NML - Argentina: An Unemotional Analysis

by Kunibert Raffer, [i]

Prime – Policy research in macroeconomics, 7th July 2014

As sovereign debtors do not enjoy any form of insolvency protection and Argentina's contracts had no collective action clauses, New York courts correctly affirmed that any hold-out has a valid title, the right to accelerate principal in the case of default, and to demand full payment including interest. Technically Argentina broke the norms she herself had accepted voluntarily in her debt contract with creditors. This decision should therefore, not come as a surprise. It has already had impacts: other holdouts followed suit – even though Argentina would not have the funds to pay them all. Taiwan sued Grenada, and Italy changed her debt contracts. The position of sovereign debtors has deteriorated.

But it is highly problematic that exchange creditors (creditors who took a "haircut" and agreed to Argentina's unilateral re-structuring offer) were taken hostages. Pari passu clauses are a debtor's obligation, not that of other creditors. The debtor has to treat all creditors equally, breaking the contract if not doing so. Argentina's pari passu clause formulates: 'The payment obligations of the Republic'. Court decisions cannot be enforced against a sovereign, even though Argentina waived immunity. Argentina's outspoken refusal to obey has obviously annoyed US courts. So have loudly voiced opinions that Argentina would not pay whatever courts may decide. As Gelpern[ii] formulated: 'Perhaps more importantly, a decade of judging Argentina left Judge Griesa thoroughly fed up. Something had to be done lest US courts look feckless'.

But the frustration of judges must not determine judicial decisions, nor the fact that international law does not permit US courts to send bailiffs to Argentina.Even less does a judge's frustration justify taking the vast majority of exchange creditors hostage. Technically, money received by trustees (agents of creditors), is the property of their principals (these creditors), and no longer of Argentina. The court's decision infringes on their property rights, in economic terms clearly a taking, as prohibited by the US constitution. The court's agreement that the new bondholders themselves would not break the law simply by getting paid, borders on the ridiculous, but opens an avenue. If paid outside the US, exchange creditors could keep their own money.

Inexplicably, Argentina has never raised the point against hold-outs that practically all debts have been signed in violation of Argentina´s constitution, which reserves this right exclusively to the Argentine Congress. The US would never honour debts not incurred constitutionally. But then, Argentina is not the US.

Another highly problematic issue is an US court's ordering institutions in other countries to abide by US laws and judgements of US courts – a clear violation of international law. In the case of Euroclear this would infringe on Belgian law and was not upheld by the Supreme Court. This is to be expected if frustrated district judges can freely vent their feelings. In the UK, courts already rejected coercion of third parties in place of securing immediate compliance by the defendant.

Apparently, Argentina is about to switch the payment mechanism outside US jurisdiction. This can be done by offering all consenting creditors a swap with new, economically identical bonds governed by another law, either before or after a formal US-court-produced default. Getting their legitimate payments should induce them to accept. Naturally, Buenos Aires is no option. Greece demonstrated the drawbacks of a debtor's national law. It would have to be any country but Argentina or, as usual before WWII, an arbitration panel with both sides nominating members, who then elect one further person. As Argentina is prepared to pay exchange creditors, enforceability would not be an issue. Creditors could be paid in Buenos Aires, but Argentina should not be chosen as the jurisdiction. Reformulating the pari passu clause would be advisable too.

Argentina's 'rights upon future offers' (RUFO) clause will expire this year, i.e. the formal obligation that non- participating creditors would not get a sweeter deal. Technically, this would allow renegotiating with hold-outs next year, but it seems unlikely to happen for a variety of reasons.

Why New York law has become so popular remains puzzling. Its courts have repeatedly considered the ''interest in maintaining New York's status as one of the foremost commercial centres in the world' one reason for decisions (as in*Allied Bank International v Banco Credito Agricola de Cartago*). Justice has been subordinated to commercial interests as perceived by New York courts, even though it seems unlikely that proper judgements would have done perceptible harm to New York's standing. The Court of Appeals did not go that far this time, explaining nevertheless 'the interest … in maintaining New York's status as one of the foremost commercial centers' would be 'advanced' by the ruling. This might be wrong. Bond issuers might be steered 'away from New York'. They should be, because any jurisdiction where such essentially extra-legal issues can determine outcomes must be avoided in the interest of law as the ars boni et aequi (art of the good and equitable). The fact that the US administration's opinion has frequently determined judgements is also of concern, even though the US sided with Argentina this time. The Rule of Law requires that a city's, an administration's, or the supreme leader Kim's interests must not influence a court's decision, even though such illegitimate interests may formally be anointed 'lawful' (as they probably are in North Korea).

Finally, a strict reading of the pari passu clause could allow hold-outs to challenge payments to the IMF or other IFIs in court – a positive result. It could end the present law-breaking practice of illegally giving preferential treatment to these institutional creditors, thus damaging private bona fide creditors substantially.

MNL *v* Argentina shows again forcefully that sovereign insolvency proceedings[iii] are urgently needed in order to allow financial markets to function well, not least to protect the legitimate interests of bona fide creditors.

Kunibert Raffer is Associate Professor at the Department of Economics, University of Vienna. Amongst many publications, he is author of "What's good for the United States must be good for the world: advocating an international Chapter 9 insolvency" - first published by the Bruno Kreisky Forum for International Dialogue in 1993. Professor Raffer was the first to propose an international insolvency

process which draws on chapter 9 of the US legal framework for the resolution of debt crises faced by US municipalities.

[i]For useful comments I am indebted to JP Bohoslavsky

[ii] Anna Gelpern, , Sovereign Damage Control', PIIE Policy Brief 13-12, May 2013, p.5

[iii] See Kunibert Raffer (2010) *Debt Management for Development – Protection of the Poor and the Millennium Development Goals*, Elgar, Cheltenham, pp.78-113, or Kunibert Raffer (2012) "Insolvency Protection and Fairness for Greece: Implementing the Raffer Proposal", in: Elena Papadopoulou & Gabriel Sakellaridis (eds) *The Political Economy of Public Debt and Austerity in the EU,* Nissos, Athens, pp.225-239, downloadable at http://homepage.univie.ac.at/kunibert.raffer/Athens2011.pdf