the FAA Bonds went beyond similar clauses in other debt securities. It remains to be seen if market participants will find this a fertile provision on which to raise questions but we anticipate more controversy (and drafting attention) on this previously more innocuous clause.

***Where in the World is…?*** The discussion of "insolvency tourism" is much more involved than can be addressed here, but we can't help wonder if the results (so far) don't encourage creditors to look for ways to get heard in a U.S. court—on at least some phase of the case. When the Dissenting Bondholders were able to obtain an injunction restraining the processing agents from making payments on the Restructured Bonds, or in any way aiding or abetting Argentina in violation of the court's order, they effectively stopped paying agents in New York from processing the payments on the Restructured Bonds. As a result, the Restructured Bondholders will likely exert enormous pressure on Argentina to resolve the dispute—or find a quick work-around—before there is a payment default on their bonds. It remains to be seen whether this tactic can be used in other situations but it merits important consideration from both sides of the table.[1]

Not specifically raised in this case, but that came to mind while reviewing the machinations employed by all sides, is the strategy by a debtor of getting *out of* the U.S. and having its restructuring implemented through a scheme of arrangement in the U.K. The U.K. High Court has recently accepted that the choice of English law to govern the debt that is intended to be compromised creates a sufficient connection to England and Wales to provide the Court with jurisdiction to sanction a scheme between a company and its creditors in respect of that debt, even where the company in question does not otherwise have a nexus to the U.K.[2] Further, the Court has also demonstrated a willingness to accept jurisdiction where the English law and jurisdiction

provision in the relevant debt document was adopted by means of an amendment approved by a simple majority of the relevant creditor group and effected solely for the purpose of establishing scheme jurisdiction.[3] The benefit of course is the relatively inexpensive and more surgical nature of compromising obligations that can be achieved under a scheme of arrangement.

But where debtors go down this route, are there opportunities for holdout creditors to assert that their claims in the U.S. cannot be extinguished or compromised in a U.K. (or similar) proceeding based on the limitations of Chapter 15 to negate TIA provisions, or arguments around the meaning of *pari passu*? Again, it remains to be seen, but we anticipate that in close situations that justify the effort, the *NML* case may inspire ever more creative joisting.

***What's Next?*** With the substantial sum at stake in the *Argentina-NML* dispute—put between approximately US$1.3 billion and US$12 billion—not surprisingly there continue to be substantial efforts on all sides to obtain a more favorable outcome. So there is more to come. While much that happens will just be a matter of interest for those not directly involved in this matter (well, at least for restructuring and international relations geeks!), we'll keep our eyes out for ideas and lessons to be learned and perhaps utilized in the more prosaic, everyday corporate deals.

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[1] Recent examples in the context of Asia-based restructurings utilizing Chapter 11 under the U.S. bankruptcy regime include an involuntary action filed by creditors in *In re PT Berlian Laju Tanker Tbk, case number 12-14874* in the U.S. Bankruptcy Court for the Southern District New York, and a voluntary filing made by the debtor in *In re: TMT USA Shipmanagement LLC, case number 4:13-bk-33740*, in the U.S. Bankruptcy Court for the Southern District of Texas

[2] See, for example: *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch).

[3] See, for example: *Re Apcoa Parking Holdings GmbH and others* [2014] EWHC 1867 (Ch).

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