European and International Law

Argentina's Sovereign Debt's Crisis before Different Fora

Agustina Noeli VAZQUEZ[1]

Abstract: On 10 September 2015, the United Nations general assembly voted on nine principles concerning the restructuring of sovereign debts. It has been largely related with the ongoing economic Greek crisis, however it is more accurate to consider this resolution as one of the latest outcomes of the long Argentinean debt crisis and its international repercussions.For over 20 years Argentina has been in the centre of international scene when talking about sovereign debt. It survived the 2001 crisis and its recovery, is one of the fewest in world history. However, its sovereign debt restructuration in 2006 ended up before courts all over the world. This produced an unthinkable effect: it showed us how much has international law developed over these last years in order to adapt itself to this new reality were States are no longer the only big players in the international arena. This paper pretends to focus on the Argentinean cases before International Courts. Having proved its value to the International Law field, this paper might be considered a small contribution in the tumultuous path to understand sovereign debt's regulation.

Keywords: Sovereign debt; International Law; Soft Law; NML vs. Argentina

1. Between Highway to Hell and Stairway to Heaven: Argentina's Debt Crisis

Sovereign debt is debt taken out by a country, either from another country (often distinguished as "public debt") or from a private creditor, such as a bank or an international credit organization (Barr, 2016, p. 1). Every country has sovereign debt and as debtors, they may sell the sovereign debt (in the form of bonds) to other creditors (Gosis, 2013, pp. 3-5). As debt grows, payments increase, and therefore

[1] Financiamiento Internacional Ministerio de Trabajo, Empleo y Seguridad Social, Argentina, Address: Av Leandro N. Alem 650, C1001AAO, Ciudad Autónoma de Buenos Aires, República Argentina, Corresponding author: agvazquez@trabajo.gob.ar.

states often attempt to restructure their debts. Debt restructuring is akin to refinancing: the debt is sold to other creditors or payments are modified, typically to have the debt repaid over a longer period of time (Potaminis, 2012, pp. 13-15). States, like private parties, have an interest in repaying their debts: states need good credit to participate in international markets, and good credit is the key to development. It has been widely recognized by Human Right's literature as the most important tool against poverty (Pogge, 2007, p. 3).

Financial crises, in their different dimensions –social chaos, external debt, balance-of-payments and banking crises or a mix of them - have been a recurrent phenomenon in Argentina (Cárdenas, Ocampo & Thorp, 2016, pp. 134-140; Nesvetailova, 2007, pp. 34-40).

By 1998, the inward investment boom that drove five years of strong economic growth had turned to capital flight (Dunning & Lundan, 2008, pp. 56-57). The government had run out of state companies to sell, the 1997 East Asian financial crisis dampened investors' appetites for all "emerging markets" (Burton & Tseng, 2006, p. 33-34) and the appreciation of the dollar priced Argentinian goods out of world markets. The country plunged into recession and severe austerity plans only aggravated the crisis. In December the government's raid on Argentinian pension funds and imposition of limits on bank withdrawals crowned the pillage.

A total of nine IMF stabilisation programmes since 1983 ended up with the largest sovereign debt default in history (Singh, 2005, pp. 23-25) and more than 40% of the country below the poverty (Gordon, 2003, pp. 26-27).

In order to activate a dead economy, the government had to freeze the prices charged by the foreign-owned electricity, gas and telephone companies and tax the exports of foreign-owned oil companies. Of course that all those economic measures resulted in major cases before de ICSID (Goodman, 2007), but somehow a 40% devaluation and converting dollar loans into the national currency worked.

But, even if the miracle worked faster than any recovery plan in history, a mere 6% of holdout bondholders of the new debt restructure was to become an Achillees heel.

Making a novation[1] in its national debts is not a new solution. It is an obvious response available to any country without money in its arcs. By a later payment of

[1] It has been clearly explained this concept by Wierzba (2015): "Novation is the act of replacing one party in a contract with another, or of replacing one debt or obligation with another. It extinguishes (cancels) the original contract and replaces it with another, requiring the consent of all parties involved."

the obligation and a severe head cut, the decade long government of the Kirchner thought that sooner or later vulture funds were going to negotiate and adapt themselves to the newer conditions. It did not happen and by selecting the New York forum in the newer bonds, the entire operation was in jeopardy.

2. International Law: A Step Behind?

Sovereign debt exists in a sparse legal space and its enforcement is uncertain, (Espósito, Li & Bohoslavsky, 2013, pp. 360-365). There are no formal bankruptcy procedures enforceable to a sovereign State.

Informal restructuring procedures are indecipherable to the public. National regulation, is limited at best in sovereign debt, where market participants are presumed to be sophisticated and in no need of protection. Treaty-based institutions –so far- have not ever consider the financial aspects of a sovereign debt restructure. Elsewhere in finance, transnational regulatory coordination has sought to fill the gaps in the formal treaty fabric (Gelpern, 2012, p. 13); however, even as it has grown in the wake of financial crises, the regulatory machinery has sidestepped sovereign debt.

Argentina defaulted on its sovereign debt in 2001, but the legal drama lasted over 14 years. Until recently, the country was being sued before more than 10 courts all over the world. When we focus on the legal side of this sovereign financial problem, we see that sovereign debt is governed by domestic laws applicable to each case.

This legal phenomenon is reinforced by the current trend of increasing domestic debt, which usually fragments applicable domestic laws even more (Espósito, Li & Bohoslavsky, 2013, pp. 245-250). However, as sovereign debt became a recurrent problem among States, and "*this debt touches upon global legal goods*" (Espósito & Garcimartín, 2012, pp. 15-17), the matter was really subjected to International Law –such as the Argentinean caseslaw teach us.

Wierzba, S. (2015), Manual de Obligaciones Civiles y Comerciales, según el nuevo Código Civil y Comercial de la Nación. Abeledo Perrot, Buenos Aires.

2.1. The NML vs. Argentina (US Supreme Court Decision)

In December 2001, the Argentine government, facing economic collapse, ceased paying its external debt.[1]

Within this unpaid debt, there were US$95 billion issued in 1994 to holders of Fiscal Agency Agreement (FAA) bonds that were governed by New York law. Argentina initiated two restructurings in 2005 and 2010, and around 94 percent of the bondholders on the defaulted bonds agreed to the proposed novation, but not everyone. NML Capital, Ltd. (NML), a holder of Argentine bonds that did not accept the restructuring and filed suit in the Southern District of New York to collect on its bonds.[2]

International Law –and specifically American interpretation of it regarding foreign States immunity before domestic courts- would have prevented this matter being subjected to American domestic courts. But, because of Argentina's waiver of sovereign immunity in its bond agreements[3], Judge Griesa was able to rule in favour of NML, commanding Argentina to pay over $2.5 billion dollars.

Argentinean tactical mistake up to this point has clearly been waiving its sovereign immunity. In American law, the Foreign Sovereign Immunities Act provides foreign governments, even including state-owned companies, with a related form of immunity -state immunity- that shields them from lawsuits except in relation to certain actions relating to commercial activity in the United States (Delaume, 1977, p. 14). This is bases in the classical distinction between "*iure imperii*" and "*iure gestioni*" acts.

States may act as a regular person through the *iure gestionis* acts, especially when engaged in commercial activity. The assets used for this ends are under no special protection. The majority of the State's assests are used for *iure imperii* acts – public activity- and so, they are protected by sovereign immunity. They affect the daily life of the State's population. However, it is not so simple to settle this distinction in real life.[4]

[1] EM Ltd. v. Republic of Argentina, 473 F.3d 463, 466 (2d Cir. 2007).
[2] EM Ltd. v. Republic of Argentina, 695 F.3d 201, 203 (2d Cir. 2012).
[3] Id.
[4] It is because of this blurred limit that Lopez Sandoval (2002) points out: "[m]ost of the academic writings consulted analyze the issue in question from a double perspective, which is differentiating expressly between the two dissimilar contexts where the clause plays its role, namely the corporate and the sovereign contexts. Certainly, there is a uniform position with regard to the meaning of the clause

When creditors face the possibility to claim sovereign debt, they first need to analyze if the States' goods are seizable and how much time this would take. Obviously, this is a venue only possible for the most economically powerful creditors. According to Olivares- Caminal (2011, pp. 18-9):

[e]xecuting property within the jurisdiction of the sovereign, the creditor is faced with the issue that it would be highly probable that due to public order, the judgment would not be enforced, or if enforced it would be payable.

Clearly, the creditors within NML were in full capacity to face such a complicate trial and so, they sought for a summary judgment on its claim that Argentina breached the pari passu clause[1] in the FAA bonds by relegating NMLs bonds to a non-paying class vis-a-vis the exchange bondholders. This was granted on December 7 2011 and soon after, the Second District fashioned an equitable remedy enjoining Argentina from making payments to the exchange bondholders without making concomitant ratable payments to NML (Barr, 2016, p. 75).

Bearing in mind the political backdrop to the litigation, the Second Circuit tried very hard to emphasize that its decision was limited to the specific facts of the dispute and the specific terms of the FAA bonds.

Immediately, Argentina filed a petition for a *writ of certiorari* before the Supreme Court. This claim was supported by exchanged bondholders and the international banks. Moreover, sovereign states, international financial institutions and even the Solicitor General of the USA supported the Argentinean position. But on June 16, 2014, the Supreme Court denied the petition and so, Judge Griesa's injunctions went into effect.

in the corporate context: It does not mean what Lowenfeld suggested. However, when referring to the sovereign context, commentators' opinions are divided".

[1] In general terms, the pari passu clause protects a bondholder against legal subordination, which makes sense when the bond issuer is subject to a bankruptcy regime or rules governing debt collection. However, the implementation of the clause is less clear in the context of sovereign debt, where there is no bankruptcy regime governing collection against sovereigns, especially given sovereign immunity protections. BROWN, C. (2012) "Pari Passu: Is There a More Equitable Way to Prioritise Taxation?". Australian Tax Teacher Association, Conference 2012 Paper, Queensland University of Technology. Available at [sydney.edu.au/law/parsons/ATTA/docs_pdfs/conference_papers/Pari_Passu_Is_there_a_more_equitable_way_to_prioritise_taxation.pdf].

But the tango was not over: Shortly after the Supreme Court's decision to deny Argentina's petition for certiorari, Argentina's Economy Minister Axel Kicillof proposed to pay the exchange bondholders in Argentina under Argentine law.[1]

Judge Griesa ordered Argentina to refrain from carrying out the proposal but it passed as an Argentinean sovereign law while requesting Judge Griesa to stay the injunctions. Observing that the total amount due to the holdout bondholders exceeded half of Argentina's reserves, it was clear that a new default was around the corner as Argentina could be in violation of the "Rights upon Future Offers" (ROFU) clause found in its restructured debt instruments.

This is a relatively simple provision that says:

"… 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 Holders`s Securities for (as applicable):

• the consideration in cash or in kind received by holders of Non-Performing Securities in connection with any such Future Exchange Offer; or

• debt obligations having terms substantially the same as those resulting from any such Future Amendment Process, in each case in accordance with the terms and conditions of such Future Exchange Offer or Future Amendment Process."

Therefore, if Argentina voluntarily were to make to NML an offer to purchase or exchange or solicits consents to amend to the holders of the Holdout Bonds, Argentina should extend such terms to the Exchange Bondholders.[2]

According to Argentina, breach of the ROFU clause could imperil the entire restructuring with the exchange bondholders. However, this was rejected as NML considered this an offense and Judge Griessa agreed. A month later, Argentina defaulted on its sovereign debt for the second time it failed to make a coupon payment of US$5.4 million (Barr, 2016, p. 80).

[1] http://www.buenosairesherald.com/article/174088/gov%E2%80%99t-defends-success-of-sovereign-payment-law.
[2] See (Bruno, 2013). Argentina Debt--The Settlement Clause. Available at SSRN 2456055.

With each default, the debt grew. Interest were now over tenth times the capital and the country was being obliged to pay investors more than it held in its national reserves. That being said, with the expiration of the ROFU clauses in the restructured bonds on December 31, 2014, as of this writing, many predicted that negotiations with the holdout bondholders were to continue in January 2015, but the political decision was taken.

Rumour has it that a group of Argentinean banks were to try to buy the debt from the hold outs but the negotiations failed. [1]

Nevertheless, the situation changed when the new administration took power in December 2015. According to Kanenguiser (2016, p. 32), the new administration "(…) *bought a house in ruins, and before fixing it he has to stop the leaks in the roof*."

The need for external credit could be easily explained by the 12% unemployment, 30% inflation and negative growth predicted for the 2016. Moreover, according to the "Estado del Estado" – a public inform released by the current administration about the general situation of the public administration in Argentina- the country was suffering a 7% deficit in government spending during 2015.[2]

According to the current head of state, settling the legal dispute would allow the country to focus its "energy" on "development, investment and the creation of employment. However, his optimistic view was not shared by everyone as on April 15 the New York Appeals court released the details of the ruling that lifted the injunctions against the country.

The most recent ruling highlighted that bondholders that did not accept the "proposed settlement" are still entitled to turn to court to "protect their interests."

"Lifting the injunctions does not deprive the district court of the authority to put in place a new and efficacious injunction in the event that future circumstances justify such action. A premise underlying the district court's decision to vacate the Injunctions is that Argentina's recent actions reflect a good-faith intention promptly to resolve its outstanding disputes with all bondholders. Should this premise prove mistaken, the district court would be free, upon an appropriate factual showing, to

[1] See http://www.infobae.com/2016/03/08/1795659-holdouts-fabrega-conto-la-historia-secreta-del-acuerdo-que-fracaso-julio-2014/.
[2] Available at http://www.casarosada.gob.ar/elestadodelestado/English Translation still pending.

respond to such recalcitrance by putting in place a new injunction aimed at forcing compliance with Argentina's legal duties."[1]

So far nothing new has happen. Time will tell.

2.2. Argentina vs. United States of America before the International Court of Justice:

The Argentinean dispute against NML did not just reduce itself to the American domestic courts. It had relevant repercussions within the International Public Law when Argentina intended to filled a claim before the ICJ against US.

On August 7, 2014, Argentina filed a claim against the United States before the International Court of Justice (ICJ), the judicial arm of the United Nations.[2] Argentina contended that the United States has violated Argentina's sovereignty, including its rights to sovereign immunity, through the decisions rendered by the U.S. courts concerning restructuring of Argentina's sovereign debt.

Washington quickly refused to allow the IJC to hear Argentina's claims, briefly announcing that:

We do not view the ICJ as an appropriate venue for addressing Argentina's debt issues, and we continue to urge Argentina to engage with its creditors to resolve remaining issues with bondholders.[3]

Buenos Aires needed Washington to voluntarily accept the ICJ's jurisdiction for the proceedings to begin as the US withdrew from compulsory jurisdiction back in 1986 after the UN court ruled that America's covert war against Nicaragua was in violation of international law. Since then, Washington accepts International Court of Justice jurisdiction only on a case-by-case basis.

The ICJ has heard cases in the past brought by one state challenging the court decisions of another state as infringing on its sovereign rights, bu it is not its usual up of tea.

For example, Germany brought a case against Italy in 2008 before the ICJ, arguing that by allowing civil claims to be brought against Germany in Italian courts for war

[1] Id.
[2] See http://www.icj-cij.org/presscom/files/4/18354.pdf.
[3] Full text available at http://www.state.gov/documents/organization/241675.pdf.

crimes committed by German forces against Italian nationals in Italy and elsewhere during World War II, Italy violated Germany's sovereign jurisdictional immunity.[1]

Acording to Ciampi (2009, pp. 4-6), this conflict started when on 21 October 2008, the Italian Court of Cassation affirmed that Italian courts have jurisdiction over claims for compensation against the Federal Republic of Germany (FRG) brought by victims of war crimes and crimes against humanity committed during Germany's occupation of Italy in the Second World War (WWII). A former member of the Hermann Göring Division, Max Josef Milde, has been convicted and sentenced to life imprisonment in the same proceedings. The Court took the view that when a conflict arises between the customary rule of state immunity from foreign courts and the principle of protection of fundamental human rights, the latter must prevail.

However, this ruling was not accepted by Germany and the matter ended before the ICJ, who held that since Germany's conduct constituted sovereign conduct, rather than commercial conduct, it was entitled to state immunity as a matter of customary international law, absent a waiver of jurisdictional immunity.

Still, even under this light, it was highly unlikely that the ICJ would actually hear Argentina's claim. Argentina based the Court's jurisdiction on Article 38(5) of the ICJ Statute. This provision provided that the ICJ will have jurisdiction to hear a claim if the other State gives its consent. Article 38(5) provides:

When the Applicant State proposes to found the jurisdiction of the Court upon a consent thereto yet to be given or manifested by the State against which such application is made, the application shall be transmitted to that State. It shall not however be entered into the General List, nor any action be taken in the proceedings, unless and until the State against which such application is made consents to the Court's jurisdiction for the purposes of the case.

As expected, United States said no. It was under no obligation to give consent, nor, frankly, did it have any incentive to do so.[2] Argentina anticipated that the United States would not consent to the Court's jurisdiction but filed its claim to focus the international law community's attention on the U.S. court decisions[3], expecting to put an end to the litigation through an intervention by the head of State.

[1] http://www.icj-cij.org/docket/files/143/16899.pdf.
[2] As seen at http://www.state.gov/documents/organization/241672.pdf.
[3] Mascarenhas, V. (2015) "The Argentine Sovereign Debt Restructuring Saga: Understanding What Comes Next in 2015", International Law News, American Bar Association,Volume 44, Number 2.

If the Executive Branch had informed federal judge Griessa that Paul Singer's doing were interfering with the president's sole authority to conduct foreign policy. As explained by Powell (1998), this possibility was based on:

"(T)he relevante of constitutional law to the distribution of power over foreign affairs and national security is clear (…) the Congress has the" preeminent role … in the formulation of foreign policy "but it is a presidential proper role to execute foreign policy"[1]

Obama could have prevented vulture hedge-fund's claims from collecting a single dollar from Argentina by invoking the long-established authority granted presidents by the US constitution's "Separation of Powers" clause, as explained *ut supra*. This was not a novel idea as former president George W Bush had invoked this power against the very same hedge fund. Bush blocked Singer's seizure of Congo-Brazzaville's US property[2] by warning the same judge to heed the directive of a president invoking his foreign policy powers.

But he did not, regardless of the State Department's warning[3] and of Singer next move against Greece during the euro crisis by threatening to create a mass default of banks across Europe[4].

In other words, there's a price for crossing such interests in the world's current economy and when International Courts would not provide any relief to the matter, United Nations seems to propose the first steps to a brighter future.

Available at http://www.kslaw.com/imageserver/KSPublic/library/publication/2015articles/05-01-2015_International-Law-News_Mascarenhas.pdf.

[1] As seen at Powell, H. J. (1998). President's Authority over Foreign Affairs: An Executive Branch Perspective. Geo. Wash. L. Rev., 67, 527.

[2] As seen at Vernengo, M. (2014). Argentina, Vulture Funds, and the American Justice System. Challenge, 57(6), 46-55.

[3] As seen at http://www.state.gov/documents/organization/241672.pdf

[4] http://www.bloomberg.com/news/articles/2012-03-15/what-greece-can-learn-from-argentinas-default

3. Conclusion

Similar to natural evolution, the evolution of international law responds to changing conditions: sovereign debt has proved to change rich Nations to poor ones. The only way to overcome this, is through development.

Access to credit is important for developed and developing nations alike[1]. For developing countries especially, external debt can be used to finance defence and social programs, such as education and welfare.[2] Through these investments, countries can build an educated and specialized workforce, improve social welfare, and ultimately raise their standard of living and economic outlook. Consequently, access to the international capital markets is crucial for developing nations looking to maximize their long-term economic growth. It has even been argued if access to credit should be a Sovereign right (Hudon, 2009, p. 55). So far, International Law has not reached a uniform opinion.

The United Nations Conference on Trade and Development (UNCTAD), which has long been developing a roadmap and guide to sovereign debt workouts, said that the UN decision to pass 10 sovereign principles to restructure future sovereign debt is an important. Throughthese principles, International Law would provide for a more rational way of handling sovereign debt crises from the very fragmented and unfair system currently in place (Mossialos, Allin & Davaki, 2005, pp. 16-19).

Could this be an exit from the highway to hell? Perhaps if this system had been in place, deep recessions such as the Argentinean (2001) and Greek (2012) ones could have been avoided (Stiglitz, 2015, pp. 28-32).

In summary, because of social change, international relations will be become more common issues to the day to day concern of regular citizens (Trachtman, 2013): States' actions matter and a more social concerned International Law might be the key towards a more developed and inclusive future.

Yesterday Argentina, today Greece, and tomorrow perhaps United Kingdom: any indebted country can be blocked from restructuring its debt. Human rights are still States' obligation and understanding that all rights are interrelated is the key to a more global united citizenship and a matter of great urgency in promoting financial stability.

[1] J Muse-Fisher, J. (2014). Starving the Vultures: NML Capital v. Republic of Argentina and Solutions to the Problem of Distressed-Debt Funds. Cal. L. Rev., 102, 1671.
[2] See id. at 1679 n.40.

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