Pari Passu’s Golden Fossils

Anna Gelpern

The stipulation in the bonds that all issues ‘rank pari passu in all respects’ means primarily that in the event of partial payments by the Reich, caused by diminished solvency, each bond is entitled to an equal share and no issues can claim to be in a privileged class … Such a right would be conceivable as a reciprocal claim between the bondholders, or as a claim of the bondholders against the Reich…

_Aktiebolaget Obligationsinteressenter v. Bank for International Settlements_

_Judgment of the Court of Appeal of the Canton of Basel-Stadt_  
_November 29, 1935_

I. Introduction

For the jilted creditor of a sovereign, the _pari passu_ clause is the most promising collection weapon to come along since 19th century gunboats. Its simple pledge of inter-creditor equality has made the world’s most powerful politicians and bankers squirm. It made Argentina default on $28 billion in bonds, and made Peru and Congo pay a king’s ransom to a few creditors for the privilege of paying a pittance to the rest. Yet it is far from clear that the clause, which has been in sovereign debt contracts since the mid-19th century, was ever meant to be a collection tool at all, let alone the creditors’ best hope. The search for the true meaning of _pari passu_ in sovereign debt contracts has driven countless deep thinkers to distraction, and has given birth to a new field of study, “contract paleontology,” which looks to historical meanings and usage of standard contract terms for guidance in their interpretation.

This essay adds to the fossil-hunting project with a preliminary account of _pari passu_ litigation in the 1930s, tangled up in the financial and economic wreckage of World War I and the collapse of the gold standard. Unlike the other contributors, I focus on past judicial interpretation of the clause, which has gone unremarked in the large _pari passu_ literature to date.

Until now, scholars put the rise of _pari passu_ in debt enforcement to a 2000 Brussels commercial court ruling, which blocked Peru from paying its restructured debt unless it paid its defaulted 1

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1 Georgetown Law. I am grateful to Mitu Gulati, Adam Levitin, Larry Solum, Nick Brock, Katherine Incantalupo and Vijay Khosa for help with this essay.


debt in full. More lawsuits around the world left the meaning of *pari passu* unresolved until 2013, when U.S. federal courts held that Argentina’s *pari passu* clause forbade selective default—and promptly triggered comprehensive default. The decisions met with outrage in some quarters and jubilation in others. Critics accused the courts of twisting the meaning of the clause, designed to protect against legal subordination (which hardly ever happened), not selective payment (which happened all the time). Fans said it was meant precisely as a nuclear commitment device, to deter discrimination in the broadest sense. Both sides faced the same awkward problem: if the clause meant what they said, *pari passu* was a contract version of the human appendix. It had no discernible function in the 21st century, yet threatened mass damage when inflamed.

Contract paleontology allays awkward feelings by explaining the function of *pari passu* long ago. It implicitly posits a distant author, who contracted for *pari passu* with the knowledge and intent lacking in today’s users of his words. The idea of contract-as-fossil feeds into institutional explanations of contract boilerplate, where parties might prefer widely used contract terms whose meaning is fixed by the courts, but where vestigial phrases can also malinger long past their prime. Judging from the combined contributions of *pari passu* paleontologists so far, old meanings do not resolve contemporary arguments. Even if we could arrange a séance with the distant author of *pari passu*, what voice, if any, should he have before U.S., English, or any other courts in 2014—and why?

My essay complicates the picture with another set of distant voices, Swiss judges interpreting *pari passu* in a 1935 lawsuit by Swedish bondholders against the Bank for International Settlements (BIS) as trustee for German bonds. The Swedes complained that the BIS, with Germany, breached *pari passu* when it paid them in devalued currency while indexing other creditors’ payments to gold. Although there is no mention of the case in the modern *pari passu* canon, it was famous at the time, and remained famous for decades. The Swiss courts had no trouble reading *pari passu* as a promise of ratable payment, much like their diplomatic contemporaries described by Sung Hui Kim, and Argentina’s holdout creditors today. More strikingly from today’s vantage point, some judges wrote that inter-creditor remedies for breach could be appropriate. Nonetheless, the creditors lost the trial and two appeals.

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As a result, both sides in the battle between Argentina and its creditors might find something in the opinions to help their case. Meanwhile, the most committed paleontologists might see a goldmine. Payment discrimination was commonplace in the 1930s, when countries abandoned the gold standard and abrogated gold indexation clauses.\(^8\) The *pari passu* clause was standard and apparently well-known. Although sovereigns still enjoyed absolute immunity from lawsuits in national courts, trustees and fiscal agents were sued a lot.\(^9\) The Swedish bondholders might not have been the first, nor the last, to plead *pari passu*.

This project came about by accident when I stumbled on the Swiss case in the files of the League of Nations Committee for the Study of International Loan Contracts in Geneva, while researching altogether different questions. My conclusions are necessarily preliminary, pending further investigation in BIS and national archives, among others, and in-depth consideration of comparative law, contract interpretation, and other theories beyond the scope of this brief essay. Nevertheless, in light of the metastasizing effects of the dispute between Argentina and its bondholders around the world and the urgent policy and contractual responses to it, it seems sensible to share the preliminary evidence sooner rather than later. After describing the Swiss case in Part II, and its potential implications for today’s sovereign debt enforcement in Part III, I conclude with thoughts on *pari passu* paleontology and its uses.

### II. Aktiebolaget Obligationsinteressenter v. Bank for International Settlements

#### A. A Doomed Loan

The BIS was no ordinary trustee. Established in 1930 with subscriptions from leading European central banks, it was both a bank and a policy institution, charged with coordinating global monetary affairs amid a deepening depression, the demise of the gold standard, proliferating capital controls, and viral banking crises. A key part of the BIS’s mandate was to administer a convoluted scheme whereby Germany borrowed foreign currency from international bondholders to pay World War I reparations to the Allied powers in Europe, which in turn owed money to the United States.

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\(^9\) A 1937 League of Nations memorandum noted that “[a]ctions have been brought by bondholders against one or more of the Trustees in France, the United States, Switzerland, Belgium and Holland, claiming in each case that the Trustee should have made payments on a gold basis out of the funds at their disposal.” Memorandum of A.P. Fachiri, League of Nations Committee for the Study of International Loan Contracts, Geneva, February 10, 1937. League of Nations Archives Registry Files, Box R 4609, Registry No. 10C:23448.
Under the 1924 Dawes Plan, Germany borrowed approximately $200 million from foreign bondholders in U.S. dollars, British pounds, Italian lire, Swedish kronor, and Swiss francs. The Dawes Plan Loan (as the bond issue was called) was part of a deal to resume reparations payments and help stimulate the German economy. The Dawes Loan bonds had priority claim on Germany’s foreign exchange, and were secured by certain tax revenues. The U.S. dollar tranche alone was indexed to gold to protect the creditors from currency depreciation. The Agent-General for Reparations, U.S. banker Parker Gilbert, oversaw currency transfers to minimize exchange rate disruptions; this gave him considerable power over German economic management.  

The Young Plan, named after U.S. industrialist Owen D. Young, succeeded the Dawes Plan in 1930. It rescheduled reparations payments and provided for the withdrawal of French troops from German territory. Like the Dawes plan, it included an international bond issue. The Young Plan Loan raised approximately $300 million, with bonds denominated in French francs, U.S dollars, British pounds, Swedish kronor, Dutch florins, Swiss francs, German reichsmarks, Italian lire, and Belgian belgas, listed in order of the respective tranche sizes.  

Two-thirds of the proceeds went to pay reparations; the rest to the German government for investment in railways and the postal service. In contrast to the Dawes Loan, all the Young Loan tranches were indexed to gold at their value on the date of issue. Germany was also made responsible for procuring the foreign exchange for external payments.  

To restore German control over domestic economic policy, the new plan did away with the office of the Agent-General and appointed the BIS as Trustee for the Young bonds and Fiscal Agent for the Dawes bonds. Envisioned as a neutral international institution, the BIS would distribute payments from Germany in different currencies to the bondholders in different countries.

The scheme fell apart almost as soon as it began. A financial crisis that started in Austria with the collapse of Credit Anstalt bank in May of 1931 quickly spread to Germany and beyond. The same year Britain and Sweden went off the gold standard; their currencies soon fell by 40 percent. Another round of intergovernmental negotiations ended Germany’s reparations obligations under the Lausanne Agreement in 1932, but specifically preserved the rights of private bondholders under the Dawes and Young Loans. The United States left the gold standard

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11 George P. Auld, The Dawes and Young Loans: Then and Now, FOREIGN AFFAIRS (1934).

12 EICHENGREEN, supra note 8.
in March of 1933; in June, the Congress passed a Joint Resolution declaring gold indexation clauses unenforceable.\textsuperscript{13}

Scarred by recent hyperinflation, Germany clung to the gold standard even as the falling currencies of its trading partners made it impossible to generate the foreign exchange necessary to service its debts. Nevertheless, it continued paying the BIS the gold value of all the Young Loan coupons through 1932, including those due to British and Swedish bondholders. Several events at the start of 1933 might have contributed to a change in course. Hitler became Chancellor in January 1933, and received extraordinary powers in March. The Nazi party had long targeted the Dawes and Young Plan payments as symbols of Germany’s postwar humiliation.\textsuperscript{14} On the other hand, U.S. legislation and English court decisions (since reversed) barring gold value payments\textsuperscript{15} gave Germany a ready legal argument. The BIS Annual Report for 1934 described the unraveling:

On May 10, 1933, however, the United States dollar having also left the gold standard, the Finance Minister of the German Reich informed the Trustee that in view of the decisions of certain English courts to the effect that the interest and principal of bonds expressed in sterling and containing a gold clause are nevertheless payable in current legal tender sterling, in the nominal amount of the coupon or bond, and having regard, also, to the fact that the Government of the United States of America had taken the position that obligations expressed in dollars and containing a gold clause were payable at their nominal value in current legal tender without regard to such clause, it was the intention to effect future payments in respect of the American, British and Swedish issues of the German Government International 5 ½ % Loan 1930 in current legal tender dollars, sterling and crowns, respectively, in amounts sufficient to pay coupons and to meet the sinking fund obligations at the respective nominal amounts, only.\textsuperscript{16}

The trustee was in a bind. The BIS could either follow the German instructions and discriminate among the tranches, or pool the money and distribute it among all the bondholders ratably in proportion to their claims on a gold value basis. As the BIS saw it, neither option complied with the bond terms. Germany promised in the Young Loan General Bond that all the bond tranches would “rank pari passu in all respects irrespective of date or place of issue or otherwise.”\textsuperscript{17}

Simply transmitting the money as instructed would give the U.S., U.K. and Swedish bondholders

\begin{itemize}
  \item \textsuperscript{14} \textit{AHAMED}, supra note 8 at __.
  \item \textsuperscript{15} The Court of King’s Bench and the Court of Appeal held in \textit{Feist v. Societe Intercommunale Belge d’Electricite} (1 Ch. 684 (1933)) that a promise to pay in gold coin did not imply a promise to pay gold value in currency when payment in gold was against public policy. The House of Lords reversed the following year (A.C. 161 (1933)). The case is discussed in Arthur Nussbaum, \textit{Comparative and International Aspects of American Gold Clause Abrogation}, 44 \textit{Yale L.J.} 53, 56-57 (1934) and in \textit{Contracts. Gold Clause}, 34 \textit{Colum. L. Rev.} 552, 560-62 (1934).
  \item \textsuperscript{17} German Government International 5 ½ Per Cent. Loan 1930, §II.
\end{itemize}
40 percent less than the others, measured by gold value. On the other hand, the gold clause in the general bond required Germany to pay principal and interest at the gold value of the currency of denomination at the time of issue, “but not less than the nominal amount of the principal and interest specified in each Bond.”

Pooling and redistributing the funds proportionately among the tranches would result in payment below nominal and gold value for the French, whose franc was still tied to gold, but above nominal and below gold value for the Swedes, now off gold. The BIS chose to pass on the discriminatory payments under protest:

After taking legal advice the Trustee decided that it was necessary, under the circumstances, while reserving the rights to the unpaid amount computed on a gold value basis, at least to pay the coupons of all issues of the Loan at their respective nominal amounts… Certain paying agents have expressed dissatisfaction … taking the position that the aggregate service should have been pooled, and divided pro rata on a gold value basis. They have indicated that a competent judicial ruling might be sought.

B. An Awkward Case

Among the three aggrieved tranches, the Swedes appear to have been the only ones to sue. The United States vigorously and fruitlessly protested the plight of its bondholders through diplomatic and banking channels; on the other hand, both the United Kingdom and Sweden had concluded bilateral clearing agreements with Germany, taking advantage of their trade surpluses with the recalcitrant debtor to recoup the bond payments.

(1) Canton Civil Court

The Swedish bondholders sued in the Basel-Stadt canton civil court, where the BIS was located. As a first order of business, the court struggled with the choice of law, left unspecified in the General Bond conditions. The BIS apparently argued that “Anglo-Saxon” law should apply, because U.S. and U.K. tranches accounted for half of the total Young Loan, because of the preeminence of U.S. and British bankers in arranging the loan, but also because the case required

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18 Id., §VI(a). Different payment currency options did not alter the valuation.
19 BIS Fourth Annual Report, supra note 14 at 41.
20 Sweden’s position might have been complicated by the involvement of “Match King” Ivar Kreuger, who had advanced Germany $125 million in exchange for a match monopoly in conjunction with the Young Loan, and took up about half of the $20 million Swedish Young Loan tranche himself, with another quarter for his firm, Kreuger & Toll, before committing suicide in 1932. GIANNI TONIOLO, CENTRAL BANK COOPERATION AT THE BANK FOR INTERNATIONAL SETTLEMENTS, 1930-1973 507 (2005); WILLIAM H. STONEMAN, THE LIFE AND DEATH OF IVAR KREUGER 204 (1932, reprinted by Forgotten Books, London, 2013). For Kreuger’s role in financing Germany, see PARTNOY, supra note 10.
21 Kim, supra note 7.
22 Auld, supra note 11 at __; Clement, supra at 44.
23 The BIS’s location was much debated at its founding. Some of the negotiators felt strongly that the bank should reside in London, a pre-eminent financial center; however, Switzerland was chosen as a more neutral location.
the court to determine its duties as trustee, a concept that had no ready equivalent in continental European law or practice. After concluding that none of these factors required recourse to English law and observing that neither side argued for Swedish law, the court proceeded to apply Swiss law as the law of the place of performance.\(^{24}\) As predicted by the BIS, this led to some awkward reasoning on the question of trust.

The Swedish bondholders argued that the BIS violated its obligations as trustee when it paid them in nominal money contrary to the gold and \textit{pari passu} clauses in the general bond. Inevitably, the case turned on the scope of the BIS’s duties—whether, as trustee, it “had not only the duty to pass on the payments to the bondholders but had the additional obligation of ensuring in all circumstances payment to the bondholders on the basis of equality, irrespective of the attitude adopted by the debtor.”

The trial court concluded that the plaintiffs failed to prove such “additional obligation” in two steps. First, it pointed out that the German position on differential payment did not arise out of financial difficulties, nor because the debtor “wished to favor” some bondholders over others, but rather because it challenged the validity of the gold clause in the three tranches in question. Overriding German instructions would have required an independent decision by the BIS as to the validity of the gold clause. Second, the court decided that the BIS’s duties were “not those of an arbitrator but of a paying agent,” a mostly-passive payment conduit. In light of the complexity of the loan, “having its origin in political events,” the court assumed that BIS “did not intend to contract any such far-reaching obligation as is implied by the contention of the plaintiff.”\(^{25}\) Having thus re-described “representative of the bondholders” as “paying agent” of the debtor, the court easily absolved the BIS of all liability under the gold and \textit{pari passu} clauses.

Along the way the Basel civil court made important observations about the meaning and consequences of a \textit{pari passu} undertaking. First, the judges found it uncontroversial that, “if the German Reich had made a partial payment, for the sole reason that it had difficulties in raising the necessary amounts, it might have been incumbent upon the defendant to employ the said payment only in such a way as to take into account the gold clause and the pari passu clause, that is to say, only for the uniform partial payment of all bondholders according to the gold value of their claims.”\(^{26}\) In other words, under different circumstances, the clause could be enforced as a promise of ratable payment, binding third parties, such as trustees.\(^{27}\) Yet the court also held that

\(^{24}\) Judgment given on April 20\(^{th}\), 1935, by the Civil Court of the Canton of Basel-Stadt in re Claim for Compensation of a Swedish Holder of Young Loan Bonds against the Trustee on Account of Alleged Wrong Distribution of Available Loan Moneys (League of Nations Committee for the Study of International Loan Contracts translation) (hereinafter, “Civil Court Judgment”) in Note by the Secretariat, Committee for the Study of International Loan Contracts, Geneva, February 11th, 1937. League of Nations Archives Registry Files, Box R 4609, Registry No. 10C:23448.

\(^{25}\) \textit{Id.} at 4-5.

\(^{26}\) \textit{Id.} at 3.

\(^{27}\) The court seemed to envision a situation where Germany would send a lump sum, short of the total owed, to the BIS with no instructions as to its distribution. Separately, it observed that the case might have come out differently
the trustee in this case—a passive conduit—could not deprive the sovereign debtor “of the practical possibility … of departing … vis-à-vis a section of the bondholders, from the agreements concluded.” 28 Put differently, it was Germany’s prerogative to discriminate in breach of its bond contract. The BIS (and, presumably, the court) could do nothing about it.

(2) Canton Court of Appeal

The Court of Appeal for Basel-Stadt began by affirming the trial court’s application of Swiss law. It noted tartly that “a uniform ‘Anglo-Saxon’ law, such as the defendant endeavors to invoke, does not exist.” 29 The appeals court then focused on the BIS’s duties, analogizing to “the bailee holding a pledge … the representative of creditors … and the testamentary executor.” 30 While it did not use the term “paying agent,” the court ruled that the BIS’s primary task was to move payments, and only “as far as possible” to see to the performance of the bond terms. The court also saw “no reason” to suppose that the BIS would, “particularly without special remuneration—... undertake a further duty to make a decision as to the validity of the Reich’s attitude … not manifestly unjustified…” (emphasis in the original). 31

Moreover, by describing the Young Loan bonds as “independent claims against the Reich,” issued in the form of “self-contained” bearer securities, the appeals court seemed to foreclose pooling and redistribution among them. This description, which seemed to contradict some of the bond provisions, created a limited opening for payment discrimination: “the debtor who owes more than one debt may determine how his payments are to be appropriated … if consistent with the basic contract.” Thus if Germany had valid reasons to pay the French but not the Swedes, 32 it could. But even if Germany were wrong, the BIS could not intervene at payment, since avoiding potential pari passu breach with respect to the Swedes would have certainly breached the gold clause with respect to the French (paying less than the nominal value of their coupon). 33 The court thus validated the BIS’s decision to follow instructions, rather than make an independent choice between the two violations.

Of the three opinions in the Swedish bondholders’ case, the Court of Appeals offered the most elaborate reading of the pari passu clause in the Young Loan bonds. In the passage excerpted at the opening of this essay, the court easily concluded that “rank pari passu” meant that Germany had to pay all the Young Loan creditors ratably, and even entertained the possibility of “a reciprocal claim between the bondholders,” which (we are told by the lower court) had not been

28 Id.
29 Id. at 7.
30 Id. at 8.
31 Id. at 8.
32 For example, if it were excused by supervening legislation abrogating gold indexation.
33 Appeals Court Judgment, supra note 2, at 7-8.
brought. Had the Swedes sued Germany, or the French and Dutch bondholders, and won, then the BIS could ignore Germany’s distribution instructions. The BIS could intervene on its own only if Germany sought to discriminate on “manifestly untenable grounds” (emphasis in the original), for example, cutting off creditors from countries “hostile to Germany.”

Like the trial court, the canton court of appeal held that the Young Loan trustee fulfilled its duties by making feckless protests while doing as it was told by Germany.

(3) Swiss Federal Court

On their second and final appeal, the Swedish bondholders argued before the Swiss Federal court that the lower courts had (i) misconstrued the concept of trust under the Young Loan agreements, (ii) wrongly held that the bonds represented independent claims against Germany, (iii) misapplied the “manifestly unfounded” standard, discussed above, to Germany’s gold clause repudiation, (iv) wrongly concluded that the BIS could and did interpret the bond contracts in good faith, and (v) wrongly assumed that the BIS was not compensated for considering the validity of Germany’s gold clause claims. For its part, the BIS (well-served by Swiss law so far) had “rightly abandoned” its claim to “Anglo-Saxon” governing law.

The federal court’s holding was anticlimactic. Like the two canton courts, it held that the bondholders stood in direct contractual relationship to the German Reich, and that the BIS was a “mere intermediary between creditor and debtor,” obliged to carry out Germany’s instructions unless they were “manifestly untenable”—and upheld the appellate court judgment.

Although the court refused to apply the pari passu clause in the Young Loan bonds, it did spin out counterfactual scenarios where the clause would come into play. For example, had Germany owed a single global debt to the BIS, with creditors holding claims against the BIS, “the so-called pari passu clause, on which the plaintiff relies, could only represent an obligation of the defendant [BIS],” and discrimination “would be out of the question.” On the facts of this case “the pari passu clause, like the gold clause, represent[ed] a contractual obligation of the Reich...,” and did not bind the BIS directly. Even if Germany breached pari passu with its payment instructions, the BIS could not stop it except in the most extreme circumstances. The federal court then set a high bar for “unjustifiable infringement” or “manifestly untenable” breach of the pari passu clause by the debtor that would excuse the BIS from following its instructions:

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34 Id. at 8.
35 At least in the League of Nations translation, the terms “manifestly unjustified,” “manifestly untenable,” and “manifestly unfounded” are used interchangeably.
36 Id. at 11.
37 Judgment given on May 26th, 1936, by the Swiss Federal Court (hereinafter, “Federal Court Judgment”) in Note by the Secretariat, Committee for the Study of International Loan Contracts, Geneva, February 11th, 1937. League of Nations Archives Registry Files, Box R 4609, Registry No. 10C:23448.
38 Id. at 13.
39 Id. at 12.
The reasons given by the German Reich for its course of action—which, it must be conceded, indisputably infringed both the gold clause and the pari passu clause—show that this measure was intended as a reprisal devised from the point of view of international law against those States which for their part had gone off the gold standard and which, disregarding obligations provided with gold clauses, had prejudiced the interests of nationals of the German Reich. It was not for the defendant to decide whether such a right of reprisal appertained to the German Reich or whether the non-observance of the provisions of the contract was impermissible even from the point of view of international law. In the absence of a clear and unmistakable provision to that effect in the loan contract, it cannot be assumed that there was any intention to grant the defendant so extensive authority, far exceeding the functions of a paying agent and a representative of the bondholders. It had to suffice for the defendant that the standpoint of the Reich was not manifestly untenable.\footnote{Id. at 13.}

In other words, it sure looked like Germany had breached the \textit{pari passu} clause to get back at the countries that went off the gold standard and harmed its trade; however, the trustee could do nothing about it because Germany’s breach might be excused under international law.

\textbf{C. The Fallout}

The Swiss court decisions were surely caught up in the complex political economy forces of the day. The judges might have felt political pressure not to destabilize the German economy, or antagonize the Nazi leaders. The likely worried about the risk of damaging a new international organization, located at a distance from major financial centers in a complex tradeoff between neutrality and expertise. The case was also a high-profile test of their capacity to deal with international financial contracts embedding Anglo-American institutional features, and to adjudicate politically fraught disputes.

The cognoscenti were unimpressed. When the League of Nations committee, established in September 1935 to review sovereign debt contract practices after a spate of messy defaults, inquired about the “leading difficulties” in the field, the Swiss decisions in the Swedish bondholder case were the very first example cited in response—several pages ahead of “inability to enforce securities” (states reneging on revenue pledges). According to the English barrister who wrote the 1937 memorandum, it was “hardly necessary to point out that the … decision is completely at variance with the whole conception of trusteeship as understood in England.”\footnote{Fachiri Memorandum, \textit{supra} note 9 at 6.} A leading German expert on common and civil law trusts was even more critical, on similar grounds.\footnote{Weiser Memorandum [insert]; also \textsc{Weiser}, \textsc{Trusts on the Continent of Europe} (1936).} The League committee experts generally agreed that the Swiss courts embarrassed themselves by conflating trustees with paying agents; they seemed to think that the proper route for the BIS on receiving an incomplete payment was to seek advice from the courts.
The League committee ultimately recommended that the institution of bond trustee be specified more clearly in the contracts, along with governing law. The final report also suggested that the office be renamed to avoid misleading the bondholders that they were more secure by virtue of the trust than they were in fact, given trustees’ limited capacity to protect them before national courts.\footnote{\textit{League of Nations Report of the Committee for the Study of International Loan Contracts}, Geneva 1939, at 15-20.}

The leading treatise on sovereign debt, published in 1951, devoted most of the chapter on trustees to criticizing the Swiss decisions—fifteen years on, still the only definitive judicial treatment of international bond trustees on the European continent.\footnote{EDWIN BORCHARD, \textit{STATE INSOLVENCY AND FOREIGN BONDHOLDERS} 52 (1951). With just a whiff of faux sadness, Borchard observed that “[t]here successive Swiss courts labored with the proper solution of the question, only to give evidence of the profound confusion created by the attempt to transplant the institution of the loan trust in the unfavorable soil of Continental law.” \textit{Id.}} The author, an eminent Yale law professor, noted in passing that Germany’s payment scheme “was violative of the \textit{pari passu} as well as of the gold value clauses of the loan contract,”\footnote{\textit{Id. at 62 n.58} (citing Jules Basdevant, who served on the League committee and was, at the time of Borchard’s publication, President of the International Court of Justice).} but spent the bulk of his energy criticizing the Swiss judges’ confusion of trustees and paying agents.

The most striking thing about the criticism, apparently pervasive and persistent in the elite international legal circles, was that no one seriously suggested that the BIS should have redistributed the money it got from Germany \textit{pro rata} among the Young Loan tranches. Borchard himself, in a footnote at the end of the chapter on trustees, cited the foremost French jurist on the League committee for the proposition that,

\begin{quote}
The practical result of the \textit{[Swiss]} decision must be approved since the question whether payment was due on a gold basis “really concerns the debtor and the bondholders” and should not be left to a decision by the trustee.\footnote{\textit{Id.}}
\end{quote}

Perhaps the biggest practical difference between the Swiss courts and their critics, then, was timing: had the BIS sought the advice of the courts before paying, rather than after, the same outcome might have been blessed, and the institution of the bond trustee would have been vindicated on the European continent. Then again, there are reasons to suppose that something like this had also occurred to the Swiss judges. The trial court of the Basel canton observed that, among other reasons, “the impossibility of having recourse, in cases of doubt, to a so-called court of equity, which might give the defendant guidance, militates against the application of English law.”\footnote{Civil Court Judgment, \textit{supra} note 24 at 2.}

A final postscript to the Young Loan \textit{pari passu} saga is in order. German debts were renegotiated after World War II, with the new terms set by the London Agreement of 1953 that also effected unprecedented debt relief. Germany’s residual obligations to the Young Loan bondholders, to be
repaid over decades, were no longer indexed to gold, but rather provided for a fixed relationship among the currencies of denomination. In the event that any of the currencies declined by more than five percent relative to another, the bondholders of the affected tranche would be compensated by reference to the value of the stronger currencies. In 1971, after Germany twice revalued its currency in the 1960s, Belgium, France, Switzerland, the United Kingdom and the United States brought a case against Germany before the Arbitral Tribunal constituted under the London Agreement. They argued that a rise in the value of the German mark was equivalent to a loss in the value of their currencies relative to the mark, and should give rise to the value maintenance procedure for their bondholders.\textsuperscript{48} The crux of the argument for the complaining countries was that equal treatment among all creditors was central to the Young Loan and its successor, the London Agreement. Refusing to give all bondholders the benefit of German currency revaluation went to the heart of the agreement—as evidenced, among other terms, by the Young Loan \textit{pari passu} clause.\textsuperscript{49} In response, Germany said that equal treatment was not as important as the creditors had claimed, and “rejected the idea that the Young Loan’s \textit{pari passu} clause was a means of creating fixed equality in payments on the bonds, since the clause was limited to giving each tranche equal rank or priority only in the event that Germany could not meet its full debt service for any reason.”\textsuperscript{50} Although it uses the word “rank” along with “equality in payments,” Germany appears to track verbatim the interpretation of \textit{pari passu} advanced by the Swiss courts. It concedes, or comes rather close to conceding, that a debtor with insufficient funds to pay all its creditors would have to pay them equally under the \textit{pari passu} clause.

In sum, combining Sung Hui Kim’s findings about the creditors’ reading of \textit{pari passu} in the diplomatic dispatches of the 1930s, with the opinions of the Swiss courts in the Swedish bondholder case and commentary thereon, and with the German position in the 1971 arbitration, would seem to suggest that everyone—the debtor, the creditors, and the courts—interpreted the phrase “rank \textit{pari passu} in all respects” as a promise of ratable payment in some if not all circumstances. Moreover, at least some of the judges interpreting the clause acknowledged the possibility of inter-creditor remedies. Judges and commentators also suggested, albeit hypothetically, that on some particularly egregious facts not present in the Young Loan case, the trustee might be authorized or even obliged to intervene to block or redistribute the payments ratably among all the loan tranches.

III. Implications in 2014

\textsuperscript{49} \textit{Id.} at 542.
\textsuperscript{50} \textit{Id.} (citing Germany’s Rejoinder in the Young Loan Arbitration at paras. 144-151 (internal citations omitted)).
At first glance, the Young Loan lawsuit and the fallout from it appear to undermine the prevailing view of the *pari passu* clause in the academic and policy circles, if not the U.S. federal courts.\(^{51}\) According to the Encyclopedia of Banking Law,

>[T]he *pari passu* clause has nothing to do with the time of payment of unsecured indebtedness, since this depends upon contractual maturities. … It is suggested that a *pari passu* clause in state credit is primarily intended to prevent the legislative ear-marking of revenues of the government, or the legislative allocation of inadequate foreign currency reserves to a single creditor and is generally directed against legal measures which have the effect of preferring one set of creditors over the others or discriminating between creditors at a time when the state is unable to pay its debts as they fall due.\(^{52}\)

With only a handful of exceptions, all the authoritative academic and professional treatments of the *pari passu* clause published since the 1990s adhere to the view that it promises equal ranking, as opposed to ratable payment.\(^{53}\) The governments of Argentina, Brazil, France, Mexico, and the United States hold fast to the same interpretation in their filings before the U.S. Federal Courts.\(^{54}\)

Yet neither those involved in the *pari passu* disputes arising out of the Young Loan bonds, nor the commentators for decades after the initial default, appear to have mentioned earmarking in connection with *pari passu*, let alone as the principal rationale for it. This is all the more curious since earmarking was an important concern in the 1930s, discussed at length in the work of the League of Nations committee on sovereign debt contracts (mostly as an unenforceable commitment of the debtor not worth pursuing), without mention of *pari passu*.\(^{55}\) Instead, every time the *pari passu* clause comes up in conjunction with the Young Loan, it seems to signify a promise of ratable payment, albeit one that has gone unenforced.

An advocate seeking to distinguish *NML v. Argentina* in 2014 from its distant ancestor in 1935 would have plenty to work with. First, the Young Loan was secured, while Argentina’s bonds were not—although the security feature was not discussed in the Young Loan opinions. Second, the principal obligation, and the only dispute over *pari passu* in the Young Loan involved creditors holding tranches of the same loan, payable at the same time—fraternal twins clearly

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\(^{51}\) [cite] note __ supra.
\(^{52}\) Encyclopedia of Banking Law (2002) at __.
\(^{55}\) Supra note __ and accompanying text.
intended to be on the same footing in all respects. Argentina’s holdout and restructured bonds are at best, distant cousins. One might even argue that they are diametrically opposed for equal treatment purposes, since the restructured claims represent deep debt reduction. The main pari passu promise in the Young Loan is what the Bank of England Financial Market Law Committee (FMLC) called “the internal limb” of the clause, whereby the bonds have equal ranking among themselves.\textsuperscript{56} The FMLC suggests that the internal limb might (though need not necessarily) imply greater obligations, including ratable payment.\textsuperscript{57} Then again, the Young Loan also provides for the issuance of more debt “ranking pari passu as to payment with the Bonds of the present Loan”\textsuperscript{58}—an “external limb” promise, in FMLC terms. Unlike the litigated “internal limb” promise, this one conspicuously mentions payment, perhaps suggesting that the drafters thought payment would not have been covered otherwise. Third, it goes without saying that a widely criticized Swiss court ruling from 1935, which was not even based on the pari passu clause, is not binding on a federal court interpreting pari passu in New York in 2014. Besides, the Swedish bondholders lost—three times.

And yet, those who have insisted on a simpler and more expansive reading of pari passu as “equal footing,” including ratable payment,\textsuperscript{59} could find solace in the direct and consistent conclusion of all involved in the Young Loan disputes that, at least in some circumstances, a clause that said “rank pari passu” meant “pay ratably” (without reference to legislative earmarking or collateral apportionment), and could serve as a basis for a remedy affecting third parties. Having been told for the past two decades that pari passu could not possibly have their meaning, ratable payment fans might feel vindicated by the Young Loan saga, and see it as a reasonably big deal.

\section*{IV. Conclusions}

Contract paleontology is addictive fun. It is easy to get carried away in the archives, especially when one is looking for two magic words in Latin. When they pop up on the yellowed pages and purple mimeos, the paleontologist’s heart skips a beat—maybe this time, the true meaning of pari passu will be revealed. The story of the Swiss litigation over the Young Loan starts a new quest. But to what end?

Based on the preliminary research excerpted in this essay, the answer is unclear. Since the first successful use of pari passu as an enforcement device by Elliott Associates against Peru in 2000,

\begin{itemize}
\item \textsuperscript{57} Id. at 21. In the same vein, Borchard, supra note 44 at 337-60, cites scores of cases where the debtor discriminated in payment among creditors. The principal criterion, in his view, was whether the creditors were similarly situated. His chapter on Priorities and Preferences seeks to establish principled ways to distinguish among classes of sovereign creditors. Id.
\item \textsuperscript{58} German Government International 5 ½ Per Cent. Loan 1930, §XIV.
\item \textsuperscript{59} See e.g., Cohen, supra note 7.
\end{itemize}
the academic debate has quietly conflated the meaning and the function of the clause. The clause could not mean ratable payment because it simply could not work as ratable payment where a sovereign debtor was involved. Litigation over Argentina’s debt surely supports the latter point. Since the U.S. Supreme Court refused to take the case, more people have gone unpaid. The courts have no power to make a sovereign pay; they can only ratchet up the pressure on those third parties—restructured bond holders, trustees, paying agents, payment systems, clearing houses, and above all, the people of Argentina—who might have more sway over the “contumacious” debtor than the court itself. Yet the fact that interpreting the clause in line with its “true meaning” can lead to deeply dysfunctional results does not automatically alter the meaning. It counsels against destructive remedies.

The implications of the Swiss pari passu litigation for contract paleontology, and for contract interpretation more broadly, could be more interesting than its application to NML v. Argentina. As a viable field of study, paleontology needs a theory for giving voice to historical meanings of private contracts. The questions might be similar to those raised in the debates about distant authorship and boilerplate, but made more complex by the extreme temporal gap between the life of the contract fossil and its present use. What weight, if any, should we give to the original drafters’ intent? And how do we know, in the global, decentralized sphere of financial contracting, that any given drafter was the sole true progenitor of today’s clause? Should we search for the intent of all the original contracting parties, or just those that cared enough to archive their most persuasive thoughts? Should highly deliberate “off-label” adoption of an old clause change its meaning? How to assess the relevant context? Is it necessary to trace the entire evolution of the clause, or merely take two snapshots, then and now? What role for the Stone Age courts, Bronze Age politicians, Neanderthal law scholars?

Finally, should sovereign contract fossils be treated differently? Then and now, they are extraordinarily hard to enforce, politically fraught, and prone to extreme spillovers. Perhaps the Swiss courts sacrificed analytical purity for the sake of political accommodation in 1935. U.S. Federal courts professed to do the opposite in 2014. Might paleontology help fashion a more principled tradeoff? Or will it simply feed new origin myths that let today’s drafters and courts off the hook in solving today’s problems?

Answering these and other questions, which might ultimately make contract paleontology into a useful method for contract interpretation, will surely take more analysis—and more fossils. The jury is still out on pari passu. But the Quest is on.

61 [Cite to Second Circuit Transcript.]
63 Mark C. Weidemaier et al., Origin Myths, Contracts, and the Hunt for Pari Passu, 38 LAW & SOC. INQUIRY 72 (2013)