KEY POINTS

- In the absence of an overarching sovereign debt restructuring mechanism, effective restructurings will require ad hoc solutions and those solutions will be heavily influenced by the nature of the country's creditors, the types of debt the country is looking to restructure and the level of IMF involvement.
- Governing law of debt is very important and local legislation can often play an important part in the solution.
- In the absence of a legal framework for sovereign debt restructurings good faith negotiations are a key part of ensuring an orderly restructuring.
- GDP-linked securities can provide real value in future restructurings.

Authors Kirsten Erichsen and Andrew Wilkinson

Sovereign debt restructuring: what can we learn from Argentina, Greece and Ukraine?

This article considers what we can learn from Greece, Argentina and Ukraine's sovereign restructurings.

INTRODUCTION

Despite efforts by the IMF and the UN in the past decade to reform or at least harmonise the world of sovereign restructuring, a multilateral legal framework for sovereign debt restructuring does not exist. As a result, effective restructurings are very much the result of ad hoc solutions and are driven by the nature of the country's creditors, the types of sovereign debt the country is looking to restructure and the level of IMF involvement.

As Argentina ends its 15 year dispute with holdout creditors, discussions around the IMF's continued participation in Greece's third bailout heat up and Ukraine embarks upon a (hopefully) successful new chapter in its history, this article takes a look at what we can learn from these three countries' restructuring experiences.

GREECE

The 2012 exchange offer reminded investors of the importance of the governing law of its sovereign debt

Greece's (mis)adventures began in 2009 when it announced that its reported fiscal deficit of 6.5% of GDP was actually double that. What followed was six years of economic (and political) turmoil and three 'bailouts' making Greece the largest sovereign restructuring to date.

As a condition to the original €130bn bailout coordinated by the International Monetary Fund (IMF) and the Eurozone countries, Greece was required to significantly reduce its outstanding bond commitments through an exchange offer.

Accordingly, in 2012 Greece set out to restructure its sovereign bonds. Approximately, 86% (or €177.3bn) of the bonds which Greece was trying to restructure were governed by local law. The problem, however, was: (i) that Greece was asking creditors to take steep haircuts on this debt (Greece was offering holders the option to exchange their bonds for new bonds worth approximately 47 cents on the euro); and (ii) that to restructure these bonds, Greece needed unanimous consent of all bondholders.

This posed an impossible hurdle, but because this debt had been issued under Greek law, Greece had the power to unilaterally change the law and therefore also the terms of its Greek law bonds, which, thanks to Rome I, the courts of most developed countries would have to recognise.

This was potentially a very powerful tool for Greece. Greece could have done almost anything to its Greek-law bonds. It could have chosen to reduce the amount of interest due on the bonds, reschedule the debt or even write down the amount payable thereunder. However, what Greece chose to do was to simply get rid of the unanimity issue by enacting the Greek Bondholder Act of 2012. This inserted cross-series collective action clauses (CACs) into the existing Greek-law governed bonds. The retrofitted CACs applied across all of the Greek-law governed bonds (rather than just to each individual series) and enabled the Greek-law governed bonds to be restructured if:

- *Quorum:* holders of at least 50% of the aggregate principal amount of existing bonds confirmed their participation in the exchange offer; and
- *Consent Threshold:* at least 2/3 of those participating in the exchange offer consented to the new terms.

Ultimately 82.5% of Greek-law bondholders accepted the exchange offer. Whilst there were likely other important political reasons why the acceptance levels were so high, Greece's introduction of retroactive CACs was a successful example of how both local law and cross series CACs can be used to affect a restructuring.

However, it also highlighted the importance of governing law of sovereign debt, in particular that an external governing law could protect bonds against changes by statute in the issuer's country. Accordingly, it comes as no surprise that the instruments offered in exchange were all to be governed by English law. Had Greece insisted on maintaining Greek law as the governing law of the new instruments, the market might have taken this as a signal

Biog box

Kirsten Erichsen is a senior associate in the debt restructuring group at Weil, Gotshal & Manges. She was involved in the recent restructuring of Ukraine's sovereign debt and in a number of high-profile domestic and cross-border restructurings and insolvencies.
Email: kirsten.erichsen@weil.com

that Greece intended to reserve an option to change the obligations unilaterally and bondholders would unlikely have been as willing to participate.

ARGENTINA

In the absence of a multilateral legal framework for sovereign debt restructuring "good faith" negotiations are a key part to ensuring an orderly restructuring

In April, Argentina ended its 15 year stand-off with the majority of its holdout creditors after it settled claims at 75% (including both principal and interest) of their original claim value and the injunctions which had prevented Argentina from paying out on its restructured bonds were lifted by the NY court.
This settlement allowed Argentina to return to the international capital markets for the first time in 15 years. However, what is interesting here is perhaps not that the holdouts were able to recover 75% of their original claim value (in circumstances where exchanged bondholders accepted haircuts between 50-70%), but the suggestion that Argentina's past behaviour may have played a large part in the prolonged nature of the dispute and influenced the remedies ordered by the NY court.

The NY judge who imposed (and subsequently lifted) the injunctions, indicated in a judgment earlier this year that the election of Argentina's new government and its willingness to negotiate in good faith with the holdouts after 15 years was pivotal in his decision to lift the injunctions.

The extent to which future judges will be influenced by a sovereign's perceived attitude towards creditors in restructuring negotiations is unclear. However, what is clear is that the IMF has made it part of its recently revised lending into arrears policy. Where the IMF is involved in sovereign restructurings, it will be prepared to lend if, amongst other things, the sovereign is making good faith efforts to reach agreement with its creditors on a contribution consistent with the parameters of the IMF-supported program.

In the absence of a multilateral legal framework for sovereign debt restructuring good faith negotiations between a sovereign and its creditors are an integral part of orderly and commercial sovereign restructurings.

UKRAINE

GDP-linked securities can provide real value in future restructurings

As with Greece, the exchange offer launched in September 2015 in relation to Ukraine's sovereign debt was prompted by IMF involvement. At the time Ukraine faced a contracting economy, a conflict with Russia in eastern Ukraine, significant short-term maturities and a funding gap of approximately $15bn. As a condition to receiving further funding from the IMF, Ukraine had to restructure certain of its sovereign and sovereign guaranteed debt.

After months of complicated negotiations, in September 2015, Ukraine launched a formal exchange offer with the IMF's support which included the offer of GDP-linked securities.

Although a security that entitles holders to a payment that is linked to a country's GDP growth is not a new concept, historically, these instruments have not proved to be the most valuable. GDP measurement is a complicated concept that has often proved open to manipulation by a sovereign. However, Ukraine's upside instrument is a market first as it created real value where previous attempts to attribute value have failed.

What distinguishes Ukraine's GDP-linked securities is:

- **Covenant Protections:** Very few existing GDP-linked securities have extensive covenants. The covenants are designed to protect holders against GDP manipulation, dilution and subsequent invalidity.
- **Cross-default provisions:** Breach of certain covenants will trigger cross-defaults into new bonds and allow them to be accelerated.
- **Put Option:** Enables creditors to be made whole in relation to the haircut.

Also, in the absence of cross-series collective action clauses in the existing bond documentation, to ensure that the sort of hold-out strategies pursued by funds in Argentina cannot occur in this instance, the terms of the exchange included:

- **Most favoured Creditor Clause:** Ukraine is prohibited from settling with holdouts on more favourable terms than the new bonds. If breached, it will trigger an Event of Default under the new bonds.
- **Loss of GDP-linked Securities:** Holdouts also lost out on the GDP-linked securities.
- **Local legislation:** Local legislation was enacted to enable: (i) Ukraine to issue GDP-linked securities; and (ii) those creditors who participated in the exchange offer to have priority in payment over those creditors who did not participate.
- **No ability for Ukraine to accept/reject exchange offers on a per-series basis:** This all or nothing approach was intended to prevent cherry-picking by Ukraine and provide creditors who held bonds across multiple series with certainty as to the overall restructuring.

CONCLUSION

Despite the absence of an overarching legal framework for sovereign debt restructurings, in practice few major sovereign restructurings have been disorderly where sovereigns and creditors have truly engaged in good faith negotiations.

The success of the Ukraine restructuring and its GDP-linked securities is evidence of a brighter future for sovereign debt restructuring. Negotiations and implementation were completed in just a few months, and despite inefficacies in the bond documentation (ie lack of cross series CACs) both the sovereign and the ad hoc committee's business-minded approach

Andrew Wilkinson is a partner in the debt restructuring group at Weil, Gotshal & Manges. He has 30 years' restructuring experience as a lawyer and as a banker. Before joining Weil, Andrew was European Head and Head of Restructuring at Goldman Sachs. He is also a Visiting Professor at UCL. Email: andrew.wilkinson@weil.com

produced a fast resolution; one which has been welcomed by both the IMF and the debt markets. ■

Further Reading:

- Sovereign bond collective action clauses: issues arising [2015] 2 JIBFL 128A.
- Reprofiling sovereign debt [2015] 1 JIBFL 19.
- LexisNexis Loan Ranger blog: Understanding the issues around sovereign default.