

PARI PASSU OVERVIEW

Anna Gelpern
Georgetown Law

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The Clause: Theme and Variations (1)

- *The Classic – eg, Belize 2013*

The Securities are general, direct, unconditional, unsubordinated and unsecured obligations of Belize ... and Belize shall ensure that its obligations hereunder shall rank pari passu among themselves and with all of its other present and future unsecured and unsubordinated Public Debt ...

- *Variation 1 – eg, Argentina 1994*

The Securities will constitute . . . direct, unconditional, unsecured, and unsubordinated obligations of the Republic and shall at all times rank pari passu and without 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 (as defined in this Agreement).

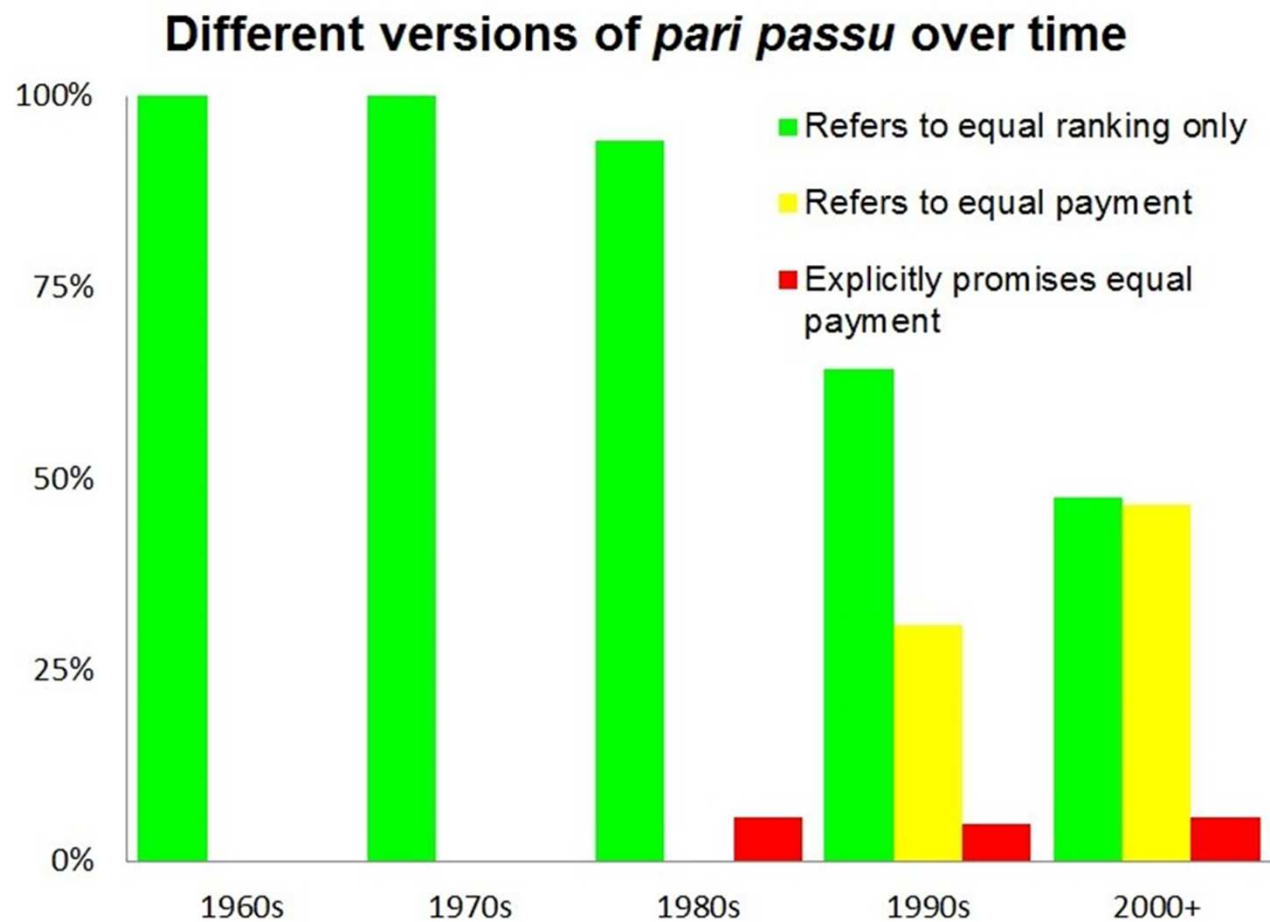
The Clause: Theme and Variations (2)

- *Variation 2 – Italy 2003*

The Securities are the direct, unconditional and general and ... unsecured obligations of Italy and **will rank equally** with all other evidences of indebtedness issued in accordance with the Fiscal Agency Agreement and with all other unsecured and unsubordinated general obligations of Italy for money borrowed. ... Amounts payable in respect of principal of (and interest on) the Securities **will be charged upon and be payable out of the [Treasury of Italy], equally and ratably** with all other amounts so charged and amounts payable in respect of all other general loan obligations of Italy.

The Clause: Theme and Variations

(Source: Weidemaier 2013, adapted from Weidemaier et al. 2013)



Adapted from Mark Weidemaier, Bob Scott, and Mitu Gulati, *Origin Myths Contracts, and the Hunt for Pari Passu*, Law and Social Inquiry (forthcoming)

The Meaning: Theme and Variations (1)

- *The Classic – Encyclopedia of Banking Law (2002)*

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

See *also* Borchard, *State Insolvency and Foreign Bondholders* Vol. 1, General Principles (1951) (Yale University Press).

The Meaning: Theme and Variations (2)

- *Variation 1 – The Tom, Dick, and Harry* (this version, 2000)

A borrower from Tom, Dick, and Harry can't say "I will pay Tom and Dick in full, and if there is anything left over I'll pay Harry." If there is not enough money to go around, **the borrower faced with a *pari passu* provision must pay all three of them on the same basis** But if the borrower proposed to pay Tom [everything], Dick [something] and Harry nothing, a court could and should issue an injunction at the behest of Harry. The injunction would run in the first instance against the borrower, but I believe (putting jurisdictional considerations aside) to Tom and Dick as well.

Declaration of Professor Andreas F. Lowenfeld Dated August 31, 2000, at 11-12 (footnote omitted), *Elliott Assocs.*, 2000 WL 1449862 (96 Civ. 7916 (RWS), 96 Civ. 7917 (RWS)).

The Meaning: Theme and Variations (3)

- *Variation 2* – U.S. Court of Appeals for the 2d Cir. (2012)

[W]e conclude that in pairing the two sentences of its *Pari Passu* Clause ... manifested an intention to protect bondholders from more than just formal subordination. ... The first sentence (“[t]he Securities will constitute . . . direct, unconditional, unsecured, and unsubordinated obligations”) prohibits Argentina, as bond *issuer*, from formally subordinating the bonds by issuing superior debt. The second sentence (“[t]he payment obligations . . . shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness.”) **prohibits Argentina, as bond *payor*, from paying on other bonds without paying on the FAA Bonds.**

The Breach

- U.S. Court of Appeals for the 2d Cir. (2012):

After declaring a moratorium on its outstanding debt in 2001, Argentina made **no payments** for six years on plaintiffs' bonds while simultaneously timely servicing the Exchange Bonds. Argentina has renewed that moratorium in its **budget laws** each year since then. It declared in the **prospectuses** associated with the exchange offers that it has no intention of resuming payments on the FAA Bonds. ... It stated in **SEC filings** that it had "classified the [FAA Bonds] as a separate category from its regular debt" and is "not in a legal . . . position to pay" them. Its legislature enacted the **Lock Law**, which has been given full effect in its courts, precluding its officials from paying defaulted bondholders and barring its courts from recognizing plaintiffs' judgments ...

The Remedy

- Southern District of New York (on remand) (2012)
 - (1) Assuming that Argentina pays 100% of what is then due on the Exchange Bonds ... Argentina would be required to pay 100% 'multiplied by the total amount currently due' to plaintiffs.
 - (2) [P]articipants in the payment process of the Exchange Bonds ...shall be bound by the terms of this ORDER as provided by Rule 65(d)(2) and prohibited from aiding and abetting any violation of this ORDER, including any further violation by the Republic of its obligations under Paragraph 1(c) of the FAA, such as any effort to make payments under the terms of the Exchange Bonds without also concurrently or in advance making a Ratable Payment to NML.

The Remedy: Who Cares?

“Participants” refer to those persons and entities who act in active concert or participation with the Republic, to assist the Republic in fulfilling its payment obligations under the Exchange Bonds, including:

- (1) the indenture trustees and/or registrars under the Exchange Bonds (including but not limited to The Bank of New York Mellon ...);
- (2) the registered owners of the Exchange Bonds and nominees of the depositories for the Exchange Bonds (including but not limited to Cede & Co. and The Bank of New York Depository (Nominees) Limited) and any institutions which act as nominees;
- (3) the **clearing corporations and systems, depositories, operators of clearing systems**, and settlement agents for the Exchange Bonds (including but not limited to the Depository Trust Company, Clearstream Banking S.A., Euroclear Bank S.A./N.V. and the Euroclear System);
- (4) trustee paying agents and transfer agents for the Exchange Bonds (including but not limited to The Bank of New York (Luxembourg) S.A. and The Bank of New York Mellon (including but not limited to the Bank of New York Mellon (London))); and
- (5) attorneys and other agents engaged by any of the foregoing or the Republic in connection with their obligations under the Exchange Bonds.

The Remedy: A Comparison

This point ...concerns the nature of the relief sought generally, which is directed towards the coercion of third parties rather than securing immediate compliance by the defendant. Because I regard this last point as determinative, I regard it as unnecessary to attempt any analysis of the pari passu clause.

Kensington Int'l Ltd. v. Republic of Congo, [2003] EWHC 2331, available at <http://www.bailii.org/cgibin/>

So What?

- Broad interpretation of the clause
- Broad definition of breach
- Broad application of the remedy

- Restructuring incentives
 - Debtor initiation
 - Creditor participation
 - Service providers and utilities
- Immunity
 - Directed at the debtor in New York
 - Restrains its use of treasury funds everywhere

No Big Deal v. A Very Big Deal

- No Big Deal
 - It is all about Argentina, which is uniquely bad
 - Unusual “payment” formulation
 - CACs make *pari passu* obsolete
- A Very Big Deal
 - No one will participate
 - Everyone will sue
 - Off to London?
- Shift to New Equilibrium – Unknown
 - Depends on market adaptation
 - Depends on policy response

No Big Deal

U.S. Court of Appeals for the 2d Circuit (2013)

We further observed that cases like this one are unlikely to occur in the future because **Argentina has been a uniquely recalcitrant debtor** and because newer bonds almost universally include **collective action clauses** (“CACs”) which permit a super-majority of bondholders to impose a restructuring on potential holdouts. ...Ultimately, though, our role is not to craft a resolution that will solve all the problems that might arise in hypothetical future litigation involving other bonds and other nations. The particular language of the FAA’s *pari passu* clause dictated a certain result in this case, but going forward, **sovereigns and lenders are free to devise various mechanisms to avoid holdout litigation** if that is what they wish to do. They may also draft different *pari passu* clauses that support the goal of avoiding holdout creditors.

A Very Big Deal

(IMF April 2013)

The Argentine decisions, if upheld, would likely give holdout creditors greater leverage and make the debt restructuring process more complicated for two reasons. First, by allowing holdouts to interrupt the flow of payments to creditors who have participated in the restructuring, the decisions would likely **discourage creditors from participating in a voluntary restructuring**. Second, by offering holdouts a mechanism to extract recovery outside a voluntary debt exchange, the decisions would increase the risk that **holdouts will multiply** and creditors who are otherwise inclined to agree to a restructuring may be less likely to do so due to inter-creditor equity concerns.

No Big Deal v. A Very Big Deal

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 - It is all about Argentina, which is uniquely bad
 - Unusual “payment” formulation
 - CACs make *pari passu* obsolete
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Adaptation (1)

- Belize National Assembly Resolution (2013)

Status of the New Bonds:

The New Bonds will be general, direct, unconditional, unsubordinated and unsecured obligations of Belize and will rank at least equally among themselves and with all of Belize's existing and future unsecured and unsubordinated bond indebtedness (it being understood that this equal ranking status shall not require Belize to pay all items of its bond indebtedness on a ratable basis).



Adaptation (2)

- Italy Fiscal Agency Agreement (2013)

The Securities are the direct, unconditional and general and ...unsecured obligations of Italy and will rank equally with all other evidences of indebtedness issued in accordance with the Fiscal Agency Agreement and with all other unsecured and unsubordinated general obligations of Italy for money borrowed, **except for such obligations as may be preferred by mandatory provisions of international treaties and similar obligations to which Italy is a party. ...**

~~Amounts payable in respect of principal of (and interest on) the Securities will be charged upon and be payable out of the [Treasury of Italy], equally and ratably with all other amounts so charged and amounts payable in respect of all other general loan obligations of Italy.~~

What Is to Be Done? – The Options

- Content:
 - Eliminate holdouts (CACs, Bankruptcy)
 - No holdouts=no *pari passu*
 - Eliminate holdout enforcement tool (strip, modify, or “clarify” *pari passu*; shield trustees, market utilities)
 - No *pari passu*=no *pari passu*
- Form:
 - Statute/Treaty
 - Contract
- Method:
 - Legislation/treaty making
 - Moral suasion
 - Institutional pressure (via market utilities)

What Is to Be Done? – The Options (2)

	Contract	Statute/Treaty
Eliminate Holdouts	CACs <ul style="list-style-type: none"> • Issue-by-Issue • Aggregation • No Drop-Outs 	Bankruptcy <ul style="list-style-type: none"> • SDRM • EDRM
Eliminate Enforcement Tactic	Pari Passu <ul style="list-style-type: none"> • Strip • “Clarify” (Belize) • Modify (Italy) 	Shield utilities <ul style="list-style-type: none"> • Belgium (Euroclear) • UCC Treatment of Intermediary Banks

How to Get There?

- Method:
 - Legislation (State/Federal)
 - Treaty (Global/Regional)
 - Moral suasion
 - Institutional pressure (via market utilities)