



## Argentina's Debt Deal Could Have Unexpected Side Effects

*Anna Gelpern says Argentina's deal with so-called "holdout" creditors may be positive in the short run, but it could set a bad precedent for future debt restructurings that might encourage unequal settlements and more litigation.*

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Pedro da Costa: Hi, I'm Pedro da Costa, Editorial Fellow here at the Peterson Institute for International Economics. I'm joined by Anna Gelpern, a Senior Fellow here. And we're going to talk about debt restructuring and, in particular, Argentina.

So Argentina has been in the news and the headlines have been fairly positive. They've basically come to a deal with their holdout creditors after over a decade of negotiations. Tell us about what the implications of the Argentine settlement are for other potential sovereign restructuring around the world.

Anna Gelpern: Right. So, this is this is going to be fun because, for starters, I think calling it 15 years of negotiation is incredibly generous for all involved. It's been sort of 15 years of kind of death matches punctuated with occasional periods of talking and deal-making and so—

Pedro da Costa: And the language is always very charged between the two sides, the hedge funds and Argentine government.

Anna Gelpern: Exactly. Right. And now, the language sometimes masks constructive negotiations behind the scenes. I think here the ratio of shouting to talking was rather low.

Pedro da Costa: Yeah.

Anna Gelpern: So nobody would begrudge the government this settlement, I think, that it's great news for Argentina and, on some level, for everybody just to have it be over because the longer it lasts the more damage to everyone involved and especially to innocent bystanders.

The problem, I think, with focusing just on the settlement itself and on the fact that Argentina can finally get back to the capital markets is that it ignores the precedent this could set for other countries and the collateral damage that has piled up over this long period of time.

Pedro da Costa: Because basically what happened is that the hedge fund managers that decided to stick their foot in the mud and not budge in the original restructuring ended up getting paid big, right? It ended up being a very worthwhile holding out basically, right?

Anna Gelpern: More than that, it's an incredibly big chunk of holdout. So we've never really had such a large proportion of holdouts relative to the participating bondholders. And some might say that's because Argentina was too confrontational early on. But the fact that this really big group could be paid off actually tells you that the strategy is much more generalizable in viable going forward. And, I think, the most uncomfortable thing, the most awkward and

disparity thing about the settlement is not just that some holdouts got paid big. But it is that of the holdouts of this big batch of holdouts, the ones that pursued the most aggressive and exotic strategy got an incredible windfall. Now, again, it's risk-reward and these are the rules. But in terms of the incentives this sets up going forward if you participate in the exchange—

Pedro da Costa: Which took place when?

Anna Gelpern: The default was late 2001. There was the first exchange in 2005 where they got a tiny bit over three quarters. And then they reopened it in 2010 and swept up about 93 percent of the total. But if you participated—you probably made your principal back and a little bit. If you held out and got a judgment, which is the straightforward thing to do, you go to a court. The court tells you Argentina has to pay. You have a judgment. And now, you go trying to attach assets or trying to make the government actually pay.

Those folks got a little bit more. But the people who didn't get a judgment who held out and pursued this exotic strategy of trying to enforce a very obscure and ambiguous clause in the contracts.

Pedro da Costa: In New York courts.

Anna Gelpern: In New York courts, in US federal courts in New York. They got paid thousands and thousands. They got a return of like 1500 percent, 2000 percent some of them, depending on how low they bought the debt.

Pedro da Costa: Does that mean that we're going to see an increase in future litigation regarding sovereign debt restructuring since it seems like basically the litigiousness paid off? Is that the idea?

Anna Gelpern: We could, right? So there are a couple of caveats to this. One is it did take a really long time. So at some level, this is not a very joyful victory. The spectacular payout, if it happens in April. We still have to wait to see whether something goes wrong. And there are folks who are probably waiting in the wings still to interrupt that set of payments. But if it goes through, it's huge, huge reward at the end of a very long tunnel. So you have to be a sort of investor who can sit for 10, 15 years and wait for effectively a change in government so that there's a political opening to settle for such spectacular amounts.

But I think, the most troublesome thing here is that the court in New York, the federal court, handed any potential free rider a weapon that can be used in a wide range of cases. This is a contract provision that is very common.

Pedro da Costa: So it goes beyond sovereign debt here.

Anna Gelpern: It goes beyond sovereign debt. Although, I think there is some debate about the potential effect of this in a world where you could file for bankruptcy and sort of short-circuit this process. But in the sovereign world where there is no bankruptcy and where virtually every contract has some version of this *pari passu* or what they call equal treatment clause. If you have a court that is willing to grant an injunction that stops payment on all of the government's other debt and effectively stops the government from issuing new debt because that debt too couldn't be paid under the terms of the injunction until the holdouts are paid in full then—

Pedro da Costa: It completely paralyzes the country.

Anna Gelpern: It completely paralyzes the country. It's effectively a financial boycott. Again, why did the judge do it? Because he was exasperated, it had been 10 years. The country would come and say, "Sorry, we can't do it. Sorry, we won't do it." So he was understandably exasperated. But the weapon that came out of this, the tool that emerged from this prolonged stalemate is one that could be incredibly destructive if another court is willing to use it. The other thing is it's also incredibly extra territorial. And so, it wasn't just New York Law bonds that were blocked. It was English Law. It was Argentine Law after a while. So, really, it's a worldwide attempt to isolate a government in order to make it pay.

Now, if it's for the sake of the creditors as a group, if it's a particularly bad actor that you're sanctioning collectively, well, then we should talk about it. So you know we can block payment systems for drug dealers and terrorists for the sake of the world as a whole. Whether the same sort of tool should apply to just your basic non-payment of debt—

Pedro da Costa: By a nation-state.

Anna Gelpern: By a nation-state for the sake of a very small group of creditors. So this is not like this money is getting distributed. So, there's \$29 billion or \$28-29 billion dollars' worth of outstanding restructured bonds. The folks who went into the 2005 and 2010 restructurings, the biggest holdouts, the folks that are most adventurous and aggressive, are getting paid under a bit under 5 billion. That's a huge in cash if this goes through. This is a huge proportion of the original deal. I think you would be remiss not to try this strategy if you're a creditor in another case.

Pedro da Costa: So what cases do you think might be eligible for such a strategy in the near future?

Anna Gelpern: Well, the ones that folks talk about the most, the one that folks talk about the most right now, is Venezuela partly because the debt stock is somewhat similar and the country is in a tricky situation at the moment, in a tricky position. So that it's mostly New York debt. Some of this debt is harder to restructure than other debt. It would be relatively easy to try to deploy a similar strategy. The law is made. The courts are open.

I do think that the courts were a bit burned by this episode and by the fact that their injunction effectively damaged the intermediaries or put pressure. I think damage is probably not the right word—but put pressure on the intermediary banks, the payment systems. Those are the ones that were worried about the injunction. The government in Argentina was in a state of political opposition. So they ultimately really didn't care what the judge in New York said.

But the fact that the trustee, the payment systems, the clearinghouses were subject to sanctions for dealing with Argentina, the shunned state, I think that that, ironically, is something that the court didn't quite—it's not that they didn't anticipate it. It's that they didn't think it would be as big as it ended up being. They really thought that the government would cave. I think that they probably didn't anticipate the level of political entrenchment that this litigation created. And so they got dragged into the fight with the government rather than leaving the fight to the creditors and the government.

So that I think future courts in the US and certainly in the UK may hesitate to impose a similar injunction. Ukraine is getting sued by Russia now. There are ironically opinions by English Law Lords about the viability of the New York interpretation under English Law, and there are conflicting opinions now. Many folks say that this is implausible under English Law and this injunction wouldn't be granted. Maybe, but nobody thought it would be granted in New York either.

So I'd say Venezuela and Ukraine are probably the most interesting cases to keep an eye on. But really, a lot of these cases we won't see because if you're a country that wants to settle badly enough, you're not going to risk this 15-year long battle. Look at Argentina now. Could they have done this differently? Could they have tried for a more comprehensive settlement, more equal, for lack of a better word, settlement?

A somewhat less jarring distribution of gains, they probably could have. But they wanted to move on. And can you blame them? So they're happy, but I think that the jury is still out for how disruptive this would be going forward?

Pedro da Costa: Thank you so much.

Anna Gelpern: Sure.

