MARKETS

Supreme Court Sides With Holdout Creditors in Argentina Debt Case

In Separate Action, High Court Gives Holdout Creditor Access to Records on Argentina's Assets

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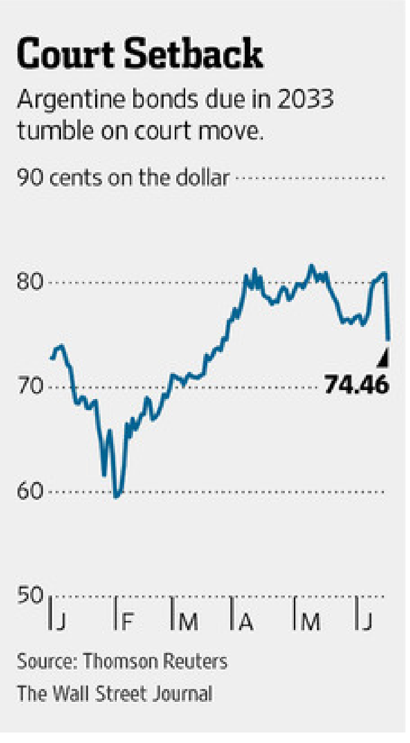
Updated June 16, 2014 9:19 p.m. ET



The U.S. Supreme Court handed Argentina a major setback in its long-running battle with a small group of determined creditors, heightening the risk the country will default for the second time in 13 years.

The justices on Monday rejected Argentina's appeal of a lower-court ruling that said the country can't make bond payments until it compensates hedge funds that refused to accept restructured debt in the years following Argentina's 2001 default. Because of that earlier ruling, Argentina must decide by the end of the month whether to reach a deal with the holdouts or default on its next debt payment.

Argentina's President Cristina Kirchner has refused to negotiate with the holdouts, calling them "vultures." But in an address Monday night, she said Argentina wouldn't default on its restructured debt and would make its interest payment at the end of June.

"Argentina has shown more than an evident willingness to negotiate [its debts]. But one has to distinguish between a negotiation and extortion," Mrs. Kirchner said in a speech broadcast on national television.

The Supreme Court's action is a pivotal—and potentially final—twist in a bitter battle pitting Argentina's government against a few deep-pocketed hedge funds that have been steadfast in their insistence on full payment. Creditors attempted to seize the presidential plane in 2007. Elliott Management Corp.'s NML Capital Ltd. impounded a navy training vessel in 2012 and this year tried to block Argentina from launching a pair of satellites. The holdouts are owed over $1.5 billion, according to a person familiar with the matter.

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Investors have been following the case for the legal precedent it might set for future sovereign-debt restructurings. As the dispute has wended its way through U.S. courts, money managers have

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also bought and sold Argentina's bonds, profiting from the roller-coaster moves in prices that came with each turn.

The development sent shock waves through Argentine markets but generated few ripples elsewhere, reflecting the country's relative isolation from the global financial system since its default. Prices of certain Argentine bonds dropped as much as 10%, while the stock market in Buenos Aires also fell 10%. Argentina has $54.8 billion in outstanding bonds that could be directly affected by the development.

The country's economy and financial markets were already in a precarious position before the Supreme Court action. The country's foreign-currency reserves, which are used partly to pay foreign bondholders, have dwindled to about $28.8 billion, nearly half what they were in 2011.

Analysts have questioned whether Argentina has enough dollars in its coffers to keep the government running until its national election next year. Many investors have also been following the dispute to gauge Argentina's ability to eventually tap global debt markets again to alleviate crippling U.S. dollar shortages at home.

"The legal process in the U.S. is over," says Marco Schnabl, a partner at law firm Skadden, Arps, Slate, Meagher & Flom LLP, who filed a brief on behalf of parties who supported Argentina's position. "What will happen is now a political question."

Argentina defaulted on about $100 billion of its debt during its financial crisis in 2001. The country in 2005 and 2010 offered holders of the defaulted bonds new, heavily discounted debt in exchange. Between the two swaps, investors agreed to exchange about 93% of the defaulted bonds.

A New York federal trial judge and the Second U.S. Circuit Court of Appeals each ruled that Argentina's refusal to pay bondholders who didn't take the deal while paying on the newer debt violated a so-called equal-treatment promise the country made on the older bonds.

The Second Circuit rejected what the court called Argentina's "blanket assertion" that a court action against the country would plunge it into a new economic crisis.

The Supreme Court declined to reconsider those rulings, in a brief written order. In a second, related case, the high court ruled that bank records about Argentina's international assets can be made available to NML, which is seeking to collect on court judgments stemming from the default.

The United States Supreme Court *Getty Images*

The action was a clear win for hedge funds that have been battling Argentina, including Elliott and Aurelius Capital Management LP. The action could reduce the likelihood of a settlement because they no longer fear losing in U.S. courts, said a person familiar with the matter.

NML said in a statement after the development, "Now it is time for Argentina to honor its commitments to creditors, which would benefit both Argentina's economy and its international standing."

Unless Argentina agrees to negotiate a settlement with the holdout hedge funds, Argentina is poised to miss at least $500 million in interest payments that are due June 30.

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"This is the most negative scenario that could have happened" for Argentina, said Peter Lannigan, a managing director at Connecticut-based broker-dealer CRT Capital Group LLC. He added that the likelihood of default has risen "substantially."

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The Supreme Court actions come after Mrs. Kirchner's government has stepped up its efforts to settle with creditors, which analysts say is a strategy aimed at regaining access to global debt markets. In May, the government agreed to pay $9.7 billion it owed to the Paris Club of creditor nations. That agreement came just weeks after Argentina paid $5 billion to oil firm Repsol SA as compensation for seizing a controlling stake in a subsidiary two years ago.

"If Argentina deals with this pragmatically, everyone will be a winner," said Alberto Ramos, an economist with Goldman Sachs Group Inc. "If they go into another default…the uncertainty and cost that will require is the best recipe for Argentina's economy to underperform and for the country to continue losing reserves."

Despite Argentina's financial troubles, opportunistic investors have always been drawn to Argentina's juicy bond yields, which are high relative to other countries' to compensate for the risk of investing there. The bet paid off last year, when Argentine bonds in the J.P. Morgan Emerging Market Bond Index returned 19% to investors, while the broader index fell 6.6%.

Some holders of Argentina's restructured bonds still believe the country will be able to buy itself more time and avoid a default, including Diego Ferro, co-chief investment officer at Greylock Capital, which manages $850 million, primarily invested in distressed debt, including a variety of Argentina's bonds.

"The likelihood of a technical default is overstated, and I don't think it will happen," Mr. Ferro said. He says he sees Monday's selloff as an opportunity to buy more Argentine bonds, because the Supreme Court action is ultimately accelerating a resolution to a dispute that has created uncertainty for all bondholders.

For now, analysts say the effects of the Supreme Court action will be contained to Argentina's markets. However, the victory for the holdouts in Argentina's case is liable to make emerging-market bond investors less willing to accept the terms of debt restructurings in the future if they see that holding out pays off.

—Matt Wirz contributed to this article.