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RESTRUCTURING A SOVEREIGN BOND PARI PASSU WORK-AROUND: CAN HOLDOUT CREDITORS EVER HAVE EQUAL TREATMENT?

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The rise of vulture fund investing in sovereign bonds has created additional hurdles to successful restructuring in an already fragile ad hoc process. Recent litigation in NML Capital, Ltd. v. Argentina *has proven courts' willingness to utilize powers of equity to enforce a ratable payment interpretation of the pari passu clause—the equal treatment provision commonly found in sovereign bond contracts—creating much uncertainty on how the ruling will affect future restructuring efforts. By looking to the tension in interpretations of the pari passu clause, discrepancies in remedial relief awarded, and international institutions' proposed solutions, this Note analyzes the role of the pari passu clause as a tool for holdout creditors to disrupt restructurings. This Note argues for a contractual solution targeted at preventing vulture fund investors from access to pari passu injunctive relief coupled with creative restructuring strategies for outstanding bonds awaiting maturity. This resolution seeks to retain some protection for traditional holdout creditors while disincentivizing investments made with intent to derail restructurings from the start.*

Unlike debtors in the domestic bankruptcy system, sovereigns have no overarching mechanism to facilitate a successful restructuring when their debt burden becomes unsustainable. Using the pari passu clause as a means to enjoin payment to restructured bondholders leaves sovereign debtors with little recourse but to cede to the demands of holdout creditors and can have a devastating long-term impact on the sovereign's capacity to rebuild debt sustainability. On the other hand, removing pari passu injunctive relief strips holdout creditors of a valuable enforcement mechanism and can leave sovereigns unrestrained. This Note balances these concerns by advocating for a solution that diminishes vulture creditor leverage that can obstruct a restructuring, while otherwise preserving creditor rights against unfair or coercive exchange terms.

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INTRODUCTION

A sovereign will go to great lengths to prevent the derailment of a debt restructuring that could result in economic disaster. In September 2014, after a hearing before a New York federal court in *NML Capital, Ltd. v. Argentina*,[1] the sovereign nation of Argentina was found to be in civil contempt for proposing a bond payment system that was found to evade a payment structure mandated by court injunction.[2] While it is extremely rare to hold a party in contempt,[3] let alone a sovereign nation,[4] courts have not shied away from employing their full arsenal of enforcement tools in sovereign debt litigation.[5] Argentina's actions were a result of its strategy to avoid a remedial order that conditioned payment to restructured bondholders on the full payment of principal and interest owed to holdout creditors, which Argentina claims would have grave economic consequences.[6] The court's power to provide such injunctive relief and grant the contempt order are both derived from the enforcement of one brief provision's meaning: the pari passu clause in the bond contract.[7]

1. *See* NML Capital, Ltd. v. Republic of Argentina, No. 08 Civ. 6978 (TPG), 2012 WL 5895784 (S.D.N.Y. Nov. 21, 2012) (establishing injunction); Order, *NML Capital*, No. 08 Civ. 6978 (S.D.N.Y. Sept. 29, 2014), ECF No. 687 (finding contempt for violating injunction).

2. Transcript of Hearing at 25:5–28:20, *NML Capital*, No. 08 Civ. 6978 (S.D.N.Y. Sept. 29, 2014), *available at* http://www.shearman.com/~/media/Files/Services/Argentine-Sovereign-Debt/2014/Arg180-093014-e9t9repc.pdf; *see also* Amended and Supplemental Contempt Order at 3, *NML Capital*, No. 08 Civ. 6978 (S.D.N.Y. Oct. 3, 2014), ECF No. 693.

3. *See* Transcript of Hearing, *supra* note 2, at 28:5–6 (explaining that "to hold a party in contempt of court is a rare thing").

4. W. Mark C. Weidemaier & Anna Gelpern, *Injunctions in Sovereign Debt Litigation*, 31 YALE J. ON REG. 189, 208 (2014) (noting that the risk of contempt typically falls on third parties when a sovereign is enjoined).

5. *See, e.g.*, Servaas Inc. v. Republic of Iraq, No. 09 Civ. 1862 (RMB), 2014 WL 279507, at *5 (S.D.N.Y. Jan. 24, 2014) (imposing $2,000 contempt sanction on Iraq for each day of failure to comply with discovery order); *see also* FG Hemisphere Assocs., LLC v. Democratic Republic of Congo, 637 F.3d 373, 377–79 (D.C. Cir. 2011); Autotech Techs. LP v. Integral Research & Dev. Corp., 499 F.3d 737, 752 (7th Cir. 2007) (finding that courts are authorized to issue monetary contempt sanctions against foreign sovereigns as well as able to use any powers necessary to bring the suit to resolution).

6. *See* Brief of Defendant at 10–11, *NML Capital*, No. 08 Civ. 6978 (S.D.N.Y. Sept. 29, 2014), ECF No. 685; *see also infra* Part II.A.2.

7. *See* Weidemaier & Gelpern, *supra* note 4, at 195.

Different interpretations of the pari passu clause have sparked much debate on the role of holdout creditors, particularly vulture funds, in the sovereign debt restructuring process.[8] Despite the small percentage of creditors who hold out in a restructuring,[9] pari passu interpretation has overwhelmingly high economic stakes at play for two main reasons. First, the numbers: it is estimated that there is currently approximately $900 billion in outstanding sovereign bonds that are affected by the interpretation.[10] Second, the interpretation's enforcement can unhinge a restructuring and impact third parties.[11] In June 2014, the consequences of the court's injunctions against Argentina reverberated loudly when the country found itself in a technical default on a $539 million interest payment to a class of restructured bondholders for failure to pay the $1.5 billion due to holdouts.[12]

U.S. Supreme Court Justice Oliver Wendell Holmes famously opined that "great cases, like hard cases, make bad law."[13] To determine whether the much-debated adage proves true with *NML Capital*, the case's progeny and the bounds of stare decisis will test the breadth of its applicability.[14] Until that time, the multibillion dollar sovereign bond market governed under New York law requires that which the ruling cannot provide: certainty, predictability, and uniformity.[15] Sovereign bond underwriters, issuers, and purchasers should therefore act now to prevent a sequel to the Argentine technical default disaster.

It is unclear how broadly the rulings will be applied, and what their implications are for future sovereign bond restructurings where the underlying bond issuances contain similar language.[16] Conflicting

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8. *Compare* 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 (2011), *with* Robert A. Cohen, *"Sometimes A Cigar Is Just A Cigar": The Simple Story of Pari Passu*, 40 HOFSTRA L. REV. 11 (2011).

9. *See* Udaibir S. Das et al., *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts* 28 (IMF, Working Paper No. WP/12/203, 2012), *available at* https://www.imf.org/external/pubs/cat/longres.aspx?sk=26190.0 (finding that participation rates in exchange offers typically exceed 90 percent).

10. *See* Sean Hagan, *Acting Collectively: A Better Way to Restructure Government*, IMFDIRECT (Nov. 24, 2014), http://blog-imfdirect.imf.org/2014/11/24/acting-collectively-a-better-way-to-restructure-government-debt/.

11. *See* Weidemaier & Gelpern, *supra* note 4, at 215–16.

12. Camila Russo & Katia Porzecanski, *Argentina Declared in Default by S&P As Talks Fail*, BLOOMBERG NEWS (July 30, 2014), http://www.bloomberg.com/news/2014-07-30/argentina-defaults-according-to-s-p-as-debt-meetings-continue.html.

13. N. Sec. Co. v. United States, 193 U.S. 197, 364, 401 (1904) (Holmes, J., dissenting) (finding that cases can be deemed "great" simply because their immediate interest creates a "hydraulic pressure which makes what previously was clear seem doubtful"); *see also* Ashutosh Bhagwat, *Hard Cases and the (D)Evolution of Constitutional Doctrine*, 30 CONN. L. REV. 961, 965–69 (1998).

14. *See* Weidemaier & Gelpern, *supra* note 4, at 192.

15. *See infra* Part II.A.

16. *Cf.* Romain Zamour, NML v. Argentina *and the Ratable Payment Interpretation of the Pari Passu Clause*, 38 YALE J. INT'L L. ONLINE 55, 63–65 (2013) (arguing that contrary to the general belief that the decision was widely applicable, it was actually narrow in scope).

understandings of the meaning of pari passu by market actors and under other governing laws suggest the potential for the New York decision to have broad and far-reaching consequences for permitting holdout creditors to block future restructurings.[17] This uncertainty is underscored by the lack of a sovereign bankruptcy mechanism that mimics the oversight provided by the domestic bankruptcy system to ensure protections for both creditors and debtors such that neither abuses the system.[18]

Part I of this Note provides an overview of the sovereign bond market, the salient features of the restructuring process including the absence of an overarching bankruptcy regime, and the relevance of the pari passu clause, particularly its use by holdout creditors in sovereign bond restructurings. Part II begins with an examination of the conflicting judicial interpretations of the pari passu clause, the tensions in remedies that follow from those interpretations, and the reactions from various market actors and governments. Part II then introduces and discusses several proposed approaches to preventing pari passu clauses from disrupting payment to exchange bondholders, which includes both contractual and sovereign bankruptcy regime solutions. Part III suggests a contractual solution that would be easier to implement than a new bankruptcy regime. This solution should be targeted at limiting remedies available to vulture funds that purchase bonds at the time the sovereign's debt burden is already unsustainable or presumed unsustainable. Finally, Part III addresses the complexities of the suggested contractual approach and the outstanding bonds whose contracts do not contain the new language.

I. SOVEREIGN BONDS: THE MARKET, THE RESTRUCTURING PROCESS, AND THE RELEVANCE OF PARI PASSU

This Note begins by laying the groundwork for the pari passu debate by placing the provision in the context of the sovereign bond market generally. Part I.A provides background on the structure of the sovereign bond market's size, reasons for countries to issue bond debt, and a history of restructurings. Part I.B then addresses the important aspects of the restructuring process, discussing the lack of an oversight mechanism and the reason creditors hold out. Part I.C introduces the equal treatment provision found in sovereign bonds, the pari passu clause, by explaining its relevance in bond restructurings and use by holdout creditors.

A. Sovereign Bond Basics

The sovereign debt market is considered to be one of the oldest securities markets currently in existence, with "sovereign states . . . borrowing from

17. *See infra* Part II.A.
18. *See* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1049 (2004). *See generally* Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 967 (2000).

time immemorial."[19] One way that sovereigns borrow money to finance a wide range of activities is through the issuance of sovereign bonds.[20] A bond is "an obligation to pay a fixed sum of money, at a definite time, with a stated interest."[21] In its simplest form, a bond is a debt instrument that memorializes the debtor's promise to pay back the principal sum received from the creditor, the interest amount on that principal, and the terms for payment of both.[22] A bond indenture is a contract that outlines the bond's face value, interest rate, maturity date, and other key features,[23] making the terms enforceable under the governing contract law.[24] This section begins with an overview of bond terminology followed by a discussion of the reasons for and benefits of structuring sovereign debt in bonds, the scope of the market, and background on sovereign debt restructurings.

1. Fundamental Concept Overview

The actual bond terms that go into an offering are determined by a host of complex factors that vary by issuing country.[25] A sovereign will decide the bonds' maturity,[26] i.e., whether to issue short-term or long-term bonds, based on internal factors and a mix of market factors that include demand and bond yield.[27] Bond yields are determined by a combination of country-specific factors, international factors, and investor risk preference.[28] Additionally, the way a country structures its bond debt depends on whether the primary target for borrowing is to raise domestic or external debt.[29]

External debt is debt that is issued under foreign law and denominated in foreign currency.[30] Historically separate debt instruments were issued for foreign investors and domestic residents, but the loosening of international capital markets has allowed both types of creditors to invest in both types of

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19. MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION 18 (2013).

20. *See generally id.* at 18–30.

21. BLACK'S LAW DICTIONARY 211 (10th ed. 2014).

22. *See* Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1324, 1329 (2002).

23. BLACK'S LAW DICTIONARY 217 (10th ed. 2014).

24. *See* Republic of Argentina v. Weltover, Inc., 504 U.S. 607, 620 (1992); *see also infra* Part I.B.2 (discussing holdout creditor enforcement litigation).

25. *See* GULATI & SCOTT, *supra* note 19, at 24.

26. The date of maturity is the date when the total bond debt becomes due. BLACK'S LAW DICTIONARY 478 (10th ed. 2014). This encompasses the entirety of the payment obligation to the creditor. *See id.* (defining "maturity value").

27. Fabrizio Zampolli, *Sovereign Debt Management As an Instrument of Monetary Policy: An Overview*, *in* THREAT OF FISCAL DOMINANCE? 102, 110 (2012), *available at* http://www.bis.org/publ/bppdf/bispap65f_rh.pdf. Internal factors for sovereign preference include desired levels of liquidity and whether there is a stronger desire to reduce risk of raising taxes in the future (long-term bonds), or to reduce interest payments (short-term bonds). *Id.*

28. *See* Blaise Gadanecz, Ken Miyajima & Chang Shu, *Exchange Rate Risk and Local Currency Sovereign Bond Yield in Emerging Markets* 2 (Bank for Int'l Settlements, Working Paper No. 474, 2014), *available at* http://www.bis.org/publ/work474.pdf.

29. *See generally* Anna Gelpern & Brad Setser, *Domestic and External Debt: The Doomed Quest for Equal Treatment*, 35 GEO. J. INT'L L. 795 (2004).

30. *Id.*

bonds.[31] The diversified debt composition has created a unique set of legal characteristics that raise concerns about inter-creditor equity in the treatment of foreign and domestic creditors, particularly in the event of financial crisis.[32]

The majority of sovereign bonds are external debt.[33] This is especially true for emerging market bonds that benefit from the economic stability of issuing bond debt under a foreign currency and can attract more investors if the bond terms are enforceable under foreign law.[34] This Note focuses on sovereign bonds that are issued as external debt. The majority of external debt is issued under and governed by New York or English law.[35] These courts are therefore the most significant in their ability to interpret and enforce the terms of the bond contract.[36]

2. Why Countries Issue Bonds

Countries enter the sovereign debt market for access to capital—frequently from foreign creditors.[37] Their reasons for borrowing can range from the need to fund daily expenditures to financing infrastructure projects and wars.[38] Although a sovereign can choose to structure its debt through different types of debt instruments,[39] the economic classification[40] and credit rating of a country can inform the financing options available to it.[41]

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31. *Id.* at 796.

32. *Id.*; *see also infra* Parts I.C, II.A (discussing the relevance of intercreditor treatment and external indebtedness).

33. *See* Das et al., *supra* note 9, at 41 ("Typically, international bonds are issued under foreign laws.").

34. *See* Elmar B. Koch, *Collective Action Clauses: The Way Forward*, 35 GEO. J. INT'L L. 665, 668 (2004) (noting the particular importance of foreign jurisdiction issuance for emerging market economies); *cf.* Lee C. Buchheit, G. Mitu Gulati & Ignacio Tirado, *The Problem of Holdout Creditors in Eurozone Sovereign Debt Restructurings* 5 (Jan. 22, 2013) (unpublished manuscript), *available at* http://ssrn.com/abstract=2205704 (discussing debt issued under domestic laws where the sovereign has the direct ability to change laws that alter their obligations under the debt instrument in the event of a debt crisis). Greece used this strategy during its recent restructuring for the 93 percent of bonds that were governed under Greek law. *Id.*

35. HOLGER SCHIER, TOWARDS A REORGANIZATION SYSTEM FOR SOVEREIGN DEBT 12 (2007); *see also* Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299, 302 (2005) (noting that the largest portion of emerging market debt is governed under New York law).

36. *See generally infra* Part II.A.

37. GULATI & SCOTT, *supra* note 19, at 18.

38. *See id.*

39. *Cf.* Das et al., *supra* note 9, at 14–18 (discussing differences between bilateral and bank debt in the restructuring context). A debt is a "specific sum of money due by agreement or otherwise." BLACK'S LAW DICTIONARY 488 (10th ed. 2014).

40. Countries are categorized as either advanced or developing/emerging market economies. *See* IMF, WORLD ECONOMIC OUTLOOK REPORT 162–66 & tbl.A (2014), *available at* http://www.imf.org/external/pubs/ft/weo/2014/02/pdf/text.pdf.

41. *See* Donato Masciandaro, *Sovereign Debt: Financial Market Over-Reliance on Credit Rating Agencies*, *in* SOVEREIGN RISK: A WORLD WITHOUT RISK-FREE ASSETS? 58 (2013), *available at* http://www.bis.org/publ/bppdf/bispap72j.pdf. Ratings also affect the prices of government bonds, and therefore affect bond yields and margins. *Id.*

For a country to engage in long-term financing through international capital markets, sovereign bonds are one of the most important mechanisms.[42] For sovereigns, bonds provide much more flexibility by allowing longer maturities and less restrictive covenants than other types of financing such as loans from commercial banks.[43] Bonds are also more easily traded on stock exchanges and have less complicated clearing and settlement procedures.[44] For investors, bonds are attractive because credit ratings make risk assessment, pricing, and trading more accessible.[45] This in turn means that the sovereign bond market creates access to more foreign investors and therefore a larger source of capital.[46]

An increase in bond issuances began largely in response to the banking crisis in the 1980s that made other forms of financing unavailable or difficult to obtain.[47] Although the initial shift was seen as temporary, the sovereign bond market began to grow in response to the realization of the many benefits bond financing provided, particularly for emerging market countries.[48] Since the 1990s, bonds have become the primary source of financing to emerging market economies.[49] Although advanced economies generally enjoy a wide variety of financing options,[50] they also hold an increasing percentage of their debt in sovereign bonds.[51]

3. Market Size

The widespread use of sovereign deficit financing with bonds has made capital markets more efficient and diversified.[52] It should therefore come as no surprise that the sovereign bond market holds trillions of dollars in value. It is estimated that in the third quarter of 2014 alone, Eurobond trading (foreign currency–denominated bonds) was valued at $597 billion.[53]

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42. RODRIGO OLIVARES-CAMINAL, LEGAL ASPECTS OF SOVEREIGN DEBT RESTRUCTURING 105 (2010).

43. Fisch & Gentile, *supra* note 18, at 1068.

44. *Id.* The clearing and settlement procedures relate solely to the instrument trading transaction and not to the settlement of claims in the event of a default, which is discussed in greater detail in Part I.B.

45. Fisch & Gentile, *supra* note 18, at 1068–69.

46. *Cf.* Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L. REV. 1627, 1632–33 (2006) (contrasting emerging market economy access to capital with developed economies that have "well-established domestic financial systems, steady access to domestic and international investors, and the capacity to issue debt in their own currencies").

47. *See id.* at 1633–34 (noting the shift from bank loans to bonds following a wave of loan defaults); *see also infra* Part I.A.3, I.B (discussing Brady Bonds and how the changing composition of sovereign debt has impacted restructurings).

48. Fisch & Gentile, *supra* note 18, at 1067 & nn.116–18.

49. *Id.* at 1069.

50. *See* Gelpern & Gulati, *supra* note 46, at 1633.

51. *See* Masciandaro, *supra* note 41, at 50 & n.2 (noting that government bonds for advanced economies have increased from 75 percent to 110 percent of GDP).

52. OLIVARES-CAMINAL, *supra* note 42, at 152.

53. Press Release, Emerging Mkt. Trade Ass'n, EMTA Survey: Third Quarter Emerging Market Debt Trading at $1.454 Trillion 2 (Dec. 2, 2014), *available at* http://www.emta.org/WorkArea/DownloadAsset.aspx?id=9168.

One figure for government bonds in 2000 found that for thirty-five countries assessed, there were $608 billion in outstanding foreign currency sovereign bonds,[54] and by 2008, bonds for long-term public external debt totaled $1.4 trillion.[55]

4. History of Restructurings

A sovereign that no longer has the ability to support its debt obligations will seek to regain debt sustainability by restructuring its payment obligations as part of a bond exchange.[56] The mechanics of this process are outlined in Part I.B.2.

There was a resurgence of sovereign bond restructurings following the Brady Plan in the mid-1990s.[57] Under the plan, bonds were partly collateralized under the U.S. Treasury, which enabled them to become a tradable instrument.[58] This system provided new capital influx to emerging economies and also had the effect of creating a liquid secondary bond market.[59]

The introduction of Brady bonds also marked a great shift in creditor lending.[60] Before the 1980s, sovereign lending was done primarily by syndicated bank loans.[61] Once the Brady Plan provided an outlet for emerging market economies to restructure their unsustainable debt—held primarily in the form of syndicated loans—by exchanging it with bonds, the majority of emerging market debt held by private investors shifted to bonds from commercial loans.[62]

While this bond structure seemed to benefit emerging market economies overall and led to an increase in foreign capital investing in those countries, the system created some new default risks that threatened debt sustainability for participating countries.[63] The default risks eventually led

54. Stijn Claessens, Daniela Klingebiel & Sergio L. Schmukler, *Government Bonds in Domestic and Foreign Currency: The Role of Institutional and Macroeconomic Factors*, 15 REV. INT'L ECON. 370, 376 & fig.3 (2007).

55. *United Nations Conference on Trade and Development, International Government Debt* 5 & fig.1 (UN, Working Paper No. 199, 2010), *available at* http://unctad.org/en/Docs/osgdp20103_en.pdf.

56. *See* Das et al., *supra* note 9, at 7.

57. *Id.* at 32.

58. *See id.* at 18.

59. *Id.*

60. *See supra* notes 47–51 and accompanying text.

61. OLIVARES-CAMINAL, *supra* note 42, at 105. Syndicate loans are loans that are provided by institutional lenders. *See* BLACK'S LAW DICTIONARY 1679 (10th ed. 2014) (defining syndicate as "[a] group organized for a common purpose; esp., an association formed to promote a common interest, carry out a particular business transaction . . . ."). Syndicate loans and commercial bank loans are used interchangeably.

62. OLIVARES-CAMINAL, *supra* note 42, at 105–06.

63. Das et al., *supra* note 9, at 18. The default risks were mainly caused by the way interest payments were structured, which threatened the debt sustainability of the debtor countries. *Id.*

to Brady Bond defaults in several countries, precipitating another bond restructuring in those cases.[64]

From 1998 to 2010, there were seventeen distressed sovereign bond restructurings.[65] During that same period, there was an increase in the number of restructurings that involved a reduction in the restructured instruments' face value.[66] The majority of deals in the 1990s and 2000s came with an implied debt write-down, which was not the case before.[67]

B. Salient Features of the Restructuring Process

This section provides a framework for understanding the ways a sovereign bond restructuring can become susceptible to disruption. Part I.B.1 discusses how the lack of a sovereign bankruptcy regime impacts the terms of restructuring as compared to one conducted under a domestic bankruptcy system. Part I.B.2 outlines the mechanics of exchange offers. Part I.B.3 then discusses holdout creditors and their role in the process.

1. Absence of a Bankruptcy Regime

As compared to the robust system established to oversee domestic bankruptcy,[68] there is no central authority to facilitate restructuring following a sovereign default.[69] Despite various proposals for creation of judicial oversight, global statutory schemes have failed to be implemented.[70] Therefore, restructuring is conducted on an ad hoc basis, addressing individual concerns case-by-case.[71] This system has many problems and can make for a process plagued by inefficiency and unpredictability.[72] This section addresses distinguishing features of the sovereign restructuring process that result from the absence of a bankruptcy regime.

64. *Id.* One country that required a Brady Bond restructuring was Peru. *See infra* notes 210–11 and accompanying text.

65. Das et al., *supra* note 9, at 33.

66. *Id.* at 34.

67. *Id.* This trend can be attributed in part to worldwide debt relief initiatives as well as changes in the administration of bond restructuring. *Id.*

68. *See* Anna Gelpern, *A Skeptic's Case for Sovereign Bankruptcy*, 50 HOUS. L. REV. 1095, 1098 (2013). *See generally* 11 U.S.C. §§ 101–1532 (2012) (demonstrating the thoroughness of the U.S. Bankruptcy Code).

69. *See In re* Bd. of Directors of Multicanal S.A., 307 B.R. 384, 392 (Bankr. S.D.N.Y. 2004) ("[A] sovereign cannot file an insolvency case, and there are no recognized proceedings available to prevent holders of debt . . . from pursuing their claims against a sovereign debtor."); *see also* Eugenio A. Bruno, *Fundamentals of Sovereign Debt*, *in* SOVEREIGN DEBT AND DEBT RESTRUCTURING 5 (Eugenio A. Bruno ed., 2013).

70. *See generally* Kenneth Rogoff & Jeromin Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976–2001*, 49 IMF STAFF PAPERS 470 (2002). The largest hurdle appears to be "substantial disagreement on which approach is the best." *Id.* at 499.

71. OLIVARES-CAMINAL, *supra* note 42, at 104.

72. *See generally* Molly Ryan, *Sovereign Bankruptcy: Why Now and Why Not in the IMF*, 82 FORDHAM L. REV. 2473 (2014).

a. Balancing Creditor and Debtor Interests

The U.S. Bankruptcy Code provides a comprehensive system of protections for both debtors and creditors, which proponents of a statutory approach to sovereign restructuring have sought to emulate.[73] Although attempts to create such a system have been unsuccessful, examining certain protections in the U.S. Bankruptcy Code, particularly corporate restructuring under Chapter 11, can provide a useful though imperfect metaphor to understanding process failures in sovereign debt restructuring.[74]

When applying bankruptcy principles to sovereigns, Chapters 9 and 11 of the U.S. Bankruptcy Code, which outline the reorganization of insolvent municipalities and corporations, respectively, are therefore most frequently viewed for comparison.[75] In understanding the analogy of commercial debt to sovereign debt, several key distinguishing features must be noted.[76] First, the inability to evaluate the debtor's actual financial condition means that it is difficult for creditors to determine when a sovereign is actually unable to pay its debts as opposed to engaging in an opportunistic default.[77] Even where the default is legitimately the result of unsustainable debt, the lack of financial transparency means that creditors can still become vulnerable to unreasonable restructuring terms.[78]

Second, under the domestic system, U.S. bankruptcy courts play a large role in balancing the concerns of both debtors and creditors to effectuate fair and equitable results in the administration of bankruptcy.[79] Once a debtor is in bankruptcy, there are a host of protections that become available.[80] Particularly necessary to successful reorganization for the debtor are: (1) the issuance of an automatic stay,[81] (2) the debtor-in-possession's access to financing,[82] and (3) the ability of a court to confirm a binding reorganization plan despite creditor objection.[83] Creditors also have a number of ways to ensure that their interests are protected,

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73. *See* ANNE O. KRUEGER, IMF, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING 10–20 (2002), *available at* http://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf.

74. *See id.*; *see also* SCHIER, *supra* note 35, at 37–44.

75. *See* 11 U.S.C. §§ 901–946 (2012) (chapter 9); *id.* §§ 1101–1174 (chapter 11); *see also* SCHIER, *supra* note 35, at 37.

76. Fisch & Gentile, *supra* note 18, at 1045.

77. *See* Stephen J. Choi, Mitu Gulati & Eric A. Posner, *The Evolution of Contractual Terms in Sovereign Bonds*, 4 J. LEGAL ANALYSIS 131, 133 (2012).

78. *Id.*

79. *See* 11 U.S.C. § 105 (outlining the broad power of the court).

80. *See* SCHIER, *supra* note 35, at 37–44.

81. *See* 11 U.S.C. §§ 362, 922.

82. *See id.* § 364.

83. *Cf. In re* Genco Shipping & Trading Ltd., 513 B.R. 233, 241 (Bankr. S.D.N.Y. 2014) (noting that a reorganization plan "may still be confirmed [by the court] over the rejection of a class of claims or interests" under 11 U.S.C. § 1129(b)(1) if it meets the other criteria in 11 U.S.C. § 1129(a) save for affirmative consent of all impaired parties).

including: (1) the implementation of creditors' committees,[84] (2) court review of reorganization plans for fairness,[85] and (3) rules such as preference avoidance that prevent creditors from receiving an unfair priority in payment.[86] In the absence of these formal procedures to safeguard creditor and debtor interests, the leverage each brings to the negotiating table can dictate the restructuring's success.[87]

b. Creditor Coordination Problems

One of the major downsides of the diversification of sovereign bond creditors is that it creates coordination problems in restructuring.[88] Bonds are held by a wide range of entities including: banks (large commercial, small commercial, local, and investment), pension funds, mutual funds, hedge funds, nonfinancial companies, and retail investors.[89] The wide dispersion of creditors, coupled with the fact that many bond purchases are made on the secondary bond market, makes it more difficult to identify major bondholders during a restructuring than with bilateral or syndicate loans, which are more concentrated.[90]

Even if creditors can be identified, they can be difficult to coordinate because they are increasingly numerous.[91] For example, there were 100,000 retail investors affected by the 2000 Ukraine bond restructuring and 600,000 impacted by the 2005 Argentine debt restructuring.[92] The varying concerns and interests represented by creditors can severely inhibit restructuring efforts and have become more problematic in recent years as the composition of sovereign debt issued in bonds increases.[93] Such a diffuse group of creditors particularly creates the risk of a collective action

84. 11 U.S.C. §§ 1102–1103 (noting the broad powers and duties of creditor committees in monitoring and participating in reorganization).

85. *Id.* § 943(b)(7) (municipal bankruptcy "best interest of creditors" standard); *id.* § 1129(a)(2) (three-part fairness test for chapter 11); *see also* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1, 38–41 (2004) (discussing differing fairness standards for court review of a reorganization plan under U.S. Bankruptcy Code for protection of creditors).

86. 11 U.S.C. § 547(b). A debtor is presumed insolvent on and during the ninety days prior to the bankruptcy petition filing. *Id.* § 547(f). A trustee in bankruptcy can avoid any transfer of the debtor's property that was made (1) for the benefit of a creditor (2) on account of an antecedent debt owed by the debtor before the transfer was made (3) while the debtor was insolvent (4) on or during the ninety days prior to filing for bankruptcy (5) that allows the creditor to receive more than the creditor would from a chapter seven liquidation if the transfer was not made and the creditor had received payment to the extent permitted by the Bankruptcy Code. *Id.* § 547(b).

87. *See* Bratton & Gulati, *supra* note 85, at 24–25.

88. *See* OLIVARES-CAMINAL, *supra* note 42, at 152.

89. Fisch & Gentile, *supra* note 18, at 1070.

90. Das et al., *supra* note 9, at 13, 17.

91. OLIVARES-CAMINAL, *supra* note 42, at 152.

92. Das et al., *supra* note 9, at 21.

93. Ronald J. Silverman & Mark W. Deveno, *Distressed Sovereign Debt: A Creditor's Perspective*, 11 AM. BANKR. INST. L. REV. 179, 180 (2003).

problem, which in turn can elicit a delay in restructuring from sovereigns to ensure maximum participation.[94]

c. Contracting with Collective Action Clauses and Exit Consents

To make restructuring more efficient, parties have sought to compensate for the lack of a bankruptcy system by including detailed contractual provisions,[95] including collective action clauses[96] (CACs) and exit consents.[97]

CACs address the issue of creditor coordination and prevent a minority of creditors from manipulating the restructuring process for their own benefit.[98] They accomplish this by specifying the supermajority percentage of creditors necessary to alter payment obligations on the bonds that become binding on all bondholders.[99] Under English law, CACs were first used as far back as 1879 and are a "regular feature" of both corporate and sovereign bonds today.[100] Although New York bonds only adopted the same standard starting in 2003,[101] CACs have been broadly incorporated in sovereign bonds since then.[102] Today, CACs are standard in all sovereign bonds.[103]

For New York law bonds issued prior to 2003, unanimous action clauses (UACs) are standard.[104] UACs require unanimous bondholder approval to modify any terms of principal or interest payment.[105] To counterbalance the problem of dissident creditors in bonds that contain UACs, exit consents are seen as a valuable alternative to CACs.[106] Exit consents make acceptance of an exchange offer conditional on the creditor's consent to amend certain nonpayment terms of the original bond.[107] Even under a UAC, nonpayment terms generally can be modified with a majority or supermajority.[108] Modifying various nonpayment terms of the original bond to reduce its value will therefore persuade exchange offer acceptance if the retention of the bond becomes less attractive to investors.[109]

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94. KRUEGER, *supra* note 73, at 1.
95. *See* GULATI & SCOTT, *supra* note 19, at 28.
96. *Id.*
97. SCHIER, *supra* note 35, at 20.
98. Koch, *supra* note 34, at 667.
99. OLIVARES-CAMINAL, *supra* note 42, at 111–13. Majority action clauses technically denote a subset of CACs, but for purposes of this discussion, the terms will be used interchangeably. *See id.*
100. Buchheit & Gulati, *supra* note 22, at 1325.
101. OLIVARES-CAMINAL, *supra* note 42, at 116.
102. *See* Koch, *supra* note 34, at 665–66.
103. GULATI & SCOTT, *supra* note 19, at 24, 28.
104. Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 EMORY L.J. 929, 932–33 (2004).
105. *Id.* at 932.
106. *See* Fisch & Gentile, *supra* note 18, at 1090–92.
107. *Id.* at 1091.
108. *Id.*
109. *Id.* The bond restructurings of Ecuador in 2000, Uruguay in 2003, and the Dominican Republic in 2005 are examples of successful restructurings that used exchange offers coupled with exit consents. Rodrigo Olivares-Caminal, *The Pari Passu Clause in*

2. Role and Mechanics of Exchange Offers

During a sovereign bond restructuring, outstanding bonds[110] are exchanged for cash or new bonds through a legal process.[111] Under the exchange, the payment terms of new bonds are designed to resolve the debt crisis episode.[112] This is achieved either by extending the maturity on the bond ("debt rescheduling"), by reducing the face value of the principal or interest rate ("debt reduction"), or a combination of both.[113] In the sixty years from 1950 to 2010, there have been more than six hundred restructurings that span over ninety-five countries.[114]

When the restructuring occurs in the wake of a sovereign debt crisis, it implies a debt exchange with terms that are less favorable than the terms on the original bond due to the sovereign's inability to pay.[115] The amount by which the original instrument's face value is decreased is called a haircut.[116] This type of restructuring is referred to as a distressed debt restructuring.[117]

The restructuring process is triggered by either a default (in the case of a post-default restructuring) or by an announcement of a restructuring (in the case of a preemptive restructuring).[118] Following the default or announcement, the negotiation period commences.[119] Throughout the negotiation period, which can take anywhere from several months to several years, the terms of the debt exchange are determined.[120] During this time, the sovereign will typically announce its fiscal and debt management plans in conjunction with a macroeconomic adjustment program as well as an

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Sovereign Debt Instruments: Developments in Recent Litigation, *in* SOVEREIGN RISK: A WORLD WITHOUT RISK-FREE ASSETS?, *supra* note 41, at 122, *available at* http://www.bis.org/publ/bppdf/bispap72u.pdf.

110. Outstanding bonds are bonds that have not yet reached maturity and are therefore unpaid debts. *See* BLACK'S LAW DICTIONARY 1278 (10th ed. 2014).

111. Das et al., *supra* note 9, at 7.

112. *Id.*

113. *Id.* A debt rescheduling occurs when the maturity period on the bond is extended, which can yield lower interest rates. *Id.* A debt reduction occurs when there is a reduction in the face or nominal value from the original instruments to the exchanged instruments. *Id.*

114. *See id.* at 30–32.

115. *Id.* at 7 (citing definition by Standard & Poor's (2006)).

116. *Id.*

117. *Id.* at 8.

118. *Id.* Greece is an example of the largest preemptive restructuring. *See* IMF, SOVEREIGN DEBT RESTRUCTURING—RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK 6, 22 (2013), *available at* https://www.imf.org/external/np/pp/eng/2013/042613.pdf (noting that Greece's €205 billion debt restructuring in February 2012 was the "largest sovereign debt restructuring in history"). Other countries such as Jamaica, Belize, Dominican Republic, and Grenada have also restructured preemptively. *Id.* at 22. IMF policy encourages member countries to initiate a preemptive restructuring rather than wait until default so that the country can continue to service its original claims during the restructuring process. *Id.* at 11. The importance of avoiding a default is to prevent "exacerbat[ing] the immediate economic and financial dislocation" and to not interfere with a sovereign's ability to re-access international private capital. *Id.*

119. Das et al., *supra* note 9, at 13.

120. *Id.* at 12–13.

overall evaluation of its financial situation.[121] Following the negotiation period, an exchange offer is prepared by the government and presented to creditors, at which point the creditors can choose to accept or reject the offer.[122]

The offer period presents the most difficulty for creditor coordination and risk of holdouts.[123] Often, a sovereign will make an exchange contingent upon acceptance by a minimum number of creditors to ensure a successful exchange.[124] Following the exchange offer period, the debt exchange takes place.[125]

One successful method to incentivize bondholder participation in a sovereign bond restructuring has been through the use of legal or financial "sweeteners."[126] The practice of using sweeteners to entice participation is widespread, and there are a number of creative options that sovereigns have used to increase participation rates.[127] In fact, actual participation rates surpassed 90 percent in most recent sovereign bond exchanges.[128]

3. Holdout Creditors

Due to the voluntary nature of the restructuring process, creditors may reject the terms of the exchange offer and "hold out" for the possibility of receiving better repayment value or even the full face value of the bond.[129] Holdout creditors have the right to enforce the obligations of the original bond under contract law.[130] In negotiating the terms of an exchange offer, creditors can therefore leverage their right to seek judicial enforcement as both a protection against unfair restructuring terms or opportunistic default and to receive better repayment terms.[131] Given the high costs of sovereign debt litigation and the difficulty of enforcing judgments against sovereigns, holdout litigation traditionally has not been an effective recovery method.[132] However, recent strategies employed by a type of holdout creditor known as a vulture fund have created an increase in holdout litigation and strengthened the role of holdouts in the restructuring process.[133]

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121. *Id.*

122. *Id.* at 13.

123. *Id.*

124. *See id.*

125. *Id.*

126. Olivares-Caminal, *supra* note 109, at 122. Some examples of contractual sweeteners include a most favored creditor clause, mandatory prepayment clauses/mandatory restatement of principle clauses, credit-linked notes, a guarantee, use of principal defeasance, or use of collateral. *Id.* The specifics of these contractual sweeteners are beyond the scope of this Note.

127. *See id.*

128. Das et al., *supra* note 9, at 26.

129. Fisch & Gentile, *supra* note 18, at 1045.

130. *See id.*

131. *See id.*

132. GULATI & SCOTT, *supra* note 19, at 45 (describing litigation against a sovereign as "largely a fruitless exercise").

133. Fisch & Gentile, *supra* note 18, at 1089–90.

a. Overcoming Sovereign Immunity in Enforcement

Under the Foreign Sovereign Immunities Act[134] (FSIA), a foreign state is presumptively granted jurisdictional immunity unless one of the enumerated exceptions applies.[135] Most courts interpret the issuance of public debt to fall under the commercial activity exception, barring sovereign immunity defenses in sovereign debt cases.[136] Sovereigns also frequently waive their immunity by consenting to U.S. court jurisdiction in their bond contracts.[137] This means that the FSIA is not a significant barrier for holdout creditors seeking to obtain a judgment, although it still remains extremely relevant for attachment proceedings to enforce the judgment.[138]

The act of state doctrine and international comity are two other potential sources of limitations on creditor recovery. Courts have declined to apply the act of state doctrine to cases of sovereign debt contract breach.[139] New York courts in particular have long understood that foreign sovereigns acting in a commercial capacity are not afforded judicial abstention because the sovereign action is not analogous to an act of state, for which judicial scrutiny would be seen as "affronting their sovereignty."[140] Likewise, international comity has not provided reprieve for sovereign debtors.[141]

b. Bond Contract Enforcement

In the Unites States, contract rights are considered so fundamental that their protection against impairment is explicitly stated in the U.S.

134. 28 U.S.C. §§ 1330, 1332, 1391, 1441, 1602–1611 (2012).

135. *Id.* § 1330 (granting original jurisdiction to federal district courts for any claim where a "foreign state is not entitled to immunity" under §§ 1605–1607 or other applicable international agreements). *See generally id.* §§ 1602–1611.

136. *See, e.g.*, Republic of Argentina v. Weltover, Inc., 504 U.S. 607, 614–15 (1992); *see also* 28 U.S.C. § 1605(a)(2) (commercial activity exception from immunity); Fisch & Gentile, *supra* note 18, at 1076.

137. *See, e.g.*, Libra Bank Ltd. v. Banco Nacional de Costa Rica, S.A., 676 F.2d 47, 48 (2d Cir. 1982); *see also* 28 U.S.C. § 1605(a)(1) (explicit or implied waiver exception to sovereign immunity); Fisch & Gentile, *supra* note 18, at 1076.

138. Walters v. Indus. & Commercial Bank of China, Ltd., 651 F.3d 280, 289 (2d Cir. 2011) (finding "execution immunity afforded sovereign property is broader than the jurisdictional immunity afforded the sovereign itself" under 28 U.S.C. § 1609); *see also* Jonathan I. Blackman & Rahul Mukhi, *The Evolution of Modern Sovereign Debt Litigation: Vultures, Alter Egos, and Other Legal Fauna*, 73 LAW & CONTEMP. PROBS. 47, 57 (2010).

139. *See, e.g.*, Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516, 522–23 (2d Cir. 1985).

140. *See* Mirabella v. Banco Indus. de la Republica Argentina, 421 N.Y.S.2d 960, 962–63 (Sup. Ct. 1979) (quoting Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682, 703 (1976)).

141. *See, e.g.*, Pravin Banker Assocs., Ltd. v. Banco Popular Del Peru, 109 F.3d 850, 852 (2d Cir. 1997) (finding that the use of comity to defer enforceability of debt would "violate United States policy"). International comity is the deference given to foreign government acts by U.S. courts. *Id.* at 854. Courts recognize the principle of international comity by declining to review foreign government acts, "allowing those acts and proceedings to have extraterritorial effect in the United States." *Id.*

Constitution.[142] Because state law governs contract disputes,[143] the particular law governing a sovereign bond is crucial to the ability of a creditor to bring a claim against a sovereign debtor.[144] For emerging market debt, the majority of outstanding bond issuances are governed by New York law.[145] A study of forty-three emerging market countries conducted by the International Monetary Fund (IMF) estimated that as of 2009, $272 billion spread over 435 issuances fell under New York jurisdiction.[146]

Litigation trends show that default-related lawsuits have been increasing despite the fact that the overall number of restructurings and defaults by sovereigns decreased in the same time period.[147] There were 109 sovereign bond default or loan recovery cases filed against debtor governments in U.S. or English courts from 1980 to 2010.[148] Recently, successes of holdout litigation have also provided incentives for holdout creditors to initiate recovery actions.[149]

c. Vulture Funds

A subset of investors that specialize in trading distressed sovereign debt are called "vulture funds" for what some perceive as their predatory investing strategies.[150] Vulture funds are institutional investors that purchase distressed bonds at a fraction of their face value in anticipation of a restructuring.[151] They purchase sovereign debt on the secondary bond market when debt is traded at a steep discount due to an impending or

142. U.S. CONST. art. I, § 10, cl.1 ("No State shall . . . pass any . . . [l]aw impairing the Obligation of Contracts."). *But see* 11 U.S.C. § 364 (2012) (U.S. Bankruptcy Code provision permitting, subject to court approval, special treatment of certain executory contract obligations in bankruptcy).

143. *See, e.g.*, 82–11 Queens Blvd. Realty, Corp. v. Sunoco, Inc. (R & M), 951 F. Supp. 2d 376, 381 (E.D.N.Y. 2013) (citing Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938)).

144. Das et al., *supra* note 9, at 41.

145. *Id.* New York choice-of-law rules are unique in that parties can chose New York law to govern despite having no minimum contacts that would otherwise avail the parties of the jurisdiction of New York courts. IRB-Brasil Resseguros, S.A. v. Inepar Invs., S.A., 982 N.E.2d 609, 611–12 (N.Y. 2012). Parties to a contract are permitted to choose New York state law to govern "whether or not such contract, agreement or undertaking bears a reasonable relation to this state" so long as the transaction covers at least $250,000. N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney 2013). The New York legislature sought to "encourage the parties of significant commercial, mercantile or financial contracts to choose New York law" to maintain New York's status as a commercial and financial center. *IRB-Brasil Resseguros*, 982 N.E.2d at 611–12 (citation omitted).

146. Das et al., *supra* note 9, at 41–42. This can be contrasted with EU nations, which were found to issue "more than 80 percent of their public bonds under their own [governing] laws between 2003 and 2010." *Id.*

147. *Id.* at 51.

148. *Id.*

149. *See id.* at 50–51; *see also infra* Part II.A.

150. Blackman & Mukhi, *supra* note 138, at 49.

151. John C. Coffee, Jr. & William A. Klein, *Bondholder Coercion: The Problem of Constrained Choice in Debt Tender Offers and Recapitalizations*, 58 U. CHI. L. REV. 1207, 1214 (1991).

actual default.[152] When an exchange offer is then made, vulture funds exercise their right to hold out and bring suit for breach of contract.[153] The fund can obtain a judgment and execute it against non-immune sovereign property under the FSIA[154] or use the threat of judicial enforcement as leverage to negotiate highly profitable settlement terms.[155]

Though problematic, vulture investments may provide benefits to the restructuring process and the capital markets.[156] First, vulture funds serve to strengthen creditor protections by invoking the right to hold out and by serving as a check against opportunistic defaults and overly oppressive restructuring terms.[157] Second, vulture funds provide liquidity to the distressed debt market that can encourage active market participation, benefiting retail investors.[158]

Vulture funds are not unique to sovereign bonds. In the corporate bond context, vulture funds became active about a decade before their investment strategies expanded into sovereign debt.[159] The key difference is that domestic corporations can rely on bankruptcy courts to mitigate the debilitating effects of holdouts on a restructuring.[160]

C. The Pari Passu Clause: Inclusion in Sovereign Bonds and Strategic Use by Holdout Creditors in Restructurings

Pari passu is a Latin phrase that directly translates to "by equal step," and means "[p]roportionally; at an equal pace; without preference."[161] In sovereign bonds, a pari passu clause, also called an equal treatment provision, acts as a financing constraint on sovereigns by claiming that the bond will "rank equally in right of payment with all other external indebtedness of the sovereign."[162] In bankruptcy, debtors may have multiple creditors who hold a variety of debt instruments at different payment priorities.[163] The pari passu clause restrains a sovereign's ability

152. Blackman & Mukhi, *supra* note 138, at 49–50. Latin American and African sovereigns have been recurring targets of vulture fund strategies mainly because of the market availability of their defaulted debt. *Id.* at 51.

153. *See id.*

154. *See supra* note 138 and accompanying text.

155. Blackman & Mukhi, *supra* note 138, at 49–50.

156. Fisch & Gentile, *supra* note 18, at 1047.

157. *Id.*

158. *Id.*

159. *Compare* Coffee, Jr. & Klein, *supra* note 151, at 1214 (discussing vulture funds as "a new player on the financial scene" in the 1991 domestic bondholder context), *with* Anne Krueger, First Deputy Managing Director, IMF, International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring (Nov. 26, 2001), *available at* http://www.imf.org/external/np/speeches/2001/112601.htm (raising concern in 2001 about the "aggressive legal strategy" being used by vulture funds as holdout creditors in sovereign restructuring).

160. *See* Coffee, Jr. & Klein, *supra* note 151, at 1209–10.

161. BLACK'S LAW DICTIONARY 1290 (10th ed. 2014).

162. GULATI & SCOTT, *supra* note 19, at 25; *see also supra* notes 29–34 and accompanying text (discussing external indebtedness).

163. *See* Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869, 872–73 (2004).

to incur debt obligations that could subordinate the right of payment for the debt instrument containing the clause.[164]

As a clause now deemed standard in sovereign bond issuances, pari passu has a long history of inclusion in sovereign debt instruments.[165] The first evidence of a pari passu clause in an unsecured sovereign bond appeared in English bonds in 1902.[166] The clause was increasingly included in unsecured sovereign bond issuances from 1940 through 2011, becoming ubiquitous after 2000.[167]

Although there are variations in how the clause is drafted, a standard pari passu clause contains several common characteristics.[168] As a central concept, the pari passu clause outlines the principle of equal treatment and defines how that principle is measured.[169] The clause can contain a mandatory law exception that permits a debtor to enact laws related to its restructuring that do not legally interfere with the bond obligations.[170] Certain jurisdictions also have laws that might alter the operation of the clause by specifying preference to debt obligations in order of date of issue or by currency type.[171] To counteract these laws, many clauses hold that "bonds are pari passu regardless of time of payment or currency of issue."[172] Lastly, the language in the clause varies based on the scope of creditor protection and can be narrowly worded to provide pari passu protection only to "external indebtedness" or, alternatively, broadly defined to encompass all unsecured creditors.[173]

Despite these variations in the clause, sovereign bonds can be seen as highly standardized, with contracts "consist[ing] primarily of boilerplate."[174] Given the extensive history of sovereign borrowing, certain terms over time have become standardized boilerplate provisions.[175] Boilerplate provisions are believed to have a settled meaning, though the interpretation still relies on the governing law of the contract.[176]

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164. *See* Choi & Gulati, *supra* note 104, at 990 (describing typical payment hierarchy in bankruptcy where legally senior and secured creditors have priority against a corporation's assets and then unsecured creditors are treated equally among themselves as to remaining assets or payment).

165. Olivares-Caminal, *supra* note 109, at 121.

166. GULATI & SCOTT, *supra* note 19, at 135.

167. *Id.* at 121–22 & tbl.3. In a sample of 691 issuances from 2000 to present, 98.7 percent had a pari passu clause. *Id.*

168. *Id.* at 63.

169. *Id.* at 63–66.

170. *See id.* at 67.

171. *Id.*

172. *Id.*

173. *Id.* at 67–68.

174. W. Mark C. Weidemaier, *Disputing Boilerplate*, 82 TEMP. L. REV. 1 (2009). The term boilerplate has been defined as "[r]eady-made or all-purpose language that will fit in a variety of documents [or] [f]ixed or standardized contractual language that the proposing party often views as relatively nonnegotiable." BLACK'S LAW DICTIONARY 209 (10th ed. 2014).

175. GULATI & SCOTT, *supra* note 19, at 2–4, 18.

176. *See, e.g.*, GIUDITTA CORDERO-MOSS, BOILERPLATE CLAUSES, INTERNATIONAL COMMERCIAL CONTRACTS AND THE APPLICABLE LAW 353, 370 (2011) ("[T]erms of a contract

Under New York law, *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*[177] is the controlling case for interpreting boilerplate terms.[178] Under *Sharon Steel*, the interpretation of boilerplate bond contract provisions is a matter of law based on the market understanding.[179] This is because the need for a consistent and uniform interpretation of boilerplate terms distinguishes those terms from "contractual provisions which are peculiar to a particular [bond contract]."[180] The significance is that the actual contracted-for terms become irrelevant because the intended meaning is believed to transcend all transactions of the same type.[181]

One of the main pushbacks on the boilerplate argument for pari passu clauses is that the clause did in fact undergo a series of changes in the mid-1990s.[182] Whereas the language of the clause was previously identical in all versions, pari passu clauses today can be grouped into three distinct categories based on the perceived litigation risk due to the language used in expressing the principle of equity.[183] Whether or not the pari passu clause is categorized as boilerplate can therefore be significant in judicial interpretation, a concept that is explored at greater length in Part II.A.

In addition to the sovereign bond context, equal ranking is also applicable to domestic bankruptcy proceedings.[184] When a corporate entity is liquidated, creditors who rank pari passu will receive equal shares of the proceeds in what is called a pro rata distribution.[185] Despite the prevalence of equal treatment in domestic bankruptcy, pari passu clauses of the type found in sovereign bonds rarely appear in domestic credit transactions.[186] This can be attributed to the fact that such equal treatment is implied in the Bankruptcy Code, and involuntary legal subordination of an existing creditor is forbidden.[187]

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are not detached from the governing law: the governing law will influence the interpretation and application of these terms.").

177. 691 F.2d 1039 (2d Cir. 1982).

178. *See id.* 1048–49; William W. Bratton, *Pari Passu and a Distressed Sovereign's Rational Choices*, 53 EMORY L.J. 823, 863–64 (2004) (explaining the "market understanding" standard of bond contract interpretation established by *Sharon Steel*).

179. *Sharon Steel*, 691 F.2d at 1048.

180. *Id.*

181. *See id.*

182. GULATI & SCOTT, *supra* note 19, at 121–22 & tbl.122.

183. *See id.* at 68, 122. For a lengthy discussion of the clause's litigation risks, see *infra* Part II.A.

184. GULATI & SCOTT, *supra* note 19, at 25.

185. *See id*. Pro rata distribution is a payment that is conducted "proportionately; according to an exact rate, measure, or interest." BLACK'S LAW DICTIONARY 1415 (10th ed. 2014). This analogy is imperfect for sovereign debt because a sovereign can never be liquidated. *See* Gelpern, *supra* note 68, at 1116–20.

186. Buchheit & Pam, *supra* note 163, at 873–74.

187. *Id.* at 873 & nn.6–7; *see also supra* notes 75–87 and accompanying text (describing features of sovereign debt distinguishing them from domestic bankruptcy proceedings). In addition to the prohibition of legal subordination, due to the function of the bankruptcy court and the ability to force a reorganization plan on unwilling creditors, no situation could arise where there would be an involuntary subordination in fact and not in law. *See supra* notes 78–86 and accompanying text. *But see* 11 U.S.C. § 510(a) (2013) (enforcing subordination agreements).

A pari passu clause does not become operative until the sovereign lacks debt sustainability.[188] Additionally, the pari passu clause is mostly relevant in a world with holdout creditors. That is because if every bondholder agreed to the terms of the bond exchange, there would be no reason to inquire into the result on inter-creditor equities.[189] The pari passu clause governs the relation of inter-creditor rights; however, after debt has been restructured, the status of unrestructured debt can be comparatively unclear.[190]

In addition to the holdout collection strategies previously mentioned,[191] holdout creditors have used the pari passu clause as a legal basis for claiming contract breach.

Following a bond exchange, a sovereign will begin making interest payments on the new debt instruments to the bondholders who participated in the restructuring.[192] Subsequent to the restructuring, the sovereign no longer makes payments on the defaulted bonds retained by holdouts.[193] Holdout creditors then claim that interest payments on the new bonds violate the pari passu clause, arguing that the original bonds are not being treated equally to the new bonds.[194] By invoking pari passu in this way, holdout creditors seek to disrupt payment on the restructured bonds by stopping interest payments until the equal treatment is restored.[195] In bringing the claim under pari passu as a breach of contract, holdout creditors can attempt to receive injunctive relief with specific performance on the contract as a remedy.[196]

This litigation strategy, which was pioneered by vulture fund investors, tethers the ability of a sovereign to make interest payments on restructured debt to the payment of obligations owed to holdouts under the original defaulted bonds.[197] By doing so, the vulture fund can either be paid as a condition of payment to the exchange bondholders or it can use this injunctive relief as leverage to extract a profitable settlement.[198] The use of this strategy has raised questions about the intended meaning of the pari passu clause and policy considerations relating to the debtor-creditor balance of power in a restructuring.[199]

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188. *See* Buchheit & Pam, *supra* note 163, at 874–76 & n.13 (noting that a lender who remains unpaid when other equally ranking creditors are current on payment would not be able to invoke pari passu as a legal grounds for relief if the borrower is still solvent).

189. *See* Yanying Li, *Playing Sovereign Debt Creditors' Orchestra: Inter-Creditor Issues in Sovereign Debt Restructuring*, 3 INT'L INSOLVENCY L. REV. 243, 251–53 (2013).

190. *See id.*

191. *See supra* Part I.B.3.

192. Olivares-Caminal, *supra* note 8, at 40.

193. *See id.*

194. *Id.* at 55–56.

195. *See id.*

196. Cohen, *supra* note 8, at 20.

197. Blackman & Mukhi, *supra* note 138, at 55 (noting that "vulture funds invented what they believed could be a devastating enforcement device").

198. *Id.* at 56.

199. These concerns are addressed in Part II.

II. UNEQUAL TREATMENT FOR THE SAME PROVISION: PARI PASSU'S DIFFERING INTERPRETATIONS, REMEDIES, AND PROPOSED SOLUTIONS

This part looks at the judicial interpretations of pari passu, the remedies that these interpretations require, and the ways that international organizations and institutions have sought to decrease the potential damage that pari passu clauses can have on future sovereign debt restructurings.

A. Court Interpretations

This section examines the judicial interpretations of pari passu clauses by courts in Belgium, the United States, and England, including remedies contemplated for pari passu breach under each jurisdiction. This analysis will incorporate the question of whether there is also a standard industry usage understanding of pari passu, and how a characterization of pari passu as boilerplate might impact judicial interpretations.

1. Belgium

In 2000, in *Elliott Associates, L.P. v. Banco de la Nacion*,[200] a court interpreted a sovereign bond's pari passu clause for the first time.[201] Elliott sought a ruling from the Belgian Court of Appeals on interpretation of a pari passu clause under New York law when there was no controlling or otherwise even persuasive judicial precedent.[202]

Prior to bringing the case in Belgium, Elliott had obtained a judgment in New York against the Republic of Peru following a sovereign bond default[203] and was awarded over $52 million in addition to an award for compound interest calculated retroactively on that sum.[204] Although an amended judgment lifted some of the restrictions on Elliott's ability to attach property for the payment of the judgment against co-party Banco de la Nacion, execution against property for both parties was still "limited to

200. Elliott Assocs., L.P., Cours d'Appel [CA] [Court of Appeal] Bruxelles, 8th Chamber Sept. 26, 2000, General Docket No. 2000/QR/92 (Belg.).

201. Buchheit & Pam, *supra* note 163, at 879.

202. *Id.*

203. Elliott Assocs., L.P. v. Banco de la Nacion, 194 F.3d 363, 381 (2d Cir. 1999). The decision held additional significance in finding that vulture fund investment strategies of purchasing with the intent to hold out are legally sound. *See id.* (determining the defense claiming violation of section 489 of the New York Judiciary Law is unavailable against creditors where, as with Elliott, the "'primary goal' is found to be satisfaction of a valid debt and its intent is only to sue absent full performance"); *see also* N.Y. JUDICIARY LAW § 489 (McKinney 2004). An amendment to N.Y. Judiciary Law section 489 that effectively eliminated the champerty defense for sovereign debt purchases in excess of $500,000 is said to be the result of vulture fund lobbying activity that convinced the New York state legislature to amend the statute. Blackman & Mukhi, *supra* note 138, at 54.

204. Elliott Assocs., L.P. v. Banco de la Nacion, 194 F.R.D. 116, 119, 122 (S.D.N.Y. 2000) (awarding Elliott summary judgment against Peru for approximately $52 million plus interest and an additional approximated $23 million plus interest against Banco de la Nacion, a Peruvian bank).

property in the United States" under the FSIA.[205] When the result of the attachment proceedings left Peru unable to utilize its U.S. payment agent for payment on its restructured bonds, Peru attempted to redirect its bondholder interest payments through a clearing system located in Brussels, Belgium.[206]

a. Birth of the Ratable Payment Theory

Ratable payment means a proportionate and ratable distribution,[207] also referred to as a pro rata payment.[208] The argument under the ratable payment interpretation is that when the bonds were restructured, payment to the restructured class would violate the pari passu clause because there were no proportionate payments made simultaneously to the holdout creditors, therefore violating equal treatment.[209]

Elliott used this argument to enforce its New York judgment in Belgium.[210] In doing so, Elliott tried to intercept a payment that was scheduled for holders of the external bonds that Peru had issued to restructured creditors.[211] First, Elliott tracked the payment method to determine which parties were involved in disbursement of interest funds to exchange bondholders.[212] Elliott then served notices on all of the parties to restrain them from making payment to the exchange bondholders.[213]

To gain judicial support for the strategy, Elliott filed an ex parte motion with the Commercial Court in Brussels to enjoin the payment-clearing agent from processing any of the payments received from Peru to pay the Brady Bonds.[214] While the Commercial Court denied the motion, Elliott challenged the denial to the Appeals Court of Brussels, putting forth an argument based on a violation of the pari passu clause.[215] The challenge alleged that the "Peruvian Republic attempts to make payments in violation of a principle of equal treatment (pari passu clause) among foreign

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205. Elliott Assocs., L.P. v. Banco de la Nacion, No. 96 Civ. 7916 (RWS), 2000 WL 1449862, at *4 (S.D.N.Y. Sept. 29, 2000) (finding the "FSIA's exception to immunity from attachment—whether for foreign states or their instrumentalities—extends at most to property located 'in the United States'" (citing 28 U.S.C. § 1610(a), (b))); *see also supra* notes 134–38 and accompanying text (discussing the FSIA limitations and property attachment following judgment).

206. 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).

207. BLACK'S LAW DICTIONARY 1451 (10th ed. 2014).

208. See *supra* note 185 and accompanying text for a definition of pro rata and discussion on intercreditor distribution.

209. *See* Buchheit & Pam, *supra* note 163, at 877.

210. *Id.*

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.*; *see also* Elliott Assocs., L.P., Cours d'Appel [CA] [Court of Appeal] Bruxelles, 8th Chamber Sept. 26, 2000, General Docket No. 2000/QR/92 (Belg.).

creditors, whereby Elliot Associates is excluded, and tries to use the [agent] to achieve that objective."[216]

To support the argument that pari passu would be violated if the Brady Bondholders were paid, Elliott submitted an affidavit from a U.S. law professor, who opined that "[a] borrower faced with a pari passu provision must pay all [creditors] on the same basis."[217] The professor believed such an understanding of pari passu was valid "whether that borrower is an individual, a company, or a sovereign state."[218] The affidavit did not cite any authority in support of these opinions.[219]

On September 26, 2000, the Belgian Court granted Elliott's motion to block the Brady Bond payment by enjoining the clearing agent and reversed the lower court decision.[220] The significance of the Belgian Court decision could not be mistaken; the ratable payment interpretation of the pari passu clause was born.[221]

Shortly after the ruling, Peru settled with Elliott for the full value of payment sought and avoided putting the Brady Bond payment in jeopardy.[222] Although Elliott had purchased the bonds for approximately $11 million on the secondary market, in settlement it received in excess of $58 million, leading the fund to realize a profit margin of over 500 percent.[223] Though there is speculation as to why Peru did not seek to fight the injunction or negotiate further with the holdouts, the decision was left unchallenged.[224]

b. The Aftermath of the Belgium Decision

Being the first court opinion to interpret the pari passu clause, the wake of the decision left many uncertain about the effect the specific ruling would have on the market.[225] There were reports, statements, and articles that sought to address the impact of the decision by many who had an interest in the area of litigation—namely lawyers, academics, investment banks, and market groups.[226] One academic noted that the ruling "became the catalyst for some of the most radical and far-reaching proposals for reform of the international financial system."[227] The question of what role vulture funds and holdouts play in sovereign debt restructuring sparked fear

216. *Id.* (as translated by Buchheit & Pam, *supra* note 163, at 877).

217. Declaration of Professor Andreas Lowenfeld at 11–12, *Elliott Assocs., L.P.*, General Docket No. 2000/QR/92 (Belg.) (executed Aug. 31, 2000).

218. *Id.* at 11.

219. *See id.*; *see also* Buchheit & Pam, *supra* note 163, at 878.

220. Buchheit & Pam, *supra* note 163, at 878–79.

221. *Id.*

222. *Id.*

223. *See* GULATI & SCOTT, *supra* note 19, at 16.

224. *Id.* at 15–16 (citing political turmoil as a potential reason for inaction).

225. *Id.* at 47–49.

226. *See id.* Years later there has still been discussion about the interpretation's consequences. *See generally* Olivares-Caminal, *supra* note 8, at 43.

227. GULATI & SCOTT, *supra* note 19, at 12. Some of these proposals are addressed in Part II.B.

that injunctive remedies might have the potential to unravel sovereign restructurings and prevent sovereigns from reentering the markets following future restructurings.[228]

One response came from the Belgian government itself. Following the decision, the Belgian parliament sought to protect clearing systems from involvement in litigation that could disrupt payment to restructured bondholders by creating INC Belgian Law 4765 (C-2004/03482) in November 2004.[229] The law did nothing to alter the interpretation of pari passu decided by the court, but it limited the enforcement ability of creditors by removing the type of injunctive relief that had been permitted in *Elliott*.[230] Additionally, because Belgium is a civil law country, the pari passu interpretation in *Elliott* was not binding on future courts the same way it would be in a common-law system.[231] In fact, the Court of Appeals in Brussels had another opportunity to hear a case on pari passu not long after the first one was decided. In *Republic of Nicaragua v. LNC Investments LLC*, the court held in 2004 that payment on restructured bonds constituted a violation of the pari passu clause for failure to pay holdouts at a proportionate rate of payment but later reversed its decision on appeal.[232]

Prior to *LNC Investments*, several other litigants had sought relief using the ratable payment pari passu interpretation applied in Belgium. In California in 2001, a district court in *Red Mountain Finance v. Republic of Congo*[233] decided that the plaintiff was permitted injunctive relief to enjoin payment of external debt without proportional payment to the holdout.[234] Despite the court denying specific performance of the pari passu clause, it found the same pari passu remedy appropriate to enforce other provisions of the credit agreement.[235] However, a settlement was reached shortly

228. GULATI & SCOTT, *supra* note 19, at 45–48 (discussing the newly perceived litigation risks and the consensus that *Elliott* "increased the probability of formal enforcement upon default").

229. Loi modifiant les lois du service public fédéral finances [Act Amending Previous Laws for Federal Public Service Finance] of Nov. 19, 2004, MONITEUR BELGE [M.B.] [Official Gazette of Belgium], Dec. 28, 2004, 85,854; *see also* Olivares-Caminal, *supra* note 8, at 52.

230. Olivares-Caminal, *supra* note 8, at 52.

231. Roozbeh B. Baker, *Universal Jurisdiction and the Case of Belgium: A Critical Assessment*, 16 ILSA J. INT'L & COMP. L. 141, 151 (2009) ("Belgian Courts are strictly limited to the application of legislation. Court decisions naturally involve interpretation, but the interpretation is not precedent that is binding on future courts that must consider the same legislation.").

232. *See* Blackman & Mukhi, *supra* note 138, at 56–57; *see also* [Commercial Court] Bruxelles, Sept. 11, 2003, General Docket No. 240/RK/03, at 16–17, *rev'd*, Cours d'Appel [CA] [Court of Appeal] Bruxelles, 9th Chamber Mar. 19, 2004, General Docket No. 2003/KR/334 (Belg.).

233. Injunction Order, Red Mountain Fin., Inc. v. Democratic Republic of Congo, No. CV 00-0164 R (BQRx) (C.D. Cal. May 29, 2001), ECF No. 123.

234. *Id.*; *see also* Andrea J. Boyack, *Sovereign Debt and the Three and a Half Minute Transaction: What Sticky Boilerplate Reveals About Contract Law and Practice*, 35 WHITTIER L. REV. 1, 25 n.127 (2013).

235. Injunction Order, *supra* note 233; *see also* OLIVARES-CAMINIAL, *supra* note 42, at 87.

thereafter and the decision was repealed.[236] In 2003, a court in England dismissed an appeal seeking injunctive relief for pari passu breach.[237] A case alleging breach of pari passu in the New York Court of Appeals from the same plaintiff, Kensington International, Ltd., was dismissed on forum non conveniens grounds because the loan and agency agreements being litigated were governed by English and French law.[238]

One of the characterizations of the pari passu clause as a boilerplate provision suggests that judicial interpretation makes the meaning difficult to change because subsequent interpretations will be determined as a matter of law.[239] Additionally, speculation that the *Elliott* decision would invite more litigation on the ratable payment interpretation proved accurate. One might assume that under these circumstances, a legitimate market response would be to change the language in the pari passu clause to reflect the "other" widely held interpretation for clarity if it was believed that the current language was merely faulty boilerplate.[240] But, no such alteration occurred.[241] There have been many factors that could explain the continued usage of the language without changing it.[242] However, those factors remain mere speculation.

2. New York

One result of the ratable payment interpretation was fear from debtor nations that the *Elliott* decision would inhibit their ability to restructure debt. As a result, in 2003, the Republic of Argentina sought a declaratory judgment in *Macrotecnic International Corp. v. Republic of Argentina*[243] to effectively nullify the precedential value for New York proceedings of the same type.[244] Although the judge found that at the time there was a

236. *See* Stipulation and Order, Red Mountain Finance v. Democratic Republic of Congo, No. 2:00-CV-00164-MLR (C.D. Cal. June 10, 2002), ECF No. 238 (dismissing action with prejudice and vacating district court orders); *see also* Cohen, *supra* note 8, at 16 & n.29 (stating orders subsequently vacated pursuant to settlement agreement).

237. Kensington Int'l Ltd. v. Republic of the Congo, [2003] EWCA (Civ) 709, [2], [16] (Eng.); *see also* OLIVARES-CAMINAL, *supra* note 42, at 87–88.

238. *See* Trial Order at 7–8, Kensington Int'l Ltd. v. BNP Paribas SA, No. 602569/03 (RBL), 2005 WL 5088276 (N.Y. Sup. Ct. Jan. 11, 2005). Forum non conveniens applies where the forum is inconvenient because "in the interest of substantial justice" another court or jurisdiction should hear the action. N.Y. C.P.L.R. § 327 (McKinney 2013).

239. See *supra* notes 174–81 and accompanying text for a discussion of the pari passu clause as boilerplate and the significance for judicial interpretation when boilerplate is determined for bond contracts.

240. *See* GULATI & SCOTT, *supra* note 19, at 30–34.

241. *Id.* at 51 (alluding to deeply engrained market failures given the fact that in the wake of *Elliott* "the pari passu clause was not revised by the simple expedient of inserting clarifying language that would reduce if not eliminate the litigation risk").

242. *See generally id.* at 33–44 (describing theories to explain the "stickiness" of contract boilerplate).

243. No. 02 Civ. 05932 (TPG) (S.D.N.Y. filed July 26, 2002).

244. Motion for Order to Preclude Interference with Payments to Other Creditors, Macrotecnic Int'l Corp. v. Republic of Argentina, No. 02 Civ. 05932 (TPG) (S.D.N.Y. Dec. 12, 2003), ECF No. 29 (seeking an order to preclude plaintiffs from interfering with payments to other creditors pursuant to N.Y. C.P.L.R. § 5240).

nonjusticiable issue as the question of pari passu breach was not yet ripe for adjudication at that time, the United States submitted a statement of interest indicating that the *Elliott* decision in Belgium was "a broad and novel interpretation of the pari passu clause."[245] The government stated that the forced simultaneous ratable payment to all creditors that would prohibit payment to third-party creditors would simply "undermine th[e] well-understood established framework" that the government and international community had been operating under in sovereign debt restructurings and would "do damage to settled market expectations."[246] According to the standard market understanding, pari passu clauses serve to preserve only the equal legal ranking of obligations and therefore no violation is found where in practice some debt is excluded from restructuring.[247] In fact, such exclusions are historically "common practice" given the realities of sovereign debt restructuring complexities.[248] Because under this explanation pari passu does not require actual uniformity of treatment, it is understood to be interpreted narrowly and not to contemplate ratable payment in the event of partial restructuring.[249]

It is rare that the United States submits a statement of interest amicus curiae, especially when unsolicited at the district court level.[250] This highlights the significance of the interpretation from a policy standpoint. The government found that to uphold the *Elliott* interpretation would not only adversely affect U.S. interests, but that the judgment mechanism would not be consistent with the FSIA.[251] The court did not have another opportunity to test the *Elliott* interpretation of pari passu until another vulture fund, NML Capital, a subsidiary to the management affiliate of Elliott, sought relief in the Southern District of New York.

a. Interpretation of the Pari Passu Provision

In 2001, Argentina experienced the worst economic crisis the country had ever seen and defaulted on over $95 billion of external debt.[252] The event was the largest sovereign default in history at the time. Through exchange offers in 2005 and 2010, Argentina restructured its debt on bonds that were issued under a 1994 Fiscal Agency Agreement (FAA).[253] Ninety-one percent of bondholders agreed to the exchanges (exchange

245. Statement of Interest of the United States at 2, *Macrotecnic Int'l Corp.*, No. 02 Civ. 05932 (TPG), 2004 WL 5475206 (S.D.N.Y. Jan. 12, 2004), ECF No. 39; *see also* OLIVARES-CAMINAL, *supra* note 42, at 89–90.

246. Statement of Interest, *supra* note 245, at 11.

247. *Id.* at 12–13; *see also* Blackman & Mukhi, *supra* note 138, at 55.

248. *See* Statement of Interest, *supra* note 245, at 11.

249. *Id.*

250. Patricia A. Millett, *"We're Your Government and We're Here to Help": Obtaining Amicus Support from the Federal Government in Supreme Court Cases*, 10 J. APP. PRAC. & PROCESS 209, 223–24 (2009).

251. *See generally* Statement of Interest, *supra* note 245.

252. Mathias Audit, *Sovereign Bonds and National Relativism: Can New York Law Contracts Safely Cross the Atlantic?*, 9 CAP. MKTS. L.J. 177, 179 (2014).

253. NML Capital, Ltd. v. Republic of Argentina, 699 F.3d 246, 253 (2d Cir. 2012).

bondholders).[254] The FAA was issued under New York law, and one of the holdout creditors, NML Capital, Ltd., sought recovery based on a breach of the pari passu clause.[255]

In 2011, in *NML Capital, Ltd. v. Republic of Argentina*, Judge Griesa in the Southern District of New York granted a motion for partial summary judgment and found that the pari passu clause was breached.[256] While there was no mention of the term "ratable" in its opinion, the court found that the clause was violated when Argentina timely paid the exchange bondholders while "failing to pay the obligations currently due under NML's Bonds."[257] The pari passu clause in the FAA asserted that the debt obligations would not only rank pari passu among themselves, but that Argentina's payment obligations would "at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness."[258] The failure of simultaneous payment was therefore tantamount to lowering the rank of NML's bonds by "relegating NML's bonds to a non-paying class."[259] In addition to the finding that payment to exchange bondholders constituted a de facto rank subordination, the court found that Argentina had breached the pari passu clause by de jure rank subordination with the country's legislative enactment of Laws 26,017 and 26,547.[260] The laws were passed in conjunction with the exchange offers of 2005 and 2010, respectively, to entice participation by prohibiting settlement with holdout creditors who were eligible for participation in the exchange offers.[261] In relevant part, Law 26,547 prohibited "more favorable treatment than what is offered to those who have not [sought to enforce the original terms of the bond contract]."[262] The order did not permit injunctive relief for specific performance on the contract at that time.[263]

b. Extending Injunctive Relief to Remedy Breach

Several months later, the court revisited the issue of enforcement and granted an equitable remedy for the pari passu clause breach, enjoining Argentina from making payments to the exchange bondholders without

254. *Id.* The 2005 exchange garnered a 76 percent participation rate. *Id.* at 252. It provided FAA bondholders with twenty-five to twenty-nine cents on the dollar for their exchange bonds. *Id.* The 2010 exchange offer provided similar terms of restructuring to FAA bondholders and brought the number of participants up to 91 percent total. *Id.* at 253.

255. *See generally id.* at 254–56.

256. NML Capital, Ltd. v. Republic of Argentina, No. 08 Civ. 6978 (TPG), 2011 WL 9522565, at *2 (S.D.N.Y. Dec. 7, 2011).

257. *Id.*

258. *Id.* at *1 (quoting ¶ 1(c) of the 1994 FAA).

259. *Id.* at *2.

260. *See id.*; *see also* Law No. 26,547, Dec. 10, 2009, [CXVII] B.O. 31,798 (Arg.).

261. *See NML Capital*, 2011 WL 9522565, at *2. Law 26,547, passed in 2009, suspended the effects of Law 26,017 for the time period of the 2010 exchange dealings. *See id.*; *see also* Law No. 26,547.

262. *NML Capital*, 2011 WL 9522565, at *2.

263. *Id.* at *3.

simultaneous ratable payments to NML.[264] Like in the *Elliott* case,[265] the injunction encompassed the third-party payment clearing agent, and Argentina was required to notify all such agents of the orders.[266] Additionally, the orders prevented Argentina from changing the payment transfer mechanism to avoid the judgment.[267]

This time, instead of settling the dispute, Argentina appealed to the Second Circuit.[268] Many academics and onlookers thought that the appellate court would overturn the decision.[269] Instead, on appeal the panel unanimously affirmed the orders, but it remanded subject to clarification for how the payment formula was intended to function and the application of injunctions on third-party intermediaries.[270] Argentina then sought a rehearing, where the United States again filed a statement of interest amicus curiae supporting Argentina to reverse what was categorized as an incorrect interpretation of the pari passu clause.[271] The Second Circuit denied the rehearing petition.[272]

The district court was then tasked with identifying the scope of the injunctive relief, a juncture that had never been reached in any previous court proceeding.[273] In the November 2012 amended orders, the court noted that the exchange bondholders and FAA holdout creditors held debt instruments that were not of the same amount or of the same nature.[274] This is irrelevant for pari passu breach,[275] however, because pari passu requires only that "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."[276]

On remand, the district court was specifically tasked with clarifying how the payment to plaintiffs would operate as well as the function of the

264. Order at 3–4, *NML Capital*, No. 08 Civ. 6978 (TPG) (S.D.N.Y. Feb. 23, 2012). These orders were subsequently amended on November 21, 2012. *NML Capital*, No. 08 Civ. 6978 (TPG), 2012 WL 5895786 (S.D.N.Y. Nov. 21, 2012), *appeal dismissed*, (Sept. 23, 2013), *aff'd*, 727 F.3d 230 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 2819 (2014).

265. *See supra* notes 211–13 and accompanying text.

266. *NML Capital*, 2012 WL 5895786, at *5.

267. *Id.*

268. NML Capital, Ltd. v. Republic of Argentina, 699 F.3d 246, 250 (2d Cir. 2012).

269. *See* Zamour, *supra* note 16, at 59–60 (denoting various reactions of shock expressed in the aftermath of the Second Circuit's decision).

270. *NML Capital*, 699 F.3d at 250.

271. Brief for the United States of America As Amicus Curiae Supporting Argentina's Petition for Panel Rehearing and Rehearing En Banc, NML Capital, Ltd. v. Republic of Argentina, No. 12-105-cv(L) (2d Cir. Dec. 28, 2012), ECF No. 653 [hereinafter U.S. Amicus Brief].

272. Order, *NML Capital*, No. 12-105-cv(L) (2d Cir. Nov. 18, 2013), ECF. No. 1035.

273. *See, e.g.*, *supra* notes 232–46 and accompanying text (discussing cases that never fully litigated the pari passu issue to see an injunctive remedy utilized).

274. *NML Capital*, 2012 WL 5895786, at *3.

275. *Id.* ("But it is obvious that a Pari Passu Clause does not require that the debts in question be in the same amount or of the same nature.").

276. *Id.*

injunctions with respect to third parties, including intermediary banks.[277] The district court found that the relief provided under the injunctions would require Argentina to pay 100 percent of the debt owed to plaintiffs any time that Argentina seeks to pay 100 percent of what is owed to the exchange bondholders.[278] This, the court stated, was the "straightforward" meaning of a "Ratable Payment."[279] In describing this straightforward meaning, the district court noted that the Second Circuit's alternative hypothetical of ratable payment meaning[280] would be a "radical departure . . . from the Pari Passu Clause."[281] No authority was provided to support this assertion.

While the court's order states that full compliance with the injunctions would require Argentina to pay the full sum of the $1.33 billion owed to the plaintiff creditors either concurrently or in advance of payment on the exchange bonds,[282] Argentina claimed that instead of resulting in enforcement, the injunctions served to place approximately $24 billion in restructured debt at risk of default.[283] In deciding that the injunctive remedy was appropriate, the court noted that while the original default was due to a legitimate financial crisis, Argentina was capable of making payments on both the exchange bonds and the holdout claims.[284] There has been disagreement over the actual ability to pay, and the exact amount Argentina holds in reserves.[285]

Proceedings continued to determine the precise bounds of the injunctive remedy. The Second Circuit found that in addition to the FAA bonds, the injunctions span to "other obligations" such as GDP-linked securities in foreign currency based on the district court's understanding of the FAA pari passu clause to rank not only other bonds but all other obligations

277. NML Capital, Ltd. v. Republic of Argentina, 699 F.3d 246, 255 (2d Cir. 2012), *cert. denied*, 134 S. Ct. 2819 (2013), *cert. denied sub nom.* Exch. Bondholder Grp. v. NML Capital, Ltd., 134 S. Ct. 2819 (2014).

278. *See NML Capital*, 2012 WL 5895786, at *3 (finding that a definition of pari passu meaning "proportionally" was "obviously referring to the use of the same proportion in paying down two kinds of debts. This is clearly reflected in the Ratable Payment provisions in the Injunctions, as correctly interpreted. These provisions properly start with the fact that if 100 [percent] of what is *currently due* to the exchange bondholders *is paid*, then 100 [percent] of what is currently due to plaintiffs must also be paid").

279. *Id.* The entire opinion and order was written without a single citation to authority or case that supports this understanding of ratable payment.

280. The Second Circuit hypothesized that ratable payment could also mean that holdout creditors would need to be paid the same percentage of the total that was being paid to exchange bondholders. *NML Capital*, 699 F.3d at 255. This means that if an interest payment to bondholders constitutes 1 percent of the total amount owed under principal and interest, then the holdout creditors would need to be paid 1 percent of the total amount owed to them. *Id.*

281. *NML Capital*, 2012 WL 5895786, at *3.

282. *Id.*

283. *See* Brief of Defendant-Appellant Republic of Argentina at 26, *NML Capital*, No. 14-2689-cv(L), 2012 WL 6777133 (2d Cir. Dec. 28, 2012), ECF No. 657.

284. *NML Capital*, 2012 WL 5895786, at *1.

285. The court has estimated that $40 billion of reserves would be adequate to cover payment, however, Argentina contends that only $28 billion are currently in reserves. *See* Letter from Argentina to Judge Griesa at 2, *NML Capital*, No. 08 Civ. 06978 (TPG) (S.D.N.Y. Nov. 6, 2014), ECF No. 708.

equally.[286] The restructured debt resulting from Argentina's default was also issued under several currencies and different governing laws. Due to the complexities of the restructuring, several clarification motions have been filed.[287] Many of these proceedings are still ongoing, however, the court has taken a broad view of the injunctions, generally declining to "start making important exceptions to the basic ruling and Injunction."[288]

c. U.S. Government Response and Aftermath

Failure to comply with the injunctions has already led Argentina to a technical default in restructured foreign law bonds.[289] Additionally, the court orders have produced new claimants seeking "me-too" injunctive orders for pre- and post-judgment actions.[290] In a letter to the court, Argentina stated that twenty-five suits had been filed from June through November of 2014, totaling approximately $1.8 billion in principal and $4.7 billion in judgments.[291] In addition to increasing Argentina-related litigation, reliance on *NML Capital* already has been cited as the basis for other sovereign litigation and enforcement matters regarding the pari passu clause.[292]

Although the United States had filed a statement of interest seeking a Second Circuit rehearing by claiming that the court had incorrectly decided the issue,[293] when the rehearing petition was denied and the Supreme Court declined to hear the issue, the orders were final.[294] Despite the characterization of the pari passu clause as boilerplate by some scholars who believe it carries a distinctive standard industry usage that is counter to the interpretation put forward by U.S. courts, the ratable payment interpretation remains New York law.

To counteract the rulings, Congress has the ability to enact legislation much like Belgium did to limit the injunctive remedy. Congress has made several failed attempts to pass legislation aimed at sovereign restructuring

286. NML Capital, Ltd. v. Argentina, 727 F.3d 230, 241 n.9 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 2819 (2014).

287. *See, e.g.*, Letter from Euro Bondholders to Judge Griesa at 1 & n.1, *NML Capital*, No. 08 Civ. 6978 (TPG) (S.D.N.Y. Nov. 25, 2014), ECF No. 723 (urging decision on emergency motion for clarification related to euro-denominated bonds governed by English law that were the result of the 2005 and 2010 exchange offers); Letter from JPMorgan Chase Bank, N.A. to Judge Griesa at 1–2, *NML Capital*, No. 08 Civ. 6978 (TPG) (S.D.N.Y. July 9, 2014), ECF No. 572 (seeking clarification on treatment of transfers to yen-denominated bonds governed by Japanese law).

288. *See* Order at 3, *NML Capital*, No. 08 Civ. 6978 (TPG) (S.D.N.Y. Nov. 25, 2014), ECF No. 724 (denying clarification motion for euro bondholders).

289. *See supra* note 12 and accompanying text.

290. Letter from Argentina to Judge Griesa, *supra* note 285, at 1.

291. *Id.* at 1 n.1.

292. *See* Weidemaier & Gelpern, *supra* note 4, at 192 (mentioning "copycat lawsuit" as evidence that NML ruling is not unique to Argentina's specific circumstances). *See generally* Exp.-Imp. Bank of the Republic of China v. Grenada, No. 13 Civ. 1450 (HB), 2013 WL 4414875, at *1–4 (S.D.N.Y. Aug. 19, 2013).

293. *See generally* U.S. Amicus Brief, *supra* note 271.

294. *See* Republic of Argentina v. NML Capital, Ltd., 134 S. Ct. 2819 (2014).

both to aid creditors in collecting and to allow sovereign debtors freedom from vulture fund investors.[295] The inability to gain enough support on either side of the issue is evidence of the lack of political will to change the status quo and indicates that legislative enactment is unlikely to be an effective means of altering the effect of the decisions.[296]

3. English Bonds and Interpretation

Along with New York law, English law is the other primary choice of law for governing foreign-issued sovereign bonds.[297] It is therefore relevant to examine how the pari passu clause is understood there as well as market reactions to the contract provisions. This section first discusses several differentiating characteristics between sovereign bonds under English law and those under New York law. Then, this section discusses a conflict of law question raised by an ongoing case and some implications of such a conflict.

In keeping with the public policy reasons for preventing holdout creditors from souring a debt workout, there have been several mutations to the pari passu clause governed by English law. Generally, the variations have adopted language that permits priorities in payment that are required or permitted under the borrower's local law.[298] This means that if a borrower's local law permits a payment preference to a subset of unsecured creditors, that payment will not violate the pari passu clause.[299] The pari passu language that dictates protection of legislatively enacted preference allowance has been increasingly used in England, and indicates that pari passu "has become less focused on involuntary subordination over time."[300] Additionally, the long-standing inclusion of CACs in English law sovereign bonds has meant that holdout creditors traditionally retain less leverage in a restructuring than do their counterparts where CACs have been less prevalent.[301]

English bonds are also typically structured under a trust indenture, where a trustee represents the interests of bondholders and can decide whether to initiate holdout enforcement proceedings on their behalf.[302] As compared to the New York system of using fiscal agency agreements where the fiscal agent represents the issuer and therefore lacks any restriction on individual

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295. *Compare* Stop Very Unscrupulous Loan Transfers from Underprivileged Countries to Rich, Exploitive [VULTURE] Funds Act, H.R. 2932, 111th Cong. § 2(8) (2009), *with* Judgment Evading Foreign States Accountability Act of 2010, H.R. 5564, 111th Cong. (2d Sess. 2009).

296. *See* John Muse-Fisher, *Starving the Vultures:* NML Capital v. Republic of Argentina *and Solutions to the Problem of Distressed-Debt Funds*, 102 CAL. L. REV. 1671, 1697–99 (2014).

297. OLIVARES-CAMINAL, *supra* note 42, at 4–5.

298. GULATI & SCOTT, *supra* note 19, at 133.

299. *See id.*

300. *Id.* at 134.

301. *See supra* notes 98–103 and accompanying text (discussing advantages of CACs and their tradition of inclusion in English law–governed bonds).

302. Koch, *supra* note 34, at 678.

holdout suits, the English trust structure limits the ability to bring individual actions.[303] English law limits holdout creditors' access to litigation over the bond terms because it prioritizes successful restructuring over providing remedies to holdout creditors.[304]

While England has taken these measures to address concerns in its own legal system, U.S. court remedies for pari passu breach affect bonds governed under English law. When Argentina conducted a bond restructuring of its 1994 FAA, euro-denominated bonds that were to be governed under English law were issued pursuant to the indenture that was the result of the exchange that occurred in 2005.[305] Under the indenture, Bank of New York Mellon became trustee of the euro-denominated bonds.[306] As a result of actions brought to enforce the pari passu clause of the original FAA under New York law,[307] injunctions prevented payment to any of the bondholders resulting from the exchange of FAA bonds until Argentina made a ratable payment in principal and interest to the holdout creditors.[308] This extended to Bank of New York Mellon and sought to prevent the transfer of funds to the euro bondholders, which would violate the Bank of New York Mellon's contractual obligations under English law.[309]

In *Knighthead Master Fund LP v. The Bank of New York Mellon*,[310] euro bondholders brought suit in England seeking declaratory judgments to address obligations under English law in light of these rulings and to understand whether a foreign court could alter a contract governed under English law.[311] While the *Knighthead* case is still ongoing,[312] it raises important questions on the meaning of the pari passu clause under English law and on the reach of remedies sought under *NML Capital* by the U.S. courts, which in turn raises a major conflict of law issue.[313]

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303. *See id.* at 681–85.

304. *See* Buchheit & Gulati, *supra* note 22, at 1324.

305. *See* Knighthead Master Fund LP v. The Bank of New York Mellon [2014] EWHC 3662 (Ch), [2]–[4] (Eng.); *see also* Gelpern & Gulati, *supra* note 46, at 1684 (noting the "twist" that occurred by having bonds governed by both New York and English law covered under the same trust indenture).

306. *Knighthead*, EWHC 3662 (Ch), ¶ 5.

307. *See supra* notes 264–88 and accompanying text.

308. *See generally* NML Capital, Ltd. v. Republic of Argentina, No. 08 Civ. 6978 (TPG), 2012 WL 5895786 (S.D.N.Y. Nov. 21, 2012), *aff'd*, 727 F.3d 230 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 2819 (2014), *cert. denied sub nom.* Exch. Bondholder Grp. v. NML Capital, Ltd., 134 S. Ct. 2819 (2014).

309. *See Knighthead*, EWHC 3662 (Ch), ¶¶ 18, 20.

310. [2014] EWHC 3662 (Ch), [2]–[4] (Eng.).

311. *Id.* ¶¶ 1–2.

312. The Court permitted a window for holdout creditors from the New York action to intervene. *Id.* ¶ 28. NML Capital declined to participate in the action. Letter from NML Capital to Judge Griesa at 1, No. 08 Civ. 06978 (TPG) (S.D.N.Y. Dec. 8, 2014), ECF No. 725. The euro bondholder matter covers interest payments in the sum of €226 million. Nishant Kumar, *London Court Seeks Argentina Creditors' Say on Debt Payments*, REUTERS (Nov. 6, 2014), http://www.reuters.com/article/2014/11/06/argentina-debt-idUSL4N0SW70420141106.

313. *Compare Knighthead*, EWHC 3662 (Ch), ¶ 19, *with* Order at 3, *NML Capital*, No. 08 Civ. 6978 (TPG) (S.D.N.Y. Nov. 25, 2014), ECF No. 724.

The *Knighthead* order explicitly notes that the Financial Markets Law Committee expressed that the pari passu clause would likely be interpreted differently under English law, and there would be a different remedial approach under English law.[314] In the New York district court order preventing the transfer of funds to exchange bondholders, the judge expressly absolved any bank of liability under the indenture governing the exchange bonds.[315] The English court stated that while such an order may allow the bank to avoid liability under U.S. law, it is "hard to see how it can do so in the eyes of the English Courts, and the bonds in question are governed by English law."[316]

Before the *Knighthead* case, there was already discussion of the differences between contract interpretation according to English law and the method articulated in *NML Capital*. Similarly to the way that *Sharon Steel* interprets boilerplate bond language as a matter of law, English contract interpretation follows a market understanding approach so that where multiple meanings might arise from the bond language, the market understanding can guide the determination of the parties' intentions at the time of contract execution.[317]

Pursuant to a review of pari passu clauses by the English Financial Markets Law Committee, it was determined that the language could give rise to two alternative interpretations.[318] First, pari passu could express equal legal ranking and was included to prevent sovereigns from legally subordinating one group of creditors by engaging in preferential legal treatment to another.[319] Second, pari passu could be a promise to pay all obligations pro rata when a debtor is unable to pay them all in full.[320] The committee concluded that under English law the traditionally understood meaning would be that of ensuring only legally equal ranking and treatment.[321] The trend in contract interpretation under English law to value the market understanding of the parties, where such a market understanding has been widely articulated, suggests that compared to the New York courts, the English courts would find a disparate interpretation stemming from the same clause.[322]

314. *Knighthead*, EWHC 3662 (Ch), ¶ 9.

315. *Id.* ¶¶ 13–14.

316. *Id.*

317. *See* Lachlan Burn, Pari Passu *Clauses: English Law After* NML v. Argentina, 9 CAP. MKTS. L.J. 2, 4 (2014); *see also supra* notes 177–81 and accompanying text.

318. Burn, *supra* note 317, at 4.

319. *Id.* This view is consistent with the standard industry usage argument propounded by opponents of the *NML* and *Elliott* interpretation in the United States. *See generally* Buchheit & Pam, *supra* note 163.

320. Burn, *supra* note 317, at 4.

321. *Id.* at 5.

322. *See* Tolek N. Petch, NML v. Argentina *in an English Legal Setting*, 9 CAP. MKTS. L.J. 266, 267–69 (2014); *accord* Gregory R. Day, *Market Failure,* Pari Passu*, and the Law and Economics Approach to the Sovereign Debt Crisis*, 22 TUL J. INT'L & COMP. L. 225, 242 n.102 (2014).

B. Proposed Solutions: Why Deeply Engrained Market Failures Bar a Simple Problem-Solving Mechanism

In response to the unraveling legal saga and the fear that *NML Capital* will encourage increasing vulture fund activity, several proposals have been put forward to prevent holdout creditors from using the pari passu clause to disrupt a restructuring. Of particular concern are the economic risks and consequences of serial defaults and long-term exclusion from the capital markets.[323] The proposed remedies have come in myriad forms but generally focus on creating a governing sovereign bankruptcy regime or implementing a contractual solution.

The modern characteristics of sovereign bond debt and the evolution of sovereign enforcement jurisprudence have created a complex role for the pari passu clause.[324] This section looks at alternative proposals for preventing vulture investors from using pari passu as a way to disrupt restructurings, discusses the ways in which these solutions reach the heart of the market failure, and addresses barriers to successful implementation.

1. ICMA Solution

The International Capital Market Association (ICMA) represents more than 470 investment banks, asset managers, and debt issuers who are located across fifty-five countries.[325] In August 2014, an ICMA working group created a standardized pari passu clause that could be placed into bond documents as a contractual solution to the holdout creditor disruption of restructurings.[326] The contractual fix is in a proviso to the pari passu clause that specifically denies any obligation to make ratable payments to other external indebtedness, particularly excepting any form of conditioning payment on notes based on payment to other obligations.[327] The purpose of the particular language chosen was a result of an initiative to "minimi[z]e or indeed, completely eradicate, the potential for holdout creditors to block or

323. *See, e.g.*, Charlie Devereux & Pablo Rosendo Gonzalez, *Argentina Will Repay Paris Club Debt 13 Years After Default*, BLOOMBERG NEWS (May 29, 2014), http://www.bloomberg.com/news/2014-05-29/argentina-agrees-to-repay-9-7-billion-to-paris-club-creditors.html. Argentina's inability to return to debt sustainability because of trouble accessing capital markets, high interest rates, currency devaluation (the peso has weakened by 35 percent since 2002), and massive costs in arbitration and litigation serve as potent examples of the impact judicial proceedings can have on a sovereign. *Id.*

324. *See* GULATI & SCOTT, *supra* note 19, at 163 ("[The] sheer number of complicating factors that distinguish the sovereign debt case study from other areas of transactional practice suggests caution in offering lessons for the future.").

325. *Membership*, ICMA, http://www.icmagroup.org/membership/ (last visited Feb. 23, 2015).

326. *Sovereign Debt Information: Standard Pari Passu Provisions for the Terms and Conditions of Sovereign Notes*, ICMA (Aug. 2014), http://www.icmagroup.org/resources/Sovereign-Debt-Information/.

327. *Id.* (supporting a standard pari passu clause proviso that reads: "provided, *however*, that the Issuer shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due on the Notes and vice versa").

frustrate a more universal approach to sovereign debt restructuring" in the wake of *NML Capital*.[328]

2. IMF Solution

Previous attempts by the IMF to establish an overarching bankruptcy measure called the Sovereign Debt Restructuring Mechanism (SDRM) have been unsuccessful over the last decade.[329] Then, in October 2014, the IMF proposed substantial changes to sovereign bond language.[330] The purpose of the contractual measure is to dissuade vulture funds from investing in underperforming debt by reducing their remedies following a default.[331] To temper the fear that the New York court decisions will exacerbate collective action problems in future restructurings, the proposed pari passu reform explicitly excludes the obligation to make ratable payments to holdout creditors.[332] The proposal advocates for changes consistent with the ICMA suggested language.[333] The IMF report finds particular need for expedient implementation of contractual reforms given: (1) the finality of the *NML Capital* decision following denial of Supreme Court review, (2) the tension between the *NML Capital* interpretation and the alternative, "well-established" view of pari passu being solely about pure legal subordination, and (3) the potential harm pari passu injunctive relief can have as a broadly applicable remedy and incentive for holdouts.[334] Additionally, the report touches on the notion that English courts would likely decline to follow the New York courts' precedent.[335]

3. ICSID Role

The World Bank's International Centre for Settlement of Investment Disputes (ICSID), an international arbitration tribunal, established jurisdiction over a sovereign debt proceeding and the first mass arbitration (with over 180,000 claimants) when it heard *Abaclat v. Argentine Republic*

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328. *ICMA Sovereign Bond Consultation Paper*, ICMA, ¶ 4 (Dec. 2013), http://www.icmagroup.org/assets/documents/Maket-Practice/Regulatory-Policy/Sovereign-Debt-Information/ICMA-Sovereign-Bond-Consultation-Paper-79801-5-863-v1-8-161213.pdf.

329. *See* SCHIER, *supra* note 35, at 44 (discussing failure of SDRM as a result of "political resistance in the international community"); *see also* Gelpern & Gulati, *supra* note 46, at 1649–51 (detailing failures of the SDRM proposal in the context of international organizations seeking widespread use of CACs as a "second best" market fix once SDRM appeared infeasible).

330. *See generally* IMF, STRENGTHENING THE CONTRACTUAL FRAMEWORK TO ADDRESS COLLECTIVE ACTION PROBLEMS IN SOVEREIGN DEBT RESTRUCTURING (Oct. 2014), *available at* http://www.imf.org/external/np/pp/eng/2014/090214.pdf.

331. *Id.*

332. *See id.* at 4, 15.

333. *Id.* at 14–15.

334. *See id.* at 7–12. Uncertainty also results from the way courts would apply the course of conduct analysis—finding pari passu breach only in narrow circumstances that mimic the actions taken by Argentina or in broader instances. *Id.* at 11.

335. *Id.* at 13.

in 2011.[336] While many touted this accomplishment as the long-awaited overarching sovereign debt restructuring mechanism,[337] subsequent arbitral adjudication efforts were plagued by similar problems experienced in the court system—lack of true sovereign enforcement power and protracted proceedings.[338] Claims stemming from the Greek debt restructuring are now before the ICSID, but the effectiveness and feasibility of a successful resolution will only come to light as the matter progresses.[339]

4. Implementation

The Republic of Kazakhstan was the first country to implement contractual changes to the pari passu clause[340] by fully implementing the ICMA recommendations to its issuance of $2.5 billion of ten- and thirty-year bonds that it began marketing in October 2014.[341] The bonds, which are the first overseas dollar-denominated offering from the country in fourteen years, could serve as a positive example of the suggested language reforms.[342] Although this change could signal a new era in bond offerings, the relative size (compared to Argentina's $95 billion default) makes implementation easier than with larger nations.

One barrier to implementation is that each country must adopt reforms individually. Contract changes only will be influential if the language becomes incorporated on a large scale in sovereign bonds going forward. While several countries have already included new language with no significant price impact,[343] to be effective it would need to be in every bond.[344] Given one characterization of the pari passu clause as boilerplate,

336. Abaclat v. Argentine Republic, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (Aug. 4, 2011), http://italaw.com/documents/AbaclatDecisiononJurisdiction.pdf.

337. *See* Jessica Beess und Chrostin, Note, *Sovereign Debt Restructuring and Mass Claims Arbitration before the ICSID,* The Abaclat Case, 53 HARV. INT'L L.J. 505 (2012), http://www.harvardilj.org/2012/09/sovereign-debt-restructuring-and-mass-claims-arbitration-before-the-icsid-the-abaclat-case/; Jan Asmus Bischoff, *The End of Sovereign Debt Restructuring*, TRANSNATIONAL NOTES (Oct. 17, 2011), http://blogs.law.nyu.edu/transnational/2011/10/the-end-of-sovereign-debt-restructuring/.

338. *See* Brief of Amicus Curiae Italian Holders of Argentine Sovereign Bonds in Support of Respondents at 11–12, Republic of Argentina v. NML Capital, Ltd., No. 13-990, 2014 WL 1878054 (May 7, 2014) (noting the arbitral award has remained unpaid by Argentina); Decision, *supra* note 336, at 7 (noting request for arbitration dated 2006, five years prior to the decision).

339. *See* Yanying Li, *Policy Implication of PoŠtová Tribunal's Jurisdiction over Sovereign Bonds: Bankruptcy Cram-Down and ICSID Arbitration*, 23 J. BANKR. L & PRAC. NL ART. 6 (2014).

340. Kazakhstan is an innovator in the sovereign bond market. In 1997, the developing nation defied the standard unanimous consent contract by permitting a 75 percent majority of bondholders to change key financial terms. Gelpern & Gulati, *supra* note 46, at 1628 n.1.

341. *See* Katia Porzecanski & Lyubov Pronina, *Kazakhstan Sells First Overseas Dollar Bonds in 14 Years*, BLOOMBERG NEWS (Oct. 6, 2014), http://www.bloomberg.com/news/2014-10-06/kazakhstan-sells-first-overseas-dollar-bonds-in-14-years.html.

342. *Id.*

343. Mexico, Vietnam, and Kazakhstan have all included new pari passu language in recent bond offerings. *See* Hagan, *supra* note 10.

344. *See id.*

and the fact that language was not significantly altered after the *Elliott* case, it would seem that other market conditions will be determinative of whether bond drafting will incorporate the new language.[345] Still, this would not have any impact on the approximately $900 billion in sovereign bonds that do not contain the new clauses.[346] Many of these do not mature for another ten years.[347]

III. A CONTRACTUAL SOLUTION TO PARI PASSU

This part explores the insufficiency of proposed solutions, synthesizes the current state of the law, and advocates for a solution that seeks to limit vulture fund disruption without leaving traditional creditors unprotected in the event of an opportunistic default or oppressive restructuring.

Preventing sovereign debtors from fully restructuring and therefore condemning them to never-ending litigation with holdouts and limited or no access to capital markets is not a sustainable model. Though there are many claims that the situation in Argentina was an anomaly, and simply a result of a "uniquely recalcitrant debtor,"[348] the broad interpretation of the pari passu clause and the specific wording in the orders suggest that *NML Capital*'s precedential value will extend well beyond the specific circumstances of the case. Such precedent will certainly be difficult to distinguish in future cases where bonds governed by New York law contain similar pari passu clauses. Given the trends in sovereign default it is not likely that Argentina will be the last nation to face this issue.[349] On the other hand, because of the high prevalence of sovereign defaults there is a need for some sort of deterrence mechanism that emphasizes the severity of a default and serves as a deterrent to overborrowing by promoting fiscal responsibility and creditor protection from coercive restructuring terms.

A. Why Proposed Solutions Are Insufficient

When looking at the proposals discussed in Part II.B, two vulnerabilities are apparent. First, there is no incentive for uniform implementation. There are many reasons why a sovereign might be reluctant to alter standard contract terms, even faulty ones.[350] Given transaction costs associated with such changes, a sovereign that is 100 percent certain that it will be able to fully pay its creditors would not need to prioritize altering bond language. Therefore, those sovereigns that are first to make the changes could signal debt obligation insecurity that might result in increased lending costs. As a check against sovereign debtors, however, such a result might bring positive changes to sovereign borrowing habits by preventing

345. *See supra* notes 239–42 and accompanying text.
346. *See supra* notes 239–42 and accompanying text.
347. *See supra* notes 239–42 and accompanying text.
348. NML Capital Ltd. v. Republic of Argentina, 727 F.3d 230, 247 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 2819 (2014).
349. *See supra* notes 57–67 and accompanying text.
350. *See supra* notes 239–42 and accompanying text (discussing the lack of language change following the *Elliott* decision).

overborrowing if cost of funds increase.[351] In aggregate, there would need to be an overall umbrella organization or incentive system to compel sovereigns to make the contract changes. Otherwise, selective implementation might not only create the aforementioned price volatility, but it would be ineffective in eliminating the problem of holdout litigation stemming from pari passu injunctive relief unless a critical mass of committed sovereigns was established. As seen with the SDRM and ICSID frameworks, overarching regimes have either been unable to come to fruition or have not proved to be an adequate alternative to the status quo.[352] Even a smaller-scale collective created solely to incentivize widespread contract language implementation likely would present some of the same difficulties.

Another lingering problem beyond the issue of actual implementation and market response is the question of how to handle bonds that have been issued under the old language, and therefore are subject to existing law on pari passu interpretation. Solving problems for future restructurings is certainly a step in the right direction, but it leaves billions of dollars of debt subject to the same conflicting legal problems that were discussed in Parts I and II of this Note. Any sort of overarching solution that would solve the pari passu problem altogether would therefore require a two-pronged remedy aimed both at future bond offerings and at those currently in existence that are vulnerable to the holdout creditor problem.

B. The Law As It Stands

The New York interpretation of the pari passu clause as a ratable payment provision is the current law.[353] The Second Circuit affirmed injunctive relief, and the Supreme Court has denied a petition to review the decision.[354] As the law currently stands, the ratable payment interpretation invites a remedy for injunctive relief to use third-party intermediary banks to prevent payments to a restructured class until the holdout creditors are paid.[355] The only way that judicial interpretation might change is if another action is brought before the court that has different pari passu language.[356] Given the broad scope of the ratable payment interpretation and the broad injunctive remedy provided, this does not seem likely.[357] Congress also has the ability to limit injunctive relief in enforcement, however that seems unlikely as well due to polarized political views on the balance of incentives to ensure sovereign debt sustainability while maintaining bondholder remedies to enforce payment.[358]

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351. *See supra* notes 77–78 and accompanying text.
352. *See supra* notes 70, 329, 347–50 and accompanying text.
353. *See supra* notes 256–91 and accompanying text. The interpretation would not, however, be binding on outside circuit courts or on New York state courts.
354. *See supra* note 294 and accompanying text.
355. *See supra* Part II.A.2.
356. *See supra* notes 16–17, 334 and accompanying text.
357. *See supra* notes 252–89, 292 and accompanying text.
358. *See supra* notes 293–96 and accompanying text.

The *Knighthead* determination[359] will be important. If the English court rules that Bank of New York Mellon is not exempt from liability to service payment to euro bondholders, and therefore must perform under the exchange bond contract, it would create a body of law that runs counter to the ratable payment interpretation. It would incentivize a country that seeks to restructure debt governed by New York law to restructure under English law in euro-denominated bonds so that it is beyond the pari passu interpretation subject to enforcement by New York courts.[360]

It cannot be the case that by restructuring bonds partially in foreign currency and governed by foreign law that those exchange bondholders get paid in full while the holders of U.S. law bonds denominated in dollars are held up until holdouts get paid. Such a practical application of the law would necessarily lead to a certain breach of any understood meaning of pari passu because it would create completely arbitrary unequal treatment of creditors who are in fact part of the same restructured class.

C. Limiting Vultures Without Disrupting Holdout Balance

A proper solution to the holdout creditor disruption of sovereign bond restructurings needs to strike a balance between limiting vulture fund investing strategies while also creating an internal control for concerns of fairness and safeguarding creditor rights, particularly in the event of an opportunistic default.

1. Infeasibility of a Sovereign Bankruptcy Structure

Creating a bankruptcy regime to govern the distribution of payments in a sovereign default would solve the problem of pari passu. Having one centralized framework to work out all creditor issues and thereafter allow the sovereign debtor to be free of restructuring disruption would create the ideal scenario for a sovereign to gain a fresh start. This approach, however, would not be feasible because of a number of practical concerns. First, a successful sovereign bankruptcy structure would require the participation of all nations.[361] Second, it would require enforcement capabilities, without which compliance with payment determinations would be voluntary and therefore essentially useless.[362]

Much like in the U.S. bankruptcy system, the bankruptcy court would need to hold exclusive jurisdiction on such matters and also the ability to enforce any money judgments or awards. Given the fact that sovereignty is highly valued under principles of foreign sovereign immunity and comity, it

359. *See supra* notes 311–16 and accompanying text.

360. *See supra* notes 311–22 and accompanying text (describing the potential conflict-of-law issue in addition to analysis of how pari passu would be interpreted under English law).

361. *See* KRUEGER, *supra* note 73, at 33–34 (discussing the importance of uniformity and an exclusive jurisdiction for a single international judicial entity to avoid fragmented dispute resolution).

362. *See supra* notes 99–128 (explaining many ways that creditors can take advantage of the voluntary bond exchange process); *supra* note 338 (illustrating, in the ICSID case, how a sovereign debtor can take advantage of essentially voluntary compliance).

would be impossible to have a successful regime without each nation waiving some large degree of sovereignty. Many nations would likely be reluctant to do so, and in the event of an unfavorable ruling, would likely have difficulty with compliance measures. Such avoidance of unfavorable rulings already has been seen in the ICSID issues with Argentina.[363] Additionally, the IMF's SDRM proposal never was able to get off the ground.[364] The failure of that attempt was not for a lack of political visibility or effort on the part of the IMF.[365] Despite much public visibility of the issues and many attempts to create an overarching framework, none has been successfully implemented to date.[366] Scholars have written on ways to alter a bankruptcy framework to address discrete barriers, yet there has been no significant headway.[367] This seems to suggest that at least as to how the market is currently situated, a bankruptcy regime therefore would not be the most efficient or expedient measure to create a resolution on the pari passu issue.

2. Contractual Solution

Given the difficulties in creating an overarching sovereign bankruptcy regime, a contractual solution to the problem likely would be the most pragmatic solution to prevent pari passu interference going forward. It would allow the language to be tailored to the purpose of preventing vulture fund holdout creditors from interfering with payment on exchange bonds but without removing creditor rights that are otherwise essential for a functioning market. While the contractual solutions proposed in Part II.B address some of these concerns, there are two reasons why they are incomplete solutions.

First, the proposed contractual language creates an imbalance of creditor rights by stripping holdouts of their right to hold out and litigate for the full value of the claims under pari passu.[368] Although provisions to that effect have been successfully included in several sovereign bond offerings without significant price variation, the widespread inclusion of such terms runs the risk of preventing creditor quid pro quo that could negatively impact their ability to bargain during a restructuring.[369] Second, it does nothing to address the nearly $900 billion in outstanding bonds that do not include a newly crafted pari passu clause. Even bonds that contain CACs are at increased risk of pari passu litigation because vulture funds can purchase a

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363. *See supra* note 338 and accompanying text.

364. *See supra* note 329 and accompanying text.

365. *See supra* note 329 and accompanying text.

366. *See supra* notes 68–72 and accompanying text.

367. *See supra* notes 68–72 and accompanying text; *see also supra* note 329 and accompanying text.

368. *See supra* note 327 and accompanying text (including language that "the Issuer shall have no obligation to effect equal or rateable payment(s) . . . to any such other external indebtedness").

369. *See supra* notes 75–87 and accompanying text (comparing balance of power between creditors and debtors in a domestic bankruptcy context to the leverage each brings to the table in a voluntary restructuring).

large enough share to block a majority or create additional reasons for other creditors to hold out in a restructuring.[370] This Note argues that a contractual solution "plus" is the best workaround to fixing the uncertainty of the pari passu clause. Such a contractual solution "plus" includes a contractual solution in conjunction with a remedy for outstanding bonds.

a. Ninety-Day Presumption Proviso

Given the fact that the vulture fund investment strategy is to purchase large quantities of defaulted or near-defaulted bonds on the secondary market and then hold out in a restructuring, a proviso to the pari passu clause should be included to limit equal treatment for those activities. The aftermath of the vulture fund victories in *Elliott* and *NML Capital* evoke a sense of unfairness at the idea that such investors can purchase large quantities of sovereign bonds at a deep discount and then halt payment on the restructured bonds when a majority of creditors accepted the reduced terms. Based on the language of the pari passu clause and the use of pro rata distribution in domestic bankruptcy,[371] if the clause is to have a meaning, it must mean that all bonds from the same issuance should be treated equally to protect creditors (though the metric to determine equality still remains a murky subject area). The ratable payment interpretation, however, clearly holds value as an enforcement tool for creditors and should not be so quickly stripped from a creditor's protective leverage in a restructuring.

In order to limit pari passu injunctive relief for vulture funds only, a contractual proviso should be aimed at what differentiates them from other investors—the timing of bond purchase coupled with the intention to hold out. A proper contractual proviso would state that the bonds rank pari passu among themselves and other current and future external indebtedness provided that the bonds were purchased on or before ninety days prior to the announcement of default or restructuring. The concept of a ninety-day period is borrowed from section 547 of the U.S. Bankruptcy Code that deals with avoidance of intercreditor preferences that disadvantage unsecured creditors.[372] While the analogy to section 547 is imperfect because voidable preferences are concerned with transfer of the debtor's property whereas in the sovereign debt context the issue is with purchases made by a creditor, the policy considerations for protection of the general body of

370. *See* Fisch & Gentile, *supra* note 18, at 1093–95 (finding disadvantages of CACs include limitation to restructure bonds beyond a particular bond issue and the inability to "eliminate the strategic use of litigation"); *see also* Koch, *supra* note 34, at 684 (finding the ratable payment interpretation of pari passu has "potential to effectively unhinge CACs").

371. *See supra* notes 185–90 and accompanying text.

372. *See supra* note 86 and accompanying text (discussing relevance of a ninety-day period in the U.S. Bankruptcy Code as a presumption that the debtor is insolvent during that period, and to avoid preferential transfer of assets to creditors during that period that would give them a priority over other unsecured creditors). There are benefits and costs to having a bright line rule. Although such a rule produces a consistent and predictable standard, it could be subject to manipulation in this context particularly because sovereign entry into restructuring is characteristically much different from corporate bankruptcy.

unsecured creditors remain the same. Like a preference, a sovereign bond sale made during a time when the sovereign is in financial distress to a vulture investor that is certain to hold out and seek injunctive relief constitutes an event that makes creditors overall worse off.

The ninety-day period would act to decrease the incentive of vulture funds to invest, but permit smaller retail investors to hold out and seek the full value of their claims in an unfair or highly coercive restructuring. Additionally, providing such a ninety-day period would create an incentive for sovereign debtors to address unsustainable debt burdens before the sovereign becomes entangled in a crisis. Such incentives for preemptive restructuring would address concerns that sovereigns tend to postpone an announcement of default, causing the sovereign to restructure too late.[373] By engaging in an earlier restructuring, sovereigns can avoid substantial value loss and increase the chances of a successful restructuring.[374]

While suspending a pari passu remedy for vulture funds might otherwise have adverse effects on the liquidity flows to the secondary bond market,[375] the ability to seek a judgment for contract breach and execute a subsequent order of attachment would not be impaired.[376] There also would be no limitation on purchasers of the distressed sovereign debt seeking to participate in a restructuring. Additionally, because such a proviso would reduce the risk of vulture fund holdouts while still retaining a check on opportunistic default for traditional creditors, the inclusion of such a clause should not result in a decrease in market value and could in fact increase the value of the debt.[377] In contrast to the issue of implementation with existing proposed contractual solutions,[378] the proviso would create market incentives for inclusion and would have fewer barriers to widespread use.

b. The Outstanding Bond Issue: The "Plus" Factor

In addressing the billions of dollars in outstanding foreign law–governed bonds, the remedy should either come from legislative enactment or from sovereign debt restructuring strategy.

i. Legislative Limitations Unlikely

On the one hand, Congress has competing interests in ensuring that there is adequate pushback on opportunistic default and less pressure for

373. COMM. ON INT'L ECON. POLICY & REFORM, REVISITING SOVEREIGN BANKRUPTCY 2, 11–12 (2013), *available at* http://www.brookings.edu/~/media/research/files/reports/2013/10/sovereign%20bankruptcy/ciepr_2013_revisitingsovereignbankruptcyreport.pdf.

374. *Id.*

375. *See supra* note 158 and accompanying text.

376. *See supra* note 138 and accompanying text.

377. *Cf.* Fisch & Gentile, *supra* note 18, at 1093–94 (concluding that a contractual approach which both solves the collective action problems and reduces the risk of holdouts should raise the value of the debt so long as the solution is not expected to "increase the likelihood of opportunistic defaults").

378. *See supra* notes 368–70 and accompanying text.

bondholders to take a large haircut.[379] On the other hand, there is an interest in permitting countries to begin anew after restructuring and not be dragged through years of debilitating litigation that strains the economy and prevents return to capital markets.[380]

The political will is not likely to emerge in the near future to put forth federal legislation like the Belgian law preventing injunctive relief.[381] Another way that Congress could act to disincentivize vulture fund investing could be to pass legislation stating that, in the event of sovereign default or restructuring, pro rata payment would be limited to the actual payment price on the bond and not the full face value.[382] The result of such action, while likely being successful to deter vulture fund investing, would also chill the secondary market and would therefore be overbroad.

The New York state legislature also has the ability to alter the bounds of equitable relief permitted by the courts. As the cause of action originates under New York law, it might even seem most appropriate for any legislative solution to originate at the state level.[383] Previous successful lobbying attempts by vulture funds, however, indicate that any statutory solution limiting holdout remedies is not likely to come to fruition.[384]

ii. Creative Interpretation: Purposeful Avoidance

One unfortunate reality is that the best option for sovereign debtors to avoid conflict with pari passu interpretation for outstanding bonds is to purposely avoid New York jurisdiction in the event of a restructuring. The *Knighthead* case is still ongoing, though it appears that the English courts will interpret pari passu not as a ratable payment understanding but rather a pure legal subordination interpretation, informed by the "traditional" market understanding of pari passu's functionality.[385] What that means is that if any of the bonds currently governed under New York law become unsustainable debt, the sovereign should restructure all of its debt under foreign law and in foreign currency, likely under English law. Because the clearing agents and disbursement mechanisms also would be under foreign law, the court in New York would lack the remedy of injunctive relief because the third-party intermediary would be beyond the reach of the court's jurisdiction.

CONCLUSION

This Note explores the sovereign bond market, the restructuring process, and the role of the pari passu clause. It discusses various interpretations of

379. *See supra* notes 294–95 and accompanying text.
380. *See supra* notes 294–95 and accompanying text.
381. *See supra* notes 294–95; *see also supra* notes 229–30 and accompanying text.
382. *Compare supra* notes 151–55 and accompanying text (discussing vulture fund purchases of bonds at a reduction of face value), *with supra* notes 66–67, 112–17 and accompanying text (discussing face value reduction generally in the context of an exchange).
383. *See supra* notes 142–45 and accompanying text.
384. *See supra* note 205.
385. *See supra* notes 314–22 and accompanying text.

the pari passu clause in sovereign bonds, remedies that are associated with those understandings, and the legal issues which are presented in the restructuring context. This Note examines several proposals for reducing restructuring disruption by holdout creditors. These have not adequately addressed the problem of the outstanding bonds or the protection of non-vulture creditors' rights. The primary proposal put forth by this Note—a contractual provision that would limit pari passu injunctive relief for bonds purchased within the ninety days before a default or restructuring announcement and also incentivize sovereign borrowers to initiate restructuring negotiations sooner—serves the interests of both debtors and creditors. Additionally, assuming Congress will not act to limit the scope of the current judicial interpretation of the pari passu clause, the best strategy for outstanding bonds is to restructure the interpretation of pari passu under another jurisdiction's law (whether English or otherwise) so that it will not risk blocking payment to exchange bondholders.