



Stop Debt Vultures: Implications of the Vulture Attack on Argentina

Debt and Development Coalition Ireland

1st September 2014

Predatory Vulture Funds

In 2001, Argentina defaulted on its debt. Mired in economic and political crisis, compounded by the devastating policies of external lenders such as the IMF, the Argentine government made an initial offer to their creditors of 25 cent in each dollar owed to them. The vast majority of creditors (92.4% of them), seeing the writing on the wall, eventually accepted a compromise deal through debt swaps (called 'exchange bonds') in 2005 and 2010, worth up to 50% of their original value.

However, opportunistic creditors, coined 'vulture funds' did not participate in the swaps. Such funds seek to buy distressed debt at the bottom of the market, or from bankrupt countries after they have defaulted, in order to claim the full value later on. They have been suing Argentina, as a route to reclaiming payment to the tune of an exorbitant profit of about 1600%.¹ The holdouts include individual investors and firms such as NML Capital (a subsidiary of Elliott Management) and Aurelius Capital Management. The legal case is being heard in New York, the jurisdiction in which legal challenges can be brought by the funds in question in the event of a dispute.

NML Capital, the main litigating fund, owned by financier Paul Singer, is no stranger to aggressive legal battles. His firm has sued the Governments of Peru and Congo in the past, resulting in wins of millions in payments on cheap purchases of their distressed debt. In the case of Peru, in the midst of economic crisis, the Government engaged in a debt restructuring process with its creditors after it defaulted on its commercial bank debt in the early 1990s, and entered into an exchange bond arrangement in 1996 (its so-called 'Brady Deal'). Just 3 months later, Elliott Management bought up some of this distressed debt worth US\$ 20 million, but at a knock down price of US\$ 11 million. After engaging in a lengthy legal battle in the New York courts, Elliott Management succeeded in being paid

¹ Kicillof, Axel, Minister of Economy and Public Finance of Argentina, *Vulture funds are showing their true colour* <http://www.ft.com/intl/cms/s/0/bf78b33a-0779-11e4-b1b0-00144feab7de.html#axzz3C0Bmuqls>, 9th July 2014

US\$ 55 million by the Government of Peru which included the principal and unpaid interest.²

The Legal Battle

The legal battle between Argentina and the vultures has been a long and dramatic one. At one point, Elliott Management even persuaded a Ghanaian court to seize an Argentine training frigate vessel called the "Libertad" that was docking in Ghana at the time in an attempt to seizing Argentine national assets. A New York appellate court finally ruled that the Argentine Government must pay US\$ 1.3 billion to the vulture funds. The Argentine Government then sought to appeal this ruling at the US Supreme Court. In June 2014, the US Supreme Court decided not to hear an appeal, ensuring that the ruling of the lower court stands.

Thomas Poole Griesa is the federal judge who heard the case. Griesa has been dealing with legal cases relating to Argentina's debt since the 2001 default. His original ruling invoked the 'pari passu' clause of equal treatment of creditors.³ Griesa argued that Argentina must pay the vulture fund / holdouts in full at the same time as it makes its next payment to holders of the exchange bonds. If it failed to do so, any bank facilitating Argentina to pay interest due on the exchange bonds would be violating the court order. Argentina of course has opposed paying the vulture funds for years, but the Griesa ruling, and a clause in Argentina's contracts with the exchange bondholders, places it in an impossible position. - The exchange bond contracts contain a "Rights Upon Future Offers" (RUFO) clause which states that if Argentina pays the vultures, it must extend the full original debt payments to the bondholders that accepted the debt swaps in 2005 and 2010. This would prompt a myriad of lawsuits from the exchange bondholders, seeking back-payments for the original debt owed to them. The UN Conference on Trade and Development (UNCTAD) indicate that this could cost Argentina a staggering US\$ 120 billion.⁴ This would result in Argentina entering into a new default, as this level of debt servicing is far beyond its capacity to pay.

So what did Argentina do?

When the time came to pay interest on its exchange bonds (on 30th June 2014), Argentina deposited US\$ 539 million into the account of its trustee bank, Bank of New York Mellon (BNY Mellon). Judge Griesa called the deposit illegal and ordered the money to be frozen, therefore preventing the payments from being drawn

² Scott & Jackson, *Sovereign Debt Restructuring: Should We Be Worried About Elliott?* <http://www.law.harvard.edu/programs/about/pifs/education/llm/2001---2002/sp44.pdf>, May 2002

³ NML Capital, Ltd., Vs Republic Of Argentina, United States District Court Southern District Of New York <http://blogs.reuters.com/felix-salmon/files/2012/04/2011-12-07-Equal-Treatment-Liability-Order.pdf>, 12/7/11

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UNCTAD, *Argentina's 'vulture fund' crisis threatens profound consequences for international financial system*, http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=783&Sitemap_x0020_Taxonomy=UNCTAD, 25th June 2014

down by the exchange bondholders. The Argentine Government placed large adverts in the international media indicating that it was being prevented from paying its debt obligations by Judge Griesa, who, as they saw it, was overstepping his mandate. Griesa indicated that he would find the Government of Argentina in contempt of court if they continued to defy his ruling. This raises serious questions about how a contempt of court ruling against a sovereign state might impact on its international relations in other areas.

Bad law

The case is all the more worrying as Judge Griesa does not appear to fully understand the detail of Argentina's bond debt arrangements and has struggled to interpret the implications of his own ruling. Argentina's exchange bonds are denominated in diverse currencies (including US dollars, Argentine Pesos, Euro and Japanese Yen). They are subject to different laws, some in New York, Argentina, Japan and the UK. Judge Griesa's ruling implies that all exchange bonds are covered by it. However, his ruling seems to ignore non-dollar exchange bonds outside of the New York jurisdiction. This caused confusion among US banks that are also trustees for issuing payments on Argentina's bond debt under other jurisdictions. Clarification was requested by Citibank, the trustee for bonds issued under Argentine law denominated in Pesos and US Dollars. Judge Griesa indicated that Citibank was free to process the interest payments on these bonds as, by his understanding, they were not covered by his ruling. This was then challenged by another hedge fund in court. It is reported that Griesa responded "*It is my understanding that the bonds being talked about in your motion are not part of the exchange*".⁵ It appears he was then informed by the hedge fund lawyers that they were in fact exchange bonds. Extraordinarily, Griesa reversed his view on the spot and indicated that they were indeed covered by his earlier ruling. It seems this ruling is a one-off decision however, so the position of future payments remains unclear. As one commentator put it "*it was not bad theatre, but it hardly inspired confidence in the American legal system*".⁶

So did Argentina Default?

Standard & Poors changed the Argentine bond grade to "selective default" on July 30th 2014 on the basis that the interest payments on the exchange bonds had not been paid out. Debt justice campaigners and commentators have called the bizarre development a "Griefault" (Griesa + default) to describe the unprecedented situation resulting from Griesa's ruling: a sovereign government, willing to pay its main creditors, and having deposited the funds into the trustee account, was stopped from doing so by an external party. As Argentine economist, Dr Alan Cibils commented to DDCI, "*This is the first 'default' in history declared by a judge from a country other than the one making the payment.*"⁷ At the time of writing Argentina

⁵ Norris, Floyd, *The Muddled Case of Argentina's Bonds*, <http://www.nytimes.com/2014/07/25/business/rulings-add-to-the-mess-in-argentine-bonds.html>, July 24th 2014

⁶ *ibid*

⁷ Email exchange with Dr Alan Cibils Professor & Chair of the Political Economy Department at the Universidad Nacional de General Sarmiento in Buenos Aires, Aug 2014

was in the process of introducing emergency legislation to invite exchange bondholders to voluntarily swap their bonds again for new ones governed by Argentine law; to change to an Argentine trustee bank; or to draw down payments from an Argentine trust fund, thereby avoiding involvement of US courts. This is a strong move by the Argentine government which aims to get itself out of the grip of the US courts, but it remains to be seen if creditors will go for it. More interestingly, as Dr Alan Cibils also noted, the Argentine Government is suggesting a reinterpretation of the pari passu clause by proposing to pay the vulture funds, but at the same rate as the exchange bonds.

Implications?

The further disempowerment of indebted countries: The global debt justice movement seeks to challenge the current practice of placing the entire responsibility for debt crises solely on the debtor country involved. The Griesa ruling is a massive setback in this regard because it sets the precedent of incentivising bondholders not to accept debt re-structuring, but instead to 'holdout', and sue the government in question through the courts instead. This threatens the power of governments of indebted countries worldwide to achieve debt reductions on unsustainable and/or illegitimate debts.

Empowerment of vulture funds: The ruling provides a status of increased credibility to vulture funds - a dangerous development given their particularly opportunistic and profiteering function in the global debt system. The failure of influential governments to intervene paves the way for financial traders to use their war-chests to define policy in an area that affects the lives of millions of people around the world.

Unrepresentative decision-making: This lack of international political will, and of any multi-lateral, legal process to deal with debt crises fairly, has resulted in a hand over of decision-making to an unrepresentative legal jurisdiction in New York to set law in an area of huge international concern.

What should be done?

Legislation: Laws should be enacted, especially in jurisdictions where the majority of vulture fund claims are made, to curtail the levels of profits available to them. This legislation should ensure that funds that buy up debt close to, or following, a sovereign default are prevented from suing for full payment. Relevant jurisdictions including the US, UK, and Japan should limit vulture fund claims to a low multiple of what they paid for the original debt. This would be a step toward putting vulture funds out of business.⁸ Any new legislation regulating claims must also include the prevention of vulture funds' ability to seize assets of the debtor country. At the time of writing, the Group of 77 Global South countries (G77) requested a vote on a

⁸ Steps in this direction are possible, as shown in 2010 in the UK. Due to pressure from campaign group Jubilee Debt Campaign UK, the UK Parliament passed the Debt Relief (Developing Countries) Act. It limits any entity in the UK engaged in suing a Global South country that has previously been given debt cancellation, to getting the amount they would have received if they'd been subject to that debt cancellation scheme.

proposal from the Group to the UN General Assembly that calls for a Multilateral Convention to govern sovereign debt restructuring measures including a call to ensure that such measures cannot be hindered by another state or be boycotted by 'holdouts'.⁹

New arrangements for bond contracts: should be supported which allow debtor governments to implement stronger safeguards to protect the full spectrum of rights of their citizens in extreme cases such as in Argentina. At the time of writing, the International Capital Markets Association (ICMA) published a revised framework for users of bond markets aimed at ensuring 'holdouts' abide by debt restructuring arrangements agreed to by the majority of bondholders.¹⁰ However, this will not impact on debt restructuring arrangements for many years to come.

Fair multi-lateral debt resolution mechanisms are needed: that re-balance the power relationship between debtors and creditors. These may be diverse in nature and range from the establishment of debtor-creditor conferences whereby debtors and creditors meet on an equal basis to negotiate cancellation or restructuring (similar to the historic London Accord Agreement in Europe in 1963)¹¹, to the formation of an international debt court that is human rights centred and truly independent of creditor interests.

Support for national debt justice campaigns: In the absence of such international arrangements, and in the event that any new arrangements are unfair, grassroots campaigns for non-payment of unjust debts in Argentina, and more widely in the Global South and North, must be supported and strengthened. This is to build solidarity and political strength among the people who are ultimately paying the price of debt crises. It is through building greater resistance from the people most affected by unjust debts that a more accountable financial system might be achieved.

Recommendations:

We ask that the Irish Government:

- Support the G77 countries in their efforts to achieve a multi-lateral convention at the UN which ensures that vulture funds abide by majority agreed debt restructuring and cancellation agreements.

⁹ Presna Latina, *Argentina Expects UN to Approve Bill against Vulture Funds*
http://www.plenglish.com/index.php?option=com_content&task=view&id=3037881&Itemid=1,
August 30th 2014

¹⁰ Reuters, *Market body revises rules for sovereign default after Argentina row*
<http://www.ifrasia.com/market-body-revises-rules-for-sovereign-default-after-argentina-row/21162238.article>, 29th Aug 2014

¹¹ DDCI et al, *Remembering Debt Justice: the 60th Anniversary of the London Debt Accord*, February 27th 2013,
http://www.debtireland.org/download/pdf/london_debt_accord_final_version_270213.pdf

- Support the introduction of legislation in EU member states to implement legally binding regulation of vulture fund claims in national jurisdictions.
- Support grassroots organisations and institutions, especially in the Global South, in leading the debate on formulating new, collective solutions to debt crises.¹²

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This project has been undertaken with the assistance of the European Union. The content is the sole responsibility of Debt and Development Coalition Ireland, and can in no way be taken to reflect the views of the European Union.

¹² Important interventions are being made by CSO groups on the Argentina case including: Jubilee South/ Dialogo 2000: <http://dialogo2000.blogspot.com.ar/2014/07/no-debemos-no-pagamos-si-la-vida-no-mas.html>, Latindad: <http://www.pagina12.com.ar/diario/economia/2-250473-2014-07-11.html>, *Righting Finance*: <http://www.rightingfinance.org/?p=900>