

# To cap it all...

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On May 19, 2009, a group of representatives from New York and Florida introduced a bill to the Committee on Financial Services and the Committee on Foreign Affairs within the United States Congress, intended to close the United States capital markets to any country that has failed to satisfy judgments from American courts totalling more than USD 100 million, for a period of two years after the judgment becomes a final judgment. Based on the proposed legislation the United States government will need to consider the status of any these countries before granting any kind of financial aid when required.<sup>1</sup>

It is no secret that Argentina seems to be immersed in a deep financial isolationism since 2001, and that recent administrations made no credible effort to overcome this situation. This is particularly so since Argentina's world-wide known USD 81 billion sovereign debt restructuring back in 2005.

Barred from international capital markets and with no domestic financing available, Argentina will sooner than later need to address the claims of foreign investors.

According to the bill introduced to the House of Representatives, Argentina still owes United States bondholders more than USD 3,500,000,000 as a result of its latest debt default.

## **Sovereign debt default**

On December 23, 2001, the recently elected president of Argentina, Adolfo Rodríguez Saa, announced that the country was going to default in its sovereign debt.

Economic crisis around the world had proven to be something frequent (Mexico, Southeast Asia, Brazil, Russia, etc.), but this was the beginning of the biggest

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<sup>1</sup> Available from: <http://www.opencongress.org/bill/111-h2493/show> [Accessed 21 May 2009].

default in history.

Argentina's sovereign debt ascended by December 2001 to U\$S 132,143 millions and public bonds represented 72% of that amount.<sup>2</sup> Creditors were estimated to be approximately 700,000 around the world; 56% of the debt was held by institutional investors of all sizes and 44% by private unsophisticated investors.<sup>3</sup> There were 152 different series of bonds, subject to eight different jurisdictions, and issued in currencies such as United States Dollars, Euros, Argentine Pesos, GB Pounds, Swiss Francs, Yens, Sweden and Norwegian Crowns, Canadian Dollars and Kuwaiti Dinars.<sup>4</sup>

Due to the time that passed from the announcement of the default to the beginning of the negotiations, Argentina was unable to use "exit consents" for the restructuring of the debt.

When the Argentine government started the negotiations most of the creditors were organized already and the minimum required consent would have been impossible to reach.<sup>5</sup>

The objective of the Argentine government was debt relief and no other. In 2003 during the International Monetary Fund – World Bank meeting in Dubai, the Secretary of Finance presented the official offer: 75% reduction with no recognition of past due interests (an offer that would thereafter suffer only a slight amendment). Judicial and arbitral actions were filed for hundreds.

A note should be made that as Argentina was not able to use exit consents to renegotiate its debt, they introduced a controversial Most Favoured Creditor clause. If they could not "force" more people to accept the offer they could certainly send a clear message to those holding out: the conditions were not going to change, because if they did the same would apply for everyone. The idea of introducing this clause was to show to those that were in the doubt of accepting the offer that they should better accepted because (1) there was nothing better for those who did not and (2) if there is something better afterwards they would be able to benefit from it

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<sup>2</sup> La Nación (2001), in Spanish.

<sup>3</sup> García Hamilton (h) et al. (2004) p. 1, in Spanish.

<sup>4</sup> La Nación (2001), in Spanish

<sup>5</sup> Olivares Caminal (2005a) p. 2, in Spanish.

anyway. The clause basically says that if there is a new and better offer before 2014, holders of the new bonds are going to be entitled to change their conditions for those of the new offer.

Although a most favoured creditor clause would normally be used to gain a better position for the lenders, in this case it was meant to strengthen the Argentine government's position. At that time it ended up being a pro borrower clause.

As Gelpern explains<sup>6</sup>, atomized creditors act in an atomized way, so creditors that were not being very successful in their litigious position started to accept the new conditions.

In the conditions of the Argentine offer the most favoured creditor principle was explained as follows: *"...if at any time on or prior to December 31, 2014, the Republic voluntarily makes an offer to purchase or exchange (a "Future Exchange Offer") or solicits consents to amend (a "Future Amendment Process") any outstanding Non-performing Securities, each Holder of Securities shall have the right, for a period of 30 calendar days following the announcement of any such Future Exchange Offer or Future Amendment Process, to exchange any of such Holder's Securities for (as applicable): (i) the consideration in cash or in kind received by holders of Non-Performing Securities in connection with any such Future Exchange Offer; or (ii) debt obligations having terms substantially the same as those resulting from any such Future Amendment Process..."*<sup>7</sup>

However, not everything was so clear. When the final version of the documents was published by the Decree No. 1735/2004 prior to the approval of the U.S. Securities and Exchange Commission, the clause read as follows:

*"Argentina reserves the right, in its absolute discretion, to purchase, exchange, offer to purchase or exchange, or enter into a settlement in respect of any Eligible Securities that are not exchange pursuant to the Offer (in accordance with their respective terms) and to the extent permitted by applicable law, purchase or offer to purchase Eligible Securities in the open market, in privately negotiated transactions or otherwise.*

*Any such purchase, exchange offer to purchase or exchange or settlement will be*

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<sup>6</sup> Gelpern (2005) p. 21.

<sup>7</sup> Gelpern (2005) p. 24.

*made in accordance with applicable law. The terms of any such purchases, exchanges, offers or settlements could differ from the terms of the Offer.*

*Holders of New Securities will be entitled to participate in any voluntary purchase, exchange, offer to purchase or exchange or settlement extended to or agreed with holders of Eligible Securities not exchanged pursuant to the Offer as described below under "Description of the New Securities-Rights Upon Future Offers"<sup>8</sup> (emphasis added).*

But when the final version was published in the Annex I of the Resolution 20/2005 of the Ministry of Economy, the word "settlement" had disappeared from the last paragraph.

The thesis of Olivares Caminal<sup>9</sup> is that a mistake of this nature in a document of this complexity is not a mistake at all. The clause that was used to attract bondholders to the offer was now a cause of worry, a window was left open.

Is it possible that the "settlement" word was voluntarily omitted to allow Argentina to *settle* with holdouts without needing to apply the same conditions to the holders of the new bonds?

### **The Argentine Capital Market**

In addition to Argentina's restricted access to international capital markets, it has not been easy to raise funds domestically; especially given the situation of world markets during 2008.

According to the IAMC (2008) throughout 2008, the performance of the domestic Merval was very much influenced by international and local events. Early in the year, the main foreign banks announced big losses due to the sub-prime crisis which impacted the real economy.

In March, the Ministry of Economy issued Resolution No.125/08, which increased certain withholding taxes on the exports of cereals. This resulted in a dispute with the agricultural sector and its rejection by Congress. The local scenario affected the number of transactions in the capital market, and domestic inflation did not help. A new wave of uncertainty aroused in September due to the US government bail-out

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<sup>8</sup> Annex II, National Decree No. 1735/2004 of the Republic of Argentina, in Spanish.

<sup>9</sup> Olivares Caminal (2005b) p. 2.

of Fannie Mae and Freddie Mac and Lehman Brothers' bankruptcy, restricting even more the already insufficient liquidity. Positions were sold in order to recover liquidity and cut or delay losses.

According again to the IAMC (2008) the situation was made worse by domestic events on October, when the Argentine government passed a bill to transfer the assets managed by the AFJP (private pension funds administrators) to the ANSES (the national administrator of public welfare).

On December 9, 2008, the Law No. 26,425 created a single public welfare system based on the distribution of state assistance and eliminated the 14 years old private welfare regime based on investments capitalization. In doing so, the law transferred the assets held by the AFJPs, including AR\$ 94 billion in publicly traded shares, to the Guarantee Fund for the Sustainability of the Public Welfare Distribution Regime of the ANSES<sup>10</sup> (reference is made to our email dated February 19, 2008).

This brought a new wave of uncertainty, pushing the volatility of domestic indexes to levels that were three times higher than those posted over the year, and similar to the 2002 levels. The result was the sharpest annual drop of the historical series in nominal terms (-49.8% in AR\$) (IAMC, 2008).

#### During 2009

Also during 2009 the Bonesi case hit hard the local market and made it clear that a new regulatory framework was needed for securitising with financial trusts.

During the last ten years or so, financial trusts have been the main issuers of the local capital market. Big electro-domestic stores would securitize their credits resulting from the financing granted to their customers with a bank or professional trustee, who would place the debt certificates issued by the financial trust among mutual funds, AFJP, individuals, etc. On July 30, 2008, National Decree No.1207/2008 eliminated the Income Tax exemption granted to most of these financial trusts, generating additional costs to the securitising companies that wanted to tap the capital market. The issuance of securities by financial trusts came immediately to a halt. This modification added to the nationalization of the AFJP and both generated an increase in interest rates and a reduction of financing

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<sup>10</sup> Created on July 12<sup>th</sup>, 2007 by National Decree No. 897/07.

terms. In April this year, the newspapers reported that the Bonesi store, who was trustor and collecting agent of receivables that had been securitised with a financial trust structured with Standard Bank, defaulted in its obligations as collecting agent and kept the funds so collected without transferring them to the trustee and, hence, to the ultimate security holders. The Bonesi case cast even more doubts over the already weakened market.

### **Judgment Evading Foreign States Accountability Act of 2009<sup>11</sup>**

In the above described context, the bill introduced to the United States Congress last May 19<sup>th</sup>, is a clear message that winds of change should blow in Argentina's current foreign policy.

In a clear statement of principles the bill proclaims that the United States shall advocate for the full compensation and fair treatment of American taxpayers and other persons in whose favour judgments have been awarded by United States courts.

The bill also asserts that the United States shall seek to protect the economic interests of the taxpayer and of those that benefit from a reliable flow of foreign capital, by restricting the access to the United States capital markets of Judgment Evading Foreign States (JEFS) and their state-owned corporations; by requiring those such persons be warned of the dangers of investing in, lending to, or doing business with such states and state-owned corporations; and subjecting to congressional scrutiny requests for aid made by JEFS to the United States Government. And finally it shall be the policy of the United States to see that the authority of American courts is protected from JEFS "wilfully flouting" the judgments of those courts.

The bill defines a JEFS as any foreign state that (i) has one or more judgments entered against it by any United States district court, the Court of International Trade, or the court of any State, the combined amount of which judgments exceeds \$100,000,000; (ii) fails to satisfy in full any such judgment for a period of more than 2 years after the judgment becomes a final judgment before the date of the enactment of the Act; (iii) is not a foreign state eligible for financing through the International Development Association (but not from the International Bank for Reconstruction and Development); and (iv) it is neither eligible for debt relief under

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<sup>11</sup> Available from: <http://www.opencongress.org/bill/111-h2493/text> [Accessed 29 May 2009]

the Enhanced HIPC Initiative nor under the Multilateral Debt Relief Initiative.

As was mentioned the access to American capital markets shall also be restricted to state-owned corporations of JEFS, these are defined in the bill as any corporation or entity that is an agency or instrumentality of a foreign state (as defined in section 1603 (b) of title 28 of the United States Code) that is a JEFS; or a majority of the shares or other ownership interest of which is held, either directly or indirectly, by a JEFS or by an agency or instrumentality of a foreign state that is a JEFS.

The SEC shall be the agency in charge of the instrumentation of the bar on access to United States lenders and investors to JEFS and state-owned corporations of JEFS. The SEC shall take all necessary measures to deny JEFS the ability, directly or indirectly, to borrow money or sell securities in the United States. As for state-owned corporations, the SEC shall deny them the ability to issue debt, equity or other securities, or borrow money. The bill states that for both the JEFS and the state-owned corporations, there shall be an exception for when the proceeds are to be used to satisfy in full all final judgments entered against JEFS.

The Securities and Exchange Commission shall also require that all periodic filings made by JEFS and by state-owned corporations of JEFS bear a legend on the covering page with a clear warning stating that the reports are submitted by a country or a corporation that has failed to satisfy outstanding United States Court judgments as has been determined by the United States Department of the Treasury.

The bill has also several provisions regarding requests for aid or assistance from JEFS. In the case of bilateral assistance proposals, i.e. those made to the United States Government, they must bear a legend warning that the request is being made by a JEFS. As for multilateral assistance proposals, i.e. those made to an international organization, the Secretary of State shall provide prompt notice of such proposals to the Congress and the notice shall bear the same legend of warning.

Finally, the bill states that the Secretary of the Treasury shall provide a report, in writing, to the Congress identifying each JEFS, and, for each JEFS, quantifying the impact on the United States economy, and cost to United States taxpayers, of the unsatisfied final judgments outstanding against the JEFS; and describing all measures that the Secretary of the Treasury and the SEC have take in the preceding year to carry out this Act. As the Secretary of the Treasury determines

that any JEFS no longer qualifies as a JEFS, the Secretary shall so certify to the Congress no later than in the next annual report to Congress, at which time the requirements and prohibitions provided in the bill shall no longer apply to such former JEFS, or to any state-owned corporation of such JEFS.

There is no doubt that the enactment of this bill will close even more the window of international financing opportunities for Argentina but, there is one more aspect of this bill that is worth noting: the findings. In this section, the Republic of Argentina is described as a “primary example” of what should not be done by countries looking to access the American capital markets: sovereign debt defaults, unilateral restructurings, arbitrary full debt payoffs, total disregard for awards from the International Centre for Settlement of Investment Disputes and for rulings from American courts.

The findings also point out the case of Ecuador that on December 12<sup>th</sup>, 2008, selectively defaulted on USD 3,800,000,000 in obligations, “citing Argentina as its example” and resulting in substantial losses to investors who lent Ecuador funds in good faith.

Finally, the bill makes a call for the United States Government’s protection, stating that “the absence of a remedy for defaults by such foreign states undermines nations that badly need to access capital from foreign lenders, with disproportionate harm falling on responsible and democratic poor nations”.

### **Concluding words**

It is clear that Argentina’s sovereign debt restructuring rose and still rises concerns internationally, and that a more conciliatory foreign policy will ease its relations with international lenders, in a manner that would permit the country to regain access to credit.

Borrowing Harding’s words as our own concluding remarks, let us say that “*What is required for a constructive atmosphere [in a society] is trustworthiness, which cannot easily be established by individuals across the whole society that has destroyed it. Again, before trustworthiness can be established there must first be institutional safeguards against the potential for disastrous consequences of dealing with others so that people can begin to take risk of cooperation in ways that, if*

*successful, would lead to trust relationships".<sup>12</sup>*

We believe it will not take long before Argentina succeeds in rebuilding its old international trustworthiness, making peace with foreign investors and opening its doors again to a country unique and full of business opportunities. Local institutions will need to grow sounder, that is true, but it will happen.

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<sup>12</sup> Harding (2002) p.191.

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