
Institute for Law and Finance at Goethe-Universität Frankfurt am Main

**Sovereign Bonds and the Hold-out Problem:
The Pari Passu Clause and CACs after NML v. Argentina**

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WHAT DID THE SECOND CIRCUIT DECIDE AND WHAT ARE THE CHANCES FOR
SUPREME COURT REVIEW?

The conversion of Argentina's *Pari Passu* Provision into an "Equal Treatment" Provision

- The *pari passu* provision found in Argentina Fiscal Agency Agreement provides as follows:
 - “[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 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...*”
 - “External Indebtedness” is limited to obligations payable in non-Argentine currency.
- The Second Circuit basically concluded that the italicized language quoted above turned Argentina's *pari passu* provision into an “Equal Treatment Provision,” and so held:
 - “We hold that *an equal treatment provision in the bonds bars Argentina from discriminating against plaintiffs’ bonds* in favor of bonds issued in connection with the restructurings and that Argentina violated that provision by ranking its payment obligations on the defaulted debt below its obligations to the holders of its restructured debt.”

The conversion of Argentina's *Pari Passu* Provision into an “Equal Treatment” Provision (cont.)

- The Court reached this conclusion when it rejected Argentina's argument that the clause prevented only “legal subordination,” and agreed with NML's argument
 - “that there was “de facto” subordination because Argentina reduced the rank of plaintiffs' bonds to a permanent non-performing status by passing legislation 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.”
- The Court then elevated the significance of the second sentence of the provision by concluding that
 - “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.
- Having given the provision its “Equal Treatment” meaning, the Court went on to
 - “affirm the judgment of the district court; we find no abuse of discretion in the injunctive relief fashioned by the district court, and we conclude that the injunctions do not violate the Foreign Sovereign Immunities Act ('FSIA').”

The Meaning to be Given to the Typical *Pari Passu* Provision

- The construction given Argentina's *pari passu* provision by the Second Circuit first saw light of day in litigation brought by Elliot Associates (an NML affiliate) against Peru in 1996 when a lower Court in Belgium issued an *ex parte* temporary restraining order that give the reading momentary credence. That credence then appeared justified when Peru capitulated and settled with Elliot before the TRO could be challenged on appeal a mere three days hence. The meaning of *pari passu* has since been much mooted without discernible success in a host of law review articles, and by commentators and industry groups in the United States and abroad.
- The Second Circuit was able to draw license for its construction from the learned views of Lee Buchheit, who remarked more than twenty years ago that “no one seems quite sure what the clause really means, at least in the context of a loan to a sovereign borrower.” Lee C. Buchheit, *The Pari Passu Clause Sub Specie Aeternitatis*, 10 Int'l Fin. L. 11, 11 (1991). Mr. Buchheit went on in that article and elsewhere, however, to make plain that the meaning of the clause was not a mystery and that the construction urged by NML was not one that made sense or was shared by market participants.

The Meaning to be Given to the Typical *Pari Passu* Provision (cont.)

- Phillip Wood has posited that the provision admits two possible constructions, one rendering it harmless boilerplate of limited utility in a sovereign context, the other converting it into a toxic and powerful recipe for stasis, harmful to borrowers and lenders alike.
- When given a narrow reading to prevent the “mandatory legal subordination” of debt, a debtor can “discriminate between creditors” so long as there is no “mandatory law” or “legally obligatory ladder of priorities” that subordinates some debt and prefers other debt. Given a broad construction, a defaulting debtor “must pay all its creditors ratably, regardless of whether there is a mandatory insolvency priority ladder imposed by law.” See Allen & Overy LLP, *The Pari Passu Clause and the Argentine Case 8* (Dec. 27, 2012).
- The *pari passu* clause here is effectively read to require all external debt rank at least equally, “and be paid as such,” but the words requiring payment nowhere appear.

The Meaning to be Given to the Typical *Pari Passu* Provision (cont.)

- A 2005 report by the Bank of England's Financial Markets Law Committee ("FMCL") analyzed the meaning of the *pari passu* clause by surveying its use in contractual agreements worldwide, and warned that "both debtors and creditors would be prejudiced" by the wider interpretation, and concluded that such a reading was "unsupportable as a matter of English law except where the clause is very clearly drafted to achieve this effect." See Fin. Markets L. Committee, Issue No. 79, *Analysis of the Role, Use and Meaning of Pari Passu Clauses in Sovereign Debt Obligations as a Matter of English Law* (Mar. 2005).
- The only English Court to consider the question declined to give a *pari passu* the broad, toxic construction adopted by the Second Circuit at the urging of NML.
- The Second Circuit rejected views contrary to those offered by NML as being from "arguably biased commentators and institutions."

What sort of foundation for the Second Circuit's Holding was laid by the District Court?

- The Second Circuit had no written opinion from the District Court.
- However, the District Court appeared to be aware that the injunctions he was being asked to issue were unprecedented, and were not mandated by the language of the clause.
 - THE COURT: Now, look, [the proposed injunction] would indeed be a mechanism for enforcement but it also presents a very serious problem. So let me ask you this. Is there any legal authority, is there any legal basis for me to use the *pari passu* clause to interfere with the payment to the exchangers? . . . Now, if I entered this order, this would impose an obligation on the banks and it might impose an impediment upon the banks with respect to the exchange offer people which does not exist now. They get the money and presumably they pay the exchangers. There is no condition, no impediment. This would obviously present an impediment, a condition. Is there any legal basis for doing that? (2/23/12 Hearing Tr., T7:2-6, T7:24-8:5)
 - THE COURT: [T]he exchange offers were lawful, people subscribed to them and have rights under them, the exchange offer provides for payments (2/23/12 Hearing Tr., T11:2-4) (emphasis added).
 - THE COURT: I don't understand the *pari passu* clause or my order to mean that the Republic is forbidden to pay the exchange offers unless they pay NML. (2/23/12 Hearing Tr., T11:25-12:2) (emphasis added).

The foundation laid for the Second Circuit's Holding NML's Position

- MR. OLSEN [NML's counsel]: So we are saying to Argentina you must, if you are going to pay the one, you have to pay the other, and we are telling you in an order from this court that you must do that and your agents and subordinates and people acting with you must not assist in evading that order.
- THE COURT: I really don't agree with that. The rights of the exchangers were not conditional on NML getting paid under the *pari passu* clause. (2/23/12 Hearing Tr., T13:5-12).
- THE COURT: I am sticking to my position. I think that I cannot interfere with the rights of the exchange offers by putting conditions on them or impediments on them. (2/23/12 Hearing Tr., T15:25-16:2).

The foundation laid for the Second Circuit's Holding

The Conclusion

- THE COURT: “The facts of life are this, that there is a *pari passu* clause in the documents. We do not have a normal situation. We don't have a situation where you have an honest debtor with assets available that can be subjected to the normal processes of the court. We don't have it. We have litigation that goes on and on.
- “What the plaintiffs here are trying to do is to see if there is yet another device which might get them their just payments and end the litigation. It has a lot of problems, but Mr. Olson and his colleagues, they know their problems. They are not poor law students. But they are trying to do something which is intended to overcome the lawlessness of the Republic.
- “I am going to sign this order. It's not the first time that a court has signed an order that may have problems. But to me the bigger overriding problem is the lawlessness of the Republic. When I say lawlessness I mean the deliberate, continued failure to honor the most clear-cut obligations in the debt instruments, the most clear-cut assurances in the debt instruments. Those have been turned into a dead letter by the Republic. Well, they are not a dead letter in this courtroom. (2/23/12 Hearing Tr., T48:12- 49:10) (emphasis added).
- The conclusion is inescapable that the injunctions issued by the District Court were strongly influenced by the District Court's frustration with Argentina.

The Construction to be Given a *Pari Passu* Clause, and the Availability of Any Remedy Other than Acceleration, are Basically Questions of State Law

- Having concluded that the *pari passu* provision required Equal Treatment, and that the undertaking to provide it had been breached, the Court of Appeals next concluded that the remedy of acceleration was not sufficient, presumably because the debt in default had already been accelerated. The Court then affirmed the District Court's effort to provide "Equal Treatment" through its resort to the equitable remedy of specific performance and its issuance of its twin injunctions. In this regard, the Court held that, because the remedy of specific performance had not been expressly excluded in the FAA, New York law permitted its use.
- The meaning to be given Argentina's *pari passu* provision, and whether anything beyond acceleration would be an appropriate remedy for its breach, are principally questions of New York law. As such, they are of limited interest to the Supreme Court even if wrongly decided. While the possibility remains that Second Circuit *en banc* could be persuaded to revisit Argentina's arguments on these issues, review by the full Court is perhaps less likely than review of the case by the Supreme Court.

What then are the federal questions implicated by the Court's decisions?

- There would appear to be at least three:
 - First, whether the mandatory injunction directing Argentina to pay NML and other holdouts if it makes any payment to the Exchange Bondholders contravenes the Foreign Sovereign Immunities Act because it inevitably requires Argentina to use property immune from enforcement – its “fiscal reserves” located outside the United States – to satisfy the injunctions.
 - Second, whether the Court ignored its own holding in Allied Bank International v. Banco Credito Agricola de Cartago when it concluded that Argentina’s payment moratoria and adherence to the Lock law effected a *de facto* subordination of holdout debt in rank.
 - Third, whether the issuance of an injunction prohibiting payment to the Exchange Bondholders, and subjecting the Indenture Trustee and clearing institutions to contempt if they exercised their fiduciary and contractual duties to the Exchange Bondholders reflected a proper balancing of the equities, and a sound exercise of discretion.

The Second Circuit's Determination of the FSIA Issues

- In its October 26 opinion affirming the Injunctions, the Second Circuit first noted that Section 1609 of the FSIA provides that
 - “[the] property of a foreign state in the United States shall be immune from attachment arrest and execution except as provided in Sections 1610 and 1611 of this chapter.”
- The corollary to this statutory rule is that property of a foreign state outside the United States – hence not “property in the United States of a foreign state . . . used for a commercial activity in the United States” – is absolutely immune from “attachment arrest and execution.”

The Second Circuit's Determination of the FSIA Issues

HOLDINGS

- After first recognizing its holding in *S&S Machinery Co. v. Masinexportimport*, 706 F.2d 411, 418 (2d. Cir. 158), by acknowledging that courts are also barred from granting, “by injunction, relief which they may not provide by attachment,” *id.* at 262, the Court stated that the terms used in Section 1609 – “attachment arrest and execution” – referred and were limited to a court’s “seizure and control over specific property.”
- The Court then went on to conclude that the Injunctions did not contravene Section 1609 because “[t]hey affect Argentina’s property *only incidentally* to the extent the order prohibited Argentina from transferring property to some bondholders and not others,” and “because they do not require Argentina to pay any bondholder any amount of money.” (Emphasis added.)
- The Court then held that, “because the Injunctions do not deprive Argentina of control over any of its property, they do not operate as attachments of foreign property prohibited by the FSIA.” Rather, the Court noted, “the injunctions allow Argentina to pay its FAA debt with whatever resources it likes.”
- The effect of the Court’s holding is to untether the enforcement remedy of specific performance from the very specific and rigorous limitations placed on enforcement by Sections 1609 and 1610 of the FSIA, and to render the situs and nature of the property subject to injunctive relief irrelevant even if clearly immune.

The Second Circuit's Determination of the FSIA Issues

ANALYSIS

- The factual assertions made by the Court to square its conclusion with the limitations imposed by Sections 1609 and 1610 are difficult to reconcile with those limitations.
 - How is it possible, for example, for Argentina not to be deprived of control over that portion of its property needed to make an “equal payment” to NML and the other holdouts?
 - How can mandatory injunctions affect Argentina’s property “only incidentally,” and how can it be that the injunctions do not require Argentina “to pay bondholder any amount of money” given the very specific direction to do so.
- The Court’s statement that the injunctions do not “limit the *other* uses to which Argentina may put its fiscal reserves,” presumably “fiscal reserves” *not* being used to comply with the injunctions, makes plain its recognition that Argentina’s use of *some* of its “fiscal reserves” was being limited (emphasis added).
- Moreover, the mere reference to “fiscal reserves” is an acknowledgment that the injunction operated to impede the use of property presumptively immune virtually by definition, because located outside the United States.

The Second Circuit's Determination of the FSIA Issues

NML II

- In addition, as the District Court noted in his clarifying opinion on November 21 following remand to determine the formula intended to the “ratable” payment order, that, “at some point in December 2012, when Argentina makes the interest payments on the Exchange Bonds, amounting to a total of \$3.14 billion, Argentina will be required to pay Plaintiffs approximately \$1.33 billion.” The payment of this amount “is to be made into an escrow account,” a directive providing further confirmation that the District Court intended to exercise dominion over Argentine property.
 - The Second Circuit did not address these observations in NML II.
- The District Court also acknowledged in his clarifying opinion on remand that “what is being done here is not literally to carry out the *Pari Passu* clause, as would be done in an ordinary commercial situation, but to provide a remedy for Argentina’s violation of the clause.”
 - The Court’s statement thus makes plain that the injunctions don’t simply “direct Argentina to comply with its contractual obligations,” one of the other predicates for the Second Circuit’s decision, but are more clearly an alternative mode of attachment or execution, whether pre- or post-judgment.
- Finally, because of NML’s repeated references in the District Court and in the Court of Appeals to reserves held by the Central Bank of Argentina with the BIS, it is clear that the Second Circuit was directing Argentina to use its immune assets to pay NML and the other holdout creditors.

The Act of State Doctrine, Argentina's Payment Moratoria and the Lock Law

- The argument that the Lock Law is the real culprit in this case has become conventional wisdom. Even the United States hoped to pin the decision on the Lock Law. See U.S. Amicus Br. in Support of Rehearing:
 - “While the United States has taken no position on whether the unique Lock Law itself violates the *pari passu* clause, it appears that such a ruling would not harm sovereign debt restructuring generally.”
- Because neither Argentina's continuing moratoria on payment to holdout creditors, as given legislative expression in the Lock Law could affect the ranking or enforceability of holdouts debt, the Lock Law is a red herring.
- The “Lock Law,” since repealed, simply provided that “[t]he national State shall be prohibited from conducting any type of in-court, out-of-court or private settlement with respect to the bonds . . .” The Lock Law was thus no more than a legislative effort to limit the ability of the Executive to settle with holdouts on terms more favorable than those received by the Exchange Bondholders.

The Act of State Doctrine, Argentina's Payment Moratoria and the Lock Law (cont.)

- As applied by the Second Circuit en banc in *Allied Bank International v. Banco Credito Agricola de Cartago*, the Act of State Doctrine renders the debt moratoria, as well as the Lock Law, ineffective as mechanisms for subordinating holdout debt except in Argentina.
- The District Court in *Allied* held that because a Costa Rican suspension of U.S. Dollar debt payments was “public in nature, rather than commercial” and “in response to a serious national economic crisis,” the Act of State doctrine required a New York court to give effect to a Costa Rican moratorium on debt repayment.
- After first affirming the District Court, the Second Circuit reversed the panel en banc, and held that, because New York was the situs of debt repayment, the Costa Rican moratorium could not be enforced in New York to prevent repayment. The United States should thus have been in a position to make plain that the Lock Law could not violate the *pari passu* provision instead of invoking it as the way to limit the applicability of the NML decision.
- *Allied* thus stands for the proposition that, when contract and debt repayment occurs outside a country's own borders, the Act of State Doctrine bars enforcement of the country's effort to interfere with efforts to enforce repayment of the debt.

The Act of State Doctrine, Argentina's Payment Moratoria and the Lock Law (cont.)

- Another aspect of the Act of State Doctrine was recognized in Underhill v. Hernandez, 168 U.S. 250, 252 (1897):
 - “Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory.”
- Viewed in the light of Underhill v Hernandez, the mandatory injunction affirmed by the Second Circuit can thus be seen as a directive by a U.S. court requiring the Argentine “national State” to violate its own moratoria, as well as the “Lock Law,” a violation that would of necessity take place within the borders of Argentina. To that extent, the Second Circuit appeared prepared “to sit in judgment on the acts of [Argentina] done within its own territory.”

The Problem of Extraterritoriality

- The trend in the U.S. has been unfavorable towards application of U.S. statutes overseas.
- Morrison v. National Australia Bank Ltd., 130 S. Ct. 2869 (2010)
 - The Court addressed a subset of Section 10(b) claims—foreign plaintiffs suing foreign defendants in connection with securities traded on foreign exchanges.
 - The Court held that Section 10(b) of the Securities Exchange Act applies to fraud “only in connection with the purchase or sale of a security listed on an American stock exchange and the purchase or sale of any security in the United States.”
 - “It is a ‘longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.’”
- Kiobel v. Royal Dutch Petroleum Co., 133 S. Ct. 1659 (2013)
 - Petitioners, a group of Nigerian nationals residing in the United States, sued certain Dutch, British, and Nigerian corporations. Petitioners sued under the Alien Tort Statute, 28 U.S.C. § 1350, “alleging that the corporations aided and abetted the Nigerian Government in committing violations of the law of nations in Nigeria.”
 - The ATS provides, in full, that “[t]he district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.”
 - Chief Justice Roberts, writing for a divided Court, concluded that “presumption against extraterritoriality applies to claims under the ATS.” Since “all the relevant conduct took place outside the United States. And even where the claims touch and concern the territory of the United States, they must do so with sufficient force to displace the presumption against extraterritorial application.”
- The District Court’s orders purport to bind anyone anywhere assisting Argentina in making non-ratable payments in any way, including payments being made to the Eurobondholders and to holders of bonds payable in Argentina.

NML II

THE RATABLE PAYMENT DETERMINATION BY THE DISTRICT COURT FOLLOWING REMAND AND THE QUESTION OF FAIRNESS TO THE EXCHANGE BONDHOLDERS AND OTHER THIRD PARTIES

- In issuing its October decision, the Second Circuit remanded for a further proceeding to ascertain the intended operation of the District Court’s ratable payment formula, and to measure the impact of the injunctions on third parties and intermediary banks.
- On remand, the District Court concluded that:
 - “[t]he ratable payment formula depends on the amount that Argentina pays. If Argentina pays 100% of what is due on its exchange bonds (e.g., \$3.14 billion in December 2012), it must pay 100% of what it owes to plaintiffs (e.g., \$1.33 billion).
- With respect to third parties, the District Court held that the ratable payment injunction applies to anyone in “active concert or participation” with Argentina, including the Trustee and clearing systems line Euroclear, Clearstream and DTC, and that disobedience could result in contempt.
 - “It goes without saying that if Argentina is able to make the payments on the Exchange Bonds without making the payments to plaintiffs, the District Court and Court of Appeals’ rulings and the Injunctions will be entirely for naught. To avoid this, it is necessary that the process for making payments on the Exchange Bonds be covered by the Injunctions, and that the parties participating in that process be so covered.”

The October 2012 Decision (NML II)

- In August 2013, the Second Circuit upheld the amended injunction.

The Viability of the *Pari Passu* Provision as a Platform for Specific Performance

- The October decision was framed as providing “specific performance” of the *pari passu* provision. An equitable remedy like specific performance “may be ordered where no adequate monetary remedy is available and that relief is favored by the balance of equities, which may include the public interest.” See 55 N.Y. Jur. 2d Equity § 18: “Consistent with the maxim that equity will not do for a person what that person can do through legal remedies without the aid of equity, equity will not entertain jurisdiction where there is an adequate remedy at law. Where an adequate remedy at law is provided, the reason for granting equitable relief disappears.”
- The Second Circuit asserted that specific performance was justified because “monetary damages are an ineffective remedy for the harm plaintiffs have suffered as a result of Argentina's breach,” since “Argentina will simply refuse to pay any judgments.”
- But the reason that monetary damages were deemed prospectively ineffective here was because the FSIA limits those assets against which a money judgment may be enforced. The holdout bondholders have no “adequate” remedy at law because Argentina has no commercial property in the U.S. available for execution and its property in Argentina which is outside the United States is immune and beyond the reach of a U.S. Court.

The Propriety of the Injunctions to Enforce a Debt Obligation

- There is a threshold question as to whether injunctive relief is appropriate to enforce a debt obligation. In *Grupo Mexicano de Desarrollo S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), the U.S. Supreme Court rejected the “innovation” of a pre-judgment remedy relying on injunction relief, and noted that such a remedy would supplant traditional state law:
 - “Why go through the trouble of complying with local attachment and garnishment statutes when this all-purpose prejudgment injunction is available? More importantly, by adding, through judicial fiat, a new and powerful weapon to the creditor’s arsenal, the new rule could radically alter the balance between debtor’s and creditor’s rights which has been developed over centuries”
- Justice Scalia for the majority noted that,
 - “the dissent concedes that federal equity courts have traditionally rejected the type of provisional relief granted in this case. It invokes, however, ‘the grand aims of equity,’ and asserts a general power to grant relief whenever legal remedies are not ‘practical and efficient,’ unless there is a statute to the contrary.”

“This expansive view of equity must be rejected. Joseph Story’s famous treatise reflects what we consider the proper rule, both with regard to the general role of equity in our ‘government of laws, not of men,’ and with regard to its application in the very case before us:

“Mr. Justice Blackstone has taken considerable pains to refute this doctrine. ‘It is said,’ he remarks, ‘that it is the business of a Court of Equity, in England, to abate the rigor of the common law. But no such power is contended for. Hard was the case of bond creditors, whose debtor devised away his real estate But a Court of Equity can give no relief’ And illustrations of the same character may be found in every state of the Union. . . . In many [States], if not in all, a debtor may prefer one creditor to another, in discharging his debts, whose assets are wholly insufficient to pay all the debts.” 1 Commentaries on Equity Jurisprudence §12, pp. 14—15 (1836).

The Injunctions as Equitable Relief

BALANCING THE EQUITIES

- In balancing the equities here, both the District Court and the Second Circuit appear to have accorded a significant weight to the social utility of a holdout premium.
- In response to the Second Circuit's post-oral argument request that Argentina propose an offer that would compensate the holdouts, Argentina made an offer based on its view that Equal Treatment would require giving its holdouts essentially the deal that the Exchange Bondholders had received in 2005 and 2010. In making its offer, Argentina pointed out that NML and the other holdouts were not seeking Equal Treatment but an astonishing 2,600% return on its investment.
 - “The estimated \$48.7 million purchase price is based on price data made publicly available by Bloomberg for purchase dates provided in a declaration submitted in the proceedings below by NML . . . For purchases made by NML in November 2008, the average of the last price of October 2008 and the first price of December 2008 was used because no price data is available for that month. In this regard, it is important to emphasize that although Argentina's default occurred approximately 11 years ago, the bonds at issue in this appeal were purchased by NML in 2008 and that NML has deliberately refrained from seeking judgments in connection with these bonds.”
 - The Second Circuit made no mention of the extraordinary economic premium to be realized by NML. In contrast, the plight of the Exchange Bondholders was given no weight whatsoever.
 - In fact, the Second Circuit completely disregarded their interests and dismissed the appeals of those Bondholders who had attempted to intervene following issuance of the October decision:
 - “They are creditors, and, as such, their interests are not plausibly affected by the injunctions because a creditor's interest in getting paid is not cognizably affected by an order for a debtor to pay a different creditor.” (Op. at 10.)
 - It is not clear what this could possibly mean.
 - One judge on the panel disagreed with the majority decision to dismiss the Exchange Bondholders appeals, but did not dissent because the “majority” apparently conceded that arguments would be taken into account as the arguments of amici curiae.

The Injunctions as Equitable Relief

BALANCING THE EQUITIES (cont.)

- The Second Circuit also rejected the argument that the ratable payment remedy was inequitable because it called for plaintiffs to receive their full principal and all accrued interest when Exchange Bondholders receive even a single installment of interest on their bonds representing only a small fraction of their investment.
 - [T]he undisputed reason that plaintiffs are entitled immediately to 100% of the principal and interest on their debt is that the FAA guarantees acceleration of principal and interest in the event of default.” (Op. at 11-12.)
- The Second Circuit also rejected Argentina’s equitable argument that NML should have been barred by laches because it had refused to address the issue until after the 2005 and 2010 exchange offers, both of which had been blessed by the District Court and the Second Circuit. In addition to the fact that the Court failed to view the laches argument as favoring the equitable position of the Exchange Bondholders, the Court concluded that they had participated in the offers at their peril:
 - “because, before accepting the exchange offers, they were expressly warned by Argentina in the accompanying prospectus that there could be ‘no assurance’ that litigation over the FAA Bonds would not ‘interfere with payments’ under the Exchange Bonds.” (Op. at 14.)
- Finally, the possible threat of a default by Argentina was brushed aside:
 - “Here, Exchange Bondholders will be affected if, after we affirm the amended injunctions, Argentina decides to default on the Exchange Bonds, but Exchange Bondholders would then be able to sue over that default. Accordingly, we find no abuse of discretion in the amended injunctions with respect to the Exchange Bondholders’ rights.” (Op. at 14 note 10.)
- The best argument mustered by the Court to justify its position was its response to Argentina’s threat to either defy the Court’s ruling or to default on the Exchange Bonds.
 - “This type of harm – harm threatened to third parties by a party subject to an injunction who avows not to obey it – does not make an otherwise lawful injunction “inequitable.” We are unwilling to permit Argentina’s threats to punish third parties to dictate the availability of terms of relief under Rule 65.” (Op. at 14.)

The Impact on the Exchange Bondholders Cannot Be Ignored

- If Argentina were to violate the injunction by transferring funds to the Trustee, the injunction would then operate to restrain funds in which Argentina has no interest.
 - The injunction would also then have the direct effect of preventing the Trustee from carrying out its contractual obligations to the Exchange Bondholders. Once the funds are held for the account of entities other than Argentina, the District Court should have no power to interdict payment.
- A U.S. court cannot issue an injunction that requires a third party to breach its contract with other third parties.
 - The Republic of Argentina has a legal obligation under its bond documents to make payments to Exchange Bondholders, and the Trustee has a corresponding legal obligation under the indenture to forward any payments received from the Republic to the Exchange Bondholders. At the very least, the injunctions place the Trustee and other institutional parties in positions of irreconcilable conflict.

A U.S. court should not issue an injunction that requires a third party to breach its contract with other third parties.

- The Republic of Argentina has a legal obligation under its bond documents to make payments to Exchange Bondholders, and the Trustee has a corresponding legal obligation under the indenture to forward any payments received from the Republic to the Exchange Bondholders. The injunctions place the Trustee and other institutional parties in positions of irreconcilable conflict.

An equitable remedy that threatens extreme injury to third parties is inequitable

- Injunctions are equitable in nature, meaning the court should balance the interests of all parties. See S.E.C. v. Mgmt. Dynamics, Inc., 515 F.2d 801, 808 (2d Cir. 1975) (“[I]n deciding whether to grant injunctive relief, a district court is called upon to assess all those considerations of fairness that have been the traditional concern of equity courts.”).
- The purpose of equity jurisdiction is to grant discretion to a court so that justice can be done in a balanced manner. To quote one U.S. Supreme Court decision, the
 - “essence of equity jurisdiction has been the power of the Chancellor to do equity and to mould each decree to the necessities of the particular case. Flexibility rather than rigidity has distinguished it. The qualities of mercy and practicality have made equity the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims.”
- While the District Court and the Second Circuit may be justified in their motivation to force Argentina to pay the defaulted bondholders, the injunctions impose substantial inequitable effects upon others not liable to the bondholders.
- The injunctions also create a very high risk that the Exchange Bondholders will not be paid if Argentina chooses to default instead of obeying a Court order it deems unlawful, again a completely inequitable result.
- The Second Circuit appears to have taken its guidance from the dissent in Grupo Mexicano: “English chancery courts traditionally had power to issue injunctions and order specific performance when no effective remedy was available at law.”
- Again: why is there no adequate remedy at law? The FSIA limits the availability of sovereign property for execution.
- Underlying issue in the case: New York judges are frustrated that a foreign sovereign would (a) submit itself to New York jurisdiction, while (b) acting in a manner to render itself judgment-proof.

Policy Implications

EFFECTS ON FUTURE RESTRUCTURINGS

- The Second Circuit views its decision as having limited significance as precedent.
 - “Argentina and various *amici* assert that the amended injunctions will imperil future sovereign debt restructurings . . . But this 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.”
 - The Second Circuit underestimated the prevalence of the *pari passu* provision.
 - By assuming incorrectly that CACs would prevent holdouts going forward, the Second Circuit underestimated the impact of the decision.
- Creditor participation rates in sovereign debt restructurings have historically been high. This is because participation in debt exchanges has been a rational creditor strategy.
 - Risk 1: By increasing the leverage of holdout creditors, the decision increases the risk that holdouts will multiply. The decision below may also encourage holdout creditors to seek preferential recovery outside of a voluntary debt exchange.
 - Risk 2: The decision below may disrupt the entire sovereign debt repayment system. Because the district court’s injunctions explicitly run against third party financial institutions that process bond payments, the Second Circuit’s decision increases the risk that holdout creditors will be able to interrupt the flow of payments to those creditors who have participated in a consensual debt restructuring.

Policy Implications

CACs AS (FALSE) PANACEA

- The Oct. 2012 decision: “The court stated that “[w]ith the inclusion of collective action clauses, the type of ‘holdout’ litigation at issue here is not likely to reoccur.”
- Issue 1: CACs typically only bind bondholders within the same issuance, and the New York law bonds did not contain aggregation provisions. Of the 36 English-law governed bond issuance with CACs that were eligible to participate in the Greek restructuring, only 17 of them were successfully restructured.
- Issue 2: The court never addressed the scope of market exposure to legacy sovereign bond instruments without CACs.
- The Second Circuit noted in reaching this conclusion that CACs “have been included in 99% of the aggregate value of New York-law bonds issued since January 2005.”

NML Has Already Had a Negative Impact

- The NML decision has already had a negative impact on the context of restructuring litigation.
- *In Export-Import Bank of the Republic of China v. Grenada*, No. 13 Civ. 01450 (HB) (S.D.N.Y. Aug. 19, 2013), the plaintiff Bank obtained a \$28 million judgment against Grenada on four loan agreements.
 - The Bank then sought (six years later) to enforce Grenada's *pari passu* agreement, arguing that Grenada had not satisfied its judgment but had continued making payments on its external debt. Exchange bondholders sought to intervene in the case.
 - Grenada sought to dismiss the complaint on merger grounds (i.e., any *pari passu* claim merged into the judgment rendered in the first suit). The court rejected that argument on the theory that the *pari passu* argument could not have been made as a part of the first suit.
 - The Bank then relied on NML to seek partial judgment. The court rejected that as well, citing language in the Oct. 2012 decision that “the combination of Argentina’s executive declarations and legislative enactments have ensured that plaintiffs’ beneficial interests do not remain direct, unconditional, unsecured and unsubordinated obligations of the Republic.” There was no similar factual record as to Grenada.
 - The court allowed the exchange bondholders to intervene., and the matter is to be tried in the next year. It is unclear what issues there are to be tried.
 - This case extends the NML *pari passu* argument to cases where the judgment has already been entered.

The Current Procedural Posture of the Case

- On June 24, 2013, Argentina filed a petition for *certiorari* seeking review of the Second Circuit October 26, 2012 decision.
- This filing may have been made out of an abundance of caution.
- Argentina sought review of the application of the FSIA and whether the court exceeded its equitable powers. It did not seek review of the Second Circuit's interpretation of the *pari passu* proviso.
- In its Aug. 2013 decision, the Second Circuit appeared to criticize Argentina for not waiting to file its petition.
 - “Apparently, Argentina filed a petition for certiorari in this matter on June 24, 2013, notwithstanding that, as of that date, no final order had yet issued in this case.”
- The Court denied Argentina's petition on Oct. 7, 2013.

The Current Procedural Posture of the Case (cont.)

- Argentina can petition for certiorari again if its petition for rehearing en banc is denied (the most likely outcome) in the Second Circuit. It took from 11/13/12 to 3/26/13 for the first petition for rehearing of the Oct. 2012 decision to be disposed of.
- En Banc Rehearing Rules
 - **Judges Eligible to Vote in an En Banc Poll.** Only an active judge may vote to determine whether a case should be heard or reheard en banc. A judge's status as an active or senior judge for the purpose of an en banc poll is determined on the date of entry of the en banc order.
 - **Judges Eligible to Participate in an En Banc Hearing or Rehearing.** Only an active judge or a senior judge who sat on the three-judge panel is eligible to participate in the en banc hearing or rehearing. A judge's status as an active or senior judge is determined on the date of the hearing or rehearing en banc, i.e., on the date oral argument is heard or the case is submitted.
 - **Judges Eligible to Participate in an En Banc Decision.** Only an active judge or a senior judge who either sat on the three-judge panel or took senior status after a case was heard or reheard en banc may participate in the en banc decision. A judge who joins the court after a case was heard or reheard en banc is not eligible to participate in the en banc decision.

The Likelihood for Supreme Court Review

CRITERIA

- Supreme Court Rule 10 outlines “Considerations Governing Review on Certiorari”
- The Court focuses on whether there is a “compelling reason” to grant review, such as:
 - Whether “a United States court of appeals . . . has so far departed from the accepted and usual course of judicial proceedings, or sanctioned such a departure by a lower court, as to call for an exercise of this Court’s supervisory power,” or
 - Whether a United States court of appeals has “decided an important question of federal law that has not been, but should be, settled by this Court.”
 - Whether a federal question has been decided differently by different courts of appeals – a split in the circuit.

The Chances for Supreme Court Review

ANALYSIS

■ Pro:

- The decision contravenes the enforcement limitations imposed by the FSIA.
- The decision threatens a disruption of sovereign debt restructurings.
- The decision implicates limitations on federal equitable power addressed in Grupo Mexicano.
- The decision has foreign policy implications for the United States.

■ Con:

- The case is, at bottom, a dispute over New York law interpretations of contractual provisions.
- It is possible to interpret the case as, at least in practice, applicable only to Argentina (an opinion in “the same class as a restricted railroad ticket, good for this day and train only.”)
- Barring intervention from the U.S. government in favor of review, the Court may not choose to intervene.