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Starving the Vultures: *NML Capital v. Republic of Argentina* and Solutions to the Problem of Distressed-Debt Funds

John Muse-Fisher*

[W]e use moral solutions. But the vulture funds have the rule of law on their side.¹

—Henry Paulson, Former U.S. Secretary of the Treasury

Sovereigns, like individuals and firms, assume debt. Unlike individuals and firms, however, sovereigns cannot die and cannot declare bankruptcy. As such, a country's ability to restructure its obligations in the face of severe financial turmoil is paramount to the smooth functioning of its domestic economy, as well as the overall global economy.

Most sovereign creditors willingly work with sovereigns to restructure debt in the face of default. However, distressed-debt funds, often referred to as "vulture funds," purchase sovereign debt at a discount on the secondary bond market and litigate against the sovereign country to compel a judgment or settlement for up to the

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1. *The State of the International Financial System: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 39–40 (2007) (statement of Henry Paulson, Secretary of the Treasury of the United States).

full value of the bonds. Such distressed-debt funds have pestered Argentina since its \$100 billion default in 2002. Although 93 percent of Argentina's bondholders restructured their debt, a small group of holdouts chose to litigate to recover the full value of their bonds. Argentina exhausted its appeals and the vulture funds have won a judgment in the United States entitling them to over a billion dollars. As of August 2014, Argentina has refused to pay the vulture funds and has entered a technical default.

This Comment tracks the litigation in NML Capital v. Republic of Argentina, and discusses potential institutional, statutory, and judicial solutions to the problem of vulture funds. Furthermore, the Comment attempts to demonstrate that the reasoning underpinning the Second Circuit's decision to uphold the district court's judgment, namely, that the judgment will not undermine future debt restructuring efforts, is based on the flawed premise that now-commonly utilized Collective Action Clauses (CACs) will prevent vulture funds from holding out in the future. Rather, after NML Capital, the recent proliferation of CACs in sovereign debt instruments could actually stymie future restructuring efforts, as bondholders' rational interests prompt them to sit out of restructuring attempts and possibly litigate to collect a greater amount.

The vulture fund problem highlights a tension between unyielding adherence to the rule of law and moral concerns for the economic well-being of developing, semi-developed, and developed countries alike. The situation reveals the muddled shades of gray between strictly upholding the rule of law, which thereby promotes the largely unproductive and malignant behavior of distressed-debt funds, and massaging the rules to help Argentina and its people escape potentially severe economic suffering, which could promote irresponsible sovereign behavior and undermine courts' vital commitment to upholding the rule of law.

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INTRODUCTION

Vultures are threatening Argentina’s sovereignty and solvency. A sovereign “vulture fund,” or distressed-debt fund, is an investment institution that purchases distressed sovereign debt at a significant discount on the secondary market, often with the intention of litigating to collect the full value of the debt instrument.² Sovereign vulture funds began honing their technique in the early 1990s.³ Vulture funds buy a sovereign’s debt cheaply from original purchasers and initiate lawsuits, typically in the United States or Europe where the bonds were issued, to collect on the full value of the debt.⁴ As the name suggests, vulture funds are often predatory, targeting the bonds of some of the world’s poorest countries.⁵ Successful vulture funds have average payouts,

2. See Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT’L L. 253, 254 (2003). The term “vulture fund” is used in both the corporate and sovereign distressed-debt context. The word “vulture” naturally carries a negative connotation. Reasonable minds, however, may differ with respect to the societal and economic value vulture funds provide. See *infra* Parts I.B–I.C. This Comment distinguishes between the largely productive behavior of so-called corporate vultures, or distressed-debt funds, and the largely unproductive behavior of so-called sovereign vultures. Thus, throughout this Comment, the terms “vulture” or “vulture fund” will refer to sovereign distressed-debt funds, while corporate distressed-debt funds will retain the less pejorative term, “distressed-debt funds.” Cf. Wheeler & Attaran, *supra*, at 254 n.3 (“In the context of sovereign debt, ‘vulture fund’ is a pejorative name for investors who purchase discounted debt on the secondary market. While the purchase and resale of such debt serves a legitimate purpose—increasing the liquidity of securities markets—the premise supporting use of the pejorative in this article is that litigation for face value of discounted sovereign debt is unjustified and, worse, disruptive of any restructuring process.”).

3. See Nick Dearden, *Greece: Here Come the Vulture Funds*, THEGUARDIAN.COM (May 17, 2012), <http://www.theguardian.com/commentisfree/2012/may/17/greece-vulture-funds>.

4. See KENNETH H. FUKUDA, WHAT IS A VULTURE FUND?, UNIV. OF IOWA COLL. OF LAW CTR. FOR INT’L FIN. & DEV. 2 (2008).

5. See “Vulture Funds,” JUBILEE USA NETWORK, <http://www.jubileeusa.org/ourwork/vulturefunds.html> (last visited Sept. 8, 2014) (“Vulture funds have been known to target cheap debt of poor or financially-distressed countries. Poor countries that are eligible for debt cancellation are especially vulnerable. Vulture funds have been known to track the debt relief process, buy debt of

after legal expenses, of between three and twenty times the amount originally paid to purchase the debt.⁶ In contrast, when a sovereign faces default, most creditors voluntarily participate in restructuring deals, meaning the “vulture funds are preying on both other creditors and on the indebted countries themselves.”⁷ The activity of vulture funds is therefore a legitimate concern for both sovereigns and sovereign creditors alike.

In October 2012, one such vulture fund, NML Capital, convinced a Ghanaian court to enforce U.S. and British legal judgments against Argentina for bonds defaulted on in 2001.⁸ The enforcement order required Ghana to hold the *Libertad*, an Argentine warship, as collateral against more than \$1 billion owed to the hedge fund.⁹ A hundred years ago, creditor nations would deploy gunboats to compel payment from delinquent sovereign debtors.¹⁰ Today, in a historical twist, private creditors have attempted to turn a sovereign’s own gunboat against it to enforce its debts.¹¹

The story of the detained Argentine warship, however, is merely a subplot to the drama unfolding in U.S. courts and around the world. In late October 2012, the United States Court of Appeals for the Second Circuit upheld a district court order forcing Argentina to pay vulture bondholders, including NML Capital, the full value of their defaulted bonds at the same time as it pays

nations about to get debt relief and then sue the country after it has received a windfall of resources thanks to debt cancellation.”)

6. See *Vulture Funds in the Sovereign Debt Context*, AFR. DEV. BANK GRP., <http://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/> (last visited Sept. 8, 2014).

7. *Id.* (“Holdout behaviour by vulture funds makes restructuring slower, more difficult, and uncertain. Debtors are harmed by the substantial uncertainty faced and also by being forced to repay individual creditors far more than the agreements negotiated with other creditors.”)

8. See David Black, *Argentinian Naval Vessel Seized Over Sovereign Defaults*, THE NAT’L (Oct. 12, 2012), <http://www.thenational.ae/business/industry-insights/shipping/argentinian-naval-vessel-seized-over-sovereign-defaults>; Stephen Kwabena Effah, *Ghana Court Rejects Request to Release Argentina Warship*, MODERN GHANA (Oct. 11, 2012), <http://www.modernghana.com/news/423276/1/ghana-court-rejects-request-to-release-argentina-w.html>.

9. See Black, *supra* note 8. The *Libertad* is a defunct frigate, used for naval training purposes, that was on a goodwill mission through West Africa when it was detained. *Argentina Takes Ship Dispute with Ghana to UN Court*, BBC NEWS (Nov. 14, 2012), <http://www.bbc.co.uk/news/world-latin-america-20332793>; *Argentine Ship Held in Ghana Causing Political Fallout in Argentina*, FOX NEWS LATINO (Oct. 19, 2012), <http://latino.foxnews.com/latino/news/2012/10/19/argentine-ship-held-in-ghana-causing-political-fallout-in-argentina/>.

10. See, e.g., Laura Alfaro, Noel Maurer & Faisal Ahmed, *Gunboats and Vultures: Market Reaction to the “Enforcement” of Sovereign Debt* (Harvard Business School, Working Paper, 2008), available at <http://www.econ.ucla.edu/workshops/papers/History/Maurer,%20Gunboats%20and%20Vultures,%20version%205.2.pdf>.

11. In December 2012, the International Tribunal for the Law of the Sea ordered Ghana to release the *Libertad*. See Liz Ford, *Maritime Tribunal Orders Ghana to Set Argentina’s Libertad Frigate Free*, THE GUARDIAN (Dec. 17, 2012), <http://www.guardian.co.uk/global-development/2012/dec/17/maritime-tribunal-ghana-argentina-libertad>. Argentina is currently suing Ghana in the same tribunal for damages sustained during the three-month detention of the *Libertad*. See *Argentina Sues Ghana for Damages . . . Over Detention of Warship*, GHANA CHRONICLE (Feb. 14, 2013), <http://thechronicle.com.gh/argentina-sues-ghana-for-damages-over-detention-of-warship/>.

the roughly 93 percent of bondholders who accepted earlier restructuring offers (“exchange bondholders”).¹² The Second Circuit’s decision was based on a novel interpretation of the *pari passu* clause, a standard clause in debt contracts that purports to place creditors on an “equal footing” with each other.¹³ Argentina’s opportunities to appeal the decision were exhausted when the Supreme Court denied certiorari in June 2014.¹⁴

Even before Argentina exhausted its appeals, the judgment impacted Argentina’s political and economic well-being. In response to the warship debacle, several Argentine defense officials either resigned or were suspended.¹⁵ More troubling, two major credit rating agencies, Fitch and Standard & Poor’s, downgraded Argentina’s sovereign debt rating following the Second Circuit’s October 2012 decision.¹⁶ Shortly after a February 2013 hearing, Moody’s downgraded Argentina’s foreign law bonds based on increased fears of default resulting from the ongoing litigation.¹⁷ Argentina’s

12. See generally *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246 (2d Cir. 2012); see also Rupert Neate, *Argentina Appeals Against US Hedge Fund Ruling*, THE GUARDIAN (Nov. 27, 2012), <http://www.theguardian.com/business/2012/nov/27/argentina-appeals-hedge-fund-ruling> (“About 93% of bondholders agreed to a restructuring.”).

13. Black’s Law dictionary defines “*pari passu*” as “[p]roportionally; at an equal pace; without preference <creditors of a bankrupt estate will receive distributions *pari passu*>.” BLACK’S LAW DICTIONARY 1290 (10th ed. 2014). The clause is conventionally understood to “prevent[] the borrower from incurring obligations to other creditors that rank legally senior to the debt instrument containing the clause.” Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869, 872 (2004). Nonetheless, the meaning of the clause in sovereign debt instruments is contested. See *infra* note 251 and accompanying text.

14. See Lyle Denniston, *No Relief for Argentina on Debt*, SCOTUSBLOG (June 16, 2014, 12:57 PM), <http://www.scotusblog.com/2014/06/no-relief-for-argentina-on-debt/> (“[W]ithout comment, the Court cleared the way for [investors who bought bonds that went into default] to demand payment on the bonds they hold whenever Argentina makes any payments to holders of later bond issues which that country has continued to honor.”).

This case attracted some powerhouse litigators. NML Capital’s attorney was Theodore Olson, former Solicitor General for George W. Bush and counsel for then candidate Bush in *Bush v. Gore*. A group of exchange bondholders who sided with Argentina hired David Boies, a famed litigator and counsel for Al Gore in *Bush v. Gore*. Though the two attorneys again found themselves in opposition, they have also worked together in the past, most notably in their effort to overturn California’s same-sex marriage ban. See *Argentina Bond Case Attracts Legal Heavies*, WALL ST. J. L. BLOG (Nov. 13, 2012, 6:39 PM), <http://blogs.wsj.com/law/2012/11/13/argentina-bond-case-attracts-legal-heavies/>. Argentina hired Paul Clement, former Solicitor General and no stranger to marquee Supreme Court arguments, as its attorney of record for its final petition for certiorari. Shane Romig, *Argentina Files U.S. Supreme Court Bond Holdout Appeal—Update*, WALL ST. J. (Feb. 18, 2014), <http://online.wsj.com/article/BT-CO-20140218-712765.html>.

15. See Emily Schmall, *Seizure of Ship from Argentina Forces Shake-Up*, N.Y. TIMES (Oct. 18, 2012), <http://www.nytimes.com/2012/10/19/world/americas/seizure-of-argentine-ship-forces-shake-up.html>.

16. See Katia Porzecanski & Camia Russo, *U.S. Court of Appeals Grants Argentina a Stay Causing Surge in Debt*, LATIN AM. HERALD TRIB. (Nov. 29, 2012), <http://www.laht.com/article.asp?ArticleId=653612&CategoryId=14093>; Jude Webber, *New York Court Backs Argentina Into a Corner*, FIN. TIMES (Oct. 31, 2012), <http://www.ft.com/intl/cms/s/0/8600c380-3977-11e2-85d3-00144feabdc0.html>.

17. See *Moody’s Downgrades Argentina’s Foreign Law Bonds to Caa1, Affirms B3 Issuer Rating, Outlook Negative*, CREDIT WRITEDOWNS (March 16, 2013, 8:26 AM), <http://www.creditwrite>

battle with the vulture funds occurs in the shadow of festering political and economic turmoil, including soaring inflation (28 percent in 2013), an unusual censure from the International Monetary Fund (IMF) for misreporting economic statistics, a long-term inability to access international financial markets,¹⁸ and even rioting in the streets.¹⁹ After the Supreme Court denied certiorari in June 2014, and Argentina's appeals were exhausted, Argentina missed a bond payment at the end of July 2014.²⁰ Some have called this event a default, while others more cautiously call it a "selective default."²¹ Regardless, the full impact of these events is yet to be determined, but the United Nations has already indicated it believes Argentina's economy will contract in 2014 behind the "default."²²

Argentina is not the only country pestered by vultures. An IMF study found that 109 cases were filed against sovereign debtors between 1980 and 2010 as the result of sovereign defaults.²³ It is noteworthy that "[m]ore than half of all cases were initiated after the year 2000, despite the fact that the number of sovereign defaults and restructurings ha[d] gone down in the last decade."²⁴ That increase is attributed, in part, to the emergence of vultures;²⁵ in the 2000s, nearly 90 percent of new lawsuits involved vulture funds.²⁶

Many of the countries subject to holdout litigation have been among the

downs.com/2013/03/full-text-moodys-downgrades-argentinas-foreign-law-bonds-to-aa1-affirms-b3-issuer-rating-outlook-negative.html.

18. As of March 2014, reports suggest that Argentina may soon have renewed access to international credit markets after being shut out since 2002. See *Update 2 – Credit Markets Open to Argentina for First Time in Years – Ministry*, REUTERS (Mar. 30, 2014), <http://www.reuters.com/article/2014/03/30/argentina-debt-goldman-idUSL1N0MR0GC20140330>.

19. See Charlie Devereux & Camila Russo, *Argentine Default Chaos Relived as Blackouts Follow Looting*, BLOOMBERG (Jan. 23, 2014), <http://www.bloomberg.com/news/2014-01-23/argentine-default-era-chaos-relived-as-blackouts-follow-looting.html>.

20. See Antonio de la Jara & Anthony Esposito, *Argentina Economy Will Likely Contract this Year: U.N.*, REUTERS (Aug. 4, 2014), <http://www.reuters.com/article/2014/08/04/us-argentina-debt-un-idUSKBN0G41ZX20140804>.

21. See *id.* ("Standard & Poor's . . . declared Argentina in selective default on Wednesday after it failed to reach an agreement with the holdouts."); David Scigliuzzo, *ISDA Sets Argentina CDS Auction for August 21*, REUTERS (Aug. 13, 2014), <http://www.reuters.com/article/2014/08/13/argentina-debt-cds-idUSL2N0QJIUM20140813> (noting that the determination committee of the International Swaps and Derivatives Association (ISDA) "put Argentina effectively in default earlier this month, by ruling unanimously that a 'failure to pay' event occurred when the sovereign missed a coupon payment on some restructured foreign-law bonds").

22. See de la Jara & Esposito, *supra* note 20.

23. Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts* 51 (IMF, Working Paper No. WP/12/203, 2012), available at <http://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf>. In the 1980s and 1990s, banks initiated the majority of these lawsuits. See Julian Schumacher, Christoph Trebesch & Henrik Enderlein, *Sovereign Defaults in Court: The Rise of Creditor Litigation 1976–2010*, at 3 (Mar. 14, 2013) (unpublished manuscript draft) (on file with CLR).

24. Das et al., *supra* note 23, at 51. It is important to note, however, that much of that rise in litigation is the result of cases filed against Argentina.

25. *Id.* at 50.

26. See Schumacher et al., *supra* note 23, at 3.

least developed, including the Democratic Republic of Congo (DRC),²⁷ Congo-Brazzaville,²⁸ Liberia,²⁹ Peru,³⁰ and Zambia.³¹ The Heavily Indebted Poor Countries (HIPCs), a group of developing countries identified by the IMF and World Bank as eligible for certain forms of debt relief, are particularly susceptible to vulture lawsuits.³² Researchers have noted that “[o]f the 20 [sovereign debt] cases filed against HIPCs, 13 were filed by ‘vultures.’”³³ Estimates suggest that claims against HIPCs surpass \$2 billion, and the individual country claims “often account for a considerable share of GDP and the government’s annual budget.”³⁴ The DRC, for instance, reportedly faces claims amounting to roughly 15 percent of its GDP; vultures brought these claims.³⁵

There are various potential ways to starve the vultures. This Comment discusses potential statutory, institutional, and judicial solutions to the vulture fund problem and considers how these solutions might have affected or may yet affect the outcome in the Argentina litigation. The Comment argues that the U.S. Congress and other national legislative bodies should act to limit the ability of vulture funds to bring suit against emerging economies in their respective jurisdictions through the creation of an internationally recognized

27. See Cth, Parliamentary Debates, House of Representatives, 25 June 2012, 7790 (Melissa Parke, Member for Fremantle) (Austl.), available at <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;db=CHAMBER;id=chamber/hansardr/7503935a-ef9f-47a5-9ab8-7a228d52f809/0283;query=Id:%22chamber/hansardr/7503935a-ef9f-47a5-9ab8-7a228d52f809/0283%22> (“In November 2010 the New South Wales Supreme Court ruled that the Democratic Republic of the Congo must pay \$30 million, plus legal costs and a \$2 million court imposed fine, to a New York based vulture fund named FG Hemisphere Associates or FG Capital Management. . . . [T]he sum forms part of a debt incurred in the 1980s by the authoritarian government of what was then Zaire. The original \$37 million loan, which has now ballooned to over \$100 million, was for power transmission lines and a hydropower dam near the home of long-time dictator Mobutu.”).

28. See Meirion Jones, *‘Vulture Funds’ Threat to Developing World*, BBC NEWSNIGHT (Feb. 14, 2007), <http://news.bbc.co.uk/2/hi/programmes/newsnight/6362783.stm> (noting that the vulture fund is seeking \$400 million for a debt purchased for \$10 million).

29. See Meirion Jones, *UK Stops ‘Vulture Funds’ Picking on Poor*, BBC NEWSNIGHT (Apr. 8, 2010), <http://news.bbc.co.uk/2/hi/programmes/newsnight/8610062.stm>. In 2009, a U.K. court ruled in favor of a vulture fund against Liberia to the tune of £12 million. Before the judgment could be enforced, however, the U.K. Parliament passed the Debt Relief (Developing Countries) Act of 2010, which was designed to undermine such judgments. See *id.*; see also *infra* Part IV.A.

30. See Jones, *supra* note 28 (noting that in 1996 a vulture fund purchased \$11 million of Peruvian debt and ultimately forced a settlement for \$58 million).

31. Donegal Int’l Ltd. v. Republic of Zam., [2007] EWHC 197 (Comm.) (judgment rendered in the United Kingdom), available at http://news.bbc.co.uk/nol/shared/bsp/hi/pdfs/16_02_07_zambiajudge.pdf; see also Jones, *supra* note 28 (noting that the judgment, worth \$15 million, was based on a 1970s debt purchased by an American vulture fund for \$3 million). The vulture fund in this case, Donegal International Limited, was operated by an American named Michael Sheehan, who allegedly went by the nickname “Goldfinger”—thus granting Mr. Sheehan the proud distinction of being the only person to aspire to be both a *Bond* villain and a bond villain. See Jones, *supra* note 29.

32. See Schumacher et al., *supra* note 23, at 3.

33. *Id.*

34. Das et al., *supra* note 23, at 50–51.

35. See *id.*

sovereign debt restructuring mechanism (SDRM). The Comment further argues that the Second Circuit's October 2012 and August 2013 decisions, as they stand, will dis-incentivize rational investors from participating in future restructuring negotiations, despite the now common presence of Collective Action Clauses (CACs).³⁶ Finally, the Comment argues that the Supreme Court should have granted certiorari and certified to the New York Court of Appeals the question over the interpretation of the *pari passu* clause, to give that court an opportunity to reinterpret the clause so that "equal footing" merely compelled Argentina to provide the same terms to the holdouts as it gave to exchange bondholders. This outcome would comport with the nature of the *pari passu* clause, provide holdouts at least *some* relief to which they are entitled, and re-incentivize rational investors to participate in restructuring negotiations.

In Part I, the Comment proceeds by describing the connection between sovereign debt and global economic development, and how vulture funds undermine sovereign debt markets and thus, economic development. Part I includes a discussion of the importance of secondary markets for sovereign debt, but distinguishes the productive activity of secondary markets from the predatory behavior of vulture funds. Part II describes in greater detail the litigation in *NML Capital v. Republic of Argentina*. Parts III and IV consider proposed statutory and institutional solutions to the vulture fund problem and their hypothetical applications to Argentina's current litigation. Part III includes a discussion of several countries' legislative solutions to the vulture fund problem. Part IV includes a discussion of the proliferation of CACs in sovereign debt instruments, their potential to undermine vulture litigation, and their shortcomings. Part V then argues that a narrower interpretation of the traditional *pari passu* clause was a possible judicial framework to resolve the case in Argentina's favor and thereby protect Argentina's economic interests and those of other potential vulture victims.

Importantly, the Argentine experience with vulture funds underscores a recurring tension between economic expectations, moral concerns, and the rule of law. The case illustrates how strict adherence to the rule of law, a hallmark of modern development theory,³⁷ can actually undermine moral and economic concerns. The Comment will demonstrate how, as state and federal statutory and case law currently exist in the United States with respect to sovereign debt, courts must either enforce the rule of law to the detriment of developing economies, or neglect the rule of law in favor of the well-being of often

36. A CAC, or majority action clause, permits bondholders to amend the terms of a bond and bind dissenting bondholders if enough bondholders agree to the changes. *See NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 253 (2d Cir. 2012).

37. In general, development theory includes the various theories purporting to describe the mechanisms for desirable change. To some development practitioners and theorists, the rule of law is "increasingly viewed as a necessary requirement, or even a silver bullet, for economic development." Tor Krever, *The Legal Turn in Late Development Theory: The Rule of Law and the World Bank's Development Model*, 52 HARV. INT'L L.J. 288, 288 (2011).

culpable foreign powers—a morally unsavory choice. This Comment offers a more palatable option that would uphold the rule of law without sacrificing the long-term economic health of struggling nations.

I.

SOVEREIGN DEBT AND GLOBAL ECONOMIC DEVELOPMENT

Sovereign nations have defaulted on debt since ancient times.³⁸ This Part describes some of the reasons that sovereigns issue debt and explains the peculiarities that arise when sovereigns default. The absence of an organized sovereign bankruptcy process means that sovereign creditors must participate in voluntary restructuring negotiations for the debtor nation to come out of default and regain access to credit. This peculiarity of sovereign debt enables vultures to potentially prey on sovereign countries.

Creditors, however, play a vitally important role in the global economy. This Part also describes the general role of creditors in various financial markets. Specifically, this Part defends the behavior of creditors in secondary markets—that is, those who buy debt from an original creditor when the original creditor needs cash—but distinguishes between the generally productive activities of most secondary market actors from the predatory behavior of sovereign vulture funds.

A. The Importance and Peculiarities of Sovereign Debt

A sovereign's access to credit is important for the economic development of developing, semi-developed, and developed countries alike. Sovereign debt is essential to bridge the gap between tax revenue and government spending on goods and services vital to a national economy. The ability to borrow on international credit markets allows sovereigns to pursue investment projects that they would otherwise be unable to afford.³⁹ Consequently, the inability to access credit can undermine economic growth through underinvestment.⁴⁰

38. See, e.g., Barry Neild, *2,388 Years of Unpaid Government Debt*, GLOBAL POST (Sept. 15, 2011), <http://www.globalpost.com/dispatch/news/regions/europe/110914/2388-years-unpaid-government-debt> (noting that the first recorded sovereign default occurred in ancient Greece in 377 B.C.).

39. See R. Gaston Gelos, Ratna Sahay & Guido Sandleris, *Sovereign Borrowing by Developing Countries: What Determines Market Access?* 4 (IMF, Working Paper No. WP/04/221, 2004), available at <http://www.imf.org/external/pubs/ft/wp/2004/wp04221.pdf>.

40. For example, a poor country that is unable to raise enough money through taxes will often issue debt to finance education, defense, and welfare programs. Such spending, if done properly, has the potential to improve a country's economic conditions. For instance, spending on education can build a more productive workforce, which can thereby improve overall economic conditions over time. The inability to access credit on the international market will undermine that country's ability to afford such programs, and potentially stymie economic growth and social welfare. It should be noted that poor countries are not the only ones reliant on sovereign debt. In fact, three of the five wealthiest countries in terms of GDP (United States, Japan, and France) are among the top ten biggest sovereign debtors. See Emily Knapp, *The 10 Most Indebted Governments in the World*, WALL ST. CHEAT SHEET (Aug. 9, 2011), <http://wallstcheatsheet.com/stocks/the-10-most-indebted-governments-in-the>

Sovereign debt, however, is unlike most forms of private debt in that it cannot be easily discharged. Unlike an individual or a corporation, a country cannot escape its debt obligations through death or bankruptcy. The doctrine of *pacta sunt servanda* holds that “foreign debt contracts are binding and continue in force until redeemed.”⁴¹ As such, even when a country’s political composition changes, debts incurred by previous regimes remain enforceable against the new one.⁴² Nonetheless, sovereign default and sovereign debt restructuring occur regularly.⁴³ Between 1950 and 2010, there were over 600 debt restructurings in 95 countries, including 186 restructurings with private creditors.⁴⁴ Yet there is no bankruptcy mechanism for sovereign debtors.⁴⁵ As a result, voluntary restructuring arrangements between debtor states and public and private creditors are essential for the smooth functioning of the sovereign debt market, and thus to the economic health of sovereigns and to global economic development generally.⁴⁶

Voluntary restructuring arrangements are particularly important for the economic development of developing countries, for which debt can be especially burdensome.⁴⁷ Too much debt reduces incentives to save and invest because any savings will be used to pay creditors rather than benefiting the country’s population.⁴⁸ Additionally, debt payments reduce the amount of national funds available for development goals like investment in education and health care.⁴⁹ Studies have found that after a debt restructuring, a country’s macroeconomic health tends to improve.⁵⁰

The important function of creditors, however, must not be overlooked. Creditors have a clear financial stake in collecting interest on money loaned to sovereigns as compensation for the risk of default and for giving up the right to use that money for a period of time. Sovereigns also have a stake in repaying and compensating creditors.⁵¹ Sovereigns may need quick access to cash in the

-world.html/.

41. YVONNE WONG, SOVEREIGN FINANCE AND THE POVERTY OF NATIONS 31 (2012).

42. *See id.*

43. *See, e.g.*, CARMEN M. REINHART & KENNETH S. ROGOFF, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY 23, 87, 91, 95, 96 (2009).

44. THE MONETARY AND CAPITAL MARKETS DEPARTMENT, IMF, A SURVEY OF EXPERIENCES WITH EMERGING MARKET SOVEREIGN DEBT RESTRUCTURINGS 9 (2012), available at <http://www.imf.org/external/np/pp/eng/2012/060512.pdf>.

45. WONG, *supra* note 41, at 70.

46. *See, e.g., id.* at 35–38, 60, 67 (noting that “informal, ad hoc negotiations and political considerations determine how debt is restructured . . . [giving] much discretion and uncertainty [for] both creditors and borrowers in a sovereign debt workout”).

47. *See, e.g., id.* at 79 (explaining that “[e]xcessive foreign debt has often been cited as the single largest obstacle to Africa’s development”).

48. Timothy Guinnane, *Financial Vergangenheitsbewältigung: The 1953 London Debt Agreement* 39 (Yale Univ. Econ. Growth Ctr., Center Discussion Paper No. 880, 2004).

49. *Id.*

50. THE MONETARY AND CAPITAL MARKETS DEPARTMENT, IMF, *supra* note 44, at 22.

51. Robert W. Kolb, *Sovereign Debt: Theory, Defaults, and Sanctions*, in SOVEREIGN DEBT: FROM SAFETY TO DEFAULT 3, 4 (Robert W. Kolb ed., 2011) (“[S]overeign governments want to

event of unforeseen economic calamities, natural disasters, or political upheaval, as well as for costly but beneficial development projects like building or improving infrastructure. If creditors were not compensated for making loans, needed cash would not be forthcoming. Additionally, if a sovereign could easily stop paying its debts, future loans would vanish.⁵² Thus, creditors are due compensation and sovereigns should, and generally do, tend to agree.

Therefore, while nations have strong incentives to issue debt, it is equally important that their debt is manageable and repaid. However, it is also important that their debt is capable of being restructured if the absolute need arises, so that national savings can benefit a population rather than go strictly to pay creditors.

B. In Defense of Secondary Markets

When investors question a sovereign's capacity to pay its debt, some creditors will sell the sovereign's debt at a discount to buyers on the secondary market.⁵³ Secondary buyers provide market liquidity,⁵⁴ and they exist in most markets for credit and other financial instruments.⁵⁵ Investors and creditors prefer market liquidity and will be more likely to invest or extend credit knowing there is a market for these instruments in the event unforeseen circumstances require their quick access to cash.⁵⁶

Distressed-debt investors operate on secondary markets, including those for sovereign and corporate debt.⁵⁷ These investors buy heavily discounted debt instruments from investors seeking to exit their position in the struggling

maintain a reputation as a good credit risk to assure future access to international funds, so they repay the debts they owe now.”)

52. See, e.g., Barry Eichengreen, *Bailing in the Private Sector: Burden Sharing in International Financial Crisis Management*, 23 FLETCHER F. WORLD AFF. 57, 71 (1999) (making the point that if contracts and institutional arrangements are altered to make the suspension of debt service too easy, the capital markets will not function at all).

53. See FUKUDA, *supra* note 4, at 1 (“The sellers of these [distressed sovereign] debts usually are more than willing to rid themselves of these debts because many of these debts may soon come into default or face restructuring negotiations.”).

54. “Liquidity refers to how quickly and cheaply an asset can be converted into cash. Money (in the form of cash) is the most liquid asset. Assets that generally can only be sold after a long exhaustive search for a buyer are known as illiquid.” *Definition of Liquidity*, ABOUT.COM, <http://economics.about.com/cs/economicsglossary/g/liquidity.htm> (last visited Sept. 8, 2014).

55. See *Secondary Market Definition*, BUSINESSDICTIONARY.COM, <http://www.businessdictionary.com/definition/secondary-market.html> (last visited Sept. 8, 2014) (“Financial market where previously issued securities (such [as] bonds, notes, shares) and financial instruments (such as bills of exchange and certificates of deposit) are bought and sold. All commodity and stock exchanges, and over-the-counter markets, serve as secondary markets which (by providing an avenue for resale) help in reducing the risk of investment and in maintaining liquidity in the financial system.”).

56. See *id.*

57. See, e.g., FUKUDA, *supra* note 4 (describing vulture funds; that is, sovereign distressed-debt investors); Paul M. Goldschmid, *More Phoenix than Vulture: The Case for Distressed Investor Presence in the Bankruptcy Reorganization Process*, 2005 COLUM. BUS. L. REV. 191, 192–93 (2005) (describing the role of distressed-debt investors in the secondary market for corporate debt).

company, country, or other issuing entity. Savvy distressed-debt investors can realize an enormous upside from purchasing the instruments at bargain prices and either patiently waiting for the entity's condition to improve or actively working to create improved conditions.⁵⁸ In making such investments, however, distressed-debt investors risk the possibility that the entity's fortunes will not improve and the value of its instruments will continue to decline.

In the corporate context, distressed-debt investors can sometimes promote orderly bankruptcy proceedings and ultimately increase the going-concern value⁵⁹ of firms.⁶⁰ By purchasing distressed corporate assets at discount prices, distressed-debt investors are able to consolidate the assets of a struggling enterprise and reorganize it in a more profitable way.⁶¹ The investors can thereby avoid the "inferior collective result" that would otherwise occur when numerous self-interested creditors clamor to be first in line for the bankrupt company's assets.⁶² This result occurs because distressed-debt investors are motivated and able to expedite business reorganizations, which allow a corporation to potentially become profitable sooner, and to protect the going-concern value of the company.⁶³ Corporate distressed-debt funds reduce the average time insolvent companies spend in bankruptcy, which in turn reduces the high transaction costs associated with bankruptcy proceedings and ultimately preserves corporate value.⁶⁴

In short, secondary markets for distressed-debt do in fact provide important liquidity to markets. Further, in the corporate context, there is evidence that corporate distressed-debt investors, also known as corporate

58. See, e.g., Goldschmid, *supra* note 57, at 200–03 (describing various corporate distressed-debt investors that purchased discounted corporate bonds in an effort to secure ownership or influence over a floundering company during its bankruptcy proceedings).

59. Going-concern value is "[t]he value of a company as an ongoing entity." This value includes not only the value of the company's tangible assets, but also the value of its intangible assets, such as its goodwill and ongoing profit potential. *Going-Concern Value Definition*, INVESTOPEDIA.COM, http://www.investopedia.com/terms/g/going_concern_value.asp (last visited Sept. 8, 2014).

60. See Goldschmid, *supra* note 57, at 192–93.

61. See *id.* at 208–09.

62. *Id.* at 193; see also Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527, 540–45 (1983). For an example of an "inferior collective result," consider the arrival of a hot pizza at a party where all the guests are selfish and hungry. The partygoers will elbow their way to the pizza, fill up their plates and start scarfing down as quickly as possible so they can go back for seconds while supplies last. In doing so, they will burn their mouths, provoke indigestion, and attract the ire of the other partygoers. This is an "inferior collective result" that occurs if everyone acts in their own self-interest. If, however, the partygoers communicate with each other and align their interests, they can agree on a fair distribution of the pizza so that everyone is sated and no one burns his or her mouth.

63. Goldschmid, *supra* note 57, at 193.

64. *Id.* at 211, 215; see also *id.* at 217–18 ("Distressed funds are appropriately incentivized to find a proper balance between [bankruptcy law's] rehabilitation benefits and the direct and indirect costs of an overly extended . . . reorganization. In this manner, distressed-debt investors can lower the transaction costs of a [bankruptcy] filing and thereby improve the economic efficiency of large corporate bankruptcies.").

vultures, promote more efficient business reorganizations, thereby enhancing the long-run value of bankrupt firms.⁶⁵ It is less clear, however, whether these arguments and analyses translate to sovereign distressed-debt investors.

C. Distinguishing Sovereign Vultures from Other Secondary Market Actors

Distressed sovereign debt investors have argued that their presence benefits the sovereign and its citizens. For example, when the investment fund FG Hemisphere Associates (FG) faced bad press⁶⁶ after it won an injunction worth \$116 million against DRC's state-owned mining company for a debt from the 1980s,⁶⁷ FG's managing director, Peter Grossman, published an open letter in his company's defense.⁶⁸ Mr. Grossman argued that "[t]he purchase of the[] claims by FG is highly beneficial to the country and to the Congolese people."⁶⁹ First, he noted the traditional (and legitimate) justification for secondary markets—that "investors into high-risk environments like the DRC need to know that a market exists for their contractual claims if things do not work out."⁷⁰ Second, Mr. Grossman explained that funds such as his "investigate in detail the commercial dealings of the country," which then brings "much needed transparency into how . . . certain countries . . . are utilizing their natural resources."⁷¹ Bringing the argument together, Mr. Grossman contended that "[t]he ultimate beneficiaries are the Congolese people as the transparency that this effort [and those of NGOs and others] engenders helps ensure that their natural resources are being utilized for their benefit

65. See *id.* at 265 ("As the residual actors of large corporate bankruptcies, the distressed debt investors mitigate transaction costs, aggregate control, and make decisions that are better aligned with the long-term value of the firm.")

66. See, e.g., Meirion Jones, *Call for Jersey to Block \$100m DR Congo 'Vulture' Debt*, BBC NEWSNIGHT (Nov. 15, 2011), <http://www.bbc.co.uk/news/business-15745003>; see also *BBC Newsnight: DR Congo Threatened by Vulture Fund Loop Hole* (BBC television broadcast Nov. 16, 2011), available at <http://www.bbc.co.uk/news/world-africa-15768460>.

67. See Michael J. Kavanagh, *Congo, Gecamines Challenge Vulture Fund Claim to \$116 Million Unpaid Debt*, BLOOMBERG (June 9, 2010), <http://www.bloomberg.com/news/2010-06-09/congo-gecamines-challenge-vulture-fund-claim-to-116-million-unpaid-debt.html>. A court in Jersey (a self-governing British Crown Dependency located in the English Channel) issued the injunction, which was based on a debt from a 1980s construction project. *Id.* Underscoring the numerous jurisdictions in which claims may be brought against debtor countries and the potentially troubling effects of court decisions, Kavanagh notes that "[i]n November 2008, a South African court effectively halted sales of power from Congo to South Africa by ruling that FG Hemisphere could seize any payments for Congolese electricity sold to the country," and "[i]n February [2010], Hong Kong's Court of Appeal froze about \$100 million from a signing bonus for Congo's \$6 billion minerals-for-infrastructure deal with China until [a separate] claim is resolved." *Id.*

68. Peter Grossman, Managing Dir., FG Hemisphere Assocs., LLC, *FG Hemisphere Associates Responds to Inaccurate and Misleading Media Reports* (Dec. 2, 2011), available at <http://www.fgcap.net/statement.html>.

69. *Id.*

70. *Id.* ("Knowing that that market exists, and that they can obtain at least something for these claims in the worst case scenario, lessens the risks associated with making these investments. Lessening the risk lowers the cost to the country of attracting the investment in the first place.")

71. *Id.*

rather than just for a few at the top”⁷² Several media sources have also taken the position that vulture funds do more good than harm.⁷³

As explained above, distressed-debt funds can improve the fortunes of bankrupt companies by expediting reorganizations and decreasing time spent in bankruptcy.⁷⁴ Sovereign distressed-debt investors, however, are distinguishable from those in the corporate context. In the corporate context, distressed-debt investors utilize the bankruptcy system to make reorganizations more efficient in order to profit from the firm as a going-concern and after reorganization.⁷⁵ Those investors can directly influence a bankrupt firm’s use of its assets and settle debts to promote its own interests, that is, making profit. The distressed-debt fund’s best interests are therefore aligned with the firm’s best interests.

The vulture fund’s interests, however, are not aligned with the sovereign’s interests. First, no comparable bankruptcy system exists for sovereigns, and private holders of sovereign debt cannot directly influence a sovereign’s use of its resources—even if they can (positively) shed light on the misuse of those resources. Second, the primary purported long-term interest of a sovereign (promoting the welfare of its citizens) does not coincide with, and is often in conflict with, the interest of creditors.⁷⁶ Although the welfare of citizens typically improves with an improving economy, the considerations for a sovereign’s management of the economy are not as clearly profit oriented as a business’s.⁷⁷ These conflicting interests are at the root of the reason why vulture funds have attracted the ire of so many: to some, the vultures appear to

72. *Id.*

73. See, e.g., Tony Allen-Mills, *‘Vultures’ Expose Corruption*, SUNDAY TIMES (June 15, 2008), <http://www.thesundaytimes.co.uk/sto/business/article99345.ece> (stating that “American bankers . . . have been derided as ‘vultures,’ but . . . have managed to find out more about corruption in Africa than Scotland Yard and the FBI,” and adding the unsubstantiated claim that “[i]n the course of its near-decade-long pursuit of Congo, [distressed-debt fund] Elliott has probably done more than any other national or corporate entity to expose corruption in Africa”); Richard W. Rahn, *RAHN: Vulture or Watchdog? Beware of Bill Providing Cover for Foreign Kleptocrats*, WASH. TIMES (Aug. 30, 2010), <http://www.washingtontimes.com/news/2010/aug/30/vulture-or-watchdog/> (“These funds, which those who pander to the corrupt and irresponsible call ‘vulture funds,’ are actually the ‘good guys,’ because the investment fund managers have a very strong incentive to make sure that crooked government officials do not run off with their money, and thus they are willing to spend considerable time and money to provide the necessary evidence about ethically challenged government officials to the courts and news media.”); *People & Power: Congo Oil Gotten Gains* (Al Jazeera television broadcast Sept. 9, 2009), available at <https://www.youtube.com/watch?v=w5SetN2Dk-I> (explaining that the “proof of the misuse of oil funds” in Congo-Brazzaville “came from an unpopular source,” that is, vulture funds).

74. See Goldschmid, *supra* note 57, at 211.

75. *Id.* at 211–12.

76. There are certainly sovereigns whose primary interest is maintaining and exploiting power, often through corruption, rather than promoting the welfare of their citizens. In these cases, the interests of creditors and citizens may be aligned inasmuch as both can potentially benefit from the reduction of corruption and the efficient use of resources. Nonetheless, corruption is not a problem for all sovereigns who have faced issues with vultures.

77. Spending on education, healthcare, and infrastructure can certainly improve the economic well-being of a country over the long-term, but such spending is not clearly “profit driven.”

disregard the actual well-being of a nation and its people, preferring only profit.

The efforts of distressed-debt investors to bring transparency to corrupt debtor nations do deserve some recognition. However, other stakeholders in the international community are similarly incentivized to seek such transparency. Even the Managing Director of FG acknowledged the numerous other individuals and organizations that have looked into the DRC's use of natural resources, including NGOs, journalists, and foreign politicians.⁷⁸ Transparency is certainly important, and rooting out corruption in developing countries so that resources are used in the best interest of people rather than for the benefit of kleptocrats is vital to the economic development of poor countries. Nonetheless, domestic and international organizations, beyond those seeking to ensure a debtor nation can pay its debts, arguably have similar potential to promote transparency and undermine corruption.⁷⁹

Moreover, despite vultures' incentives to root out corruption in countries in which they hold debt, their presence ultimately undermines the smooth functioning of the sovereign debt market. In the corporate context, bankruptcy proceedings are meant to protect "going-concern value from the potentially inefficient and destructive behavior of competing and self-motivated creditors."⁸⁰ The corporate bankruptcy system seeks to undermine a prisoner's dilemma in which "the aggregation of individualistic, albeit rational, decisions lead[s] to an inferior collective result."⁸¹ Corporate distressed-debt investors undermine the prisoner's dilemma by aggregating claims and influencing the restructuring process to make it more efficient, and thereby more profitable for themselves.

In the sovereign context, however, vulture funds actually *create* a prisoner's dilemma.⁸² Vulture funds cause a "holdout" problem in the orderly restructuring of sovereign debt.⁸³ The refusal to participate in a voluntary debt restructuring can deter other bondholders from participating in the restructuring process and can threaten to derail restructuring agreements after they are achieved.⁸⁴ That is, individual creditors recognize that they "can be better off by rejecting a restructuring and free-riding on a majority of participating creditors."⁸⁵

Finally, some supporters of distressed-debt funds argue that their removal would ultimately hurt developing countries by increasing the cost of capital.⁸⁶

78. Grossman, *supra* note 68.

79. *See id.*

80. Goldschmid, *supra* note 57, at 192.

81. *Id.* at 193.

82. *See* Schumacher et al., *supra* note 23, at 14.

83. *See* Wheeler & Attaran, *supra* note 2, at 254.

84. *Id.*

85. Schumacher et al., *supra* note 23, at 14.

86. *See, e.g.,* Elliott Assocs. v. Banco de la Nación, 194 F.3d 363, 380 (2d Cir. 1999) (reasoning that "the long term effect [of impeding a debt buyer on the secondary market from

This argument, however, is not supported by research. Economists studying the effect of CACs, which undermine vultures by forcing holdout bondholders to restructure after a supermajority of fellow bondholders agree to restructure, suggest that the clauses “do[] not necessarily raise borrowing costs.”⁸⁷ If the CACs did raise borrowing costs, it could indicate that bond-buyers place a premium on the ability to holdout, and that the ability to holdout reduces the sovereign’s cost of issuing debt.⁸⁸ This all suggests that vulture funds’ purported positive effect of reducing the cost of capital is in fact overstated.

In sum, sovereign vulture funds are distinguishable from corporate distressed-debt funds. Specifically, the best interests of sovereign vultures are not aligned with the best interests of the sovereign itself, whereas the interests of a corporate distressed-debt fund are generally aligned with the interests of the bankrupt company. Additionally, the benefits vulture funds provide debtor nations are likely overstated, whether in their ability to unilaterally root out corruption or to reduce the cost of capital. In fact, the presence of vultures creates a holdout problem and undermines the effectiveness of needed restructuring efforts. In short, sovereign vulture funds create problems that outweigh their spurious benefits.

The competing visions of the virtues and pitfalls of sovereign distressed-investors provide a useful backdrop for analyzing a specific vulture fund lawsuit: *NML Capital v. Republic of Argentina*, “the sovereign debt trial of the century.”⁸⁹

II.

NML CAPITAL V. REPUBLIC OF ARGENTINA

The Argentine economy suffered greatly in the late 1990s, culminating in 2001 with the largest sovereign default in history up to that point.⁹⁰ By 2010,

enforcing its claim for full value] would be to cause significant harm to . . . developing nations and their institutions seeking to borrow capital in New York”).

87. Wheeler & Attaran, *supra* note 2, at 283 (citing BARRY EICHENGREEN & ASHOKA MODY, WORLD BANK DEVELOPMENT PROSPECTS GROUP, WOULD COLLECTIVE ACTION CLAUSES RAISE BORROWING COSTS?: AN UPDATE AND ADDITIONAL RESULTS (2000)). Note, however, that the findings so far are more nuanced. Eichengreen and Mody found that “collective action clauses raise costs of borrowing for low-rated issuers but reduce them for issuers with high credit ratings.” BARRY EICHENGREEN & ASHOKA MODY, WORLD BANK DEVELOPMENT PROSPECTS GROUP, WOULD COLLECTIVE ACTION CLAUSES RAISE BORROWING COSTS?: AN UPDATE AND ADDITIONAL RESULTS i (2000). The point remains, however, that CACs do not categorically or necessarily increase the cost of borrowing.

88. *Cf.* EICHENGREEN & MODY, *supra* note 87, at 2 (disputing the “fear that collective-action clauses would raise borrowing costs [because e]asier restructuring, by heightening the temptation for borrowers to walk away from their debts, would render investors reluctant to lend”).

89. Schumacher et al., *supra* note 23, at 1.

90. Alan B. Cibils, Mark Weisbrot & Debayani Kar, *Argentina Since Default: The IMF and the Depression*, CTR FOR ECON. & POLICY RESEARCH (Sept. 3, 2002), http://www.cepr.net/documents/publications/argentina_2002_09_03.htm; *Argentina is Ordered by New York Judge to Pay Debts in Full*, FOX NEWS LATINO (Nov. 23, 2012), <http://latino.foxnews.com/latino/politics/>

roughly 93 percent of bondholders had accepted restructuring offers to recoup at least *some* of what was lost.⁹¹ Many of those who did not voluntarily restructure, the “holdouts” or “vultures,” sued Argentina to collect the full value of the defaulted bonds.⁹² This Part describes the economic and political conditions during the lead-up to default, the restructuring deals of 2005 and 2010, and the litigation between Argentina and the vulture funds.

A. Lead-up to Default

In the 1980s, Argentina suffered hyperinflation and a severe recession.⁹³ To strengthen its economy and its currency, Argentina pegged the value of its currency to the U.S. Dollar in 1991.⁹⁴ After a period of relative economic stability, Argentina slid into a deep, four-year-long recession beginning in late 1998.⁹⁵ The period was marked by dramatic political, economic, and social turmoil that “threaten[ed] total collapse of the Government and the Argentine State.”⁹⁶ Prices fell, unemployment rose, GDP declined, and the risks from instability made it impossible for the country to borrow further on international credit markets.⁹⁷ As it became apparent that Argentina might default on its sovereign debt, Argentines and foreigners withdrew substantial deposits from banks, leading the government to implement restrictions on withdrawals and currency transfers.⁹⁸

In December 2001, the president and his cabinet resigned.⁹⁹ Five persons held the presidency in roughly two weeks.¹⁰⁰ By late 2001, the unemployment rate was nearly 25 percent, with almost half of the population below the poverty line and a quarter living below subsistence.¹⁰¹ Protests, rioting, looting, and violent demonstrations became commonplace.¹⁰² In early 2002, the

2012/11/23/argentina-is-ordered-by-new-york-judge-to-pay-debts-in-full/.

91. See Neate, *supra* note 12 (“About 93% of bondholders agreed to a restructuring.”).

92. See *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 252–53 (2d Cir. 2012); Stephen Davidoff Solomon, *In Court Battle, a Game of Brinkmanship With Argentina*, N.Y. TIMES (Nov. 27, 2012), <http://dealbook.nytimes.com/2012/11/27/in-court-battle-a-game-of-brinkmanship-with-argentina/>.

93. *LG&E Energy Corp. v. Arg. Republic*, ICSID Case No. ARB/02/1, Decision on Liability, ¶ 35 (Oct. 3, 2006), <http://italaw.com/sites/default/files/case-documents/ita0460.pdf>.

94. *Id.* ¶ 36; see also Law No. 23928, Mar. 27, 1991, [27104] B.O. 1 (Arg.) (“Convertibility Law”).

95. *LG&E* ¶ 54 (noting that Argentina characterized this period as the worst economic crisis in its history).

96. *Id.* ¶ 231.

97. *Id.* ¶¶ 55, 232; see also *id.* ¶ 233 (“At this time, capital outflow was a critical problem for the Government. In the fourth quarter of 2001, the Central Bank of Argentina lost US\$ 11 billion in liquid reserves, amounting to 40%. The banking system lost 25% of its total deposits.”).

98. *Id.* ¶ 63; see also Decree No. 1570/01, Dec. 3, 2001, [29787] B.O. 1 (Arg.).

99. *LG&E* ¶ 63.

100. See *PBS NewsHour: Argentina: Troubled Nation* (PBS television broadcast Jan. 2, 2002), available at http://www.pbs.org/newshour/bb/latin_america/jan-june02/argentina_1-2.html.

101. *LG&E*, ¶ 234.

102. *Id.* ¶ 235.

Argentine Congress de-pegged its currency from the U.S. dollar.¹⁰³ Amid the turmoil Argentina committed the largest sovereign default in history, at that time, by defaulting on roughly \$100 billion of debt.¹⁰⁴

B. Restructuring Deals

Through restructuring deals in 2005 and 2010, approximately 93 percent of bondholders exchanged their defaulted bonds for new bonds, worth roughly thirty cents on the dollar.¹⁰⁵ These are the “exchange bondholders.” In 2005, 76 percent of all bondholders agreed to restructure their holdings.¹⁰⁶ After the 2005 restructuring offer, the Argentine Congress passed the “Lock Law,” forbidding the government from renegotiating or paying on the remaining defaulted bonds without Congressional approval.¹⁰⁷ The law further prohibited the state from “conducting any type of in-court, out-of-court or private settlement with respect to the bonds.”¹⁰⁸ In 2009 and 2010, the Argentine Congress temporarily suspended the “Lock Law” to allow a second round of restructuring, in which another 17 percent of all bondholders participated.¹⁰⁹

C. Holdout Litigation

The remaining bondholders, now representing an estimated \$11 billion in debt, refused to restructure, many opting instead to litigate for the full value of the bonds.¹¹⁰ These bondholders are the “holdouts” or “vultures.”¹¹¹ The holdouts primarily bought their bonds on the secondary market after it was

103. *Id.* ¶ 64; *see also* Law No. 25561, Jan. 6, 2002, [29810] B.O. 1 (Arg.).

104. *See Argentina is Ordered by New York Judge to Pay Debts in Full, supra* note 90; *see also* Anna Gelpem, *What Bond Markets Can Learn From Argentina*, 24 INT’L FIN. L. REV. 19, 19 (2005).

105. *See Ghana Court Refuses to Free Argentine Warship Libertad*, BBC NEWS (Oct. 11, 2012), <http://www.bbc.co.uk/news/world-africa-19910141>.

106. *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 252 (2d Cir. 2012); *see also* Kevin P. Gallagher, *The New Vulture Culture: Sovereign Debt Restructuring and Trade in Investment Treaties* 8, 14 (The IDEAs Working Paper Series, Working Paper No. 02/2011, 2011), *available at* <http://www.ase.tufts.edu/gdae/publications/GallagherSovereignDebt.pdf>.

107. *NML Capital*, 699 F.3d at 252; Guido Nejamkis & Hilary Burke, *Scenarios: Argentina Faces Tough Choices After U.S. Debt Ruling*, REUTERS (Nov. 5, 2012), <http://www.reuters.com/article/2012/11/05/us-argentina-debt-decision-idUSBRE8A412E20121105>.

108. *NML Capital*, 699 F.3d at 252.

109. *Id.* at 252–53; *see also* Jude Webber, *Argentina Debt Repayment Order Frozen*, FIN. TIMES (Nov. 29, 2012), <http://www.ft.com/intl/cms/s/0/8600c380-3977-11e2-85d3-00144feabd0.html#axzz3Ct5edSQd>.

110. *See NML Capital*, 699 F.3d at 252–53; Davidoff Solomon, *supra* note 92.

111. It is important to note that the vulture funds are not the only holdouts. Others include individuals, mostly Argentine and Italian pensioners, who are not accurately lumped in with the vultures. Nonetheless, one estimate suggests that the pensioners would be entitled to less than \$1 million if the judgment is ultimately paid. *See Argentina’s Debt Holdouts Say They’re Savers, Not Vultures*, REUTERS (Nov. 29, 2012), <http://www.reuters.com/article/2012/11/29/argentina-debt-holdouts-idUSL1E8MS7UX20121129>; *see also* Davidoff Solomon, *supra* note 92 (noting that the holdouts included “thousands of Italian pensioners”).

clear that Argentina would likely default, or even after default had occurred.¹¹² Some bonds were purchased as recently as 2010, after two restructuring opportunities; some were purchased for as little as fifteen cents on the dollar.¹¹³

Since its 2001 default, Argentina has faced abundant creditor litigation.¹¹⁴ The remainder of this Section proceeds by tracing the trajectory of one of those cases through the courts, describing the courts' reasoning, and analyzing the potential effects of key judgments.

NML Capital and other holdout bondholders have been embroiled in litigation against Argentina since at least 2005.¹¹⁵ For purposes of this Comment, the first important disposition occurred in December 2011 when Judge Thomas P. Griesa of the United States District Court for the Southern District of New York interpreted a clause in the fiscal agency agreement (FAA) bonds, the *pari passu* clause, to prohibit Argentina from discriminating against the holdout bondholders in favor of the exchange bondholders.¹¹⁶ The court found that Argentina violated the clause by ranking its payment obligations on the original defaulted bonds below its obligations to the exchange bondholders.¹¹⁷ The *pari passu*, or "equal footing clause," is a common component of bond contracts, but its meaning is debated.¹¹⁸ Alternative

112. *NML Capital*, 699 F.3d at 251.

113. *See id.*; Webber, *supra* note 16.

114. A WestlawNext search for "Argentina" & "bond" between January 2002 and March 2014 returned 326 cases. Of those cases, 33 were in the Second Circuit and 190 were in the Southern District of New York. Of the cases heard in the S.D.N.Y., 150 were heard before Judge Thomas Griesa. The earliest results for Judge Griesa's court are in April 2003, less than sixteen months after Argentina's default occurred.

115. *See NML Capital Ltd. v. Republic of Arg.*, No. 02 Civ. 3804, 2005 WL 743086 (S.D.N.Y. Mar. 31, 2005), *aff'd sub nom. EM Ltd. v. Republic of Arg.*, 131 F. App'x 745 (2d Cir. 2005).

116. *See NML Capital, Ltd. v. Republic of Arg.*, No. 08 Civ. 6978(TPG), 2011 WL 9522565, at *2 (S.D.N.Y. Dec. 7, 2011) ("It is DECLARED, ADJUDGED, and DECREED that the Republic is required under Paragraph 1(c) of the FAA at all times to rank its payment obligations pursuant to NML's Bonds at least equally with all the Republic's other present and future unsecured and unsubordinated External Indebtedness."). The specific *pari passu* clause provides that "[t]he Securities will constitute . . . direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank *pari passu* and without any preference among themselves. The payment obligations of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness. . . ." *Id.* at *1.

117. *See id.* at *2 ("5. It is DECLARED, ADJUDGED, and DECREED that the Republic lowered the rank of NML's bonds in violation of Paragraph 1(c) of the FAA when it made payments currently due under the Exchange Bonds, while persisting in its refusal to satisfy its payment obligations currently due under NML's Bonds. 6. It is DECLARED, ADJUDGED, and DECREED that the Republic lowered the rank of NML's bonds in violation of Paragraph 1(c) of the FAA when it enacted [the Lock Laws].").

118. Argentina argued that the clause is "a boilerplate provision." *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 258 (2d Cir. 2012). Argentina also argued, however, that the clause has a settled meaning and is meant "to provide protection from *legal subordination* or other discriminatory *legal ranking* by preventing the creation of *legal priorities* by the sovereign in favor of creditors holding particular classes of debt." *Id.* (quoting Brief for Appellant at 32, 34). Nonetheless, the Second Circuit found that the clause does not have "this well settled meaning." *Id.*; *see also* Lee C.

interpretations of the *pari passu* clause are discussed in Part V.

In February 2012, Judge Griesa granted a permanent injunction to prevent Argentina from making payments to exchange bondholders without also making payments to the holdouts.¹¹⁹ In October 2012, the Second Circuit affirmed Judge Griesa's decision, upholding the injunction and the district court's interpretation of the *pari passu* clause.¹²⁰

In making its ruling, the Second Circuit rejected Argentina's argument that the decision to force payment to the vulture funds would cause serious harm to Argentina's economy.¹²¹ In fact, the court found that Argentina's access to \$40 billion in foreign currency reserves underscored its ability to pay.¹²²

The Second Circuit also rejected an argument submitted by the United States as amicus. The United States argued that upholding the district court's decision could "undermine the decades of effort the United States has expended to encourage a system of cooperative resolution of sovereign debt crises" and would permit "a single creditor to thwart the implementation of an internationally supported restructuring plan."¹²³ The Second Circuit suggested that the recent proliferation of CACs in sovereign debt issued under New York law would prevent future vultures from holding out on restructuring offers.¹²⁴ A critique of the court's suggestion that CACs will discourage holdouts is taken up below, *infra* Part IV-B.

Though the Second Circuit upheld the reasoning underlying the district court decision, the court remanded for Judge Griesa to clarify how the injunction's payment formula would function and how the injunction would apply to third parties, such as intermediary banks.¹²⁵

On November 21, 2012, Judge Griesa issued an order requiring payment to the holdouts to be put into effect "at the earliest possible time," in order to undermine Argentina's opportunity to "devise means for evasion."¹²⁶ The

Buchheit, *The Pari Passu Clause Sub Specie Aeternitatis*, 10 INT'L FIN. L. REV. 11, 11 (1991) ("[N]o one seems quite sure what the clause really means, at least in the context of a loan to a sovereign borrower.").

119. *NML Capital*, 699 F.3d at 254.

120. *Id.* at 265.

121. *Id.* at 263–64.

122. *Id.* at 263. As of January 23, 2014, Argentina's foreign currency reserves dwindled below \$30 billion, amid the collapsing value of the peso, efforts to repay other debts, and Judge Griesa's looming, yet so far unenforced, judgment. See Linette Lopez, *Chart of the Day: The Argentine Peso Completely Collapses*, BUS. INSIDER (Jan. 23, 2014), <http://www.businessinsider.com/chart-of-the-day-2014-1>.

123. Brief for the United States of America as Amicus Curiae at 5, *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246 (2d Cir. 2012) (No. 12-105-cv(L)); *NML Capital*, 699 F.3d at 264; see also Nejamkis & Burke, *supra* note 107.

124. See *NML Capital*, 699 F.3d at 253, 264.

125. *Id.* at 264–65.

126. *NML Capital, Ltd. v. Republic of Arg.*, No. 08 Civ. 6978 (TPG), 2012 U.S. Dist. LEXIS 168292 (S.D.N.Y. Nov. 21, 2012) ("*NML Capital Remand*").

payment formula required Argentina to pay the holdouts in full; this is considered a “ratable payment.”¹²⁷ In issuing the order, Judge Griesa took into account the “inflammatory declarations that the court rulings will not be obeyed,” which were made by Argentine public officials including President Cristina Fernandez de Kirchner and the then-Minister of the Economy Hernán Lorenzino.¹²⁸ The court specifically stated that payment would be due to holdouts on December 15, 2012, when an interest payment was due to exchange bondholders.¹²⁹

A week after Judge Griesa’s order, however, the Second Circuit stayed the district court’s order for further consideration.¹³⁰ Two months later, on February 27, 2013, a three-judge panel of the Second Circuit heard arguments in an overflowing courtroom.¹³¹ Underscoring the importance of the case, Argentinean Vice President Amado Boudou and Economy Minister Hernán Lorenzino attended.¹³² Ted Olson, counsel for the holdouts and famed litigator of *Bush v. Gore* and *Hollingsworth v. Perry*, argued that Argentina, not the holdouts, were responsible for “hostage holding.”¹³³ David Boies, another powerhouse litigator and Mr. Olson’s once foe (*Bush v. Gore*) and occasional ally (*Hollingsworth v. Perry*), argued on behalf of the exchange bondholders that the district court order undermined *their* property rights by preventing them from accepting “money [they] were contractually owed.”¹³⁴ Finally, Counsel for Argentina, Jonathan Blackman, affirmed Argentina’s position that it would not pay the holdouts even if ordered to do so.¹³⁵ Nonetheless, Mr.

127. See *id.* at *10. Judge Griesa used the term “ratable payment.” “Ratable payment” is a financial term. In this context, “a decision to make an equal ‘ratable payment’” would mean a decision to pay each creditor the same percentage of the amount they originally lent, instead of one creditor having a preferred status over the other.” *Definition of Ratable*, FIN. TIMES LEXICON, <http://lexicon.ft.com/Term?term=ratable> (last visited Sept. 8, 2014). Specifically, here “ratable payments” means that “if Argentina intended to repay the exchange bond holders in full then it should also repay . . . (the hold-outs) in full.” *NML Capital Remand*, 2012 U.S. Dist. LEXIS 168292, at *10.

128. *Id.* at *9; see also Nikhil Kumar, *Argentina on the Brink as US Court Orders it to Pay \$1.3bn Debt to ‘Vulture’ Funds*, THE INDEPENDENT (Nov. 22, 2012), <http://www.independent.co.uk/news/world/americas/argentina-on-the-brink-as-us-court-orders-it-to-pay-13bn-debt-to-vulture-funds-8344477.html> (explaining that Argentine President Cristina Fernández de Kirchner said the country would not pay “one dollar to the vulture funds”); Davidoff Solomon, *supra* note 92 (describing Argentine Economy Minister Hernan Lorenzino’s angry reaction to the court decision, calling it “legal colonialism” and suggesting that all “we need now is for Griesa to send us the Fifth Fleet”).

129. *NML Capital Remand*, 2012 U.S. Dist. LEXIS 168292, at *11.

130. Order to Stay November 21, 2012 Injunction, *NML Capital, Ltd. v. Republic of Arg.*, Nov. 28, 2012.

131. Peter Eavis, *Argentina’s Bond Case Is Being Closely Watched for Ramifications*, N.Y. TIMES (Feb. 27, 2013), <http://dealbook.nytimes.com/2013/02/27/argentinas-bond-case-is-being-closely-watched-for-ramifications/>.

132. *Argentina Firm on Refusing to Pay Bond Holdouts*, GLOBAL POST (Feb. 27, 2013), <http://www.globalpost.com/dispatch/news/afp/130227/argentina-firm-refusing-pay-bond-holdouts>.

133. Eavis, *supra* note 131.

134. *Id.*

135. Joseph Cotterill & Jude Webber, *Argentine Bond Litigation Sparks Default Fears*, FIN. TIMES (Feb. 28, 2013), <http://www.ft.com/intl/cms/s/0/eb055954-8138-11e2-9fae-00144feabdc0.html>

Blackman implored the court to “do no harm,” even if Argentina “does not appeal [to the judges].”¹³⁶ After the hearing, commentators noted the panel’s apparent hostility toward Argentina. One of the judges on the panel, Judge Reena Raggi, commented that it was the court’s job to enforce contracts and “not to rewrite them.”¹³⁷

On March 1, 2013, two days after the hearing, the court ordered Argentina to suggest a payment formula.¹³⁸ Though Argentine President Fernandez had previously sworn never to pay the holdouts, soon after the court’s order she quickly signaled that Argentina would be willing to pay *something* to the holdouts to resolve the dispute.¹³⁹

On March 29, 2013, Argentina responded to the court’s order, offering holdouts approximately one-sixth of what would be owed under Judge Griesa’s November order.¹⁴⁰ The proposed payment formula essentially followed the payment structure accepted by exchange bondholders in 2010.¹⁴¹ Argentina argued that “[t]he proposal fulfills the court’s dual objectives to satisfy the *pari passu* clause: non-discrimination in payment priority and equal treatment

#axzz2N4mJEGf; see also David B. Caruso, *Argentina, Creditors Face off in NY Over Debts*, ASSOCIATED PRESS (Feb. 27, 2013), <http://bigstory.ap.org/article/argentina-creditors-face-ny-over-debts> (quoting Mr. Blackman as stating, “We are representing a government, and governments will not be told to do things that fundamentally violate their principles.”).

136. Eavis, *supra* note 131.

137. Sujata Rao & Jorge Otaola, *Argentine Bonds Suffer as U.S. Hearing Fuels Default Fear*, REUTERS (Feb. 28, 2013), <http://uk.reuters.com/article/2013/02/28/uk-argentina-debt-idUKBRE91R0RW20130228>.

138. Bob Van Voris, *Argentina Told by Court to Provide Bond Payment Formula*, BLOOMBERG (Mar. 1, 2013, 9:01 PM), <http://www.bloomberg.com/news/2013-03-01/argentina-asked-by-u-s-court-to-provide-bondholder-pay-formula.html>. The order stated: “Because neither the parameters of Argentina’s proposal nor its commitment to abide by it is clear from the record, it is hereby ordered that . . . Argentina submit . . . the precise terms of any alternative payment formula and schedule to which it is prepared to commit.” See Michael Warren, *NY Court Eyeing Argentine Swap Offer in Debt Case*, ASSOCIATED PRESS (Mar. 1, 2013), <http://bigstory.ap.org/article/ny-court-eyeing-argentine-swap-offer-debt-case> (additionally, the order required Argentina to explain “(1) how and when it proposes to make current those debt obligations on the original bonds that have gone unpaid over the last 11 years; (2) the rate at which it proposes to repay debt obligations on the original bonds going forward; and (3) what assurances, if any, it can provide that the official government action necessary to implement its proposal will be taken, and the timetable for such action”).

139. Warren, *supra* note 138 (quoting President Fernandez as saying, “We have rigorously paid everything we’ve promised. And we are also prepared to pay these vulture funds, but not at terms that are better than the 93 percent who believed in and supported Argentina.”).

140. Bob Van Voris, *Argentina Offers One-Sixth of Court-Ordered Bond Payment*, BLOOMBERG (Mar. 29, 2013), <http://www.bloomberg.com/news/2013-03-30/argentina-submits-payment-proposal-to-court-in-bonds-case.html>. Argentina proposed two payment options: the “discount option,” which would entitle NML to approximately \$120.6 million, and the “par option,” which would entitle NML to new bonds issued on specific terms and would include payments tied to GDP growth. See *id.* (providing more specifics).

141. See Shane Romig, Katy Bume & Chad Brady, *Argentina’s New Debt Offer Rejected by Holdout Creditors*, WALL ST. J. (Apr. 20, 2013), <http://online.wsj.com/news/articles/SB10001424127887323309604578433263545843212> (“Argentina’s plan was virtually a ‘carbon copy’ of a 2010 debt swap deal the holdouts rejected and would in effect give them about one-fifth of what they’ve been awarded by the courts, according to Vladimir Werning, executive director at J.P. Morgan Chase.”).

among bondholders.”¹⁴²

The court subsequently asked the holdouts for a response to Argentina’s proposal;¹⁴³ the holdouts ultimately rejected the proposal in April 2013.¹⁴⁴ NML’s brief explained that “[n]ot only are the details of Argentina’s proposal unacceptable and unresponsive; Argentina fails even to provide th[e] court with meaningful ‘assurances’ that it will actually comply with its own proposal.”¹⁴⁵

On March 26, 2013, the Second Circuit denied Argentina’s petition for an *en banc* review of its October 2012 decision.¹⁴⁶ Furthermore, on August 23, 2013, the Second Circuit affirmed Judge Griesa’s November 2012 order and upheld the “ratable payments” formula.¹⁴⁷ The court also dismissed Argentina’s proposed alternative payment formula as unproductive.¹⁴⁸ Among other things, the court reiterated Argentina’s apparent ability to pay,¹⁴⁹ indicated that suggestions that the decision would “imperil future sovereign debt restructurings” were overblown,¹⁵⁰ and dismissed arguments that CACs are not actually a safeguard against future restructuring failures.¹⁵¹

In October 2013, the Supreme Court rejected Argentina’s first petition for review, and in November 2013 the Second Circuit denied its petition for a rehearing *en banc* of the August 2013 decision.¹⁵² Argentina petitioned the

142. Van Voris, *supra* note 140.

143. Nate Raymond, *Court Demands Argentine Bondholders Address Pay Plan*, REUTERS (Apr. 2, 2013), <http://www.reuters.com/article/2013/04/02/us-argentina-debt-response-idUSBRE9310XX20130402>.

144. See Romig, Burne & Brady, *supra* note 141.

145. See *id.* (quoting the brief for the holdouts).

146. See Nate Raymond, *U.S. Appeals Court Declines to Rehear Argentina Bond Case*, REUTERS (Mar. 26, 2013), <http://www.reuters.com/article/2013/03/26/us-argentina-appeal-idUSBRE92P14A20130326> (no reason was given for the denial).

147. *NML Capital, Ltd. v. Republic of Arg.*, 727 F.3d 230, 238 (2d Cir. 2013).

148. See *id.* at 238 (“[T]he proposal submitted by Argentina ignored the outstanding bonds and proposed an entirely new set of substitute bonds. In sum, no productive proposals have been forthcoming.”) (internal citation omitted).

149. *Id.* at 246 (“[A]s we observed in our last opinion, other than this speculation, ‘Argentina makes no real argument that, to avoid defaulting on its other debt, it cannot afford to service the defaulted debt, and it certainly fails to demonstrate that the district court’s finding to the contrary was clearly erroneous.’”) (citing *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 263 (2d Cir. 2012)).

150. *Id.* at 247 (citing generally, *Amicus Anne Krueger Br.* 11–16). The court explained: “[T]his case is an exceptional one with little apparent bearing on transactions that can be expected in the future. Our decision here does not control the interpretation of all *pari passu* clauses or the obligations of other sovereign debtors under *pari passu* clauses in other debt instruments. . . . We simply affirm the district court’s conclusion that Argentina’s extraordinary behavior was a violation of the particular *pari passu* clause found in the FAA.” *Id.* (citations omitted).

151. *Id.* at 247–48. In response to arguments that CACs *do not* in fact undermine the likelihood of restructuring failures, the court explained that “[a] restructuring failure on one series would still allow restructuring of the remainder of a sovereign’s debt. And, as one amicus notes, ‘if transaction costs and other procedural inefficiencies are sufficient to block a super-majority of creditors from voting in favor of a proposed restructuring, the proposed restructuring is likely to fail under any circumstances.’” *Id.* at 24 (citing *Amicus Kenneth W. Dam Br.* 14 n.5).

152. Shane Romig, *U.S. Court Rejects Argentina Appeal in Holdout Creditor Case*, WALL ST. J. (Nov. 18, 2013), <http://online.wsj.com/news/articles/SB10001424052702303755504579206493707>

Supreme Court for rehearing in mid-February 2014.¹⁵³ The Court denied Argentina's petition in June 2014.¹⁵⁴

The various events have attracted broad attention, with one enthusiastic commentator describing the litigation as “the single most interesting case in the history of the Second Circuit!”¹⁵⁵ More precisely, even before the Supreme Court denied certiorari, some commentators suggested that the Second Circuit's decision and Judge Griesa's orders could precipitate a financial crisis if they were upheld.¹⁵⁶ One argument suggested that if Judge Griesa's order was upheld and Argentina was unable to pay exchange bondholders without also paying holdout creditors, Argentina would be forced to pay neither, leading to a technical default.¹⁵⁷ This is exactly what happened.¹⁵⁸

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153. See *Petition for Writ of Certiorari, Republic of Arg. v. NML Capital, Ltd.*, 134 S.Ct. 2250 (2013) (No. 12-842), available at <http://sblog.s3.amazonaws.com/wp-content/uploads/2014/03/2014-02-18-Argentina-Petition-for-Certiorari-Final-as-filed1.pdf>. Argentina's petition presents the questions:

1. Whether this Court should certify to the New York Court of Appeals this question: Whether a foreign sovereign is in breach of a *pari passu* clause when it makes periodic interest payments on performing debt without also paying on its defaulted debt.
2. Whether a district court can enter an injunction coercing a foreign sovereign into paying money damages, without regard to whether payment would be made with assets that the FSIA makes immune from “attachment arrest and execution,” 28 U.S.C. §§ 1609–1611.

Id. at *ii*.

Though the Justice Department considered filing an amicus brief on behalf of Argentina's 2013 petition for Supreme Court review, it ultimately declined to do so. See Anna Yukhananov, *IMF Backs off Plan to File with Top U.S. Court in Argentina Case*, REUTERS (July 24, 2013), <http://www.reuters.com/article/2013/07/24/us-imf-argentina-idUSBRE96N02E20130724>. Similarly, in 2013 the IMF seriously contemplated filing its first-ever amicus brief to the Supreme Court, in support of Argentina, but eventually decided against it after receiving pressure from its largest contributor, the United States. See *id.* (quoting an anonymous IMF official as saying, “The Fund remains deeply concerned about the broad systemic implications that the lower court decision could have for the debt restructuring process in general.”).

154. See Denniston, *supra* note 14 (“[W]ithout comment, the Court cleared the way for [investors who bought bonds that went into default] to demand payment on the bonds they hold whenever Argentina makes any payments to holders of later bond issues which that country has continued to honor.”).

155. Felix TV, *The Multi-Billion-Dollar Fight for National Sovereignty*, YOUTUBE (Nov. 30, 2012), http://www.youtube.com/watch?feature=player_embedded&v=uspuc-lunA8#! (Twenty second mark). Felix Salmon is a financial journalist for Reuters; this particular video attempts to describe the *NML Capital* litigation using Legos and other toys and is well worth watching.

156. See, e.g., Heather Stewart & Uki Goñi, *Argentina Fears Default After American Court Ruling*, THE GUARDIAN (Nov. 22, 2012), <http://www.theguardian.com/world/2012/nov/22/american-ruling-fears-default-argentina> (“If some of the country's repayments were diverted to the vulture funds, however, it could reduce the amount available for Argentina's other lenders, pushing it into a technical default on more than \$60bn in outstanding debts.”); Katia Porzecanski, *Stiglitz Plans to Back Argentina in U.S. High Court Case*, BLOOMBERG (Mar. 21, 2014), <http://www.bloomberg.com/news/2014-03-21/brazil-seeks-to-back-argentina-in-u-s-high-court-case.html> (noting that the cost of Argentine credit default swaps, financial instruments that protect against the risk of default, “are the costliest in the world” because investors believe the likelihood of default is high).

157. See Nejamkis & Burke, *supra* note 107; Webber, *supra* note 16.

158. See Hugh Bronstein & David Scigliuzzo, *Argentina Dubs Holdouts an ‘International Mafia’ as Deal Hopes Fade*, REUTERS (Aug. 14, 2014), <http://www.reuters.com/article/2014/08/14/us->

After the Court denied cert, Judge Griesa's judgment became final. Argentina failed to negotiate a settlement with the holdouts and the injunction prohibited Argentina from making a bond payment to exchange bondholders in time, triggering a technical default.¹⁵⁹ As of August 2014, Argentina and the holdouts failed to negotiate a settlement that would allow Argentina to pay the exchange bondholders and thereby remove the country from default.¹⁶⁰

Argentina has been unable to raise money in traditional sovereign debt markets since its 2002 default, partially because any effort to raise funds would constitute "commercial activity" and any funds raised would be subject to seizure by holdout creditors.¹⁶¹ The renewed default will continue to hinder Argentina's access to the international sovereign debt market.¹⁶² Moreover, if the United States is right in its amicus brief to the Second Circuit that the ruling undermines a "system of cooperative resolution of sovereign debt crises," the current outcome of *NML Capital* could make future voluntary restructurings even more difficult.¹⁶³ All this could potentially undermine the capital flows essential for a healthy global economy. With the stakes in this litigation so high, many parties sympathetic to Argentina's plight—and the plight of other potential victims of vulture funds—have sought various solutions, whether legislative, institutional, or judicial.

III.

LEGISLATIVE SOLUTIONS

Legislative solutions will likely have no effect on the Argentine situation. Nonetheless, their potential form and hypothetical effect are worth considering. They provide possible models for avoiding vulture fund litigation in the future and highlight shortcomings in protecting a relatively wealthy sovereign like

argentina-debt-idUSKBN0GE1FC20140814.

159. *See id.*

160. *Id.* In its frustration, Argentina attempted to sue the United States in the International Court of Justice (ICJ) for violating its sovereignty. *See* Ken Parks, *Argentina Sues U.S. in International Court of Justice over Debt Dispute*, WALL ST. J. (Aug. 7, 2014), <http://online.wsj.com/articles/argentina-sues-u-s-in-international-court-of-justice-over-debt-dispute-1407431003>. However, the ICJ requires that the party-states consent to the court's jurisdiction and the United States indicated it would not consent to the suit. *See* Nicole Hong & Daniel Huang, *Argentina Under Fire From Judge Over Ads*, WALL ST. J. (Aug. 8, 2014), <http://online.wsj.com/articles/argentina-under-fire-from-judge-over-ads-1407552574>.

161. *See, e.g.*, *Republic of Arg. v. Weltover, Inc.*, 504 U.S. 607, 617 (1992) (holding that, when a foreign state issues 'garden variety' public debt in the U.S. market, it is engaging in commercial activity regardless of the activity's purpose, and the state may thus be sued based upon that act); *see also* Jonathan I. Blackman & Rahul Mukhi, *The Evolution of Modern Sovereign Debt Litigation: Vultures, Alter Egos, and Other Legal Fauna*, 73 LAW & CONTEMP. PROBS. 47, 52 (2010) ("[*Weltover*] essentially foreclosed the sovereign-immunity defense to suit for countries that had accessed the U.S. debt markets and had agreed to repayment in the United States.").

162. *See de la Jara & Esposito, supra* note 20.

163. Brief for the United States of America as Amicus Curiae at 5, *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246 (2d Cir. 2012) (No. 12-105-cv(L)).

Argentina. This Part describes legislative solutions implemented in the United Kingdom and several smaller jurisdictions, as well as proposed legislative solutions in Australia and the United States. The Part also describes the ineffectiveness of these legislative solutions for Argentina's situation.

Although the United States has not succeeded in passing legislation regulating vulture funds, the United Kingdom has. This is particularly important because U.K. law, like New York law, governs many sovereign bonds.¹⁶⁴

In 2010, the U.K. Parliament passed the Debt Relief (Developing Nations) Act, and permanently renewed it the next year.¹⁶⁵ The law was passed in response to an episode in which hedge funds bought Zambian and Liberian debt at significant discounts.¹⁶⁶ The hedge funds successfully sued in U.K. courts for the enforcement of the full amount of the bonds.¹⁶⁷ Public outcry in response to the hedge funds' victories prompted passage of the Act.¹⁶⁸

However, even assuming the Act governed New York law contracts, it would still have been inapplicable to Argentina's situation. The law is limited to protecting Highly Indebted Poor Countries (HIPC), as identified by the World Bank and IMF.¹⁶⁹ Argentina does not qualify as an HIPC,¹⁷⁰ and is, in fact, a member of the G20.¹⁷¹

Furthermore, the U.K. Act is limited in that it only applies retroactively. The U.K. Government feared that "in the absence of similar legislation in other major financial jurisdictions (notably New York), a forward-looking application of the law, covering future indebtedness, would chill the degree to which sovereign lenders and creditors would choose English law to govern

164. See N.Y.C. BAR ASS'N, COMM. ON FOREIGN AND COMPARATIVE LAW, GOVERNING LAW IN SOVEREIGN DEBT – LESSONS FROM THE GREEK CRISIS AND ARGENTINA DISPUTE OF 2012, at 3, 9 (2013), available at <http://www2.nycbar.org/pdf/report/uploads/20072390-GoverningLawinSovereignDebt.pdf> (noting that "English and New York law are the two primary alternative choices when local law is not the governing law in a sovereign debt issue").

165. Debt Relief (Developing Nations) Act, 2010, c. 22 (U.K.); see also GAVIN MCLEAN & FRANCIS FITZHERBERT-BROCKHOLES, WHITE & CASE, INSIGHT: CAPITAL MARKETS: THE UK DEBT RELIEF (DEVELOPING COUNTRIES) 2010 ACT: CAUSES AND EFFECTS (2010), available at <http://www.whitecase.com/alerts-09072010-2/>.

166. See MCLEAN & FITZHERBERT-BROCKHOLES, *supra* note 165; see also WONG, *supra* note 41, at 84.

167. WONG, *supra* note 41, at 84.

168. *Id.* at 84 n.52.

169. Debt Relief (Developing Nations) Act, 2010, c. 22, § 1(1)–(6) (U.K.); see also MCLEAN & FITZHERBERT-BROCKHOLES, *supra* note 165.

170. See IMF, HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE AND MULTILATERAL DEBT INITIATIVE (MDRI) – STATISTICAL UPDATE 6 (2013), available at <http://www.imf.org/external/np/pp/eng/2013/041113.pdf> (listing Heavily Indebted Poor Countries as of the end of December 2012).

171. See Robert Plummer, *Argentina Still Tackling Debt Burden*, BBC (Nov. 23, 2010), <http://www.bbc.co.uk/news/business-11764535> (noting that Argentina is a member of G20 and discussing critiques about its G20 membership status).

future debts.”¹⁷² Thus, for such laws to have a strong and prospective effect, jurisdictions with major financial centers must act in some degree of unison.

Several other countries and smaller jurisdictions have implemented or are considering laws similar to the United Kingdom’s.¹⁷³ For example, in October 2012, the Australian Parliament narrowly passed an initiative directing the Government “to commence a process to examine the risks and benefits of enacting legislation to curb the facility for creditor litigation in Australia against those countries who have been deemed by the International Monetary Fund and World Bank eligible for debt relief under the enhanced Heavily Indebted Poor Countries Initiative.”¹⁷⁴ The Government issued a report in May 2013, but as of August 2014, no further action has been taken.¹⁷⁵

Additionally, three very small jurisdictions have also taken steps to mitigate the ability of vulture funds to collect sovereign debts in their territory. In December 2012, the Isle of Man, a self-governing British Crown Dependency, passed an act essentially mirroring the U.K. Debt Relief Act.¹⁷⁶ Reports suggest that Guernsey, another British Crown Dependency, debated similar legislation in late 2012, even though vultures have not yet used its courts.¹⁷⁷ Finally, after vultures successfully used the courts of Jersey (a third British Crown Dependency) to enforce a debt against the DRC, politicians there enacted a law to bring the small island in line with the U.K. law.¹⁷⁸ The law came into effect in February 2013.¹⁷⁹

In the United States, no similar law exists. Nonetheless, in prior sessions of Congress, members have proposed variations on a bill comparable to the

172. MCLEAN & FITZHERBERT-BROCKHOLES, *supra* note 165.

173. In addition to Australia’s proposal, described above, Belgium enacted a law similar to the United Kingdom’s. See PATRICK WAUTELET, VULTURE FUNDS, CREDITORS AND SOVEREIGN DEBTORS: HOW TO FIND A BALANCE? 20–23 (2011), available at <http://orbi.ulg.ac.be/bitstream/2268/87549/1/Vulture%20funds%20and%20sovereign%20debtors%20Wautelet.pdf> (describing the Belgian law).

174. Cth, Votes and Proceedings, House of Representatives, 11 Oct. 2012, 1875 (Austl.) (*Heavily Indebted Poor Countries Initiative 2012* passed 69 votes to 66 votes).

175. *Id.*

176. Heavily Indebted Poor Countries (Limitation on Debt Recovery) Act, 2012 (Isle of Man); see also *Isle of Man Introduces Legislation to Outlaw Vulture Funds*, GOV.IM, <https://www.gov.im/news/2012/dec/12/isle-of-man-introduces-legislation-to-outlaw-vulture-funds/> (last visited Sept. 9, 2014) (“The new law, which is equivalent to the UK Debt Relief (Developing Countries) Act 2010, supports an international initiative to provide debt relief to heavily indebted low income countries.”).

177. See *Guernsey Government Targets ‘Vulture Funds’*, BBC (Oct. 20, 2012), <http://www.bbc.co.uk/news/world-europe-guernsey-20015952> (describing the purpose of the legislation as “limit[ing] the amount so called vulture funds can recover or enforce through the Guernsey courts in line with debt reductions agreed internationally”) (internal citations omitted); see also HANSARD, 1 OFFICIAL REPORT OF THE STATES OF DELIBERATION OF THE ISLAND OF GUERNSEY 716–19 (2012), available at <http://www.gov.gg/CHHttpHandler.ashx?id=79923&p=0> (noting that, “[t]o date, the courts within this Bailiwick have not been used to enforce payment of debts covered by the HIPC Initiative”).

178. *Jersey Law to Stop ‘Vulture Funds’ Comes into Force*, BBC (Mar. 1, 2013), <http://www.bbc.co.uk/news/world-europe-jersey-21627406>.

179. See Debt Relief (Developing Countries) Law, 2013 (Jersey).

U.K.'s law, including the Stop VULTURE Funds Act.¹⁸⁰ The 2009 version of the proposed Act would have made it a crime to engage in "sovereign debt profiteering" against "qualified poor countr[ies]," prohibited U.S. courts from hearing claims by sovereign debt profiteers, and instructed the Secretary of the Treasury to maintain a list of "qualified poor countr[ies]" eligible for protection from vulture funds.¹⁸¹ Under the proposal, the list of qualified poor countries would be compiled from those nations "eligible for financing from the International Development Association [IDA]," excluding countries that meet certain conditions indicating hostility to the United States or its policies.¹⁸² As with the U.K. Act, the proposed Stop VULTURE Funds Act would probably not have protected Argentina even if it were in effect. Argentina is not eligible for IDA financing,¹⁸³ and would therefore not likely qualify for protection against sovereign debt profiteering under the proposed version of the Act.

It is worth noting that some news sources have indicated that Congresswoman Maxine Waters, one of the bill's original sponsors, was improperly influenced by a lobbying firm funded by "the corrupt president of the Republic of Congo," whom such a bill would almost certainly benefit.¹⁸⁴ Congresswoman Waters denied any knowledge of the Congolese President's involvement in lobbying efforts.¹⁸⁵ It is also worth noting that different members of Congress, responding to lobbying efforts funded largely by vulture funds,¹⁸⁶ sought to introduce punitive legislation against Argentina, the goal of which was to "protect future investors by motivating those countries identified

180. Stop Very Unscrupulous Loan Transfers from Underprivileged Countries to Rich, Exploitive [VULTURE] Funds Act, H.R. 2932, 111th Cong. § 2(8) (2009) [hereinafter Stop VULTURE Funds Act].

181. *Id.* § 3(4), § 5.

182. *Id.* § 6.

183. See *IDA Borrowing Countries*, THE WORLD BANK, <http://www.worldbank.org/ida/borrowing-countries.html> (last visited Sept. 9, 2014) (providing list of IDA borrowing countries, which does not include Argentina).

184. See Rahn, *supra* note 73; see also *People & Power*, *supra* note 73, at 12:34–15:30.

185. See *People & Power*, *supra* note 73, at 14:50–15:30.

186. The lobbying organization is called American Task Force Argentina (ATFA). J.F. HORNBECK, CONG. RESEARCH SERV., ARGENTINA'S DEFAULTED SOVEREIGN DEBT: DEALING WITH THE "HOLDOUTS" (2013), available at <http://www.fas.org/sgp/crs/row/R41029.pdf>. NML Capital's parent company, Elliott Capital Management, is one of ATFA's original funders. Ianthe Jeanne Dugan, *Argentine Lobby Mystifies 'Members'*, WALL ST. J. (Oct. 15, 2012), <http://online.wsj.com/article/SB10000872396390444657804578050923796499176.html>. ATFA ran into some trouble when it listed on its membership rolls "groups representing ranchers, teachers and famers" that were "baffled" by the discovery that they were supporting the ATFA. *Id.* As of January 2014, ATFA had spent more than \$4 million on its lobbying efforts. See *American Task Force Argentina*, INFLUENCE EXPLORER, <http://influenceexplorer.com/organization/american-task-force-argentina/c2020803ecd540249c72a17cf44f8db7> (last visited Sept. 8, 2014). ATFA's lobbying efforts reportedly include ads characterizing Argentina as a "safe haven for narcotics traffickers" and having made a "pact with the Devil" (meaning Iran). See Christina Wilkie & Ryan Grim, *Vulture Capitalists Battle Argentina Over Decade-Old Debt Default*, HUFFINGTON POST (June 20, 2013), http://www.huffingtonpost.com/2013/06/20/vulture-capitalists-argentina_n_3466679.html.

as ‘judgment evading foreign states’ to ‘raise their standards of behavior.’”¹⁸⁷ The bill was never enacted.

The failure of the various anti-vulture-fund statutes to protect a middle-income economy like Argentina illustrates a shortcoming within the current legislative solutions to the problem of vulture funds. The emphasis on protecting only HIPCs, or similarly poor countries, though important and admirable, does not go far enough to undermine vulture funds. One possible solution to such deficient coverage is to require that judgments against middle-income countries not exceed a certain amount, rather than to say that such judgments cannot be made at all. For example, legislation could limit awards to an amount reflecting the country’s capacity to pay by linking payments to GDP growth or, as one scholar suggests, “by setting payments as a percentage of exports or trade balances.”¹⁸⁸

Though the proposed and enacted schemes have a relatively limited reach, there is some solace to be found in the fact that such legislation is even on the minds of members of the U.K. Parliament, U.S. Congress, and others. Nonetheless, the limited scope of these laws suggests that other solutions are necessary to broadly undermine the incentives for vulture funds to prey on indebted countries. Institutional solutions could potentially have a broader reach than narrowly focused domestic statutes. Examples of such institutional solutions are discussed below.

IV.

INSTITUTIONAL SOLUTIONS

“Institutional solutions” refer to solutions that apply broadly across the sovereign finance market. This Part describes two possible institutional solutions: (1) the use of contractual, market-based CACs, which permit a supermajority of bondholders to bind dissenting bondholders into changing a bond’s terms; or (2) a centralized SDRM, which would function much like a national bankruptcy system.

187. HORNBECK, *supra* note 186, at 11–12 (explaining that the proposed bill would deprive ‘judgment evading states’ and any state-owned corporations from issuing debt in the U.S. capital markets, and would “require that any future debt offerings carry a warning label that notifies would-be purchasers that the state had previously failed to satisfy outstanding judgments against it”); *see also* Judgment Evading Foreign States Accountability Act of 2009, H.R. 2493, 111th Cong. (2009). The full title of the bill reads: “To prevent wealthy and middle-income foreign states that do business, issue securities, or borrow money in the United States, and then fail to satisfy United States court judgments totaling \$100,000,000 or more based on such activities, from inflicting further economic injuries in the United States, from undermining the integrity of United States courts, and from discouraging responsible lending to poor and developing nations by undermining the secondary and primary markets for sovereign debt.” This bill was unsuccessfully reintroduced in 2010 and 2011. *See American Task Force Argentina, supra* note 186.

188. *See* Guinnane, *supra* note 48, at 41. These mechanisms are similar to those used in the 1952 London Agreement, which restructured Germany’s debt incurred from World War I to World War II.

This Part first describes CACs and their shortcomings. Using economic analysis, this Part further argues that the assumption that CACs will undermine future holdout litigation is deeply flawed. The threshold requirements to effectuate amendments are high and possibly impractical when bondholders act in their best interest, and the terms of typical CACs leave room for holdout bondholders to block bond amendments. Importantly, the Second Circuit's interpretation of the *pari passu* clause, discussed *infra* Part V, will further undermine the effectiveness of CACs by emboldening holdouts and discouraging rational bondholders from participating in restructuring negotiations.

This Part then argues that institutional actors should reconsider creating an SDRM, a solution that was widely considered but ultimately abandoned in the early 2000s. In 2002, when the IMF first drafted an SDRM proposal, there allegedly existed "widespread agreement that a new approach [was] necessary, and that a fairer, more efficient process for sovereign debt restructurings would represent a substantial strengthening of the international financial system."¹⁸⁹ However, disfavor among some creditors and debtors, a lack of political will (particularly in the United States),¹⁹⁰ and the difficulty of practical implementation prevented the SDRM from moving forward, and other similar proposals have not made headway.¹⁹¹ Instead, the U.S. Treasury and other institutional actors have favored a market-driven approach: writing CACs into sovereign bond contracts.¹⁹²

189. ANNE O. KRUEGER, IMF, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING 40 (2002), available at <http://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf>.

190. See BRAD SETSER, IPD TASK FORCE ON SOVEREIGN DEBT, THE POLITICAL ECONOMY OF THE SDRM 2 (2008). According to one analysis, however, it was in fact U.S. Treasury Secretary Paul O'Neill's "willingness to look for a fresh solution to old problems . . . [that] created the political space that allowed IMF staff to develop its blueprint [for an SDRM]." *Id.* at 2. It turned out, however, that Secretary's O'Neill's statements did not conform to the Bush administration's position, and a day after the IMF presented its proposal, a Treasury undersecretary indicated that the United States preferred a more "decentralized and market-oriented" approach than an SDRM. Paul Blustein, *IMF Crisis Plan Torpedoed*, WASH. POST (Apr. 3, 2002), <http://www.globalpolicy.org/component/content/article/209/42982.html> (quoting Treasury Undersecretary for International Affairs John Taylor, who added that "[a] decentralized approach . . . makes much more sense and is much more workable" than an SDRM).

191. See generally Marcus Miller & Dania Thomas, *Sovereign Debt Restructuring: The Judge, the Vultures and Creditor Rights*, 30 WORLD ECON. 1491 (2007). Currently, some practitioners are attempting to design a workable SDRM-like institution specifically for the Eurozone. See generally Christoph G. Paulus, *Sovereign Defaults to be Solved by Politicians or by a Legal Proceeding?*, 1 LAW & ECON. YEARLY REV. 203 (2012). Professor Paulus's proposal includes three main elements: (1) a contract clause to be written into debt issues referring defaults or potential defaults to a "resolvency" court; (2) the creation of a "resolvency" court, which would function through a president who appoints senior statespersons to serve as judges in resolvency proceedings; and (3) draft rules of procedure. See generally *id.*

192. See generally Miller & Thomas, *supra* note 191.

A. Collective Action Clauses

Collective action clauses in sovereign bond contracts allow a majority or supermajority of bondholders to change the terms of the bond for the entire class of bondholders.¹⁹³ Such clauses would ideally “constrain any maverick elements within the bondholder group.”¹⁹⁴ CACs have become commonplace in bonds governed under New York law issued since the mid-2000s and were included in the exchange bonds issued during Argentina’s 2005 and 2010 restructurings.¹⁹⁵ In *NML Capital*, the Second Circuit noted that CACs “have been included in 99% of the aggregate value of New York-law bonds issued since January 2005.”¹⁹⁶ The court noted the proliferation of CACs in response to the U.S. Government’s fears that the district court decision will enable “a single creditor to thwart the implementation of an internationally supported restructuring plan,” indicating that the Second Circuit believes CACs will undermine future vulture fund litigation.¹⁹⁷ The Second Circuit, however, failed to consider the several shortcomings of CACs, described below.

1. Shortcomings of the CAC Solution

The Second Circuit’s assurances that CACs will undermine future holdout litigation are not comforting for several reasons. First, the common inclusion of CACs in recent New York-law bond offerings will only have a prospective effect; many pre-2005 sovereign bond issues for several different countries lack CACs.¹⁹⁸ Precise details about the stock of non-CAC bonds still outstanding are currently unavailable; however, World Bank data provides a useful basis for formulating assumptions.

193. See, e.g., Lee. C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L. J. 1317, 1321 (2002). For an example of CAC terms, see *infra* notes 210–216 and accompanying text.

194. Buchheit & Gulati, *supra* note 193, at 1321.

195. *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 253, 264 (2d Cir. 2012); see also THE MONETARY AND CAPITAL MARKETS DEPARTMENT, IMF, *supra* note 44, at 14 (“Mexico was the first country to include CACs in its sovereign bond issue in the New York market in February 2003. Other countries quickly followed suit, including Uruguay and Brazil (April 2003), Korea and South Africa (May), Belize (June), Italy (July), and Turkey (September). Since then, the inclusion of CACs in New York law bonds has become the norm. During the same period, EU countries agreed to update their bond documentation on internationally issued bonds to include CACs.”).

196. *NML Capital*, 699 F.3d at 264.

197. *Id.*

198. See, e.g., Wheeler & Attaran, *supra* note 2, at 254.

Table 1: Debt of All Developing Countries (US\$ million)¹⁹⁹

<i>Long-term external debt</i>	1995 (CACs Uncommon)	2000 (CACs Uncommon)	2005 (CACs Common)	2010 (CACs Common)
Private creditors - Total	469,528	535,744	567,659	760,010
Private creditors - Bonds	220,501	341,957	400,279	527,752
Private nonguaranteed -	208,491	490,902	681,149	1,392,674
Total				
Private nonguaranteed -	51,018	89,492	155,162	311,827
Bonds				
<i>Average Terms of New Commitments, Private Creditors</i>				
Maturity (years)	7.4	11.2	11.3	12.4
Grace Period (years)	3.4	8.5	8.7	8.2

Focusing on the bonds issued to all developing countries in 2000 provides a rough estimate of bonds outstanding without CACs. The average maturity for bonds issued in or before 2000 is 11.2 years, and adding the average grace period of 8.5 years means a number of these bonds will not be retired until nearly 2020.²⁰⁰ It is reasonable to assume that a fair percentage of the nearly \$342 billion in private bonds issued to developing countries in or before 2000 was issued under New York law, before CACs became commonplace. Absent more data, it is reasonable to assume that billions of dollars of non-CAC bonds remain outstanding. Moreover, debt restructuring can involve many different bond series;²⁰¹ those bonds lacking CACs, or those without an aggregation clause, would not qualify for the compelled restructuring.²⁰² With billions of

199. Data adapted from THE WORLD BANK, GLOBAL DEVELOPMENT FINANCE: EXTERNAL DEBT OF DEVELOPING COUNTRIES 40–41 (2012), available at http://data.worldbank.org/sites/default/files/gdf_2012.pdf.

200. See *id.*

201. “Bond series” refers to the fact that bonds will often be issued at various times, and may include differing terms.

202. See Lee C. Buchheit & Mitu Gulati, *Drafting a Model Collective Action Clause for Eurozone Sovereign Bonds*, 6 CAPITAL MARKETS L. J. 317, 318 (2011) (noting that “Argentina had 152 bond issues outstanding at the time of its restructuring in 2005”); see also Anna Gelpert, *Sovereign Restructuring after NML v. Argentina: CACs Don’t Make Pari Passu Go Away*, CREDIT SLIPS (May 3, 2012, 10:38AM), <http://www.creditslips.org/creditslips/2012/05/sovereign-restructuring-after-nml-v-argentina-cacs-dont-make-pari-passu-go-away.html> (“Even assuming that ‘all’ foreign

dollars tied up in non-CAC bonds, the Second Circuit misguidedly relies on CACs to undermine future holdout litigation.

An additional shortcoming of CACs is that “they do not apply to other types of indebtedness, such as bank claims and domestic debt.”²⁰³ This is particularly important to note because, of the estimated \$2 billion in creditor lawsuits filed against HIPC, the majority are related to non-bond and non-loan liabilities, “such as unpaid energy bills or trade invoices.”²⁰⁴ Though government liabilities other than bonds and loans are largely outside the scope of this Comment, it is important to note that the presence of CACs does not undermine vultures’ ability to sue on other types of government debt, and is of doubtful use for undermining vultures’ ability to sue on bonds. As IMF First Deputy Managing Director Anne Krueger argued in support of an SDRM, the diversity of the private creditor community undermines the efficacy of purely market-based solutions and highlights the need for a mechanism that would “apply to all forms of private credit to sovereigns.”²⁰⁵

In addition to the abovementioned shortcomings of CACs, the Second Circuit’s interpretation of the *pari passu* clause may further undermine their efficacy by changing bondholders’ rational economic choices, particularly in light of the typically high thresholds required to impose changes across bond issues. The remainder of this Section uses economic analysis to highlight additional shortcomings of CACs. First, rational bondholders may not participate in the decision to restructure a sovereign’s debt if there is a likelihood that the required threshold to activate the CAC will not be achieved. Second, CACs require high bondholder participation to effectuate changes to the bonds, which may be difficult to achieve when bondholders act rationally, and which may provide holdouts room to block amendments. Third, CACs provide an opportunity for aggressive vultures to purchase enough of the

sovereign bonds soon come to have CACs . . . [the Second Circuit’s] argument fails for two reasons. First, not all sovereign debt is in the form of CACed or CACable bonds. Second, not all CACs contain an aggregation feature, which allows majority amendment across multiple bond series. As a result, . . . a holdout can obtain an obscure little instrument that is not even syndicated let alone bonded, and sue to her heart’s content. In the alternative, . . . she can buy a blocking position in a tiny bond issue trading at a deep discount, block the restructuring of that issue, and *pari passu* right ahead. Holdout strategies have never been about joining the masses—they are all about piggy-backing on the masses’ concessions. From that perspective, and at least until aggregation becomes pervasive, CACs clear the field for the holdouts.”); *see also* KRUEGER, *supra* note 189, at 15 (“Majority restructuring provisions . . . only bind bondholders within the same issue. They have no effect on bondholders of other issuances, which may in any event be governed by different legal jurisdictions.”); *id.* at 30–31 (“Another barrier to the establishment of [a CAC] framework is the transitional problem. Even if all new bonds make use of the needed contractual provisions, a large portion of outstanding bonds with long maturities, including bonds governed by New York law, do not contain such provisions. While this problem could conceivably be addressed by a series of exchanges that retired existing bonds, it is not clear how debtors and creditors would be persuaded to take such action.”)

203. KRUEGER, *supra* note 189, at 15.

204. Das et al., *supra* note 23, at 50–51.

205. KRUEGER, *supra* note 189, at 15.

sovereign's debt to achieve a blocking position and prevent restructuring altogether. Importantly, the Second Circuit's interpretation of the *pari passu* clause will exacerbate the shortcomings of CACs and further undermine bondholders' incentives to participate in restructuring deals, even when CACs are present in the bonds.

2. Rational Choice to Participate in a Restructuring

Absent an SDRM or other judicial mechanism to compel creditor participation in a sovereign debt write-down, the holdout problem will likely persist even with CACs because creditors, acting in their self-interest, will lack incentive to agree to a write-down.²⁰⁶ A creditor will likely have three rational options with respect to a defaulted CAC bond: (1) volunteer for a write-down and hope that a supermajority agrees; (2) do nothing and accept the write-down when a supermajority opts for it; or (3) do nothing, wait to see if a majority will agree to a write-down, and if not, litigate.

For a vulture fund, the marginal costs of (2) and (3) are likely lower than litigating from the get-go on a bond with a CAC. Waiting for a possible payout through litigation (option (3)) is less costly than litigating from the start if there is a possibility that an early litigation effort will be undermined by a supermajority's agreement to restructure. Regardless, a CAC will not likely motivate a creditor who is more likely to holdout without a CAC to volunteer for a write-down now that the CAC is in place—rather, he will likely wait, see, and then litigate.

For a non-likely-holdout bondholder who *is* willing to participate in a write-down, the marginal cost of (1) could be greater than (2). This is because the time and resources involved in organizing with other creditors to create a supermajority and the bargaining costs associated with signaling a willingness to restructure (option (1)), *may* be greater than the costs associated with entering a write-down at a later time without signaling a willingness to restructure (option (2)).²⁰⁷

Moreover, the current disposition of *NML Capital* demonstrates that holdouts can gain handsomely through their obstinacy, which could indicate to bondholders that the benefits of option (3) outweigh options (1) and (2), even for those bondholders who may have been more inclined to participate in a write-down without a CAC. As such, in the aftermath of *NML Capital*, a CAC

206. In the debt restructuring context, a “write-down” is “[a] lender’s agreement to accept less than the full principal balance of a loan, usually in recognition of the fact that it won’t collect the full balance anyway.” *Write-Down Definition*, THE FREE DICTIONARY, <http://financial-dictionary.thefreedictionary.com/write-down> (last visited Sept. 9, 2014).

207. By signaling a willingness to accept a write-down (option (1)), the bondholder may lose negotiating power and ultimately accept a larger write-down than desired. By way of analogy, consider a first-time car buyer who seems overeager to purchase a particular model. Seeing the buyer’s eagerness, the salesman will believe that he can extract a higher price for the car and therefore negotiate from a position of power.

may not motivate a non-likely-holdout creditor to voluntarily enter a write-down, and may actually encourage such a creditor to take a wait-and-see approach comparable to holdouts.²⁰⁸

3. CAC Threshold Requirements for Bond Amendments

The high threshold of voter approval required to amend bonds further undermines the efficacy of CACs.²⁰⁹ A sample of CAC language from four bonds, including Argentina's 2005 and 2010 issues, suggests *some* consistency across debt issues.²¹⁰ In these bonds, certain, relatively mundane modifications to a single series require consent of 66.6 percent of the aggregate principal amount of the outstanding issue.²¹¹ However, certain other changes, often called "reserve matter modification[s]," require a higher threshold of the aggregate principal, regularly 75 percent.²¹² Matters classified as "reserve" include changing the due date for payment of principal or interest installments, reducing the principal amount, reducing the interest rate, and changing the

208. See, e.g., Sujata Rao, *Analysis: Argentina Debt Case Weakens Incentives to Settle*, REUTERS (Dec. 11, 2012), <http://www.reuters.com/article/2012/12/11/us-argentina-restructuring-idUSBRE8BA0N420121211> (quoting Bart Van der Made, lead portfolio manager at ING Investment Management, which swapped its Argentine bonds: "Such a ruling [as in *NML Capital*] creates a big incentive to be a holdout going forward If you think there's a judge waiting around the corner who says you will be paid in full and with past due interest—well, in that case, everyone will hold back and you won't hit the 75 percent approval rate required to [trigger] the CAC."); see also Gelpert, *supra* note 202.

209. Recent studies have tried to ascertain how CAC thresholds are established, but no clear consensus has emerged. See, e.g., ANDREW G. HALDANE ET AL., IMF, OPTIMAL COLLECTIVE ACTION CLAUSE THRESHOLDS 3 (2004) ("The choice of threshold that strikes the optimal balance between [the] costs and benefits depends on debtor risk preferences and creditworthiness. Risk neutral debtors prefer high thresholds because the *ex post* costs of getting away with a lower offer are more than outweighed by the *ex ante* benefits of lower interest rates and a lower probability for a liquidity run. Risk averse debtors may however prefer lower CACs. Moreover, for a given level of risk aversion, the lower the debtor's creditworthiness the more likely they will want to issue bonds with higher CAC-thresholds. In other words, different choices of threshold between countries emerge as an optimal debtor response to different risk preferences and creditworthiness.").

210. See generally CLEARY GOTTlieb STEEN & HAMILTON LLP, COLLECTIVE ACTION CLAUSES WITH AGGREGATION MECHANISMS (2011), available at http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3004&context=faculty_scholarship (providing samples of the CACs in bond issues from Uruguay (2003), Dominican Republic (2005), and Argentina (2005, 2010)). This sample size should, admittedly, be expanded, but the conclusions here should still hold water, at least for similarly situated countries (that is, low to middle income countries in Latin America).

211. *Id.* at 5 (Uruguay Prospectus at 76), 11 (2005 Argentina Prospectus at 206), 15 (Dominican Republic Prospectus at 136), 21 (2010 Argentina Prospectus at 22). The typical language used is:

Any modification, amendment, supplement or waiver to the terms and conditions of the debt securities of a single series, or to the indenture insofar as it affects the debt securities of a single series may generally be made, and future compliance therewith may be waived, with the consent of [Sovereign] and the holders of not less than 66 2/3% in aggregate principal amount of the debt securities of such series at the time outstanding.

Id. What these modifications, amendments, supplements, or waivers entail is not entirely clear, particularly given the list of possible changes ("reserve matters") that require 75 percent approval.

212. See *id.*

bond's governing law.²¹³ These “reserve matters” are the types of changes that a country would likely desire after a default or when default is looming.

Additionally, to achieve any “reserve matter modification” over two or more series, an even higher threshold is required.²¹⁴ For example, the 2005 Argentina exchange bonds require consent from “the holders of not less than 85% in aggregate principal amount of the outstanding debt securities of all series affected by that modification (taken in aggregate),” and “the holders of not less than 66 2/3% in aggregate principal amount of the outstanding debt securities of that series (taken individually).”²¹⁵

Furthermore, for purposes of calculating the percentage of bondholders who have consented to modifications, any debt “owned or controlled, directly or indirectly” by the issuing country is not considered outstanding debt.²¹⁶ Thus, the actual percentage of outstanding debt required to consent often would be higher than the numerical threshold required on the face of the bonds.²¹⁷ Finally, from my reading of four CACs, holdouts face no apparent penalty for refusal to consent to a modification when the threshold is reached, other than to have the modification compelled upon them.²¹⁸ That is, a holdout is not penalized for letting others do the work of achieving the required threshold.

In sum, within this small sample of CACs, substantive changes that sovereign debtors would likely seek in the face of default require a high consent threshold (75 percent consent for changes to a single series and 85 percent aggregate for changes to multiple series, as well as 66.6 percent consent

213. *See id.*

214. *See id.*

215. *Id.* at 12 (2005 Argentina Prospectus at 207).

216. *See id.* at 7 (Uruguay Prospectus at 78), 13 (2005 Argentina Prospectus at 208).

217. For example, assume the fictional country Ruritania issued a single series bond in the amount of \$1,000,000. Under one of these CACs, to effectuate a “reserve modification,” Ruritania would need to solicit the consent from bondholders who control at least \$750,000. If, however, Ruritania recognized that it might default in the future and attempted to retire some of its debt at a discount by repurchasing on the secondary market bonds worth \$200,000 in principal, \$800,000 would be the new baseline for calculating the consent threshold. Without this new baseline, Ruritania would only need to solicit consent from holders of \$550,000, which together with its \$200,000 would equal \$750,000 for 75 percent consent. However, with the new baseline, Ruritania would have to solicit support from holders of \$600,000 of principal ($0.75 \times \$800,000$). Thus, now a potential holdout that controls \$210,000 can block consent whereas the same holder would not be able to do so before Ruritania repurchased \$200,000 worth of its debt.

This is actually a desirable outcome. Without this outcome, the entire debt issue could be completely retired as soon as a government took control of 75 percent of the outstanding amount and could singlehandedly consent to rewrite the bond terms entirely to the government's benefit. Nonetheless, it is important to note that this clause also benefits potential holdouts by making it possible for a smaller amount of control to be sufficient to block modifications in some circumstances.

218. *See, e.g., id.* at 12 (2005 Argentina Prospectus at 207) (“Any modification consented to or approved by the holders of the debt securities of one or more series pursuant to the modification provisions will be conclusive and binding on all holders of the debt securities of that series, whether or not they have given such consent or were present at a meeting of holders at which such action was taken, and on all future holders of the debt securities of that series whether or not notation of such modification is made upon the debt securities of that series.”).

on each individual series). Such high, though not altogether unreasonable, consent thresholds provide potential holdouts a larger voice, particularly if the incentives to holdout improve, as may be the case under Judge Griesa's ratable payments formula used in *NML Capital*.

4. *The Ability of Holdouts to Block CAC Activation*

The inclusion of CACs may additionally provide an incentive for holdouts to bid up the price of defaulted bonds in order to achieve a blocking position. For example, imagine if the fictional country "Ruritania" is soliciting consent from bondholders to rewrite a single bond issue in such a way that would effectuate a 60 percent write down. Assume a vulture fund already owns 5 percent of the aggregate principal bond issue. If the fund is sufficiently well-capitalized and the debt issue is small enough, the fund could offer other bondholders, those who might consent to the write down, 50 percent of the bond's value. The other bondholders would do better financially by accepting the offer from the vulture fund than they would by consenting to the 60 percent write down, and the vulture fund could potentially achieve a 25 percent blocking position. If Ruritania were soliciting consent to change the terms of multiple series, a vulture fund could frustrate the restructuring efforts by holding 15 percent of the aggregate series.²¹⁹ Alternatively, the vulture fund could focus on the smallest debt series and block restructuring with a 33.3 percent position in a single, small issue.²²⁰

219. *Contra* HALDANE ET AL., *supra* note 209, at 5 n.6 ("We have not allowed for secondary market trading because there are no pure strategy equilibria to such a subgame (full proof available from the authors). Vulture funds have weak incentives to bid for bond issues when: (i) ownership of the issue is widely dispersed; (ii) each creditor owns small proportion of the total issue; and (iii) contractual provisions ensure that during the subsequent restructuring stage holdouts are kept in check, so that all creditors that hold on to their bonds get the same return. In essence, the argument is identical to the one made . . . in the context of corporate raids. Creditors . . . have very little incentive to tender their bonds . . . to a vulture fund . . . whose participation in the restructuring stage . . . is expected to increase the value of the debtor's offer . . . for all, when each creditor . . . is small enough not to affect the outcome of the vulture's . . . bid.").

220. *See, e.g.*, Felix Salmon, *The Consequences of Elliott [NML Capital] vs Argentina*, REUTERS (Nov. 26, 2012), <http://blogs.reuters.com/felix-salmon/2012/11/26/the-consequences-of-elliott-vs-argentina/> ("Even if all of those [bonds] have CACs, many of them will be small, on the order of say \$100 million or so face value; these are known in the market as 'orphans', and they tend to trade at a discount because they're illiquid. So when a sovereign credit is trading at distressed levels, orphan bonds will be even cheaper. If the sovereign's benchmark bonds are trading at 25 cents on the dollar, the orphans might trade at 20 cents. As a result, a vulture fund could buy up 25% of a \$100 million bond issue for just \$5 million. At that point, the CAC will do the issuer no good at all. If the CAC needs 75% of bondholders to accept a deal, then a carefully-picked \$5 million purchase can effectively veto the deal, and turn the entire bond issue into a holdout. All of which is to say that whenever there's a sovereign restructuring, there *will* be holdouts. They're something of a fact of life—but so long as countries like Argentina can credibly threaten not to pay them, restructurings can still happen, either with or without CACs. . . . The problem with the Elliott [NML Capital] vs Argentina precedent, if it ends up with Elliott getting paid, is that it eviscerates the credibility of that threat. If holdouts have a powerful tool which ensures that they will get paid after a restructuring, then restructurings will never get off the ground: no bondholder will have any incentive to accept a haircut

The “ratable payments” interpretation of the *pari passu* clause reduces the risk that vulture funds would face in pursuing these potentially expensive strategies. Thus, CACs may not only fail to curb holdout litigation, but could actually incentivize the well-capitalized vulture fund to pursue a blocking position, especially if the “ratable payments” interpretation of the *pari passu* clause is sustained.²²¹

In sum, though CACs may prospectively ameliorate the impact of vultures, a ruling favorable to the vulture funds in *NML Capital* may actually increase the incentives to holdout and thereby undermine the efficacy of CACs. Moreover, the presently widespread use of CACs does nothing to protect Argentina in the current litigation or to protect other sovereigns that issued debt prior to the CAC revolution. Although a recent IMF study concluded that “[s]ome features embodied in the bond contracts (CACs and other legal clauses) appeared to facilitate debt crisis resolution . . . [,] their presence alone did not guarantee a smooth restructuring process.”²²² Arguing in this vein, economist Joseph Stiglitz succinctly states, “The fact that every advanced country has found it necessary to have a bankruptcy law reinforces the conclusions of economic theory, that collective action clauses will not suffice; some judicial process is required.”²²³

B. Sovereign Debt Restructuring Mechanism

Observers have noted that “[p]rofitteering in defaulted sovereign debt is made possible by the absence of the same type of bankruptcy protections for sovereign debtors that are available to private debtors.”²²⁴ As such, one proposed institutional innovation is the creation and adoption of an international governing structure for sovereign bankruptcy. In the early 2000s, the IMF, under First Deputy Managing Director Anne Krueger, floated the idea of developing an international, statutory framework for handling sovereign defaults.²²⁵ In an IMF sponsored report, Krueger explained the several, somewhat competing, aims of such a framework:

It should strive to create incentives for a debtor with unsustainable debts to approach its creditors promptly—and preferably before it interrupts its payments. But it should also avoid creating incentives for

if they can instead holdout and get paid in full.”)

221. For the economically and graphically inclined, some of these conclusions are charted in a decision tree in Appendix B.

222. See THE MONETARY AND CAPITAL MARKETS DEPARTMENT, IMF, *supra* note 44, at 1. The study also noted, however, that “[d]espite lengthy negotiations and delays in many debt restructuring cases, creditor coordination and holdouts have not generally been a major problem.” *Id.* at 22.

223. JOSEPH E. STIGLITZ, MAKING GLOBALIZATION WORK 239 (2006).

224. Stop VULTURE Funds Act, *supra* note 180.

225. See KRUEGER, *supra* note 189; see also Miller & Thomas, *supra* note 191. It is worth noting that former U.S. Treasury Secretary Timothy Geithner “contributed to [the] thinking” on the SDRM issue while he worked at the IMF. KRUEGER, *supra*, at v.

countries with sustainable debts to suspend payments rather than make necessary adjustments to their economic policies. Debt restructuring should not become a measure of first resort. By the same token, however, when there is no feasible set of policy adjustments to resolve the crisis unless accompanied by a restructuring, it is in the interests of neither the debtor nor the majority of its creditors to delay the inevitable.²²⁶

The objective of an SDRM tracks that of bankruptcy proceedings in the corporate context, discussed above. The idea is to “facilitate the orderly, predictable, and rapid restructuring of unsustainable sovereign debt, while protecting asset values and creditors’ rights.”²²⁷ A well-designed SDRM would “reduce the costs of a restructuring for sovereign debtors and their creditors, and contribute to the efficiency of international capital markets.”²²⁸ Additionally, the very existence of an SDRM, providing “a predictable legal mechanism,” could encourage creditors and debtors to “reach agreement without the need for formal activation” of the process.²²⁹

Key features of the proposed SDRM would have included: (1) a majority restructuring provision allowing “a qualified majority of creditors to bind a dissenting minority to the terms of a restructuring agreement”; (2) a stay on creditor enforcement, temporarily preventing creditor litigation during the restructuring process; (3) protections of creditor interests during the stay, including prohibiting the sovereign from making payments to non-priority creditors and “assurances that the debtor would conduct policies in a fashion that preserves asset values”; and (4) the facilitation of priority financing to encourage private creditors to provide the sovereign with new money during the stay.²³⁰ A single body would oversee the process, verify creditor claims, and resolve disputes.²³¹

Like national bankruptcy systems, an SDRM would provide important predictability and give struggling countries the opportunity to improve their condition. A well-designed bankruptcy system can allow the “honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.”²³² Creditors would also benefit from an SDRM’s predictability, organization, and capacity to help struggling nations regain their economic footing and thereby take out future loans and service future debt.²³³ In light of the shortcomings of

226. KRUEGER, *supra* note 189, at 2.

227. *Id.* at 4.

228. *Id.*

229. *Id.*

230. *Id.* at 14–17, 40.

231. *Id.* at 40.

232. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

233. See, e.g., ANDREA ORZAN, SOVEREIGN DEBT RESTRUCTURING MECHANISM: WHO OPPOSES IT AND WHY? 2 (2004), available at <http://www.cilae.org/publicaciones/SDRM.pdf> (“[T]he ability of the majority to force decisions on a potentially dissenting minority, the rapid and orderly

the market-based approach—that is, CACs—institutional actors should reconsider the creation of an international SDRM.

V.

JUDICIAL SOLUTIONS

This Part describes two possible judicial solutions to the situation in *NML Capital*, should the situation ever reappear. First, courts can reinterpret the *pari passu* clause narrowly in contrast to the interpretation adopted by the Second Circuit. This Part describes in more detail the *pari passu* clause at issue in *NML Capital* and critiques the Second Circuit’s “ratable payments” interpretation of the clause. The *pari passu* clause is generally considered boilerplate, and boilerplate contract language is traditionally interpreted to avoid sacrificing principal interests of all parties to a contract. The Second Circuit’s broad “ratable payments” interpretation of the clause sacrifices a sovereign’s principal interest in being able to restructure its debt in dire situations, while a narrower, legal subordination-based interpretation does not sacrifice the principal interests of the sovereign or the creditor.

Second, this Part argues that courts can rely on rules of privity to prevent an injunction against third-party intermediaries that are responsible for facilitating payments from sovereigns to bondholders. If courts were to adopt this reasoning, an injunction like the one imposed against Argentina and its clearinghouse, Bank of New York Mellon, would be meaningless and vulture funds would ultimately lack an enforcement mechanism.

A. Reinterpreting the “Pari Passu” Clause

Although the Second Circuit in *NML Capital* affirmed an interpretation of the *pari passu* clause unfavorable to Argentina, more favorable interpretations may be available for other jurisdictions to adopt, if a similar situation arises.²³⁴

The *pari passu* clause in Argentina’s FAA Bonds provides that:

[t]he Securities will constitute . . . direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank *pari passu* without any preference among themselves. *The payment*

resolution of restructuring processes, the role of the IMF as (non-compulsory) *arbiter* of the debtor’s unsustainability of its debt (increasing clarity and reducing information asymmetry), and the consequent lesser fall in the bonds’ value would all benefit creditors.”).

234. Note that even if the Supreme Court granted certiorari in *NML Capital*, the Court would not likely have considered the *pari passu* clause, as that is a matter of state law. *See, e.g.*, Bob Van Voris, *Argentina ‘Greek Tragedy’ Nears End as Debt Ruling Looms*, BLOOMBERG BUSINESSWEEK (Apr. 1, 2013), <http://www.businessweek.com/news/2013-03-31/argentina-greek-tragedy-nears-end-as-debt-ruling-looms>. Nonetheless, Argentina asked the court in its petition for certiorari to certify to the New York Court of Appeals the question regarding the proper interpretation of the *pari passu* clause. Argentina framed that question as “[w]hether a foreign sovereign is in breach of a *pari passu* clause when it makes periodic interest payments on performing debt without also paying on its defaulted debt.” Petition for Writ of Certiorari, *supra* note 153, at ii.

*obligations of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness . . .*²³⁵

The parties disputed what constitutes “subordination” under the clause.²³⁶ Argentina argued that “the clause refers only to legal subordination,” which it said did not occur here.²³⁷ Meanwhile, the plaintiffs argued that there is “‘de facto’ subordination because Argentina reduced the rank of plaintiffs’ bonds to a permanent non-performing status by passing [the ‘Lock Law’] barring payments on them while continuing to pay on the restructured debt and by repeatedly asserting that it has no intention of making payments on plaintiffs’ bonds.”²³⁸

In determining the meaning of the provision, the Second Circuit engaged in “simple . . . contract interpretation.”²³⁹ The court held that the first sentence of the *pari passu* clause “prohibits Argentina, as bond issuer, from formally subordinating the bonds by issuing superior debt.”²⁴⁰ The court continued, stating that “[t]he second sentence . . . prohibits Argentina, as bond payor, from paying on [the exchange] bonds without paying on the [holdout] bonds.”²⁴¹ In so holding, the court concluded “the combination of Argentina’s executive declarations and legislative enactments” subordinated plaintiffs’ interests, and Argentina thereby “breached the *Pari Passu* Clause of the FAA.”²⁴² Thus, the

235. *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 251 (2d Cir. 2012).

236. *Id.* at 258.

237. *Id.* Argentina justified its argument, stating that “any claims that may arise from the Republic’s restructured debt have no priority in any court of law over claims arising out of the Republic’s unstructured debt.” *See id.* “Subordinate debt” is a “debt that is junior or inferior to other types or classes of debt.” BLACK’S LAW DICTIONARY 463 (9th ed. 2009). Legal subordination implies the bond issuer created an inferior class of debt through operation of law, usually understood “only against the backdrop of bankruptcy law,” where there are rules governing the order of debt collection. Romain Zamour, *NML v. Argentina and the Ratable Payment Interpretation of the Pari Passu Clause*, 38 YALE J. INT’L L. ONLINE 55, 60 n.54 (2013), <http://www.yjil.org/docs/pub/o-38-zamour-nml-v-argentina.pdf> (“*Pari passu* clauses are not boilerplate clauses.”).

238. *NML Capital*, 699 F.3d at 258. The Second Circuit held in the alternative that Argentina breached the “legal subordination” interpretation of the *pari passu* clause by enacting the Lock Law. *Id.* at 260 (“Thus, even under Argentina’s interpretation of the Equal Treatment Provision as preventing only ‘legal subordination’ of the FAA Bonds to others, the Republic breached the Provision.”). As Argentina argued in its 2014 petition for certiorari to the Supreme Court, “Even if this were correct, breaching a ‘legal subordination’ promise would provide no basis for injunctions requiring ‘ratable payments.’” Petition for Writ of Certiorari, *supra* note 153, at 22. This Comment proposes that the legal subordination interpretation may, however, provide a basis for requiring Argentina to offer holdouts the same terms as the exchange bondholders accepted. Furthermore, Argentina suspended the Lock Law in September 2013, rendering moot the Second Circuit’s alternative “legal subordination” conclusion. *See* Law No. 26886, Sept. 20, 2013, [32728] B.O. 1 (Arg.). Translated into English, Article 7 reads: “Suspending the applicability of articles 2, 3, and 4 of law 26.017 [the ‘Lock Law’] until the National Congress declares the process of restructuring of bonds achieved by the abovementioned standard.”

239. *NML Capital*, 699 F.3d at 258.

240. *Id.* at 259.

241. *Id.*

242. *Id.* at 260.

court upheld the district court's order that Argentina "make 'Ratable Payments' to plaintiffs concurrent with or in advance of its payments to holders of the 2005 and 2010 restructured debt."²⁴³

This outcome is almost identical to a 2000 decision in the Court of Appeals of Brussels, in which the court granted an *ex parte* petition filed by hedge fund Elliott Associates,²⁴⁴ restraining a third party settlement company²⁴⁵ from processing a payment from Peru to holders of its restructured debt.²⁴⁶ The Brussels Court accepted Elliott's argument—identical to NML Capital's argument above—that the *pari passu* clause required Peru to make "ratable payments" to all creditors and disallowed payments to restructured bondholders in preference over holdout creditors.²⁴⁷ Rather than risk defaulting on its restructured bonds, Peru settled with Elliott for \$56.3 million; Elliott had purchased the bonds five years earlier for only \$11.4 million.²⁴⁸

243. *Id.* at 265. The "ratable payments" interpretation entitles the holdouts to full repayment of principal and interest when exchange bondholders receive a periodic interest payment because of an "acceleration clause" in the original FAA bond. Acceleration clauses are common features of bonds. An acceleration clause can be invoked if the bond issuer defaults, and once invoked the bondholder is immediately entitled to all principal and accrued interest. Petition for Writ of Certiorari, *supra* note 153, at 8–9.

244. Elliott Associates is one of the most prominent and litigious distressed asset (that is, vulture) funds, and is the parent company of NML Capital. FUKUDA, *supra* note 4, at 5; Shane Romig, *Argentine Navy Ship Remains Impounded in Ghana*, WALL ST. J. (Oct. 11, 2012), <http://online.wsj.com/news/articles/SB10000872396390443749204578051231734377620> (noting that Elliott Management is NML's parent company).

245. A settlement company, or clearinghouse, is a conduit that transfers money from a debtor to a creditor in satisfaction of the debt contract. See *Clearinghouse Definition*, MERRIAM-WEBSTER.COM, <http://www.merriam-webster.com/dictionary/clearinghouse> (last visited Sept. 9, 2014). The settlement company in the Brussels case was Euroclear. In *NML Capital* the primary clearinghouse is Bank of New York Mellon. See Bob Van Voris, *Argentina Asks U.S. Supreme Court to Hear Bond-Default Case (1)*, BLOOMBERG NEWS (June 26, 2013), <http://www.businessweek.com/news/2013-06-26/argentina-asks-u-dot-s-dot-supreme-court-to-hear-bond-default-case-1>.

246. G. Mitu Gulati & Kenneth N. Klee, *Sovereign Piracy*, 56 BUS. LAW. 635, 636 (2001) (citing the Brussels opinion as Elliott Assocs., L.P., General Docket No. 2000/QR/92 (Court of Appeals of Brussels, 8th Chamber, Sept. 26, 2000)). In this case, Peru was required to pay interest on "Brady Bonds," bonds issued in the 1980s and 1990s to help Latin American governments re-enter the sovereign debt market after a wave of defaults in the 1980s.

247. Gulati & Klee, *supra* note 246, at 636–37. According to a translation of the Brussels Court's holding, the court found:

It also appears from the basic agreement that governs the repayment of the foreign debt of Peru that the various creditors benefit from a *pari passu* clause that in effect provides that the debt must be repaid *pro rata* among all creditors. This seems to lead to the conclusion that, upon an interest payment, no creditor can be deprived of its proportionate share.

Buchheit & Pam, *supra* note 13, at 879.

248. Gulati & Klee, *supra* note 246, at 635–36. To add some perspective, the settlement cost more than \$2 per Peruvian where, in 2000, the GDP per capita was about \$2,050. See *GDP Per Capita (Current US\$)*, THE WORLD BANK, <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD?page=2> (last visited Sept. 2, 2014); *Peru Country Report*, GLOBAL FIN., <http://www.gfmag.com/gdp-data-country-reports/199-peru-gdp-country-report.html#axzz2xqdzinFE> (last visited Sept. 9, 2014) (indicating Peru's population in 2000 was 25.21 million, meaning the \$56.3 million settlement with Elliott cost Peru more than \$2 per person).

The Brussels Court decision has been the subject of great criticism.²⁴⁹ One common criticism is that the “ratable payments” interpretation of the *pari passu* clause is inconsistent with market expectations, increases uncertainty and inefficiency, and creates incentives for holdouts to engage in “sovereign piracy.”²⁵⁰ This criticism is just as applicable to the interpretation in *NML Capital*, and it presents a potential legal argument for reinterpreting the *pari passu* clause to promote market expectations.

A reviewing court should use a different method of analysis—relying on traditional methods of interpreting boilerplate language—to reach a different outcome than the Second Circuit in *NML Capital*. The meaning of a *pari passu* clause in a sovereign debt instrument is unclear.²⁵¹ Yet, the clause has been a common feature of contracts since at least the late nineteenth century, and a common feature of sovereign debt contracts since at least the 1970s.²⁵² The clause is widely regarded as “boilerplate.”²⁵³ In *Sharon Steel Corp.*, the Second Circuit described an approach to interpreting boilerplate contract language:

Where contractual language seems designed to protect the interests of both parties and where conflicting interpretations are argued, the contract should be construed to sacrifice the principal interests of each party as little as possible. An interpretation which sacrifices a major interest of one of the parties while furthering only a marginal interest of the other should be rejected in favor of an interpretation which sacrifices marginal interests of both parties in order to protect their major concerns.²⁵⁴

249. See, e.g., Gulati & Klee, *supra* note 246, at 638 (“What the Brussels Opinion does is to put a large hammer in the hands of holdout creditors, thereby enabling them to cause even more disruption in restructurings. Those inclined to be holdouts have a stronger position, and it encourages others to hold out.”); Buchheit & Pam, *supra* note 13, at 883–91 (describing various criticisms of the “ratable payments” interpretation of the *pari passu* clause).

250. Gulati & Klee, *supra* note 246, at 650.

251. See, e.g., PHILIP R. WOOD, PROJECT FINANCE, SUBORDINATED DEBT AND STATE LOANS 165 (1995) (“In the state context, the meaning of the clause is uncertain because there is no hierarchy of payment which is legally enforced under a bankruptcy regime.”); Buchheit, *supra* note 118, at 11 (“[N]o one seems quite sure what the clause really means, at least in the context of a loan to a sovereign borrower.”); Stephen J. Choi & G. Mitu Gulati, *Contract as Statute*, 104 MICH. L. REV. 1129, 1134 (2006) (“The leading commentators on sovereign contracts acknowledged that there exists ambiguity as to the meaning of this clause.”); Gulati & Klee, *supra* note 246, at 646 (“[I]n the sovereign context there is at least disagreement about the meaning of the clause.”); see also, *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 258 (2d Cir. 2012).

252. See generally Buchheit & Pam, *supra* note 13, at 247 (detailing the meaning of the clause, the recent “ratable payment interpretation,” and its historical uses and interpretations).

253. See, e.g., Gulati & Klee, *supra* note 246, at 647; Choi & Gulati, *supra* note 251, at 1131. *Contra* Zamour, *supra* note 237, at 65 (“*Pari passu* clauses are not boilerplate clauses.”).

254. *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1051 (2d Cir. 1982). One could argue that the *pari passu* clause only protects the interests of creditors. The *pari passu* clause, however, protects the sovereign’s interests inasmuch as it is crucial to supporting the sovereign’s credibility as a borrower. Without certain commitments, a sovereign is uniquely situated to change the rules that govern its behavior—including which bondholders it chooses to repay—without legal recourse. Including the *pari passu* clause in its bonds commits the sovereign to treat lenders

This analysis is comparable to an interpretative technique used in law and economics, which advises courts to “[i]mpute the terms to the contract that the parties would have agreed to if they had bargained over all the relevant risk.”²⁵⁵

Under the *Sharon Steel* framework, Argentina, or a similarly situated debtor-country, could argue that the court’s interpretation of the *pari passu* clause unreasonably sacrifices its “principal interest[]” in being able to restructure its debt in the face of economic crisis. As one commentator noted, sovereign default is as certain as death and taxes.²⁵⁶ Even if it is not a certainty, sovereign default is a reality of our time. The absence of a bankruptcy framework for sovereign default makes it necessary for bondholders to be willing to restructure their debt.

A “ratable payments” interpretation of the *pari passu* clause will almost certainly undermine incentives for rational bondholders to restructure.²⁵⁷ Moreover, as described above, there is reason to be skeptical of the Second Circuit’s assurances that the proliferation of CACs will “effectively eliminate the possibility of ‘holdout litigation.’”²⁵⁸ Rather, because the *pari passu* clause continues to be a common feature of sovereign bonds, bondholders might be less willing to agree to a write-down under the “ratable payments” interpretation.²⁵⁹ Additionally, the supermajority required by CACs—often between 66 percent and 75 percent—is still substantial.²⁶⁰ Argentina barely achieved 76 percent participation for its first restructuring offer in 2005—under the threats imposed by the “Lock Law”—demonstrating the difficult bargaining position sovereigns may still face with CACs. Thus, the ratable payments interpretation seems to undermine a sovereign’s principal interest in being able to restructure its debt when the absolute need arises.

Additionally, Argentina could argue that the “principal interest[]” of all bondholders in the *pari passu* clause is to be paid *something*, at least “on equal footing” with other bondholders who receive payments. In March 2013 the Second Circuit ordered Argentina to provide a payment formula stating “the

equally (although this is not necessarily true according to Judge Griesa’s “ratable payments” interpretation). This commitment enhances the likelihood that creditors are willing to provide loans. Thus, the *pari passu* clause protects the sovereign’s interest in appearing as a credible borrower, and thereby promotes its access to credit.

255. ROBERT COOTER & THOMAS ULEN, *LAW & ECONOMICS* 293 (6th ed. 2012); *see also* David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815 (1991).

256. Alfaro, Maurer & Ahmed, *supra* note 10, at 1.

257. *See supra* Part IV.

258. *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 264 (2d Cir. 2012); *see also supra* Part IV.

259. *See, e.g.*, Rao, *supra* note 208 (noting that the *NML Capital* ruling “could make it harder to secure the majority needed to trigger CACs in [the] future”).

260. *NML Capital*, 699 F.3d at 253; *supra* Part IV.B.1. *But see* William W. Bratton, *Pari Passu and a Distressed Sovereign’s Rational Choices*, 53 EMORY L.J. 823, 849 (2004) (noting that “none of those complaining about the holdout problem offers evidence that holdouts regularly cause exchange offers to fail”).

precise terms of any alternative payment formula and schedule to which [Argentina] is prepared to commit.”²⁶¹ Argentina responded with an offer comparable to that given to exchange bondholders in 2010 and a commitment that the government would do anything required to settle with the holdouts on the same terms accepted by the others.²⁶² In its filing, Argentina speculated that NML Capital purchased the bonds for approximately \$48.7 million, and Argentina’s payment scheme would entitle the fund to \$120.6 million—a fairly impressive return by any standard.²⁶³ As described above, Judge Griesa’s ruling granted NML Capital \$720 million out of a total judgment worth \$1.3 billion.²⁶⁴ Argentina’s filing explained that its “proposal fulfills the court’s dual objectives to satisfy the *pari passu* clause: non-discrimination in payment priority and equal treatment among bondholders.”²⁶⁵ That is, under Argentina’s proposed payment plan, neither Argentina nor the holdouts would have sacrificed a principal interest.

However, without the “ratable payments” interpretation of the *pari passu* clause, investors like NML Capital may worry that sovereign creditors are too limited in their recourse to a sovereign default and bondholders’ “principal interests” would thereby be jeopardized. One legal scholar argues that litigious distressed-debt investors who “pursue their right to recover” help maintain “balance in the sovereign debt market.”²⁶⁶ The argument continues that the ability to litigate for equal treatment “gives private creditors some leverage against a sovereign state that is cocooned in immunity . . . and capable of engaging in strategic defaults or promoting one-sided exchange offers.”²⁶⁷

Although preserving the “balance in the sovereign debt market” could potentially be described as a holdout creditor’s “principal interest[,]” other

261. See Warren, *supra* note 138.

262. See, e.g., Nate Raymond & Hugh Bronstein, *Argentina Challenges U.S. Court with Bond Plan*, REUTERS (Mar. 30, 2013), <http://www.reuters.com/article/2013/03/31/us-argentina-debt-formula-idUSBRE92T01H20130331>.

263. Van Voris, *supra* note 140.

264. See *id.* It is also worth noting that Argentina has argued that NML Capital holds significant positions in credit default swaps for Argentine debt, which pay out if Argentina defaults. See Camila Russo, *Argentina Bond Holdout Singer Denial Failing to Quell Win-Win Charge*, LATIN AM. HERALD TRIB. (Apr. 12, 2013), <http://www.laht.com/article.asp?ArticleId=743095&CategoryId=14093>. Some have argued that “ownership of swaps is an incentive for [the] fund to pursue litigation that may trigger a default or increase in the contracts’ prices.” *Id.* During the February 27 hearing, Judge Rosemary Pooler asked NML Capital’s attorney, Ted Olson, whether NML Capital owned the swaps. *Id.* Mr. Olson responded, “I don’t know that that’s true. I’m informed it isn’t true. But if it was true, it would be utterly irrelevant.” *Id.* Underscoring the tension between market expectations based on the rule of law and moral considerations, Russell Dallen, a bond trader, commented: “The whole idea that there’s something morally wrong with them buying insurance [such as credit default swaps] just doesn’t fly. The market is an amoral place. It’s about profit and loss.” *Id.*

265. See Van Voris, *supra* note 140.

266. Robert A. Cohen, “*Sometimes a Cigar is Just a Cigar*”: *The Simple Story of Pari Passu*, 40 HOFSTRA L. REV. 11, 13 (2011) (citing William W. Bratton, *Pari Passu and a Distressed Sovereign’s Rational Choices*, 53 EMORY L.J. 823, 843 (2004)).

267. *Id.*

forces seem to have a greater effect on preserving the balance in the sovereign debt market. These forces include, most notably, the value of a good reputation for future access to credit and a good reputation's value that "go[es] beyond access to credit."²⁶⁸ Moreover, many commentators have argued that the presence of holdouts actually undermines the "balance in the sovereign debt market": holdouts create uncertainty in the market and undermine smooth restructuring.²⁶⁹ The importance of assuring that a sovereign can restructure in the face of default (a practical inevitability) ought to outweigh the lesser possibility of "strategic defaults."²⁷⁰

As Gulati and Klee explain, the court's opinion in *Sharon Steel* "underscored the need for uniform interpretation of boilerplate provisions, irrespective of the intent of the parties, based on public policy interests in protecting the efficiency of financial markets."²⁷¹ The *Sharon Steel* court essentially suggested that a consistent wrong interpretation is better than an interpretation that gives uncertainty to the meaning of boilerplate provisions.²⁷² The Second Circuit's October 2012 and August 2013 decisions in *NML Capital*, as well as Judge Griesa's "ratable payments" formula, create uncertainty and run counter to the widely accepted, if somewhat ambiguous, understanding that the *pari passu* clause relates to *legal* subordination, and does not contemplate ratable payments. For instance, in response to the Brussels Opinion, the London-based Financial Markets Law Committee²⁷³ convened a working group to analyze the meaning of *pari passu* clauses in sovereign bonds issued under English law. The Committee determined that the "ratable payment" interpretation would not be acceptable to debtors or creditors, "and would be unworkable."²⁷⁴ The Committee determined that this interpretation

268. Seema Jayachandran & Michael Kremer, *Odious Debt* 14 (Nov. 1, 2004) (unpublished manuscript), available at <http://escholarship.org/uc/item/4894k72x>; Miller & Thomas, *supra* note 191, at 1491, 1493–96 (explaining why sovereigns pay, including public and private sanctions, policy conditionality, market access, and reputation).

269. *See, e.g.*, Brief for the United States of America as Amicus Curiae, *supra* note 123, at 5.

270. Cohen, *supra* note 266, at 13.

271. Gulati & Klee, *supra* note 246, at 647.

272. *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1048 (2d Cir. 1982) ("Whereas participants in the capital market can adjust their affairs according to a uniform interpretation, whether it be correct or not as an initial proposition, the creation of enduring uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital markets. Such uncertainties would vastly increase the risks and, therefore, the costs of borrowing with no offsetting benefits either in the capital market or in the administration of justice.").

273. The Financial Markets Law Committee is an independent committee of legal experts whose role is "to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed." FIN. MARKETS L. COMM., <http://www.fmlc.org/about-the-fmlc.html> (last visited Sept. 9, 2014).

274. FIN. MARKETS L. COMM., ANALYSIS OF THE ROLE, USE AND MEANING OF *PARI PASSU* CLAUSES IN SOVEREIGN DEBT OBLIGATIONS AS A MATTER OF ENGLISH LAW 2 (2005) [hereinafter FMLC], available at <http://www.fmlc.org/uploads/2/6/5/8/26584807/79.pdf>. At least one commentator

would be prejudicial to both debtors and creditors “by making it impracticable for all creditors to sustain the debtor’s business if only one of them objected.”²⁷⁵ Furthermore, as discussed above, CACs would not likely diminish this prejudice.²⁷⁶ Similarly, the United States argued that the decision could “have the practical effect of enabling ‘a single creditor to thwart the implementation of an internationally supported restructuring plan.’”²⁷⁷

In addition to the U.S. Government, the New York Federal Reserve, clearinghouses, exchange bondholders, and many legal scholars all support a narrower interpretation of the *pari passu* clause, which would have been more favorable to Argentina.²⁷⁸ For example, a court could adopt a narrower interpretation of the *pari passu* clause requiring, at the most, that a debtor sovereign offer holdouts the same terms accepted by bondholders who willingly restructured when the sovereign faced or entered default. This is essentially what Argentina proposed in March 2013, and it comports with the *pari passu* clause’s requirements of “non-discrimination in payment priority and equal treatment among bondholders.”²⁷⁹

The Supreme Court should have granted certiorari and thereafter certified to the New York State Court of Appeals the question of the interpretation of the *pari passu* clause. The New York State Court of Appeals could have then adopted a narrower interpretation of the clause than adopted by the Second Circuit. Specifically, in the context of *NML Capital*, a narrower interpretation of the clause would require only that Argentina offer the holdouts the same terms as the exchange bondholders. Importantly, as Gulati and Klee explain, such a narrower interpretation of the *pari passu* clause “would comport with market expectations.”²⁸⁰ Conforming to market expectations creates an efficient market, which is beneficial for creditors and debtors alike.

B. Preventing the Injunction Against Third-Party Intermediaries

In the future, a country facing threats from vulture funds could also argue that a district court cannot prevent a clearinghouse from issuing payments to exchange bondholders. Again, the Brussels Court of Appeals experienced a similar situation. In 2004, that court determined that the *pari passu* clause could

believes “this publication is likely to be seen as authoritative not only with respect to English law-governed clauses and sovereign debt instruments, but also for corporate obligations governed by U.S. or other law.” Charles G. Berry, ‘Pari Passu’ Means What Now?, N.Y. L.J. (Mar. 6, 2006), http://www.arnoldporter.com/resources/documents/Pari_Passu.pdf.

275. FMLC, *supra* note 274, at 2.

276. See *supra* Part IV.A.

277. *NML Capital, Ltd. v. Republic of Arg.*, 699 F.3d 246, 263–64 (2d Cir. 2012).

278. Nouriel Roubini & Brad Setser, *The Reform of the Sovereign Debt Restructuring Process: Problems, Proposed Solutions and the Argentine Episode*, 1 J. RESTRUCTURING FIN. 173, 183 (2004).

279. Van Voris, *supra* note 140.

280. Gulati & Klee, *supra* note 246, at 650.

not be used against a third-party intermediary because the intermediary “was not a party to the contract under which the *pari passu* clause arose”; that is, the intermediary was not in privity with the contracting parties.²⁸¹ In agreement, the Belgian Parliament instituted a law protecting clearinghouses from such injunctions shortly after the court’s ruling.²⁸²

Judge Griesa’s November 21st order forbids “the parties involved in payments to exchange bondholders,” including third party intermediaries like the Bank of New York Mellon, from processing payments to the exchange bondholders without making payments to a fund for the holdout creditors.²⁸³ As a result, the clearinghouse involved, namely Bank of New York Mellon, may have a reasonable argument that because it was not a party to the original bond contracts, the injunction should not have been imposed against it. Such a result would reflect the fear of turning “the world’s largest payments system into collection agencies.”²⁸⁴ Though this solution would not have necessarily relieved Argentina of the burden of making payments on the un-restructured debt, it would severely frustrate the court’s ability to enforce the order. Finally, the Belgian Parliament’s law to forbid injunctions against third-party intermediaries absent privity should send a signal that such an injunction is undesirable and frustrates efficient capital transactions. Moreover, it suggests a legislative path for the U.S. Congress or New York legislature to frustrate such injunctions, if either develops the political will to do so.

CONCLUSION

In 2007, former Secretary of the Treasury Henry Paulson testified before the House Committee on Financial Services about the state of the international financial system.²⁸⁵ Congresswoman Gwen Moore of Wisconsin used her time to ask Mr. Paulson why the United States was not doing more to address the vulture fund problem, particularly with respect to Africa.²⁸⁶ Paulson’s response aptly summarizes the tension between the rule of law and reasonable moral concern for the well-being of struggling, though not blameless, countries like

281. See Blackman & Mukhi, *supra* note 161, at 56–57 & n.54 (citing Republic of Nicaragua v. LNC Invs. & Euroclear Bank, S.A., No. 2003/KR/334 (Court of Appeals of Brussels, 9th Chamber, Mar. 19, 2004)).

282. *Id.* at 57 & n.55 (citing Belgian Law 1119201, art. 15).

283. NML Capital, Ltd. v. Republic of Arg., 2012 U.S. Dist. LEXIS 168292, *11–12 (S.D.N.Y. Nov. 21, 2012) (*NML Capital Remand*) (“[T]he parties involved in payments to exchange bondholders [are put] on notice that the . . . interest payments due to exchange bondholders cannot be made unless Argentina certifies that it is making the appropriate payment for the benefit of plaintiffs to the escrow account [to be created for the holdout creditors], either in advance of or concurrent with any payment to exchange bondholders.”).

284. Gelpert, *supra* note 104, at 23.

285. *The State of the International Financial System: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 39–40 (2007) (statement of Henry Paulson, Secretary of the Treasury of the United States).

286. *Id.*

Argentina:

We are doing everything we can to help [African countries that are prey to vulture funds], and I deplore what the vulture funds are doing, and *we use moral solutions. But the vulture funds have the rule of law on their side.* When countries enter into debt agreements, laws apply.²⁸⁷

The Argentine litigation, and issues with vulture funds generally, highlight a tension among the rule of law, market expectations, and moral considerations. *NML Capital* illustrates how strict adherence to the rule of law, a hallmark of modern development theory, can sometimes trump moral and economic considerations. Laws tend to be in place to advance moral and practical economic interests. Consider, for example, laws against murder, theft, and rape, which advance moral interests, and laws granting a right to exclude from use of property, or a sovereign's power to tax, which advance practical economic interests.

The vulture funds have a clear property interest in the defaulted bonds, based on a legitimate expectation that Argentina will, or at least should, pay its debts. Nonetheless, legal systems occasionally make normative value judgments that allow the public interest to trump individual property interests, such as under the doctrine of eminent domain. Moreover, moral considerations will often trump property interests, such as under the doctrines of unclean hands or unconscionability and historical limitations on usury.

NML Capital brings to light several potential opportunities in this tug-of-war between moral solutions and the rule of law. Legislative systems have the opportunity to respond to a serious, high-stakes issue by passing thoughtful, forward-looking laws that restrict vulture litigation while preserving the market for sovereign debt; international actors have the opportunity to cooperate in order to institutionalize procedures or norms that undermine the parasitic and mostly unproductive behavior of vulture funds; and judicial systems have the opportunity to uphold the rule of law while making the morally appealing choice by simply, and correctly, narrowing the scope of the *pari passu* clause.

In his testimony before Congress, former Secretary Treasurer Paulson explained, “[T]he one thing I take some comfort in is that [vulture funds] haven’t been overly successful. The judgments they have realized at the end have not been as high as they might have been.”²⁸⁸ If the judicial system fails to revisit its reasoning in *NML Capital* or legislative bodies fail to take action, we

287. *Id.* (emphasis added). Similarly, when deciding a vulture fund’s claim against Zambia, an English judge clarified, “I am concerned, of course, with the legal questions that are raised by the applications before me and not with questions of morality or humanity.” *Donegal Int’l Ltd. v. Republic of Zam.*, [2007] EWHC 197 (Comm.), 2 (appeal taken from Eng.), available at http://news.bbc.co.uk/nol/shared/bsp/hi/pdfs/16_02_07_zambiajudge.pdf.

288. *The State of the International Financial System: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 40 (2007) (statement of Henry Paulson, Sec’y of the Treasury of the United States).

will no longer be able to take such comfort in vulture funds' limited success. The holdouts are positioned for a \$1.6 billion payout.²⁸⁹ Moreover, the decision in *NML Capital* will potentially subject Argentina to nearly \$10 billion more in obligations to holdouts that are not party to the present litigation.²⁹⁰ As the decision against Argentina stands, numerous countries—developing, semi-developed, and developed alike—will lose an important bargaining chip in the inevitable future efforts to restructure debt. Worse still, the decision will almost certainly undermine the positive potential of the recent proliferation of CACs by further encouraging holdout litigation.²⁹¹

With decisions like *NML Capital*, hedge funds have reason to be excited. And they are: as one hedge fund representative explained, “I think you’ll look back in two or three years’ time on this crisis and the Argentine U.S. court decision . . . will prove to be a very, very interesting juncture—a very strong strengthening of a creditor’s hand and a weakening of government[’]s.”²⁹² While hedge funds are excited, sovereigns, traditional bondholders, and clearinghouses—indeed anyone with a stake in the global economy—have reason to worry.

289. See Parks, *supra* note 160.

290. See Davidoff Solomon, *supra* note 92 (noting that total holdouts, including Italian pensioners, “own what is now about \$11 billion in debt”).

291. It is important to note that any changes in favor of sovereign debtors must be balanced against the legitimate interests of creditors. There is a genuine risk that any changes could backfire and “erode the confidence of the well-intentioned investors in the efficacy of their legal remedies, [in which case] the private market may simply withdraw from unsecured lending to emerging market sovereigns.” Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 *UCLA L. REV.* 59, 62 (2000); see also Eichengreen, *supra* note 52, at 71 (making the point that if contracts and institutional arrangements are altered to make the suspension of debt service too easy, the capital markets will not function at all). As Buchheit and Gulati note, “[s]uppressing holdout creditor behavior is not the overriding objective. The overriding objective is to find a procedure that will, when necessary, permit an orderly rearrangement of sovereign bond indebtedness without discouraging private capital flows to emerging market countries.” Buchheit & Gulati, *supra*, at 83.

292. Rao, *supra* note 208 (quoting Lee Robinson of hedge fund Altana Wealth).

APPENDIX A: VULTURES' INCENTIVES TO LITIGATE AS JUDGE GRIESA'S ORDER STANDS: AN ECONOMIC ANALYSIS

Game theory predicts that a plaintiff “will only start a lawsuit if the expected value of going to court exceeds the expected value of not doing so.”²⁹³ Three factors determine whether a bondholder will sue a sovereign for collection of its debt: (1) the value of the claim if the bondholder wins multiplied by the expected probability of success; (2) the recovery value if the bondholder loses multiplied by the expected probability of losing; and (3) the costs of litigation.²⁹⁴

To model the probability of whether a bondholder will sue, let the full value of the original bond equal b , the probability of success equal p , and the cost of litigation equal L . Let the value of the exchange offer equal x (for example, an exchange offer of 40 percent would equal 0.4), the probability of losing equal $1 - p$, and the cost of settlement equal S .

The bondholder will sue if: $pb - L > xb(1 - p) - S$.

The left side of the equation represents the value of a claim if the bondholder goes to court, and the right side is the value of the claim if the bondholder accepts a restructuring offer. The bondholder should sue if the left side is greater than the right side.

Schumacher et al. describe other factors that affect a bondholder's decision to sue:

Litigation [against a defaulting sovereign] is more likely (i) when the damage is large, i.e. in case of high [write-downs] and larger restructuring amounts, (ii) when litigation costs are low for the plaintiffs, i.e. when borrowing costs are low, and (iii) when the defendant is vulnerable, e.g. when the defaulting country has a high degree of financial and trade openness.²⁹⁵

Judge Griesa's order on the *pari passu* clause creates precedent favorable to holdouts because it interprets a common clause to require ratable payments to the holdouts. This means that a victorious holdout would be entitled to the full value of its claim, regardless of the price paid for the bonds or the amount settled upon with exchange bondholders. Such precedent would thereby increase the probability of success (p) and decrease the probability of losing ($1 - p$). Furthermore, the precedent, as it stands, potentially decreases the cost of

293. See Schumacher et al., *supra* note 23, at 13; see also Robert D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LITERATURE 1067 (1989).

294. Schumacher et al., *supra* note 23, at 13.

295. *Id.* at 21–22; see also *id.* at 14 (“We assume that the sovereign will always have sufficient resources to repay the individual creditor's debt holding d , even if it is unable or unwilling to repay the entire debt stock D . This situation gives rise to a classical prisoners' dilemma, in which individual creditors can be better off by rejecting a restructuring and instead free-riding on a majority of participating creditors. Once the exchange offer has been launched, creditors have two options: they can either accept the haircut or they can reject it and try to recover the full claim by legal means.”).

litigation, L , for two reasons. First, as the Second Circuit precedent stands, future sovereign defendants will not have the same recourse to appeals on the *parri passu* issue as Argentina has had. Secondly, the experience gained by the vulture fund and its attorneys in this case could translate into greater efficiency in pursuing future claims.²⁹⁶ Thus, if the “ratable payments” interpretation is upheld, it will become more likely that the left side of the equation is greater than the right side ($pb - L > xb(1 - p) - S$), meaning a potential plaintiff will be more likely to start a lawsuit. Increased bondholder litigiousness will further disrupt the sovereign debt market and complicate future restructuring efforts.

296. Note, however, that Schumacher et al. explain that “[t]he cost of litigation seem [sic] to be on the rise.” The authors add, “The duration of cases has also increased, to an average of 6 years. Moreover, we observe more and more attachment attempts. In recent years, more than half of all pending cases involved at least one attempt to seize sovereign assets abroad.” *Id.* at 3.

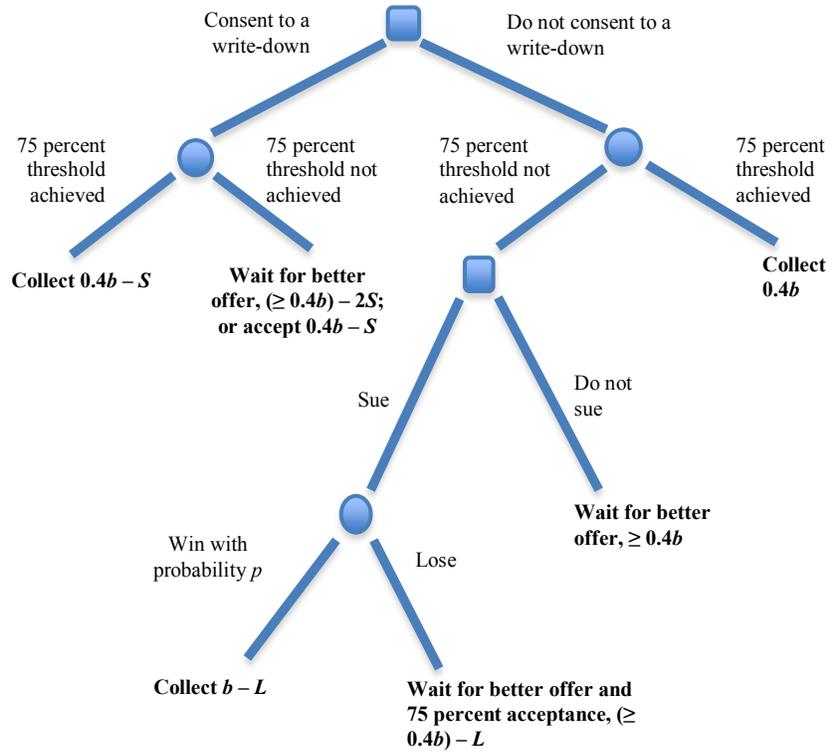
APPENDIX B: THE LIKELY EFFECT OF JUDGE GRIESA'S "RATABLE PAYMENTS"
INTERPRETATION OF THE PARI PASSU CLAUSE ON FUTURE BONDS WITH
COLLECTIVE ACTION CLAUSES

The Second Circuit has tried to frame this case as *sui generis*, based in part on the now common use of CACs in New York law bonds. That is, the Second Circuit believes that Judge Griesa's "ratable payments" interpretation of the *pari passu* clause will not undermine future restructuring efforts, in part because of the now widespread inclusion of CACs.

But consider this hypothetical: Ruritania offers a 60 percent write-down on one series of bonds governed under New York law. In this fact pattern, *NML Capital* is not overturned and New York law now includes Judge Griesa's "ratable payments" interpretation of the *pari passu* clause. The bonds have a CAC requiring 75 percent bondholder approval to restructure the debt.

Bondholder H , a bondholder with a preexisting propensity to hold out, owns bonds worth b . Settlement costs are worth S , and litigation costs are worth L . In general, we assume settlement costs are less than litigation costs, so $S < L$.

The decision tree below demonstrates the choices that Bondholder H can make at the various stages after a sovereign debtor has indicated its desire for bondholders to vote to activate the CAC to effectuate a 60 percent write-down. The tree also shows the costs to Bondholder H at each step. Circles represent probabilities and squares represent choices. At the first square, Bondholder H can choose to consent to a write-down or to not consent. At the first circle, there is an unknown probability that the CAC's 75 percent consent threshold will be achieved. At the second square, Bondholder H can choose to sue or not sue. Finally, if Bondholder H chooses to sue to collect the full value of its bonds, there is an unknown probability that Bondholder H will win or lose. As described in Appendix A, if Judge Griesa's ratable payments interpretation of the *pari passu* clause is upheld, we assume that the probability of winning increases, and the cost of litigation, L , decreases.



	Bond value less costs if <i>H</i> consents to the write-down	Bond value less costs if <i>H</i> does <i>not</i> consent to write-down
75 percent threshold achieved	$0.4b - S$	$0.4b$
75 percent threshold not achieved	$(\geq 0.4b) - 2S$; or $0.4b - S$	$\geq 0.4b$
Sue and win	$b - L - S$	$b - L$
Sue and lose, or Ruritania makes better offer and 75 percent CAC Acceptance	$(\geq 0.4b) - L - S$	$(\geq 0.4b) - L$

The decision tree and the table show that the least profitable scenario would be to sue and lose, while the most profitable scenario is to sue and win. Judge Griesa's "ratable payments" interpretation of the *pari passu* clause will likely improve the chances of winning in a lawsuit against a sovereign debtor, as described in Appendix A above. Moreover, the chart shows that the rational bondholder, and the bondholder who would likely have held out anyway, will be incentivized to holdout, or at least take no action with respect to a restructuring vote, and thereby save the transaction costs associated with settlement. Thus, CACs are likely much less effective at undermining holdout litigation than anticipated by the Second Circuit, and the decision in *NML Capital* may in fact increase incentives to holdout.

