



A Greek odyssey: Greece's sovereign debt restructuring and its impact on holders of Greek bonds

Finance Alert

26 Mar 2012

The Hellenic Republic has recently completed the largest sovereign debt restructuring in history. Large public deficits have been a defining characteristic of the Greek social model since the reestablishment of democracy in Greece in 1974. However, the financial crisis that began in 2007, and intensified in 2008, catastrophically affected the Greek economy, leaving Greece unable to service its bond indebtedness. Prior to the bond exchange offer that is the subject of this memorandum, total Greek debt was estimated at €350 billion (US\$456 billion).^[i]

As a condition to the €130 billion (US\$172 billion) bailout orchestrated by the International Monetary Fund (the IMF) and the Eurozone countries, Greece was required to refinance, and to reduce significantly, its outstanding bond indebtedness through an exchange offer.

Greece's bond debt, which, prior to the recently completed exchange offer, was approximately €200 billion (US\$260 billion),^[ii] represented the largest portion of the country's total debt. Pursuant to an exchange offer made on February 24, 2012, the Greek government offered holders of Greek bonds the option to exchange their bonds for new bonds worth approximately 47 cents on the euro. In a historic development, the exchange offer was successful: on March 12, 2012, the Greek government announced that holders of €177.25 billion in bonds governed by Greek law had agreed to participate in the exchange. As a result of the implementation of a collective action clause (discussed below), which compelled non-tendering holders of bonds governed by Greek law to participate in the exchange, 100 percent of the holders of these bonds will participate in the exchange offer, and a total of 95.7 percent of all holders of Greece's bonds are participating in the exchange.

The goal of the exchange offer is to contribute to Greece's effort to reduce its debt-to-GDP ratio to 120.5 percent by 2020. The exchange offer will reduce the aggregate outstanding principal amount owed to existing bondholders by 53.5 percent. Notwithstanding the successful implementation of the exchange offer, however, many analysts believe that Greece will inevitably default on the new bonds.

Most of the existing bonds (approximately 86 percent) are governed by Greek law, and the Greek parliament was authorized as a result to modify the terms of those laws, and therefore the rights of the holders of those bonds, through legislation. The exchange offer was accompanied by new legislation, known as the Greek Bondholder Law, which severely reduced the already minimal rights of holders who did not participate in the exchange offer. In particular, the Greek Bondholder Law contained a collective action clause that had the effect of cramming down non-consenting bondholders if one-third of the holders of the Greek law-governed bonds consented to the

exchange, which they did.

In this article, we summarize the salient features of the bailout package, the terms of the exchange offer and the Greek Bondholder Law. In addition, we discuss the treatment of credit default swaps in light of the exchange offer, and possible outcomes with respect to non-tendering bondholders.

The bailout package

On February 21, 2012, the European Central Bank (the ECB), along with the IMF and representatives of the Eurozone countries, approved a Greek bailout package in the amount of €130 billion (US\$172 billion). The vast majority of the funds under the program will be used to finance the exchange offer and to ensure the stability of Greece's banking system. The European Financial Stability Facility (the EFSF), whose membership consists of the various Eurozone countries, will lend €30 billion to Greece, in the form of the Private Sector Involvement Liability Management Facility (the PSI LM Facility), which provides financial incentives for private-sector debtholders to agree to the exchange offer. About €41 billion in bailout funds will go toward the purchase of tendered bonds and the payment of accrued interest on the existing bonds, while approximately €23 billion will go to recapitalize Greek banks.^[iii] The successful implementation of the exchange offer is a condition to Greece's receipt of the bailout funds.

In addition, in order to stabilize the value of Greece's bonds, and to permit institutional bondholders to reduce their exposure to Greece, the ECB purchased €55 billion (US\$71.6 billion) in Greek bonds at a discounted price equivalent to 70 to 75 cents on the euro.^[iv] Under the restructuring, bonds held by the ECB will not be subject to the exchange or any other reduction in principal amount. The fact that the ECB can expect to be repaid in full on its bonds has raised the ire of other holders, who now have become effectively subordinated to the ECB.^[v]

The exchange offer

On February 24, 2012, the Greek government approved the terms of the exchange offer to be made to the holders of existing Greek bonds. In total, 95.7 percent of the holders of existing bonds will participate in the exchange. This figure represents all of the bonds governed by Greek law and a sizeable percentage of the bonds governed by foreign law. The Greek government has indicated that it will extend the exchange offer until March 23, 2012, in order to give the holdouts an additional opportunity to tender their bonds.

Under the terms of the exchange offer, existing holders will receive (i) new bonds having a face amount equal to 31.5 percent of the face amount of the exchanged bonds and a scheduled maturity of February 24, 2042), (ii) detachable GDP-linked securities having a notional amount equal to the face amount of each holder's new bonds, designed to give bondholders the potential right to receive an additional amount if Greece's GDP growth rate in any year exceeds a certain rate (the GDP-linked securities) and (ii) notes issued by the EFSF to Greece pursuant to the PSI LM Facility, and in turn delivered to the holders, having a face amount equal to 15.0 percent of the face amount of the exchanged bonds and a scheduled maturity of February 24, 2014 (the PSI payment notes), which are considered cash equivalents for the bondholders. All of the above securities are governed by English law.

The new bonds and the GDP-linked securities will be registered in the book-entry system of the Bank of Greece. In addition, application will be made to admit the new bonds and the GDP-linked securities for trading on the Athens Stock Exchange and the Electronic Secondary Securities Market operated by the Bank of Greece.

The new bonds and the GDP-linked securities will constitute direct, general, unconditional, unsubordinated and unsecured obligations of the Greek government. The new bonds and the GDP-linked securities will rank *pari passu* among themselves and with all other unsecured, unsubordinated Greek debt. Payment of the bonds and performance by Greece of its obligations thereunder are backed by the full faith and credit of Greece.

US holders of existing bonds will not receive any PSI payment notes. Rather, US holders will be paid in cash proceeds realized from the sale of the PSI payment notes they would have otherwise received. Bondholders tendering their bonds into the exchange offer will lose approximately 75 percent of the value of their securities.

The terms of each of the new bonds, the GDP-linked securities and the PSI payment notes are summarized below.

Non-tendering bondholders are entitled to receive payment of accrued and unpaid interest on their bonds up to but excluding the date of the exchange offer. Non-US holders will receive this interest payment in the form of payment-in-kind notes issued by the EFSF (the accrued interest notes), maturing on or before December 31, 2012, while US holders will receive cash proceeds realized from the sale of the accrued interest notes they would have otherwise received.

The Greek government has made the full terms of the exchange offer available in electronic form here. To participate in the exchange offer, holders are required to comply with the procedures and offer and distribution restrictions described in the related information memorandum available on the website.

New bonds

Each tendering bondholder will receive new bonds in a face amount equal to 31.5 percent of the face amount of the exchanged bonds. The aggregate face amount of the new bonds will be spread among 20 series with maturity dates and face amounts as set forth below:

Series	Maturity dates of each series	Face amount of each series (% of aggregate face amount of exchanged bonds)
1 – 5	11th to 15th anniversary of February 24, 2012	1.5%
6 – 20	16th to 30th anniversary of February 24, 2012	1.6%

Interest on the new bonds will be payable in arrears on an annual basis beginning on February 24, 2013, as set forth below:

Interest payment date(s)	Interest rate
February 24 of each year from 2013 through 2015	2.00% per annum
February 24 of each year from 2016 through 2020	3.00% per annum
February 24, 2021	3.65% per annum
February 24 of each year from 2022 through 2042	4.30% per annum

The new bonds are subject to a negative pledge. So long as any new bond remains outstanding, the Greek government will be prevented from issuing any secured bonds in the future unless the new bonds are secured ratably with such future debt.

Under US tax law, the original issue discount (OID) on the new bonds constitutes taxable income for US holders. As a result, US holders are subject to certain reporting requirements with respect to OID under the terms of the new bonds.

The new bonds are subject to certain events of default, including (i) failure by Greece to make payment when due

on any series of new bonds or any GDP-linked securities issued in connection with the new bonds, subject to a 30-day grace period; (ii) failure by Greece to comply with any covenant with respect to the new bonds or the co-financing facility (as defined below), subject to a 30-day cure period; (iii) a payment default or acceleration with respect to any future bond indebtedness; or (iv) an acceleration of the PSI LM Facility.

Holders of the new bonds will be entitled to the benefit of, and will be bound by, a co-financing agreement among Greece, the EFSF, Wilmington Trust (London) Limited, as trustee for the holders of the new bonds, and certain other parties. The co-financing agreement links the new bonds to the PSI LM Facility in a variety of ways, including the appointment of a common paying agent, the inclusion of a turnover covenant and the payment of principal and interest on the new bonds and the PSI LM Facility on the same dates and on a pro rata basis.

GDP-linked securities

As a financial inducement to bondholders, each tendering bondholder will receive GDP-linked securities in a notional amount equal to the face amount of that bondholder's new bonds. The notional amount is then decreased over the life of the security. Bondholders will receive payment on the GDP-linked securities if Greece's GDP growth rate in a given year exceeds the reference rate for that year (ranging from 2 percent to approximately 2.9 percent, depending on the year). Payment on the GDP-linked securities will be made annually and will be calculated based on a formula that refers to (i) the difference between the real GDP growth rate and the reference rate for that year and (ii) the notional amount of the GDP-linked securities for that year. In addition, payment on the GDP-linked securities will only be made in a given year if the nominal GDP for that year exceeds the reference nominal GDP for that year.

The GDP-linked securities are callable by the Greek government at any time after January 1, 2020.

While the GDP-linked securities were designed to function as an additional incentive for holders to exchange their bonds for the new package, observers have pointed out that payout under these securities is unlikely, claiming that the reference figures for GDP growth and nominal GDP are not realistic. Further, the austerity measures that Greece has been required to put in place (to the extent such measures are successfully implemented) will almost certainly have the effect of reducing GDP growth.

PSI payment notes

Under the PSI LM Facility, the EFSF will issue PSI payment notes to Greece. Greece will in turn deliver the PSI payment notes to qualified holders of existing bonds who have tendered their bonds for exchange. Each PSI payment note will be issued with a face amount equal to 15 percent of the face amount of the exchanged bond. US holders will not receive PSI payment notes and instead will be paid in cash proceeds realized from the sale of the PSI payment notes they would have otherwise received.

The PSI payment notes will consist of (i) notes issued with a maturity date one year from the issue date of the PSI payment notes, on or around March 12, 2012 (the issue date) (the one-year PSI payment notes), and (ii) notes issued with a maturity date two years from the issue date (the two-year PSI payment notes). Together, the aggregate face amounts of the one-year PSI payment notes and the two-year PSI payment notes will equal €15 billion. The PSI payment notes will be guaranteed jointly by the various Eurozone countries.

Interest on the PSI payment notes will be payable in arrears on the applicable maturity date, at a fixed rate to be determined on the issue date.

The PSI payment notes will be governed by English law.

The Greek Bondholder Law

In order to effect the exchange offer, the Greek government was required to amend the existing bonds to allow for their exchange. The Greek legislature did so by means of a new law, passed on February 23, 2012, known as the Greek Bondholder Law, which, through inclusion of a collective action clause, compelled those holders of Greek-law

governed bonds who planned to refrain from tendering their bonds to participate in the exchange offer.

Under the Greek Bondholder Law, the amendments to existing bonds were deemed effective if (a) (i) holders of at least 50 percent of the aggregate principal amount of eligible existing bonds confirmed their participation in the exchange offer (even if they did not ultimately tender their bonds for exchange), and (ii) at least two-thirds of those holders that confirmed their participation in the exchange offer consented to the proposed amendments, and (b) subject to certain conditions, including the participation of 90 percent of the holders of existing bond debt in the exchange (the minimum participation condition), the Greek government elected to put the amendments into effect. By tendering existing bonds for exchange pursuant to the exchange offer, a bondholder was deemed to have consented to the proposed amendments.

The main purpose of the new legislation was to put in place a collective action clause, minimizing the ability of non-tendering bondholders to block the execution of the exchange offer. This cram-down helped ensure that the minimum participation condition was met with respect to the bonds.

Treatment of credit default swaps

Many holders of Greek bonds have purchased credit default swaps (CDSs) to protect the value of their investments against the risk of default by the Greek government. While approximately €70 billion of Greek CDSs have been issued in the aggregate, when long and short positions on the contracts are netted out, the amount is much smaller (approximately €3 billion).

On March 9, 2012, the International Swaps and Derivatives Association (ISDA) announced that the implementation of the collective action clause under the Greek Bondholder Law constituted a default under ISDA regulations, triggering the CDSs. Bondholders whose investments are protected by CDSs will thus be able to recover any losses arising from the debt restructuring.

ISDA's announcement marks the end of months of uncertain and at times conflicting messages from the association as to whether the CDSs would be triggered. An "ISDA default" includes (i) a bankruptcy or other insolvency event; (ii) acceleration of obligations; (iii) default on any of the non-payment obligations of the issuer which could result in acceleration under the bond documents; (iv) failure to pay; (v) repudiation or moratorium by the issuer; and (vi) a restructuring. While the exchange offer seems to fit squarely into this last category, ISDA did not make a definitive statement as to whether this qualifies as a default until the March 9 announcement.

On March 19, ISDA conducted an auction to determine the price at which Greek CDSs would be paid out. The auction resulted in a final price of 21.5 percent, meaning that holders of CDSs will be paid out in cash at 78.5 cents on the euro.^[vi] Unlike the bond exchange itself, participation in the ISDA auction was not compulsory.

The auction was held in two stages. At the first stage, participants indicated the price at which they were willing to buy or sell bonds, as applicable, from a pre-approved subset of the bonds. Bid and offer prices were then matched by ranking the bid prices in descending order and the offer prices in ascending order to form a series of pairs. All of the pairs in which the offer price was equal to or greater than the bid price were averaged together to determine the auction price. The first stage of the auction resulted in a "net open interest" of €291.6 million, meaning that dealers were more interested in selling the bonds than in purchasing them.

At the second stage of the auction, dealers submitted their bids for the outstanding €291.6 million of bonds, along with the amount (denominated in €5 million lots) they were willing to acquire. These bids were then ranked until the total amount was accounted for, and the corresponding amount was set as the final price of 21.5 percent. At the conclusion of the auction, the participants traded the bonds at the final price.

English law-governed bonds

A significant percentage of Greek bonds governed by English law have not been tendered into the exchange offer. One reason that many holders of these bonds have elected not to participate in the exchange is that these bonds have more extensive remedies than the Greek law-governed bonds (and were not subject to the amendments

effected by the Greek Bondholder Law). The English law-governed bonds contain a negative pledge and a *pari passu* clause, and, in certain of those bonds, events of default that include a cross-default triggered by a default by the Greek government on “external indebtedness” in excess of a certain threshold. In addition, English law-governed bonds issued after 2004 contain a collective action clause (CAC), which permits holders of a specified percentage of the principal amount of bonds to declare a default and accelerate the maturity date of the bonds upon the occurrence of an event of default.

With respect to the *pari passu* clause, some courts have interpreted this language to require debtors not yet in bankruptcy to pay debts to all creditors *pari passu*.^[vii] Although this interpretation has been disputed, it may provide a contractual basis for asserting a right to payment on the bonds.

Upon the occurrence of an “event of default,” as defined under the governing documents of the English law bonds, bondholders have the right, subject to the CAC, to declare a default, accelerate the maturity date of the bonds, and seek to enforce their right to payment through enforcement proceeding brought in English courts, under English law.

The English law-governed bonds that we have examined include some or all of the following events of default:

- failure to pay interest or principal in respect of the bonds which remains uncured by payment thereof within 30 days from the due date for such payment
- failure to perform any other covenant, condition or provision of the bonds which continues for 30 days after written notice thereof
- any government order, decree or enactment which prevents the observation and performance of the obligations of the bond
- external indebtedness in an amount equal to or exceeding US\$25 million (or its equivalent) is accelerated so that it becomes due and payable prior to the stated maturity thereof as a result of a default thereunder, and such acceleration has not been rescinded or annulled; or any payment obligation under such indebtedness is not paid as and when due (including any applicable grace period) and
- general moratorium is declared by Greece or the Bank of Greece in respect of its external indebtedness; or Greece or the Bank of Greece announces its inability to pay its external indebtedness as it matures

In bond documents executed after 2004, the right of the holders of the English law-governed bonds to accelerate the maturity date of the bonds upon the occurrence of an Event of Default is conditioned upon compliance with the requirements of the CAC. In the case of the English law-governed bond documents that we have reviewed, the CACs require that the bondholders who wish to declare a default hold at least 25 percent of the aggregate outstanding principal amount of the issue. Those bondholders may then enforce their remedies by accelerating the bonds, and, if the bonds are not paid in full, bringing an action in court to enforce payment, and seeking attachment of assets of Greece in order to secure payment following a favorable judgment.

Those bondholders who have elected not to participate in the exchange offer have certain rights and remedies to obtain payment on their bonds, above and beyond the payments offered under the terms of the exchange. However, realizing those rights is likely to be difficult, time-consuming and expensive, in terms of legal fees.

Nonetheless, there are certain remedies available to the holders of English law-governed bonds who have chosen not to participate in the exchange. These holders have the option to accelerate their bonds, provided they can satisfy the specified percentage in the applicable CAC. Once the bonds have been accelerated, it is unlikely that the Greek government will be able to pay the accelerated bonds. The affected holders may then bring legal action against the Greek government to enforce their right to payment, either in London or in US federal court, subject to their ability to establish an exception to immunity under the Foreign Sovereign Immunities Act (FSIA).

In order for any bondholder to bring an action against the Greek government in the courts of the United States, they will have to overcome the protections afforded to Greece by the FSIA, which provides a foreign state immunity from suit in American courts. In order to overcome the FSIA protections, bondholders will need to illustrate (A) that Greece has explicitly or implicitly waived its immunity; or (B) that the action is based upon a commercial activity carried on in the US by the foreign state, or upon an act performed in the US in connection

with a commercial activity of the foreign state elsewhere, or upon an act outside the territory of the US in connection with a commercial activity of the foreign state elsewhere that causes a direct effect in the US.^[viii] Upon the determination that a US court has jurisdiction over Greece, a breach of contract claim may be brought by dissenting bondholders upon a Greek default or an unfavorable exchange offer.

Conclusion

While Greece has now successfully emerged from its immediate debt crisis, whether Greece may avoid future financial difficulty will depend on its ability to comply with its obligations with respect to the new bonds, the GDP-linked securities and the PSI payment notes over the life of those securities. In addition, because the makeup of Greece's creditors has now radically shifted from the private to the public sector, it will be much more difficult for Greece to negotiate any subsequent refinancing.

A foreign law-governed bondholder who has chosen not to participate in the exchange is now faced with two options: costly and protracted litigation, or – a highly unlikely scenario – negotiating to obtain a better deal post-exchange. Because the vast majority of bondholders are participating in the exchange, either voluntarily or involuntarily, the negotiating position of the holdouts is not likely to be strong.

This article is not intended to provide a comprehensive summary of the exchange offer and related restructuring issues. If you would like to discuss the issues raised here, feel free to contact any of the DLA Piper lawyers listed below:

Peter V. Darrow

Richard F. Hans

*This article was prepared with the assistance of **Elena O. Keil**, an associate in DLA Piper's New York office.*

[i] "European Union Turns Screws on Greece, Spain, as Recession Looms," *The Economic Times*, January 24, 2012.

[ii] M. Petrakis, "Greek Creditors Make 'Maximum' Debt-Swap Offer, Dallara Says," *Bloomberg Businessweek*, January 23, 2012.

[iii] L. Baker, "Euro Zone Leaders Hash Out Details of Second Greek Bailout," *International Business Times*, February 20, 2012.

[iv] L. Thomas and J. Knater, "European Central Bank Moves to Avoid Loss on Greek Bonds," *New York Times*, January 24, 2012.

[v] S. Cruise and C. Vellacott, "Investors Call on ECB to Play Fair in Sovereign Credit," Reuters, March 5, 2012.

[vi] "A Guide to the Greek CDS Auction," *Financial News*, March 22, 2012.

[vii] A decision issued by the Court of Appeals of Brussels, in *Elliott Associates., L.P.*, General Docket No. 2000/QR/92, introduced a novel interpretation of the meaning of the *pari passu* language. Elliott brought suit against the Government of Peru and a Peruvian bank arising from Elliott's ownership of Peruvian debt after the Peruvian government had defaulted on its bond debt and attempted to restructure its debt. Elliot refused to accept the restructuring and based its claim for payment on a unique interpretation of the language of the *pari passu* clause in the governing bond documents – that, as a holder of Peruvian bonds, Elliot was entitled to a pro rata payment any time the government made payments to other creditors. The court determined that an issuer of debt governed by a *pari passu* clause is restricted from making any payment to any unsecured creditor without making a pro rata payment to all other creditors of the same class. In support of its judgment, the court explained that since the *pari passu* language in question required equal treatment of creditors in bankruptcy, such language necessarily required equal treatment of creditors whenever payment to any such creditor was made. However, holdouts have had limited success in replicating the success represented by the *Elliott* decision. See C. Berry and K. Blake, "Pari Passu Means What Now?, Corporate Restructuring and Bankruptcy," *New York Law Journal* (March 6, 2006).

[viii] 28 U.S.C. § 1605(a).