THE *PARI PASSU* INTERPRETATION IN THE *ELLIOTT* CASE: A BRILLIANT STRATEGY BUT AN AWFUL (MID-LONG TERM) OUTCOME?

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> "[H]e that will not apply new remedies must expect new evils; for time is the greatest innovator . . . ."
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> – Francis Bacon (1561-1626)[1]

I. INTRODUCTION

Sovereigns can amass unsustainable debts, fueling the increasing need to restructure to prevent or resolve financial and economic crises and to achieve debt sustainability levels. From the 1990s, many sovereign debt restructuring episodes experienced difficulties because some bondholders did not accept the sovereign's exchange offer and instead claimed the total value of the debt.[2] These creditors are known as "holdouts" or "rogue creditors."

As a result of the debt exchange and the fact that after the settlement there were outstanding bondholders that were holdouts and that did not take part in the exchange offer, the dynamics in the

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1. Francis Bacon, *Essays, Civil and Moral*, *in* 3 THE HARVARD CLASSICS 7, 65 (Charles W. Eliot ed., 1909). Francis Bacon was 1st Viscount St. Albans, English philosopher, statesman, lawyer, scientist, and jurist. He served as Attorney General and Lord Chancellor of England. *Bacon, Francis (1561-1626), of Gray's Inn and Gorhambury Herts*, HISTORY OF PARLIAMENT (1981), http://www.historyofparliamentonline.org/volume/1558-1603/member/bacon-francis-1561-1626; *Francis Bacon (1561-1626)*, BBC, http://www.bbc.co.uk/history/historic_figures/bacon_francis.shtml (last visited Mar. 1, 2012).

2. *See* William W. Bratton, Pari Passu *and a Distressed Sovereign's Rational Choices*, 53 EMORY L.J. 823, 857 (2004).

relationship of the involved parties has changed. The parties involved are:

> (1) The sovereign, debtor of the so-called "old bonds" and the "new bonds." The old bonds are those held by the holdouts that did not participate in the exchange offer. The new bonds are those that were issued to creditors as a result of the exchange offer.
> (2) The bondholder who holds an old bond, that is, the holdout.
> (3) The bondholder who holds a new bond, that is, the creditor that voluntarily entered the exchange offer.[3]

Both bondholders would like to collect on their bonds. The holder of the old bond would like to collect principal and accrued interest by trying to attach any possible assets of the sovereign by adopting an active litigation strategy.[4] Different is the role to be performed by the holder of the new bonds who will be passive while waiting for interest payments to become due and to collect principal upon maturity. With this scenario, the sovereign debtor does not have many options left. The sovereign debtor would have to pay the holders of the new bonds regularly because otherwise it will be in default again, while trying to avoid any attachment on its assets that will disrupt the flow of payments.[5] The priority of the sovereign debtor is to maintain the flow of payments unaltered while sorting out what to do with the holdout minority.

Why is it relevant to analyze the payment of these debt instruments, particularly that of the new bonds? Simply because it implies a flow of funds, and it can represent an attachable asset.

Obtaining a favorable ruling against a sovereign who has missed a payment under a debt instrument subject to New York or English law is quite straightforward. There are several cases to draw from. Once a favorable ruling has been obtained, a creditor can attempt to execute property in the jurisdiction of the issuer or abroad (usually New York).[6] These two scenarios are briefly analyzed below.

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3. Rodrigo Olivares-Caminal, *Understanding the* Pari Passu *Clause in Sovereign Debt Instruments: A Complex Quest*, 43 INT'L LAW. 1217 (2009) [hereinafter *Understanding the* Pari Passu *Clause*].

4. *See* Bratton, *supra* note 2, at 846.

5. *Id.* at 830.

6. *See, e.g.*, EM Ltd. v. Republic of Argentina, No. 03 Civ. 2507 TPG, 2003 WL 22120745, at *1-2 (S.D.N.Y. Sept. 16, 2003); Lightwater Corp. v. Republic of Argentina, No. 02 Civ. 3804 (TPG), 2003 WL 21146665, at *1 (S.D.N.Y. May 16, 2003); LNC Invs., Inc. v. Republic of Nicaragua, No. 96 Civ. 6360 JFK, 2000 WL 745550, at *1, 5-6 (S.D.N.Y. June 8, 2000).

Executing property within the jurisdiction of the sovereign, the creditor is faced with the issue that it would be highly probable that due to *public order*, the judgment would not be enforced, or if enforced it would be payable with other debt instruments issued by the sovereign debtor (domestic bonds) with very unattractive financial and contractual terms (long-term maturity, subject to local law, domestically listed, and usually trading in a secondary market at a steep discount).[7] The pros are that there would be assets to enforce the money judgment forcing the sovereign to settle or be condemned to pay in-kind (with domestic bonds). The cons are that the execution process would be completely uncertain.

On the other hand, if the creditor tries to execute the money judgment outside the jurisdiction of the issuer, for example in New York, the pros are that the whole process is clearly determined and an outcome can be predicted because there have been many cases where sovereigns have been sued as a result of their default (as opposed to the uncertainty of suing in the sovereign's own courts). However, the con is that it would be very difficult to find assets to enforce the money judgment.

Another relevant element to be considered regarding the possible execution is related to the fact that the issuer has either chosen a fiscal agent or a trust structure. Under a fiscal agent agreement, a fiscal agent is appointed to handle the "fiscal"[8] matters of the issuer (for example, redeeming bonds and coupons at maturity).[9] Under a trust structure (trust indenture or trust deed, depending if it is under New York or English law), a trustee is appointed as a fiduciary managing the matters related to the issuance.[10] The main difference between these two structures used in bond issuances is that the fiscal agent acts as a representative and agent of the issuer while the trustee is a fiduciary representing the bondholders.[11] The fiscal agent structures have been the prevailing practice in international bond issuances. However, recent bond issuances have shifted to the use of trust structures (for example, the Republic of Argentina's bonds subject to English and New York law, Belize, Dominica, Ecuador, Grenada, and Uruguay).[12]

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7. 1 EDWIN BORCHARD, STATE INSOLVENCY AND FOREIGN BONDHOLDERS 157-58 (1951).

8. "Fiscal" is used in a monetary sense as involving financial matters rather than taxes only.

9. 1 BORCHARD, *supra* note 7, at 42-43 (1951).

10. 2 PHILIP R. WOOD, THE LAW AND PRACTICE OF INTERNATIONAL FINANCE SERIES: COMPARATIVE LAW OF SECURITY INTERESTS AND TITLE FINANCE § 4-020, at 75 (2d ed. 2007).

11. *Id.* § 4-020, at 75; 1 BORCHARD, *supra* note 7, at 42.

12. *See* Lee C. Buchheit, *Supermajority Control Wins Out*, INT'L FIN. L. REV., Apr. 2007, at 21, 21 [hereinafter *Supermajority Control Wins Out*].

The distinction between the fiscal agent and the trustee is not a minor issue in this analysis. The difference is that payments done through a trustee cannot be attached because as soon as the funds are deposited in the trustee's account they are not the sovereign's funds anymore, on the contrary, they are held by the trustee acting on behalf of the bondholders.[13] The case of the fiscal agent is different since the funds held on a fiscal agent account are funds of the sovereign until those funds are deposited in each creditor's accounts.[14]

The use of these structures relates to the place of payment of the debt instruments. Until the funds have been deposited in the trust account, they are in transit and subject to attachments (they still are funds of the sovereign as in *Elliott Associates, L.P.*[15]). This is the reason why the place of payment is relevant. There are two possible scenarios, that is, that the fiscal agent or the trustee has an account to have the funds deposited outside or inside the sovereign's jurisdiction (the issuer). If the account is held outside the sovereign's jurisdiction, the funds can be threatened by an attachment.[16] The second scenario, that is, an account within the sovereign's jurisdiction, requires a two-fold analysis: the case of the fiscal agent and the case of the trustee. In the case of the fiscal agent with an account within the jurisdiction of the sovereign, the situation would be the same as in the case of an account outside the jurisdiction because the fiscal agent will have to repatriate the funds (transfer the funds to the place of payment) to arrange the payments to the sovereign's creditors on its behalf. The case of the trustee is different—different because funds can be safely deposited into the trustee's account within the sovereign's jurisdiction and then transferred abroad. Once the funds have reached the trustee's account safely, the ownership over those funds is transferred to the bondholders via the fiduciary duty of the trustee.

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13. 1 BORCHARD, *supra* note 7, at 43, 50.

14. *Id.* at 43.

15. General Docket No. 2000/QR/92 (Court of Appeal of Brussels, 8th Chamber, Sept. 26, 2000) (unofficial translation on file with the Hofstra Law Review). Any reference in this Article to the *Elliott* case refers to the case resolved by the 8th Chamber of the Brussels Court of Appeal on September 26, 2000 in which Elliott requested an ex parte motion. *Id.* Also, any reference to the court deciding on the *Elliott* case should be interpreted as the 8th Chamber of the Brussels Court of Appeal. If a reference is made to a different *Elliott* case or a different court entertaining a different claim where Elliott has also been a claimant, it will be clearly indicated.

16. *See, e.g.*, Eduardo Luis Lopez Sandoval, Sovereign Debt Restructuring: Should We Be Worried About Elliott? 4 (Harvard Law Sch., Int'l Fin. Seminar, 2002), *available at* http://www.law.harvard.edu/programs/about/pifs/llm/sp44.pdf ("Elliott Associates tried to intercept and attach the Peruvian funds that were being transferred internationally for the payment of those creditors who had agreed to the . . . restructuring.").

Finally, it is worth mentioning that the "safeness" of the governmental funds within its own jurisdiction lies in its power to arbitrate the required mechanisms to shield said funds from potential attachments. It could be either by enacting an executive decree or resorting to the legislative branch and bending its arm to pass an emergency law in favor of the stability and well-being of the country's economy, overruling the rule of law (if necessary).

II. THE (IN)FAMOUS *ELLIOTT* CASE

The *Elliott* case[17] is directly related to the *pari passu*[18] clause in sovereign debt instruments and it is the most important case on the subject matter. The peculiarity of this case was that the lack of assets to attach in the United States forced the claimant to resort to the courts of Belgium, Canada, England, Germany, Luxembourg, and the Netherlands to seek enforcement of the decision.[19] However, it is worth noting that attachment orders were previously obtained in different states (Florida, Maryland, New York) and Washington, D.C. which interfered with the payments to be performed by the fiscal agent.[20]

On September 26, 2000, Elliott Associates, L.P. ("Elliott") obtained a restraining order from a Brussels court of appeal[21] prohibiting Chase Manhattan (financial agent) and Euroclear from paying interest on the Republic of Peru's Brady bonds (approximately $80 million that was due on October 6, 2000).[22] The Brussels Court of Appeal resolution stated that "[t]he basic agreement regulating the reimbursement of the Peruvian foreign debt, also indicates that the different creditors enjoy a

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17. For an enlargement on the *Elliott* case and an in-depth analysis of the *pari passu* clause, see generally 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. AMERICAS 745 (2009) [hereinafter *To Rank* Pari Passu] and *Understanding the* Pari Passu *Clause*, *supra* note 3.

18. MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (forthcoming 2012) (manuscript at 21) (on file with the Hofstra Law Review).

19. *See* Lopez Sandoval, *supra* note 16, at 12.

20. Rodrigo Olivares-Caminal, *Sovereign Default: More Business Opportunities*, HEDGEFUND J. (Mar. 2010), http://www.thehedgefundjournal.com/magazine/201003/commentary/sovereign-default-more-business-opportunities.php [hereinafter *Sovereign Default*].

21. Elliott Assocs., L.P., General Docket No. 2000/QR/92, ¶ 8 (Court of Appeal of Brussels, 8th Chamber, Sept. 26, 2000) (unofficial translation on file with the Hofstra Law Review).

22. *Id.* ¶¶ 5, 8; MINISTERIO DE ECONOMIA Y FINANZAS [MINISTRY OF ECON. AND FIN. OF PERU], INFORME FINAL ACUERDO CON ELLIOTT ASSOCIATES LLP [FINAL REPORT: AGREEMENT WITH ELLIOTT ASSOCIATES LLP] 6, *available at* http://www.mef.gob.pe/contenidos/deuda_publ/documentos/caso_E_1_informe_b.pdf [hereinafter MINISTRY OF ECON. AND FIN. OF PERU]. These payments were going to be made by the fiscal agent (Chase Manhattan Bank) through the depository trust company in New York—Euroclear in Brussels and Clearstream in Luxembourg.

'pari passu clause', which has as a result that the debt should be paid down equally towards all creditors in proportion to their claim."[23]

With the judicial order of not making any payment, Peru was facing default on the restructured bonds totaling $3837 million.[24] Although Peru did not make the payment of interest on the due date, it technically had a thirty-day period to fulfill the payment before the default was declared.[25]

Therefore, Peru attempted to create a trust to twice a year make the payment of interest due on the Brady bonds on its behalf in order to keep on servicing interest rates and avoid a disruption of the flow of funds.[26] Shortly after, Peru desisted of implementing the trust structure because not only payments through the depository trust company were curtailed as a result of the attachment orders in different states in the United States but also through Euroclear.[27] The only window that was left open—although temporarily—was to perform the payments through Clearstream.[28] Performing the interest payments through Clearstream would have implied that only those bondholders holding an account with Clearstream would be paid or that bondholders not holding an account with Clearstream should open an account there (which implied an additional cost to Peru).[29] In addition, it was a matter of time until Elliott would obtain a restraining order in Luxembourg.[30]

This scenario forced Peru to reach an agreement with Elliott in order to avoid a new default on its restructured debt under the auspices of the "Brady Plan." On September 28, 2000, Peru enacted Urgent Decree No. 083-2000 and Resolution No. 143-2000-EF of the Ministry of Economy and Finance of Peru to negotiate and settle Elliott's claim.[31] These norms were complemented by Urgent Decree No. 084-2000 that authorized a loan granted by the National Bank to the Ministry of

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23. *Elliott Assocs.*, ¶ 6 (emphasis added).

24. MINISTRY OF ECON. AND FIN. OF PERU, *supra* note 22, at 1. *See also* Lopez Sandoval, *supra* note 16, at 14.

25. MINISTRY OF ECON. AND FIN. OF PERU, *supra* note 22, at 6. *See also* Lopez Sandoval, *supra* note 16, at 13-14.

26. MINISTRY OF ECON. AND FIN. OF PERU, *supra* note 22, at 2-3. *See also Sovereign Default*, *supra* note 20. In relation to the trust structure, see REPUBLICA DE PERU [REPUBLIC OF PERU], RESOLUTION MINISTERIAL [MINISTERIAL RESOLUTION] NO. 140-2000-EF/75 (2000) (on file with the Hofstra Law Review).

27. Lopez Sandoval, *supra* note 16, at 14.

28. *Id.*

29. *Sovereign Default*, *supra* note 20; *see* MINISTRY OF ECON. AND FIN. OF PERU, *supra* note 22, at 3.

30. *Sovereign Default*, *supra* note 20.

31. *Understanding the* Pari Passu *Clause*, *supra* note 3, at 1225.

Economy and Finance to procure the required funds to settle Elliott's claim.[32]

The final settlement agreement implied a payment for all concepts in the total amount of $58.45 million.[33] The settlement agreement was executed on September 29, 2000 and ratified by Supreme Decree No. 106-2000-EF.[34] General releases were executed together with the settlement.[35] Finally, Peru was able to pay the due interest in time, and avoided incurring a new default. By means of the settlement agreement, Elliott obtained a gain worth 400 percent of the purchase value of the defaulted bonds.[36]

The decision of the Brussels Court of Appeal was grounded on the violation of equal treatment of creditors under the *pari passu* clause.[37] The Belgium court mistakenly opened a door that changed forever sovereign debt practices.

III. AN(OTHER) ATTEMPT ON THE *PARI PASSU* CLAUSE

The great commotion around the *pari passu* clause is that as of the year 2000, various creditors in different jurisdictions (Belgium, California, England, and New York)[38] have argued that as a result of the *pari passu* clause, sovereigns should be prevented from making payments to other creditors without paying creditors on a *pro rata* basis.[39] The *pari passu* clause seemed "a harmless relic of the historical evolution" in standard sovereign bonds—a useless decorative accessory—that suddenly returned from its grave.[40]

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32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. JOHN NOLAN, FIN. POLICY FORUM DERIVATIVES STUDY CTR., EMERGING MARKET DEBT & VULTURE HEDGE FUNDS: FREE-RIDERSHIP, LEGAL & MARKET REMEDIES 13 (2001), *available at* http://www.financialpolicy.org/DSCNolan.htm. For a further discussion on the *Elliott* case, see generally G. Mitu Gulati & Kenneth N. Klee, *Sovereign Piracy* (Univ. of Cal., L.A., Research Paper No. 01-7, 2001), *available at* http://papers.ssrn.com/paper.taf?abstract_id=272194.

37. *See* Elliott Assocs., L.P., General Docket No. 2000/QR/92, ¶ 6 (Court of Appeal of Brussels, 8th Chamber, Sept. 26, 2000) (unofficial translation on file with the Hofstra Law Review).

38. Republic of Nicaragua v. LNC Invs. LLC, General Docket No. 2003/KR/334, ¶ 11 (Court of Appeal of Brussels, 9th Chamber, Mar. 19, 2004) (unofficial translation on file with the Hofstra Law Review); Kensington Int'l Ltd. v. Republic of Congo, [2003] EWCA (Civ) 709 [2] (Eng.), 2003 WL 1935493 (May 13, 2003); Order Granting Motion for (1) Specific Performance in Aid of Execution; and (2) Assignment of Assets at 2, Red Mountain Fin., Inc. v. Democratic Republic of Congo, No. CV 00-0164 R (BQRx) (C.D. Cal. May 29, 2001); Complaint at 11, 15, Kensington Int'l Ltd. v. BNP Paribas SA, No. 03602569 (N.Y. Sup. Ct. Aug. 13, 2003).

39. *Pari Passu Clauses*, FIN. MKTS. LAW COMM., 10 (March 2005), http://www.fmlc.org/papers/fmlc79mar_2005.pdf.

40. *See* GULATI & SCOTT, *supra* note 18 (manuscript at 54).

A *pari passu* clause is a standard clause included in public or private international debt obligations (syndicated loan agreements and bond issuances).[41] Many years ago, Francis B. Palmer expressed, "[t]here is no special virtue in the words 'pari passu', 'equally' would have the same effect or any other words showing that the [bonds] were intended to stand on the same level footing without preference or priority among themselves."[42] Philip R. Wood is of the opinion that "[i]n the state context, the meaning of the clause is uncertain because there is no hierarchy of payment which is legally enforced under a bankruptcy regime."[43] He adds that "[p]robably the clause means that on a de facto inability to pay external debt as it falls due, one creditor will not be preferred by . . . a method going beyond contract . . . ."[44] The *pari passu* clause, as brilliantly noted by Lee C. Buchheit "is short, obscure and sports a bit of Latin; all characteristics that lawyers find endearing."[45] As noted by Mitu Gulati and Robert E. Scott, legal professionals still do not agree on its meaning or purpose and even less on its origin.[46]

From a close reading of the clause, it can be argued that it has two limbs: (1) an internal limb, that is, that the bonds will rank *pari passu* with each other; and (2) an external limb, that is, that the bonds will rank *pari passu* with other unsecured (present or future) indebtedness of the issuer.

However, not all *pari passu* clauses are drafted in the same format. They vary according to its drafter, denoting diversity in the language of the same clause which might derive in a different interpretation. Gulati and Scott refer to five different variants of the *pari passu* clause.[47] Simplifying the discussion, there are mainly two possible interpretations: (1) the narrow or "ranking" interpretation, where obligations of the debtor rank and will rank *pari passu* with all other unsecured debt; and (2) the broad or "payment" interpretation, that when the debtor is unable to pay all its obligations, they will be paid on a *pro rata* basis (as in the *Elliott* case). Wood is of the opinion that the key word is "rank" and that "rank" means "rank," not "will pay" or "will give equal treatment."[48]

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41. *Understanding the* Pari Passu *Clause*, *supra* note 3, at 1226.

42. *Id.* (citation omitted).

43. PHILIP R. WOOD, PROJECT FINANCE, SUBORDINATED DEBT AND STATE LOANS § 16-12, at 165 (1995).

44. *Id.*

45. LEE C. BUCHHEIT, HOW TO NEGOTIATE EUROCURRENCY LOAN AGREEMENTS 82 (2d ed. 2000).

46. GULATI & SCOTT, *supra* note 18 (manuscript at 122-32).

47. *Id.*

48. Philip C. Wood, *Pari Passu Clauses—What Do They Mean?*, 18 BUTTERWORTHS J. INT'L BANKING & FIN. L. 371, 372 (2003) (internal quotation marks omitted).

According to Buchheit and Jeremiah S. Pam, the broad or "payment" interpretation has four practical implications:

> (1) It may provide a legal basis for a creditor to seek specific performance of the covenant; that is, a court order directing the debtor not to pay other debts of equal rank without making a ratable payment under the debt benefiting from the clause.
> (2) It may provide a legal basis for a judicial order directed to a third-party creditor instructing that creditor not to accept a payment from the debtor unless the *pari passu*-protected lender receives a ratable payment.
> (3) It may provide a legal basis for a court order directing a third-party financial intermediary such as a fiscal agent or a bond clearing system to freeze any non-ratable payment received from the debtor and to turn over to the *pari passu*-protected creditor its ratable share of the funds.
> (4) It may make a third-party creditor that has knowingly received and accepted a nonratable payment answerable to the *pari passu*-protected creditor for a ratable share of the funds.[49]

If according to the broad or "payment" interpretation the *pari passu* clause should be understood as a *pro rata* distribution rule upon an event of default, why has a "sharing clause" been included side by side with the *pari passu* clause in some debt instruments? A sharing clause is a common feature of syndicated loans to guarantee that if one of the members of the syndicate received a greater payment, it will share ratably with the other members.[50] As Buchheit and Pam have noted, the sharing clause can be four or five pages long while the *pari passu* clause in three or four lines achieves the same feature without even mentioning the word "share" or one of its synonyms.[51] These authors also pose the following hypothetical questions: What would happen if a creditor that has sued to recover on a defaulted bond containing a *pari passu* clause collects the money? Since the creditor knew of the inclusion of the *pari passu* clause, is the creditor going to act as trustee of its fellow bondholders and hold the funds for a ratable distribution?[52] This was the argument used in *Kensington International Ltd. v. BNP Paribas SA*.[53] Nonetheless, the aim of the sharing clause is to suppress litigation, so if

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49. Lee C. Buchheit & Jeremiah S. Pam, *The* Pari Passu *Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869, 880 (2004).

50. *Id.* at 884.

51. *Id.*

52. *Id.* at 888.

53. *See* Complaint at 15, Kensington Int'l Ltd. v. BNP Paribas SA, No. 03602569 (N.Y. Sup. Ct. Aug. 13, 2003).

the latter is the correct interpretation it will collide with the interests of those pursuing litigation.[54]

In the same line of thinking, the use of a "most favored creditor clause" can also be questioned. The aim of this clause—common in workout agreements—is to ensure that if one creditor is paid more, the others will be paid as well—it works as an inverse cross-default clause. This type of clause usually includes a list of exceptions (for example, secured senior debts).[55]

Why can a *pari passu* clause be found together with either a sharing clause or a most favored creditor clause if in the end they will produce similar effects?[56] Simply because the broad or "payment" sense is not the correct interpretation of the *pari passu* clause. Therefore, it is clear that the *Elliott* interpretation of the *pari passu* clause is mistaken.

Another fact that should be considered in analyzing the feasibility of the broad or "payment" interpretation is the fact that it will foster holdout creditors disrupting an orderly restructuring, against what have been endorsed in G-7 and G-10 statements.[57] As noted by the Federal Reserve Bank of New York, "[t]he Belgian courts' interpretation of *pari passu*, however, favors collection over settlement."[58] Moreover, in the aftermath of the Asian crisis and the structuring of the "new financial architecture," in 1998, the G-10 governments suggested the use of collective action clauses ("CACs") and sharing clauses in sovereign bonds.[59] Why would they suggest such a thing if the *pari passu* clause

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54. Lee C. Buchheit, *Changing Bond Documentation: The Sharing Clause*, INT'L FIN. L. REV., July 1998, at 17, 18 ("A true maverick creditor will not much like the presence of a sharing clause in a bond issue it is about to buy. Mavericks buy debt instruments on the secondary market at steep discounts from their face value after the borrower gets into financial trouble. . . . If the terms of a particular bond render it unsuitable for litigation, the maverick is not likely to buy that bond."). *See also* Lee C. Buchheit, *The Sharing Clause as a Litigation Shield*, INT'L FIN. L. REV., Oct. 1990, at 15, 15-16.

55. *Understanding the* Pari Passu *Clause*, *supra* note 3, at 1232.

56. It is worth noting that sharing clauses are difficult to implement in bonds due to their bearer nature. However, trust structures sometimes include certain obligations similar to a sharing clause. *Pari Passu Clauses*, *supra* note 39, at 17-18, 17 n.32.

57. *See* GROUP OF TEN, REPORT OF THE G-10 WORKING GROUP ON CONTRACTUAL CLAUSES 6 (2002), *available at* http://www.bis.org/publ/gten08.pdf; Press Release, U.S. Dep't of the Treasury, Communiqué of the Ministers and Governors of the Group of Ten, Washington, D.C., 27 September 2002 (Sept. 27, 2002), http://www.treasury.gov/press-center/press-releases/Pages/po3472.aspx; Press Release, U.S. Dep't of the Treasury, Statement of G-7 Fin. Ministers and Central Bank Governors, Washington, D.C., 27 September 2002 (Sept. 27, 2002), http://www.treasury.gov/press-center/press-releases/Pages/po3473.aspx.

58. Memorandum of Law of Amicus Curiae Federal Reserve Bank of New York in Support of Defendant's Motion for an Order Pursuant to CPLR § 5240 Denying Plaintiffs the Use of Injunctive Relief to Prevent Payments to Other Creditors at 11, Macrotecnic Int'l Corp. v. Republic of Argentina, 2004 WL 445131 (S.D.N.Y. Mar. 12, 2004) (No. 02 CV 5932 (TPG)).

59. G-22 WORKING GROUP ON INT'L FIN. CRISES, REPORT OF THE WORKING GROUP ON

achieves the sharing bit? Were they aware of the existence of the *pari passu* clause in sovereign debt instruments? The answer again is that they were aware of the clause, but that the broad or "payment" interpretation is wrong. Since the *pari passu* clause does not mean to share on a *pro rata* basis, they were proposing the inclusion of a sharing clause. The counter reaction to this proposal was the rejection of the sharing clause proposal by the investor community.[60] But why did they reject the proposal? Was this feature not already available in sovereign debt instruments by means of the *pari passu* clause since the nineteenth century? Again, it seems that everyone but a few (Elliott, the Brussels Court of Appeal, Red Mountain Financial, Inc., etc.) got the correct interpretation of the clause.

IV. THE (DREADFUL) AFTERMATH OF *ELLIOTT*

Even as it has been argued that the *Elliott* decision lacks precedential value due to its ex parte nature, this court order—wrong as it was—changed the sovereign debt landscape as it is briefly explained below.[61]

The *Elliott* case sets an ex ante and ex post situation in relation to the interpretation of the *pari passu* clause. The ex ante situation was that there was only one possible interpretation of the clause: the narrow or ranking interpretation and that it was included to avoid the creation of preferences either by the sovereign (paying one or some creditors in detriment of others) or by creditors. After the decision of the Belgium court in the *Elliott* case, other cases followed.[62] Creditors were willing to benefit from the broad or "payment" interpretation. This is the ex post situation.

In the analysis of the ex post situation, there were several other initiatives or developments. Each one of them is an independent aspect of sovereign debt "history," but surprisingly, in a search of a common thread, undoubtedly *Elliott* played a central role. Despite the fact that *Elliott* from a technical point of view did not have precedential value since it was an ex parte motion on a preliminary injunction, a misguided interpretation of the *pari passu* clause in the *Elliott* case in Belgium

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INTERNATIONAL FINANCIAL CRISES 19-20 (1998).

60. *See, e.g.*, Edward Luce, *Pakistan a Warning for Bond Holders*, FIN. TIMES, Feb. 18, 2009, at 6 (reporting that the head of the International Primary Market Association expressly stated that "the market opposes the sharing clause").

61. This piece is a contribution to the "Idea" section of the *Hofstra Law Review* which serves as a vehicle for short pieces that provide brief observations on important legal questions. It does not attempt to be exhaustive but to provide some ideas for further consideration.

62. *See supra* note 38 and accompanying text.

opened the door to litigation on incorrect grounds (*pro rata* payment interpretation or broad interpretation of the *pari passu* clause).

The first logical immediate effect of the *Elliott* decision was that the government of Peru entered a final settlement agreement to avoid incurring a new default—a win for vulture funds. Elliott's brilliant strategy was short lived since the settlement agreement has been out-shadowed by subsequent developments—other developments that could not have been anticipated at that time, developments that are completely disproportionate, developments that have unbalanced the status quo, and disproportionate developments—which are analyzed below.

A. Public v. Private Sector Reaction

So far in sovereign debt restructuring episodes the major issue of concern has been the issue of holdout creditors. In light of this situation, the International Monetary Fund ("IMF") has come with a statutory approach proposing the Sovereign Debt Restructuring Mechanism ("SDRM") which is based on Chapter 11 of the U.S. Bankruptcy Code.[63] The market itself came up with two techniques to deal with the same issue: (1) the use of CACs, and (2) exit consents or exit amendments.

The SDRM was based on two complementary approaches to create a more orderly and predictable process for sovereign debt restructuring.[64] There are several elements to link the SDRM proposal with the *Elliott* outcome. For example, according to the IMF, if "claims are purchased by vulture creditors, the SDRM could be used to prevent disruptive litigation."[65] Also, Anne Krueger, who mothered the SDRM proposal, argues that a formal SDRM would need to be built on—among others—the aim of deterring disruptive litigation to achieve its objectives (that is, preventing creditors from obtaining relief through national courts to avoid holdouts, rogue creditors, free riders, and vultures from disrupting negotiations that could lead to a restructuring agreement).[66]

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63. Richard Euliss, *The Feasibility of the IMF's Sovereign Debt Restructuring Mechanism: An Alternative Statutory Approach to Mollify American Reservations*, 19 AM. U. INT'L L. REV. 107, 123-24 (2003).

64. Firstly, the contractual approach to debt restructuring would be facilitated by enhanced use of certain contractual provisions in sovereign debt contracts. Public Information Notice No. 02/106, Int'l Monetary Fund, *IMF Board Discusses Possible Features of a New Sovereign Debt Restructuring Mechanism* (Sept. 24, 2002), http://www.imf.org/external/np/sec/pn/2002/pn02106.htm. The second approach is the establishment of a universal statutory framework that would create a legal framework for collective decisions by debtors and a supermajority of its creditors. *Id.*

65. INT'L MONETARY FUND, THE DESIGN OF THE SOVEREIGN DEBT RESTRUCTURING MECHANISM—FURTHER CONSIDERATIONS 25 (2002), *available at* http://www.imf.org/external/np/pdr/sdrm/2002/112702.pdf.

66. Anne Krueger, First Deputy Managing Dir., Int'l Monetary Fund, Address at the National

This was shortly followed by the "private sector" reaction which pushed for the adoption of CACs and the use of exit consent to induce a greater participation of bondholders in exchange offers and reduce holdouts and their potential disruptive litigation. CACs are clauses whereby, if they are included in the prospectuses of the bonds, the interaction of the bondholders is required. There are four different types of CACs: (1) collective representation clauses, (2) majority action clauses, (3) sharing clauses, and (4) acceleration clauses.[67]

Within CACs, majority action clauses are the type of clauses that have been strongly pursued by the official sector since the endorsement of the "Rey Report" in 1996[68] and many academics, and the clauses were effectively incorporated in bond issuances.[69] Former U.S. Under Secretary of the Treasury for International Affairs John B. Taylor was the father of this approach, and in his own words "a majority action clause would prevent a small minority from delaying or otherwise disrupting an agreement."[70] Majority action clauses enable the amendment of any of the terms and conditions of the bonds, including the payment terms, if the required majority therein established is obtained. So far, the required threshold to amend the terms of the bonds containing majority action clauses has been seventy-five percent in aggregate principal amount of the outstanding bonds (for example, Egypt, Lebanon, Mexico, Qatar, Uruguay, etc.).[71] Brazil and Belize have been the only cases where eighty-five percent has been required.[72]

Exit consent is the technique by which holders of bonds in default who decide to accept an exchange offer, at the moment of accepting the said offer, grant their consent to amend certain terms of the bonds that are being exchanged.[73] By using the exit consent technique, the exchange offer is conditioned to a minimum threshold of creditors'

Economists' Club Annual Members' Dinner: International Financial Architecture for 2002 (Nov. 26, 2001) (transcript *available at* http://www.imf.org/external/np/speeches/2001/112601.htm).

67. Ioannis Kokkoris et al., *The Greek Tragedy: Is There A* Deus ex Machina*?, in* MANAGING RISK IN THE FINANCIAL SYSTEM 155, 166 n.13 (John Raymond LaBrosse et al. eds., 2011).

68. *See generally* GROUP OF TEN, THE RESOLUTION OF SOVEREIGN LIQUIDITY CRISES (1996), *available at* http://www.bis.org/publ/gten03.pdf. The report is commonly referred to as the "G-10 Report" or the "Rey Report" (named after Jean-Jacques Rey).

69. Kokkoris et al., *supra* note 67, at 166 n.13.

70. John B. Taylor, Under Sec'y of the Treasury for Int'l Affairs, Remarks at the Institute for International Economics: "Sovereign Debt Workouts: Hopes and Hazards" Conference (Apr. 2, 2002) (transcript *available at* http://www.iie.com/publications/papers/paper.cfm?ResearchID=455).

71. Kokkoris et al., *supra* note 67, at 166 n.13.

72. *Id.*; Yuefen Li et al., *Avoiding Avoidable Debt Crises: Lessons from Recent Defaults, in* SOVEREIGN DEBT AND THE FINANCIAL CRISES 243, 251 (Carlos A. Primo Braga & Gallina A. Vincelette eds., 2011).

73. *Id.* at 166 n.12.

acceptance and the amendments to the terms are performed once the required majority has been obtained.[74] By means of these amendments, the defaulted bonds subject to the exchange offer become less attractive (in legal and financial terms), forcing a greater number of bondholders to accept the exchange offer. Otherwise, if holdout bondholders do not accept the exchange offer, they will be holding an impaired bond not featuring some of the original contractual enhancements.

B. Legislative Developments

In November 2004, the Belgium Parliament passed Law 4765 [C-2004/03482][75] reinforcing Article 9 of the Belgian Law of April 28, 1999[76] that implemented in Belgium the European Union ("EU") Directive of the European Parliament and of the Council of May 19, 1998 ("EU Settlement Finality Directive") on settlement finality in payment and securities settlement systems.[77] The EU Settlement Finality Directive became effective in December of the same year. As noted in a report by the National Bank of Belgium, "[t]he issue raised by those cases [*Elliott* and *LNC Investments, Inc. v. Republic of Nicaragua*[78]] was addressed . . . by an amendment to the Belgian legislation."[79]

Although the EU Settlement Finality Directive does not prevent attachments, the objective in reinforcing the law implementing this Directive was to shield the flow of funds through Euroclear.[80] According

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74. *Id.*

75. Loi modifiant la loi du 22 mars 1993 relative au statut et au contrôle des établissements de crédit, la loi du 9 juillet 1975 relative au contrôle des enterprises d'assurances, la loi du 2 août 2002 relative à la surveillance du secteur financier et aux services financiers et la loi du 28 avril 1999 visant à transposer law Directive 98/26/CE du 19 mai 1998 concernant le caractère définitif du règlement dans les systèmes de paiement et de règlement des operations sur titres [4765 C-2004/03482] of Nov. 19, 2004, MONITEUR BELGE [M.B.] [Official Gazette of Belgium], Dec. 28, 2004, 85,854, http://www.ejustice.just.fgov.be/mopdf/2004/12/28_1.pdf.

76. Loi visant à transposer la Directive 98/26/CE du 19 mai 1998 concernant le caractère définitif du règlement dans les systèmes de paiement et de règlement des operations sur titres [S-C-99/03307] of Apr. 28, 1999, MONITEUR BELGE [M.B.] [Official Gazette of Belgium], Jan. 6, 1999, 19,563, http://www.ejustice.just.fgov.be/mopdf/1999/06/01_1.pdf.

77. Council Directive 98/26/EC, 1998 O.J. (L 166) 45.

78. No. 96 Civ. 6360 JFK, 2000 WL 745550 (S.D.N.Y. June 8, 2000).

79. NAT'L BANK OF BELG., FINANCIAL STABILITY REVIEW 2005, at 162 (2005), *available at* http://www.bnb.be/doc/ts/Publications/FSR/FSR_2005_EN.pdf.

80. The text of the reformed norm reads as follows:

> No cash settlement account with a settlement system operator or agent, nor any transfer of money to be credited to such cash settlement account, via a Belgian or foreign credit institution, may in any manner whatsoever be attached, put under trusteeship or blocked by a participant (other than the settlement system operator or agent), a counterparty or a third party.

Projet de loi modifiant notamment, en matière de procédures d'insolvabilité, la loi du 22 mars 1993 relative au statut et au contrôle des établissements de crédit et la loi du 9 juillet 1975 relative au

to the explanatory memorandum that accompanied the new law (Law 4765 [C-2004/03482]), the aim is to avoid disruptive actions by creditors by attaching cash accounts held with Belgium clearing systems or obtaining injunctions such as the ones obtained by Elliott and LNC Investments, Inc.[81] Although this law protects the flow of funds made through Euroclear from the attachments or liens of creditors, the latter might resort to other jurisdictions or strategies in order to force a settlement. A clear example is the attachment that was levied on the Argentine bonds tendered by those creditors who accepted the debt exchange offer, which resulted in a delay in the settlement of the bonds.[82]

In April 2010, the U.K. Parliament passed the Debt Relief (Developing Countries) Act 2010.[83] This Act was designed to tackle the problem of vulture funds attempting to collect on Heavily Indebted Poor Countries ("HIPC") by temporarily restricting the actions of vulture funds in U.K. courts.[84] The Act had a limited temporary validity until June 2011.[85] However, the U.K. government has passed legislation to make the law permanent.[86]

C. An Odious Mutation

The "immediate" public and private sector initiatives, generated reactions from the private sector (for example, an increase in vulture fund practices) and political activism from non-governmental

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contrôle des enterprises d'assurances [DOC 51 1157/011] of 25 May 2004, at 64 (emphasis added) (on file with the Hofstra Law Review).

81. *Id.*

82. NML Capital Ltd. and EM Ltd. moved to attach the bonds tendered in the 2005 exchange offer of the Republic of Argentina. EM Ltd. v. Argentina, 473 F.3d 463, 465, 468 (2d Cir. 2007). The plaintiffs were seeking to attach these bonds, which were held by the Federal Reserve Bank of New York (the fiduciary and payment agent), and had been tendered by the bondholders in order to receive the new bonds being issued as a result of the exchange offer. *Id.* at 465. The plaintiffs' main argument was that they were held by the Federal Reserve Bank of New York on behalf of the Argentine government, who will have a future right on the bonds and was going to destroy them upon settlement. *Id.* at 474. However, technically speaking, the attachment was not levied on the bonds, as Argentina was not owner of the bonds until settlement under the exchange offer was performed. The attachment was levied on Argentina's future right to receive such bonds when New York's attachment law, N.Y. C.P.L.R. § 5201(b) (MCKINNEY 1997 & Supp. 2011), requires an attachable interest. *EM Ltd.*, 473 F.3d at 465-66, 476 n.13.

83. Debt Relief (Developing Countries) Act, 2010, c. 22 (U.K.).

84. *UK Stops 'Vultures' Profiting from Poor Country Debt*, DEP'T FOR INT'L DEV., http://www.dfid.gov.uk/news/latest-news/2011/uk-stops-vulture-funds-profiting-from-poor-country-debt (last updated Oct. 3, 2011).

85. Debt Relief (Developing Countries) Act, c. 22, §§ 9–10.

86. The Debt Relief (Developing Countries) Act 2010 (Permanent Effect) Order, 2011, S.I. 2011/1336, ¶ 2 (U.K.).

organizations ("NGOs") advocating for the repudiation of debts (many in the hands of vulture funds) on (mistaken) grounds of odiousness[87] or (more recently) illegitimacy. The Norwegian characterization of the debts resulting from the Ship Export Campaign[88] as "illegitimate" gave a new twist to the "odious debt" discussion. As a result of the narrow exceptions of the doctrine of state succession—which made inapplicable the odious debts exception unless there is a newly independent state (which is not usually the case)—the NGOs embraced a new terminology: illegitimate debts. However, they forgot the caveat made by the Norwegian government: "illegitimate" not in the legal sense, but more a mere expression of will. The use of the terminology "illegitimate debts"

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87. For a detailed discussion on odious debts and how they mutated into illegitimate debts, see generally RODRIGO OLIVARES-CAMINAL, LEGAL ASPECTS OF SOVEREIGN DEBT RESTRUCTURING §§ 3-083 to 3-099, at 167-84 (2009) [hereinafter LEGAL ASPECTS OF SOVEREIGN DEBT RESTRUCTURING]. This debate about "odious debts" and the so-called "debts of an odious regime" is one difficult to have because—as noted by Buchheit and Gulati—one side (the activists) is talking mostly about moral issues while the other side (academics, practicing lawyers, and policy makers) is talking about legal and economic realities. Lee C. Buchheit & G. Mitu Gulati, *Odious Debts and Nation-Building: When the Incubus Departs*, 60 ME. L. REV. 477, 481 (2008). Andrew Yianni and David Tinkler refer to the first group as the "supporters of the political approach" and note that they make an argument based on political principles rather than using legal techniques and cannot be subject to serious legal analysis because it is not based on legal principles. Andrew Yianni & David Tinkler, *Is There a Recognized Legal Doctrine of Odious Debts?*, 32 N.C. J. INT'L L. & COM. REG. 749, 750, 752 (2007).

88. *See* Annex to Press Release No. 118/06 02.10.06, Royal Norwegian Ministry of Foreign Affairs, Cancellation of Debts Incurred as a Result of the Norwegian Ship Export Campaign (1976-80) (Oct. 2, 2006), http://www.regjeringen.no/en/dep/ud/Documents/Reports-programmes-of-action-and-plans/Reports/2006/Cancellation-of-debts-incurred-as-a-result-of-the-Norwegian-Ship-Export-Campaign-1976-80.html?id=420457 [hereinafter Annex to Press Release]. Between 1976 and 1980, Norway developed an export campaign known as the Norwegian Ship Export Campaign. *Id.* In this campaign, 156 vessels and ship equipment in the amount of NOK 3.7 billion were exported to twenty-one countries. *Id.* The way in which the export campaign was structured positioned the Norwegian government as holder of guarantees against the debtor countries. MINISTRY OF FOREIGN AFFAIRS, DEBT RELIEF FOR DEVELOPMENT 6 (2004), *available at* http://www.regjeringen.no/upload/kilde/ud/rap/2004/0225/ddd/pdfv/217380-debtplan.pdf [hereinafter DEBT RELIEF FOR DEVELOPMENT]. In the 1980s, there were a series of defaults of the outstanding debts, the guarantees were triggered, and the Norwegian government became the creditor of government-to-government debt. *See id.* at 13. In 1988 and 1989, the Norwegian Government conducted an evaluation of the Ship Export Campaign, where the main conclusion was that this kind of campaign should not be repeated. Annex to Press Release, *supra*. In October 2006, the Norwegian Ministry of Foreign Affairs published a press release where it announced the unilateral cancellation in 2007 of debts incurred as a result of the export campaign on the grounds that "the Ship Export Campaign was a development policy failure" and that "Norway shares part of the responsibility." *Id.* The Norwegian government expressly stated that the unilateral forgiveness of debt will be a one-off debt relief policy measure and that all future debt forgiveness will be performed through multilaterally coordinated debt relief operations. *See generally* DEBT RELIEF FOR DEVELOPMENT, *supra*. In documents filed with the Parliament in 2007, it was stated that "[t]here is . . . no justification to characterize these debts as illegitimate in the legal sense." LEGAL ASPECTS OF SOVEREIGN DEBT RESTRUCTURING, *supra* note 87, § 3-097, at 182.

has gained notorious popularity, without there existing a general understanding of its real meaning.[89] As Cephas Lumina has noted, the concept of illegitimate debts has not been conceived as a purely legal definition but rather encompassing ethical, social, political, and economic implications.[90] The only thing that seems to be clear is that the odious debt concept has mutated into a more expansive, albeit controversial, concept.

Another related development—in part as a result of NGOs' lobbying, developing countries' activism, and also due to the generosity of the Norwegian government—is that the U.N. Conference on Trade and Development also launched an initiative to explore the legitimacy of debt and promote responsible lending practices to counter effect—to a certain extent—vulture fund practices.[91]

D. Rogue Creditors and Debtors

Some of the developments analysed above have pushed both sides to a more aggressive position. Creditors have become more belligerent

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89. The terminology "illegitimate debts" has been increasingly invoked as a rationale for different types of sovereign debt repudiation and cancellation. The main problem with the new terminology is that due to the lack of a clear denomination, different stakeholders have developed their own definitions. The multiple definitions of illegitimate debts usually include: (1) debt incurred by non-democratic governments; (2) debts incurred with elements of corruption; (3) debts used against the interests of the people who have to repay them; (4) debts which cannot be serviced without causing harm to the population (threatening the realization of basic human rights); (5) debts incurred with high interest rates (usurary or predatory); and (6) debt resulting from Brady Plan agreements. *See, e.g.*, AFRICAN FORUM & NETWORK ON DEBT & DEV., ISSUES PAPER NO. 1/2002: FAIR AND TRANSPARENT ARBITRATION ON DEBT 4 (2002), *available at* http://www.odiousdebts.org/odiousdebts/publications/IssuesPaper.pdf; JUBILEE USA NETWORK, RECENT DEVELOPMENTS ON ODIOUS & ILLEGITIMATE DEBT 2 (2008), *available at* http://www.jubileeusa.org/fileadmin/user_upload/Resources/Policy_Archive/408briefnoteodiousilldebt.pdf; NEW ECON. FOUND., DEBT RELIEF AS IF PEOPLE MATTERED: A RIGHTS-BASED APPROACH TO DEBT SUSTAINABILITY 21-22 (2006), *available at* http://www.i-r-e.org/docs/a006_rights-based-approach-to-debt-sustainability.pdf; PARLAMENTO LATINO AMERICANO [LATIN AMERICAN PARLIAMENT], INFORME VERSIÓN VII: LA DEUDA EXTERNA ANTE EL DERECHO INTERNATIONAL PUBLICO [EXTERNAL DEBT BEFORE PUBLIC INTERNATIONAL LAW] (2001) (on file with the Hofstra Law Review); WORLD COUNCIL OF CHURCHES, DOSSIER ON GLOBALISATION AND DEBT 6 (1999).

90. U.N. Secretary-General, *Effects of Foreign Debt and Other Related International Financial Obligations of States on the Full Enjoyment of All Human Rights, Particularly Economic, Social and Cultural Rights*, ¶ 21, U.N. Doc. A/64/289 (Aug. 12, 2009).

91. This initiative is the project on "Promoting Responsible Sovereign Lending and Borrowing." *Promoting Responsible Lending and Borrowing*, UNITED NATIONS CONFERENCE ON TRADE & DEV., http://www.unctad.org/templates/WebFlyer.asp?intItemID=5213&lang=1 (last visited Mar. 1, 2012). Having been personally involved in this initiative, in its early stage, the initiative was heavily influenced by activists condemning vulture fund practices and advocating for debt repudiation. This tendency was—in some way—balanced with a broader involvement of other sectors participating in the dialogue.

and debtors more aggressive. On the creditor side, we have seen more vulture litigation and even an alleged payment of bribes.

However, although the issue of a rogue debtor has not been extensively addressed in the academic literature, it poses a real threat to the international financial architecture. First, it was Peru in 1985 under the aegis of Alan García Pérez (recently re-elected in 2006),[92] then Argentina in 2001-2002 that created a new precedent in the international markets: (1) its defiant position; (2) its lack of dialogue with creditors;[93] (3) proposing the biggest write-off in recent bond restructuring history with its initial proposal of ninety-two percent net present value write-off;[94] and (4) exceeding the precedents of the 1990s regarding the time elapsed between the default and the date on which the restructuring was finally announced.[95]

Argentina's proposal can be understood as a negotiation technique in an attempt to show creditors that it is making an improvement and taking into account their comments when at a later stage it makes a better proposal. In any event, a proposal of this magnitude cannot be considered seriously. As noted by Arturo C. Porzecanski, a demand for such massive debt relief has seen no precedent, neither in Argentina's troubled history nor in much poorer countries (for example, Albania in 1995, Bolivia in 1992, Guyana in 1999, Niger in 1991, and Yemen in 2001).[96] Moreover, Porzecanski also stressed the fact that the creditors in those occasions were commercial banks and the sums involved have been far smaller.[97]

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92. Then-President García, of Peru, in a memorable speech stated that: "[w]e will begin a dialogue with our creditors without using the International Monetary Fund as a middleman and for the next 12 months and while situations do not change, we will only devote to the service of the foreign debt not more than 10% of the total value of our exports and not the 60% that has been demanded." Cynthia Weber, *Representing Debt: Peruvian Presidents Balaúnde's and García's Reading/Writing of Peruvian Debt*, 34 INT'L STUD. Q. 353, 353 (1990). Thereafter, the foreign debt payments were suspended for six months to stimulate economic domestic growth. *Id.*

93. Letter to the Editor, *Argentina's Foolish Debt Gamble*, FIN. TIMES, Jan. 14, 2005, at 16.

94. Rodrigo Olivares-Caminal, *Sovereign Bonds: A Critical Analysis of Argentina's Debt Exchange Offer*, 10 J. BANKING REG. 28, 31 (2008). If a comparison is made between the seventy-five percent obtained in terms of par value (sixty-six percent net present value) against Ecuador's forty percent or Russia's thirty-six percent (Ukraine, Pakistan, and Uruguay made no haircut), Argentina's haircut was much larger, and this could have discouraged participation by certain creditors, who opted to recover their claims through court actions. *To Rank* Pari Passu, *supra* note 17, at 750.

95. On January 13, 2005—after thirty-six months of default—Argentina released, by means of Resolution 20/05 issued by the Ministry of Economy, the final offering prospectus and supplement including the terms and conditions of the exchange offer. *To Rank* Pari Passu, *supra* note 17, at 747-48.

96. Arturo C. Porzecanski, *From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default*, 6 CHI. J. INT'L L. 311, 325 (2005).

97. *Id.*

Argentina's default was followed by Ecuador's default in 2008.[98] At the moment of the default, Ecuador had three outstanding series of bonds: (1) twelve percent USD global bonds due 2012; (2) USD step-up global bonds due 2030; and (3) USD global bonds due 2015.[99] The 2012 and 2030 bonds were issued in 2000 to restructure the Brady bonds.[100] The 2015 bonds were issued to purchase some of the 2012 bonds in accordance with the issuance terms of the latter (mandatory pre-payment arrangement).[101]

Because of previous debt-restructuring exercises and reserve accumulation due to high oil prices, market participants did not perceive Ecuador as having an unsustainable debt situation prior to the default. Nevertheless, Ecuador decided to stop servicing a subset of its external bonds because these bonds were found to be illegitimate or illegal by the debt audit commission (Comisión para la Auditoría Integral del Crédito Público ("CAIC")) mandated by a presidential decree in 2006.[102] The audit report produced by the CAIC found several cases in which Ecuador's debt was incurred by illegal and/or illegitimate means.[103] Although the CAIC concluded that several debt instruments (including the three bonds and other debt instruments) were illegal and/or illegitimate, Ecuador decided to default only on the 2012 and 2030 bonds.[104]

In April 2009, Ecuador launched a cash buyback offer to repurchase the 2012 and 2030 bonds which was accepted by ninety-one percent of the bondholders.[105] The Ecuadorian default is a landmark case because it is the first default in modern history in which ability to pay played almost no role.[106] In addition, it is important to stress that Ecuador

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98. Li et al., *supra* note 72, at 252.

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* "The objective of the CAIC is to audit the processes by which public debt has been incurred to determine its legitimacy, legality, transparency, quality, efficacy, and efficiency, considering legal and financial aspects; economical, social, gender, and environmental impacts; and the impacts on nationalities and people." *Id.* at 266 n.10. The scope of the audit comprised agreements, contracts, and other forms of public financing between 1976 and 2006. *Id.*

103. *Id.* at 252.

104. *Id.*

105. Press Release, Maria Elsa Viteri Acaiturri, Minister of Fin., Republic of Ecuador, Republic of Ecuador US Dollar Denominated Step-Up Global Bonds Due 2030 (the "2030 Bonds") and 12 Per Cent; US Dollar Denominated Global Bonds Due 2012 (the "2012 Bonds") (Together the "Bonds") (June 12, 2009) (on file with the Hofstra Law Review).

106. In the Ecuadorian Noteholder Circular dated April 20, 2009 (to submit to a modified Dutch auction to sell bonds for cash) it was stated that as of December 31, 2008 the total internal and external debt represented 26.1 percent of gross domestic product, which was totally manageable. Li et al., *supra* note 72, at 267 n.11. A 2008 financial report stated that "it is still

allegedly performed an aggressively secondary repurchase via intermediaries when the price for the defaulted 2012 and 2030 bonds hit rock bottom.[107] Therefore, the participation percentage does not reflect the reality. It remains to be seen if Ecuador will pay a long-term reputational cost for its action and if the actions of Ecuador will have an effect on the workings of the market for the sovereign debt of emerging market countries. As we can see, it is not a one-off situation but one that is becoming recurrent.

E. Other Escalating Events

The importance and relevance that *Elliott* acquired can also be highlighted by several other events that took place since this decision. These include high profile politician speeches to actual documents such as "statement of interest" briefs to Paris Club press releases. Some of the most relevant include:

(1) In a 2002 widely echoed speech to the U.N. General Assembly, the then-U.K. Chancellor of the Exchequer, Gordon Brown, stated that "[the U.K.] particularly condemn[ed] the perversity where Vulture Funds purchase debt at a reduced price and make a profit from suing the debtor country to recover the full amount owed—a morally outrageous outcome."[108]

(2) In 2004, the U.S. Department of Justice, for only the third time in the history of the sovereign debt market, filed a "statement of interest" brief in litigation in New York against Argentina in which the *pari passu* issue was raised.[109] Surprisingly, the filing occurred before the issue had been established.

(3) In May 2007, the Paris Club issued a press release addressing the issue of vulture litigation:

> In particular, consistent with the Paris Club principle of comparability of treatment and taking stock of the

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difficult to argue that Ecuador's debt faces a sustainability problem. . . . [T]he current situation is triggered by a lack of willingness to pay (rather than a lack of ability to pay)." DEUTSCHE BANK, ECUADOR: ON THE LIKELIHOOD OF DEBT RESTRUCTURING 1 (2008).

107. Li et al., *supra* note 72, at 253.

108. Gordon Brown, Chancellor of the Exchequer, Speech at the United Nations General Assembly Special Session on Children: Financing a World Fit for Children (May 10, 2002) (transcript *available at* http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/Newsroom_and_Speeches/Press/2002/press_46_02.cfm).

109. Statement of Interest of the United States at 2, 6, Macrotecnic Int'l Corp. v. Republic of Argentina, 2004 WL 445131 (S.D.N.Y. Mar. 12, 2004) (No. 02 CV 5932 (TPG)).

> harmful consequences of litigation[,] . . . Paris Club creditors confirm that they are committed to avoid selling their claims on HIPC . . . to other creditors who do not intend to provide debt relief under the HIPC initiative, and urge other creditors to follow suit.[110]

(4) Vulture fund activities also reached the meetings of the G-7 Finance Ministers in 2007. In a meeting in Washington, D.C., the Finance Ministers expressed that they "remain[ed] concerned about the problem of aggressive litigation against HIPC . . . [and] urge[ed] all sovereign creditors not to on-sell claims on HIPCs, and are examining additional steps that might be taken."[111]

(5) In the United States in 2009, two bills were introduced: (a) H.R. 2493, titled the Judgment Evading Foreign States Accountability Act of 2009, introduced to "prevent wealthy and middle-income foreign states that do business, issue securities, or borrow money in the United States, and then fail to satisfy United States court judgments totaling $1,000,000 or more . . . from inflicting further economic injuries in the United States";[112] and (b) H.R. 2932, titled the Stop Very Unscrupulous Loan Transfers from Underprivileged Countries to Rich, Exploitive Funds Act (or the "Stop VULTURE Funds Act"), prohibiting any U.S. person from engaging in "sovereign debt profiteering," or any person at all from engaging in such profiteering in the United States and any U.S. court from issuing "a summons, subpoena, writ, judgment, attachment, or execution, in aid of a claim . . . would further[] sovereign debt profiteering."[113]

In an article on supermajority, Buchheit contends that:

> Perhaps the well-publicized attempts by holdout creditors to seize payments destined for fellow lenders that *had* given the sovereign debt relief in the past brought home the first rule of Sherwood Forest: when

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110. Press Release, Paris Club, Press Release of the Paris Club on the Threats Posed by Some Litigating Creditors to Heavily Indebted Poor Countries (May 22, 2007), http://www.clubdeparis.org/sections/communication/archives-2007/communique-presse-du.

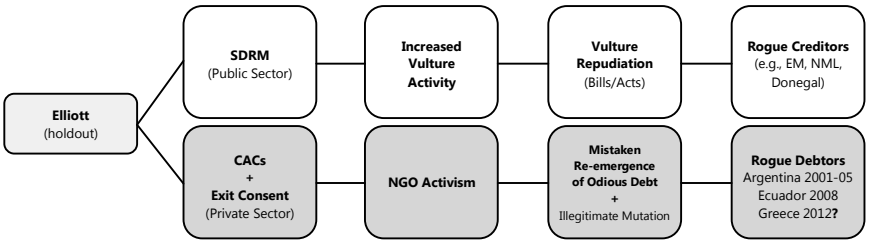
111. Press Release, U.S. Dep't of the Treasury, Statement of G-7 Finincial Ministers and Central Bank Governors October 19, 2007 (Oct. 19, 2007), http://www.treasury.gov/press-center/press-releases/Pages/hp625.aspx.

112. Judgment Evading Foreign States Accountability Act of 2009, H.R. 2493, 111th Cong. §§ 1–2.

113. Stop Very Unscrupulous Loan Transfers from Underprivileged Countries to Rich, Exploitive Funds Act, H.R. 2932, 111th Cong. §§ 1, 4–5 (2009).

> he takes from someone else, he is Robin Hood; when he takes from you, he is a brigand.[114]

Thereafter, all the developments that we have seen can be summarized in the following diagram:



As expressly pointed out by Gulati and Scott:

> With hindsight, we know that none of the solutions that was implemented—the Belgian legislation, the filing of amicus briefs by the U.S. Department of Justice, the introduction of [CACs], the [Financial Markets Law Committee] Report—fully resolved the problem. Pari passu litigation against sovereigns remains a live concern . . . .[115]

This assertion re-confirms the causal relationship between several of the post-*Elliott* initiatives and reminds us that it is still an ongoing issue.

V. *NML CAPITAL LTD. V. ARGENTINA*: A NEW CHAPTER IN THE *PARI PASSU* SAGA

In *Elliott* there was no breach of the *pari passu* clause, just a wrong understanding of its meaning. In the *NML Capital Ltd. v. Republic of Argentina*[116]case, the whole story could be different since it can be correctly interpreted as a breach of the *pari passu* clause in its ranking or narrow form.[117] It is important to stress the difference between these two scenarios, that is, litigation *pre* and *post* Argentina's sovereign debt exchange offer. Pre-Argentina's litigation was based on an incorrect

114. *Supermajority Control Wins Out*, *supra* note 12, at 21.

115. GULATI & SCOTT, *supra* note 18 (manuscript at 111-12).

116. No. 08 Civ. 6978 (TPG), 2011 WL 4529332 (S.D.N.Y. Sept. 28, 2011).

117. Memorandum of Law in Support of the Motion by NML Capital, Ltd. for Partial Summary Judgment and for Injunctive Relief Pursuant to the Equal Treatment Provision at 14-15, *NML Capital, Ltd.*, 2011 WL 4529332 (No. 08 Civ. 6978 (TPG)) ("This *formal*, *legal* lowering of NML's rank violates the Equal Treatment Provision even under Argentina's interpretation (as well as under NML's interpretation).").

interpretation of the *pari passu* clause made by a Belgium court. Post-Argentina's litigation is based on a correct interpretation and an actual breach of the *pari passu* clause. If this is the case, a new wake of *pari passu* litigation may be triggered.

Without having the possibility of using CACs or exit consents, Argentina to a certain extent ran out of options to enhance creditor participation in its exchange offer in 2005.[118] The only option left was to creatively use the contractual terms of the bonds (for example, the most favored creditor clause).[119] Therefore, Argentina passed Law 26,017[120] (the "Padlock Law") to reassure participating creditors that the offer was the only possible choice.[121] However, something that seemed so simple—such as passing a law to gain credibility and to leave the blunder of the most favored creditor clause included in the exchange offer prospectus in the past—is at center stage in a *pari passu* attack.

The Padlock Law provided a basis for considering an alteration in the legal ranking of the existing unsecured creditors resulting in the involuntary subordination of the holdout creditors. The obligation imposed on a sovereign debtor under the ranking interpretation of the *pari passu* clause was generally to prevent sovereigns from adopting legal measures which have the effect of preferring one set of creditors against the others. As a result, the holdout creditors can meet their end by resorting to litigation in the hope of obtaining a better outcome than that of the exchange offer—but due to a breach of the *pari passu* clause on legal subordination grounds rather than on a broad or ratable payment interpretation. The problem here is not the issuance of performing debt as a result of the exchange offer and their interest payments. The problem is that a law—a formal act—subordinated the holdouts to non-performing status and therefore payments do not rank equally anymore. The old bonds are formally subordinated to the new bonds.

VI. CONCLUDING REMARKS

The *Elliott* decision was an aberration,[122] but one that caused furor. The problem was that in the *Elliott* case there was no actual breach of the

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118. *To Rank* Pari Passu, *supra* note 17, at 766.

119. For an enlargement on the most favored creditor clause and the *pari passu* clause in the Argentine saga, see *id*. at 755-57.

120. Law No. 26,017, art. 3, Feb. 10, 2005 (Arg.) (unofficial translation on file with the Hofstra Law Review).

121. *To Rank* Pari Passu, *supra* note 17, at 757. For an enlargement on the Padlock Law, see *id.* at 757-66.

122. It has been argued that the "Belgian judges [were] wholly unfamiliar with the finer points of New York sovereign bond documentation." GULATI & SCOTT, *supra* note 28 (manuscript at 55).

pari passu clause, just a misinterpretation of its meaning and scope. The best way to illustrate this rationale is by citing the text of an interview providing a view on market participants. In such an opportunity, it was stated that "the market participants never thought that the Belgian court was right. We should not tinker with what is not broken."[123]

Since lawyers are educated and trained to rely on legal precedents, that is what they are going to do. They did not register the *Elliott* outcome as a possible outcome in a second case and therefore, lawyers stick to the legal precedent: a contract that has been tested in hundreds of deals. The tested contract is the precedent, not the ex parte foreign court order applying New York law. However, they are forcing their clients to eventually face an unnecessary risk, exposing a principal-agent problem. Using former Secretary of Defense Donald Rumsfeld as an aid in an attempt to describe the current status, we can say that:

"[T]here are known knowns; there are things we know we know."	That is, the *Elliot* interpretation of the *pari passu* clause.
"We also know there are known unknowns; that is to say we know there are some things we do not know."	That is, what will happen if we remove the *pari passu* clause from a debt instrument.
"But there are also unknown unknowns—the ones we don't know we don't know."[124]	That the *pari passu* clause can eventually be interpreted by a more authoritative court that can sympathize with the *Elliott* interpretation.

Gulati and Scott correctly pointed out that although much ink has been spilt already on the *raison d'être* of the clause (even a bit more on this Article) a vast majority of sovereign debt practitioners emphasized that the clause has little or no meaning in the sovereign context although it "apparently" cannot be removed.[125] As they noted, boilerplates are

123. *Id.* (manuscript at 118).

124. Donald Rumsfeld, Sec'y of Def., U.S. Dep't of Def., DoD News Briefing—Secretary Rumsfeld and Gen. Myers (Feb. 12, 2002) (transcript *available at* http://www.defense.gov/transcripts/transcript.aspx?transcriptid=2636) (addressing the absence of evidence linking the government of Iraq with the supply of weapons of mass destruction to terrorist groups).

125. *See generally* GULATI & SCOTT, *supra* note 18.

"sticky."[126] The only problem is that a meaning or use must be found for the *pari passu* clause in debt instruments because otherwise, another court might fill in the gap with similar disastrous consequences as those in the *Elliott* case. In the meantime, it is costing lawyers' clients real money (as much as fifty basis points) since the *Elliott*-type *pari passu* clause is seen in the market as more risky and priced accordingly, as demonstrated by Gulati and Scott.[127] Therefore, the next question should be what is more costly—the lawyers' fees to analyze the need of the *pari passu* clause in a bond instrument or fifty basis points in each issuance? Markets and their players (including transactional lawyers) are creatures of habit and as such will resist changes—changes that are not known ("unknown unknowns").

Elliott's strategy, that is, to use the *pari passu* clause, is an innovation that served its purpose. The million dollar question is whether such brilliance really benefited Elliott or has become a curse since the whole plethora of counter-reactions to said ruling changed the whole landscape. The outcome of the *pari passu* litigation in the Argentine case is uncertain, but since it is in under New York jurisdiction it can change things forever.

126. *Id.* (manuscript at 18).
127. *Id.* (manuscript at 84).