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The Required Threshold to Restructure Sovereign Debt

JOSÉ GARCÍA-HAMILTON JR., RODRIGO OLIVARES-CAMINAL &
OCTAVIO M. ZENARRUZA *

I. INTRODUCTION

Debt has been the largest source of capital flow to developing countries in the past fifty years.¹ During the 1970s, lending increased drastically due to the use of petro-dollars and to the developing Eurodollar market.² In the 1980s, the global debt crisis hit less developed countries (LDCs).³ As a way out of this debt crisis, in March 1989, U.S. Treasury Secretary Nicholas F. Brady articulated the Brady Plan to address the debt crisis.⁴ The Brady Plan not only addressed debt relief to LDCs, but also tried to restore solvency to the highly indebted banks that continued to pour money into these countries.⁵

The effect of the Brady Plan was to convert the form of private debt from commercial bank loans into bonds.⁶ The bond

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1. Randall Dodd, *Sovereign Debt Restructuring*, 9 FINANCIER 1-4 (2002), available at <http://www.financialpolicy.org/dscsovdebt.pdf> (last visited Jul. 25, 2005).

2. See LEX RIEFFEL, RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD HOC MACHINERY 153-54 (2003).

3. See *id.* at 154.

4. See *id.* at 170.

5. See generally *id.* at 149-77 (detailing the Brady Plan).

6. Lee C. Buchheit, *Sovereign Debtors and Their Bondholders*, UNITAR Training Programmes on Foreign Economic Relations 4 (Feb. 2000), available at http://www.unitar.org/dfm/Resource_center/Experts/Buchheit/BooksChap.htm ("As a result of the Brady Plan, most of the emerging market debt held by private investors is

market has increased four times as quickly as syndicated bank loans.⁷ This rapid increase of bond issuances and the worsening financial crisis made bond restructuring more important, especially for sovereign borrowers.⁸

Since the conception of the Brady Plan in 1989, Argentina, Brazil, Bulgaria, Costa Rica, the Dominican Republic, Ecuador, Ivory Coast (Cote d'Ivoire), Jordan, Mexico, Nigeria, Panama, Peru, the Philippines, Poland, Uruguay, Venezuela, and Vietnam have reduced their debt—mostly in syndicated loans—by the issuance of Brady bonds.⁹ This notwithstanding, these and other developing countries continued to issue bonds to fulfill further financing needs or simply to raise money from the capital markets.¹⁰ In many cases, countries amassed unsustainable debt burdens, fueling the increasing need to restructure sovereign debts, such as in Russia, Ukraine, Ecuador, Pakistan, Uruguay, and Argentina.¹¹

These restructuring cases were achieved through a market-oriented approach based on corporate debt restructuring procedures, which involved a maturity extension and, in some cases, a haircut.¹²

This Article explores the holdout of creditors, which has been the major issue in sovereign debt restructuring since the late 1990s. Part II discusses the rights and case law of holdout creditors

now in the form of bonds, not in commercial bank loans.”)

7. Anne Krueger, International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring, Address at the National Economists' Club Annual Members' Dinner (Nov. 26, 2001), available at <http://www.imf.org/external/np/speeches/2001/112601.htm>.

8. U.N. CONFERENCE ON TRADE AND DEVELOPMENT, TRADE AND DEVELOPMENT REPORT, 2001, U.N. Doc. UNCTAD/TDR/(2001), U.N. Sales No. E.01.II.D.10 (2001), available at http://www.unctad.org/en/docs/tdr2001_en.pdf (last visited Jul. 25, 2005) [hereinafter TRADE AND DEVELOPMENT REPORT].

9. See RIEFFEL, *supra* note 2, at 171.

10. See *id.* at 5.

11. This is the authors' conclusions based on the analysis and study of previous (i.e. Russia, Ukraine, Pakistan, Ecuador and Uruguay) and present (i.e. Argentina) restructuring cases. For an in depth analysis of these cases, see, e.g., POLICY DEV. & REV. & LEGAL DEP'TS, INT'L MONETARY FUND, INVOLVING THE PRIVATE SECTOR IN THE RESOLUTION OF THE FINANCIAL CRISES—RESTRUCTURING INTERNATIONAL SOVEREIGN BONDS [hereinafter POLICY DEV & REV. & LEGAL DEP'TS], available at <http://www.imf.org/external/pubs/ft/series/03/IPS.pdf> (Jan. 24, 2001); Alinna Arora & R. Olivares Caminal, *Rethinking the Sovereign Debt Restructuring Approach*, 9 L. & BUS. REV. AM. 629, 630 (2003).

12. See *supra* note 11 and accompanying text.

regarding sovereign debt restructuring. Part III discusses Argentina's debt restructuring resulting from its 2001-2002 default. Part IV explores techniques to deal with holdout creditors under New York and English law, which are the laws that govern most sovereign debt issuances, and to a lesser extent the relevant German and Japanese law. Part V analyzes how the techniques referred to in Part IV were applied in two case studies: Ukraine and Ecuador. Finally, Part VI concludes with the best alternatives available to solve the holdout issue.

II. DEBT SWAPS, EXCHANGE OFFERS

Sovereign states can restructure their debt to prevent or resolve financial and economic crises and to achieve debt sustainability levels.¹³ Sovereign debt restructuring has two aspects: procedural and substantial.¹⁴ The procedural aspect focuses on the way restructuring should be performed, e.g., its architecture, and the substantial aspect focuses on the actual restructuring of debt, "which is normally characterized by rescheduling amortization schedules as well as writing off the debt principal."¹⁵

During the 1990s, many sovereign debt restructurings ("debt swaps") experienced difficulties because some bondholders did not want to accept the sovereign's exchange offer, which includes a write-off, and instead claimed the total value of the debt.¹⁶ These creditors are known as "holdout" or "rouge creditors."¹⁷ This practice was upheld in some court decisions.¹⁸ The most relevant cases which protect holdout creditors and encourage their practices are analyzed below.

A. *Pravin Banker Assocs. v. Banco Popular del Peru*

Pravin Banker Associates ("Pravin") invested in Banco

13. Arora & Caminal, *supra* note 11, at 630.

14. *Id.*

15. *Id.*

16. See Hill E. Fisch & Carolina M. Gentile, *Vultures or Vanguard?: The Role of Litigation in Sovereign Debt Restructuring*, 52 EMORY L.J. 1043, 1045 (2004).

17. See *id.* at 1045. Holdout or rouge creditors are commonly known as "vulture funds." *Id.* Vulture funds refer to investment funds that focus on distressed debt. See *id.* at 1045 n.1.

18. See *id.* at 1045-46. See, e.g., *Pravin Banker Assocs. v. Banco Popular del Peru*, 109 F.3d 850 (2d Cir. 1997); *Elliott Assocs., L.P. v. Banco de la Nacion*, 194 F.3d 363 (2d Cir.1999).

Popular del Peru's ("Banco Popular") debt.¹⁹ Banco Popular's main shareholder, the Republic of Peru ("Peru"), collateralized the debt.²⁰ Due to Peru's financial crisis, Banco Popular defaulted on its principal payments on the debt.²¹ Pravin, after sending a notice to the defaulted debtor, claimed payment for the total outstanding debt.²² Peru appointed a liquidation committee to restructure Banco Popular's debt,²³ but Pravin refused to participate in Peru's liquidation process and instead filed a claim for the payment of its debt at the nominal value against Banco Popular and Peru.²⁴

During the trial, Peru stated that Pravin bought the Peruvian debt at a substantial discount over its face value, and that a total recovery of the debt could not be considered by any party.²⁵ A total recovery would have meant an illegal enrichment and would have allowed Pravin to obtain an unexpected gain, to Peru's disgrace. In *Pravin Banker Assocs.*, the New York Court of Appeals balanced two principles to determine whether international comity should be extended to the United States: the success of public debt restructuring, including the International Monetary Fund's (IMF) involvement under the Brady Plan, and the payment of valid debts under contract law principles.²⁶

After having granted two waiting periods, first six months and then another two months, the court of appeals held that Pravin was not obligated to abide by the Brady Plan because the participation of creditors in such restructuring processes was strictly voluntary.²⁷ In addition, the court considered that an undefined suspension of the proceedings would prejudice U.S. interests with respect to the terms and conditions of valid contracts executed under U.S. law.²⁸

19. See *Pravin Banker Assocs.*, 109 F.3d at 852.

20. *Id.*

21. See *id.*

22. See *id.* at 853.

23. *Id.*

24. *Id.*

25. See generally *Pravin Banker Assocs.*, 109 F.3d 850.

26. See *id.* at 855.

27. *Id.*; see International Debt Management Act of 1988, 22 U.S.C. § 5331(b)(4).

28. See *Pravin Banker Assocs.*, 109 F.3d at 855.

B. Elliott Assocs. LLP v. Banco de la Nacion

After *Pravin Banker Assocs.*, Peru found itself in court again in *Elliott Assocs.* The court of appeals held that the purchase of Peru's distressed sovereign debt with the intention to bring suit did not violate section 489 of the New York Judiciary Law.²⁹ Section 489 prohibits the purchase of a claim "with the intent and for the purpose of bringing an action or proceeding thereon."³⁰

The court of appeals held that the investor did not violate the law since the debt instrument was acquired for the primary purpose of enforcement, with intent to resort to litigation only if necessary to accomplish this purpose.³¹ The decision to file a claim was the consequence of nonpayment.³²

As in *Pravin Banker Assocs.*, the court of appeals balanced two aspects: 1) granting U.S. citizen bondholders an opportunity to claim payment of their credit, which limited the chances of achieving debt restructuring under the IMF's umbrella; and 2) not allowing the claim because it would prejudice New York as a financial world center.³³ Both issues were important for U.S. foreign affairs policy.³⁴ The court of appeals believed that investor protection was a stronger priority.³⁵

The peculiarity of this case, although similar to *Pravin Banker Assocs.*, was the lack of assets to attach in the United States, which forced the claimant to resort to the courts of Brussels in Belgium in order to seek enforcement of the decision.³⁶

The Brussels Court of Appeals rendered a decision prohibiting Chase Manhattan, as financial agent, and Euroclear to

29. *Elliott Assocs.*, 194 F.3d at 372.

30. N.Y. [Jud.] § 489 (Consol. 1983); see also J. García Hamilton, Jr., R. Olivares Caminal & O. M. Zenarruza, *Juicios contra la República Argentina, Class Actions y Embargo de Bienes Públicos*, in *DEFAULT Y REESTRUCTURACIÓN DE LA DEUDA EXTERNA*, 2003 LA LEY 137 Supp.

31. *Elliott Assocs.*, 194 F.3d at 372.

32. *Id.* at 379.

33. John Nolan, *Special Policy Report 3: Emerging Market Debt & Vulture Hedge Funds: Free-Ridership, Legal & Market Remedies*, FINANCIAL POLICY FORUM, at <http://www.financialpolicy.org/DSCNolan.htm> (Sept. 29, 2001).

34. See Samuel E. Goldman, Comment, *Mavericks in the Market: The Emerging Problem of Hold-Outs in Sovereign Debt Restructurings*, 5 UCLA J. INT'L L. & FOREIGN AFF. 159, 196 (2000).

35. See *id.* at 196; see also Nolan, *supra* note 33, at <http://www.financialpolicy.org/DSCNolan.htm>.

36. Nolan, *supra* note 33, at <http://www.financialpolicy.org/DSCNolan.htm>.

pay interest on Peru's Brady Plan bonds.³⁷ These Brady bonds were issued as the result of a sovereign debt restructuring.³⁸ With a court order not to make any payments, Peru was facing default on the restructured bonds.³⁹ Although Peru did not pay interest on the due date, it technically had a thirty-day period to fulfill the payment before the default was declared.⁴⁰

Facing this situation, Peru was obligated to reach an agreement with Elliott Associates L.P. ("Elliott") in order to avoid a new default on its restructured debt.⁴¹ Under this agreement, Elliott obtained a gain worth 400% of the purchase value of the defaulted bonds.⁴²

C. LNC Investments, Inc. v. The Republic of Nicaragua

In 1999, New York courts decided *LNC Investments*, obligating Nicaragua to pay \$87 million resulting from defaulted commercial loans granted in the 1980s.⁴³ LNC Investments preferred to file a claim rather than participate in the successful sovereign debt restructuring procedure.⁴⁴

LNC Investments enforced the U.S. judgment in a Brussels court, following the precedent of *Elliott Assocs.*⁴⁵ As in *Elliott Assocs.*, LNC Investments obtained a judicial order that prohibited interest payments of restructured bonds.⁴⁶ The order was directed toward Euroclear to refuse orders of payments from Bankers Trust Deutsche Bank.⁴⁷

The Brussels Court of Appeal reversed the decision upon

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. *See id.*

42. *See Nolan, supra* note 33, at <http://www.financialpolicy.org/DSCNolan.htm>.

43. *LNC Investments, Inc. v. The Republic of Nicaragua*, No. 96 Civ. 6360, 2000 U.S. Dist. LEXIS 7738, at *1 (S.D.N.Y. June 6, 2000).

44. *Id.* at *13.

45. Unilateral order granted by the Vice-president of the Commercial Tribunal of Brussels (Tribunal de commerce de Bruxelles) (R.R. 101/03) dated July 25, 2003 in re La Republique du Nicaragua vs. LNC Investments LLC et Euroclear Bank S.A. (not reported); *Republique Du Nicaragua v. LNC Invs. LLC et Euroclear Bank*, No. R.K. 240/03 [Tribunal de Commerce de Bruxelles] 2003 (Belg.) (on file with author).

46. *Republique Du Nicaragua v. LNC Invs. LLC*, No. 2003/KR/334, at 2 (Cour D'Appel de Bruselas, Neuvieme Chambre [Ct. App. Brussels, 9th Chamber] 2004) (on file with author).

47. *Id.* at 9.

appeal.⁴⁸ Although it seems that the Brussels court reversed the criteria set forth in *Elliott Assocs.*, in fact the Brussels court did not directly consider the *pari-passu* clause⁴⁹ as it did in *Elliott Assocs.*⁵⁰

It is unfortunate that Belgian courts have had to interpret New York law.⁵¹ In 2003, for the first time, a New York court faced a *pari-passu* clause issue but regrettably it was not analyzed.⁵²

III. ARGENTINE PROPOSAL

Due to its complexity, the recent case of Argentina's sovereign debt crisis is to some extent challenging the current debt restructuring framework. We will refer to the issue of exit consent and collective action clauses (CACs) in connection to the Argentine case, as well as a new development in the litigation field.

The Argentine government announced its moratorium on

48. *Id.* at 19.

49. According to L. Buchheit, "the purpose of the *pari-passu* clause is to ensure that the borrower does not have, nor will it subsequently create, a class of creditors whose claims against the borrower will rank legally senior to the indebtedness represented by the loan agreement." See L. BUCHHEIT, HOW TO NEGOTIATE EUROCURRENCY LOAN AGREEMENTS 83 (Rob Manis ed., 2d ed. 2004).

50. The criteria set forth in *Elliott* was that Perú was trying to make a payment to some but not all of its creditors in violation of the principle of equal treatment stated by the Brussels court in its interpretation of the *pari-passu* clause, which provides that all creditors should be paid pro-rata. For an enlargement on the *Elliott* case, see Eduardo Luis Lopez Sandoval, *Sovereign Debt Restructuring: Should We Be Worried About Elliott?*, HARVARD LAW SCHOOL INTERNATIONAL FINANCE SEMINAR 26 (2002), available at http://www.law.harvard.edu/programs/pifs/pdfs/eduardo_sandoval.pdf. For an elaboration on the *pari-passu* clause, see Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869 (2004); Phillip R. Wood, *Pari Passu Clauses: What Do They Mean?*, 18 BUTTERWORTH J. OF INT'L BANKING & FIN. L. 371-374 (2003).

51. *Republique Du Nicaragua v. LNC Invs. LLC et Euroclear Bank*, No. R.K. 240/03 [Tribunal de Commerce de Bruxelles] 2003 (Belg.) (on file with author).

52. On January 13, 2004, upon the memorandum of law of Argentina and the plaintiffs, the US Statement of Interest and the amicus curiae briefs filed by the Federal Reserve Bank of New York and the New York Clearing House, a New York court was asked to resolve the *pari passu* issue for the first time in the US. Although the court did not resolve the *pari passu* issue, the plaintiffs had to sign an agreement giving the court 30 days notice before filing papers intended to stop such payments under the *pari passu* clause. Although the core issue was not resolved, an order was issued by the court ordering Argentina to divulge information about government property outside the country that is used for commercial purposes. See Alinna Arora & R. Olivares Caminal, *Rethinking the Sovereign Debt Restructuring Approach*, 9 L. & BUS. REV. AM. 629, 666 (2003); *Macrotecnic Int'l Corp. vs. Republic of Argentina*, No. 02 Civ. 5932 (TPG), 2003 U.S. Dist. LEXIS 6156 (S.D.N.Y. Apr. 14, 2003); *EM Ltd. vs. Republic of Argentina*, No. 03 Civ. 2507 (TPG), 2003 U.S. Dist. LEXIS 15975 (S.D.N.Y. Sept. 16, 2003).

December 2001,⁵³ officially declaring its default on April 25, 2002 pursuant to the Ministry of Economy Resolution No. 73/2002.⁵⁴ This Resolution postponed sovereign debt payments until December 31, 2002.⁵⁵

From a total outstanding debt of approximately \$180 million, \$95 million would be restructured.⁵⁶ The following chart shows the composition of the Argentine debt:⁵⁷

Republic of Argentina Outstanding Debt

Outstanding Debt		
Debt to be Restructured	Millions USD	%
Eligible Debt (Bonds)	87.050	48.7
Bilaterals (Paris Club)	5.217	2.9
Commercial Banks	1.724	1
Other Creditors	.311	0.2
Total	94.302	52.7
Excluded Debt		
Excluded Debt	Millions USD	%
International Financial Institutions	30.792	17.2
BODENS*	22.580	12.6
Guaranteed Loans	15.588	8.7
Provincial Guaranteed Bonds*	10.200	5.7
Exceptions Payments*	.606	0.3
Others*	4.727	2.6
Total	84.493	47.3
TOTAL:	178.795	100

* Issues resulting from the devaluation of the AR\$

Source: Argentine Ministry of Economy

53. See *IMF May Help Bail out Argentina*, at CNN.com, <http://edition.cnn.com/2001/WORLD/americas/12/27/argentina.imf/index.html> (Dec. 20, 2001).

54. SEC. EXCH. COMM'N ANN. REP. 2002, Sec. Exch. Act 1934, Comm'n No. 1-14278, [Form 20-F] at 8, at http://www.quinsa.com.ar/quinsanewweb/Financial/annual_reporte.html (last visited Jul. 25, 2005).

55. *Id.*

56. See Dr. Guillermo Nielsen, Speech of the Secretary of Finance: Argentina's Restructuring Guidelines (Sept. 22, 2003), at http://www.argentinedebtinfo.gov.ar/documentos/discurso_gn_dubai_con_diap_english.pdf [hereinafter Argentina's Restructuring Guidelines].

57. *Id.*

Argentine public debt has particular characteristics since it is the largest default to date,⁵⁸ followed by the Russian default in 1998 where \$31.6 million were restructured, and Uruguay's debt re-profiling in 2003 worth \$4.9 million.⁵⁹

In addition, because bonds replaced syndicated loans, which resulted in an increased creditor base, Argentina's biggest problem⁶⁰ was to coordinate its over 700,000 creditors with differing interests.⁶¹ Furthermore, there are 152 different series of bonds, with eight different governing laws.⁶²

Institutional investors hold 56.5% of the total outstanding debt to be restructured, while the remaining 43.5% is held by retail investors.⁶³ Almost 40% of Argentine defaulted debt is held by Argentinean bondholders and the remaining 60% is distributed in more than eight countries.⁶⁴ Within this framework, Argentina's challenge does not seem to fit a textbook Wall Street case.

On January 12, 2005, Argentina announced its final sovereign debt restructuring proposal.⁶⁵ The first proposal was announced in September 2003 in Dubai during an IMF annual meeting.⁶⁶ This proposal consisted of a 75% nominal value write-off and no interest payments.⁶⁷

The second proposal was announced on June 1, 2004 and it recognized: (i) the unpaid interests from December 2001 until the

58. See Arora & Caminal, *supra* note 12, at 664.

59. Dr. Guillermo Nielsen, Presentation Secretary of Finance, Ministry of Economy and Production, Argentina: From Stabilization to Economic Growth (Aug. 2003), at http://www.argentinedebtinfo.gov.ar/documentos/europe_presentation_english_august.pdf [hereinafter Argentina: From Stabilization to Economic Growth].

60. See Arora & Caminal, *supra* note 12, at 62.

61. Andrew Balls & Adam Thomson, *Argentina Defiant Towards Private Creditors*, FINANCIAL TIMES, Mar. 11, 2004, at 1, available at 2004 WL 72878019.

62. Argentina's Restructuring Guidelines, *supra* note 56, at http://www.argentinedebtinfo.gov.ar/ing_presen.htm. Fifty-one percent of Argentine debt is subject to New York Law, eighteen percent to UK Law, seventeen percent to German Law, eleven percent to Argentine Law, two percent to Japanese Law, and the remaining one percent to other jurisdictions. *Id.*

63. See *id.*

64. See *id.* More information concerning the Argentine proposal is available at the Argentine Republic's Ministry of Economy and Production website at http://www.mecon.gov.ar/finanzas/basehome/renegociacion_deuda.htm (last visited Jul. 25, 2005).

65. Martín Kanenguiser, *La Salida del Default: Se Presentó Oficialmente la Propuesta en Buenos Aires*, LA NACION (Jan. 13, 2005), available at <http://www.lanacion.com.ar/670761>.

66. See *id.*

67. See *id.*

end of 2003 for \$18.2 billion as long as the proposal is accepted by seventy percent of the bondholders;⁶⁸ and, (ii) an annual cash sweetener tied to the gross domestic product.⁶⁹ According to the proposal, Argentina would face payments of around \$1 billion in the first year after the restructuring.⁷⁰

The guidelines of the final proposal presented on January 12, 2005 are as follows:

(i) **Principal:** A seventy-five percent write-off over the nominal value of a total outstanding debt of \$81,200 million in default.

(ii) **Nominal Write Off:** It is performed on the principal. In nominal terms, it totals \$60.9 million (81,200 x 75/100).

(iii) **Acknowledgement of Due Interests:** The original offer made in Dubai on September 2003 posed: (a) a seventy-five percent write-off over the nominal value of a total outstanding debt of \$81,200 billion in default; and, (b) a 100% write-off of the accrued interests corresponding to the period between December 2001 (the date of the moratorium announcement) and December 2003 (the date the definite offer was supposed to be announced), which amounts to \$18.2 billion.⁷¹

In the final proposal, the Argentine government acknowledged the accrued interests. Therefore, the amount of debt to be restructured is \$99.4 billion, considering that a seventy-five percent write-off on principal is still applicable. Although the interests are acknowledged, they would be capitalized in the same time frame as the new bonds to be issued (between thirty and forty-two years), thereby resulting in a bigger share of par bonds and quasi par bonds.⁷²

(iv) **New Debt Issuance:** The following are the major terms and

68. See Martín Kanenguiser, *Se Pagarán los Interese a los Acreedores en Default*, LA NACION LINE (June 1, 2004), available at http://www.lanacion.com.ar/herramientas/printfriendly.asp?origen=3ra¬a_id=606669. If the percentage of acceptance exceeded seventy percent, the interest payment period would extend to June 2004, resulting in \$22.5 million. See *id.*

69. See MINISTERIO DE ECONOMÍA Y PRODUCCIÓN, OFERTA DE CANJE (Jan. 12, 2005), available at http://www.mecon.gov.ar/basehome/argentina_roadshow_presentation_enero_12_2005_v_final_web.pdf [hereinafter OFERTA DE CANJE].

70. See José E. Jorge, *La Segunda Oferta: Argentina Renegocia su Deuda en Default*, June 2003, available at <http://www.cambiocultural.com.ar/actualidad/deudab.htm>.

71. See Press Release, Comisión de Economía, Once Puntos Básicos sobre la Reducción de la Deuda Pública del País (June 1, 2004), available at <http://www.cai.org.ar/economia/m-oncepuntos.html> [hereinafter Comisión de Economía].

72. See *id.*

conditions of the bonds to be issued in place of the outstanding debt:

a) \$38.5 million corresponds to the outstanding debt plus accrued interests up to December 31, 2003, with an applicable write-off of seventy-five percent.⁷³

b) In the event that the percentage of acceptance is equal to, or exceeds, seventy percent of the total amount of bondholders, the new debt to be issued would be \$43.2 million.⁷⁴

c) If Argentina were to exchange, amend, or repurchase any of the eligible bonds which are not tendered in the final proposal before December 2014, then the participating bondholders in the exchange offer would have the option to participate in any such new exchange, amendment,⁷⁵ or repurchase on the basis of their original debt holdings.

73. *See id.*

74. *Id.* This will correspond to \$104,100,000 minus \$60,900,000 which equals \$43,200,000—the total amount of outstanding eligible debt including interests as of June 30, 2004, minus the write off mentioned in (ii) above. *Id.*

75. Prospectus Supplement (to the Prospectus of the Republic of Argentina dated Dec. 27, 2004), Reg. No. 333-117111, available at <http://www.sec.gov> [hereinafter Prospectus Supplement, Republic of Argentina]. This clause is known as the “most favoured creditor clause.” *See* OFERTA DE CANJE, *supra* note 69, available at http://www.mecon.gov.ar/basehome/argentina_roadshow_presentation_enero_12_2005_v_final_web.pdf. This clause has been used for marketing purposes of the exchange offer by the Argentine government because it was supposed to guarantee to the accepting creditors of the offer that no better terms would be offered to other creditors. *Id.* The clause included in the Prospectus Supplement, Republic of Argentina, states:

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 exchanged 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 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 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.” *Id.*

The word “settlement” was not included in the Prospectus Supplement finally approved by the SEC, but it was included in Annex I of the Argentine Presidential Decree No.

d) As from the issuance date (December 31, 2003) and up to a period of six years (2004-2009), the payment capability allocated for the new bonds which are not tendered will be used exclusively to repurchase public debt, with the exception of non performing bonds not participating in the exchange offer.⁷⁶

e) The issuance date of the new bonds will be December 31, 2003, the early subscription period will go from January 14 until February 4, 2005, and the remaining period will be until February 25, 2005.⁷⁷ The new bonds will be divided into three different types of bonds. Each type of bond will be issued according to the following detail:⁷⁸

Type of Bond	Nominal Value if the offer is accepted by less than 70% of the bondholders	Nominal Value if the offer is accepted by 70% or more of the bondholders
Par	\$ 10,000	\$ 15,000
Quasi-Par	\$ 8,300	\$ 8,300
Discount	\$ 20,200	\$ 18,500
TOTAL	\$ 38,500	\$ 41,800

The main characteristics of the bonds to be issued, which will replace the current 152 series of bonds in default, are as follows:⁷⁹

(i) **Par Bonds:** These bonds will be subject to any write-off on the nominal value of the bonds they replace, but will have a longer maturity period with a lower interest rate than the bonds being swapped. They will be issued in the amount of \$10

1735/04 published in December 2004. This last minute change diluted the purpose of this clause because a window was left open to settle claims with holdout creditors without triggering the clause. After this blunder, the Argentine Congress passed Law 26,017 prohibiting the reopening of the exchange offer or the performing of any kind of settlement.

76. See OFERTA DE CANJE, *supra* note 69, available at http://www.mecon.gov.ar/basehome/argentina_roadshow_presentation_enero_12_2005_v_final_web.pdf.

77. *Id.*

78. Comisión de Economía, *supra* note 71, available at <http://www.cai.org.ar/economia/m-oncepuntos.html>.

79. See OFERTA DE CANJE, *supra* note 69, available at http://www.mecon.gov.ar/basehome/argentina_roadshow_presentation_enero_12_2005_v_final_web.pdf.

billion⁸⁰ with a thirty-five year maturity and a twenty-five year grace period. They will have a “step up” coupon, which increases the interest to be paid over time. The applicable interest rates would be 1.3% from the first to the fifth year; 2.5% from the sixth to the fifteenth year; 3.75% from the sixteenth to the twenty-fifth year; and, 5.25% from the twenty-sixth year onwards. These bonds will mature in 2038 and amortization will commence in 2029. Payments will be semi-annual. Additionally, par bondholders will receive outstanding accrued interest from December 31, 2003 to January 4, 2005.⁸¹

(ii) **Quasi Par Bonds:** These will be subject to 30.1% write-off on the nominal value of the bonds that they replace and will be issued in Argentine pesos.⁸² They will be issued in the amount of \$8.3 million, with a forty-two year maturity and a thirty-two year grace period.⁸³ The coupon would have a 5.57% annual interest rate that will be capitalized during the first ten years and would be paid from the eleventh year onwards,⁸⁴ and the capital will be adjusted by an indexation ratio of peso-fied debts commonly known as *Coeficiente de Estabilización de Referencia* (CER).⁸⁵ These bonds will mature in 2045 and amortization will commence in 2036.⁸⁶

(iii) **Discount Bonds:** These will have a write-off of 66.3% on the nominal value of the bonds that they replace.⁸⁷ They will be

80. If more than seventy percent of the outstanding debt were to be tendered, then the issuance of par bonds would increase to \$15 billion. OFERTA DE CANJE, *supra* note 69, available at http://www.mecon.gov.ar/basehome/argentina_roadshow_presentation_enero_12_2005_v_final_web.pdf.

81. *Id.*

82. *Id.*

83. See Jorge, *supra* note 65, available at www.cambiocultural.com.ar/actualidad/deuda.htm. The quasi par bonds were converted into Argentine pesos (AR\$). The conversion rate established was AR\$1.40 per each U.S. dollar, or its equivalent in other currency, and was adjusted by an index ratio of debts commonly known as CER (*Coeficiente de Estabilización de Referencia*). See *id.*

84. See Jorge, *supra* note 65, available at www.cambiocultural.com.ar/actualidad/deuda.htm. The quasi par bonds are targeted to the pension funds (AFJPs), which hold twenty percent of the defaulted debt. See *id.* Moreover, the AFJPs have an old rivalry with the Argentine government due to the mandatory conversion into AR\$ of some guaranteed loans. See *id.*; see generally R. Olivares Caminal, *El Principio de Seguridad Jurídica en los Canjes de Deuda Pública*, 2004 LA LEY, 7-12.

85. OFERTA DE CANJE, *supra* note 69, available at http://www.mecon.gov.ar/basehome/argentina_roadshow_presentation_enero_12_2005_v_final_web.pdf.

86. See *id.*

87. *Id.*

issued in the amount of \$20.2 billion,⁸⁸ with a thirty year maturity and a twenty year grace period. They are going to have a "step up" coupon, which increases the interest to be paid over time. The applicable interests would be 3.97% from the first to the fifth year; 5.77% from the sixth to the tenth year; and 8.28% from the eleventh year onward.⁸⁹ In addition, they will have a "step up" capitalization of interest during the first ten years of 4.31% from the first to the fifth year and 2.51% from the sixth to the tenth year.⁹⁰ These bonds will mature in 2033 and amortization will commence in 2024.⁹¹ Additionally, discount bondholders will receive outstanding accrued interest from December 31, 2003 to January 4, 2005.⁹²

(iv) **GDP linked Value Recovery Right:** All bonds will have a GDP linked Value Recovery Right (VRR). The VRR will annually increase the payments resulting from the new bonds in the event that Argentina's GDP growth during the year exceeds the calculus done by the Argentine government and that would be jointly presented with the restructuring offer.⁹³ The exceeding amount that triggers the payment is defined in the medium term as the amount exceeding an annual growth estimated at three percent.⁹⁴

Due to the time elapse since Argentina's default, some bondholders opposed to the debt exchange offer organized themselves or obtained the required majorities to oppose the amendments of the terms and conditions of the bonds in default, becoming a "blocking holding."⁹⁵ This did not permit Argentina to

88. *Id.* If more than seventy percent of the outstanding debt were to be tendered, then the issuance of discount bonds will decrease to \$18.5 billion.

89. *Id.*

90. *Id.*

91. OFERTA DE CANJE, *supra* note 69, available at http://www.mecon.gov.ar/basehome/argentina_roadshow_presentation_enero_12_2005_v_final_web.pdf.

92. *Id.*

93. Comisión de Economía, *supra* note 71, available at <http://www.cai.org.ar/economia/oncepuntos.html>.

94. *Id.*

95. This is the authors' interpretation of Argentina's decision not to use the exit consent technique. Memorandum of Law of the Republic of Argentina in Opposition to Plaintiffs' Motion for a Preliminary Injunction, *Seijas v. The Republic of Argentina* (04 Civ. 400). Using the exit consent technique would have resulted in a potential increase in the number of exchange offer acceptances. This analysis is based upon the Ecuador and Uruguay restructuring cases. *see* POLICY DEV & REV. & LEGAL DEP'TS, available at <http://www.imf.org/external/pubs/ft/series/03/IPS.pdf> (Jan. 24, 2001).

Moreover, on December 3, 2004, in London, one of the authors confirmed this

make an exchange offer using a combined mechanism with the use of exit consent and the grant of an express mandate for those accepting the exchange offer, as was done in the cases of Ecuador and Ukraine, respectively.⁹⁶ Hence, Argentina lost the chance to use the mechanism that would have lessened the holdout problem by discouraging the non-accepting creditors without affecting the payment terms, provided that the required percentage to amend the terms and conditions of the prospectus was obtained.⁹⁷

For this reason, on November 15, 2004, Argentina filed a Memorandum of Law with the District Court of the Southern District of New York opposing plaintiffs' motion for a preliminary injunction.⁹⁸ Argentina confirmed that it would not use exit consent in its final exchange offer launched on January 12, 2005.⁹⁹ The relevant part of the Memorandum states:

Plaintiffs' ex parte motion for a preliminary injunction is based on their incorrect speculation that the Republic's as-yet unannounced Exchange Offer will contain "exit consents" that will somehow inflict irreparable harm upon them. Of course had plaintiffs simply waited until the November 29 launch of the Exchange Offer (which is not scheduled to close until 2005) they would have learned what the Republic has publicly confirmed: the Exchange Offer will not include exit consents.¹⁰⁰

Argentina's final debt proposal included a cash payment as an incentive to the accepting bondholders, of accrued outstanding interest, as a way to increase the degree of acceptance of the debt exchange offer.¹⁰¹ Otherwise the number of bondholders' claims

during an informal conversation with one of the lawyers advising the Argentine government in its sovereign debt restructuring.

96. *Id.*

97. This occurred in Ecuador and Uruguay debt restructuring cases. For an enlargement of the results in Ecuador and Uruguay in using the exit consent technique, see generally Lee C. Buchheit, *How Ecuador Escaped the Brady Bond Trap*, INT'L FIN. L. REV., 17 (2000); Lee C. Buchheit & Jeremiah S. Pam, *Uruguay's Innovations*, 19 J. INT'L BANKING L. & REG. 28 (2004).

98. Memorandum of Law of the Republic of Argentina in Opposition to Plaintiffs' Motion for a Preliminary Injunction, *Seijas v. The Republic of Argentina* (04 Civ. 400).

99. *Id.* at 1.

100. *Id.*

101. See OFERTA DE CANJE, *supra* note 69, available at http://www.mecon.gov.ar/basehome/argentina_roadshow_presentation_enero_12_2005_v_final_web.pdf; see also Kentaro Tamura, *The Problem of Sovereign Debt Restructuring: How Can We Deal with the Problem?*, HARVARD LAW SCHOOL INTERNATIONAL FINANCE SEMINAR 16 (Apr. 2002), available at http://www.law.harvard.edu/programs/pifs/pdfs/kentaro_tamura.pdf.

against Argentina could have increased. Currently, Argentina is facing many claims in different courts (e.g., New York, Italy, Germany, and some local claims).¹⁰²

Argentina has already missed the opportunity of implementing the use of “exit consent” to tackle the holdout problem, having to resort to a cash payment of accrued interests to increase the degree of acceptance and to decrease the holdout threat.¹⁰³

In addition, another threat looms in Argentina's horizon that might affect the success of Argentina's final exchange offer–class actions. An attempt to use a class action in sovereign restructuring was tested in two cases, although no class was certified because the parties settled the case prior to any further development.¹⁰⁴ Within Argentina's recent default, a class was certified for the first time in the sovereign context.¹⁰⁵

On December 30, 2003, a class certification was granted in *H.W. Urban GmbH v. the Republic of Argentina*.¹⁰⁶ This action involved the following bonds of the Republic of Argentina: (i) bonds issued on January 30, 1997 and due on January 30, 2017, bearing an 11.375% interest rate; and, (ii) bonds issued on April 7, 1999 and due on April 7, 2017, bearing an 11.75% interest rate.¹⁰⁷

The court stated:

[T]here is no basis for ruling that a properly defined class action should not be similarly entertained by the court pursuant to the law governing class actions. That this action complies with the requirements of Fed. R. Civ. P. 23 is clear and requires little discussion. The class is sufficiently numerous for class action treatment. The questions of law and fact upon which liability depends are common to all members of the class, since liability depends on contractual terms applicable to all bonds. Plaintiff, being a bondholder, has claims typical of those of the class by virtue of being subject to the same contractual terms.

102. See Hamilton, Caminal & Zenarruza, *supra* note 30, at 135.

103. See *supra* text accompanying notes 95 & 102.

104. *Hirshon v. Republic of Bolivia*, 979 F. Supp. 908 (D.D.C. 1997); *Carl Marks & Co., Inc. v. Union of Soviet Socialist Republics*, 665 F. Supp. 323 (S.D.N.Y. 1987).

105. *H.W. Urban GmbH v. Republic of Argentina*, No. 02 Civ. 5699 (TPG), 2003 U.S. Dist. LEXIS 23363 (S.D.N.Y. Dec. 30, 2003).

106. Motion for Class Action Certification, *H.W. Urban GmbH v. Republic of Argentina*, No. 02 Civ. 5699 (TPG), 2003 U.S. Dist. LEXIS 23363 (S.D.N.Y. Dec. 30, 2003) (02 Civ 5699).

107. *Id.*

There is no reason to doubt that plaintiff can act as a proper representative, and his attorneys have a record of experience in comparable litigation.

What has been said covers the requirement of Rule 23(a). With regard to Rule 23(b), the court needs to find, in addition to what is required under 23(a), that one of three alternative conditions is satisfied. The part of Rule 23(b) relevant to the present case is Rule 23(b)(3), which provides that class action treatment is appropriate where: (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

It is clear that the questions of law and fact common to the members of the class predominate over any individual questions. As already described, all questions relating to liability are common. Questions as to the type of relief will also be common. The remaining individual issues about the quantum of relief can undoubtedly be resolved by the processing of claims, which need not be unduly complex. As to the superiority of a class action to other procedures, the court notes the following. As indicated earlier, certain bondholders prefer to bring their own individual actions, and have done so. But for those who wish to be part of this proposed class action, it is reasonable for them to believe that it is superior to their bringing individual actions. For those who do not wish to be a part of the present class action, they will have an opportunity to make that choice.

What has just been said takes care of items (A) and (B). As to item (C), there is surely nothing desirable about having the claims of the members of the proposed class spread around in different courts.

Regarding item (D), the court does not see that there will be any particular difficulties in management, now that the class has

been defined to relate to two series of bonds. At least, there would appear to be no greater difficulty than occurs in other large class actions. The court does not agree with the Republic that notice will present an insuperable difficulty. Although it may be necessary to go through an institution, or even more than one institution, to reach the actual bondholders, this is apparently accomplished in order to make payments of interest, and the same should be true for giving notice of the action.

The court wishes to add the following comment as to how the action will proceed. The court is required, under Rule 23(c)(2), to give notice to class members, offering them an opportunity to "opt out." But the court also has discretion under Rule 23(d) to require class members to come forward affirmatively and "present claims." In fact, the need to do this at some appropriate time is obvious because no judgment can be rendered without the presentation of such claims. It would be the intention of the court in this case to accelerate the claim procedure as much as possible, in order to arrive at a definite determination of who is participating in the class action. For one thing, it is desirable in order to provide information to those negotiating the restructuring as to who has chosen the class action litigation route and who has not.¹⁰⁸

Therefore the success of Argentina's debt exchange offer will be conditioned by the final outcome of the class action litigation, which might open a window for a completely new approach in sovereign debt restructuring.

IV. IMPORTANCE OF THE APPLICABLE LAW TO THE CURRENT SERIES OF BONDS

A. Introduction

Because there is no standard legal regime applicable to sovereign debt restructuring and usually there is more than one applicable legislation, the international financial community has tried to offset the holdout practice by means of (i) exit consent; (ii) the International Monetary Fund's (IMF) proposal to establish a Sovereign Debt Restructuring Mechanism (SDRM); and, (iii) the

108. *Id.*

acceptance of collective action clauses (CACs).¹⁰⁹ SDRM is a proposal under the umbrella of the IMF aimed at tackling the holdout problem through an internationally binding legal regime, while exit consent and CACs are two different techniques that can be used by a market-oriented approach to sovereign debt restructuring.

B. Exit Consent, SDRM and CACs

Exit consent is the technique developed in Ecuador's sovereign debt restructuring in 2000, by which the holders of defaulted bonds that accepted to swap their old bonds in an exchange offer—at the moment of accepting such exchange offer—grant their consent to amend certain terms of the old bonds.¹¹⁰ The amendment to the terms of the old bonds would take place once the required majority accepted the exchange offer.¹¹¹ The amendment would make the old bonds less attractive, forcing more bondholders to potential holdout because the bonds would be stripped of its original guarantees.¹¹²

The SDRM proposed by the IMF is an international restructuring procedure for sovereign states.¹¹³ The IMF's proposal is based on a “twin-track” mechanism which is based on two complementary approaches—contractual and statutory—to create a more orderly restructuring scenario.¹¹⁴ While the former implies the use of certain terms such as the CACs, the latter would create a legal framework for collective decisions by debtors and a super-

109. See generally POLICY DEV. & REV. & LEGAL DEP'TS, *supra* note 12, available at <http://www.imf.org/external/pubs/ft/series/03/IPS.pdf>.

110. See *id.* at 11.

111. See *id.*; see also Michael M. Chamberlain, At the Frontier of Exit Consents, Remarks at the Bear Stearns & EMCA Sovereign Creditors Rights Conference (Nov. 9, 2001), available at <http://www.emta.org/ndevelop/exitcons.pdf>.

112. POLICY DEV. & REV. & LEGAL DEP'TS, *supra* note 12, at 11, available at <http://www.imf.org/external/pubs/ft/series/03/IPS.pdf>. The leading case on exit consent is *Katz v. Oak Indus.*, 508 A.2d 873 (Del. Ch. 1986), where the validity and legitimacy of using this technique was recognized in a case of commercial bonds. Subsequently, New York courts have recognized its validity in many cases such as *Unigard Security Ins. Co. v. North River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993). In *Unigard*, the court recognized the argument that the use of exit consent is legitimate because the drafters of the terms and conditions of the bonds issued after the *Oak Industries* case did not make any amendments to the contractual terms of the bonds to limit the use of exit consent. Countries which have used exit consent in cases of sovereign debt restructuring include Ecuador and Uruguay.

113. Arora & Caminal, *supra* note 12, at 632-33.

114. *Id.* at 633.

majority of its creditors.¹¹⁵

A new trend that has been developed by the Mexican and Brazilian debt issuances during 2003 is the use of CACs.¹¹⁶ CACs are bond clauses that allow amendment of all the terms of the bonds by a pre-established holding majority.¹¹⁷ The required majority is usually seventy-five percent of the bondholders, but in other cases it is eighty-five percent.¹¹⁸

Uruguay re-profiled all of its global debt and included CACs in the new terms of the bonds.¹¹⁹ The use of CACs permits a more orderly debt workout, without necessitating any recourse to an exchange offer.¹²⁰ Moreover, in the event of future debt restructuring, the holdout problem would be overridden because a supermajority would bind a dissenting minority.¹²¹

Most of the Argentine bond series do not include CACs.¹²² Moreover, the SDRM is not in force yet and will not be in the short run.¹²³ Therefore, exit consent would have become relevant in Argentina's debt restructuring. The terms and conditions to amend the terms of the bonds in the event that exit consent would have been used differ depending on the applicable law.

C. *Applicable Laws to Amend the Terms of the Argentine Bonds*

Most of the series of bonds issued by the Republic of Argentina are subject either to New York law or English law.¹²⁴

115. *Id.*

116. *See id.* at 662.

117. *See* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1, 4 (2003).

118. *See* Arora & Caminal, *supra* note 12, at 663; *see also* R. Olivares Caminal, *Reestructuración de Deuda Pública: Diferentes Mecanismos*, in DEFAULT Y REESTRUCTURACIÓN DE LA DEUDA EXTERNA, 2003 LA LEY 97.

119. *See* Arora & Caminal, *supra* note 12, at 662.

120. *See id.* at 663.

121. Arora & Caminal, *supra* note 12, at 663.

122. *See* Arora & Caminal, *supra* note 12, at 665. Argentine sovereign bonds generally do not include CACs, except for only a few issuances in the 1990s, and the bonds subject to English law.

123. *See id.* at 664-65.

124. Ministerio de Economía y Producción, Lineamientos de Reestructuración de la Deuda Soberana (Sept. 23, 2003), available at http://www.argentinedebtinfor.gov.ar/documentos/dubai_esp_22-9.pdf. For purposes of this article, Argentine bonds subject to German law and Japanese law are comparable to bonds issued under New York law and English law, respectively. *See* Yan Liu, *Collective Action Clauses in International Sovereign Bonds* (Aug. 30, 2002), available at <http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/liu.pdf>.

The requirements to amend the terms and conditions are included in the prospectus of each series of bonds.¹²⁵ The requirements might change depending on each issuance.¹²⁶ However, prospectuses subject to the New York law or English law include certain features of their own legal systems that are usually applied in corporate bond issuances that allow us to trace certain general guidelines.¹²⁷

In order to amend the bonds subject to New York law, the terms and conditions can be divided into three categories:¹²⁸

(i) **Category I:** These clauses expressly require unanimous amendment by the bondholders and are related to the payment terms. Examples of these clauses include the amount of debt or face value of the bond, the maturity date, the currency of the issuance, and the terms to amend the bond's terms.

(ii) **Category II:** These clauses, if modified, affect the clauses related to the payment terms mentioned above. Examples of these clauses include the applicable law, events of default, and acceleration rights.

(iii) **Category III:** These are remaining clauses not included under Category I or II. Examples of these clauses include jurisdictional immunity, financial covenants, listing requirements, and *pari-passu* clauses.

In order to amend the clauses under Category I, the affirmative vote of all bondholders is required, which is nearly impossible.¹²⁹ Category II is a grey area.¹³⁰ Finally, Category III

125. See, e.g., Lee C. Buchheit & G. Mitu Gulati, Article, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, app. at 1361-63 (2002) [hereinafter *Sovereign Bonds and the Collective Will*].

126. See, e.g., *id.*

127. See *id.* at 1329.

128. See Remarks of Michael M. Chamberlin, *supra* note 111, available at <http://www.emta.org/ndevelop/exitcons.pdf>. Chamberlain used this classification for exit consent but it can also be used to classify amendable clauses of a bond.

129. In the recent case of Argentina's 2001-2002 debt crisis, there were: (i) 152 series of bonds; (ii) governed by eight different laws; and (iii) an estimation that at the moment of the default there were over 700,000 creditors around the globe, mainly in Italy (15.6%), Switzerland (10.3%), U.S. (9.1%), Germany (5.1%), Japan (3.1%), United Kingdom (1.1%), Netherlands (1%) and Luxembourg (0.8%). See Ministerio de Economía y Producción, Lineamientos de Reestructuración de la Deuda Soberana (Sept. 23, 2003), available at http://www.argentinedebtinfo.gov.ar/documentos/dubai_esp_22-9.pdf. Bearing this in mind, it can be said that it is almost impossible to achieve the assistance of all the creditors due to their geographical distribution and, for some, the unwillingness to incur the expense of being represented. Moreover, considering that it is difficult to make all

includes bond clauses that usually can be amended by 66⅔% of the bondholders.¹³¹

On the other hand, to amend any clause (classified under Categories I, II and III for bonds issued subject to New York law) subject to English law, a supermajority is required.¹³² To amend the payment terms (Category I), however, a quorum of seventy-five percent of the bondholders is required together with the required votes, which may vary according to the terms set forth in the prospectus and its supplement from a simple majority to 75 percent of the aggregate majority.¹³³ As in the bonds subject to New York law, the conditions to amend the terms are set forth in the issuance terms and conditions included in the prospectus.¹³⁴

shareholders of a listed company (who usually are residents within the same country) assist at a conveyed meeting, the chance is even less of getting bondholders involved in an event of this kind since the bondholders are anonymous and more difficult to notify.

130. See Lee C. Bucheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchange*, 48 UCLA L. REV. 59, 80 (2000).

131. 66⅔₃ is the percentage usually required to amend Category III clauses. See, e.g., Republic of Arg., USD 20,415,457,800 Debt Securities and Warrants to Purchase or Exchange Debt Securities, filed with the SEC on May 18, 2001, Reg. No. 333-13536. The modifications clause states:

Meetings and Amendments: ... Argentina, the fiscal agent and the holders of the debt securities may generally modify or take action with respect to the Fiscal Agency Agreement or the terms of the debt securities of a series upon the affirmative vote or written consent of the holders of not less than 66⅔₃ % of the outstanding principal amount of the debt securities of the series. The following modifications, however, require the consent of the holder of each debt security of a series: (i) a change in the payment dates for the payment of principal, premium, or interest; (ii) a reduction of the principal amount, the portion of the principal amount payable upon acceleration or the interest rate; a change in the payment currency or places of payment; (iii) a change in procedures for or in the definition of an event of redemption in the debt securities of a series; (iv) a shortening of the period during which Argentina is not permitted to redeem the debt securities of a series if, prior to that action, Argentina is not permitted to redeem the debt securities; (v) a reduction of the proportion of the principal amount of the debt securities of a series of a series to vote or consent of the holders of which is necessary to take action with respect to or modify the Fiscal Agency Agreement or the terms and conditions of the debt securities of the series; or, (v) a change in Argentina's obligation to pay additional amounts. . . .

132. See *Sovereign Bonds and the Collective Will*, *supra* note 125, at 1324-25.

133. See *id.* at 1325.

134. The following is the example of an amendment clause of a standard sovereign debt prospectus under English law:

Meetings of Noteholders, Modification and Waiver: (a) Meetings of Noteholders: ... [T]he quorum for any meeting to consider an Extraordinary Resolution will be two or more persons holding or representing a clear majority in nominal amount of the Notes of the relevant Series for the time being outstanding, or at any adjourned meeting two or more persons holding or

Considering that all the terms and conditions can be modified (including the payment terms under Category I) by a majority, bonds issued under English law have CACs.¹³⁵

To summarize:

- (i) The terms and conditions required to amend a bond issued under New York law are: (a) a fifty-one percent nominal value quorum in the first meeting or a twenty-five percent quorum on any subsequent adjourned meeting;¹³⁶ (b) unanimity (100% of the nominal value of the series) to amend the payment terms (Categories I and II); and, (c) a 66⅔% of the nominal value of the series to amend any other term (Category III) which does not imply to amend the clauses included under Categories I and II.¹³⁷

representing holders of Notes of the relevant Series whatever the nominal amount of the Notes of the relevant Series held or represented, unless the business of such meeting includes consideration of proposals, inter alia, (i) to amend the dates of maturity or redemption of the Notes of any Series or any date for payment of interest thereon, (ii) to reduce or cancel the nominal amount of the Notes of any Series, (iii) to reduce the rate or rates of interest in respect of the Notes of any Series or to vary the method or basis of calculating the rate or rates or amount of interest, (iv) if there is shown on the face of the Notes of any Series a Final Redemption Amount, Early Redemption Amount, Optional Redemption Amount, Minimum Rate of Interest and/or a Maximum Rate of Interest, to reduce such Redemption Amount, Minimum Rate of Interest and/or such Maximum Rate of Interest, (v) to change the method of calculating the Final Redemption Amount, the Early Redemption Amount, the Optional Redemption Amount or the Amortised Face Amount, as the case may be, in respect of the Notes of any Series, (vi) to change the currency or currencies of payment of the Notes of any Series or (vii) to modify the provisions concerning the quorum required at any meeting of Noteholders of any Series or the majority required to pass the Extraordinary Resolution, in which case the necessary quorum will be two or more persons holding or representing not less than 75 per cent., or at any adjourned meeting not less than 25 per cent., in nominal amount of the Notes of the relevant Series for the time being outstanding ... In the Trust Deed, "Extraordinary Resolution" is defined to mean a resolution passed at a meeting of holders of Notes of a Series, which meeting was duly convened and held in accordance with the provisions of the Trust Deed, by a majority consisting of not less than 50 per cent. of the votes cast.

Information Memorandum, Republic of Argentina, *U.S.\$20,000,000,000, Medium-Term Note Programme for the Issuance of Notes due from 30 days to 30 years from the Date of Issue* 34-35 (2001), at http://www.infoarg.org/docs/2001_InfoMemo_Boilerplate.pdf [hereinafter Information Memorandum]; see also, e.g., *Sovereign Bonds and the Collective Will*, *supra* note 125, app. at 1361.

135. See Remarks of Michael M. Chamberlin, *supra* note 111, available at <http://www.emta.org/ndevelop/exitcons.pdf>.

136. See Republic of Arg., *supra* note 131.

137. See *id.* at 1324-25; Information Memorandum, *supra* note 134, at

(ii) The terms and conditions required to amend a bond issued under English law are: (a) simple majority or an aggravated majority (i.e. 75%) as set forth in the terms of the bonds of the nominal value of each series to adopt resolutions; (b) the quorum required to amend the payment terms or other clauses that may affect the payment terms (Categories I and II) will usually be two or more persons holding or representing not less than seventy-five percent, or at any adjourned meeting not less than twenty-five percent of the nominal value of the series; and, (c) the quorum required to amend any other terms of the bond that do not affect the payment terms (Category III) will usually be two or more persons holding or representing not less than fifty percent of the nominal value of the series.¹³⁸

V. UKRAINE AND ECUADOR DEBT RESTRUCTURING

This section will analyze the use of CACs and exit consent in the previous sovereign debt restructuring episodes of Ukraine in 1999 and Ecuador in 2000.

Both Ukraine's and Ecuador's debt restructurings dealt with English law, which includes CACs,¹³⁹ and New York law, which includes Brady Bonds that did not include provisions for the amendment of the payment conditions (Category I).¹⁴⁰ Each of these debt swaps involved an exchange offer upon which bondholders were invited to exchange their old bonds for new ones.¹⁴¹ Ukraine's debt swap is an example of a CAC's debt exchange.¹⁴² In contrast, Ecuador's debt swap is an example of debt exchange through the use of exit consent.¹⁴³

In Ukraine's debt exchange offer, the consent of the accepting bondholders included their consent to amend the terms and conditions of the old debt instruments.¹⁴⁴ Ukraine conditioned the summoning of a bondholders' meeting to the prior confirmation

http://www.infoarg.org/docs/2001_InfoMemo_Boilerplate.pdf.

138. See, e.g., *Sovereign Bonds and the Collective Will*, *supra* note 125, app. at 1361.

139. POLICY DEV. & REV. & LEGAL DEP'TS, *supra* note 12, at 4, available at <http://www.imf.org/external/pubs/ft/series/03/IPS.pdf>. The applicable law in Ukraine's case was the law of Luxembourg, according to which the effect of CACs and amendments to the terms and conditions of bonds is similar to the effect under English Law.

140. *Id.*

141. *Id.*

142. See *id.* at 6.

143. *Id.* at 11.

144. *Id.* at 6.

that it had obtained the required percentage to introduce the proposed amendments to the terms and conditions of the bonds in default.¹⁴⁵ Once it had obtained the necessary proxies from bondholders representing the required percentage, according to terms and conditions set forth in the corresponding prospects, the bondholders' meeting was called. Ukraine, with the proxies (representing the required percentage to amend the terms of the old bonds), amended the terms and conditions of the bonds in default, and thereby equalized its terms and conditions to those of the new bonds.¹⁴⁶

Through CACs, Ukraine was able to introduce amendments to every term and condition of the bonds in default (payment and others), making such amendments applicable to the minorities.¹⁴⁷ Ecuador, on the other hand, did not have such a possibility and was forced to use an exchange offer as its only alternative.¹⁴⁸

Although Ecuador's bonds did not include CACs to amend payment conditions, the other terms of the bonds could be amended through a simple majority because "the bonds did include provisions that allow bondholders holding a simple majority of principal, either during a bondholders' meeting or by written notice, to bind a minority with respect to amendments of bond clauses other than those regarding payment—such as waiver of sovereign immunity, submission of jurisdiction, financial covenants, and listing."¹⁴⁹ In this way, it could amend Category III conditions, forcing the minority to accept such amendments.¹⁵⁰ Ecuador was the first sovereign state to use the exit consent technique to confront holdouts in an exchange offer where the original bonds did not include CACs.¹⁵¹

The amendments made to the original terms of the bonds were:

- (i) the requirement that all payment defaults must be cured as a condition to any rescission of acceleration; (ii) the provision

145. POLICY DEV. & REV. & LEGAL DEP'TS, *supra* note 12, at 6, available at <http://www.imf.org/external/pubs/ft/series/03/IPS.pdf>.

146. *Id.*

147. *Id.*

148. *See id.* at 10.

149. *Id.* at 35.

150. *See id.*

151. POLICY DEV. & REV. & LEGAL DEP'TS, *supra* note 12, at 11, available at <http://www.imf.org/external/pubs/ft/series/03/IPS.pdf>.

that restricts Ecuador from purchasing any of the Brady bonds while a payment default is continuing; (iii) the covenant that prohibits Ecuador from seeking a further restructuring of Brady bonds; (iv) the cross-default clause; (v) the negative pledge covenant; and (vi) the covenant to maintain the listing of the defaulted instruments on the Luxembourg Stock Exchange.¹⁵²

Following Ukraine's experience, every mandate granted to Ecuador to amend the terms and conditions of the bonds was made on an irrevocable basis subject to obtaining the required majorities to pass such amendments.¹⁵³

The use of exit consents allowed Ecuador to restructure its sovereign debt with ninety-seven percent acceptance.¹⁵⁴ The use of exit consents was vigorously criticized by certain bondholders, who considered it a coercive mechanism instead of an incentive to agree to the debt exchange.¹⁵⁵ Sovereign states, which intend to force the use of exit consents, might end up being sued by its creditors.¹⁵⁶

VI. CONCLUSION

In the sovereign debt restructuring episodes, either in the case of syndicated loans and/or bonds, the market has been able to come up with a solution without the need of a statutory approach. There are two available techniques that have already been tested satisfactorily. Even though Argentina pushed the limits, an orderly sovereign debt restructuring can be achieved.

The recent Argentina class actions illustrate an intermediate approach—between a formal statutory approach and a market driven approach—because to have court supervision, one of the parties must make the judicial request. Although it might be too early to make any assumptions, we may be facing the development of another market-based technique to deal with holdout creditors.

152. *Id.* at 8.

153. *Id.* at 35.

154. *Id.*

155. Remarks of Michael M. Chamberlain, *supra* note 111, available at <http://www.emta.org/ndevelop/exitcons.pdf>.

156. *Id.*