

# FEDERAL RESERVE BANK *of* NEW YORK

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**THOMAS C. BAXTER, JR.**  
GENERAL COUNSEL AND  
EXECUTIVE VICE PRESIDENT

November 16, 2012

BY HAND

Hon. Thomas P. Griesa  
United States District Judge  
Daniel Patrick Moynihan United States Courthouse  
500 Pearl Street, Room 1630  
New York, NY 10007-1312

Re: NML Capital, Ltd. v. Republic of Argentina, 08 Civ. 6978, 09 Civ. 1707, 09 Civ. 1708; Aurelius Capital Master, Ltd., et al. v. Republic of Argentina, Nos. 09 Civ. 8757, 09 Civ. 10620, 10 Civ. 1602, 10 Civ. 3507, 10 Civ. 3970, 10 Civ. 8339; Blue Angel Capital I, LLC v. Republic of Argentina, Nos. 10 Civ. 4101, 10 Civ. 4782; Pablo Alberto Varela, et al. v. Republic of Argentina, No. 10 Civ. 5338; Olifant Fund, Ltd. v. Republic of Argentina, 10 Civ. 9587

Dear Judge Griesa:

The Federal Reserve Bank of New York ("New York Fed") respectfully submits this letter to assist the Court in its consideration of the issues remanded by the United States Court of Appeals for the Second Circuit in its October 26, 2012 Opinion in the above-referenced matters. The Second Circuit affirmed in part and remanded in part the Court's Orders issued on February 23, 2012 granting permanent injunctions (the "Injunctions") pursuant to the *pari passu* clause of the Fiscal Agency Agreement ("FAA"). The FRBNY takes no position with respect to the Court's ultimate factual conclusion that the Republic of Argentina (the "Republic") failed to perform its obligations under the *pari passu* clause of the FAA.

The Second Circuit expressed concern "about the Injunctions' applications to banks acting as pure intermediaries in the process of sending money from Argentina to the holders of the Exchange Bonds." (October 26, 2012 Opinion at 27-28.) The New York Fed shares this concern.

The expansive application of the Injunctions urged by Plaintiffs—including the broad definition of "agents and participants" and the suggested possible application to funds transfer systems—is overbroad and could have operational ramifications that impede the smooth and efficient operation of the payments system. The New York Fed thus urges the Court to limit

the reach of the Injunctions, in accordance with the provisions of Article 4A of the Uniform Commercial Code and Federal Reserve Regulation J, so that they apply only to Argentina and those acting in privity with it.

### Background

The New York Fed, together with the other eleven Federal Reserve Banks (collectively the “Reserve Banks”), constitute the operational component of the nation’s central bank. Congress, responding in part to the breakdown of the check-collection system in the early 1900s, made the Reserve Banks active participants in the payments system when it established the Federal Reserve in 1913. From the beginning, the Reserve Banks’ active involvement in payments, and in developing the legal infrastructure supporting payments, has helped to develop key infrastructure that supports the nation’s financial system. For example, in keeping with the Reserve Banks’ role as payments system operators, the Reserve Banks own and operate the Fedwire Funds Service (“Fedwire”) in which more than 7000 financial institutions initiate funds transfers that are immediate, final, and irrevocable when processed. Fedwire and the Clearing House Interbank Payments System (“CHIPS”) funds transfer system are the principal wholesale funds-transfer systems in the United States. See generally, T. Baxter, S. Heller, and P. Turner, Article 4A: Funds Transfers, *The ABCs of the UCC* 12-17 (A.B.A. 2d Ed. 2006).

Reserve Banks routinely act as intermediary banks in the transfers that are sent over the Fedwire system. Funds transfers are typically used by commercial institutions in the financial markets, and for commercial trade, to discharge large-value payment obligations. Financial market participants use Fedwire to handle large-value, time-critical payments, such as payments for the settlement of money-market transactions; the purchase, sale, and financing of securities transactions; the disbursement or repayment of loans; and the settlement of real estate transactions. On an average day in 2011, Fedwire processed about 506,000 transfers, with an aggregate average daily value of \$2.6 trillion.<sup>1</sup>

Because of its interest in promoting certainty and finality in the payments system, the New York Fed was involved at an early stage in the process that led to the development of what is now Article 4A of the Uniform Commercial Code (“U.C.C.”) and the ultimate adoption of Article 4A as both federal law and the law of the state of New York. 12 C.F.R. pt. 210 Appendix B; N.Y. U.C.C. Art. 4A. Article 4A of the U.C.C. governs funds transfers in New York and in the 51 other jurisdictions where it has been adopted. For transfers processed over Fedwire, the Board of Governors of the Federal Reserve System has adopted Article 4A as

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<sup>1</sup> Fedwire and Net Settlement at <http://www.federalreserve.gov/PaymentSystems/FedWire/default.htm>.

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federal law in its Regulation J. See Federal Reserve System Regulation J, 12 C.F.R. pt. 210 (2007).

Plaintiffs' Proposal Exceeds the Parameters of Article 4A and Regulation J

Plaintiffs' proposed amendments exceed the scope of Article 4A and Regulation J. Plaintiffs propose to include beneficiary banks within the scope of the Injunctions, although under the ordinary operation of the U.C.C., creditors of the originator cannot attach funds by service of process on the beneficiary's bank. See N.Y. U.C.C. § 4A-104(2); § 4-A-502 cmt. 4. Article 4A and Regulation J provide clear guidance to parties seeking to restrain the proceeds of a wire transfer: they may serve process at the originator's bank with respect to creditors of the originator, or at the beneficiary's bank with respect to creditors of the beneficiary. Regulation J and Article 4A, however, do not permit process to restrain a funds transfer at an intermediary bank. 12 C.F.R. pt. 210; N.Y. U.C.C. Art. 4A-503. See also Shipping Corp. of India, Ltd. v. Jaldhi Overseas Pte Ltd., 585 F.3d 58, 70-71 (2d Cir. 2009), cert. denied, 130 S. Ct. 1896 (2010).

The Plaintiffs' proposed carve out for "intermediary banks" is thus too narrow and should be rejected. Plaintiffs' proposed amendments would subject beneficiary banks to requirements and potential liability not permitted under applicable law. Pursuant to both federal and state law, the underlying obligation of an originator to pay a beneficiary is discharged by means of a funds transfer when the beneficiary's bank accepts its sender's payment order. See 12 C.F.R. pt. 210, Appendix B; N.Y. U.C.C. § 4A-406. The discharge of the originator's obligation to pay the beneficiary occurs simultaneously with the creation of an obligation of the beneficiary's bank to pay the beneficiary. Until acceptance by the beneficiary's bank, the originator remains indebted to the beneficiary. The law provides that the originator is generally entitled to a refund of any payment that it has made in connection with the funds transfer if the funds transfer is not completed. See 12 C.F.R. pt. 210, Appendix B; N.Y. U.C.C. § 4A-402. An identical refund right exists for each of the banks in the funds transfer chain. This is known among bankers as the money-back guarantee. When a funds transfer is attached at an intermediary bank, the funds transfer cannot be completed and the payment obligation that the originator was attempting to discharge through the use of the funds transfer remains unsatisfied. This can have severe consequences, not only for the party that is subject to the attachment order, but also for wholly unrelated and "innocent" parties.

In lieu of Plaintiffs' proposal, the Court should craft the Injunctions to comport with, and not to exceed, the limits of Article 4A and Regulation J.

The Second Circuit has indicated that Article 4A is "the exclusive means of determining the rights, duties, and liabilities of the affected parties in any situation covered by particular provisions of [Article 4A]." Grain Traders, Inc. v. Citibank, N.A., 160 F.3d 97, 103 (2d Cir. 1998) (quoting Official Comment to U.C.C. § 4A-102). This Second Circuit does not

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recognize claims that “would impose liability inconsistent with the rights and liabilities expressly created by Article [4A].” *Id.* at 103.

This result is supported by strong policy considerations. One of Article 4A’s primary goals is “to promote certainty and finality.” *Grain Traders*, 160 F.3d at 102. Funds transfers under Article 4A are large-value, time-critical payments characterized by their high speed, efficiency, and low cost. *See* Prefatory Note to U.C.C. Art. 4A. To require intermediaries, like the FRBNY,

to investigate the financial circumstances and various legal relations of the other parties to the transfer.... matters as to which an intermediary bank ordinarily should not have to be concerned... would impede the use of rapid electronic funds transfers in commerce by causing delays and driving up costs.

*Grain Traders*, 160 F.3d at 102.

Plaintiffs’ Suggested Application of the Injunctions to  
“Agents and Participants” Is Overly Broad

Plaintiffs have suggested amendments to the February 23 Orders that would apply the Injunctions broadly to Argentina and any “persons and entities who act as the Republic’s agents, or act in active concert or participation with the Republic or its agents, to assist the Republic in fulfilling its payment obligations under the Exchange Bonds.”

Plaintiffs urge a broad definition of covered “agents and participants” that excludes only intermediary banks as defined in Article 4A of the U.C.C. Plaintiffs offer some examples of agents and participants, but their list is not exhaustive and leaves significant questions about who is covered. Plaintiffs propose to include clearing corporations and systems, depositories, operators of clearing systems and settlement agents for the Exchange Bonds in the definition of “agents” of Argentina. It is unclear whether Plaintiffs intend to include payments systems, such as Fedwire, within this definition.<sup>2</sup>

To avoid unnecessary confusion and disruption to the smooth and efficient functioning of the payments system, the New York Fed urges the Court to enumerate precisely what persons or entities are covered by the Injunctions, to limit this list only to Argentina and others in direct privity with it, to specifically exempt payments systems such as Fedwire, and to

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<sup>2</sup> As discussed above, Fedwire functions as a payments system when Reserve Banks act as intermediary banks.

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reject Plaintiffs' invitation to broaden the reach of the Injunctions to clearing corporations and systems generally.

Otherwise, under the scheme proposed by Plaintiffs, beneficiary banks (including, in certain instances, the New York Fed) would have to screen all incoming payment orders to attempt to identify funds transfers originated by Argentina or its agents, and then make inquiries of their senders to find out whether the transfer was in payment of amounts owing on the Exchange Bonds or for some other purpose. As the sender is likely to be an intermediary bank with no knowledge of the purpose of the transaction, the inquiry would have to be sent up the chain back to the originator's bank, causing significant delay for legitimate payments. The policy underlying Article 4A is to facilitate "a high-speed electronic environment analogous to an interstate highway. The 'flow of funds-transfer traffic' should not be disrupted by creditor process, just as all automobile traffic on a busy highway should not be stopped so that a single car can be inspected." E. Patrikis, T. Baxter, and R. Bhala, Wire Transfers: A Guide to U.S. and International Laws Governing Funds Transfers 135 (Probus 1993).

What the Second Circuit recognized in Grain Traders, and what is fundamental to commercial law, is the concept that commercial parties should not be expected to look beyond pre-existing contractual relationships that anticipate and allocate risk. It is this concept, contractual privity, which provides the necessary certainty to the payments system:

To allow a party to, in effect, skip over the bank with which it dealt directly, and go to the next bank in the chain would result in uncertainty as to rights and liabilities, would create a risk of multiple or inconsistent liabilities, and would require intermediary banks to investigate the financial circumstances and various legal relations of the other parties to the transfer. *These are matters as to which an intermediary bank ordinarily should not have to be concerned and, if it were otherwise, would impede the use of rapid electronic funds transfers in commerce by causing delays and driving up costs.*

Grain Traders, 160 F.3d at 102 (emphasis added).

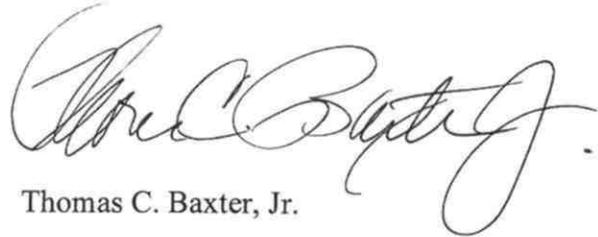
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In light of the foregoing and to prevent the harms discussed above, the New York Fed respectfully urges the Court to construe the Injunctions narrowly, in accordance with the limits of Article 4A of the Uniform Commercial Code and Federal Reserve Regulation J.

Respectfully submitted,



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