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## Argentina: Tamed by the US Courts? The CDS Consequences

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### Brief History

In April 2010, the Republic of Argentina made exchange offers to holders of its bonds issued on or before 1 July 2005 to exchange those bonds for new instruments. The majority were exchanged. There were some hold-outs. Argentina has adamantly refused to pay out on the non-exchanged bonds. The hold-outs, which include the entities to whom they subsequently sold the non-exchanged bonds, have been working hard to get paid.

### Recent History

Most recently, the hold-outs have been successful in the United States, in the District Court and the 2nd Circuit. An injunction has been granted requiring Argentina, if it pays out on the new instruments, to make a rateable payment on the non-exchanged bonds. The injunction is currently stayed while the courts work out what they really mean by “rateable”, among other things, and guidance from the District Court and the 2nd Circuit is anticipated in the near future. There is also a real chance that an injunction comes into effect before the next payment on the new instruments is due on December 3.

If you wish to review more information on the litigation, you may refer to <http://www.shearman.com/argentine-sovereign-debt/>

### Sovereign CDS on Argentina

Standard Latin American Sovereign CDS terms (which would apply to Argentina CDS) are set out in the ISDA Physical Settlement Matrix [see [http://www.isda.org/c\\_and\\_a/Credit-Derivatives-Physical-Settlement-Matrix.html](http://www.isda.org/c_and_a/Credit-Derivatives-Physical-Settlement-Matrix.html)] with one special Argentinian additional provision, namely that the old bonds are excluded from any assessment of Credit Events (e.g. failure to pay on an old bond cannot create a Credit Event) and any CDS settlement process. The Credit Events are: Failure to Pay, Obligation Acceleration, Repudiation/Moratorium and Restructuring. The obligations of Argentina against which these Credit Events are tested are the new bonds, excluding any subordinated bonds, any peso-denominated bonds, any Argentine law bonds and any domestically issued bonds. Because the obligations for this test must be “Bonds”, they must be obligations for the payment or repayment of “borrowed money”; it is not clear that the new GDP-based instruments satisfy this requirement, so they may well also be excluded.

### How Does the Injunction Fit In?

While the injunction is stayed, it can have no effect in relation to Credit Events.

If the injunction becomes effective, its mere existence will not create a Credit Event. The Credit Events look at actual payments (or more properly their failure), actual acceleration, actual repudiation or moratoria (which will also require an actual failure to pay or an actual restructuring) and actual restructuring. The injunction is none of those things: it is

not even a prohibition on payment – Argentina could still pay on the new bonds, but it must then also pay on the old bonds.

If the injunction becomes effective and continues to apply in broadly the form summarized above, there are really four potential outcomes in the short term (there could be other longer term arrangements, such as fresh exchange offers, restructurings and so on):

- Argentina could pay in full on the new and the old bonds, complying with the injunction. This would clearly not be a Credit Event of any sort.
- Argentina could pay in part on the new and the old bonds in compliance with the injunction. This would not be a Credit Event (after any relevant grace period) only if the non-payment on the new bonds were very small indeed.
- Argentina could pay nothing on the new bonds. Again this would not be a breach of the injunction. After the relevant grace period, this would be a Credit Event. The injunction would not protect against a Credit Event.
- Argentina might, in breach of the injunction, find a way to pay in full on the new bonds but pay nothing (or not a full pro rata amount) on the old bonds. This would also not be a Credit Event, as the required payment on the new bonds would have been made.

## Conclusion

As can be seen, the determination of a Credit Event does not depend on (i) the existence of the injunction or (ii) whether or not Argentina complies with it. But the existence of the injunction may change Argentina's behavior in relation to the new bonds and so change the likelihood of the occurrence of a credit event.

So what do you think Argentina will do?

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