STUDENT NOTES/COMMENTS

An Analysis of the Argentinian Bond Crisis

Irakli Shalolashvili*

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Have you ever watched a poker game where the winner walks away with ninety billion dollars? The World Series of Poker, which awards prizes ranging from five to eight million dollars[1] to the winner of the main event, cannot compete with the risk taking that was recently on display at the United States Court of Appeals for the Second Circuit. A hedge fund tried to collect the full value on Argentinian bonds that it had purchased at a significant discount while simultaneously bringing the international bond market to its knees. The legal question that the Second Circuit

* Irakli Shalolashvili received his B.A. in 2006 and his M.A. in 2008 from the Rabbinical Seminary of America, and he will be graduating *Magna Cum Laude* from the University of Miami School of Law in May 2015. Eric was the Student Writing Editor for the *Inter-American Law Review* from 2014-2015.

1. The winner of the 2013 Annual World Series of Poker was awarded $8,361,570.00. Final Results of Event #62: No-Limit Hold'em Main Event, WORLD SERIES OF POKER, http://www.wsop.com/tournaments/results.asp?grid=968&tid=12861 (last visited Feb. 16, 2014).

faced was one of simple contract interpretation. The Court's decision was so controversial, however, that countries, like France, had no choice but to publicly criticize the ruling and file amicus briefs on behalf of Argentina with the Supreme Court of the United States.[2] The ruling was met with such criticism because the Second Circuit interpreted the clause in question in contrast to how courts had been interpreting it for decades. As a result, the international bond markets suffered. Had the court given more weight to market forces and the principles of efficiency maximization, it would have reached a different result.

I. Background

On December 26, 2001, Argentina defaulted on more than 94 billion dollars in sovereign debt by not paying the interest on its outstanding bonds.[3] The country was in a political crisis, having elected its third president in four days,[4] largely due to the financial turmoil created by the massive debt owed to the bondholders. Adolfo Saa, the country's new President, said, "Argentines demand change . . . today we accept that challenge."[5] Part of the change that President Saa referred to was Argentina's decision to default on the bonds, which freed up capital that his government desperately needed for domestic spending. Argentina's default was the largest default in history.[6] After the country defaulted, it asked the bondholders to renegotiate the terms of the bonds.[7]

The renegotiation of bonds, especially 94 billion dollars' worth, is an inherently high-risk undertaking. The bond issuer's objective is to pay as little as possible on each dollar owed while at the same time getting all of the bondholders to agree on the settlement. The bondholder's objective is to minimize their losses and get as much as possible out of the bond issuer. In 2005, during the first restructuring, the Argentinian government settled with the

2. *See* Anna Gelpern, *France is Man Enough to Pari Passu*, Credit Slips (July 27, 2013, 7:59 AM), http://www.creditslips.org/creditslips/2013/07/france-is-man-enough-to-pari-passu.html.

3. Sophie Arie & Andrew Cave, *Argentina Makes Biggest Debt Default in History,* The Telegraph (Dec. 24, 2001), http://www.telegraph.co.uk/news/worldnews/southamerica/argentina/1366218/Argentina-makes-biggest-debt-default-in-history.html.

4. *Id.*

5. *Id.*

6. *Id.*

7. *See generally* J.F. Hornbeck, *Argentina's Defaulted Sovereign Debt: Dealing with the "Holdouts"* 1, Cong. Research Serv. (Feb. 6, 2013), http://www.fas.org/sgp/crs/row/R41029.pdf.

affected bondholders for a fraction of the money owed.[8] For two-thirds of the bondholders, the settlement provided for a 27-30% recovery rate of the original debt.[9,10] The remaining third continued to hold bonds that were in default.

In 2010, the Argentinian government entered into negotiations with most of the remaining holdout bondholders.[11] The bondholders were threatening to seize Argentinian assets abroad and obtain an injunction to stop the government from paying the settled bonds and defaulting on the holdouts.[12] The negotiations led to another settlement, bringing the total percentage of bondholders that settled to over ninety percent.[13] The remaining bondholders who did not accept the 2010 settlement are known as the vulture funds.

Vulture funds have one goal: collect 100 percent of the money owed—not pennies on the dollar.[14] Though the vulture funds turned to the judicial system for relief, suing a sovereign in federal court is very complicated. The Foreign Sovereign Immunities Act ("FSIA")[15] generally shields governments from being sued in the United States. A notable exception to FSIA exists when the foreign state has waived its immunity.[16]

Although the jurisdictional question is a fascinating one, it is not the main focus of this paper. Even if the vulture funds got into federal court, winning was not a certainty. To win, the funds had to convince the court of its interpretation of the central clause in the bond agreement between Argentina and the bondholders.[17] The clause in question is the *pari passu* clause. The vulture funds succeeded in convincing the court that the question was a narrow

8. *Id.* at 5.

9. *Id.*

10. Who the bondholders are is an important question that will be addressed later in the paper.

11. *See* Hornbeck, *supra* note 7, at 8.

12. Agustino Fontevecchia, *The Real Story of How a Hedge Fund Detained a Vessel in Ghana and Even Went for Argentina's 'Air Force One,'* FORBES (Oct. 5, 2012), http://www.forbes.com/sites/afontevecchia/2012/10/05/the-real-story-behind-the-argentine-vessel-in-ghana-and-how-hedge-funds-tried-to-seize-the-presidential-plane/.

13. *See* Hornbeck, *supra* note 7, at 8.

14. It goes without saying that these funds stood to profit from the deal because they bought the bonds—pennies on the dollar, before the first settlement.

15. Foreign Sovereign Immunities Act, 28 U.S.C. § 1604 (2010).

16. 28 U.S.C. § 1605 (2008).

17. This is why this case is so fascinating. There are so many legal questions lurking in the background, yet everything hinges on the interpretation of a single (boilerplate) clause in the agreement—making this one of the largest known contract disputes.

one; specifically, the definition of the *pari passu* clause. Because the issue was not what the ramifications of the decision would be, the vulture funds secured victory for its investors—at the expense of poor Argentinians that need infrastructure, and more generally, at the expense of international bond markets.

Pari passu is the contractual equivalent of "all for one and one for all." *Pari passu* means "by equal step" in Latin.[18] The vulture funds[19] argued that this clause requires the government to pay all the bondholders equally. Because Argentina was paying the bondholders who settled, and not the holdouts, it was in violation of this clause.[20] The vulture funds sought an injunction that would prohibit U.S. banks from issuing payments to the funds that settled. The vulture funds even tried to seize an Argentinian naval ship[21] by arguing that any Argentinian assets could be seized in lieu of payment of money owed to the funds.[22]

It is important to note that the funds' reading of the *pari passu* clause is not the only interpretation. The Argentinian government had an equally plausible reading of the clause in question. One scholar noted that "[n]o one seems quite sure what the clause really means, at least in the context of a loan to a sovereign borrower."[23] The *pari passu* clause reads:

> The Securities will constitute . . . direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all time 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*

18. PARI PASSU, BLACK'S LAW DICTIONARY (10th ed. 2014).

19. "Vulture funds" is a term widely used to describe the holdout bondholders.

20. Granted, the settled bondholders were getting less than a 100 percent of their investment, the vulture funds argued that any payment triggered the *pari passu* clause.

21. *See* Sam Jones & Jude Webber, *Argentine Ship Seized in Asset Fight,* FIN. TIMES (OCT. 3, 2012), http://www.ft.com/cms/s/0/edb12a4e-0d92-11e2-97a1-00144feabdc0.html#axzz2iJ9EW4gK.

22. *Id.*

23. Lee C. Buchheit, *The* Pari Passu *Clause Sub Specie Aeternitatis*, 10 INT'L FIN. L. REV. 11, 11 (1991); *see also* G. Mitu Gulati & Kenneth N. Klee, *Sovereign Piracy*, 56 BUS. LAW 635, 646 (2001) (noting that "[i]n the sovereign context there is at least disagreement about the meaning of the clause."); *see also* Stephen J. Choi & G. Mitu Gulati, *Contract as Statute*, 104 MICH. L. REV. 1129, 1134 (2006) (observing that "[t]he leading commentators on sovereign contracts acknowledged that there exists ambiguity as to the meaning of the clause"); *see generally* PHILLIP R. WOOD, PROJECT FINANCE, SUBORDINATED DEBT AND STATE LOANS 165 (1995) (finding that "[i]n the state context, the meaning of the clause is uncertain because there is no hierarchy of payments which is legally enforced under a bankruptcy regime.").

unsubordinated External Indebtedness . . . .[24]

The competing interpretations were brought to light when the case was argued in the Southern District of New York and then on appeal at the United States Court of Appeals for the Second Circuit.[25]

II. The Parties

A. *NML Capital*

NML Capital is a subsidiary of Elliott Associates, a New York based hedge fund.[26] Elliott Associates has successfully used its position as a vulture fund against other governments.[27] Typically, a vulture fund can profit in three ways: (1) by buying a sovereign's default debt, and if the market improves, then the vulture fund profits to the degree that the debt price increased; (2) if there is any increase in the bond price, the fund is in a stronger negotiating position because holding out longer is not as risky; and (3) the fund may sue the sovereign to collect the face value of the bond. Elliott has taken the third approach, and in at least in one scenario, profited 400%.[28]

The first major legal victory by a vulture fund was against Peru.[29] The Southern District of New York agreed with Elliott that if a country paid some of its creditors, but not others, the *pari passu* clause was violated.[30] The court's decision was largely based on a narrow interpretation of the *pari passu* clause.[31] Much like its current case against Argentina, Elliott purchased approximately 10 million dollars of Peruvian bonds.[32] Rebuffing Peru's attempts

24. *The Pari Passu Clause and the Argentine Case*, Allen & Overy 4 (Dec. 27, 2012), http://www.allenovery.com/SiteCollectionDocuments/The%20pari%20passu%20clause%20and%20the%20Argentine%20case.pdf.

25. NML Capital, Ltd. v. Rep. of Arg., 699 F.3d 246 (2d Cir. 2012).

26. *See* Nick Dearden, *Greece: Here Come the Vulture Funds,* The Guardian (May 17, 2012), http://www.guardian.co.uk/commentisfree/2012/may/17/greece-vulture-funds.

27. *See id.*

28. *See generally* Robert Auray, Note, *In Bonds We Trustee: A New Contractual Mechanism to Improve Sovereign Bond Restructurings,* 82 Fordham L. Rev. 899, 914 (2013).

29. *See* Pravin Banker Assoc., Ltd. v. Banco Popular del Peru, 895 F. Supp. 660 (S.D.N.Y. 1995); *see also* Pravin Banker Assoc., Ltd. v. Banco Popular del Peru, 109 F.3d 850 (2d Cir. 1997).

30. *Id.*

31. *Id*.

32. *See* Pravin Bankers Assocs., Ltd. v. Banco Popular del Peru (*Pravin I*), 165 B.R. 379, 382 (Bankr. S.D.N.Y. 1994).

to settle the case for pennies on the dollar, Elliott sued to recover the full value of the bonds.[33] In *Pravin* I, Peru argued to the Southern District of New York that comity, a legal doctrine which allows United States courts to defer to the decisions of foreign sovereigns if those decisions do not conflict with American interests, prevented the plaintiff from obtaining an injunction from a foreign court.[34,35] Peru argued that Elliott was a private hedge fund that was stubbornly refusing to settle the defaulted bonds at the (lower) market rate. Additionally, Peru argued that the interests of the United States were not implicated in this case and an injunction should not be issued.[36] Pravin argued that New York had a significant interest in seeing the contract between the parties enforced because the parties chose New York law to govern any potential disputes between them.[37] As a result, Pravin argued that comity was inapplicable here.[38]

Initially, the Southern District of New York issued a number of stays, partially in order to give the parties ample time to negotiate.[39,40] After negotiations failed, however, the Court ruled against Peru—ordering Peru to pay fully on the bonds that the Plaintiff held.[41] The Second Circuit affirmed the ruling, holding that "broader interests of enforcing contract provisions" were superior to Peru's comity argument.[42] Peru attempted to circumvent the ruling by paying the interest due to the renegotiated bondholders through a Brussels bank.[43] Elliott, in an *ex parte* motion, asked a Brussels court to enjoin the bank from making the payments.[44] The Court agreed.[45]

The victory, however, was a largely empty one because winning a case and recovering damages are not synonymous. There have been many victories against sovereigns in United States

33. *See generally* Gulati & Klee, *supra* note 23, at 635.
34. *Pravin* I, 165 B.R. at 384.
35. *Id.*
36. *Id.* at 385.
37. *Id.* at 386-89.
38. *Id.* at 386.
39. *Id.*
40. The stays were a possible early indication by the court that it would rather not settle this dispute through conventional contract law.
41. *See* Pravin Banker Assoc., Ltd. v. Banco Popular del Peru, 895 F. Supp. 660, 668 (S.D.N.Y. 1995).
42. Pravin Banker Assocs., Ltd. v. Banco Popular del Peru, 109 F.3d 850, 856 (2d Cir. 1997).
43. *See* Gulati & Klee, *supra* note 23, at 635-37.
44. *Id.*
45. *Id.* at 636.

courts that never resulted in payment to the plaintiffs. Notable examples include litigation against Cuba, Iran, and Syria.[46] Winning in court is one thing— enforcement is another.[47] That's where Elliott came in.

Elliott[48] also sued Peru in the Southern District of New York.[49] Having lost with its comity defense against Pravin, Peru now asserted champerty.[50,51] The district court, surprisingly, allowed the champerty defense and dismissed the case.[52] On appeal, the Second Circuit disagreed.[53] The Second Circuit held that Elliott's intention was not to harass Peru, but rather to enforce the contract provisions that implicated New York law.[54] The victory put Elliott in the same state as Pravin—victory in hand, but no enforcement provision in sight. Elliott tried to obtain attachment orders against Peruvian assets. Specifically, Elliott tried to freeze Peruvian assets that were payments to the bondholders of the settled bonds.[55] The attachment orders Elliott sought were on assets all over the world, including, but not limited to assets in the United States, Canada, Belgium, the Netherlands, England, Luxembourg, and Germany.[56] The Southern District of New York, on remand from the Second Circuit, effectively enjoined Chase Bank from making payments to the Peruvian bondholders that had settled.[57] Peru attempted to do an end-around by commissioning Euroclear, a clearinghouse in Brussels, to make the payments.[58] Elliott, however, sued for an attachment

46. *See* Debra Cassens Weiss, *Cuban Exile Awarded $2.8B in Suit Against Castro Government*, ABA JOURNAL (Aug. 25, 2011), http://www.abajournal.com/news/article/cuban_exile_awarded_2.8b_in_suit_against_castro_government (Cuba); *see also* Marcy Oster, *Bombing Victim's Family Wins $323M Judgment Against Iran, Syria*, JTA (May, 16, 2012), http://www.jta.org/2012/05/16/news-opinion/united-states/bombing-victims-family-wins-323m-judgment-against-iran-syria (Iran and Syria).

47. *See generally* Cassens Weiss, *supra* note 46.

48. The Pravin suit was not brought by Elliott.

49. *See* Elliott Assocs., L.P. v. Rep. of Peru, 12 F. Supp. 2d 328 (S.D.N.Y. 1998).

50. *Id.* at 344.

51. *Id.*

52. *See* Elliott Assocs., L.P., 12 F. Supp. 2d at 345, 360.

53. *See* Elliott Assocs., L.P., 194 F.3d 363 (2d Cir. 1999).

54. *See id.* at 381.

55. *See* Auray, *supra* note 28, at 914; *see also* Michael Bradley, James D. Cox & Mitu Gulati, *The Market Reaction to Legal Shocks and Their Antidotes: Lessons from the Sovereign Debt Market*, 39 J. LEGAL STUD. 289, 292 (2010).

56. *See* Auray, *supra* note 28, at 915.

57. *See* Elliott Assocs. v. Banco de la Nacion, 194 F.R.D. 116, 122 (S.D.N.Y. 2000).

58. *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, 257 (2003).

order against Euroclear in a Brussels court.[59] The Brussels court declined to issue an injunction.[60] The Court of Appeals of Brussels granted the injunction.[61] As a result, Peru had two alternatives: pay Elliott or risk not being able to raise capital. Not being able to pay the settled bonds would have been catastrophic for Peru. Among other problems, non-payment would trigger acceleration clauses in other bonds, which would cause Peru to default on almost all of its sovereign obligations.[62] Peru was not going to let this happen. It reached an out of court settlement with Elliott for $56.3 million dollars.[63] The fact that the court agreed with its interpretation was more important to Elliott than the monetary award. The award, in essence, gave Elliott the license to recycle this strategy on a larger scale.

The world's leaders reacted swiftly. Gordon Brown, the Chancellor of the Exchequer in the United Kingdom at the time, said, "[the U.K.] particularly condemns the perversity [of] Vulture Funds purchas[ing] debt at a reduced price and mak[ing] a profit from suing the debtor country to recover the full amount owed—a morally outrageous outcome."[64] The United States Department of Justice filed a "statement of interest" brief in the litigation against Argentina.[65] The issue of vulture fund activities also reached the meetings of the G-7 Finance Ministers in 2007. In a meeting in Washington, D.C., the Finance Ministers expressed that they "remain[ed] concerned about the problem of aggressive litigation against heavily indebted poor countries ("HIPC") . . . urg[ed] all sovereign creditors not to on-sell claims on HIPCs, and [were] examining additional steps that might be taken."[66] Finally, Congress considered two separate bills, H.R. 2493 and H.R. 2932, that essentially outlawed tactics of the vulture funds.[67]

Elliott's tactics, forcing Peru to pay a hefty settlement to holdouts, was the first of its kind in the history of the sovereign bond market. Most hedge funds would be proud of its accomplish-

59. *Id.*
60. *Id.*
61. LP Elliott Assocs. No. 2000/QR/92 (Court of Appeals of Brussels, 8th Chamber Belg. Sept. 26, 2000).
62. *See* Wheeler & Attaran, *supra* note 58, at 258.
63. *Id.*
64. Dr. Rodrigo Olivares-Caminal, *The Pari Passu Interpretation in the Elliott Case: A Brilliant Strategy but an Awful (Mid-Long Term) Outcome?*, 40 HOFSTRA L. REV. 39, 58 (2011).
65. *Id.*
66. *Id.* at 59.
67. *See id.*

ments—for Elliott this victory was a stepping-stone to the real prize—the massive Argentinian bond market.

B. Argentina

Argentina boasts a Gross Domestic Product (GDP) of more than $510 billion, making it one of the largest economies in South America.[68] The World Bank classifies Argentina's economy as an upper middle-income economy.[69] Argentina is also considered an emerging market and is one of the G-20's major economies.[70] Like many sovereigns, Argentina financed major projects by issuing sovereign bonds. When Argentina defaulted on its sovereign debt in 2001,[71] the stage was set for the largest default bond litigation in history. Law and economics allow the fact finder to view the case from *both* an economic and legal perspective.

III. Law and Economics

The interdisciplinary approach to law and economics has slowly made inroads in the United States' judicial system. Some even argue that it has reached "international prominence."[72] The main problem that law and economics faces is that "[i]t is difficult for the movement to penetrate the doctrinal approach of civil law jurists . . ."[73] Law and economics is a way of thinking that puts significant weight on efficiency and market forces. The law, on its own, is often constricted to "the four corners of the document" or whether there was a "meeting of the minds." As one scholar put it, "[t]raditional academic commentary has served as an important doctrinal purpose in advising courts on the proper interpretations of legal rules."[74]

Although non-economists erroneously associate economics with money, capitalism, and selfishness, the essence of economics is something else altogether.[75] Law and economics is an "[a]nalysis

68. *Argentina*, The World Bank, http://www.worldbank.org/en/country/argentina/overview (last updated Oct. 9, 2014).

69. *Id.*

70. *Id.*

71. *Argy Bargy,* The Economist (Dec. 1, 2012), http://www.economist.com/news/finance-and-economics/21567386-argy-bargy.

72. *See* John Linarelli, *Law and Economics: The International Library of Critical Writings in Economics, Richard A. Posner and Francesco Parisi,* 17 Wis. Int'l L.J. 509, 509 (1999).

73. *Id.*

74. *Id.* at 510.

75. Richard A. Posner, *Values and Consequences: An Introduction to Economic*

consist[ing] of tracing out the consequences of assuming that people are more or less rational in their social interactions."[76,77] Another assumption is that a person is a "rational utility maximizer in all areas of life—not just in his 'economic affairs.'"[78] Consider a law student deciding whether or not to take a class from an undesirable professor. Initially, she might resist choosing such a course. If, however, she found out that the professor gives a higher number of "A's" than other professors, the student will be more inclined to take the "undesirable" course. In essence, the professor has compensated the student for the "low perceived value" of the course by giving higher grades.[79]

Many legal scholars considered law and economics a "fad."[80] However, due to the scholarship of Judges Richard Posner and Guido Calabresi, it seems that law and economics "has successfully found a place at the core of the legal arguments made in courts, administrative agencies, and other legal settings."[81] In fact, "[j]udicial opinions refer to economic concepts and cite economic books and articles; and a number of federal judges, including a Justice of the Supreme Court (Stephen Breyer) are alumni of the law and economics movement."[82]

A. *An Example of a Law and Economics Analysis*

One scholar examines the doctrine of law and economics by applying it to the adoption market. He argues that charging prospective parents for adoptions would properly incentivize parents

Analysis of Law 2-3 (Chicago Law Sch. Coase-Sandor Inst. Law & Econ., Working Paper No. 53, 1998), http://www.law.uchicago.edu/files/files/53.Posner.Values_0.pdf.

76. *Id.* at 3.

77. Assumptions are a vital part of economics, some argue to a fault. To illustrate, consider the following: A shipwreck has left a physicist, a chemist, and an economist without food on a deserted island. They find a can of beans that needs to be opened. The physicist proposes to open the can by throwing it up at the perfect velocity and landing it on a rock, thus opening the can. The chemist counters that it would be better to boil the can until the top is melted away. Not satisfied with either approach, the economist says he has come up with the most efficient solution. Assume a can opener. *Id.* at 1.

78. Posner, *supra* note 75, at 4.

79. *Id.* at 3.

80. *See* Morton J. Horwitz, *Law and Economics: Science or Politics?*, 8 HOFSTRA L. REV. 905, 905 (1980) ("I have the strong feeling that the economic analysis of law has 'peaked out' as the latest fad in legal scholarship."); *see also* Owen M. Fiss, *The Law Regained*, 74 CORNELL L. REV. 245, 245 (1989) ("law and economics . . . seems to have peaked.").

81. Bryant G. Garth, *Strategic Research in Law and Society*, 18 FLA. ST. U. L. REV. 57, 59 (1990).

82. Posner, *supra* note 75, at 2.

to invest in the well-being of the child.[83] He argues that child abuse is not the "normal motive for adopting a child," as such "the willingness to pay money for a baby would seem on the whole a reassuring factor from the standpoint of child welfare."[84] Law and economics demands that the court ask questions such as: "Since few people buy television sets in order to smash them, could we allow payment for adoptions in this jurisdiction"? At first, the question seems foolish. What do television sets and adoptions have in common? After further thought, however, the line of reasoning becomes a little clearer. People are generally rational with money; by charging for an item (television sets or babies), the seller could discern how much the potential buyer really wants the item. There seems to be a rule that consumers follow: the more costly a purchase, the more care the purchaser will lavish on it. Recent studies suggest that the more costly it is for parents to obtain a child, the more they will invest in the child's quality attributes, such as health and education.[85] Does this type of analysis rule out the possibility that one pedophile will purchase a baby and go on to abuse that child? Of course not. Law and economics urge courts to look at the aggregate. Overall, babies that are adopted might be better cared for in a pay-for-adoption scheme than the alternative.

Suppose a country passed a law, as most have, that prohibits payment for adoptions out of concern for child abuse. Some children might be spared the horrors of abuse, but most children would suffer from being adopted into families that are not as invested in raising children as those families that are willing to pay for an adoption. In other words, problem solving through the judiciary is limited because the law is often times crippled with tunnel vision and creating unwanted inefficiencies, which are contrary to the law's intent to begin with. Here, the law is intended to protect children from abuse; however, by denying parents the ability to pay for an adoption, the courts are giving access to parents who are less qualified to properly care for the adopted child—or worse, that might abuse the child. Money can serve as an important screening tool that separates fit and unfit parents. Unfortunately, in most jurisdictions, this valuable tool is unavailable. The law does not have all of the answers.

Applying the same rationale to the Argentinian bond crisis,

83. Linarelli, *supra* note 72, at 513.
84. *Id.*
85. *Id.* at 513.

the court's punitive remedy[86] is too shortsighted. The court wants to punish Argentina for breaking its contract; however, the vulture funds invested in the funds *after* Argentina defaulted. The real victims, the original bond buyers that sold their stake to NML, cannot be made whole. They already sold their shares to NML for pennies on the dollar. The punitive punishment, therefore, only benefits a large hedge fund that is market driven. A court applying a law and economics theory would reach a far different outcome in both this case and the Peru case discussed earlier. The original bondholders would have received a larger settlement because the vulture funds would not expect to fully collect on the bonds. While the court intends to punish Argentina, the only people hurting are the Argentinian citizens and the rest of the developing countries. Had the court not been motivated to punish the Argentinian government for "flagrantly" breaking the contract when they had no choice in the matter (because of the debt GDP ratio being over 100 percent), the investors would have been better off.

B. Differences Between Sovereign Debt and Private Debt

The differences between sovereign and private debt highlight the importance of the international bond market. Countries need financing for massive projects that banks are ill equipped to finance. It is a questionable practice for a court to insert itself into the international bond market "in the interest of New York contract law" when the contract law of the state is ill-equipped to deal with a scenario with far reaching consequences—such as sovereign default. There are at least three differences between sovereign debt and private debt. First, a sovereign can always repay its debt[87] because it almost always has the option of raising taxes on its constituents.[88,89] Furthermore, a sovereign can take funds from another project and repay its debt.[90] Although this would leave the project in question unfunded, the debt could always be repaid. A private corporation, on the other hand, does not have these

86. As will be discussed in detail later, the court essentially ordered Argentina to repay the vulture funds in full.

87. *See* Auray, *supra* note 28, at 905.

88. *Id.*

89. There are exceptions to this proposition. Recently, Greece could not meet its obligations, despite its taxing power. As a general rule, however, most economists agree that the power to tax makes sovereigns a "safe" investment.

90. *See* Auray, *supra* note 28, at 905.

options at its disposal. A private company is limited to the assets that it has. It can go beyond its assets by asking for a loan or by selling stock. Ultimately, however, the financial strength of the company will dictate the degree to which the company will be successful in fundraising. A private company certainly does not have the luxury of taxing its employees or officers. Therefore, at least theoretically, a sovereign is generally in a better position to repay its debts than a private company.

Second, sovereigns almost never use collateral to secure its debt.[91] It is illogical to take collateral against a sovereign unless the debtor is in possession of the collateral outside of the sovereign's jurisdiction, because then the sovereign has the ability to rule that the debtor is not entitled to the collateral.[92] This is especially true in emerging economies where the judicial branch of government is not fully independent from the legislative branch. Private debt, on the other hand, is almost always securitized in some way.[93] The collateral gives the debtor some assurance that the debt will be serviced.[94] In the event that it is not, the creditor could seize the collateral and ask a court to enforce the contract. The same is simply not true in the case of a sovereign.

The lack of collateral eventually led Elliott to seize an Argentinian Naval Ship docked in Ghana.[95] The fact that the naval ship was docked in Ghana allowed Elliott to "collateralize" it, because Elliott held a U.S. judgment against Argentina.[96] Argentina was at the mercy of Ghana's court, which eventually ruled in favor of Argentina.[97] However, the episode highlighted the importance of the securitization of debt. Although Elliott was ultimately unsuccessful in seizing the naval ship, it was successful in sending a message to the Argentinian government that, much like the litigation against Peru where Elliott went to numerous countries' courts for relief, Argentina's assets were not safe from lawsuits anywhere in the world—not even Ghana.

Finally, at least in pre Elliot-styled litigation, creditors have

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91. *Id.* at 906.

92. *See generally id.*

93. *See id.* at 905.

94. *See id.*

95. *See id.* at 906.

96. *See* Auray, *supra* note 28, at 906*; see also* Drew Benson, *Bond Vigilantes' Ghana Ambush Proves Default Hex Unbroken,* BLOOMBERG BUSINESS (Oct. 4, 2012), http://www.bloomberg.com/news/2012-10-04/bond-vigilantes-ghana-trap-shows-de fault-hex-argentina-credit.html.

97. *See* Auray, *supra* note 28, at 906.

very limited relief options from the courts when the sovereign context is compared to that of private debt.[98] As discussed earlier, courts sitting in the sovereign are unlikely to be of any help. International courts are severely limited in enforcing judgments against sovereigns. In fact, many countries have laws similar to the Foreign Sovereign Immunities Act, which makes it difficult to sue a sovereign let alone collect from one. Conversely, collecting from a private company is as simple as filing a complaint against it in the appropriate court. If the company is insolvent, the creditor may ask for relief from a bankruptcy court. However, there are no international bankruptcy courts that have jurisdiction over sovereigns.[99] Therefore, settlement is the only option for any holder of defaulted sovereign bonds.

In light of the above, the parties in these settlement negotiations are not on equal footing. Once a sovereign defaults, it can basically dictate the terms of the restructure. Because the debt is unsecured, there is the absence of an international bankruptcy regime, and judicial enforcement is nearly impossible. Bondholders have no viable recourse to collect. They cannot sue—even if they could sue, they cannot collect—and they hold no collateral. Even though the creditors do not have anything tangible to bargain with, they may have some "intangible" bargaining chips.

C. Creditors' Intangible Bargaining Chips

The first of these chips is the "economic dislocation" that will ensue if the sovereign defaults and refuses to negotiate with creditors in good faith.[100] Economic dislocation includes the blocking of lenders of last resort in bailing the sovereign out of financial insolvency or illiquidity.[101] A lender of last resort at the international stage is similar to the "discount window" at the Federal Reserve Bank of the United States.[102] In the United States, banks must hold a certain amount of cash in proportion to its debt at the close of each business day.[103] Banks are sometimes short, and in order to meet that day's requirement, they often borrow from other banks. If other banks are unwilling to lend to the troubled bank, it can borrow the funds from the Federal Reserve's discount win-

98. *Id.*
99. *Id.* at 907.
100. *Id.* at 908.
101. *Id.*
102. *See The Discount Rate,* FEDERAL RESERVE, http://www.federalreserve.gov/monetarypolicy/discountrate.htm (last updated Feb. 24, 2015).
103. *Id.*

dow—a practice frowned upon by the banks because it creates a perception that the bank is not trustworthy.[104] Here, the International Monetary Fund and the World Bank act as lenders of last resort to sovereigns.[105] As a result, sovereigns are unwilling to allow themselves to be in positions of economic dislocation.[106]

A second "intangible bargaining chip" that creditors have is that sovereigns are worried about its reputations.[107] This is largely common sense; if a sovereign defaults on its debt and offers to pay a penny on the dollar, no one would ever lend to them again. This phenomenon is known as a "lender embargo."[108] A lender embargo is essentially a black list.[109] No country wants to be on this list because if a sovereign is unable to raise money through bonds, it will be unable to finance major infrastructure projects such as roads, defense, national heath-care, or the army.[110] Therefore, countries are hesitant to turn to opportunistic restructurings. Ecuador's 2008 default is an example of an opportunistic restructuring. Although the ratio of Ecuador's debt to Gross Domestic Product was only 23 percent, Ecuador defaulted on its debt and negotiated a restructured payment, giving the bond-holders 65 to 70 cents on the dollar.[111] The ratio of Argentina's debt to its Gross Domestic Product was 130%.[112] The contrast is truly striking.

Even though the creditors are not sitting at the table without any chips, no one could legitimately argue that the creditors and the sovereigns have equal bargaining power. In order to even the parties' bargaining power in sovereign bond restructurings, the International Money Fund introduced the Sovereign Debt Restructuring Mechanism (SDRM).[113]

D. The SDRM

In 2003, in response to growing litigation in the distressed debt arena, the IMF proposed a way to restructure unsustainable debt efficiently. The SDRM was a failed attempt to create a cen-

104. *See generally* Olivier Armantier *et. al., Discount Window During the 2007-2008 Financial Crisis,* FED. RESERVE BANK OF N.Y. 1 (Sept. 2013), http://www.newyorkfed.org/research/staff_reports/sr483.pdf.
105. *See* Auray, *supra* note 28, at n.75.
106. *Id.* at 908.
107. *See id.*
108. *Id.* at 909.
109. *See generally id.*
110. *See* Auray, *supra* note 28, at 909.
111. *Id.*
112. *Id.*
113. *Id.* at 916.

tral authority to control debt restructurings. The SDRM had four main functions: (1) it would prevent vulture funds, like Elliott, from disturbing the settlement process; (2) it guaranteed to creditors that the sovereign would pay some creditors and not others; (3) similar to some bankruptcy codes, new creditors were given preferred creditor status; and (4) in order to prevent vulture funds from disturbing the settlement process, once a certain pre-determined percentage of bond holders accepted the restructuring agreement, the deal was binding on all bond holders.[114] Although the IMF had high hopes for the SDRM, the international community never accepted it.[115] One scholar claimed that the SDRM failed because the IMF "[h]ad given itself unreasonable powers under the SDRM to pre-determine the outcome of the debt restructuring process."[116] The failure of the SDRM is important because it highlights the complexity of this case. Specifically, if an international organization charged with maintaining the health of the global economy was unable to resolve the distressed debt dilemma, then is it rational to expect a New York court to efficiently solve this problem? With this backdrop, we now turn to the Argentinian bond crisis.

IV. The District Court's Interpretation of the Pari Passu Clause

Elliott, specifically its subsidiary NML Capital, sued the Republic of Argentina in the Southern District of New York.[117] Plaintiff alleged breach of contract, and sought injunctive relief, asking the Court to enforce the contract's Equal Treatment Provision.[118] The contract between the parties is governed by New York law and allows jurisdiction in any State or Federal court in New York.[119] However, as part of its sovereign bond default, Argentina passed the "Lock Law," which does not allow it to recognize any judgment from the New York courts.[120] In December 2012, the district court ruled that whenever the Argentinian government "[l]owers the rank of its payment obligations under [plaintiffs']

114. *Id.* at 916-17.
115. *Id.* at 917.
116. *See* Ann Pettifor, *The IMF's New Consultation on an SDRM: Reflections on the Last SDRM*, Prime Economics (May 30, 2013), http://www.primeeconomics.org/articles/1864.
117. *See* NML Capital, Ltd. v. Rep. of Arg., 699 F.3d 246 (2d Cir. 2012).
118. *See id.* at 253.
119. *Id.* at 254.
120. *Id.*

Bonds below that of any other present or future unsecured and unsubordinated External indebtedness," it violates the Equal Treatment Provision.[121] The district court observed that Argentina lowered NML's status by treating it unfairly in two ways: (1) "when it made payments currently due under the Exchange Bonds, while persisting in its refusal to satisfy its payment obligations currently due under [plaintiffs'] Bonds," and (2) "when it enacted [the Lock Law] and [the Lock Law Suspension]."[122] The district court explained:

> It's hard for me to believe that there is not a violation of the [Equal Treatment Provision] accomplished by the [Argentinian] congressional legislation in '05 and ' 10, simply saying that the Republic will not honor these judgments. It is difficult to imagine anything would reduce the rank, reduce the equal status or simply wipe out the equal status of these bonds under the [Equal Treatment Provision] [more than the Lock Law and the Lock Law Suspension]. . . . [The Equal Treatment Provision] can't be interpreted to allow the Argentine government to simply declare that these judgments will not be paid, and that's what they have done.[123]

The fact that Peru lost in the Second Circuit with its comity and champerty arguments left Argentina with only one option—it had to argue that non-payment to the vulture funds did not violate the *pari passu* clause of the contract between Argentina and the vulture funds. In order to bolster its argument, Argentina convinced Anne Krueger, who unsuccessfully promoted the SDRM as the deputy chief of the International Monetary Fund, to argue that NML's proposed interpretation of the *pari passu* clause would be devastating to the international bond markets.[124] Krueger's argument was four-fold: (1) debt sustainability; (2) importance of international capital market for emerging markets; (3) need for short term external funding; and (4) likely negative consequences of the court decision on the sovereign debt bond market.[125]

Krueger argued that sometimes debt for a sovereign is simply unsustainable. For instance, a sovereign's major export might

121. *Id.*
122. *Id.*
123. *NML Capital, Ltd.*, 699 F.3d at 254.
124. *See generally* Brief for Amicus Curiae Professor Anne Krueger in Support of the Republic of Argentina, NML Capital, Ltd. v. Rep. of Arg., 699 F.3d 246 (2d Cir. 2012) (No. 12-105) [hereinafter Krueger Brief].
125. *Id.* at 3.

have decreased in price. As a result, the sovereign has less capital at its disposal and it must prioritize between servicing the bonds and paying for pressing domestic obligations such as the army, defense, police, etc.[126] The sovereign has the option of printing more money, but that is of little help due to the fact that the market will absorb the new money, and in turn, the currency will be "devalued." Also, more of the money will be needed to service the debt—in essence, taking the situation back to square one. Increasing taxes is not a feasible option either due to the fact that "some of these countries' governments incurred rising fiscal deficits because tax revenues were down (due to domestic recession or other reasons), and fiscal expenditures increased to offset the effects of recession."[127]

Krueger also tried to impress upon the court the importance of the international capital market for emerging markets. She argued that because of the absence of an international bankruptcy regime for sovereigns, it is imperative that debt be restructured expeditiously because a sovereign's ability to meet its debts will often be in question.[128] Furthermore, the lack of a bankruptcy regime and the fact that a sovereign cannot be forced to sell off assets, makes the resolution of this magnitude in court highly inefficient.[129]

Thirdly, Krueger argued that sovereigns have a pressing need for short term external funding for the same reasons that the sovereign is defaulting on its sovereign bonds. If the court does not allow the sovereign to restructure the debt for market price, but rather forces Argentina to pay full price on its obligations, then Argentina will almost certainly have to default. The reason for this is self-evident. If a country needs to renegotiate its obligations because it cannot meet them, judiciously forcing them to meet its obligations hardly seems to be an efficient solution.[130] If the judiciary hijacks the case, then a country will not be able to get short term financing because it will have to pay its outstanding debt first. The pool of potential lenders that are willing to expose themselves to such high risk situations is thus decreased.

Finally, Krueger argued that a court's intervention will likely

126. *Id.*
127. *Id.* at 5.
128. *Id.* at 7.
129. *Id.*
130. Krueger Brief, *supra* note 124, at 9.

have negative consequences on the international sovereign bond market in general. Repurcussions include:

> (1) the increased reluctance of creditors to share in any restructuring and hence an increase in the likelihood and number of holdouts; (2) higher interest costs for all sovereign borrowers; (3) a reduction in capital inflows even for countries with sound macroeconomic policies; (4) increased delays by sovereigns before accepting the need for restructuring and thus higher costs to borrower and creditors alike; and (5) issues for the International Monetary Fund in supporting countries where policy reform could lead to a return to debt sustainability and voluntary debt-servicing if debt were restructured.[131]

In other words, Krueger was arguing that this case was not simply about money. Rather, the future of the international sovereign bond market—and more importantly, the role that the bonds play in developing emerging nations—was at stake. Krueger ended her amicus brief by observing that "[a]ll of these consequences would reduce prospects for growth in developing countries, increase the costs to creditors and debtors of debt resolution, harm the international sovereign debt market, and reduce the ability of the private international capital market to enhance the growth of developing countries."[132] The court, however, was unimpressed.[133]

In light of Argentina's refusal to pay the holdouts, the district court first issued a temporary restraining order, which enjoined Argentina from:

> altering or amending the processes or specific transfer mechanisms (including the use of specific firms) by which it makes payments due to holders of bonds or other securities issued pursuant to its 2005 and 2030 exchange offers, including without limitation by using agents, financial intermediaries and financial vehicles other than those used at the time of this Order.[134]

This injunction was a major signal as to how the district court would rule on the underlying case. Later, in February 2012, the district court ordered Argentina to "[p]erform [on] its obligations" under the *pari passu* clause. Specifically, any time that the Argentinians pay any amount under the terms of the Exchange bonds,

131. *Id.* at 12.
132. *Id.* at 17-18.
133. The court's reasoning is detailed below.
134. NML Capital, Ltd. v. Rep. of Arg., 699 F.3d 246, 254 (2d Cir. 2012).

"[they] must concurrently or in advance pay plaintiffs the same fraction of the amount due to them."[135] In other words, Argentina would have to pay the holdouts any time it made a payment to the Exchange bondholders. The district court ordered that the injunction should be issued to all banks engaging in business with Argentina. The significance of this particular injunction cannot be stressed enough because the injunction did not allow Argentina to circumvent the court's ruling by going to the banks of different countries to make payments to the Exchange bondholders.[136] The court was concerned that the injunction would not be followed because the Argentinian government refused to follow the judgments of the Southern District of New York. The court reasoned that by codifying the Lock Law and the Lock Suspension, the Argentinians were signaling their intention to defy any ruling of the American courts that went against Argentina's interests. The court justified issuing the injunction on a different basis as well. The district court stated that:

> [t]he public interest of enforcing contracts and upholding the rule of law will be served by the issuance of these injunctions, particularly here, where creditors of the Republic have no recourse to bankruptcy regimes to protect their interests and must rely upon courts to enforce contractual promises. No less than any other entering into a commercial transaction, there is a strong public interest in holding the Republic [Argentina] to its contractual obligations.[137]

The problem with this view is that it is circular: the obligation of the Republic to pay was only the "rule of law" because the district said so. Had the district court ruled in favor of the Argentinians, there would be no contractual obligation. The factors the court considered in making its decision and what weight it assigned to each argument was truly critical.

A. *Other Interpretations of the Clause*

As discussed earlier, there is no settled interpretation of the *pari passu* clause. Consider France's argument to the Supreme Court, in which it urged the Court to overrule the Second Circuit:

> The market understanding of a *pari passu* clause - most of

135. *Id.*
136. Recall the litigation against Peru, discussed earlier, that similarly barred Peru from circumventing the court's decision.
137. *NML Capital, Ltd.*, 699 F.3d at 256.

> which are drafted as a variant of the clause appearing in Argentina's defaulted bonds - is that it is a legal ranking covenant, intended to ensure that the borrower's obligations will rank equally in right of payment among each other, within a particular series of bonds, and with all of the sovereign borrower's other unsubordinated external indebtedness.[138]

In fact, the United States agreed with France's position stating, "[T]he district court's interpretation of the *pari passu* clause . . . deviate[d] from decades of settled market expectations."[139] The Second Circuit's interpretation, moreover, is contrary to international capital markets because the principal participants in those markets "[d]o not interpret the *pari passu* clause as a covenant that would condition certain creditors' receipt of payments to which they are entitled on the debtor's willingness and ability to pay other creditors."[140] In fact, France argued that the last time a court misinterpreted the *pari passu* clause, the legislature stepped in and codified the correct interpretation, which was necessary to disrupt international capital markets.[141] France was referring to the Belgian Court of Appeals, which upheld Elliott's reading of the *pari passu* clause against Peru. The Belgian legislature subsequently declined to follow that interpretation.[142] Moreover, France argued that NML's interpretation was counter to that of European scholars.[143] The prevailing view is reinforced by historical experience as the *pari passu* clause never impeded sovereign restructurings in the 1980's and 1990's.[144]

The United States' opposition to the Second's Circuit's ruling can be summarized as follows:

> The panel believed that the first sentence of the *pari passu* clause prohibits "the issuance of other superior debt" and the second prohibits "the giving of priority to other pay-

138. Brief for the Republic of France as Amicus Curiae in Support of Argentina's Petition for a Writ of Certiorari at 7, NML Capital, Ltd. v. Rep. of Arg. (No. 13-990) [hereinafter France Brief].

139. Brief for the United States of America as Amicus Curiae in Support of Reversal at 5, NML Capital, Ltd., v. Rep. of Arg., 699 F.3d 246 (2d Cir. 2012) (No. 12-105) [hereinafter United States Brief].

140. France Brief, *supra* note 138, at 7.

141. *Id*. at 9.

142. *See id.*

143. *See id.* at 8 ("French legal authorities insist that a contrary interpretation of the *pari passu* clause, such as that espoused by the Court of Appeals is both 'difficult to admit' and 'lacking support' as much as from the practice of financial credits as from doctrinal thoughts.").

144. *Id*.

> ment obligations." Slip op. at 18-19. The better reading, however, is that the two sentences separately address changes in rank within a particular bond issuance and changes in rank across all external indebtedness, not a debtor's obligations as issuer and as payor, see FMLC Study at 4, as the panel believed. Thus, the first sentence bars changes in legal rank in bonds "among themselves" and the second sentence-which requires only that payment "obligations" (as opposed to the payments themselves) rank equally-prohibits changes in legal rank among all "External Indebtedness."[145]

In other words, the United States argued that the *pari passu* clause forbids the ranking of debt within "a particular bond issuance"—not a new issuance of bonds. Consider the reason *pari passu* clauses are generally reserved for international agreements. There is less of a need to include the clause in (US) domestic obligations because the "[g]eneral parity of unsecured debt obligations, absent statutory priorities or the exercise of a court's equitable powers of subordination, is well established by law."[146] International debt markets, in contrast, lack the legal guarantees to protect debtors from subordination.[147] Therefore, international debt agreements include the *pari passu* clause. Importantly, it is unlikely that the parties intended the *pari passu* clause to guard against anything more than involuntary subordination. In fact, prior to the December 2012 District Court Orders, no New York court had endorsed Elliott's reading of the clause.[148]

Others argue that "the *pari passu* clause introduces reinforced protection against unfair discrimination in the process of

145. United States Brief, *supra* note 139.

146. Brief for Clearing House Ass'n, L.L.C. as Amicus Curiae in Support of Reversal at 9-10, NMI Capital Ltd., v. Rep. of Arg., 699 F.3d 246 (2d Cir. 2012) (No. 12-105).

147. *See id*. at 10 ("In contrast, for non-U.S. debt, it is the practice to include such clauses in the debt contracts because there is not always the same certainty that the legal regimes generally applicable to such debtors will necessarily protect creditors from involuntary subordination.").

148. *See id.* at n.15 ("To date no court in New York has adopted either the *Elliott* or *Nicaragua* interpretation of the *pari passu* clause. The *Elliott* case was cited but not followed in *Nacional Financiera, S.N.C v. Chase Manhattan Bank, N.A.*, No. 00 Civ. 1571 (JSM), 2003 WL 1878415 (S.D.N.Y. Apr. 14, 2003), which noted only that the presence of an injunction such as was entered in *Elliott* would present a different case. Similarly, the English courts have not addressed the merits of the issue with respect to *pari passu* clauses in English-law debt instruments. *See Kensington Int'l Ltd v. Republic of the Congo*, 2002 No. 1088, transcript at 27 (Eng. Commercial Ct. Apr. 16, 2003) (noting absence of English authority and denying injunction on equitable grounds) (A-1991-97).").

debt restructuring. The sovereign debtor that would propose bond exchange offers, with varying contents, to the bondholders, without a defensible reason, would be acting in breach of the *pari passu* treatment."[149] The author gives an example of a "defensible" reason—he claims that a sovereign favoring a national bank should be considered "defensible," and courts should be deferential to the sovereign's judgment.[150] But this interpretation does not define "defensible" or "indefensible" in any meaningful way. Moreover, in light of the fact that *pari passu* clauses are likely included to prevent involuntary subordination, clear boundaries of "defensible" conduct need to be defined. Kupelyants strikes a balance between NML's and Argentina's interpretations by arguing that, contrary to Argentina's view, the clause gives some practical protections to bondholders—not just "legal priorities."[151] The clause does not, however, require rateable payments to all creditors.[152] Although Kupelyants departs from a historical interpretation of the clause, even he is not willing to embrace the Second Circuit's interpretation.

V. The Appeal

Argentina raised six issues on appeal. It argued that (1) the exchange bonds were not given legal preference over the holdout bonds because both bonds remained "direct, unconditional, unsecured, and unsubordinated obligations of the Republic." (It argued this despite the fact that it is currently paying the exchange bonds and not the holdout bonds); (2) it is immune to the violations under the FSIA; (3) the injunction violated New York law because the assets the injunction restrains are not the property of the Argentinian government, but rather they are held in a trust for the bondholders; (4) because the only damage the plaintiffs suffered was monetary, the damage is not irreparable, therefore the injunction was unwarranted; (5) the hardship to exchange bondholders and to the Argentinians (as a people) stemming from the injunction far outweighs the potential prejudice to the holdouts. This is because the holdout bondholders bought their debt with full knowledge of the limitations on their ability to collect. On

149. *See* Hayk Kupelyants, *Pari Passu Clauses: An Alternative Interpretation*, Opinio Juris (May 8, 2014, 4:00 PM), http://opiniojuris.org/2014/05/08/pari-passu-clauses-alternative-interpretation/.
150. *Id.*
151. *Id.*
152. *Id.*

the other hand, the injunction will "[t]hrust the Republic into another economic crisis and undermine the consensual sovereign debt restructuring process the United States has been at pains to foster for the past several decades"; and (6) the plaintiffs claim was barred by laches.[153,154,155]

This paper will focus on the first and fifth reasons enumerated above. The first reason is an argument that is based on contract interpetation. What did the parties mean by the *pari passu* clause? Unfortunately, there is no easy answer to this question. In light of all these sources that show that the *pari passu* clause is unclear, it was unreasonable for the district court and subsequently the Second Circuit to rule against Argentina. Specifically, one of the rationales that the Court gave was that the public interest of enforcing contracts was a driving force behind its decision. Additionally, the court said that the rule of law must be followed in order for the public to have confidence in the judicial system.

The counter-argument is that in light of the confusion that dates back many decades, there is no settled interpretation and more generally, no rule of law to the *pari passu* clause. Therefore, the court should have decided this issue based on the market. Specifically, what were the holdout bonds worth at the time the complaint was filed? This is the connection between the first and the fifth arguments that Argentina unsuccessfully advanced in the Second Circuit. First, there is no settled law on what the clause means. Therefore, the market should decide because the harm to the Argentinians is far greater than the harm to the bondholders. The argument is strengthened by the fact that the court discusses the historical problem of interpreting the *pari passu* clause while at the same time arguing that the "rule of law" would be violated if the opposite result were to be reached. Finally, as mentioned earlier, the "rule of law" argument is circular because it is only violated because the court ruled that Argentina violated its obligations—a ruling that was not based on any meaningful historical precedent.[156]

153. *See* NML Capital, Ltd. v. Rep. of Arg., 699 F.3d 246, 257 (2d Cir. 2012).

154. "The equitable doctrine by which a court denies relief to a claimant who has unreasonably delayed in asserting the claim, when that delay has prejudiced the party against whom relief is sought." LACHES, BLACK'S LAW DICTIONARY (10th ed. 2014). Here, the Argentinians were prejudiced by the long delay because the Lock Law was passed in 2005 and the suit was brought in the in 2010.

155. *See NML Capital, Ltd.*, 699 F.3d at 256-57.

156. The counterargument that this case creates the law and thus sets precedent is unconvincing. The stakes were simply too high to use this case as precedent for the interpretation of the *pari passu* clause.

The court started its analysis by noting that under New York law, a bond is a contract.[157] The court found that there is "ample evidence" that Argentina has given priority to the exchange bondholders over the holdouts. Among the reasons the court gave for its finding were: (1) Argentina made no payments for six years to the holdouts, during which time Argentina filed with the SEC and claimed it was not "[u]nder a . . . legal obligation" to pay the holdouts; (2) the passage of the Lock Laws imposed a barrier on the holdouts to collect the debt, while at the same time the exchange bond holders did not face any legislation that prevented them from collecting should Argentina default from its bonds again—the court interpreted this as legal subordination of the debt, thus presenting a problem even under Argentina's interpretation of the *pari passu* clause; and (3) the practical ramification of the enacted legislation in Argentina is that the holdouts and the exchange bondholders are not on same footing in the Argentinian courts, courts which effectively violated the *pari passu* clause as well.[158]

Turning to the fifth argument, the court stated that it does not agree that the Argentinians have suffered more harm than the holdout bondholders. The court noted that "Argentina repeatedly expresses its frustration with plaintiffs for refusing to accept the exchange offers."[159]

> But plaintiffs were completely within their rights to reject the 25–cents-on-the-dollar exchange offers. And because the FAA does not contain a collective action clause, Argentina has no right to force them to accept a restructuring, even one approved by a super-majority.[160]

Whether Argentina is harmed more than the holdouts should not be the central question that the court considers. This case is larger than Elliott or Argentina. The Paris Club, a network of governments that lend each other money, has convinced France to file an amicus brief to the United States Supreme Court to review the case, citing global implications.[161] One scholar noted that "[t]he substance of the brief is less important" because the filing might

157. *NML Capital, Ltd.*, 699 F.3d at 258.

158. *Id.* at 260.

159. *Id.* at n.15; *see* Appellant's Br. 47 ("A holder of defaulted debt cannot *voluntarily* decline to participate in a restructuring and then afterward assert that the creditors who elected to settle their claims are a 'preferred class.'" (emphasis in original)).

160. *Id*.

161. Gelpern, *supra* note 2.

convince the United States and the IMF to file briefs as well.[162] The mere fact that the United States, the IMF, and France would consider filing briefs on behalf of Argentina speaks volumes as to the importance of this case. One scholar noted that:

> This embargo discourages third parties from dealing with the sovereign and, if sufficiently costly, can induce the sovereign to comply. Nevertheless, we are skeptical about injunctions in sovereign debt litigation. They are prone to dramatic spillover effects precisely because they cannot reach their primary target, the sovereign government. Recent decisions in *NML v. Argentina* illustrate the way in which a court's inability to compel compliance by the sovereign may lead it to impose dramatic and unwarranted costs on third parties, turning traditional equitable analysis on its head.[163]

This argument is similar to a law and economics argument because it takes into account the broader costs of the court's decision on third parties. Moreover, the "dramatic spillover effects" are costs that simply cannot be measured in dollars and cents. For example, if raising money for infrastructure is more costly for governments as a result of this decision, how much does that spillover cost?

Furthermore, what metric did the Second Circuit use in determining the harm to Argentina? How could one measure the economic harm to an entire country due to less infrastructure or the effects of a lower credit rating? While the harm to Elliott is easily quantifiable in dollars and cents, the harm to Argentina goes far beyond money. Indeed, the very future of this developing country is at stake. Yet, the court thinks that "on balance," the Argentinians have not suffered more harm than Elliott. In economic terms this problem is called "the problem of valuation."[164] The classic example of a valuation problem is comparing the costs of a breach of contract to pollution costs.[165] In a breach of contract case for a purchase of goods, the loss of the non-breaching is the value of the good.[166] The affected buyer can be made whole if it recovers the price of the good at the time of the breach plus any transactional

162. *Id.*
163. Mark Weidemaier, *No Argentine Settlement Yet. Light Reading While You Wait?,* CREDIT SLIPS (Nov. 4, 2013, 6:45 AM) http://www.creditslips.org/creditslips/2013/11/no-argentine-settlement-yet.html.
164. A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 123 (2003).
165. *Id.*
166. *Id.*

costs.[167] The "valuation process," however, is harder if the loss is "non-standardized or unique."[168] Consider the valuation process for someone who was forced to move out of their house due to a polluting chemical factory. The factory might be in a position, and even willing, to compensate the family. However, how is the loss to the family calculated? Some economists have suggested that the affected individual should determine how much he values the loss or the gain.[169]

This approach is criticized for two reasons. The affected individual has an incentive to overstate his loss, and more importantly, two potential questions arise. First, "how much would you be willing to pay to avoid the loss" or second, "how much would you have to be paid to have the loss imposed on you."[170] The answer to the questions is obviously not the same and thus highlights the problem of valuating non-standardized or unique losses. The "valuation problem" is exacerbated in our scenario because the affected party is an entire country, making the valuation process almost impossible. Therefore, the court's balancing test of the relative harms to Argentina and Elliott is correct, remains suspect—at least economically speaking. One possible explanation as to the court's rationale is that Argentina's harm is largely self-inflicted. It could have designed the bond contracts in a way that the *pari passu* clause would not be implicated. In fact, it could have insisted on leaving the *pari passu* clause out altogether. In light of the serious global implications, it hardly seems fair to punish innocent citizens of Argentina for the mistakes of those who drafted the bond contract—probably a large New York law firm.[171]

VI. The Second Circuit's Question

The Second Circuit found the formula imposed by the Southern District of New York ambiguous. Specifically, the Second Circuit observed that the formula:

> could be read to mean that if, for example, Argentina owed the holders of restructured debt $100,000 in interest and paid 100% of that amount then it would be required to pay

167. *Id.*
168. *Id.*
169. *Id.* at 124.
170. Polinsky, *supra* note 164, at 124.
171. *See* Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. Rev. 59, 59 (2000) ("Many of these [sovereign] bonds are governed by the law of the state of New York."). If New York law governs the bonds, New York law firms cannot be too far behind.

> the plaintiffs 100% of the accelerated principal and all accrued interest. Or it could be read to mean that, if such a $100,000 payment to the exchange bondholders represented 1% of the principal and interest outstanding on the restructured debt, then Argentina must pay plaintiffs 1% of the amount owed to them. We cannot tell precisely what result the district court intended.[172]

To better understand the Second Circuit's question, a close reading of the district court's injunctions might be helpful:

> a. Whenever the Republic pays any amount due under terms of the bonds or other obligations issued pursuant to the Republic's 2005 or 2030 Exchange Offers, or any subsequent exchange of or substitution for the 2005 and 2030 Exchange Offers that may occur in the future (collectively, the "Exchange Bonds"), the Republic shall concurrently or in advance make a "Ratable Payment" (as defined below) to NML.
>
> b. Such "Ratable Payment" that the Republic is ORDERED to make to NML shall be an amount equal to the "Payment Percentage" (as defined below) multiplied by the total amount currently due to NML in respect of the bonds at issue in these cases (08 Civ. 6978, 09 Civ. 1707, and 09 Civ. 1708), including prejudgment interest (the "NML Bonds").
>
> c. Such "Payment Percentage" shall be the fraction calculated by dividing the amount actually paid or which the Republic intends to pay under the terms of the Exchange Bonds by the total amount then due under the terms of the Exchange Bonds.[173]

In other words, the Second Circuit found that the district court's intention was ambiguous. Were the payments to be considered in full satisfaction of the principal and interest? Further, would this result in Argentina having to pay all of its obligations to the holdout bondholders or would the holdout bondholders be paid in proportion to the amount Argentina paid the settled bondholders? On remand, the district court answered the Second Circuit's question. The district court simplified its ruling by giving a real life example of how it intended the holdouts to be paid:

> In December 2012, there are interest payments of approximately $3.14 billion due on the Exchange Bonds. Presuma-

172. NML Capital, Ltd. v. Rep. of Arg., 699 F.3d 246, 255 (2d Cir. 2012).

173. NML Capital, Ltd. v. Rep. of Arg., No. 08 Civ. 6978 (TPG), 2012 WL 5895786, at *1-2 (S.D.N.Y. Nov. 21, 2012), *aff'd* 727 F.3d 230 (2d Cir. 2013).

> bly, Argentina intends to pay 100% of what is owed. There are currently debts owed to plaintiffs by Argentina of approximately $1.33 billion. It should be emphasized that these are debts *currently owed,* not debts spaced out over future periods of time. In order to comply with the terms of the Injunctions, Argentina must pay plaintiffs 100% of that $1.33 billion concurrently with or in advance of the payments on the Exchange Bonds.[174]

The district court reached this decision because it read the *pari passu* clause almost literally. According to the district court, if Argentina paid any bondholders, it must have paid the holdouts fully. The district court thought it was irrelevant that the debt owed to the holdout bondholders and the settled bondholders were fundamentally different. The court described its rationale by first noting that it recognized that the holdout and the Exchange bondholders differed in the amount owed to them and the nature of the underlying debt.[175] The court ruled that these distinctions were not sufficient to warrant a broad reading of the *pari passu* clause. The central issue to the Court was "[t]hat the obligations under the various debts are complied with to the same extent, rather than having the obligations on one debt honored and the obligations on the other debt repudiated, as has occurred in the present case."[176]

The district court rejected the Second Circuit's second hypothetical which raised the question of whether Argentina should be obligated to pay the holdouts the same percentage of the total debt as the renegotiated bond holders. The district court saw no excuse to spread out the payments to holdout bondholders. The court noted that Argentina owed the accelerated principal and interest and it "owes it now . . . moreover, and this is most important, to apply the second hypothetical of the Court of Appeals and spread payment to plaintiffs over a period of time, would be a far cry from a proper remedy for the flagrant and intentional contract violations committed by Argentina."[177]

The court was clearly signaling that its interpretation of the *pari passu* clause was partially motivated by its desire to punish

174. *Id.* at 3.

175. The two debts are different in nature, because the Exchange bondholders are owed interest payments, while the holdout bondholders are owed accelerated principal and interest.

176. *NML Capital, Ltd.*, 2012 WL 5895786, at *3.

177. *Id.* at 4.

Argentina's "flagrant and intentional contract violations."[178] By punishing Argentina, however, the court was willing to treat Argentinians as necessary collateral damage and, at the same time, jeopardize the global sovereign bond market. Perhaps in the future, Argentina, or any other similarly situated sovereign, should buy the bonds at market price at the time it re-structures its obligations. If this path is chosen, a sovereign will likely be able to negotiate with those that are willing and buy the rest of the bonds at a significant discount—much the same way NML did. This course would avoid litigation against vulture funds, although it may also spark a bidding war for the remaining bonds if it is known that a sovereign needs to buy out the remaining bonds.

VII. Conclusion

Law and economics has its shortcomings. However, in a case such as this, where the issue could be broadly framed as the market price of the bonds rather than contractual interpretation, courts should not wreak economic havoc on the markets by judicial fiat.

178. *Id.*