

Argentina: Set to appeal until it becomes necessary to offer investors (the now NPV positive!) off-shore payment option

Following our first impressions of Judge Griesa's ruling (see Argentina: Facing a "cold turkey" moment as Judge orders \$1.3 bn payment into escrow by Dec 15) it is worthwhile to lay out some assumptions about next steps.

These steps require assuming possible responses from Argentina, financial intermediaries, and regulators as well as the dynamics of the pending Appeals process that could lead up to or away from a "technical default" - a massive precedent for EM (see last section below).

Regarding Argentina, we highlight press comments by Minister of Infrastructure De Vido and Minister of Economy Lorenzino. We expect technocrats (the Lorenzino's) are likely to initiate Argentina's response (challenge the escrow payment, testing the system by paying bonds into Trust) but their strategy is always liable to be derailed if politicians (the De Vido's) feel uncertain regarding its benefits (preferring in that case, to initiate a re-routing of the payment system).

Argentine technocrats are in the driver's seat... until Dec 15

Given today's public reaction by Argentina, it seems technocrats like Minister Lorenzino may have a mandate from politicians to keep the ball in the US Courts' court. But we think this is a mandate that expires on December 15. Argentina's bet will be for the Appeals Court to extend the stays that the District Court lifted and to consider with more depth the arguments that Argentina, bondholders, financial intermediaries and regulators presented before making a definitive ruling that might benefit Argentina. We are not optimistic but because timing is important we lay out our thoughts in a separate section below.

Today Minister Lorenzino's comments were the more carefully articulated (with their impact on Judge's likely in mind) than they have been in the recent past:

- It can be argued that Griesa's request for 100% payment does not reflect not pari passu
- The order to pay in escrow Dec 15 is inconsistent with FSIA (Foreign Sovereign Immunity Act)
- Argentina will rely on Appeals Court of District Court to extend the stays until due process is finished.
- The Appeals Court has authority and, irrespective of what the Judge orders, the former dictates the ruling
- Argentina will seek a rehearing by Appeals Court in order to defend itself at every available stage of due process

What this all means in our view is that if Appeals Court get sufficiently involved before December 15 (when Griesa's ruling requires an escrow payment by Argentina) and overturns the District Court order, Argentina will continue to make payments as expected to restructured bondholders and participate in the continuation of the appeals process in US courts with the hope that matters will work out in its favor at the end. Note that the process for paying bondholders allows Argentina to send a check directly to registered holder (Cede and BoNY) rather than the normal payment into BoNY trust. This is not a re-routing of payments (and hence does not involve contempt of court) since it is considered an option in the indenture (see below for more on this).

Why would Argentines go to so much trouble if the judge's quick-and-dirty ruling and US regulators' timid intervention in the case does not provide much hope for a shift in the Appeals Court to favor Argentina? We

believe that motivation lies in the fact that authorities are obsessed with the idea that holdout creditors are playing the CDS market to profit from Argentina's "technical default". Thus, for politicians it would be a sweet victory to frustrate such a devilish plot and expose the conspiracy by being able to turn around the ruling and continue to pay restructured bondholders normally.

Politicians call the shots and Kirchnerism always doubles down

That said, it was Minister De Vido who better exposed the state of mind of Argentine politicians. Three considerations he made (and our interpretations) are worthwhile to highlight:

- Holdout claims are illegitimate and illegal, holdouts were offered two restructurings and did not accept either.

(we would interpret this as the equivalent of... holdouts will not be paid directly nor would Argentina consider making a payment into escrow as a guarantee while the appeals continues)

- The judge's actions were merely based on a reaction to public statements made by authorities of a sovereign nation

(we would interpret this as the equivalent of... the judge's ruling is not based on fundamental facts but on superficial interpretation of informal comments in the context of Argentine domestic politics)

- Prior Argentine governments erroneously gave up local legal jurisdiction for NY jurisdiction and this constitutes the real problem

(we interpret as the equivalent of... Argentina will not allow prior excessively generous and short-sighted commitments [i.e. from political enemies of or scapegoats for the Kirchner administration] to foreign jurisdictions undermine current sovereign decisions - like paying restructured bonds but not holdouts - particularly when there is no obstacle to those decisions being carried out in Argentina).

Our impressions is that this boils down to a blueprint for an end game where Argentina snuffs NY law, its courts and its payment system and it offers restructured bondholders the option of getting paid fully in Buenos Aires - thus, reaffirming the popular conviction that the current international rules are inconsistent or somehow rigged, and that "going local" is in investors' own interest.

How would re-routing payments work in an end game scenario ?

In the section following this one we describe some of the technical steps that might play out in the month ahead if Argentina tries initially to play the system from within. But in practice, we think the end-game is a re-routing of payments. Indeed, the strategy of walking the thin line between "technical default" and performing payments in NY will become unbearably reliant on issues that politicians will consider technical nuisances. Thus, the technocratic "within-system resolution" has a deadline: give or take a few weeks, it is centered on December 15.

We therefore first consider what Argentina would do if it becomes obvious that the Appeals Court feels comfortable with Judge Griesa's ruling and that decisions have to be taken on December 15 under the assumption that an escrow payment is as inevitable (as much as it is unacceptable for a sovereign). In this scenario politicians are likely to demand that technocrats execute a re-routing of the payment system. Its an easy decision to take due to two facts

- 1- The debt whose debt service is potentially obstructed by NY litigation represents only 22% of Argentine bonds. For politicians this is probably a side-show and they may consider that the risk of falling into technical default while trying to make good on those payments is not a disproportionate obstacle to confront. After all, adding this set of bonds to the other 78% local law bonds (some USD, some ARS) can be sold as consolidating "national sovereignty".

- 2- While investor participation in a proposal to change the location of payment is not certain, given today's

pricing that decision is facilitated by the fact that (a) adopting local legislation is actually an NPV positive proposal today and (b) given where bonds are trading after plummeting it promises to deliver price increases if the risk of technical default dissipates.

How might this "outside-system resolution" be approached?

A CAC vote to cram down the proposed change of payment location seems a straightforward option (unless holdouts have 25% of an issue, holdout again and exercise their capacity to accelerate bonds that do not receive payment along the lines of the original contract). Whether this vote is successful will depend on the weight that the second point above carries with investors caught in the uncomfortable cross-fire and looking for a least-worse option. The important thing to keep in mind is that if investors do not accept to be paid in full in Buenos Aires then from a politicians viewpoint investors have only themselves to blame if they do not receive payment in NY. Argentine policymakers are unlikely to lose sleep if participation of restructured bondholders in a re-routing falls short of 100% so that possibility is not an impediment to attempting the strategy.

In fact, since court orders do not constitute attachments an attractive option for Argentina might be to pay investors who wish to re-route in Buenos Aires in full and to deposit funds in BoNY (or issue a check to Cede) to pay the remainder of investors who have preferred to stay in NY (of course, these funds will not find their way to the bondholder and there will be disputes as to whether Argentina's obligation is extinguished, but they will remain property of those who opted for NY payments). The first leg of the strategy provides the impression that the local economy and the heterodox model protects property rights of honest investors better than NY and the orthodox model. The second leg provides the impression that Argentina has willingness to pay notwithstanding the situation... a very attractive story for politicians to spell out and then go on with whatever they were doing before.

Argentine acrobatics amid "technical default" trip-wires

Having laid out the likely end-game, we consider a map of the month ahead and what a "within-system" strategy by Argentina might imply. A within system strategy on the part of Argentina is simply one which buys time to continue the status quo in the hope the Appeals Court changes its mind and that in the process no "technical default" trap-wire is triggered. It is a game that optimists hoping to frustrate a presumed CDS market conspiracy may attempt to play for as long as the risks are not high. That is why technicalities require discussion. Here is a telegraphed mapping of the key dates and technical considerations for the month ahead:

November

- Argentine politicians repudiate the Griesa ruling publicly
- Argentina's lawyers claim the escrow payment violates FSIA and seek extension of stays from appeals court

December 2:

- Payment on Rep 17 bond is made normally.
- No technical default

First weeks of December

- Argentine technocrats decide whether to pay BoNY (and argue obligation is de facto extinguished) or send a check to Cede directly which extinguishes the obligation de jure)

December 15

If Argentina pays via BoNY:

- Argentina deposits GDP warrant funds with BoNY
- Argentina does not deposit money for holdouts in escrow
- BoNY has property of funds on behalf of bond holders
- BoNY does not transfer funds to Cede and so does not extinguish Argentina's obligation formally
- The funds for GDP sits idle in BoNY - they cannot be attached by Court, but bond holders cannot access

funds

- Argentina claims it has done all it can, funds are not its property and considers its obligation extinguished

If Argentina pays Cede directly:

- Argentina deposits GDP by sending check to Cede,
- Argentina does not deposit money for holdouts in escrow
- Cede has property of funds on behalf of bond holders
- Cede does not transfer to DTC but its possession means Argentina has extinguished its obligation de Jure
- The funds for GDP sits idle in Cede - they cannot be attached by Court, but cannot be taken out by bond holders
- Holdouts claim Argentina has re-routed the payments and is not complying with injunction
- Argentina's lawyers claim payment to Cede is contemplated in the indenture and does not constitute re-routing

In Cede option there is no dispute, obligations have been extinguished de jure, no default, technical or otherwise.

But in BoNY option there may arise a dispute over extinguishing the obligation de jure or de facto between Argentina and bond holders. Technical Thus, there is a dispute over whether technical default exists.

However, the expected sign posts of default are not visible because:

- GDP does not have principal, holders cannot accelerate
- GDP is not a bond, does not cross default to bonds, CDS is not triggered
- In any case, there is a 30 day grace period before formal default is declared

Mid-December:

At some point due process continues at the Appeals Court and (maybe) results in a timely ruling. Does the AC consider the escrow payment consistent with FSIA? Does the AC consider the breadth of financial intermediaries enjoined like Griesa? Does the Fed raise concerns over the implications of the remands in a sufficiently louder voice than until now ?

December 20:

- CDS cut off date passes and no bonds have been defaulted
- GDP payments were made (ambiguity over extinguished obligation may persist though),
- No bond payments were missed, December CDS contract rolls off without triggering

If by this time if Argentina has not re-routed payments what follows:

December 31

- A plain vanilla bond (Disc 33) now comes due and credit implications are more linear than with GDP warrants
- Argentina can claim that any funds paid (either to BoNY or Cede) are not its property anymore,
- If Cede was paid obligations are de jure extinguished. Very difficult to argue that an event of default exists

If payment is to BoNY:

- The latter does not transfer funds and seeks Court protection from indemnity
- Cede says it has not received funds so obligation is not formally extinguished
- This implies a technical default (technical: money does not reach Cede, default: it's on a bond)
- This allows acceleration of bonds, cross default
- The dispute between Argentina, BoNY and bond holders escalate
- CDS triggers (January contract and thereafter): note that net CDS outstanding is \$1.85 bn (incl. Dec contract)

An EM precedent: Will/should the Appeals Court reconsider?... Two separate questions

Argentina's *pari passu* saga and potential "technical default" will unveil the unprecedented and broader consequences for Emerging Markets sovereigns of the US Court's (a) controversial interpretation of *pari passu*, (b) its choice of *pro rata* payments as adequate remedy and (c) its inclination to enjoin a broad set of financial intermediaries participants of the NY payment system against the NYFRB's (timid but clear) plea to the contrary.

Judges may complacently assume CACs will work marvels to avoid collective action problems or that EM sovereigns are so far from a debt restructuring event (at least for relevant EMs) that the problem will not occur on their watch, or that Argentinean policymakers warrant so little sympathy that it's no longer about the precedent but about letting the Court set an example. Whatever the reason, the consequences will need to be debated more deeply once the urgent matters facing Argentina (and therefore, its bondholders) is behind, and observers can focus on important matters facing EM.

For practical purposes, we view the implications for EM of the (still incomplete) ruling are "to transform the debt service of sovereign restructured bonds into contingent payments" (see our recent presentation, Argentina: The Potential EM Precedent for "Technical Default" (a Crash-Course in *Pari Passu* Holdout Litigation and Restructured Bond Payment Mechanics). And by doing so, the (still incomplete) ruling will inevitably undermine investor's inclination to participate in future sovereign debt restructurings involving foreign law bonds.

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