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*By Tim R Samples**

Abstract: Coined the "trial of the century" in sovereign debt litigation, NML v. Argentina (NML) involves a radical departure from the traditional unenforceability of sovereign debt contracts in favor of the opposite extreme: enforcement through potent injunctive remedies applicable to third parties. Problems with the NML precedent could extend far beyond Argentina's immediate situation. NML is the latest landmark in a trend that creates serious uncertainties for sovereign debt markets—a major concern for sovereigns, their creditors, and financial institutions around the world. This Article argues that NML creates "bad law" by overcompensating for unenforceability problems with an ambitious reading of the pari passu clause and supercharged injunctive remedies. As a practical matter, the milk is spilled; "rogue" precedent now exists. But until broader solutions for problems in sovereign debt are available, there are compelling grounds for other courts to apply the NML precedent as narrowly as possible. In addition to the extraordinary factual circumstances of NML, the Second Circuit provided a starting point for distinguishing NML from future cases.

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I. INTRODUCTION: SOVEREIGN DEBT'S "TRIAL OF THE CENTURY"

Fifty-three trillion dollars and counting reads the *Economist*'s Global Debt Clock, which tracks global public debt.[1] Government debt represents a hefty portion—roughly a fifth of financial assets worldwide.[2] Foreign-held sovereign debt is worth trillions of dollars and is an increasingly vital component of international finance.[3] Beyond the trillions of dollars at stake, sovereign debt impacts the lives of billions of people with important social and economic consequences.[4] Sovereign debt holdings also play an important stabilizing role in the portfolios of pension funds, central banks, and institutional investors around the world.[5] Trends in sovereign debt have crucial consequences around the world for human welfare, political stability, financial systems, and even national security.[6]

Unfortunately, sovereign debt defaults are more than hypothetical disaster scenarios in waiting; they are already a serious problem.[7] Debt

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[1] *World Debt Comparison: The Global Debt Clock*, ECONOMIST, http://www.economist.com/content/global_debt_clock (last visited July 28, 2014).

[2] *See* SUSAN LUND ET AL., MCKINSEY GLOBAL INST., FINANCIAL GLOBALIZATION: RETREAT OR RESET? 14 (2013).

[3] Emerging market debt held by foreign interests is worth $1 trillion. *See* Serkan Arslanalp & Takahiro Tsuda, *Tracking Global Demand for Emerging Market Sovereign Debt* 4 (IMF, Working Paper WP/14/39, 2014), *available at* http://www.imf.org/external/pubs/ft/wp/2014/wp1439.pdf. Advanced economy debt held by foreign interests grew from $5 to $14 trillion between 2004 and 2011. *See* Serkan Arslanalp & Takahiro Tsuda, *Tracking Global Demand for Advanced Economy Sovereign Debt* 23 (IMF, Working Paper WP/12/284, 2012), *available at* https://www.imf.org/external/pubs/ft/wp/2012/wp12284.pdf. Foreign holders of U.S. sovereign debt account for almost $6 trillion of the $17.6 trillion total. *See* U.S. DEP'T OF TREAS., MAJOR FOREIGN HOLDERS OF TREASURY SECURITIES (2014), *available at* http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/ mfh.txt; U.S. DEP'T. OF TREAS., *Debt to the Penny and Who Holds It*, TREASURYDIRECT, http://www.treasurydirect.gov/NP/debt/current (last updated Jan. 8, 2015).

[4] *See, e.g.*, Carmen M. Reinhart & Kenneth S. Rogoff, *Growth in a Time of Debt*, 100 AM. ECON. REV. 573, 573–78 (2010), *available at* http://www.ycsg.yale.edu/center/forms/growth-debt.pdf (explaining frictions between growth rates and rising sovereign debt); *see also* Manmohoan S. Kumar & Jaejoon Woo, *Public Debt and Growth* 27 (IMF, Working Paper WP/10/174, 2010), *available at* http://www.imf.org/external/pubs/ft/wp/2010/wp10174.pdf (projecting that U.S. debt will cost Americans $2.4 trillion in lost growth over the next five years).

[5] *See* PRINCIPLES FOR RESPONSIBLE INVESTMENT INITIATIVE, SOVEREIGN BONDS: SPOTLIGHT ON ESG RISKS 4 (2013), *available at* http://www.unpri.org/publications/.

[6] *See generally* Francis E. Warnock, *How Dangerous Is U.S. Government Debt?*, COUNCIL ON FOREIGN RELATIONS (June 2010), http://www.cfr.org/financial-crises/dangerous-us-government-debt/p22408. *See also* Lee C. Buchheit & G. Mitu Gulati, *Responsible Sovereign Lending and Borrowing*, 73 LAW & CONTEMP. PROBS. 63, 64, 69–70 (2010) (addressing social costs and intergenerational tensions in sovereign debt).

[7] Between 1950 and 2010, there were 600 sovereign debt restructurings in ninety-five countries, sometimes with disastrous economic and social consequences. *See* Udaibir S. Das et al., *Sovereign Debt*

defaults tend to plague middle income and highly indebted poor countries (HIPCs).[8] However, debt crises in the eurozone show that this vulnerability extends beyond emerging markets.[9] Recent events in the United States even illustrated the potential for politically manufactured sovereign defaults.[10] Increasingly in question is the common assumption that advanced economies are completely different than emerging markets in terms of available policy solutions in managing unsustainable debt burdens.[11]

Sometimes likened to a Greek tragedy, Argentina's troubled history with sovereign debt goes back centuries.[12] The latest chapter began in late 2001 when Argentina suspended payments on roughly $100 billion in sovereign bonds—the largest sovereign debt default in world history.[13] After contentious restructuring negotiations, Argentina eventually exchanged most of its defaulted bonds for new debt, but not before a significant number of bonds were acquired by distressed-debt hedge funds, often referred to as "vulture" funds, which specialize in acquiring cheap, distressed debt and subsequently litigating for a profit.[14]

In 2012, a lawsuit led by vulture hedge funds resulted in the Southern District of New York's groundbreaking decision in *NML Capital, Ltd. v. Republic of Argentina* (*NML*).[15] Plaintiffs successfully sued Argentina for

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Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts 5–6 (IMF, Working Paper WP/12/203, 2012), *available at* http://www.un.org/esa/ffd/ecosoc/debt/2013/IMF_wp12_203.pdf.

[8] *See* Julian Schumacher et al., *Sovereign Defaults in Court: The Rise of Creditor Litigation 1976-2010* 12 (Feb. 15, 2013) (unpublished manuscript), *available at* http://www.scu.edu/business/economics/upload/SovereignDefaultsinCourt.pdf; *see also* IMF & INT'L DEV. ASSOC., HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE — PERSPECTIVES ON THE CURRENT FRAMEWORK AND OPTIONS FOR CHANGE (Apr. 2, 1999), *available at* http://www.imf.org/external/np/hipc/options/options.pdf (providing background on the HIPC Initiative, which was launched in 1996).

[9] For extensive coverage of the eurozone crisis, see *The Euro Zone: That Sinking Feeling (Again)*, ECONOMIST, Aug. 30, 2014, at 10.

[10] *See* Nicole Hong, *U.S. Debt Rating Put on Watch by Fitch*, WALL ST. J. (Oct. 16, 2013, 8:08 PM), http://online.wsj.com/news/articles/SB10001424052702304330904579137851778625112?mod=_newsreel_3.

[11] *See, e.g.*, Carmen M. Reinhart & Kenneth S. Rogoff, *Financial and Sovereign Debt Crises: Some Lessons Learned and Those Forgotten* (IMF, Working Paper WP/13/266, 2013), *available at* https://www.imf.org/external/pubs/ft/wp/2013/wp13266.pdf.

[12] *See* Bob Van Voris, *Argentina 'Greek Tragedy' Nears End as Debt Ruling Looms*, BLOOMBERG (Apr. 1, 2013), http://www.bloomberg.com/news/2013-03-31/argentina-greek-tragedy-nears-end-as-debt-ruling-looms.

[13] *See* J.F. HORNBECK, CONG. RESEARCH SERV., R41029, ARGENTINA , CONG. RESEARCH SERV.13-03-31 5 (2013).

[14] *See id*. ("A diverse group of 'holdouts' representing $18.6 billion did not tender their bonds and some have opted to litigate instead."). For the sake of brevity, distressed debt hedge funds are at times referred to as "vulture" funds in this Article.

[15] *See Sovereign Debt: Hold-outs Upheld*, ECONOMIST, Nov. 3, 2012, at 74–75, *available at* http://www.economist.com/news/finance-and-economics/21565635-court-ruling-against-argentina-has-

the breach of a *pari passu* or "equal footing" covenant,[16] obtaining potent injunctive remedies to enforce the judgment against Argentina and sending shockwaves through sovereign debt markets.[17] Plaintiffs won again, decisively, in a Second Circuit appeal.[18] The Supreme Court then denied Argentina's petition for review of the Second Circuit's interpretation of Argentina's *pari passu* obligations.[19]

NML creates uncertainties for sovereign debt markets with problematic consequences for sovereign borrowers, their creditors, and third parties involved in international financial services.[20] Exchange bondholders have been caught in the crossfire as well.[21] *NML*'s radical solution to unenforceability problems could complicate sovereign debt restructuring.[22] Also, New York is a critical jurisdiction, not just for sovereign debt but also for corporate debt issuances.[23] Thus, for good reason, the *Financial Times* suggests that *NML* is the "the trial of the century" in sovereign debt litigation.[24]

Scholars and practitioners alike have analyzed the recent evolution of sovereign debt law, which has undergone important changes in the last few

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implications-other-governments-hold-outs.

[16] Though the Latin phrase *pari passu* literally means "in equal step," its legal meaning in sovereign debt contracts is the subject of considerable debate. Most *pari passu* clauses provide that a debtor will maintain equal footing among obligations. *See infra* notes 201–11 and accompanying text.

[17] NML Capital, Ltd. v. Republic of Argentina, No. 08 Civ. 6978, 2012 WL 5895784 (S.D.N.Y. Nov. 21, 2012), *appeal dismissed*, 727 F.3d 230 (2d Cir. 2013) (granting specific performance and permanent injunctions). *See* Sujata Rao, *Investment Focus – Argentine Case Adds to Sovereign Debt Doubts*, REUTERS (Nov. 23, 2012), http://www.reuters.com/article/2012/11/23/investment-focus-idUSL5E8MN83Y20121123.

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

[19] *See* Camila Russo & Katia Porzecanski, *Argentine Bonds Plunge After U.S. Court Rejects Apeeal* [sic], BLOOMBERG (June 16, 2014), http://www.bloomberg.com/news/2014-06-16/argentine-bonds-plunge-after-u-s-supreme-court-rejects-appeal.html.

[20] *See* Brief of the American Bankers Ass'n as Amicus Curiae Supporting Nonparty, the Bank of New York Mellon at 14–15, NML Capital, Ltd. v. Republic of Argentina, No. 12-105-cv(L) (2d Cir. Jan. 4, 2013); *see also* Brief for Amicus Curiae the Clearing House Ass'n L.L.C. in Support of Reversal at 25–27, NML Capital, Ltd. v. Republic of Argentina, No. 12-105-cv(L) (2d Cir. Jan. 4, 2013).

[21] Exchange bondholders participated in the restructuring of Argentina's sovereign debt, taking a loss and exchanging their bonds for new ones rather than holding out and litigating. *See* Vivianne Rodrigues & John Paul Rathbone, *Argentina Bond Investors Challenge Long Arm of US Law*, FIN. TIMES (July 3, 2014, 5:47 PM), www.ft.com/intl/cms/s/0/471b5be2-02c7-11e4-a68d-00144feab7de.html.

[22] Brief for the United States of America as Amicus Curiae in Support of the Republic of Argentina's Petition for Panel Rehearing and Rehearing En Banc at 3, NML Capital, Ltd. v. Republic of Argentina, No. 12-105-cv(L), 2012 WL 6777132, at *3 (2d Cir. Dec. 28, 2012); Brief for the United States of America as Amicus Curiae in Support of Reversal at 17–18, NML Capital, Ltd. v. Republic of Argentina, No. 12-105-cv(L) (2d Cir. Apr. 4, 2012).

[23] *See* Das et al., *supra* note 7, at 41 (illustrating that New York law governs $272 billion out of a total of $411 billion in emerging market sovereign bonds, representing 435 issuances out of a total of 631 issuances).

[24] Joseph Cotterill, *Pari Passu Saga*, FIN. TIMES ALPHAVILLE BLOG, http://ftalphaville.ft.com/tag/pari-passu-saga/ (last visited Jan. 31, 2014).

decades.[25] For example, quantitative studies have measured the rise in sovereign debt litigation.[26] A wide range of economic issues in sovereign debt have been explored over the last several decades.[27] Existing literature has documented the history and debate on the meaning of *pari passu*—the covenant at the heart of the most recent and disruptive wave of sovereign debt litigation.[28] This Article builds on existing literature by analyzing *NML* within the context of "rogue" trends in sovereign debt and developing practical arguments to support a narrow application of *NML*.[29]

"Bad facts make bad law," goes the old common law axiom. *NML* brings that cliché to life. Faced with bad facts, the *NML* court made bad law to punish an uncooperative sovereign defendant. In doing so, the court resorted to drastic measures, relying on enforcement against innocent third parties through injunctive remedies. As a result, *NML* creates major uncertainties for sovereign debt markets. Unfortunately, *NML* is unlikely to remain an isolated occurrence. Faced with unenforceability and essentially rendered powerless to compel payment by unwilling sovereign defendants, other courts have succumbed—as future courts likely will—to the temptation of injunctive remedies.

There are compelling grounds for a narrow approach regarding *NML*'s precedential value. Not only is *NML* an unsuitable point of departure with exceptional factual circumstances, the Second Circuit opinion explicitly provides textual grounds for distinguishing *NML* from future cases. *NML* is a true factual outlier. Although the Second Circuit partially recognized Argentina as a "uniquely recalcitrant" debtor, *NML* represents the most exceptional sovereign debt situation in modern history.[30] Until broader

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[25] *See* Lee C. Buchheit & Jeremiah Pam, *The* Pari Passu *Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869, 877–91 (2004) (detailing the emergence and proliferation of *pari passu* litigation in sovereign debt); *see also* Rodrigo Olivares-Caminal, *Understanding the* Pari Passu *Clause in Sovereign Debt Instruments: A Complex Quest*, 43 INT'L LAW 1217 (2009) [hereinafter Olivares-Caminal, *Quest*]; Rodrigo Olivares-Caminal, *To Rank* Pari Passu *or Not to Rank* Pari Passu*: That Is the Question in Sovereign Bonds After the Latest Episode of the Argentine Saga*, 15 LAW & BUS. REV. AM. 745 (2009) [hereinafter Olivares-Caminal, *Rank*].

[26] *See, e.g.*, Schumacher et al., *supra* note 8, at 11.

[27] For a review of recent economic literature on sovereign debt, see Ugo Panizza et al., *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LITERATURE 651, 659–64 (2009). For interpretations of empirical data on sovereign debt and sovereign defaults, see *id.* at 664–93.

[28] *See* G. Mitu Gulati & Kenneth N. Klee, *Sovereign Piracy*, 56 BUS. LAW. 635, 650 (2001) (making the case against the ratable payment approach to *pari passu*); FIN. MKTS. L. COMM., ANALYSIS OF THE ROLE, USE AND MEANING OF PARI PASSU CLAUSES IN SOVEREIGN DEBT OBLIGATIONS AS A MATTER OF ENGLISH LAW 17, n.31 (2005) [hereinafter FMLC STUDY], *available at* http://www.fmlc.org/uploads/2/6/5/8/26584807/79.pdf (clarifying that the meaning of *pari passu* under English law does not support the ratable payment approach).

[29] *See* Arturo C. Porzecanski, *From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default*, 6 CHI. J. INT'L L. 311, 316–17 (2005).

[30] NML Capital, Ltd. v. Republic of Argentina, 727 F.3d 230, 247 (2d. Cir. 2013).

solutions are implemented, a narrow application of *NML* is the most desirable of available options to mitigate the consequences of a rogue trend in sovereign debt litigation. In supporting this position, this Article underscores the hazards of perfect storms in sovereign debt—where rogue creditors, rogue debtors, and rogue court decisions converge to create undesirable and destabilizing precedent in a crucial area of the law.

This Article is organized as follows: Part II provides background on the law of sovereign debt, restructuring practices, and the current environment for sovereign debt litigation. Part III sets forth the exceptional nature of Argentina's situation across the various stages of sovereign debt. Part IV analyzes Argentina's *pari passu* clause and the *NML* decision. Building on language from the Second Circuit's opinion, Part V justifies a narrow reading and limited application of *NML* to future sovereign debt cases.

II. THE EVOLVING LAW OF SOVEREIGN DEBT

For good reason, sovereign debt is often characterized as unenforceable.[31] Courts generally lack effective enforcement and collection mechanisms required to hold accountable unwilling sovereigns.[32] In nonsovereign, "normal" situations, the remedy for a failure to repay debt is typically a money judgment enforceable with asset seizures. In sovereign debt, assets are often beyond the reach of creditors because collection is complicated if not impossible.[33] Sovereigns usually have few, if any, commercial assets outside of their own borders for creditors to attach.[34] Moreover, military options available in extraordinary situations during the era of "gunboat diplomacy" are no longer available to powerful creditor nations.[35]

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[31] *See* Anna Gelpern, *Contract Hope and Sovereign Redemption*, 8 CAP. MKTS. L.J. 132, 132 (2013) [hereinafter Gelpern, *Contract Hope*] ("Sovereign debt is unenforceable.").

[32] *See* EDWIN BORCHARD, 1 STATE INSOLVENCY AND FOREIGN BONDHOLDERS 122 (1951); *see also* Gelpern, *Contract Hope*, *supra* note 31, at 133.

[33] *See* Olivares-Caminal, *Quest*, *supra* note 25, at 1220; *see also* Gelpern, *Contract Hope*, *supra* note 31.

[34] Jonathan I. Blackman & Rahul Mukhi, *The Evolution of Modern Sovereign Debt Litigation: Vultures, Alter Egos, and Other Legal Fauna*, 73 L. & CONTEMP. PROBS. 47, 59 (2010); *see also* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1 *passim* (2004) (describing challenges associated with enforcing claims against sovereign debtors).

[35] Historically, creditors could turn to their home governments to intervene on their behalf in such disputes. Many such requests were made in vain, but several instances of dramatic military interventions exemplify the era of gunboat diplomacy: 1880–1913. *Compare* MICHAEL TOMZ, REPUTATION AND INTERNATIONAL COOPERATION: SOVEREIGN DEBT ACROSS THREE CENTURIES (Princeton Univ. Press 2007), *with* Kris J. Mitchener & Marc D. Weidenmier, *Supersanctions and Sovereign Debt Repayment*, 29 J. INT'L MONEY & FIN. 19 (2010).

This Part provides background information on the law of sovereign debt, restructuring practices, and the current environment for sovereign debt litigation. First, this Part briefly explains increasing pressures on the unenforceability of sovereign debt contracts. Second, this Part assesses the current environment of sovereign debt litigation and the role of distressed debt hedge funds in recent legal developments. Third, this Part addresses the legal nature of sovereign debt restructuring in the absence of sovereign insolvency mechanisms.

A. Unenforceability Under Fire

Following the Latin American debt crises in the 1980s, sovereign debt markets underwent an important shift under the Brady Plan from syndicated lending to bond financing.[36] During the syndicated lending era, sovereigns typically borrowed from commercial banks under a single loan agreement.[37] Under the Brady Plan, existing loan obligations were securitized and converted into bonds. As a result, sovereign creditors became far more numerous and atomized. A secondary market for sovereign debt instruments thus emerged. However, atomization also created new complexities and exacerbated collective action problems, all of which further complicated orderly debt restructuring.[38] While commercial banks proved willing participants in voluntary debt restructuring efforts, atomized bondholders with divergent interests have proven more difficult. Recent years have seen increasing creditor litigation against sovereigns while the identity of plaintiffs has shifted from large banks to distressed debt hedge funds, which account for 90% of such lawsuits since 2000.[39] Also on the rise is the percentage of sovereign defaults that trigger lawsuits, which has doubled in recent years.[40]

Unenforceability has shown some signs of erosion beginning in the 1970s. First, the scope of sovereign immunity was trimmed with the U.S. Foreign Sovereign Immunities Act (FSIA) of 1976 and the U.K. State Immunities Act of 1978.[41] Next, a series of judicial decisions disposed of

[36] Under the Brady Plan, named after U.S. Treasury Secretary Nicholas Brady, bank loans to sovereigns were converted into dollar-denominated sovereign bonds. *See* Lee C. Buchheit & Ralph Reisner, *The Effect of the Sovereign Debt Restructuring Process on Inter-Creditor Relationships*, 1988 U. ILL. L. REV. 493, 500 (1988).

[37] *Id.*

[38] Bratton & Gulati, *supra* note 34, at 20–22.

[39] Schumacher et al., *supra* note 8, at 3.

[40] *Id.* at 2 ("The likelihood that a debt crisis is accompanied by creditor litigation has more than doubled over the past decade, to more than 40% in recent years."). For details on the complexity of the Argentine default, see *infra* note 122 and accompanying text.

[41] The FSIA codified several exceptions to sovereign immunity, including commercial activities.

key state defenses—including act of state,[42] international comity,[43] and champerty[44]—opening new doors for litigious holdout creditors. Finally, as explained further below, the *pari passu* era gained momentum in the 1990s with groundbreaking litigation in New York and Belgium.[45]

The demise of the comity defense and act of the state defense came in 1985 with *Allied v. Costa Rica*.[46] Meanwhile, sovereign borrowing came to be considered a "commercial activity" in 1992—thus lacking immunity under the FSIA—with the Supreme Court decision in *Republic of Argentina v. Weltover*.[47] The champerty defense was weakened in 1995 by *CIBC v. Brazil*[48] before legislation effectively eliminated it under New York law.[49] Gradually, as classic defenses and immunity from lawsuits eroded, attachment of assets became the main obstacle to collecting against sovereigns.[50] For this reason, asset hunting is increasingly crucial in modern sovereign debt disputes.[51]

See Foreign Sovereign Immunities Act, 28 U.S.C. §§ 1330, 1602–1611 (1976) (codified as amended in scattered sections of 28 U.S.C.). Two years later, the United Kingdom passed similar legislation. *See* State Immunity Act, 1978, c. 33, §§ 1–23 (Eng.).

[42] *See infra* note 49 and accompanying text.

[43] *See infra* note 49 and accompanying text.

[44] *See infra* notes 52–53 and accompanying text.

[45] *See* Elliott Assocs., L.P. v. Banco de la Nacila, 194 F.3d 363 (2d Cir. 1999); Elliott Assocs., L.P. v. Banco de la Nacila, 194 F.R.D. 116 (S.D.N.Y. 2000); Elliott Assocs., L.P. v. Republic of Peru, 12 F. Supp. 2d 328 (S.D.N.Y. 1998); Elliott Assocs., L.P. v. Republic of Peru, 961 F. Supp. 83 (S.D.N.Y. 1997); Elliott Assocs. L.P. v. Republic of Peru, 948 F. Supp. 1203 (S.D.N.Y. 1996). *See generally* William W. Bratton, Pari Passu *and a Distressed Sovereign's Rational Choices*, 53 EMORY L.J. 823 (2004); 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) (discussing the *Elliott Assocs*. decisions).

[46] *See* Allied Bank Int'l v. Banco Crédito Agricola de Cartago, 566 F. Supp. 1440 (S.D.N.Y. 1983), *aff'd*, No. 83-7714, slip op. (2d Cir. Apr. 23, 1984) (per curiam), *rev'd*, 757 F.2d 516 (2d Cir. 1985). For an in-depth discussion of the comity defense in sovereign debt litigation, see Stephen Bainbridge, *Comity and Sovereign Debt Litigation: A Bankruptcy Analogy*, 10 MD. J. INT'L L. & TRADE 1 (1986).

[47] Republic of Argentina v. Weltover, Inc., 504 U.S. 607, 614–16 (1992) (concluding that issuing bonds is a "commercial activity" similar in nature to a private party's issuance of commercial bonds). For further discussion of the scope of the commercial activity exception under FSIA, see William R. Dorsey, III, *Reflections on the Foreign Sovereign Immunities Act After Twenty Years*, 28 J. MAR. L. & COM. 257, 263–66 (1997).

[48] *See* CIBC Bank & Trust Co. (Cayman) v. Banco Cent. do Brasil, 886 F. Supp. 1105, 1110–11 (S.D.N.Y. 1995).

[49] Champerty is a common law doctrine that precludes recovery when debt is purchased with the sole intent and purpose to litigate on it. Passed in 2004, Judiciary Law 489 eliminated champerty for debts worth more than $500,000. For a discussion of the decline of the champerty defense in sovereign debt litigation, see Blackman & Mukhi, *supra* note 34, at 52.

[50] *See* Olivares-Caminal, *Quest*, *supra* note 25, at 1220; *see also* Schumacher et al., *supra* note 8, at 8 (describing the current environment for sovereign debt litigation as a "hunt for assets").

[51] *See infra* Part II.B.

More recently, holdout creditors have succeeded in suing states for breaches of the *pari passu* clause.[52] A landmark case for the current era of *pari passu* litigation is *Elliott v. Peru*, in which Elliott Associates, L.P. (Elliott Associates) convinced a Belgian appeals court to enforce a sovereign debt judgment with injunctive remedies applicable to third-party financial entities.[53] In doing so, the Belgian court embraced a ratable payment interpretation of *pari passu* advocated in a declaration by Professor Andreas Lowenfeld.[54] This approach to *pari passu* requires a sovereign to pay holdouts *and* exchange bondholders alike. Relying on the ratable interpretation, the court crafted injunctions prohibiting financial institutions from processing payments from Peru to exchange bondholders. In doing so, the Belgian court denied Peru's ability to prioritize payments among creditors—an established privilege of sovereign borrowers for the better part of a century.[55] In effect, this approach forced Peru to decide between defaulting on the exchanged bonds and paying the holdouts. Facing these scenarios, Peru opted to settle with Elliott Associates for $58.4 million, a 400% gain on the purchase value of the defaulted bonds for the hedge fund.[56]

Importantly, the ratable approach in *pari passu* litigation allows holdouts to interfere with a sovereign's cross-border payments to other creditors—namely exchange bondholders who participated in debt restructuring—rather than engaging in the difficult game of attaching the sovereign's assets. Finding a court willing to adopt this radical approach may be challenging, but the ratable interpretation of *pari passu* combined with injunctive relief alleviates the classic attachment problem for collecting against sovereigns. But this approach also has high collateral costs, often at the expense of innocent third parties like exchange creditors and financial institutions.[57] Importantly, this approach weakens creditor

[52] For detailed chronology and critiques of the *pari passu* trend in sovereign debt litigation, see Buchheit & Pam, *supra* note 25, at 877–91. *See also* Olivares-Caminal, *Quest*, *supra* note 25, at 1228–34.

[53] The remedies involved restraining orders against financial parties involved in payment processing from Peru to exchange bondholders Chase Manhattan Bank, Euroclear System, and Depository Trust Company. *See* Cours d'Appel [CA] [Courts of Appeal] Brussels, 8e ch. Sept. 26, 2000, General Docket No. 2000/QR/92 (Belg.). *See generally* Bratton, *supra* note 45; Olivares-Caminal, *supra* note 45.

[54] The ratable payment interpretation of *pari passu* extends equal footing obligations to actual payments, as opposed to rank, and provides grounds for the injunctive relief seen in *Elliott* and *NML*. For an extensive review of *Elliott* and the Lowenfeld Declaration, see Buchheit & Pam, *supra* note 25, at 877–80 (citing Declaration of Professor Andreas F. Lowenfeld Dated August 31, 2000, at 11–12).

[55] *See* BORCHARD, *supra* note 32; *see also* Buchheit & Pam, *supra* note 25, at 898 n.64; Bratton, *supra* note 45, at 844–46 (explaining priority of payment as an established choice for sovereigns).

[56] *See* Olivares-Caminal, *Quest*, *supra* note 28, at 1225 n.60 (citing John Nolan, *Special Policy Report 3: Emerging Market Debt & Vulture Hedge Funds: Free-Ridership, Legal & Market Remedies*, FIN. POLICY FORUM: DERIVATIVES STUDY CTR. (Sept. 29, 2001), http://www.financialpolicy.org/DSCNolan.htm; Gulati & Klee, *supra* note 28).

[57] *See* Joint Response Brief of Plaintiffs-Appellees NML Capital, Ltd. et al. at 39, NML Capital,

incentives to participate in sovereign restructurings. Accordingly, the *Elliott* decision had its share of critics, many of them prominent voices in sovereign debt.[58]

B. Needles in Haystacks: The Hunt for Sovereign Assets

Most of the legal innovation in sovereign debt litigation stems from cases brought by distressed debt hedge funds, also known as "vulture" funds.[59] These funds specialize in acquiring distressed sovereign debt at deep discounts before attempting to recover a profit through more favorable swaps or litigation.[60] Like the role of the vulture in a real ecosystem, vulture funds play a somewhat underappreciated role in financial markets, providing scarce liquidity to bondholders seeking an exit in distressed times.[61] Fairness and ethics aside, vulturing is also a legal activity. In fact, the business of vulturing is fundamentally legal in nature—dependent almost entirely on the judicial enforcement of contractual rights.[62]

But these hedge funds have their share of critics, ranging from United Nations officials and IMF economists to religious charities.[63] Many dismiss

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Ltd. v. Republic of Argentina, No. 12-0105-cv(L) (2d Cir. Jan. 25, 2013); Brief for Non-Party Appellants Exchange Bondholder Group at 2, NML Capital Ltd. v. Republic of Argentina, No. 12-0105-cv(L) (2d Cir. Dec. 28, 2012) (arguing against *NML* injunctions that would infringe on property rights of exchange bondholders); *see also* Brief of the American Bankers Ass'n, *supra* note 20; Brief for Amicus Curiae the Clearing House Ass'n, *supra* note 20.

[58] *See* FMLC STUDY, *supra* note 28, at 11; *see also* Buchheit & Pam, *supra* note 25, at 883–92; W.M.C. Weidemaier, *Sovereign Debt After NML v. Argentina*, 8 CAP. MKTS. L.J. 123, 125 (2013); Gulati & Klee, *supra* note 28, at 650; G. MITU GULATI & ROBERT E. SCOTT, THE 3 1/2 MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN 45−52 , (Univ. of Chicago Press 2012); *See generally* Olivares-Caminal, *Quest*, *supra* note 25; Brief of the American Bankers Ass'n, *supra* note 20; Brief for Amicus Curiae the Clearing House Ass'n, *supra* note 20.

[59] *See* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1049–51 (2004); *see also* Schumacher et al., *supra* note 8, at 7–9.

[60] *See* Robin Wigglesworth, *Vulture Funds Come Under Sovereign Fire*, FIN. TIMES (Apr. 24, 2013, 10:09 AM), http://www.ft.com/intl/cms/s/0/41a633ae-ab3d-11e2-8c63-00144feabdc0.html#axzz2r QrOZWe2.

[61] Journalist Felix Salmon presents both sides of the vulture argument. *Compare* Felix Salmon, *Vulture Funds in Distress*, REUTERS (Feb. 24, 2011), http://blogs.reuters.com/felix-salmon/2011/02/23/vulture-funds-in-distress/, *with* Felix Salmon, *In Defense of Vulture Funds* (Feb. 24, 2011), http://www.felixsalmon.com/2007/02/in-defense-of-vulture-funds/.

[62] *See* Sam Jones, *Singer Banks on the Full Force of Law*, FIN. TIMES (Oct. 5, 2012, 6:00 PM), http://www.ft.com/intl/cms/s/0/aaf5e32c-0ee9-11e2-ba6b-00144feabdc0.html#axzz2r QrOZWe2.

[63] *See* Jonathan Lynn, *U.N. Debt Expert to Focus on Vulture Funds*, REUTERS (Jan. 21, 2010), http://www.reuters.com/article/2010/01/21/idUSLDE60K1S8; *see also* Ashley Seager, *MPs Act to Keep the Vultures at Bay*, GUARDIAN (May 5, 2009), http://www.theguardian.com/business/2009/may/06/vulture-funds. Jubilee USA Network has been a particularly vocal critic of the vulture fund industry. *See* JUBILEE USA NETWORK, VULTURE FUNDS AND POOR COUNTRY DEBT: RECENT DEVELOPMENTS AND POLICY RESPONSES (2008), *available at* http://www.jubileeusa.org/fileadmin/user_upload/Resources/Policy _Archive/408briefnotevulturefunds.pdf.

the industry as an unethical practice that further burdens the poor and undermines debt relief for HIPCs.[64] Indeed, vulture funds are particularly likely to be plaintiffs in legal actions against HIPCs.[65] On average, targets of vulture litigation tend to be middle income and poor countries that have recently undergone serious economic distress.[66] Critics also maintain that vulture funds benefit a small number of elites at the expense of taxpayers in developing countries.[67]

Adding to popular intrigue, the vulture industry is also famously opaque and often staged from offshore tax havens through various limited liability investment vehicles.[68] These tendencies reinforce the perception that these funds prey on taxpayers in developing countries to benefit wealthy tycoons. Two of the most famous and successful vulture funds include Dart Management (founded by Kenneth Dart) and Elliott Management (founded by Paul Elliott Singer).[69] Dart and Singer are prominent faces in the distressed debt industry; both are plaintiffs in *NML* through affiliated entities.[70]

Returns in the distressed debt business can be extremely lucrative.[71] But the business model does not suit just anyone; it requires an appetite for risk and ample cash for expensive legal battles against sovereigns.[72] Though funds may buy sovereign debt for a fraction of face value, the deep discounts usually reflect the likelihood of creditor losses and the significant costs and risks associated with collection. Indeed, full repayment is not the

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[64] *See* Lynn, *infra* note 66.

[65] *See* Schumacher et al., *supra* note 8, at 3 ("'Vulture' funds are also particularly likely to initiate legal disputes against Highly Indebted Poor Countries (HIPC). Of the 20 cases filed against HIPC, 13 were filed by 'vultures.'").

[66] *See id.* at 12.

[67] *See, e.g.*, Greg Palast et al., *UK Urged to Prevent Vulture Funds Preying on the World's Poorest Countries*, GUARDIAN (Nov. 15, 2011, 6:15 PM), http://www.theguardian.com/global-development/2011/nov/15/call-action-vulture-funds-poor.

[68] *Id. See also* Eliana Raszewski, *Billionaire Dart's Argentine Unit Raided by Tax Agents*, BLOOMBERG (May 21, 2013), http://www.bloomberg.com/news/2013-05-21/billionaire-dart-s-argentine-foam-cup-unit-raided-by-tax-agents.html ("Dart gave up his U.S. citizenship in the 1990s to avoid taxes and moved to the Cayman Islands.").

[69] Landon Thomas Jr., *Rejecting Greek Debt Deal Results In a Hefty Payoff for the Holdouts*, N.Y. TIMES, May 16, 2012, § B (Late Edition, Business/Financial Desk), at 3 (stating that the Dart fund's founder is Kenneth Dart, heir to a billion-dollar Styrofoam cup business and a U.S. tax exile who lives in the Cayman Islands); *see also* Jones, *supra* note 62 (profiling Paul Elliott Singer and the success of Elliott Management).

[70] Drew Benson, *Bond Vigilantes' Ghana Ambush Proves Default Hex Unbroken*, BLOOMBERG BUSINESSWEEK (Oct 4, 2012), http://www.businessweek.com/news/2012-10-04/bond-vigilantes-ghana-trap-shows-default-hex-argentina-credit.

[71] *A Victory by Default?*, ECONOMIST (Mar. 3, 2005), http://www.economist.com/ node/3715779 ("According to Manmohan Singh, an economist at the [IMF], the annualized returns from successful litigation can be more than 300%").

[72] *See* Wigglesworth, *supra* note 60.

norm. If litigation or collection efforts fail, a distressed debt investor may end up taking a total loss.

Collecting sovereign assets is notoriously difficult.[73] Although most attachment efforts prove fruitless, they often make headlines—as with the attempted seizures of Argentine assets around the world.[74] In October 2012, Elliott Associates persuaded Ghanaian authorities to seize the *Libertad*, a classic three-masted sailing frigate used for naval training and goodwill missions.[75] After some dramatic moments and a drawn-out legal battle, the U.N. Tribunal for the Law of the Sea ordered that the *Libertad* be released.[76] Meanwhile, Argentina's presidential plane, the Tango 01, remained conspicuously grounded following the debacle in Ghana.[77] Other asset skirmishes involved efforts to attach $105 million in reserves held by the Central Bank of Argentina.[78] On another occasion, the office of a representative of the province of Buenos Aires in New York was targeted. Even dinosaur fossils on exhibition in Europe were targets for attachment.[79] Though none of these attempts successfully yielded valuable assets, they were all costly and embarrassing for Argentina. The financial impact of asset battles can easily run into the millions.[80] More difficult to quantify but also painful, these skirmishes also involve reputational damage and interference with international commerce and other cross-border

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[73] *See* Gelpern, *Contract Hope*, *supra* note 31; *see also* Bratton, *supra* note 45, at 824 ("Sovereigns in default rarely leave valuables lying around subject to attachment in creditor-friendly jurisdictions.").

[74] *See* Benson, *supra* note 70; *see also Gauchos and Gadflies*, ECONOMIST (Oct. 22, 2011), http://www.economist.com/node/21533453.

[75] *See* Chris Barrett, *Frigate Libertad: Vulture Funds and Cabin Fever in West Africa*, ARGENTINA INDEP. (Nov. 14, 2012), http://www.argentinaindependent.com/currentaffairs/ frigate-libertad-vulture-funds-and-cabin-fever-in-west-africa/.

[76] *See Ghana Told to Free Argentine Ship Libertad by UN Court*, BBC (Dec. 15, 2012), http://www.bbc.co.uk/news/world-latin-america-20743016.

[77] *See* Linette Lopez, *Hedge Funder Paul Singer Went Ballistic on Argentina In His Q4 Investor Letter*, BUS. INSIDER (Jan. 30, 2013, 1:13 PM), http://www.businessinsider.com/ elliott-management-q4-investor-letter-2013-1.

[78] *See U.S. Supreme Court Rules in Favour of Argentina and Unfreezes Funds*, MERCOPRESS (June 26, 2012, 6:25 AM), http://en.mercopress.com/2012/06/26/us-supreme-court-rules-in-favour-of-argentina-and-unfreezes-funds (describing how the U.S. Supreme Court denied the request for attachment of the Central Bank of Argentina reserves in October 2007).

[79] *See* Michael Hiltzik, *Argentina is Cautionary Tale as U.S. Debates Debt Limit*, L.A. TIMES (Jan. 15, 2013), http://articles.latimes.com/2013/jan/15/business/la-fi-hiltzik-201 30116.

[80] A prominent Argentine newspaper, *La Nación*, estimated that the seizure of the Libertad in Ghana cost the Argentine government around $5 million. *See* Mariano De Vedia, *Enviar Marinos Para Traer la Fragata Costó $5 Millones*, LA NACIÓN (Dec. 26, 2012), http://www.lanacion.com.ar/1540147-enviar-marinos-para-traer-la-fragata-costo-5-millones. The incident cost Ghana several million as well. *See ARA Libertad: Ghana Port Authority Lost 7.6m Dollars; Could Demand NML Capital*, MERCOPRESS (Dec. 20, 2012, 6:00 PM), http://en.mercopress.com/2012/12/20/ara-libertad-ghana-port-authority-lost-7.6m-dollars-could-demand-nml-capital.

activities.[81] Partially or wholly state-owned enterprises may also be targeted in the hunt for assets.[82]

C. Sovereign Debt and Restructuring

For decades, scholars and multilateral institutions alike have explored possibilities for quasi-bankruptcy or debt restructuring regimes for sovereigns.[83] Yet, no such system exists. In the absence of a formal insolvency regime, sovereign debt defaults typically lead to voluntary negotiated restructurings and reissuances of new debt.[84] Existing debt obligations are exchanged for new debt obligations through negotiated restructuring. Though imperfect, restructuring practices have balanced the interests of creditors and sovereign debtors for generations.[85] In most cases, the vast majority of creditors participate in the debt exchanges because the burden of a financial crisis is shared between the debtor and its creditors.[86] "Holdout" creditors are those who decide not to participate in a debt exchange whereas "exchange" creditors do. Institutional lenders, such as large banks, prefer participation and collaborative restructuring to holding out. Though hedge funds are usually the most visible and significant holdouts, sometimes retail investors or pensioners holdout as well.

In exchange for granting debt relief to allow a distressed sovereign the chance to restore fiscal stability, creditors agree to take a loss—the so-called "haircut"—and receive newly issued debt.[87] Surprisingly, given the

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[81] *See* Panizza et al., *supra* note 27, at 659–64.

[82] *See* Pablo Gonzalez, *YPF Slumps as NML's Singer Seeks Argentine Asset Information*, BLOOMBERG (Jun. 19, 2014), http://www.bloomberg.com/news/2014-06-19/ypf-slumps-as-nml-s-singer-seeks-argentine-asset-information.html.

[83] For examples of early sovereign insolvency proposals, see generally UNCTAD, TRADE AND DEVELOPMENT REPORT (1986). *See also* Bratton, *supra* note 45; Anna Gelpern, *A Skeptic's Case for Sovereign Bankruptcy*, 50 HOUS. L. REV. 1095 (2013) [hereinafter Gelpern, *Bankruptcy*]; Anna Gelpern, *Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt*, 121 YALE L.J. 888 (2012) [hereinafter Gelpern, *Quasi-Sovereign*]; Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299 (2005); IMF, SOVEREIGN DEBT RESTRUCTURING, *infra* note 227; Kenneth Rogoff & Jeromin Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976–2001*, 49 IMF STAFF PAPERS 470 (2002) .

[84] *See* Blackman & Mukhi, *supra* note 34, at 48 (describing the voluntary nature of sovereign debt restructuring and contrasting the practice with the bankruptcy process); *see also* Anna Gelpern, *Building a Better Seating Chart for Sovereign Restructurings*, 53 EMORY L.J. 1115 (2004) [hereinafter Gelpern, *Building*].

[85] *See* Weidemaier, *supra* note 58, at 127.

[86] Between 1997 and 2013, the average participation rate in sovereign debt defaults was 95%. During that period, only Argentina and Dominica had participation rates under 90%. *See* ELENA DUGGAR, MOODY'S, NEW EVIDENCE ON THE ROLE OF HOLDOUT CREDITORS IN SOVEREIGN DEBT RESTRUCTURINGS 9 (2013).

[87] *See* Bratton, *supra* note 45, at 828.

unenforceability of sovereign debt and voluntary nature of sovereign restructuring, creditor haircuts in sovereign debt restructurings (30%, weighted for volume) tend to be significantly lower than haircuts in corporate bond and loan restructurings in United States (64%).[88] But without an insolvency regime, sovereigns do not enjoy benefits of debtor-friendly provisions found, for example, in U.S. bankruptcy law. Detroit, for instance, has relied upon the threat of "cram downs" and bankruptcy protections to convince creditors and pensioners to take haircuts.[89] Theoretical models predict that when haircuts are deemed excessive relative to the sovereign's ability to pay, an exchange offer is more likely to fail.[90] Likewise, deep haircuts are more likely to spawn litigation.[91]

Although sovereign creditors lack leverage enjoyed by creditors in other areas of the law, sovereign borrowers and their creditors have resolved disputes through restructuring for generations.[92] Despite limited enforcement mechanisms, sovereigns have compelling reasons to pay debts. Traditionally, sovereign motivation was explained by diplomacy, access to markets, sanctions, and reputational factors.[93] More recent accounts have addressed domestic costs of default as an explanation for sovereign motivation, including the political consequences of debt default.[94]

III. *NML*: SOVEREIGN DEBT OUTLIER

The Second Circuit recognized Argentina's situation as an "exceptional" on unlikely to be seen again in the future.[95] The Second Circuit arrived at this conclusion in light of Argentina's track record as a "recalcitrant" debtor with "a long history of defaulting on its debts," while describing Argentina's behavior as "extraordinary."[96] Although the Second

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[88] *See* Juan J. Cruces & Christoph Trebesch, *Sovereign Defaults: The Price of Haircuts* 10–11 (CESifo, Working Paper No. 3604, 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1943411 (citing MOODY'S, DEFAULT AND RECOVERY RATES OF CORPORATE BOND ISSUERS, 1920–2005 (2006)).

[89] *See* Marcelo Etchebarne, *Guest post: Argentina and Detroit – Different (Zip) Codes*, FIN. TIMES (Mar. 4, 2014), http://blogs.ft.com/beyond-brics/2014/03/04/guest-post-argentina-and-detroit-different-zip-codes/# (underscoring creditor-friendly bankruptcy provisions that are unavailable to sovereigns).

[90] *See* Ran Bi et al., *The Problem That Wasn't: Coordination Failures in Sovereign Debt Restructurings* (IMF, Working Paper No. WP/11/265, 2011).

[91] *See* Schumacher et al., *supra* note 8, at 22.

[92] *See* Weidemaier, *supra* note 58, at 127.

[93] *See* Panizza et al., *supra* note 27, at 659–64 (reviewing literature exploring questions of why sovereigns pay their creditors); *see also* BORCHARD, *supra* note 32, at 122.

[94] *See* Eduardo Borensztein & Ugo Panizza, *The Costs of Sovereign Default*, 56 IMF STAFF PAPERS 683, 688–90 (2009).

[95] NML Capital, Ltd. v. Republic of Argentina, 727 F.3d 230, *appeal docketed*, No. 12-105(L) at 23 (2d Cir. Aug. 23, 2013).

[96] *Id.*

Circuit correctly identified this aspect of the *NML* situation as extraordinary, Argentina's exceptionalism extends to virtually all phases of sovereign debt: lending, default, restructuring, and litigation. Ultimately, *NML* is readily distinguishable from other sovereign debt situations.[97]

This part illustrates that *NML*'s facts make it an outlier by wide margins. First, this part explains Argentina's exceptional sovereign debt history. Second, Argentina's default was the largest and most complex in world history.[98] Third, the circumstances leading up to the 2001 crisis were also exceptional, casting doubt about the legitimacy of Argentina's foreign debt—particularly within Argentina's political system—from the outset of the default.[99] Fourth, Argentina's "uniquely unilateral and coercive" approach to restructuring was unparalleled, setting the stage for a similarly unprecedented flood of sovereign debt litigation.[100] Finally, during the litigation stage, the Argentine situation has again defied historic trends in sovereign debt.[101]

A. Argentina's Unique Sovereign Debt History

The Argentine government has been labeled—fairly or unfairly—as a "rogue debtor" and a "serial defaulter."[102] Putting it slightly more delicately, the Second Circuit opted for the label of "recalcitrant debtor."[103] As explained in this part, these labels are nothing new for Argentina. Almost a decade prior to the 2001 default, one writer observed, "Argentina emerged as the single most resistant debtor in international finance."[104] Studies have concluded that there may be a self-perpetuating aspect to serial defaults: the less reputational capital a debtor has to lose, the more attractive the default option might become.[105]

Though several countries have defaulted more often, Argentina is often portrayed as an exceptionally rogue debtor.[106] Argentina has nearly a

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[97] *See id.*

[98] *See A Victory by Default?*, *supra* note 71.

[99] *See infra* note 147–150 and accompanying text.

[100] ELENA DUGGAR, MOODY'S, THE ROLE OF HOLDOUT CREDITORS AND CACS IN SOVEREIGN DEBT RESTRUCTURINGS 2 (2013).

[101] *See infra* Part III.E.

[102] *See* Porzecanski, *supra* note 29, at 316–17.

[103] NML Capital, Ltd. v. Republic of Argentina, 727 F.3d 230, 247 (2d Cir. 2013).

[104] ERNEST J. OLIVERI, LATIN AMERICAN DEBT AND THE POLITICS OF INTERNATIONAL FINANCE 164 (1992).

[105] *See, e.g.*, Carmen M. Reinhart et al., *Debt Intolerance* 10 (Nat'l Bureau of Econ. Research, Working Paper No. 9908, 2003).

[106] *See Argentina's Debt Saga: No Movement*, ECONOMIST (Aug. 2, 2014), http://www.economist.com/news/americas/21610296-argentina-has-defaulted-again-deal-its-creditors-not-out-question-no?fsrc=scn%2Ftw_ec%2Fno_movement.

two centuries long history of difficulties with creditors.[107] This history is extensive and painful, a "long-festering wound" in Argentina's side.[108] A museum at the School of Economic Sciences at the University of Buenos Aires has a dedicated exhibit that tells the story from an Argentine perspective.[109] At one point in the 1840s, Argentine *caudillo* Juan Manuel de Rosas offered to pay bondholders with *las Malvinas*, which are commonly known as the Falkland Islands in English.[110] Even the genesis of the Paris Club involved an Argentine debt crisis.[111]

Argentina led Latin America—and the developing world, for that matter—in scholarship on sovereign debt from the perspective of former colonies. Historically, Argentine scholars and diplomats have been at the forefront of theory on the law of sovereign debt, especially concerning rights of newly independent sovereigns.[112] In 1863, Argentine jurist Carlos Calvo published the foundations of the highly influential Calvo Doctrine.[113] As Venezuela was facing a "gunboat diplomacy" style intervention by European powers in 1902, Luis M. Drago, Argentina's Minister of Foreign Affairs, wrote a letter that established the Drago Doctrine.[114] Both doctrines advocate for host government sovereign rights in investment disputes, which were especially important to newly independent nations emerging from colonialism.[115]

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[107] *See* Boris Korby & Karia Porzecanski, *Argentina Bust Lures Investors After 200 Years of Defaults*, BLOOMBERG (Feb. 3, 2014, 1:45 PM), http://www.bloomberg.com/news/2014-02-03/argentina-bust-lures-bass-led-investors-in-200-years-of-defaults.html (characterizing Argentina as a "deadbeat country with few peers in history").

[108] Jude Webber, *Debt – Argentina's Long-Festering Wound*, FIN. TIMES (Nov. 28, 2012, 3:31 AM), www.ft.com/intl/cms/s/0/1521e81c-3894-11e2-bd7d-00144feabdc0.html.

[109] MUSEO DE LA DEUDA EXTERNA, http://www.museodeladeuda.com.ar/ (last visited Feb. 12, 2014).

[110] *See* Emilio Ocampo, *El Día que Rosas Quiso Pagar a los Bonistas con las Malvinas*, LA NACIÓN (Jan. 9, 2013), http://www.lanacion.com.ar/1544122-el-dia-que-rosas-quiso-pagar-a-los-bonistas-con-las-malvinas.

[111] According to the official website of the Paris Club: "The Paris Club is an informal group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries." The Paris Club has nineteen permanent member countries. The IMF and the World Bank participate in debt negotiations as observers. *See* CLUB DE PARIS, http://www.clubdeparis.org/en/ (last visited Feb. 7, 2014).

[112] *See* EM Ltd. v. Republic of Argentina, 473 F.3d 463, 466 n.2 (2d Cir. 2007).

[113] The Calvo Doctrine condemned armed and diplomatic interventions for investment disputes. *See* Amos Hershey, *The Calvo and Drago Doctrines*, 1 AM. J. INT'L L. 26, 26–27 (1907).

[114] *Id.* at 30 ("[T]he public debt [of an American state] can not occasion armed intervention, nor even the actual occupation of the territory of American nations by a European power." (quoting Letter from Luis M. Drago, Argentine Minister of Foreign Affairs, to Sr. Merou, Argentine Minister at Washington (Dec. 29, 1902))).

[115] *See* Hershey, *supra* note 113; *see also* Amitav Acharya, *Ideas, Norms and Regional Orders*, *in* INTERNATIONAL RELATIONS THEORY AND REGIONAL TRANSFORMATION 183 (T.V. Paul ed., Cambridge University Press 2012) *available at* http://www.amitavacharya.com/sites/default/files/

B. Argentina's Crisis of 2001–2002: "The Worst of All"

During 2001–2002, Argentina suffered an economic crisis of epic proportions following a broader wave of emerging market crises that swept through East Asia and Russia.[116] The collapse was comprehensive and tragically spectacular—one of the worst currency crises of the modern era. Argentina's crisis involved the deepest drop in gross domestic product (GDP) suffered during peaceful times by any capitalist country with a significant economy since at least World War II.[117] Real per capita GDP fell backwards by three decades.[118] The Argentine *peso* declined 75% versus the U.S. dollar in a matter of months.[119] Meanwhile, Argentina's public debt ballooned from 45.7% of GDP in 2000 to 166.3% in 2002.[120]

Argentina formally defaulted on bonds worth $81.2 billion in December of 2001.[121] The dimensions of this default were staggering. As illustrated in Figure 1 below, Argentina's default remains by far the largest sovereign debt default in history, dwarfing prior defaults by Russia ($30 billion), Ecuador ($6 billion), and Uruguay ($5 billion).[122] The Argentine default was also the most complex ever seen. Over half a million creditors scattered around the world held 152 varieties of defaulted debt instruments, which were denominated in six currencies under the laws of eight different jurisdictions.[123]

Ideas%20norms%20and%20regional%20orders.pdf (discussing the role played by the Calvo and Drago doctrines in the adoption of the principle of non-intervention in Latin America).

[116] Due in large part to a steep climb in interest rates, debt rollover costs spiked in the wake of the crises in East Asia and Russia. The rising cost of financing exacerbated Argentina's already unsustainable debt load. *See* Mario Damill et al., *Las Cuentas Públicas y la Crisis de la Convertibilidad en la Argentina*, 43 DESARROLLO ECONÓMICO 203 (2003).

[117] Lucas Llach, *A Depression in Perspective: The Economic and the Political Economy of Argentina's Crisis of the Millenium*, *in* THE ARGENTINE CRISIS AT THE TURN OF THE MILLENIUM 40 (Flavia Fiourcci & Marcus Klein eds., 2004).

[118] *See* J.F. HORNBECK, CONG. RESEARCH SERV., RL32637, ARGENTINA'S SOVEREIGN DEBT RESTRUCTURING 5 (2004).

[119] *See* PAUL BLUSTEIN, AND THE MONEY KEPT ROLLING IN (AND OUT) 2 (2006).

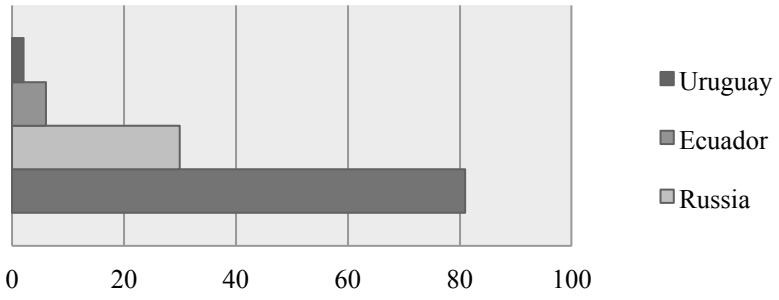
[120] *See* HORNBECK, *supra* note 13, at 3.

[121] *See A Victory by Default?*, *supra* note 71, at 1.

[122] *See* ELENA DUGGAR, MOODY'S, SOVEREIGN DEFAULT AND RECOVERY RATES, 1983-2007 7–8 (2008), *available at* https://www.moodys.com/sites/products/DefaultResearch/2007100000482445.pdf. Greece's debt exchange in 2012 became the largest sovereign restructuring in history but did not involve a technical default. *See* Landon Thomas Jr., *Next Time, Greece May Need New Tactics*, N.Y. TIMES (Mar. 9, 2012), http://www.nytimes.com/ 2012/03/10/business/global/greece-debt-restructuring-deal-private-lenders.html?pagewanted =all&_r=0.

[123] *See A Victory by Default?*, *supra* note 71, at 1.

Figure 1: Largest Sovereign Debt Defaults



Billions (USD)
Source: Moody's (2013)

As the economy crashed, so did the nation's government and banking systems.[124] Political upheaval ensued as looting, protests, and even rioting took hold of urban centers.[125] At one point, Argentina technically had five presidents in the course of two weeks.[126] For Argentines, who are rather accustomed to enduring crises, this was *la peor de todas*, the worst of all.[127] Social costs were tragic. Argentina, a country with a history of relative prosperity and an established middle class, saw over half of its population fall below the poverty line.[128] Post crisis, approximately 25% of Argentina lived in extreme poverty compared to just 4% in 1992.[129] Unemployment exceeded 20%.[130] Malnutrition became a serious problem in a country renowned for fine beef and abundant grains.[131] Living standards dropped

[124] *See* Clifford Krauss, *Reeling from Riots, Argentina Declares a State of Siege*, N.Y. TIMES (Dec. 20, 2001), http://www.nytimes.com/2001/12/20/world/reeling-from-riots-argentina-declares-a-state-of-siege.html.

[125] *Id.*; *see also* BLUSTEIN, *supra* note 119, at 184–87, 190–96 (explaining the political, social, and economic chaos that arrived with the 2001 crisis).

[126] *See New Man Takes Helm in Argentina*, BBC AMERICAS (Jan. 2, 2002, 7:12 AM), http://news.bbc.co.uk/2/hi/americas/1737562.stm.

[127] *See* Jorge Oviedo, *Crisis, la Peor de Todas*, LA NACIÓN (July 14, 2002), http://www.lanacion.com.ar/413669-crisis-la-peor-de-todas.

[128] *See* LEONARDO GASPARINI, CEDLAS-THE WORLD BANK, POVERTY AND INEQUALITY IN ARGENTINA: METHODOLOGICAL ISSUES AND A LITERATURE REVIEW 35 (2004), *available at* http://www.depeco.econo.unlp.edu.ar/cedlas/monitoreo/pdfs/review_argentina.pdf.

[129] *Id.*

[130] *See* SHINJI TAKAGI, INDEPENDENT EVALUATION OFFICE, IMF, THE IMF AND ARGENTINA 1991-2001 8 (2004), *available at* http://www.imf.org/external/np/ieo/2004/ arg/eng/pdf/report.pdf.

[131] *See* Larry Rohter, *Once Secure, Argentines Now Lack Food and Hope*, N.Y. TIMES (Mar. 2, 2003), http://www.nytimes.com/2003/03/02/world/once-secure-argentines-now-lack-food-and-hope.html?page wanted=all&src=pm; *see also* Hannah Baldock, *Child Hunger Deaths Shock Argentina*, GUARDIAN (Nov. 24, 2002), http://www.theguardian.com/world/ 2002/nov/25/famine.argentina.

dramatically and Argentines watched their wealth evaporate in the wake of deep currency devaluations and capital flight.

C. Exceptional Circumstances: The Other Crisis (of Legitimacy)

The history behind *NML* raises poignant legitimacy questions and helps explain the politics of Argentina's behavior towards creditors. Just years before the largest sovereign default in world history, Argentina had been the emerging market darling of the international financial community.[132] Under President Carlos Saúl Menem in the 1990s, Argentina adhered to the "Washington Consensus," removing trade barriers, deregulating the economy, welcoming foreign investment, and privatizing key industries.[133] During this time, Argentina was continuously engaged with the IMF through policy advice and five successive financing arrangements.[134] Argentina was widely considered a "star pupil" of the IMF.[135] In 1998, President Menem was invited to address the IMF at its annual meeting to discuss the "absolute economic miracle" Argentina had undergone during his administration.[136]

On one hand, there is little doubt that Argentina was the victim of self-inflicted damage. The government overborrowed while failing to practice the fiscal discipline required by a strict currency regime and its own economic policies.[137] Ultimately, responsibility for the failed policies of the 1990s belongs to the Argentine government.[138] On the other hand, Argentina was not alone in setting the stage for the largest sovereign debt default in history.[139] Wall Street, the IMF, and even the broader

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[132] *See* Todd Jatras, *Cavallo To Argentina's Rescue*, FORBES (Mar. 22, 2001, 6:00 AM), http://www.forbes.com/2001/03/22/0322argentina.html (characterizing Argentina's economy minister, Domingo Cavallo, as a "Wall Street darling"); *see also* Ken Parks, Taos Turner & John Lyons, *Argentina Reels: A Populist Formula Goes Flat*, WALL ST. J., Jan. 24, 2014, at A1 (describing Argentina's "long decline from a darling of global capitalism to economic pariah").

[133] *See* BLUSTEIN, *supra* note 119, at 4.

[134] *See* TAKAGI, *supra* note 130, at 9, 77.

[135] *See* Hector Tobar, *The Good Life Is No More for Argentina*, L.A. TIMES (Feb. 18, 2003), http://articles.latimes.com/2003/feb/18/world/fg-argecon18.

[136] CARLOS SARL MENEM, PRESIDENT, REPUBLIC OF ARGENTINA, STATEMENT TO THE 1998 JOINT ANNUAL MEETINGS (Oct. 6, 1998), *available at* http://www.imf.org/external/am/1998/speeches/pr05e.pdf.

[137] Enacted under the Menem Administration in 1991 and intended to curb the kind of hyperinflation spikes that toppled the Alfonsín Administration, Argentina's "convertibility" plan pegged the Argentine peso to the U.S. dollar. However, coupled with unsustainable debt and public spending, the rigid plan eventually set the stage for the 2001 default. *See* TAKAGI, *supra* note 130, at 3 (2004).

[138] *See* BLUSTEIN, *supra* note 119, at 199 (critiquing the "popular myth" that the IMF was dictating Argentina's economic policy throughout the 1990s.).

[139] *See* Todd Benson, *Report Looks Harshly at I.M.F.'s Role in Argentine Debt Crisis*, N.Y. TIMES (July 30, 2004), http://www.nytimes.com/2004/07/30/business/report-looks-harshly-at-imf-s-role-in-

international finance community compounded Argentina's crisis significantly.[140]

After the crisis, the IMF published a self-critical evaluation of its role in Argentina's crisis.[141] An independent report by the Independent Evaluation Office of the IMF was even more critical of the IMF's role in Argentina's debt situation.[142] As noted by the *Economist* in 2005, "Argentina defaulted so heavily because it defaulted so late."[143] If anything, Argentina may have been too reluctant to default on its obligations, racking up billions more in debt when default was already an inevitable conclusion.[144] Two loans extended in 2001, for instance, only exacerbated the existing debt burden.[145]

The causal inquiry into Argentina's crash is a well-documented and vigorously debated topic.[146] Analyzing the economic meltdown is beyond the scope of this Article, but the backlash within Argentina against the IMF and the international financial community is particularly relevant here. Combined with rising poverty and high unemployment, this perception of great injustice—however accurate—brought the legitimacy of Argentina's international obligations and external debt into doubt from the outset of the crash.[147] As part of the exceptional nature of Argentina's sovereign debt situation, this reaction shaped the behavior of Argentina's leaders during the restructuring process and continues to influence policy towards holdout creditors.[148] Vulture funds are widely despised in Argentina; settling with

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argentine-debt-crisis.html?pagewanted=print&src=pm.

[140] *Id.*; *see also Argentina: Writing of the Wreckage*, ECONOMIST (Mar. 3, 2005), http://www.economist.com/node/3714880 ("Wall Street investment banks raked in fees for issuing yet more Argentine bonds even as some of their analysts were privately gloomy about the country."); *see also* BLUSTEIN, *supra* note 119, at 199–200.

[141] *See* POLICY DEV. & REVIEW DEP'T, IMF, LESSONS FROM THE CRISIS IN ARGENTINA 63–67 (2003), *available at* https://www.imf.org/external/np/pdr/lessons/100803.pdf.

[142] *See* TAKAGI, *supra* note 130.

[143] *A Victory by Default?*, *supra* note 71.

[144] *Id.*

[145] *See Argentina: Writing of the Wreckage*, *supra* note 140.

[146] For a thorough review of the literature, see IMF, LESSONS FROM THE CRISIS IN ARGENTINA, *supra* note 141, at 5.

[147] The IMF's contributing role in exacerbating Argentina's debt load impacted the perceived legitimacy of foreign debt. *See* BLUSTEIN, *supra* note 119; *see also* Cephas Lumina, United Nations Independent Expert, End of Mission Statement (Nov. 29, 2013), *available at* http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=14040&LangID=E (noting questions about legitimacy of debt acquired prior to the 2001 default); Larry Rohter, *Argentine Leader Slashes Debt and Tightens Grip*, N.Y. TIMES (Jan. 3, 2006), http://www.nytimes.com/ 2006/01/03/world/ americas/03iht-buenos.html?pagewanted=all&_r=0.

[148] *See Argentina's Kirchner Boosts Approval on IMF Clashes (Update 1)*, BLOOMBERG (Jan. 6, 2004), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=afHs6w HOB6JI; *see also* BLUSTEIN, *supra* note 119, at 206–07; Patrice M. Jones, *President Buoys Argentina*, CHI. TRIB. (Nov. 27, 2003), http://articles.chicagotribune.com/ 2003-11-27/news/0311270371_1_president-nestor-

them is a politically charged issue with practical and moral implications.[149] Argentina entered into default following the *NML* ruling instead of settling with the holdouts, although this decision may have had more to do with potential liabilities stemming from the so-called RUFO clause than with distaste for the vultures.[150]

D. An Unparalleled Debt Restructuring

Restructuring negotiations following Argentina's default were easily among the most adversarial restructuring negotiations ever. The Argentine restructuring defied established guidelines of sovereign debt negotiation and was widely considered "unique in its unilateral and coercive approach to the debt restructuring."[151] President Néstor Kirchner took a hard line, insisting that creditors take a sizeable haircut in line with Argentina's devastating losses.[152] The IMF, usually a key participant in sovereign debt restructuring negotiations, was much less involved due to controversy surrounding the Fund's role leading up to Argentina's economic crisis.

In January 2005, after years of bitter negotiations, Argentina opened a bond exchange (the 2005 Exchange) hoping to reach a final settlement on as many of the defaulted bonds as possible—roughly $104.1 billion in principal ($81.2 billion) and past due interest ($22.9 billion).[153] At that time, the $104.1 billion in defaulted bonds only represented about 53% of Argentina's total of $194.6 billion in unsustainable public debt.[154] As a consequence, bondholders shouldered a disproportionate burden in Argentina's attempt to achieve a sustainable level of debt through restructuring.[155]

Like the crisis and the default, the 2005 Exchange was exceptional across the board: the amount in default ($104.1 billion), the lengthy duration of the restructuring process (over three years), the deep creditor haircut (roughly 76%), and the low participation rate (only 72% of bondholders).[156] In an average restructuring, negotiations last seven months and participation exceeds 95%. Representing par value of $62.3 billion,

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kirchner-president-carlos-menem-amnesty-laws.

[149] *See* John Paul Rathbone et al., *Argentina in default as contest with holdouts enters endgame*, FIN. TIMES (June 29, 2014, 1:35 PM), http://www.ft.com/intl/cms/s/0/15c4c27e-fded-11e3-acf8-00144feab7de.html.

[150] *Argentina's Endless Debt Dilemma*, FIN. TIMES (Jul. 31, 2014, 6:39 PM), http://www.ft.com/intl/cms/s/0/561bb58c-18a8-11e4-a51a-00144feabdc0.html.

[151] DUGGAR, *supra* note 100.

[152] *See* HORNBECK, *supra* note 121, at 6–11.

[153] *Id.* at 3.

[154] *Id*.

[155] *Id.*

[156] *See* DUGGAR, *supra* note 100.

creditors received roughly 35 cents on the dollar in the 2005 Exchange.[157] Comparisons with average indicators in other sovereign debt exchanges indicate the truly exceptional nature of Argentina's restructuring, as illustrated in Figures 2–4 below.

Figure 2: Participation (%)

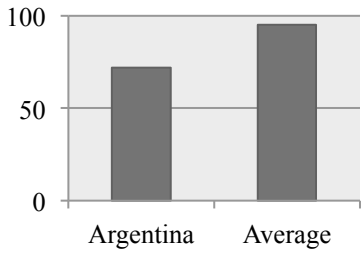
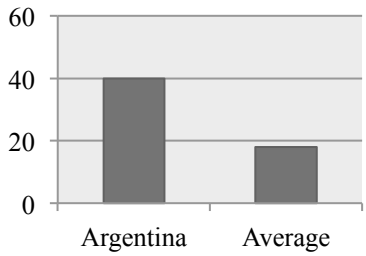
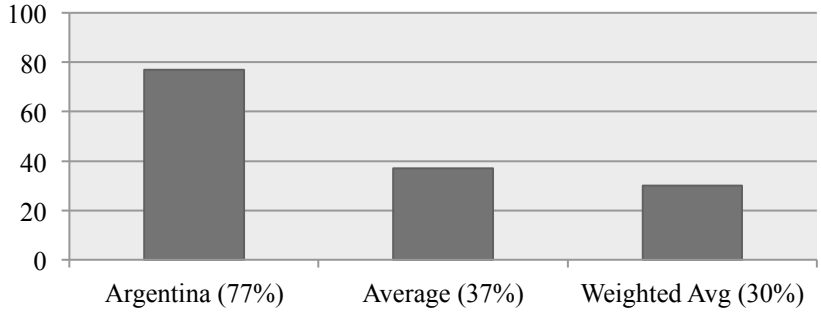


Figure 3: Duration (months)



Source for Figures 2–3: Moody's Investors Service (2013)

Figure 4: Creditor Haircut (%)



Source for Figure 4: Cruces and Trebesch (2011)

At 72%, the participation rate of the 2005 Exchange fell far below the mean (Figure 2).[158] Between 1997 and 2013, the average participation rate in sovereign debt exchanges was 95%.[159] All but two restructurings—Argentina and Dominica—had participation rates over 90%.[160] Through subsequent negotiations, Argentina achieved almost 93% participation and

[157] *A Victory By Default?*, *supra* note 71.
[158] *See* DUGGAR, *supra* note 100.
[159] *Id.*
[160] *Id.*

Dominica achieved almost 100%.[161] But in Argentina's case, achieving even this modest level of participation took the better part of a decade.

According to one model, deeper haircuts decrease creditor participation and increase the likelihood of holdouts and litigation.[162] As illustrated in Figure 4 above, in a sample of 180 restructurings from 1970 to 2010, the haircut imposed on Argentina's creditors (roughly 77% in the 2005 Exchange) comes in far above average.[163] The average haircut during that period was 37% or just 30% in a volume weighted average.[164] Again, Argentina's sovereign debt situation is a quantitative outlier that defies modern restructuring trends.[165] Even the tone of the negotiations were exceptionally bitter, described as "unusually contentious"[166] and "unique[ly] . . . unilateral and coercive"[167] by prominent observers.

However, the haircut story has a second chapter. Though the nominal haircut during the 2005 Exchange was unusually deep, Argentina's bond issuances in the 2005 and 2010 Exchanges included warranty payments linked to the country's future GDP growth. The GDP warrants provide that bondholders receive payments when Argentina's GDP growth exceeds predefined annual benchmarks.[168] In this way, the GDP-linked bonds resembled equity shares in Argentina's economy, which fared remarkably well in years following the 2005 Exchange in large part due to robust international demand for commodities like soy and grain as well as automobile exports to Brazil.[169]

Holders of GDP-linked warrants saw dramatic gains in years following the debt restructurings. As a result, Argentina's haircut turned out to be fairly close to average for a sovereign restructuring: returns on the GDP-linked warrants reduced Argentina's haircut from roughly 77% to less than

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[161] *Id.*

[162] *See* Bi et al., *supra* note 90, at 4.

[163] Cruces & Trebesch, *supra* note 88, at 10–11.

[164] *Id.*

[165] *See* Bi et al., *supra* note 90, at 19 (characterizing Argentina's restructuring as the "one major exception" to modern sovereign debt restructuring trends).

[166] Anna Gelpern, *What Bond Markets Can Learn From Argentina*, 24 INT'L FIN. L. REV. 19, 19 (April 2005) ("It is hard to find a public or private sector participant who did not care or one who did not feel deeply wronged.").

[167] DUGGAR, *supra* note 100.

[168] *See* REPUBLIC OF ARGENTINA, PROSPECTUS SUPPLEMENT (TO PROSPECTUS DATED DEC. 27, 2004) S-64–66 (2005), *available at* http://www.sec.gov/Archives/edgar/ data/914021/ 0000950123 05000302/y04567e424b5.htm [hereinafter PROSPECTUS SUPPLEMENT].

[169] *See* Miguel Kiguel, *Argentina's Debt: The Good, the Bad and the Ugly*, *in* THINK TANK 20: THE G-20 AND CENTRAL BANKS IN THE NEW WORLD OF UNCONVENTIONAL MONETARY POLICY 6 (2013) (indicating that GDP-linked bonds have reduced Argentina's haircut to less than 40%), *available at* http://www.brookings.edu/~/media/Research/Files/Reports/2013/08/g20%20central%20banks%20monetary%20policy/TT20%20central%20banks%20monetary%20policy%202.pdf.

40%.[170] Because the GDP warrants were given almost no value at the time of the exchange negotiations, this gain for investors has been Argentina's loss. Between 2006 and 2013, the warrants have returned 43% a year.[171] Payment caps on the GDP warrants limit the total amount that can be paid to 48 cents on the dollar, which still allows for further reduction in the true restructuring haircut. To date, Argentina has paid almost $10 billion under the GDP warrants.[172]

Considering the scale and exceptional nature of Argentina's default, it may not be surprising that the duration of Argentina's restructuring negotiations was far longer than average as well. Forty months elapsed before the 2005 Exchange—more than double the eighteen-month average for a restructuring negotiation (Figure 3).[173] Even more impressive, this comparison does not consider time elapsed between the 2001 default and the 2010 Exchange, which accounted for about 15% of the total bonds exchanged.

Also outside the norm were the extent and formality of Argentina's measures to prohibit payments to holdout bondholders. While prioritization of payments—or even nonpayments—is fairly common in sovereign debt, measures like Argentina's are rare. Leading up to the 2005 Exchange, Argentina insisted that holdouts would remain excluded from future payments on the defaulted bonds.[174] These intentions were formally acknowledged in the "rights upon future offers" (RUFO) clause of Argentina's restructuring prospectus, which assured exchange bondholders that subsequent exchange offers would not contain superior terms to the 2005 Exchange.[175] Government officials reinforced this position vowing never to pay holdouts. But Argentina went further in passing Law 26017 known as *la ley cerrojo* (the Padlock Law), which prohibited the Argentine executive from reopening an exchange offer with holdout creditors: "Article 2 – The national Executive Branch may not, with respect to the [holdout bounds], reopen the swap process established in the [2005

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[170] *See* STEPHANY GRIFFITH-JONES & DAGMAR HERTOVA, CESIFO DICE REPORT, GROWTH-LINKED BONDS (2013), *available at* http://policydialogue.org/files/publications/CESifo_DICE-Report_3-2013_Griffith-JonesHertova_Final_draft.pdf; *see also* Drew Benson & Boris Korby, *Argentina's 'Scorching' Growth Helps GDP Warrants Trump Bonds on 28% Surge*, BLOOMBERG (Aug. 10, 2010, 5:00 PM), http://www.bloomberg.com/news/2010-08-10/argentina-s-scorching-growth-helps-gdp-warrants-trump-bonds-on-28-surge.html; Hilary Burke, *Buy or Sell - Argentine GDP Warrants Still Have Room to Grow?*, REUTERS (Oct. 1, 2010, 6:42 PM), http://www.reuters.com/ article/2010/10/01/ buysell-argentina-gdpwarrants-idUSN0120720420101001.

[171] *See* Charlie Devereux & Katia Porzecanski, *Argentine GDP Warrants Plunge as Growth Misses Trigger*, BLOOMBERG (Mar. 28, 2014), http://www.bloomberg.com/news/2014-03-28/argentine-warrant-holders-seen-losing-out-as-gdp-misses-forecast.html.

[172] GRIFFITH-JONES & HERTOVA, *supra* note 170, at 36.

[173] DUGGAR, *supra* note 100, at 4, 6.

[174] *See* HORNBECK, *supra* note 13, at 5.

[175] *See* PROSPECTUS SUPPLEMENT, *supra* note 168, at S-69.

Exchange offer]."[176]

Despite promises to the contrary, but in an effort to increase overall restructuring participation, Argentina opened a second exchange offer in April of 2010 (the 2010 Exchange) with substantially similar payment terms as the 2005 Exchange. Argentina passed Law 26547 (the Padlock Law Suspension),[177] to temporarily suspend the Padlock Law and thus enable the 2010 Exchange.[178] Again, the 2010 Exchange prospectus reinforced previous statements warning that nonexchange bonds could remain in default indefinitely.[179] The 2010 Exchange closed in December of 2010 with roughly 67% participation among outstanding holders of defaulted bonds, bringing Argentina from 76% to 91.3% in overall exchange participation rate.[180]

E. Argentina as a Sovereign Defendant

Argentina has been no less exceptional at the dispute phase. Between 1976 and 2010, one study identified 108 sovereign debt cases against 25 sovereign debtors.[181] Almost 88% of these cases were filed in the United States, mainly in the Southern District of New York, underscoring the importance of New York law for sovereign debt litigation.[182] With 41 out of 108 total cases, Argentina accounted for a weighty 37% of sovereign debt cases filed between 1976 and 2013.[183] As illustrated in Figure 5 below, the rest of the pack is far behind: Peru had 12, Iraq 4, and Nicaragua 4.[184]

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[176] *See* Law No. 26017, art. 2, Feb. 10, 2005, B.O. 30590 (Arg.).

[177] Law 26547 reiterated that the Argentine government was prohibited from offering holdouts that had initiated judicial action more favorable treatment than what has been offered to exchange bondholders. *See* Law No. 26547, art. 1, Dec. 9, 2009, B.O. 31798 (Arg.).

[178] *Id.*

[179] *See* NML Capital, Ltd. v. Republic of Argentina, 699 F.3d 246, 251–53 (2d. Cir. 2012).

[180] *See* HORNBECK, *supra* note 13, at 7.

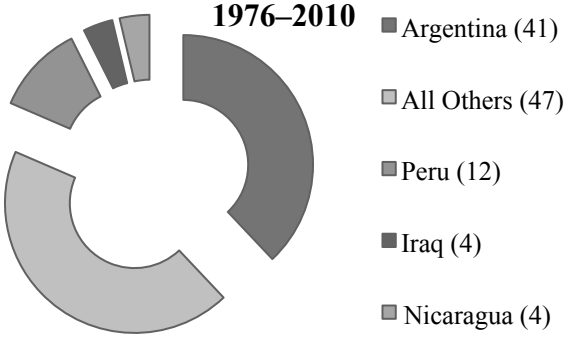
[181] *See* Schumacher et al., *supra* note 8, at 11.

[182] *Id.*

[183] *Id.*

[184] *Id.*

Figure 5:
Number of Sovereign Debt Lawsuits, 1976–2010



Source: Schumacher, et al. (2013)

Estimated volumes of litigation also illustrate the extraordinary nature of Argentina's sovereign debt situation. At $3.7 billion, Argentina's amount under litigation is approximately seventy-four times the average claim of $50 million, as illustrated in Table 6.[185] After Argentina, the next largest amount litigated involved Brazil in the $1.4 billion *CIBC v. Brazil* lawsuit.[186] Even still, these samples only represent one component of Argentina's legal crisis: The Argentine government estimates as much as $15 billion in holdout claims remain in default, including the $1.3 billion at stake in *NML*.[187] In addition to the sovereign debt litigation, Argentina faced loan defaults[188] and an avalanche of investment arbitration claims in forums such as the International Centre for the Settlement of Investment Disputes.[189]

Argentina has been a unique adversary to holdouts and plaintiffs. Sovereigns are rarely eager to cooperate with vulture plaintiffs, but perhaps no other government has taken such strong measures as Argentina to prevent payments from reaching holdouts adversaries.[190] Indeed,

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[185] *See* Schumacher et al., *supra* note 8, at 11–12.

[186] CIBC Bank & Trust Co. (Cayman) v. Banco Central do Brasil, 886 F. Supp. 1105 (S.D.N.Y. 1995).

[187] *See* Russo & Porzecanski, *supra* note 19, at 2.

[188] *See* HORNBECK, *supra* note 118, at 2–3.

[189] *See Argentina Faces 65bn Dollars In Claims; Plans to Abandon International Litigations Court*, MERCOPRESS (Nov. 28, 2012, 8:28 PM), http://en.mercopress.com/ 2012/11/28/argentina-faces-65bn-dollars-in-claims-plans-to-abandon-international-litigations-court ("Argentina faces 42 claims at the World Bank's ICSID in which the plaintiffs are demanding compensations for almost 65 billion dollars . . . .").

[190] *See* Robin Wigglesworth & Jude Webber, *Markets: An Unforgiven Debt*, FIN. TIMES (Nov. 27, 2012, 7:47 PM), http://www.ft.com/cms/s/0/11558dc6-3888-11e2-bd7d-00144feabdc0.html ("Argentina's obstinacy also makes it an outlier in the history of sovereign restructurings.").

Argentina's Padlock Law and prospectus statements are unusual for their certainty, formality, and openly public nature.[191]

Clashing with creditors has its costs. Argentina has suffered exceptionally harsh market penalties—yet another anomalous aspect of Argentina's situation.[192] Typically, markets have fairly short memories; sovereigns are usually readmitted to capital markets just two years after a default.[193] Argentina, however, remains essentially shunned from international capital markets to date.[194] This exclusion is largely associated with its so-called "pariah" status due to Argentina's ongoing disputes with investors and creditors. As a result, the Fernández Kirchner government has resorted to creative—but controversial and arguably unsustainable—methods to raise capital.[195]

IV. THE *NML* DECISION

NML stems from Argentina's 2001 default. While Argentina has made all payments due on the exchange bonds following the 2005 and 2010 Exchanges, no payments were made on holdout bonds.[196] Led by NML Capital, a diverse coalition of holdout plaintiffs sued Argentina in the Southern District of New York. The *NML* plaintiffs successfully argued that Argentina violated the *pari passu* clause by paying the exchange bondholders without paying holdout bondholders.[197] The court's holding was possible because it found Argentina's *pari passu* obligations required ratable payments to all bondholders. Further, the court remedied this

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[191] *See* NML Capital, Ltd. v. Republic of Argentina, 699 F.3d 246, 251–53 (2d Cir. 2012).

[192] The impact of the default has lasted much longer for Argentina, likely due to the nature and length of the restructuring process as well as reputational damage. *See* Borensztein & Panizza, *supra* note 94, at 22 ("Reputation of sovereign borrowers that fall in default, as measured by credit ratings and spreads, is tainted, but only for a short time.").

[193] *See id.*

[194] This outcome is consistent with findings of one recent study suggesting that deeper haircuts result in harsher consequences for sovereigns. *See* Cruces & Trebesch, *supra* note 88; *see also* MONETARY & CAPITAL MKT. DEP'T, IMF, A SURVEY OF EXPERIENCES WITH EMERGING MARKET SOVEREIGN DEBT RESTRUCTURINGS 19 (2012), *available at* www.imf.org/external/np/pp/eng/2012/060512.pdf ("The case of Argentina perhaps remains the most extreme, where the country has not been able to access the global markets since its 2001 default.").

[195] *See* HORNBECK, *supra* note 13, at 6 ("Argentina has met its financial needs by monetizing its debt, placing bonds with domestic government agencies, restructuring domestically held debt, selling bonds directly to the government of Venezuela, and nationalizing private pension funds"); *see also Argentina's State-Owned Firms: So Far, Not So Good*, ECONOMIST (May 12, 2012), http://www.economist.com/node/21554569.

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

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

breach by granting broad injunctive relief applicable to third parties.[198] Plaintiffs won again on appeal when a unanimous panel of the Second Circuit substantially affirmed the orders.[199] In February 2014, Argentina filed a petition for a writ of certiorari with the Supreme Court for review of the Second Circuit's interpretation of Argentina's *pari passu* obligations. Review was denied in June 2014.[200]

This Part focuses on Argentina's *pari passu* clause and the significance of the *NML* decision in the broader context of a rogue trend towards ratable payment injunctions in *pari passu* litigation. First, this Part reviews the emergence of *pari passu* litigation and the competing interpretations of the *pari passu* clause. Next, this Part analyzes the Second Circuit's approach to Argentina's *pari passu* clause and the consequences this approach has for judicial remedies.

A. Competing Interpretations of *Pari Passu*

The *pari passu* trend in sovereign debt litigation is the most recent and potentially the most disruptive development to date. Although the erosion of sovereign immunity since 1976 and the disposal of classic state defenses during the 1980s–1990s made obtaining a judgment against a sovereign more feasible, the challenge of collection remained constant. But with rogue decisions in *pari passu* litigation, namely *Elliott* and *NML*, a critical pillar of unenforceability is now under stress. In these cases, courts have interpreted *pari passu* broadly enough to support a radical solution to sovereign unenforceability—sweeping injunctive remedies applicable to third parties.

Though the Latin phrase *pari passu* literally means "in equal step," which refers to equal footing among obligations, the exact meaning of the clause in sovereign debt contracts remains unclear. A version of the *pari passu* clause appears in most public and private international debt instruments, including syndicated loans and bonds.[201] Over time, and perhaps somewhat inadvertently, the clause appears to have migrated from secured cross-border private lending to unsecured sovereign debt lending.[202] Historically, the *pari passu* covenant has been something of an afterthought—a short boilerplate clause that rarely occupies more than two sentences in complex, intensely negotiated credit instruments.[203] The *pari*

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[198] *Id.* at *3.

[199] *See* NML Capital, Ltd. v. Republic of Argentina, 699 F.3d at 250.

[200] *See* Russo & Porzecanski, *supra* note 19, at 1.

[201] *See* Buchheit & Pam, *supra* note 25, at 906.

[202] *Id.* at 875.

[203] *Id.* at 920 (describing the *pari passu* clause as "an obscure boilerplate provision"); ALLEN & OVERY, THE *PARI PASSU* CLAUSE AND THE ARGENTINE CASE 10 (2012*), available at*

passu clause in Argentina's 1994 Fiscal Agency Agreement, pursuant to which the holdout bonds were issued, reads as follows:

> The securities will constitute . . . direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank *pari passu* without any preference among themselves. The payment obligations of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness.[204]

At the heart of the current *pari passu* controversy are two competing interpretations of the clause: a "narrow" reading versus a "broad" or "ratable payment" reading. Both sides of this debate were represented in *amicus* briefs filed in *NML*.[205] The broad reading of *pari passu* developed through a handful of cases brought since 2000.[206] This approach takes a broad view of the scope of the *pari passu* covenant by interpreting the second sentence of Argentina's clause above to prohibit prioritizing other "payment obligations" in making the payments themselves.[207] Unlike the narrow approach, the broad reading considers that prioritizing payments—for instance, paying exchange bondholders but not holdouts—may constitute a subordination of rank. Essentially, the broad reading extends beyond formal, legal subordination to prohibit de facto subordination as well.

Thus, the broad approach implies a requirement not only to maintain legal rank equally, but also to make payments equally—or on a pro rata basis—when a debtor is unable to pay all obligations in full. The pro rata extension is especially critical because it provides legal grounds for the injunctive relief, including court orders to third parties, seen in *Elliott* and

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http://www.allenovery.com/SiteCollectionDocuments/The%20pari%20passu%20clause%20and%20the%20Argentine%20case.pdf ("[T]he [*pari passu*] clause is generally regarded as boilerplate without great force"); Brief for the Republic of France as Amicus Curiae in Support of the Republic of Argentina's Petition for Writ of Certiorari at 7, Republic of Argentina v. NML Capital Ltd., No. 12-1494, 2013 WL 3930517, at *7 (2013).

[204] NML Capital, Ltd. v. Republic of Argentina, 699 F.3d at 251.

[205] For positions against the *NML* ratable payment interpretation of *pari passu*, see Salmon, *supra* note 64 and accompanying text. For positions supporting the *NML* interpretation, see Brief for Amicus Curiae Kenneth W. Dam in Support of Affirmance, NML Capital Ltd. v. Republic of Argentina, No. 12-105-cv(L), 2013 WL 100419 (2d Cir. Jan. 4, 2013) (arguing in favor of ratable payment interpretation of *pari passu* and third party injunctions); Brief of Washington Legal Foundation as Amicus Curiae in Support of Appellees Urging Affirmance, NML Capital Ltd. v. Republic of Argentina, No. 12-105-cv(L), 2013 WL 210378 (2d Cir. Jan. 4, 2013); Brief of Amici Curiae Italian Holders of Argentine Sovereign Bonds in Support of Plaintiffs-Appellees, NML Capital, Ltd. v. Republic of Argentina, No. 12-105-cv(L) (2d Cir. Jan. 4, 2013).

[206] *See supra* note 28 and accompanying text.

[207] *See* NML Capital, Ltd. v. Republic of Argentina, 699 F.3d at 18–19.

NML. This represents a drastic change in a sovereign's options in debt restructurings—namely the ability to prioritize payments, long considered a privilege of sovereign borrowers.[208] In effect, this interpretation prohibits a sovereign from making payments on restructured bonds without paying holdouts.

On the other hand, proponents of the narrow reading insist that the *pari passu* obligations involve two prongs: one internal and the other external.[209] In other words, the first sentence of *pari passu* addresses subordination *within* a bond issuance whereas the second sentence pertains to changes in rank *across* all indebtedness.[210] Key to the narrow interpretation is the usage of the word "rank" in the second sentence, which continues to mean "rank" rather than to "be paid." Practically speaking, the narrow reading affords scarce protection to creditors. Short of establishing a "legal basis" for discrimination among creditors—for example the Padlock Law—the narrow reading does not limit a sovereign's ability to prioritize payments.

As a result, while the narrow approach may forbid legal subordination it does not prohibit a sovereign from making differential payments among creditors. This understanding of a sovereign's ability to prioritize payments is supported by generations of prevailing practices and norms in sovereign debt.[211] The distinction between the broad ratable payment obligations and the narrow prohibition on formal subordination is vital to the question of remedies. Only a broad reading of Argentina's *pari passu* obligations could support the ratable payment injunctions prescribed by the court in *NML*.

B. The *NML* Approach to *Pari Passu*

Even if the Second Circuit's opinion does not definitively embrace the broad interpretation, the decisions certainly point in that direction. The Second Circuit distanced itself from a definitive interpretation of Argentina's *pari passu* clause in its most recent opinion.[212] Yet the court upheld the ratable payment injunctions, which created an awkward and uncertain gap in the opinion's reasoning. In the Second Circuit's view, Argentina's overall course of conduct—its "extraordinary behavior"—amounted to a constructive subordination of the holdout bonds.[213] More specifically, the district court found subordination in (a) Argentina's

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[208] *See supra* note 58 and accompanying text.

[209] *See, e.g.*, Brief of the United States as Amicus Curiae, *supra* note 22; FMLC STUDY, *supra* note 28, at 5.

[210] *See* Brief of the United States as Amicus Curiae, *supra* note 22, at 3.

[211] *See* Weidemaier, *supra* note 58, at 127.

[212] NML Capital, Ltd. v. Republic of Argentina, 727 F.3d 230, 247 (2d Cir. Aug. 23, 2013).

[213] *Id.*

continuing payments to exchange bondholders and (b) legislation prohibiting payments to holdouts, namely the Padlock Law and the Padlock Law Suspension.[214]

Instead of committing to an interpretation of *pari passu* obligations, the Second Circuit opted for ambiguity.[215] Neither the district court nor the appeals opinion clearly specified whether either action—prioritizing payments or the Padlock Law—taken on its own would constitute subordination. Under any interpretation of Argentina's *pari passu* clause, a formal legal subordination, such as the Padlock Law, would almost certainly amount to a violation of the clause. Accordingly, Argentina's actions could probably be considered a breach of either the broad or the narrow reading of the *pari passu* clause. The lack of clarity in the opinions may reflect tension between a desire to hold Argentina to account and awareness of the potentially awkward precedent.

A narrow view of *pari passu* in *NML* could have mitigated disruptive consequences and uncertainties for sovereign debt markets. Sovereigns rarely pass legislation similar to the Padlock Law. Such a holding would have also put other sovereigns on notice that this kind of legislation could breach *pari passu* obligations.[216] But it was perhaps the question of remedies that guided the Second Circuit away from the narrow reading of *pari passu*. The court's ratable payment injunctions prescribed by the court depend on a broad reading of the *pari passu* clause.[217] At least one prominent observer wondered if the court, exasperated with Argentina's disregard for judicial authority, might have been grasping for a way to punish the "recalcitrant" defendant.[218]

The court's ratable payment injunctions forbid Argentina from making payments to exchange bondholders without paying the plaintiff holdouts. Expecting Argentina to defy its orders, the court aimed the injunctions beyond Argentina to include third parties, including financial service providers. The court's injunctions cast a shockingly wide net: orders were aimed at "all parties involved, directly or indirectly, in advising upon, preparing, processing, or facilitating any payment of the Exchange Bonds."[219] Essentially, having realized that Argentina would continue to

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[214] Order, NML Capital, Ltd. v. Republic of Argentina, No. 08-CV-6978 (TPG), 2011 WL 9522565, at *4–5 (S.D.N.Y. Dec. 7, 2011).

[215] NML Capital, Ltd. v. Republic of Argentina, 727 F.3d 230, 247 (2d Cir. Aug. 23, 2013).

[216] *See* ALLEN & OVERY, *supra* note 203, at 11.

[217] *See supra* notes 209–14 and accompanying text.

[218] Gelpern, *Contract Hope*, *supra* note 31; Floyd Norris, *The Muddled Case of Argentine Bonds*, N.Y. TIMES (Jul. 24, 2014), http://www.nytimes.com/2014/07/25/ business/rulings-add-to-the-mess-in-argentine-bonds.html (addressing complexities of the *NML* decision that "Judge Griesa seems not to have understood").

[219] Order at 4, NML Capital Ltd. v. Republic of Argentina, No. 09-CV-01707 (S.D.N.Y. Feb. 23, 2012).

defy judicial orders, the court decided to enforce its judgments against innocent—yet likely compliant—third parties.[220]

In justifying these drastic remedies, the court found that "the equities and the public interest strongly support issuance of equitable relief" to prevent Argentina from further breach of its *pari passu* obligations.[221] Without means to hold an unwilling sovereign to account, the court resorted to drastic enforcement measures, which rely on an ambitious reading of Argentina's *pari passu* obligations. Facing limited enforcement options, the temptation of these injunctions is understandable. However, the result is a dramatic overcorrection for unenforceability—a highly complex one with significant costs. It is difficult to imagine that sovereigns like Argentina have been signing away generations of restructuring practices—essentially promising *not* to restructure—with just two sentences of ambiguous text. Crafting radical judicial remedies with small shreds of ambiguous language seems overzealous, given the high stakes in a critical area of law.

V. ROGUE TRENDS IN SOVEREIGN DEBT

Problems associated with rogue creditors and rogue debtors are widely known and frequently discussed.[222] Less visible, but no less important, is the problem of rogue courts or rogue precedent in sovereign debt. Market participants have long recognized this threat to orderly restructuring posed by rogue courts.[223] Cases like *Elliott* and *NML* illustrate the potential of rogue precedent to produce unpredictable results and uncertainty for sovereign debt markets. However, in recognizing *NML's* extraordinary and fact-driven nature, the Second Circuit provided ample grounds for other courts to distinguish *NML* in future cases. Therefore, until broader solutions for sovereign debt problems are implemented, other courts should apply *NML* as narrowly as possible.

A. The Problem of Rogue Precedent

Opposition to the *NML* court's interpretation of *pari passu* by the likes

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[220] The court was well aware of the likelihood that Argentina would continue to defy its orders. *See, e.g.*, Transcript of Hearing at 15, NML v. Argentina, Nos. 08-CV-6978 and 09-CV-1708 (S.D.N.Y. Nov. 9, 2012).

[221] *Id.* at 2.

[222] *See* Porzecanski, *supra* note 29; *see also* Fisch & Gentile, *supra* note 59.

[223] *See* Gelpern, *Building*, *supra* note 84, at 1133 ("Even industry associations went on record to say that rogue courts are a bigger danger to emerging market debt than rogue creditors.") (citing EMTA, POSITION REGARDING THE QUEST FOR MORE ORDERLY SOVEREIGN WORK-OUTS (2002), *available at* http://www.emta.org/ndevelop/keymsg1.pdf).

of the United States, France, and the IMF speaks volumes.[224] For their part, the United States and the IMF have serious reservations about Argentina's approach to international obligations since the 2001 default.[225] Argentina and the IMF have also been at odds over official statistics.[226] Among other debts and unsettled disputes, Argentina owed billions to the Paris Club.[227] France, a key member of the Paris Club, overcame its concerns with Argentina's approach to international obligations in formally opposing *NML*.[228] Brazil and Mexico also raised concerns in separate amicus briefs filed with the Supreme Court.[229] In light of these concerns, it is remarkable that all these parties are united—in certain terms and highly visible fashion—against the *NML* approach to *pari passu* and injunctive remedies.

A primary concern among these parties is the impact of *NML* precedent on the orderly restructuring of sovereign debt.[230] Threats to restructuring have serious adverse consequences not just for sovereign debtors, but also for exchange creditors who participate in restructurings.[231] Granting holdouts broad rights to recover in full undermines the fair sharing of burden among sovereign creditors and the sovereign in distress. At the

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[224] For U.S. views, see *supra* note 22. For French views, see Brief for the Republic of France as Amicus Curiae in Support of the Republic of Argentina's Petition for Writ of Certiorari at 2–3, Republic of Argentina v. NML Capital Ltd., No. 12-1494 (July 26, 2013). For the IMF's views, see IMF, SOVEREIGN DEBT RESTRUCTURING—RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK (2013), *available at* http://www.imf.org/external/np/pp/eng/2013/042613.pdf.

[225] *See* Brief for the United States of America as Amicus Curiae, *supra* note 22, at 1 (While the United States does not condone Argentina's actions in the international financial arena, Argentina's petition for rehearing en banc presents a "question of exceptional importance"); *see also* Joseph Cotterill, *The IMF Won't be Argentina's* Pari Passu *Frenemy. Why?*, FIN. TIMES ALPHAVILLE BLOG (July 24, 2013, 4:17 AM), http://ftalphaville.ft.com/ 2013/07/24/1579752/.

[226] *See* Jude Webber, *IMF Acts Over Flawed Argentine Economic Data*, FIN. TIMES (Feb. 1, 2013, 11:15 PM), http://www.ft.com/intl/cms/s/0/eb704c98-6cbe-11e2-953f-00144feab49a.html?siteedition=intl#axzz2sD6MLLgr.

[227] *See* Jude Webber, *Argentina's Debt: Quantified*, FIN. TIMES BEYONDBRICS BLOG (Oct. 4, 2011, 10:43 PM), http://blogs.ft.com/beyond-brics/2011/10/04/argentina-much-more-indebted-that-you-think/#axzz2sCuR8Wva; *see also* Pablo Gonzalez, *Argentina Submits Offer to Paris Club for $10 Billion Debt*, BLOOMBERG (Jan. 20, 2014), http://www.bloomberg.com/news/2014-01-20/argentina-sees-agreement-on-10-billion-debt-with-paris-club.html.

[228] *See* Anna Gelpern, *France is Man Enough to Pari Passu*, CREDIT SLIPS (Jul. 27, 2013, 7:59 AM), http://www.creditslips.org/creditslips/2013/07/france-is-man-enough-to-pari-passu.html ("Like the United States and the IMF, the Paris Club is mad-mad-mad at Argentina for failing to repay billions of dollars, but France is evidently more worried about the impact of the Second Circuit decision on debt restructuring and the rest of the Paris Club business").

[229] *See* Anthony Harrup & Shane Romig, *Mexico Backs Argentina in Dispute with Bond Holdouts*, WALL ST. J. (Mar. 26, 2014), http://online.wsj.com/news/articles/SB10001424052702304688104579463771537655770.

[230] *See* Brief for the United States of America as Amicus Curiae, *supra* note 22, at 4–5; *see also* Brief for the Republic of France as Amicus Curiae, *supra* note 224, at 10–17.

[231] *See supra* note 58 and accompanying text.

same time, this approach reduces incentives for participation in restructuring and creates serious uncertainties for financial market service providers.

The Second Circuit brushed these concerns aside rather summarily, concluding that the collective action clauses (CACs) will prevent holdout situations like this in the future.[232] Unfortunately, the court's position depends on an overly optimistic view of the ability of CACs to resolve holdout issues in the future. CACs were introduced to sovereign bonds governed by New York law with Mexico's adoption of a CAC in a 2003 bond issuance.[233] CACs limit the ability of a minority of bondholders to derail a restructuring by allowing a majority—usually 75%—of bondholders to make restructuring decisions across an entire issuance.[234] Properly drafted, CACs offer a significant improvement over unanimity action clauses, especially for bonds with atomized holders. In theory, CACs alleviate coordination and collective action problems common in sovereign debt restructurings.[235]

However, prevailing practices tell a different story than the Second Circuit's understanding of the CAC solution. For one, many outstanding sovereign bonds simply do not have CACs.[236] Another problem is that many CACs bind only bondholders *within* a particular issuance. Sovereigns often have multiple issuances. An outside investor could buy in at just over 25%—conceivably, at a relatively modest price—of just one issuance to block a restructuring. Indeed, holdout creditors recently blocked Greece's restructuring of a substantial chunk of debt in spite of CACs.[237] Aggregation clauses mitigate the cross-issuance problems to an extent, but they are not yet in wide use.[238] Contrary to the Second Circuit's understanding, contractual drafting in sovereign bonds has not yet evolved to address legal gaps in the sovereign debt system.

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[232] NML Capital, Ltd. v. Republic of Argentina, 727 F.3d 230, 247–48 (2d Cir. Aug. 23, 2013).

[233] *Id.* at 248.

[234] There are two primary categories of CACs. Modification clauses allow a predefined majority of holders in a series of bonds to bind other holders in that series to an agreement to restructure the entire series. Acceleration clauses prevent individual bondholders from demanding full payment upon default by requiring a bondholder vote to approve the demand. *See* W. Mark C. Weidemaier & Mitu Gulati, *A People's History of Collective Action Clauses*, 54 VA. J. INT'L L. 51, 53 (2013).

[235] *Id.*

[236] *See* Declaration of Stephen Choi at 26, NML Capital, Ltd. v. Republic of Argentina, No. 08-CV-6978 (S.D.N.Y. Nov. 16, 2012) (noting that "65 or 25.3% of New York law governed bond issuances with a maturity date of 2013 or later employ a [unanimity action clauses] for changes to payment related terms").

[237] *See* IMF, SOVEREIGN DEBT RESTRUCTURING, *supra* note 224, at 28.

[238] *See* Declaration of Stephen Choi, *supra* note 236, at 10.

B. Drastic Measures are Undesirable

Drastic measures like the injunctive remedies in *NML* offer a tempting fix for unenforceability. Courts are understandably reluctant to appear hapless when dealing with a "recalcitrant" sovereign. But injunctive remedies overcorrect for unenforceability and shift burdens to third parties. Though satisfying in some respects, the costs outweigh the benefits. Furthermore, drastic overcorrections threaten to disrupt the broader sovereign debt system, creating undesirable costs for various nonrogue actors in the market.

The dysfunctionality of the sovereign debt system is exaggerated by a small handful of high profile restructuring failures, namely Peru and Argentina. Unfortunately, it is precisely these outlier situations that have led to rogue precedent on sovereign debt, namely *Elliott* and *NML*. The vast majority of sovereign debt restructurings proceed in orderly fashion. Even though sovereign debt litigation is on the rise, few defaults trigger a wave of lawsuits.[239] Between 1976 and 2013, just twenty-nine of 176 restructurings were followed by litigation.[240] And only Argentina's restructuring resulted in persistent holdout litigation. Those that do trigger waves of litigation—again, Argentina and Peru—account for the lion's share of total volumes.[241]

In addition to low rates of incidence, the weight of claims also remains relatively low. IMF economist Manmohan Singh once suggested that vultures might be more aptly named "mosquitos," based on their actual import.[242] Though pesky and irritating, amounts litigated are relatively small compared to the total amounts restructured. In a sample of 108 cases, the amounts litigated averaged 3.6% of total the amounts restructured with a median of just 1.7%.[243] Even the record-smashing litigation against Argentina represents just 4.5% of the original amount of Argentina's 2001 default, though this number could increase significantly as non-*NML* plaintiff holdouts come forward.[244]

To be sure, the existing regime—or lack thereof—for sovereign debt is an imperfect system. Governing the sovereign ungovernable is a difficult task for courts. But, even as incomplete as the existing system is, it works most of the time. For all their righteous indignation about sanctity of contract and creditors rights, sovereign debt holdouts may not be as

[239] *See* Schumacher et al., *supra* note 8, at 11 (Observing that "runs" on the courthouse only happened in two situations: Argentina and Peru).

[240] *Id.*

[241] *Id.*

[242] *A Victory by Default?*, *supra* note 71.

[243] Schumacher et al., *supra* note 8, at 12.

[244] *See* Russo & Porzecanski, *supra* note 19.

victimized as they would like to appear. On average, sovereign debt haircuts are much less drastic than corporate loan and debt restructurings—despite the vast leverage supposedly possessed by sovereigns.[245] In the United States, debtor-friendly provisions in bankruptcy law often leave unpaid creditors or pension haircuts for workers in the wake of insolvency.[246] Less sympathetic is indignation among hedge funds that buy in at heavily discounted prices to gamble for full recovery through judicial relief.

While the need for a sovereign debt insolvency mechanism is clear, potential solutions remain highly incomplete.[247] Unfortunately, a recent spasm of case law relying on strained—if not simply mistaken—readings of *pari passu* combined with supercharged injunctive remedies threatens further aggravation of an already imperfect system. In addition to overinflating incentives to holdout, *NML* also weakens incentives for participation in sovereign debt exchanges. Rogue precedent creates serious uncertainty for sovereigns, their creditors, and even third parties in the financial system such as trustees, clearing houses, and payments systems.[248]

C. Applying *NML* Narrowly

In light of *NML*'s outlier facts across the various stages of sovereign debt—as a debtor, as a sovereign in crisis, as a negotiating sovereign in default, and as a defendant—there are ample grounds to consider the *NML* precedent narrowly. *NML* is an unsuitable point of departure for creating highly disruptive precedent in a critical area of law for sovereign debt. Amplifying the gravity of the *NML* precedent, a majority of emerging market sovereign bonds issued internationally are subject to New York law and most sovereign debt litigation is brought in the Southern District of New York.[249] Further, many outstanding sovereign bonds contain *pari passu* clauses like Argentina's. Sovereign bonds are frequently long-term instruments with maturities measured in decades. Unfortunately, contractual innovations like CACs lag behind contemporary problems in sovereign debt.[250]

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[245] *See supra* note 88 and accompanying text.

[246] Chris Christoff, *Detroit Manager Outlines Pension-Cut Plans for Workers*, BLOOMBERG (June 21, 2013), http://www.bloomberg.com/news/2013-06-20/detroit-manager-orders-probe-of-benefit-programs-1-.html (discussing reactions to haircuts for workers and bondholders in Detroit's restructuring); *Detroit Creditors Brace for Haircuts, or Worse, at Meeting to Avoid Bankruptcy*, REUTERS (June 14, 2013, 12:00 AM), http://www.reuters.com/article/2013/06/14/usa-detroit-creditors-idUSL2N0EN20520130614 (highlighting the leverage of a debtor heading towards Chapter 9 bankruptcy vis-á-vis creditors).

[247] *See* Gelpern, *Quasi-Sovereign*, *supra* note 83; Gelpern, *Bankruptcy*, *supra* note 83.

[248] *See supra* notes 19–20 and accompanying text.

[249] *See supra* note 22 and accompanying text.

[250] *See supra* notes 57, 224, 234, 236 and accompanying text.

In its August 23, 2012 opinion, the Second Circuit wisely recognized the uncomfortable reality facing the court. The opinion recognized the extraordinary and fact-driven nature of *NML*—distancing the decision from potentially disruptive and awkward precedent:

> But this case is an exceptional one with little apparent bearing on transactions that can be expected in the future. Our decision here does not control the interpretation of all *pari passu* clauses or the obligations of other sovereign debtors under *pari passu* clauses in other debt instruments. As we explicitly stated in our last opinion, we have not held that a sovereign debtor breaches its *pari passu* clause every time it pays one creditor and not another, or even every time it enacts a law disparately affecting a creditor's rights. We simply affirm the district court's conclusion that Argentina's extraordinary behavior was a violation of the particular *pari passu* clause found in the FAA.[251]

In recognizing the extraordinary nature of *NML*, the Second Circuit provided grounds to apply the *NML* precedent narrowly. Other courts should consider this message from the Second Circuit as a starting point for distinguishing *NML* from future sovereign debt cases. Though a holding based on a decisive interpretation of *pari passu* would have supplied more clarity, the Second Circuit's language at least provides grounds for mitigating the *NML* precedent until more permanent solutions for sovereign insolvency emerge.

V. CONCLUSIONS

Although the Second Circuit partially recognized the "exceptional" circumstances of this case, the *NML* situation is exceptional across all phases of sovereign debt. Faced with bad facts, *NML* has already created bad law. But other courts can mitigate the fallout by distinguishing this case from others until broader sovereign debt solutions are available. There are ample and compelling grounds to apply *NML* narrowly. Cases like *Elliott* and *NML* underscore the dangerous temptation facing courts to overcorrect for unenforceability in sovereign debt litigation. Until contractual innovations or institutional solutions catch up with the rogue trends in sovereign debt, it is likely these temptations will persist.[252]

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[251] NML Capital, Ltd. v. Republic of Argentina, 727 F.3d 230, 247 (2d Cir. Aug. 23, 2012).

[252] Contractual solutions set forth by the International Capital Market Association, including a modified pari passu clause and more robust aggregated CACs are a good starting point. *See Sovereign Debt Information*, INT'L CAP. MKT. ASS'N, http://www.icmagroup.org/resources/Sovereign-Debt-Information/ (last visited Nov. 5, 2014).