

SOVEREIGN DEBT CONTRACTS: RECENT DEVELOPMENTS

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LEAGUE OF NATIONS.

I.L.50.

Geneva, November 18th, 1937.

COMMITTEE FOR THE STUDY OF INTERNATIONAL LOAN CONTRACTS.

Legal Questions concerning International Loans.

Note on the Literature of the Subject.

Part III - Trustees and Bondholders' Representatives.

C o n t e n t s .

14. Introduction.
15. Trustees:
 - a) Private Trustees.
 - b) Corporate Trustees:
 - 1) England
 - 11) U.S.A.
 - c) Netherlands.
 - d) International Loans.
16. Issuing houses or fiscal agents as representatives of bondholders.
17. Majority clauses in loan contracts.
18. Majority clauses in legislation.
19. Bondholders' representatives.
20. Protective committees.

G-10 Working Group

September 2002

Collective Action Clauses:

- Majority Amendment
 - Reserve Matters: 75% of outstanding through a written procedure
 - Non-Reserve: 66 2/3 % either in writing or in a meeting (50% quorum)
- Majority enforcement
 - Acceleration: By permanent representative or by vote of holders representing not less than 25% of outstanding
 - De-Acceleration: Provided the event of default is cured, by vote of holders representing not less than 66 2/3% of outstanding
 - Lawsuits: By permanent representative or same upon instruction of holders representing not less than 25% of outstanding, with reasonable indemnity. Proceeds shared pro rata.
- Disenfranchisement: Owned or controlled

Creditor Representation:

- Trustee or other permanent representative
- Negotiating representative(s) elected by 66 2/3 % of bondholders (upon soon after default)

Other: Information covenant, general support for aggregation

United Mexican States, \$1,000,000,000, 6.625% Notes Due 2015 (Feb. 26, 2003)

However, the holders of **not less than 75%** of the aggregate principal amount of the outstanding notes, voting at a meeting or by written consent, must consent to any amendment, modification, change or waiver with respect to the notes that would:

- change the due dates for the payment of principal of or interest on the notes;
- reduce any amounts payable on the notes;
- ...; or
- change the **status of the notes**

ICMA CACs

October 2004

Collective Action Clauses:

- Majority Amendment
 - Reserve Matters: 75% of outstanding through a written procedure
 - Non-Reserve: 66 2/3 % in writing or in a meeting (50% quorum)
 - Unanimity for governing law and most-favored treatment
- Majority enforcement
 - Acceleration: By permanent representative or by vote of holders representing not less than 25% of outstanding
 - De-Acceleration: Provided the event of default is cured, by vote of holders representing not less than 66 2/3% of outstanding
- Disenfranchisement: Owned or controlled

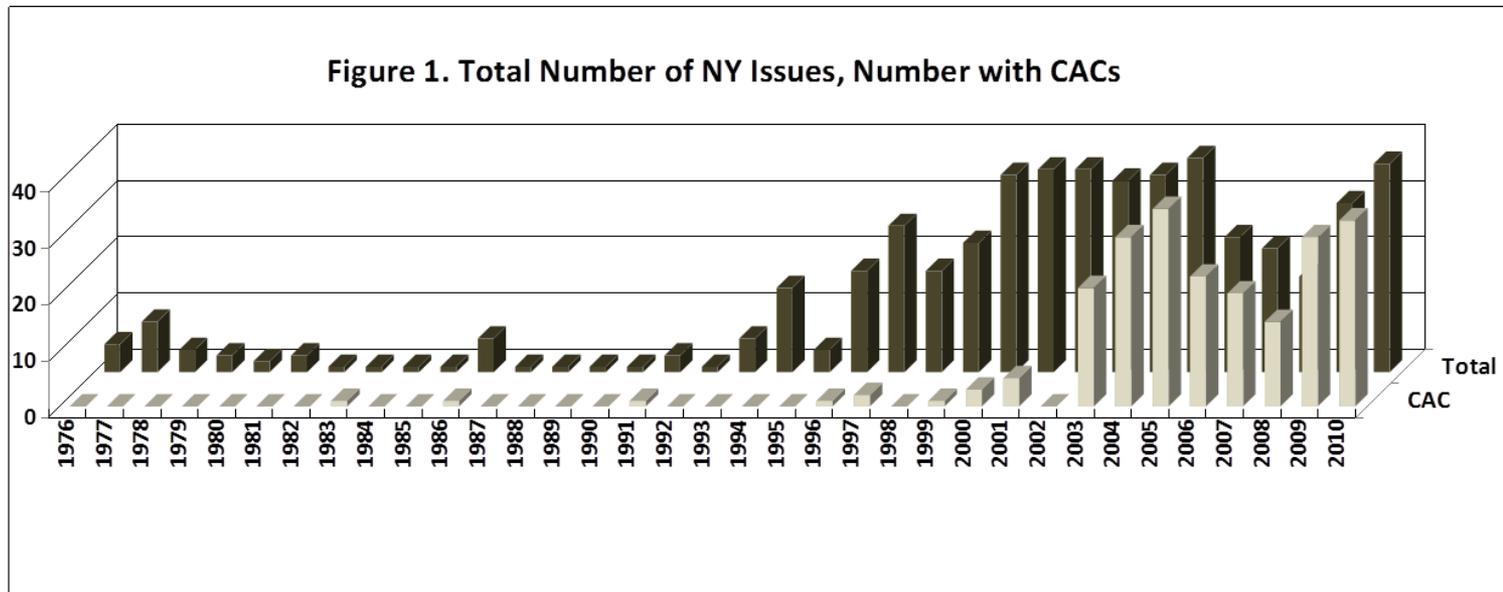
Creditor Representation:

- Committee to be appointed by at least 50% of outstanding

Other: Information covenant

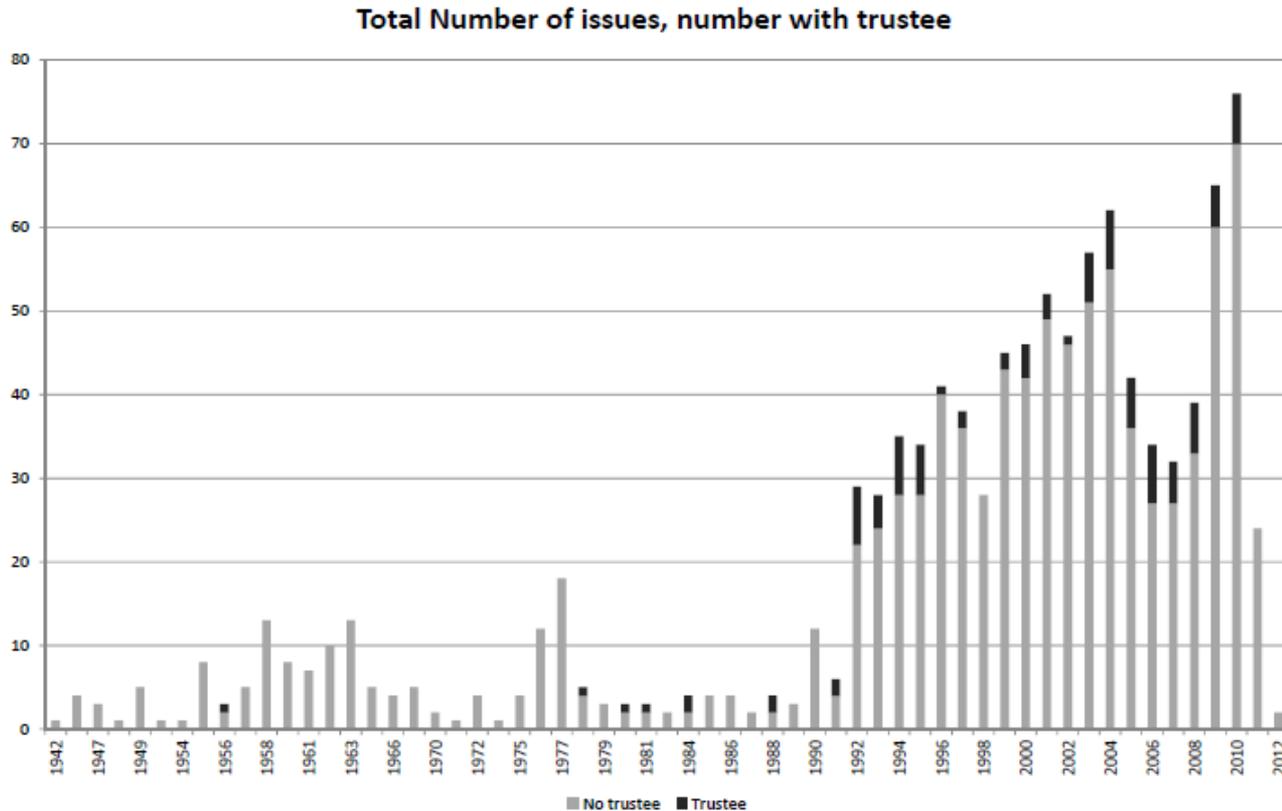
CACs 2003-2010

(Source: Bradley & Gulati 2012)



Trustees through 2012

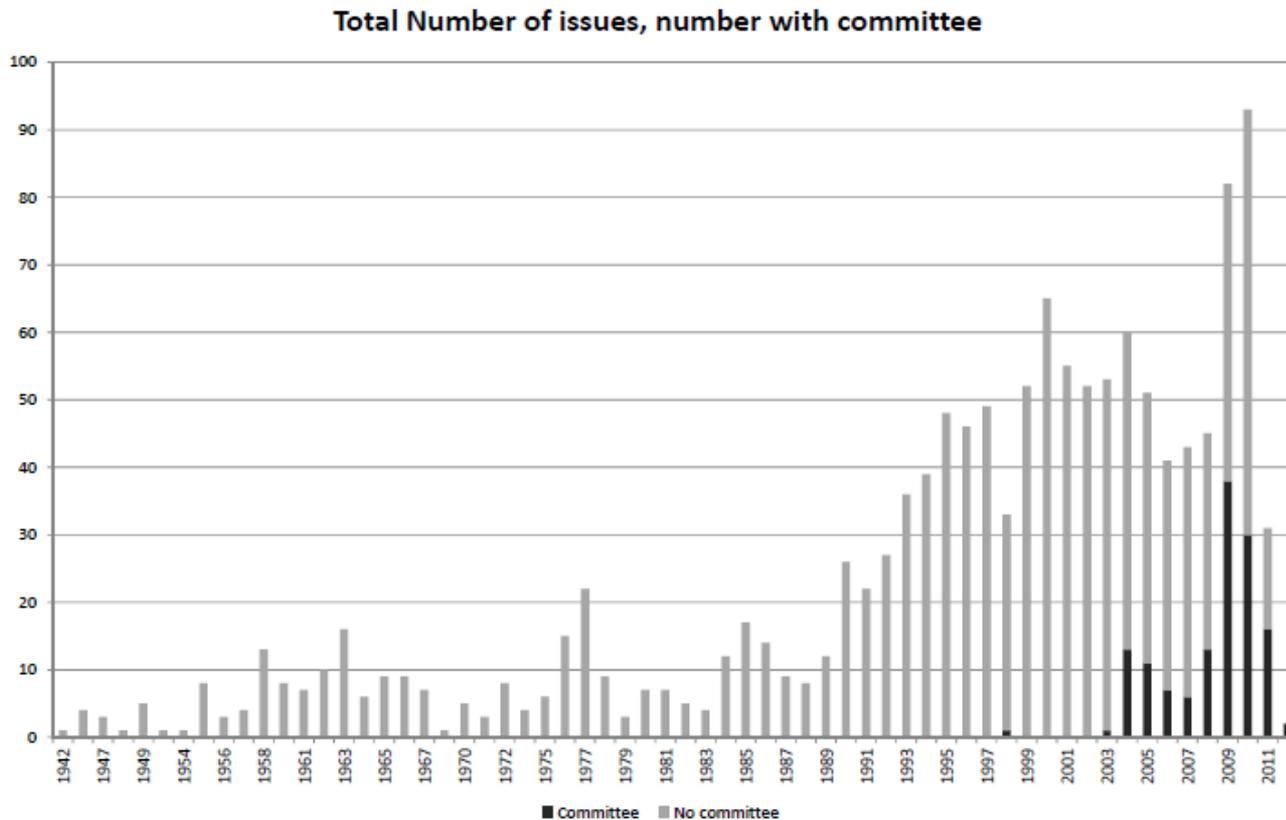
(Managed issues)



Source: WIP with Gulati, based on data from DCM, Thomson, Perfect Information)

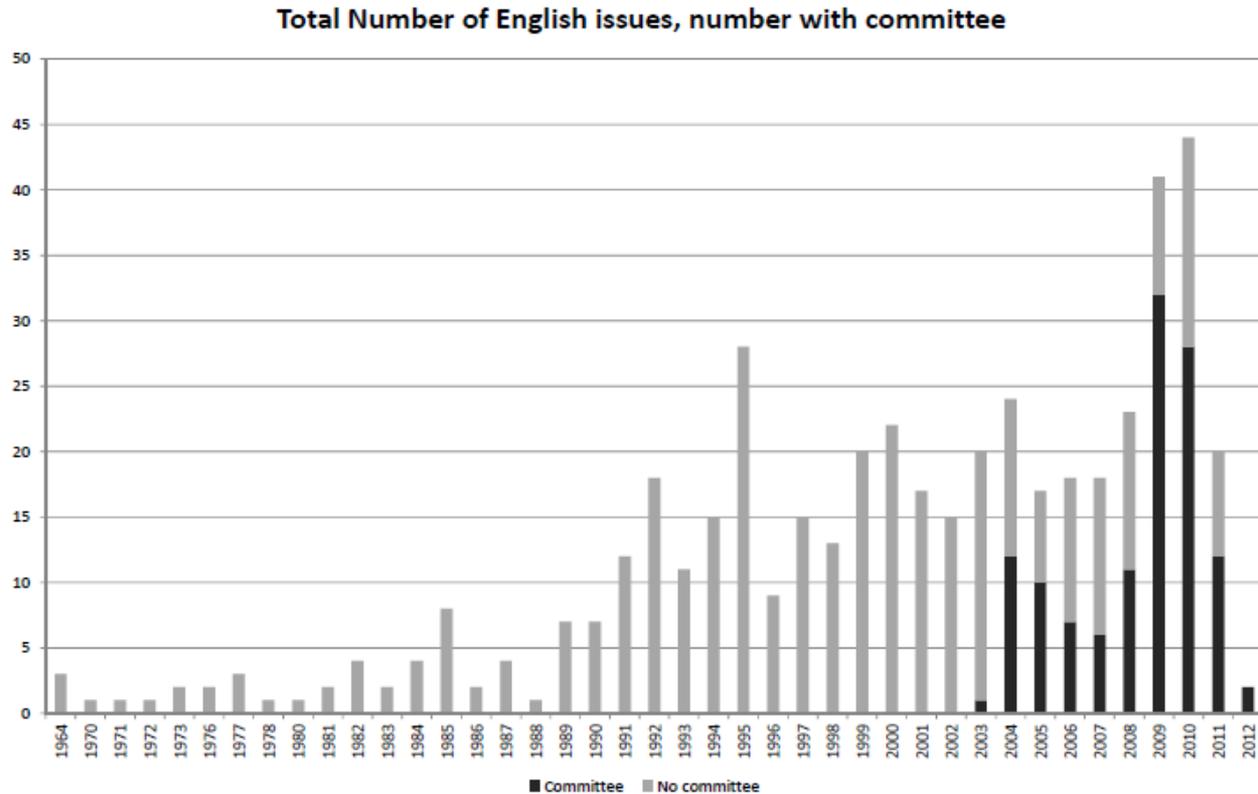
Committees through 2012

(Managed issues)



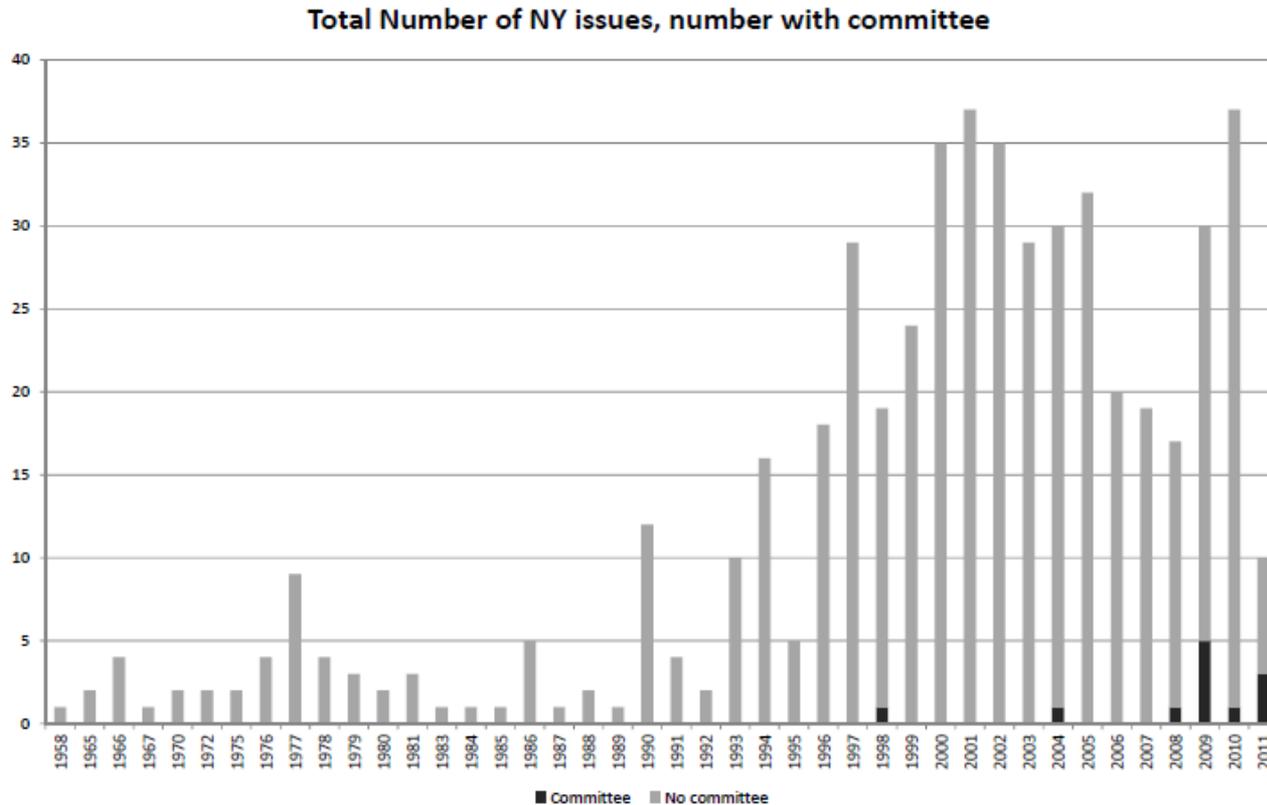
Source: WIP with Gulati, based on data from DCM, Thomson, Perfect Information)

Committees: English Law



Source: WIP with Gulati, based on data from DCM, Thomson, Perfect Information)

Committees: New York Law



Source: WIP with Gulati, based on data from DCM, Thomson, Perfect Information)

Euro Area Crisis

Eurogroup Announcement November 2010

[S]tandardized and identical collective action clauses (CACs) will be included ... starting in June 2013. Those CACs would be consistent with those common under UK and US law after the G10 report on CACs, including **aggregation** clauses allowing all debt securities issued by a Member State to be considered together in negotiations.

EU EFC Bonds and Bills Subcommittee Model CACs (2012)

2. ~~Reserved Matter Modification~~ The terms

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AGGREGATION:

Meeting: 75% all + **66 2/3%** each (66 2/3 quorum)

Written Resolution: 66 2/3% all + **50%** each

TO HOLD OUT, MUST BUY 55/50%+ OF A BOND ISSUE WITH CACs

DISENFRANCHISEMENT:

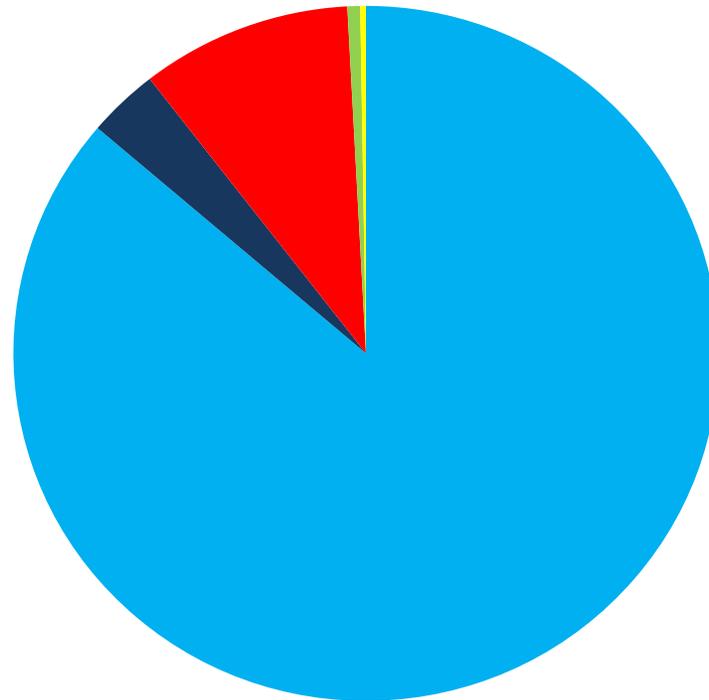
Autonomy of Decision exception

(b) a written resolution signed by or on behalf of holders of **not less than 66 2/3%** of the aggregate principal amount of the Bonds then outstanding.

Greek Debt Restructuring

(Zettelmeyer et al. 2013)

- Greek Law (sovereign) - retroactive legislation, ONE VOTE, no holdouts
- Greek Law (guaranteed) - 4.3% holdouts
- English Law (sovereign and guaranteed) - CACs, 44.1% holdouts
- Italian or Japanese Law (sovereign and guaranteed) - 20.6% holdouts
- Swiss Law (sovereign) - CACs, 100% holdouts



NML et al. v. Argentina

U.S. Court of Appeals for the 2d Cir. (Oct. 2012)

[W]e conclude that in pairing the two sentences of its *Pari Passu* Clause ... manifested an intention to protect bondholders from more than just formal subordination. ...The first sentence (“[t]he Securities will constitute . . . direct, unconditional, unsecured, and unsubordinated obligations”) prohibits Argentina, as bond *issuer*, from formally subordinating the bonds by issuing superior debt. The second sentence (“[t]he payment obligations . . . shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness.”) **prohibits Argentina, as bond payor, from paying on other bonds without paying on the FAA Bonds.**

NML et al. v. Argentina

U.S. Court of Appeals for the 2d Cir. (Oct. 2012)

After declaring a moratorium on its outstanding debt in 2001, Argentina made **no payments** for six years on plaintiffs' bonds while simultaneously timely servicing the Exchange Bonds. Argentina has renewed that moratorium in its **budget laws** each year since then. It declared in the **prospectuses** associated with the exchange offers that it has no intention of resuming payments on the FAA Bonds. ... It stated in **SEC filings** that it had "classified the [FAA Bonds] as a separate category from its regular debt" and is "not in a legal . . . position to pay" them. Its legislature enacted the **Lock Law**, which has been given full effect in its courts, precluding its officials from paying defaulted bondholders and barring its courts from recognizing plaintiffs' judgments ...

NML et al. v. Argentina

SDNY, November 2012

- Assuming that Argentina pays 100% of what is then due on the Exchange Bonds ... Argentina would be required to pay 100% ‘multiplied by the total amount currently due’ to plaintiffs.
- [P]articipants in the payment process of the Exchange Bonds ...shall be bound by the terms of this ORDER ... and prohibited from aiding and abetting any violation of this ORDER, including ... any effort to make payments under the terms of the Exchange Bonds without also concurrently or in advance making a Ratable Payment to NML.

NML et al. v. Argentina

SDNY, November 2012

“Participants” refer to those persons and entities who act in active concert or participation with the Republic, to assist the Republic in fulfilling its payment obligations under the Exchange Bonds, including:

- (1) the indenture trustees and/or registrars under the Exchange Bonds ...;
- (2) the registered owners of the Exchange Bonds and nominees of the depositaries for the Exchange Bonds ... and any ... nominees;
- (3) the **clearing corporations and systems, depositaries, operators of clearing systems**, and settlement agents for the Exchange Bonds (including but not limited to the Depository Trust Company, **Clearstream Banking S.A., Euroclear Bank S.A./N.V. and the Euroclear System**);
- (4) trustee paying agents and transfer agents for the Exchange Bonds (including but not limited to The Bank of New York (**Luxembourg**) S.A. and The Bank of New York Mellon (including but not limited to the Bank of New York Mellon (**London**)); and
- (5) attorneys and other agents engaged by any of the foregoing or the Republic in connection with their obligations under the Exchange Bonds.

NML v. Argentina

Supreme Court of the United States
June 16, 2014

13-990) ARGENTINA V. NML CAPITAL, LTD., ET AL.
)
13-991) EXCHANGE BONDHOLDER GROUP V. NML CAPITAL, LTD., ET AL.

The petitions for writs of certiorari are denied. Justice Sotomayor took no part in the consideration or decision of these petitions.

Pari Passu Remedy: A Comparison

This point ...concerns the nature of the relief sought generally, which is directed towards the coercion of third parties rather than securing immediate compliance by the defendant. Because I regard this last point as determinative, I regard it as unnecessary to attempt any analysis of the *pari passu* clause.

Kensington Int'l Ltd. v. Republic of Congo, [2003] EWHC 2331, available at <http://www.bailii.org/cgibin/>

Pari Passu: Theme and Variations

- *The Classic – eg, Belize 2013 (NY Law)*

The Securities are general, direct, unconditional, unsubordinated and unsecured obligations of Belize ... and Belize shall ensure that its obligations hereunder shall rank *pari passu* among themselves and with all of its other present and future unsecured and unsubordinated Public Debt ...

- *Variation 1 – eg, Argentina 1994 (NY Law)*

[Classic] + The **payment obligations** of the Republic under the Securities shall at all times **rank at least equally** with all its other present and future unsecured and unsubordinated External Indebtedness (as defined in this Agreement).

- *Variation 2 – eg, Ukraine 2012 (English Law)*

[Argentina] + ... save only for such obligations as may be preferred by mandatory provisions of applicable law.

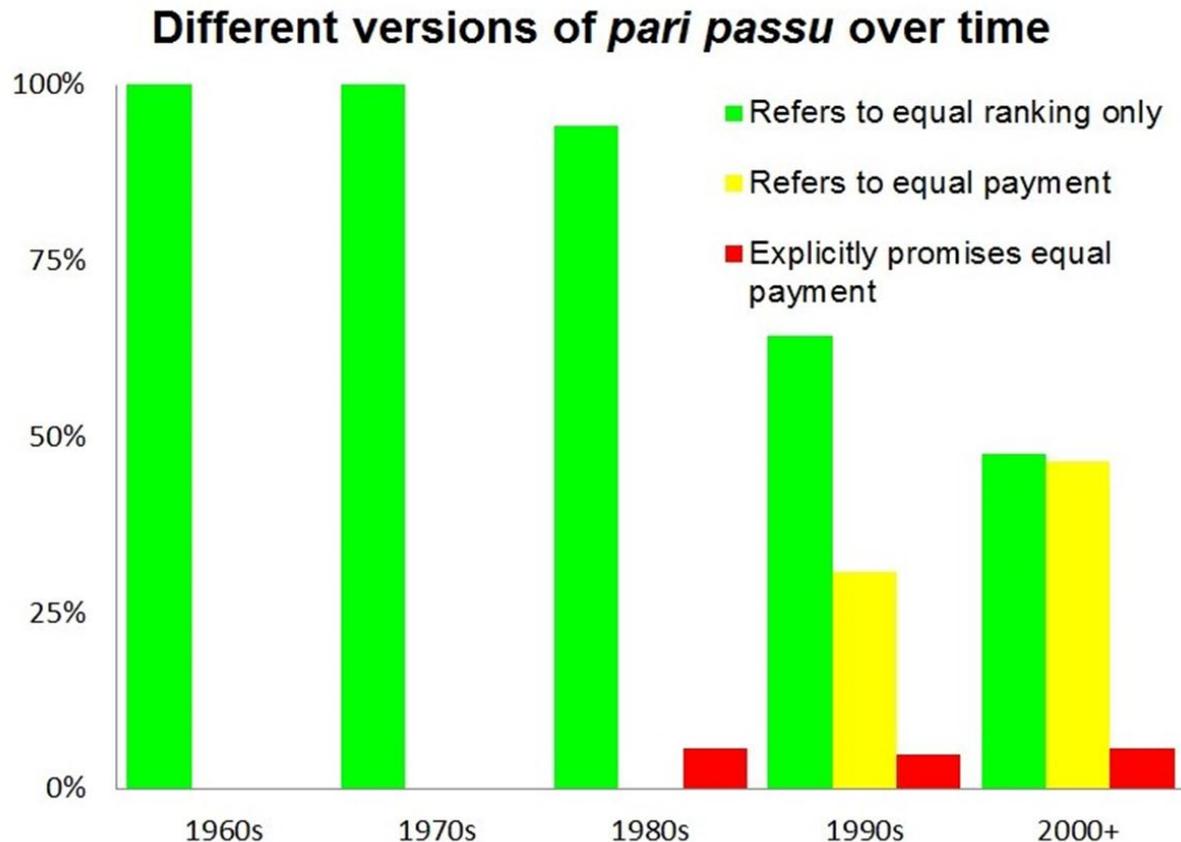
Pari Passu: Theme and Variations

- *Variation 3 – Italy 2003*

The Securities are the direct, unconditional and general and ... unsecured obligations of Italy and **will rank equally** with all other evidences of indebtedness issued in accordance with the Fiscal Agency Agreement and with all other unsecured and unsubordinated general obligations of Italy for money borrowed. ... Amounts payable in respect of principal of (and interest on) the Securities **will be charged upon and be payable out of the [Treasury of Italy], equally and ratably** with all other amounts so charged and amounts payable in respect of all other general loan obligations of Italy.

Pari Passu: Theme and Variations

(Source: Weidemaier 2013, adapted from Weidemaier et al. 2013)



Adapted from Mark Weidemaier, Bob Scott, and Mitu Gulati, *Origin Myths Contracts, and the Hunt for Pari Passu*, Law and Social Inquiry (forthcoming)

Adaptation: Pari Passu and CACs

U.S. Court of Appeals for the 2d Circuit (2013)

We further observed that cases like this one are unlikely to occur in the future because Argentina has been a uniquely recalcitrant debtor and because newer bonds almost universally include **collective action clauses** (“CACs”) which permit a super-majority of bondholders to impose a restructuring on potential holdouts. ...[G]oing forward, sovereigns and lenders are free to devise various mechanisms to avoid holdout litigation if that is what they wish to do. They may also **draft different *pari passu* clauses** that support the goal of avoiding holdout creditors.

Adaptation: Pari Passu and CACs

- Removing or clarifying *pari passu* pre-empts the boycott
- Majority Amendment CACs reduce the number of holdouts
 - Depends on voting thresholds and structure
 - None eliminate holdouts
- Majority Enforcement CACs impede lawsuits

Adaptation: Pari Passu

- Belize National Assembly Resolution (2013) and Securities Disclosure

Status of the New Bonds: The New Bonds will be general, direct, unconditional, unsubordinated and unsecured obligations of Belize and will rank at least equally among themselves and with all of Belize's existing and future unsecured and unsubordinated bond indebtedness (it being understood that this equal ranking status shall not require Belize to pay all items of its bond indebtedness on a ratable basis).



Adaptation: Pari Passu

- Italy Fiscal Agency Agreement (2013)

The Securities are the direct, unconditional and general and ...unsecured obligations of Italy and will rank equally with all other evidences of indebtedness issued in accordance with the Fiscal Agency Agreement and with all other unsecured and unsubordinated general obligations of Italy for money borrowed, **except for such obligations as may be preferred by mandatory provisions of international treaties and similar obligations to which Italy is a party. ...** ~~Amounts payable in respect of principal of (and interest on) the Securities will be charged upon and be payable out of the [Treasury of Italy], equally and ratably with all other amounts so charged and amounts payable in respect of all other general loan obligations of Italy.~~

Adaptation: Pari Passu

ICMA Model Clauses, August 29, 2014

The Notes are the direct, unconditional and unsecured obligations of the Issuer and rank and will rank *pari passu*, without preference among themselves, with all other unsecured External Indebtedness of the Issuer, from time to time outstanding, *provided, however, that the Issuer shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due on the Notes and vice versa.*

Adaptation: Pari Passu

Ghana, September 2014 (English Law)

The Notes constitute direct, unconditional and ... unsecured obligations of the Issuer and ... rank and will rank pari passu, without any preference among themselves, and with all other present and future unsecured and unsubordinated obligations of the Issuer, save only for such obligations as may be preferred by mandatory provisions of applicable law, provided, however, that the Issuer shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other unsecured and unsubordinated obligations of the Issuer and, in particular, shall have no obligation to pay other unsecured and unsubordinated obligations of the Issuer at the same time or as a condition of paying sums due on the Notes and vice versa.

Adaptation: Pari Passu

Panama, September 2014 (New York Law)

The global bonds will rank equally in right of payment with all other indebtedness issued in accordance with the fiscal agency agreement and with all other unsecured and unsubordinated Indebtedness of Panama, but Panama will have no obligation to effect equal or ratable payment or payments at any time with respect to any such other Indebtedness and, in particular, will have no obligation to pay other Indebtedness at the same time or as a condition of paying sums due on the global bonds and vice versa.

Adaptation: Pari Passu

Mexico, November 2014 (New York Law)

The debt securities rank and will rank without any preference among themselves and equally with all other unsubordinated public external indebtedness of Mexico. It is understood that this provision shall not be construed so as to require Mexico to make payments under the debt securities ratably with payments being made under any other public external indebtedness.

Adaptation: Aggregated CACs before 2014

- Series-by-series vote is the default
- Two-tier aggregated vote
 - Uruguay 2003, Argentina 2005:
85% all + 66 2/3% each
 - Euro CACs 2012: 75% all + 66 2/3% each*
* Quorum=66 2/3%
or 66 2/3% all + 50% each
 - ICMA 2014: 66 2/3% all + 50% each

Individual series drop-out thresholds are key

Adaptation: Aggregated CACs from 2014

- Three options – (i) series-by-series, (ii) two-tier aggregation (as above) and/or **(iii) stock-wide vote**
 - Precedent:
 - Greek Law 2012: 66 2/3% of all aggregated series*
*Quorum=50%
 - ICMA Model 2014: 75% of aggregated outstanding**
**provided new terms “Uniformly Applicable”

*In stock-wide vote, holders/series cannot drop out;
Restructuring succeeds/fails for all aggregated series.
Issuer may choose a combination of the three methods*

Additional Features: ICMA 2014

- Information Covenant
- Disenfranchisement: “owned or controlled”

Supplementary Provisions:

- Committee appointed with 25% of outstanding
- Issuer engagement
- Collective enforcement: 25% of outstanding to accelerate, 50% to de-accelerate

ICMA Model Adoption

- Kazakhstan (English Law, Oct. 2014) – ICMA model including supplementary provisions
- Ethiopia (English Law, Dec. 2014) – no committees
- Vietnam (New York Law, exempt, Nov. 2014) – no committees
- Mexico, Chile (New York Law, registered, Nov.-Dec. 2014) – no committees, **plus trust structure**