December 29, 2016

Sovereign Debt Litigation

District Court Opinion Limits the Applicability of Previous *Pari Passu* Decisions in the Argentine Debt Litigation

SUMMARY

In a decision last week in the long-running Argentine debt litigation, the United States District Court for the Southern District of New York spelled out significant limitations on prior rulings it had issued that were based on the *pari passu* clause in Argentina's defaulted bonds. In those earlier rulings, the court had imposed injunctions barring Argentina from performing on new debt unless it likewise paid the defaulted debt. Those injunctions were lifted earlier this year in a settlement with most of the holdout creditors. In the new decision, the court held that Argentina's payments to creditors who participated in the settlement were not a violation of the rights of the non-settling investors. The Court also found that even if the *pari passu* clause had been breached, monetary damages would be barred as duplicative of the damages from failure to pay, and an injunction would be granted only in extraordinary circumstances. The district court's new opinion seems likely to limit the precedential effect of its earlier rulings on sovereign debt restructurings for the large number of still-outstanding securities that contain *pari passu* clauses similar to those in the defaulted Argentine bonds, even as the market has now moved to different wording for the rankings clause in New York-law governed sovereign debt securities.

BACKGROUND

During an economic crisis in December 2001, the Republic of Argentina (the "Republic" or "Argentina") declared a moratorium on payment of its sovereign debts. Certain bondholders sued Argentina in federal court in New York and obtained judgments on the defaulted bonds, which Argentina did not pay.[1] Instead, in 2005 and again in 2010, Argentina made offers to bondholders to exchange the defaulted bonds at a significant discount. The Argentine Congress passed a number of laws during this time period, including Law 26,017, the "Lock Law," enacted in 2005, which prohibited Argentina from repaying

bondholders who did not participate in the exchange offers. Several of the bondholders that declined to participate sought relief relying on the *pari passu* clauses in a 1994 fiscal agency agreement under which their bonds were issued. The *pari passu* clause stated that the debt held by the plaintiffs and associated payment obligations would "rank at least equally" with certain bonds issued by Argentina in the future. On February 23, 2012, Judge Thomas P. Griesa of the United States District Court for the Southern District of New York agreed with the plaintiffs and entered injunctions prohibiting Argentina from making payments on the exchange bonds unless a ratable payment of the amount due was made to the plaintiffs at the same time.[2] In a pair of decisions in 2012 and 2013, the Court of Appeals for the Second Circuit affirmed.[3] The Second Circuit decisions focused on the particular language of the *pari passu* clause and the specific circumstances of this "uniquely recalcitrant" debtor's legislative and executive actions.[4] Similar injunctions were subsequently granted to other similarly situated parties. The injunctions had the effect of stopping payments of interest or principal on the newly issued exchange bonds.

In November 2015, Argentina elected a new president, Mauricio Macri, who made settling with the remaining bondholders a high priority. By early 2016, Argentina had reached settlement agreements with most of the plaintiffs who had *pari passu* claims in front of Judge Griesa. In February 2016, in order to enable it to issue new bonds to fund the settlements, Argentina asked Judge Griesa to vacate all of the *pari passu* injunctions upon its fulfillment of certain conditions. On March 2, 2016, Judge Griesa issued an order stating that the *pari passu* injunctions would be vacated when two conditions were met: (1) Argentina repealed several laws, including the "Lock Law," and (2) Argentina paid any plaintiff with whom Argentina had entered into a settlement agreement on or before February 29, 2016.[5] The Second Circuit affirmed the order on April 15, 2016,[6] and Judge Griesa vacated the February 2012 order on April 22, 2016.[7]

In the wake of the Argentine debt experience and sovereign debt restructuring efforts of other countries, various law firms and official-sector participants proposed revised versions of the *pari passu* clause—now called the "rankings clause" and no longer using the *pari passu* terminology—for use in the New York market.[8] That language was ultimately utilized in an issuance of debt by the United Mexican States in November 2014 and in other issuances that followed.[9] The revised bond ranking language contains the explicit statement, "It is understood that this provision shall not be construed so as to require the Issuer to make payments under the Bonds ratably with payments being made under any other External Indebtedness."[10]

After the announcement of the 2016 settlements, institutional investors that chose not to participate in the 2005 and 2010 exchanges or the 2016 settlements filed suit seeking damages for nonpayment of principal and interest as well as injunctive relief and money damages for breach of the *pari passu* clauses. The *pari passu* claims were based on the payments to other creditors stemming from the 2005 and 2010 exchanges as well as the issuance of bonds in 2014 (issued solely within Argentina in Argentine pesos) and 2016.[11] To buttress their claims, plaintiffs identified statements from 2014 by

former Republic President Cristina Kirchner and Economy Minister Axel Kicillof that purportedly showed an intent to defy the New York court orders, and cited legislative enactments like Law 27,249, enacted in 2016, which the plaintiffs called a "New Lock Law."[12] Argentina sought partial dismissal under Rule 12(b)(6) of the claims for the breach of the *pari passu* clause and any claims that accrued more than six years before the plaintiffs' complaints were filed.

THE DISTRICT COURT'S DECISION

On December 22, 2016, Judge Griesa issued an opinion dismissing claims against Argentina for breach of the *pari passu* clause and any claims accruing outside of the six-year statute of limitations.

First, Judge Griesa held that nonpayment on defaulted debt alone, without extraordinary circumstances such as the legislative enactments or executive declarations, was insufficient to show breach of the *pari passu* clause. Judge Griesa acknowledged previous orders finding Argentina in breach of the clause[13] but noted that those decisions relied not only on Argentina's failure to make scheduled payments on its debts but on an overall assessment of the Republic's purportedly extraordinary course of conduct in its offending executive declarations and legislative enactments.[14] Judge Griesa found that Argentina's repeal of the offending legislative enactments and the efforts under President Macri to resolve creditor disputes show that "the 'combination' and 'course of conduct' that formerly constituted breach of the *pari passu* clause no longer exists."[15] Judge Griesa also rejected allegations that a "New Lock Law" had been enacted with Law 27,249, noting that the legislation actually repeals the "Lock Law" and other at-issue enactments.[16] Ultimately, Judge Griesa concluded that mere payment to other creditors does not constitute a violation of plaintiffs' rights while they "hold out for a better deal" and that breach cannot be found based only on nonpayment, *i.e.*, where one creditor is paid but not another, or certain indebtedness is paid in preference to the obligations outstanding under the agreement in which the clause appears, or when new bonds are issued during settlement with creditors.[17]

Second, Judge Griesa found that even if Argentina were in breach of the *pari passu* clause, injunctive relief would only be available in extraordinary circumstances and monetary damages would not be available at all. As to injunctive relief, the court relied on the previous analysis of significantly changed circumstances to conclude that this extraordinary remedy for a breach of contract is unwarranted.[18] As to money damages, the court found them to be no more than claims for unpaid principal and interest and held that there is no separate claim for damages for breach of the *pari passu* clause.[19]

Finally, Judge Griesa found that the applicable statute of limitations is the six-year period for breach of contract actions generally under New York law, rather than a twenty-year period that the court found was restricted to actions on certain municipal and state debt issued in New York, and not debt issued by foreign sovereigns.[20]

IMPLICATIONS

The *pari passu* clause in the Argentine bonds is similar to clauses contained in numerous still-outstanding sovereign bonds issued over several decades. The New York courts' interpretation of that clause to provide a basis for a powerful injunctive remedy was widely viewed as novel. The District Court's new ruling seems likely to limit the precedential value of the *pari passu* decisions issued in the Argentine litigation. The new opinion holds that merely preferring one creditor over another is insufficient to constitute a violation of the clause, and relies on various circumstances peculiar to the Argentine situation, including adoption of the "Lock Law" barring payment on the defaulted debt and the Republic's prolonged refusal to pay outstanding judgments, to support the conclusion that Argentina had breached its *pari passu* clause and to explain why an injunction was necessary but is no longer justified. The holding that a breach of the *pari passu* clause does not itself give rise to a claim for money damages may also serve to limit the long-term significance of the decisions to situations where "extraordinary circumstances" justify requests by creditors for injunctive or other equitable relief. But the precise boundaries of the doctrine developed in the Argentine litigation will likely be delineated only in future sovereign debt litigation. Notably, the market's shift to the new wording of the rankings clause, as well as the wider adoption of "collective action clauses" (which limit the power of "holdouts" who decline a settlement favored by a specified majority of bondholders), is likely to further limit the impact of the earlier decisions.

As to Argentina, the decisions vacating the injunctions and the settlements with bondholders removed the obstacles to its return to the international debt markets, which it re-entered with a successful $16.5 billion offering in April 2016. The litigation with respect to the remaining holdout creditors remains pending in a reduced form, but the material issues that could have an impact on non-parties appear to have been resolved.

* * *

ENDNOTES

[1] Sullivan & Cromwell LLP has represented the Central Bank of Argentina in litigation related to Argentina's 2001 default. For a previous publication on related litigation, *see* SULLIVAN & CROMWELL LLP CLIENT MEMORANDUM, "Sovereign Debt Litigation: District Court Order Paves the Way for the Republic of Argentina to Return to International Credit Markets" (Updated Mar. 10, 2016), *available at* https://www.sullcrom.com/sovereign-debt-litigation-district-court-order-paves-the-way-for-the-republic-of-argentina-to-return-to-international-credit-markets.

[2] Order, *NML Capital, Ltd.* v. *Republic of Argentina*, No. 08-cv-6978 (S.D.N.Y. Feb. 23, 2012), Dkt. No. 371.

[3] *See NML Capital, Ltd.* v. *Republic of Argentina*, 727 F.3d 230 (2d Cir. 2013); *NML Capital, Ltd.* v. *Republic of Argentina*, 699 F.3d 246 (2d Cir. 2012). The United States Supreme Court denied Argentina's petition for a writ of certiorari both times. *See Republic of Argentina* v. *NML Capital, Ltd.*, 134 S. Ct. 2819 (2014); *Republic of Argentina* v. *NML Capital, Ltd.*, 134 S. Ct. 201 (2013).

[4] *NML Capital, Ltd.* v. *Republic of Argentina*, 727 F.3d 230, at 247 (2d Cir. 2013). *See also NML Capital, Ltd.* v. *Republic of Argentina*, 699 F.3d 246, at 259-60 (2d Cir. 2012) (citing to the executive declarations and legislative enactments to find breach).

[5] Opinion and Order, *NML Capital, Ltd.* v. *Republic of Argentina*, No. 08-cv-6978, at 4 (S.D.N.Y. Mar. 2, 2016), Dkt. No. 912.

[6] Order, *Aurelius Capital Master, Ltd.* v. *Republic of Argentina*, No. 16-628, 2016 WL 1540614 (2d Cir. Apr. 15, 2016), Dkt. No. 566.

[7] Order, *NML Capital, Ltd.* v. *Republic of Argentina*, No. 08-cv-6978 (S.D.N.Y. Apr. 22, 2016), Dkt. No. 937.

[8] Sullivan & Cromwell LLP participated in these efforts, alongside other law firms and official-sector constituents, including the International Monetary Fund, the New York Federal Reserve Bank and the U.S. Treasury.

[9] Sullivan & Cromwell LLP was counsel to the underwriters in Mexico's November 2014 debt issuance.

[10] INTERNATIONAL CAPITAL MARKET ASSOCIATION, "ICMA New York and English Law Standard CACs, *Pari Passu* and Creditor Engagement Provisions - May 2015," http://www.icmagroup.org/resources/Sovereign-Debt-Information (last visited Dec. 28, 2016).

[11] *White Hawthorne, LLC, et al.* v. *Republic of Argentina*, No. 16-cv-1042 (S.D.N.Y. 2016); *Master Fund LP, et al.* v. *Republic of Argentina*, No. 16-cv-1192 (S.D.N.Y. 2016); and *Trinity Invs. Ltd.* v. *Republic of Argentina*, No. 16-cv-1436 (S.D.N.Y. 2016). *See, e.g.*, Amended Complaint, *White Hawthorne, LLC, et al*. v. *Republic of Argentina*, No. 16-cv-1042, at 2-3 (S.D.N.Y. June 22, 2016), Dkt. No. 26; Plaintiff's Opposition to the Republic of Argentina's Motion to Dismiss Pursuant to Rule 12(b)(6), *White Hawthorne, LLC, et al.* v. *Republic of Argentina*, No. 16-cv-1042, at 4 (S.D.N.Y. Aug. 25, 2016), Dkt. No. 40.

[12] *See, e.g.*, Amended Complaint, *White Hawthorne, LLC, et al*. v. *Republic of Argentina*, No. 16-cv-1042, at 8, 13, 15-16 (S.D.N.Y. June 22, 2016), Dkt. No. 26.

[13] Opinion, *White Hawthorne, LLC, et al*. v. *Republic of Argentina*, No. 16-cv-1042, slip op. at 5 (S.D.N.Y. Dec. 22, 2016), Dkt. No. 49. *See, e.g.*, Amended Complaint, *White Hawthorne, LLC, et al*. v. *Republic of Argentina*, No. 16-cv-1042, at 12-13 (S.D.N.Y. June 22, 2016), Dkt. No. 26.

[14] Opinion, *White Hawthorne, LLC, et al*. v. *Republic of Argentina*, slip op. at 6.

[15] *Id.* at 8.

[16] *Id.*

ENDNOTES (CONTINUED)

17 *Id.* at 7-8.

18 *Id.* at 9.

19 *Id.* at 10-12.

20 *Id.* at 12-26.

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Michael B. Soleta (+1-212-558-3974; soletam@sullcrom.com) in our New York office.

CONTACTS

New York		
Sergio J. Galvis	+1-212-558-4740	galviss@sullcrom.com
Christopher L. Mann	+1-212-558-4625	mannc@sullcrom.com
Joseph E. Neuhaus	+1-212-558-4240	neuhausj@sullcrom.com
Washington, D.C.		
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Dennis C. Sullivan	+1-202-956-7554	sullivand@sullcrom.com
London		
David Rockwell	+44-20-7959-8575	rockwelld@sullcrom.com
Hong Kong		
Garth W. Bray	+852-2826-8691	brayg@sullcrom.com