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International Arbitration Case Law

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NML CAPITAL, LTD., AURELIUS CAPITAL MASTER, LTD., ACP MASTER, LTD., ET AL. V. THE REPUBLIC OF ARGENTINA
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT
(DOCKET NO. 12-105 L)

Case Report by Orlando F. Cabrera C. **
Edited by Ignacio Torterola***

A judgment decided on October 26, 2012. Plaintiffs appealed from permanent injunctions entered by the U. S. District Court of the Southern District of New York (Griesa, J.) designed to remedy Argentina's breach of its obligations to pay bondholders after the default on its sovereign debt of 2001. The Court of Appeals held that Argentina breached its promise and affirmed the underlying judgments of the district court. The case was remanded in part in order to clarify how the injunctions were to function.

Tribunal:	Pooler, B.D. Parker and Raggi, Circuit Judges
Plaintiff-Appellee's Counsel:	Theodore B. Olson of Gibson, Dunn & Crutcher LLP; Robert A. Cohen, Charles I. Poret, Eric C. Kirsch, Dechert LLP; Stephen D. Poss Robert D. Carroll, Godwin Procter LLP; Michael C. Spencer, Milberg LLP; Edward A. Friedman, Daniel B. Rapport, Friedman Kaplan Seiler & Adelman LLP, et al.
Defendant-Appellant's Counsel:	Jonathan I. Blackman (Carmine D. Boccuzzi, Sara A. Sanchez, Michael M. Brennan on the brief) of CLEARY GOTTLIEB STEEN & HAMILTON LLP

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1. Facts of the Case

1.1 Overview

In 1994, Argentina issued debt securities pursuant to a Fiscal Agency Agreement ("FAA Bonds"). A number of plaintiffs-appellees bought FAA Bonds starting December 1998 and the others purchased FAA Bonds on the secondary market. The FAA contains the "*Pari Passu* Clause" that provides 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…"*

The Court referred to the second sentence of the *Pari Passu* Clause as the "Equal Treatment Provision." Following the 2001 default on the FAA Bonds, Argentina offered holders of the FAA Bonds new exchange bonds in 2005 and 2010 (the "Exchange Bonds"). Argentina continued to make payments to holders of those Exchange Bonds while failed to pay the defaulted FAA Bonds. After the default, the President of Argentina declared a "temporary moratorium" on payments on more than $80 billion of its public external debt including the FAA Bonds. Argentina has renewed the moratorium and has not paid the defaulted debt.

The plaintiffs alleged that Argentina violated the *Pari Passu* Clause by subordinating their FAA Bonds to the Exchange Bonds and lowering the ranking of their FAA Bonds below the Exchange Bonds. The primary issues on appeal were whether Argentina violated the *Pari Passu* Clause, and if so, whether the remedy ordered by the district court was appropriate.[1]

1.2 Argentina's Restructurings

In 2005, Argentina initiated an exchange offer in which it allowed FAA bondholders to exchange their defaulted bonds for new unsecured and unsubordinated external debt. In exchange for the new debt, participants agreed to forgo various rights and remedies previously availed under the FAA.

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[1] Judgment, pp. 4-6

In 2010, Argentina initiated a second exchange offer with a payment scheme similar to the 2005 offer. In both exchanges, Argentina exerted pressure on bondholders to accept the respective exchange offers. After the two exchanges, Argentina had restructured over 91% of the defaulted foreign debt. Plaintiffs did not participate in any of the above exchanges. However, Argentina has made all payments due on the debt it restructured in 2005 and 2010.[2]

1.3 Proceedings Below

Plaintiffs sued Argentina on the defaulted FAA Bonds at various points from 2009 to 2011, alleging breach of contract and seeking injunctive relief, including specific performance of the Equal Treatment Provision. Plaintiffs hold judgments against Argentina in separate litigation that its courts have refused to honor.

The FAA is governed by the New York law and further provides for jurisdiction in "*any state or federal court in The City of New York*." However, Argentina's courts have held that Law 26,017 (the "Lock Law") and the moratoria on payments prevent them from recognizing the New York judgments regarding the FAA Bonds. In SEC filings, Argentina stated that it has classified unexchanged FAA Bonds as a category separate from its regular debt and that, since 2005 it has "*not* [been] *in a legal … position to pay*" that category.[3]

In December 2011, the district court granted plaintiffs partial summary judgment (the "Declaratory Orders"). The Court observed that Argentina violates the Equal Treatment Provision "*whenever it lowers the rank of its payment obligations under [plaintiffs'] Bonds below that of any other present or future unsecured and unsubordinated External Indebtedness.*"

The district court held that Argentina "lowered the rank" of the plaintiffs' bonds in two ways: (1) "*when it made payments currently due under the Exchange Bonds, while persisting in its refusal to pay its obligations currently due under* [plaintiffs'] *Bonds*" and (2) "*when it enacted"* Lock Law and Lock Law Suspension[4]."

In January 2012, the district court issued a temporary order enjoining Argentina

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[2] Judgment pp. 6-9.

[3] This Law states as follows: "*Article 3 – The national State shall be prohibited from conducting any type of in-court or private settlement with respect to the bonds…"*

[4] To overcome the Lock Law's prohibition against reopening the Exchange, Argentina temporarily suspended the Lock Law by means of Law 26,547 (Lock Law Suspension).

> "*from altering or amending the processes or specific transfer mechanisms (including the use of specific firms) by which it makes payments due to holders of bonds or other securities issued pursuant to its 2005 and 2010 exchange offers, including without limitation by using agents, financial intermediaries and financial vehicles other than those used at the time of this Order.*"

1.4 The District Court's Injunctions

In February 2012, the district court granted injunctive relief, ordering Argentina to specifically perform its obligations under the Equal Treatment Provision (the "Injunctions"). The Injunctions provide that "*whenever the Republic pays any amount due under the terms of the [exchange] bonds*" it must "*concurrently or in advance*" pay plaintiffs the same fraction of the amount due to them (the "Rentable Payment"). However, the court of appeals was unable to discern precisely how the formula was intended to operate. On remand the district court will have the opportunity to clarify how it intends this injunction to operate.

Parties, their officers, agents, servants, employees, attorneys and other persons who are in active concert or participation with them, are bound by injunctions. Additionally, the Injunctions expressly prohibit Argentina's agents from

> "*aiding and abetting any violation of this ORDER, including any further violation by [Argentina] of its obligations under [the Equal Treatment Provision], such as any effort to make payments under the terms of the Exchange Bonds without also concurrently or in advance making a ratable payment to [plaintiffs]*"

To give effect to this provision, the Injunctions prevent Argentina from "*altering or amending the processes or specific transfer mechanisms by which it makes payments on the Exchange Bonds*" without approval of the court. Argentina shall certify to the court, concurrently or in advance of making a payment on the Exchange Bonds, that it has satisfied its obligations under the Injunctions.

In justifying the remedy, the court reasoned that absent equitable relief, plaintiffs would suffer irreparable harm since the Republic's payment obligations to plaintiffs would remind debased of their contractually guaranteed status, and plaintiffs would never be restored to the position they were promised that they would hold relative to other creditors in the event of default. In addition, there was no adequate remedy at law since the Republic made clear its intention to defy any money judgment issued by the district court. The Injunctions do not jeopardize the rights of the exchange bondholders because all that Argentina has to do is to honor its legal obligations.

2. Legal Issues Discussed in the Decision

2.1 Interpretation of the Equal Treatment Provision

The district court held that Argentina violated the Provision when it made payments currently due under the Exchange Bonds while refusing to pay its obligations to plaintiffs and when it enacted the Lock Law and the Lock Law Suspension.

"*In New York a bond is a contract …*"[5] As such, the dispute over the meaning of the Equal Treatment Provision presented a "*simple question of contract interpretation*."[6] The Court of Appeals found the construction of *pari passu* clauses in the sovereign debt context far from "*general, uniform and unvarying.*[7]"

As to the *Pari Passu* Clause, the Court of Appeals noted that the first sentence (*"[t]he Securities will constitute … direct, unconditional, unsecured, and unsubordinated obligations …"*) prohibits Argentina, as bond *issuer,* from formally subordination the bonds by issuing superior debt. The second sentence ("*[t]he payment obligations … shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness."*) prohibits Argentina, as bond *payor,* from paying on other bonds without paying on the FAA Bonds. Consequently, the two sentences protect against discrimination: the issuance of other superior debt (first sentence) and giving of priority to other payment obligations (second sentence).

In addition, the Court of Appeals stated that this constraint on Argentina as payor makes good sense in the context of sovereign debt. When sovereigns default they do not enter bankruptcy proceedings where the legal rank of debt determines the order in which creditors will be paid. Instead, sovereigns can choose for themselves the order in which creditors will be paid. Thus, the Equal Treatment Provisions prevents Argentina as payor from discriminating against the FAA Bonds in favor of other unsubordinated, foreign bonds.

Furthermore, the Court of Appeals found that Argentina had ranked its payment obligations to the plaintiffs below those of the exchange bondholders. After declaring the moratorium on its outstanding debt in 2001, Argentina made no payment for six years on plaintiffs' bonds while simultaneously timely servicing

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[5] Citing *Arch Ins. Co. v. Precision Stone, Inc.*, 584 F3d 33, 39 n4 (2d Cir. 2009)

[6] Citing *EM Ltd. v. Republic of Argentina*, 382 F3d 291, 292 (2d Cir. 2004).

[7] Citing *Law Debenture Trust Co. of N.Y. v. Maverick Tube Corp.*, 595 F3d 458, 466 (2d Cir. 2010)

the Exchange Bonds. It declared in the prospectuses associated with the exchange offers that it has no intention of resuming payments on the FAA Bonds.[8] It stated in SEC filings that it had "*classified the [FAA Bonds] as a separate category from its regular debt*" and is "*not in a legal … position to pay*" them.

Lock Law has precluded the Argentinean officials from paying defaulted bondholders and barred courts from recognizing judgments. Conversely, were Argentina to default on the Exchange Bonds, and were those bondholders to obtain New York judgments against Argentina, there would be no barrier to the Republic's courts recognizing those judgments. Even under Argentina's interpretation of the Equal Treatment Provision as preventing only "legal subordination" of the FAA Bonds to others, the Republic breached the Provision.

The Court of Appeals determined that Plaintiffs' beneficial interests do not remain direct, unconditional, unsecured and unsubordinated obligations of the Republic and that any claims that may arise from Argentina's restructured debt do have priority in Argentinean courts over claims arising out of the unstructured debt. Therefore, Argentina breached the *Pari Passu* Clause.

Moreover, Argentina's laches argument failed as it had not yet violated the Equal Treatment Provision when it sought a declaration in 2003 that plaintiffs could not invoke the Provision to bar its restructuring efforts. Argentina violated the Provision later by persisting in its policy of discriminatory treatment of plaintiffs.

2.2 Challenges to the Injunctions

Specific performance may be ordered where no adequate monetary remedy is available and that relief is favored by the balance of equities, which may include the public interest.[9] Once the district court determined that Argentina had

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[8] Like the 2005 prospectus, the 2010 exchange offer prospectus also warned of "Risks of Not Participating in the [2010 restructuring]": *"Eligible Securities that are in default and that are not tendered may remain in default indefinitely and, if you elect to litigate, Argentina intends to oppose such attempts to collect on its defaulted debt. … Consequently if you elect not to tender your Eligible Securities in default pursuant to the Invitation there can be no assurance that you will receive any future payments or be able to collect through litigation in respect of you Eligible Securities in default."* 2010 Prospectus.

[9] *Guinness-Harp Corp. v. Jos. Schlitz Brewing Co.*, 613 F.2d 468, 473 (2d Cir. 1980); *Nemer Jeep-Eagle, Inc. v. Jeep-Eagle Sales Corp.*, 992 F.2d 430, 433 (2d Cir. 1993); *Winter v. Nat. Res. Def. Council, Inc.*, 555 U.S. 7, 24, 32 (2008), *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006) To be eligible for specific performance of a contractual provision, a party also needs to show that *"(1) a valid contract exists between the parties, (2) the plaintiffs has substantially performed its part of the contract and (3) plaintiff and defendant are each able to continue performing their parts of the agreement."* These factors were undisputed and were satisfied.

breached the FAA and the injunctive relief was warranted, the court had considerable latitude in fashioning the relief. The performance required by a decree need not be identical with the contract. Thus, where the desirable solution is not possible the Court of Appeals may affirm an order of specific performance so long as it achieves a "*fair result*" under the "*totality of the circumstances*".

The FAA does not contain a clause limiting the remedies available for a breach of the agreement. Nor does it contain a provision precluding specific performance or injunctive relief. Under New York law absence of the parties' express intention to restrict the remedies available for breach of the agreement means that the full panoply of remedies remains available.[10]

Furthermore, the Court of Appeals found clear that monetary damages are an ineffective remedy for the harm plaintiffs have suffered. Argentina would refuse to pay any judgments. It has done so in this case by closing the doors of its courts to judgment creditors. As such, the district court ordered specific performance.

Compliance with the Injunctions would not deprive Argentina of control over any of its property; they do not operate as attachments of foreign property prohibited by the Foreign Sovereign Immunities Act (FSIA).[11] However, courts are also barred from granting "*by injunction, relief which they may not provide by attachment.*"[12] The Court of Appeals determined that the injunctions at issue are not barred by FSIA. They do not attach, arrest, or execute upon any property. They direct Argentina to comply with its contractual obligations not to alter the rank of its payment obligations. They affect Argentina's property only incidentally to the extent that the order prohibits Argentina from transferring money to some bondholders and not others.

Additionally, Argentina voluntarily waived its immunity from the jurisdiction of the district court and the FSIA imposes no limits on the equitable powers of a district court that has obtained jurisdiction over a foreign sovereign, at least where the district court's use of its equitable powers does not conflict with the separate execution immunities created by FSIA.

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[10] *Citing Vacold LLC v. Cerami*, 545 F.3d 114, 130 (2d Cir. 2008). New York courts "*recognize limitations on available remedies*" "*only when the contract contains a clause specifically setting forth the remedies available…*"

[11] Section 1609 of the FSIA establishes that "*the property in the United States of a foreign state shall be immune from attachment arrest and execution.*" Each of these three terms refers to a court's seizure and control over specific property.

[12] *Citing S&S Machinery Co.*, 706 F.2d at 418; *Stephens v. Nat'l Distillers & Chem. Corp.*, 69 F.3d 1229 (2d Cir. 1995)

A "*federal court sitting as a court of equity having personal jurisdiction over a party has power to enjoin him from committing acts elsewhere.*"[13] Moreover, the district court found that Argentina had over $40 billion in foreign currency reserves, that is, "*the financial wherewithal to meet its commitment of providing equal treatment to*" plaintiffs and the exchange bondholders.

The Court of Appeals had concerns about the Injunctions' application to bank acting as intermediaries in the process of sending money from Argentina to the holders of the Exchange Bonds. Thus, it remanded the Injunctions to the district court[14] for such further proceedings as are necessary to address the Injunctions' application to third parties and the operation of their payment formula.[15]

3. Conclusion

The judgment of the district court (1) granting summary judgment to plaintiffs on their claims for breach of the Equal Treatment Provision and (2) ordering Argentina to make "Retable Payments" to plaintiffs concurrent with or in advance of its payments to holders of the 2005 and 2010 restructured debt were affirmed. The case was remanded to the district court for such proceedings as are necessary to address the operation of the payment formula and the Injunctions' application to third parties and intermediary banks.[16]

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[13] *Bano v. Union Carbide Corp.*, 361 F.3d 696, 716 (2d Cir. 2004)

[14] *Under United States v. Jacobson*, 15 F.3d at 22

[15] Judgment pp. 22 and 27

[16] Judgment pp. 28 and 29