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IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

NML CAPITAL, LTD., AURELIUS CAPITAL MASTER, LTD., ACP MASTER, LTD., BLUE ANGEL CAPITAL I LLC, AURELIUS OPPORTUNITIES FUND II, LLC, PABLO ALBERTO VARELA, LILA INES BURGUENO, MIRTA SUSANA DIEGUEZ, MARIA EVANGELINA CARBALLO, LEANDRO DANIEL POMILIO, SUSANA AQUERRETA, MARIA ELENA CORRAL, TERESA MUNOZ DE CORRAL, NORMA ELSA LAVORATO, CARMEN IRMA LAVORATO, CESAR RUBEN VAZQUEZ, NORMA HAYDEE GINES, MARTA AZUCENA VAZQUEZ, OLIFANT FUND, LTD.,

Plaintiffs-Appellees,

against

THE REPUBLIC OF ARGENTINA,

Defendant-Appellant.

(Caption Continued on the Reverse)

On Appeal from the United States District Court for the Southern District of New York

BRIEF FOR *AMICUS CURIAE* KENNETH W. DAM IN SUPPORT OF AFFIRMANCE

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THE BANK OF NEW YORK MELLON, AS INDENTURE TRUSTEE,
EXCHANGE BONDHOLDER GROUP, ICE CANYON LLC, FINTECH ADVISORY INC.,

Non-Party Appellants,

and

EURO BONDHOLDERS,

Intervenor.

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With the Court's leave, Kenneth W. Dam, Professor Emeritus at the University of Chicago Law School, submits this brief as *amicus curiae* supporting affirmance of the November 21, 2012 Orders of the United States District Court for the Southern District of New York by the Honorable Thomas P. Griesa and, in particular, addressing arguments by Argentina and other parties to the effect that collective action clauses do not limit future prospects for litigation against sovereign bond issuers by so-called "holdout" creditors.[1]

STATEMENT OF INTEREST

Prof. Dam is the Max Pam Professor Emeritus of American & Foreign Law and a Senior Lecturer at the University of Chicago Law School.

Prof. Dam has devoted his career to public policy issues, both as a practitioner and as a professor. In the former capacity, he has served as deputy secretary (the second-ranking official) in the Department of Treasury (2001-2003) and in the Department of State (1982-1985). In 1973, he was executive director of the Council on Economic Policy, a White House office responsible for coordinating U.S. domestic and international economic policy. From 1971 to 1973, he served as assistant director for national security and international policy of the Office of Management and Budget.

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[1] Pursuant to Local Rule 29.1, Kenneth W. Dam states that he authored this brief and that it was not authored or funded by any party to this action.

Prof. Dam's academic career has centered primarily on law and economics, particularly with respect to international issues. His publications include a number of books, of which the best known are The GATT: Law and International Economic Organization (1970); Economic Policy Beyond the Headlines (with George P. Shultz) (1977) (2d ed. 1998); and, most recently, The Law-Growth Nexus: The Rule of Law and Economic Development (2006). Other publications include: The Rules of the Global Game: A New Look at U.S. International Policymaking (2001); and The Rules of the Game: Reform and Evolution in the International Monetary System (1982).

Prof. Dam's teaching in recent years has focused on U.S., European, and other financial regulatory systems and the role of international financial institutions.

Prof. Dam is an honorary member of the board of the Brookings Institution and serves as a nonresident senior fellow of that organization. He is also a board member of the Committee for Economic Development and has served as a board member of a number of nonprofit institutions, including the Council on Foreign Relations (New York) and the Chicago Council on Foreign Relations.

Prof. Dam has a substantial interest in the outcome of this action because it presents issues involving the international financial markets, the role of international financial institutions, and U.S. international policymaking that he has written on and studied extensively.[2]

PRIOR PROCEEDINGS

Appellee NML Capital, Ltd. ("NML") and the eighteen other appellees (collectively, the "Appellees") filed suits against the Republic of Argentina ("Argentina"), alleging that debts owed to them by Argentina had not been paid. Final judgments have not been entered in any of the actions currently before the Court, although NML and certain others have obtained judgments in related actions against Argentina. On October 20, 2010, NML moved to amend its complaints in three of its actions to add claims for breaches of the *pari passu* clause in the bonds underlying those actions.

NML's motion for leave to amend its complaints was granted at a September 28, 2011 hearing. In an Order dated December 7, 2011, the district court granted partial summary judgment with respect to the *pari passu* claims, holding that the clause required ratable payments to both holdout creditors and other creditors. The Court declined, without prejudice, to grant relief so that it could further consider an appropriate remedy. NML brought a renewed motion for injunctive relief by order

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2 Prof. Dam's *curriculum vitae* and a full list of his publications can be found at *http://www.law.uchicago.edu/faculty/dam*.

to show cause on January 5, 2012.[3] On February 23, 2012, the district court granted the renewed motion for injunctive relief and entered an injunction in favor of NML requiring Argentina to make ratable payments to Appellees concurrent with or in advance of its payments to holders of Argentina's 2005 and 2010 restructured debt. Argentina appealed.

On October 26, 2012, this Court affirmed the district court's grant of partial summary judgment and held that the injunctive relief fashioned by the district court, particularly its order requiring Argentina to make ratable payments to Appellees concurrent with or in advance of its payments to holders of the 2005 and 2010 restructured debt, was not an abuse of the district court's discretion. The Court then remanded the case to the district court so that it could clarify how the ratable payment formula was intended to work and address certain questions regarding the application of the injunction to third parties.

The district court issued further orders addressing this Court's questions on November 21, 2012. With respect to the ratable payment formula, the district court clarified that, if Argentina made full payment to holders of exchange debt of any amount currently due to them, it was also to make full payment to Plaintiffs on all amounts currently owed to them. If Argentina were to pay exchange debt

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[3] Shortly thereafter, the other Appellees filed motions in their respective actions seeking identical relief.

holders some lesser percentage of an amount currently owed to them, it was to pay plaintiffs the same percentage of all amounts currently owed to them. Argentina has appealed.

STATEMENT OF FACTS

In December 2001, Argentina suspended payment on more than $140 billion of debt, including the bonds owned by Appellees, in what amounted to the largest sovereign default in history. *See* Arturo C. Porzecanski, *From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default*, 6 CHI. J. INT'L L. 311, 317 (2005).

Argentina, a G20 country, is a true outlier in the world of debt default, having defaulted 6 times over the period 1820–2004. Federico Sturzenegger and Jeromin Zettlemeyer, *Debt Defaults and Lessons From a Decade of Crisis*, 13 tbl. 1.1 (MIT Press 2007). Four of these defaults, including the present one, were after 1980. *Id*. Indeed, Argentina is widely regarded as a serial debt defaulter.

In 2005, Argentina launched a debt restructuring plan for $81.8 billion of its outstanding debt, plus past due interest of $21.4 billion. *See* J. F. Hornbeck, *Argentina's Defaulted Sovereign Debt: Dealing with the "Holdouts"* 4 (Congressional Research Service September 24, 2010), http://assets.opencrs.com/rpts/R41029_20100924.pdf. The plan provided that bondholders who accepted an exchange offer would receive only 25–29 cents on the dollar. *See* Hal S. Scott, *Sovereign Debt Default, Cry for the United States, Not Argentina* 3 (Washington Legal Foundation 2006), available at http://www.wlf.org/upload/Scott%20WP%20Final.pdf. The implied 71–75% haircut greatly exceeded the average haircut of 36% on 20 other sovereign debt restructurings since 1990. *Id*. There was no good faith effort on the part of Argentina to consult with bondholders over the terms of the offer – it was put forward as a take-it-or-leave-it proposition. *See* Larry Rohter, *Argentina Announces Deal on its Debt Default*, N. Y. TIMES, Mar. 4, 2005, at C1. "Many believed Argentina could have made a more generous offer, given that by the time of the exchange offer it had experienced two years of steady growth . . . with relatively low inflation." See Scott, *supra*, at 4.

The 2005 exchange offer was accepted by 76% of all bondholders. *Id.* However, state-owned banks and other institutions controlled by Argentina owned 46.9% of the outstanding debt at the time, so the effective acceptance rate among international creditors was approximately 53.4%. *Id.* This is significantly lower than the acceptance rates in virtually every other recent sovereign debt restructuring over the past 15 years, including the 2000 restructuring by Ecuador (97%), the 1999 restructuring by Pakistan (95%), the 1998-2000 restructuring by Russia (98%), the 1998-2000 restructuring by Ukraine (95%), the 2002 restructuring of Moldova (100%), the 2003 restructuring by Uruguay (93%), the

2005 restructuring by the Dominica (97%), the 2005 restructuring by Grenada (90%), the 2007 restructuring by Belize (98%), and the 2009 restructuring by Seychelles (89%). *See Id.*; Udaibir Das, Michael Papaioannou, and Christopher Trebesch, *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data and Stylized Facts*, IMF Working Paper 12/203, 24-25 (August 2012), available at http://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf.

Bondholders owning approximately $20 billion of Argentine debt, including Appellees, refused to accept the 2005 exchange offer. Hornbeck, *supra*, at 4. Some $3.6 billion of this debt was owned by U.S. investors. *Id.* at 5. Numerous bondholders, including certain of the Appellees, obtained judgments for the amounts then owed to them by Argentina, but Argentina has consistently refused to satisfy these judgments or repay any of its other indebtedness to private parties – including the pre-judgment debts at issue in this appeal – apart from the exchange offer. Indeed, in February 2005, the Argentine Congress codified the repudiation of the remaining external debt in Law 26,017, the so-called "Lock Law," which prohibited the government from conducting any type of in-court, out-of-court or private settlement of the public debt in default.

In April of 2010, following a temporary suspension of the Lock Law, Argentina made a second exchange offer to the remaining holders of its defaulted debt. Non-retail investors were offered replacement bonds with a face amount equal to 33.7% of the defaulted debt they held, and amounts owed in past due interest were discharged through the issuance of a seven-year global bond. *Id. at Summary*. Investors were also issued a GDP-linked security that provides for additional payments if the Argentine economy grows at higher-than-anticipated rates stipulated in the exchange offer. *Id.* Some 66% of the eligible bondholders participated in the second exchange offer, still low by international standards, and a lower rate of acceptance than occurred in Argentina's 2005 bond exchange. *Id.* Prior to the offer, Argentina owed approximately $29 billion in principal and interest to bond holders. *Id.* at 5. After the offer, approximately only $6.2 billion in face amount of the defaulted debt remained outstanding. *Id.* at Summary. Approximately half of this amount is held by U.S. investors. *Id.* at Summary, 5. Most of the remainder is owned by Italian retail investors. *Id.* at Summary; Hal S. Scott and Anna Gelpern, *International Finance: Transactions, Policy, And Regulation* ch. 19 (19th ed. 2012).

Judge Griesa, the district court judge in this case and the judge who has overseen most of the litigation between Argentina and its creditors, has summarized the attitude of Argentina as follows: "In all the years of litigation, the Republic has shown not the slightest recognition of [its] obligation to pay. And it is clear beyond any question that the Republic, as it went on from the crisis of 2001, has at times had resources at its command to pay the judgments, or at least to make substantial part-payments. But the Republic thus far has paid *nothing* on these judgments." *EM Ltd. v. Republic of Argentina*, 720 F. Supp.2d 273, 279 (S.D.N.Y. 2010) (emphasis in original), *rev'd on other grounds*, 652 F.3d 172 (2d Cir. 2011).

ARGUMENT

This Court's October 26, 2012 decision expressly states that "the judgments of the district court ordering . . . Argentina to make 'Ratable Payments' to plaintiffs concurrent with or in advance of its payments to holders of the 2005 and 2010 restructured debt are affirmed." SPE-295. In arriving at that ruling, this Court considered and rejected arguments advanced by Argentina and the United States that requiring Argentina to make ratable payments of any sort to Appellees would imperil future sovereign debt restructurings by significantly reducing the incentive of creditors to participate in them. SPE-275, 294. Reargument of that issue would seem to be beyond the scope of this appeal, since the Court already expressly rejected it. Argentina does, however, seek to reargue the issue. The focus of my brief is to respond to those arguments.

Argentina, as it did in the prior appeal, urges that the district court's rulings, insofar as they provide a mechanism for holdout creditors to secure full payment on their obligations, will upset the current regime that enables sovereigns to avoid paying such creditors. The ultimate outcome, Argentina says, will be to increase what this Court labeled "'holdout' litigation," SPE-275, and thereby undermine the orderly restructuring of sovereign debts. (Br. at 26.)

In its decision of October 26, 2012, this Court rejected that argument. Agreeing with a point I had raised in the *amicus curiae* brief I previously submitted in this case, the Court observed:

> [I]t is highly unlikely that in the future sovereigns will find themselves in Argentina's predicament. Collective action clauses—which effectively eliminate the possibility of "holdout" litigation—have been included in 99% of the aggregate value of New York- law bonds issued since January 2005, including Argentina's 2005 and 2010 Exchange Bonds. Only 5 of 211 issuances under New York law during that period did not include collective action clauses, and all of those issuances came from a single nation, Jamaica. Moreover, none of the bonds issued by Greece, Portugal, or Spain—nations identified by Argentina as the next in line for restructuring—are governed by New York law.

SPE-294

The Court was correct on this point. Collective Action Clauses ("CACs") allow a specified majority of creditors—normally between 67% and 85%, but typically 75%—to bind the minority to the terms of a restructuring, thus effectively ending the ability of a holdout minority to litigate based on a *pari passu* clause or any other contractual provision. As John Taylor, then Under Secretary of the Treasury for International Affairs, explained in a 2002 speech before the Emerging Market Trade Association, CACs "provide for early dialogue, coordination, and communication among creditors and a sovereign and limit disruptive legal actions" by holdout creditors to enforce the original provisions of sovereign bonds. John B. Taylor, *Prepared Remarks at the EMTA Annual Meeting John B. Taylor Under Secretary of Treasury for International Affairs* (December 5, 2002), available at http://www.treasury.gov/press-center/press-releases/Pages/po3672.aspx. Under Secretary Taylor stressed that this solution would be market-based, i.e., it would be up to the sovereigns and their investors as to whether or not to insert CACs into bond contracts. *Id.*

A recent example of how CACs facilitate debt restructuring is found in the recent restructuring carried out by Greece. In March 2012, Greece restructured €206 billion of its debt (including state owned enterprise debt that it had guaranteed) by exchanging old bonds for new ones. *See Here's the Greek Bond Tally*, WALL ST. J., Mar. 9, 2012, http://blogs.wsj.com/marketbeat/2012/03/09/heres-the-greek-bond-tally. None of the bonds issued under Greek law had CACs. It is estimated that the new bonds were worth about 25% in value of the old bonds and would likely have been subject to the risk of substantial holdouts and subsequent litigation. *See* Chares Forelle And Katy Burne, *Insurance Pays Off In Greece*, WALL ST. J., Mar. 20, 2012, at C4 ("The new securities included high-quality bonds issued by the eurozone bailout fund and a series of lower-quality new Greek bonds; in total, the package was valued at around 23 cents for every euro of debt exchanged.").

To avoid this possibility, Greece enacted legislation that retroactively inserted CACs in its existing domestic law bonds. *See* Charles Forelle, *Greece Defaults, and Tries to Move On*, WALL ST. J., Mar. 10, 2012, at A6. The CACs provided that 66.6% of bondholders could bind all bondholders to the proposed restructuring. *See Here's the Greek Bond* Tally, *supra.* Subsequently, 85.8% of domestic bondholders holding €152 billion in debt tendered their bonds. *Id.* Since this percentage exceeded the 66.6% threshold necessary to trigger the CACs, Greece did trigger the CACs, increasing participation to 95%. *Id.*

Argentina maintains that CACs "do not eliminate the dangers posed by the Amended Injunctions to sovereign restructurings." (Br. At 49.) Citing a declaration submitted in this case by Professor Stephen Choi on behalf of Gramercy Funds Management LLC, one of the exchange bond holders, Argentina notes that "billions of dollars of non-CAC debt remains outstanding." (Br. at 50 (citing Declaration of Stephen Choi ¶ 26, dated Nov. 16, 2012 ("Choi Decl.") (SPE-1133)). Choi, in turn, relies on a study he conducted with Mitu Gulati to conclude that some 25 percent of sovereign New York law bond issuances with a maturity date of 2013 or later, with an aggregate principal amount of $45.8 billion, do not have CACs. (Choi Decl. ¶ 26 and n.11).

Choi's conclusions, which were apparently based on a dataset of bonds issued during 1995-2004, before CACs became so widespread, SPE-1133 (citing Stephen Choi and Mitu Gulati, Innovation in Boilerplate Contracts: The Case of Sovereign Bonds, 53 Emory L. J. 929 (2004)), are not inconsistent with the Court's observation, based in part on a later study by Mitu Gulati, that "99% of the aggregate value of New York- law bonds issued *since January 2005*, including Argentina's 2005 and 2010 Exchange Bonds" include CACs."[4] SPE-294.

More fundamentally, the fact that some small amount of bonds issued prior to the widespread adoption of CACs remain outstanding is neither surprising nor significant. The salient point is that the market is overwhelmingly embracing CACs as a mechanism to facilitate sovereign restructurings and thwart holdout creditors. *See, e.g.*, Lee C. Buchheit & Mitu Gulati, The Coroner's Inquest, 28 Int'l Fin. L. Rev. 2, 2 (2009) (CACs "are now standard in most emerging market deals"). In recognition of the wide use of CACs in foreign bonds, all 17 Member States of the Eurozone (those European Union states with the Euro as a currency)

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[4] In assessing Choi's conclusions, it also bears noting that he inflates the percentage of outstanding sovereign New York law bonds by leaving out $41.7 billion of outstanding issuances by Argentina with CACs. He also makes no effort to address the quality of the issuers of the outstanding sovereign New York law bonds without CACs. To the extent there is no realistic prospect of these issuers defaulting before the non-CAC debt matures, the absence of CACs in such bonds presents at most an academic issue.

have agreed that as of January 1, 2013, all new debt under domestic law will contain a model CAC developed by the European Union's Economic and Financial Committee's Sub-Committee on EU Sovereign Debt Markets (customized as necessary to account for the issuer's local law). *See* Michael Bradley and Mitu Gulati, *Collective Action Clause for the Eurozone: An Empirical Analysis* (2011) 3, available at http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3082&context=faculty_scholarship. This avoids the necessity of injecting CACs in domestic law bonds through legislation, as Greece did in its recent restructuring. These facts suggest that CACs have been successful and are widely recognized and accepted as the most appropriate and effective market-based mechanism to effectuate a clean restructuring that severely limits the threat of holdout litigation.

Argentina also argues that decisions like the one in this case could reduce the efficacy of CACs by incentivizing creditors to vote against restructurings, thereby making it difficult for sovereigns to achieve the super-majority of creditors required to restructure a bond that includes a CAC.[5] This, however, overlooks the

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[5] Similarly, Prof. Choi surmises that CACs may prove ineffective against "the threat of holdouts" because "small and dispersed, individual bondholders will face a collective action problem in determining whether a restructuring offer is good for the group of bondholders." (Choi Decl. ¶ 27). This, too, is mere speculation. Additionally, if transaction costs and other procedural inefficiencies are sufficient to block a super-majority of creditors from voting in favor of a proposed restructuring, the proposed restructuring is likely to fail under any circumstances.

fact that most sovereign bond issuances are hundreds of millions or billions of dollars in size, making it difficult at best for a would-be holdout to amass or organize a blocking position sufficient to prevent an affirmative vote by a super-majority. It also overlooks the large cost of litigating against a sovereign, combined with the risk that a holdout's legal action may fail.

That aside, the concern Argentina raises is at bottom mere speculation, and the wide-spread adoption of CACs suggests the market finds it unpersuasive. It also begs the question of whether a restructuring that cannot garner the support of between 66 2/3 and 85 percent (as applicable) of creditors could (or should) go forward in any circumstances. In successful exchanges since 2000, an IMF Working Paper finds that in 10 of the 12 cases studied the acceptance rate was over 89 percent, higher than the highest-used CAC percentage of 85. The only exceptions were Argentina at 76 percent and the Dominica at 72 percent, still higher than the lowest CAC percentage used of 66 2/3 percent. *See* Udaibir Das, Michael Papaioannou, and Christopher Trebesch, *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data and Stylized Facts*, IMF Working Paper 12/203 (August 2012), *supra.*

The United States asserts that holdouts can block amendment of bond issues that would facilitate restructuring despite the presence of CACs. *See* Dec. 2012 U.S. Br. at 4. Clearly the presence of CACs does not ensure a successful restructuring; but that is not the issue here. What is relevant here is that once a sovereign can obtain the required percentage of votes required by a CAC, holdouts are foreclosed from using the pari passu clause, or any other contractual provisions in their bonds, to collect anything more than provided under the restructuring.

Again relying on Prof. Choi, Argentina also contends that CACs are ineffective because "many sovereign bond issuances containing a CAC bind only the bondholders of a particular bond issuance, thus allowing holdouts to purchase a large stake in a particular bond and block . . . restructuring of that bond." (Br. at 50 (citing Choi Decl. ¶¶ 27-28 (SPE-1134))). To the extent a creditor could obtain a blocking position in a single bond issuance, however, this does not preclude a restructuring of all the rest of the bonds from going forward. Professor Choi and Argentina then argue that the limited utility of CACs to limit a blocking position on one bond issue–which I do not regard as a serious limitation–can only be addressed by using an aggregation clause (AC), a clause which is not widespread in existing bonds. An AC allows for modification of a payment term across all bond issuances upon an affirmative vote of an elevated supermajority–85 percent in the case of Argentina's Exchange Bonds–of the aggregate principal amount of the entire series as well as the affirmative vote of a lesser majority–66 2/3 percent in Argentina's case– of the principal amount of each bond issuance. At best, this is only a marginal improvement in protecting against holdouts. The majority required to block holdouts on any single bond issuance is only lowered from the 75 percent majority required under a typical CAC by 8 1/3 percent, and the benefit of the AC can only be achieved by getting an 85% overall vote on all bond issuances, 10% higher than the vote needed by just using the 75 percent requirement of the CAC. Note, the sovereign would be better off just adopting a lower CAC percentage, say 66 2/3 percent on each bond issuance, thus avoiding the need for a super-majority of 85 percent on all bonds.

Finally, while my focus in this brief has been on the efficacy of CACs in preventing holdout litigation in the sovereign bond context, it should be noted that there are numerous other contractual mechanisms available to sovereigns to thwart holdouts. These include provisions (common in English law bonds) vesting a trustee with the exclusive right to initiate litigation, which would prevent holdout creditors from pursuing their own actions against sovereigns. Such provisions are commonly coupled with sharing clauses, which mandate that amounts recovered through litigation initiated by a trustee be distributed pro rata among all bond holders, thus reducing the incentive for any single creditor to amass a position large enough to give it power to direct a trustee to take enforcement action. In addition, "exit consents" allow a majority (or a supermajority lower than a CAC threshold) to accept an exchange while simultaneously agreeing to remove a number of important provisions from the bond contract, thus eliminating the possibility of certain violations or limiting enforcement opportunities. Exit consents have been successfully used in a number of exchange offers including Uruguay (2003) and the Dominica (2005). While this coercive tactic does not eliminate holdouts, it makes it considerably less attractive to choose to be a holdout should the requisite majority of creditors choose to participate in an exchange.

Other provisions that may be used to preclude holdouts include those allowing acceleration only upon a vote of 25 percent of the value of the bond issue; and de-acceleration clauses, which enable a majority supermajority of creditors to rescind an acceleration. All of these mechanisms have been previously employed in sovereign bonds, and they remain available should the market deem them necessary to achieve a proper balance among sovereigns and their creditors.

CONCLUSION

For the reasons stated herein, the Orders of the district court should be affirmed.

Dated: New York, New York
January 4, 2013

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CERTIFICATE OF COMPLIANCE WITH FRAP 32(a)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 4,188 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman, 14 point font.

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