# INSOL International

## Potential Legal Issues for Bondholders Seeking Recovery on Sovereign Bond Debt in U.S.

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# Potential Legal Issues for Bondholders Seeking Recovery on Sovereign Bond Debt in U.S.



INSOL International
6-7 Queen Street, London, EC4N 1SP
Tel: +44 (0) 20 7248 3333 Fax: +44 (0) 20 7248 3384

## Acknowledgement

INSOL International is very pleased to present the 27th Technical Paper under its Technical Papers Series titled “Potential Legal Issues for Bondholders Seeking Recovery on Sovereign Bond Debt in U.S.” by Lynn P. Harrison 3rd, Curtis, Mallet-Prevost, Colt & Mosle LLP.

The ongoing sovereign debt crisis in Europe has spurred worldwide debate regarding the implementation of a sovereign debt restructuring mechanism that would allow a country to engage in a consensual restructuring of its debt with bondholders. In certain instances however the bond contracts do not allow for amendment or modifications to the terms of such contracts without unanimous consent. Where a restructuring is not a possibility or the bondholders have otherwise refused to engage in a consensual restructuring, such parties will likely consider commencing suit against the sovereign, provided that the contract terms permit them to do so.

This paper deals with key issues that bondholders may consider when they decide to initiate lawsuits in the US to recover foreign sovereign debt. These include: the interpretation and application of the Foreign Sovereign Immunities Act; discussion about the “Act of State Doctrine”; the role of international comity in decisions by U.S. courts to decline ruling on issues between a foreign country and its creditors; and significant contractual provisions in bond contracts that may affect a bondholder’s ability to commence a lawsuit in the U.S. when international restructurings have failed.

INSOL International sincerely thanks Lynn Harrison for writing this excellent paper.

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**Potential Legal Issues for Bondholders Seeking Recovery on Sovereign Bond Debt in U.S.**[*]

**L. P. Harrison 3rd**[**]
**Curtis, Mallet-Prevost, Colt & Mosle LLP**
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## I. Introduction

The current state of affairs in Europe over the sovereign debt crisis has spurred worldwide debate regarding the implementation of a sovereign debt restructuring protocol that would allow a country to engage in a consensual restructuring of its debt with bondholders. However, in the event a restructuring is not possible and bondholders have otherwise refused to engage in a consensual restructuring, such parties may consider commencing a lawsuit in a United States (the "U.S.") court against the sovereign. In doing so, the bondholder must consider a number of issues that will undoubtedly be raised when proceeding against a foreign sovereign.

This technical paper discusses some of the threshold issues that a bondholder would face if a suit is brought in a court in the U.S. for payment on sovereign debt. Such issues include sovereign immunity, the application of the act of state doctrine, and international comity. Furthermore, various contractual provisions, such as *pari passu* clauses and collective action clauses, also must be reviewed in order to determine whether if, and where, a suit may be brought and whether doing so is a viable course of action.

## II. The Foreign Sovereign Immunities Act of 1976

Traditionally, foreign states enjoyed broad sovereign immunity from lawsuits in U.S. courts. However, in 1976, Congress passed the Foreign Sovereign Immunities Act ("FSIA") which provides standard governing access to the federal and state courts for plaintiffs asserting claims against foreign states and their instrumentalities. *See Dar El-Bina Engineering & Contracting Co, Ltd. v. Republic of Iraq*, 79 F. Supp. 2d 374, 379 (S.D.N.Y. 2000). In addition, the FSIA establishes a framework for determining whether the property of a foreign state is immune from attachment or execution. It has been noted that the FSIA provides the sole basis for obtaining jurisdiction over a foreign sovereign in the U.S. and for attaching a foreign state's property in the U.S. *Republic of Argentina v. Weltover, Inc.*, 504 U.S. 607, 611 (1992); *NML Capital, Ltd. v. Spaceport Systems Int'l, L.P.*, 788 F. Supp. 2d 1111, 1119 (C.D. Cal. 2011).

Section 1603(a) of the FSIA provides that the term "foreign state" includes a political subdivision of a foreign state or an agency or instrumentality of a foreign state. An "agency or instrumentality of a foreign state" means any entity

(i) which is a separate legal person, corporate or otherwise, and

(ii) which is an organ of a foreign state or political subdivision thereof, or a majority of whose

(iii) shares or other ownership interest is owned by a foreign state or political subdivision thereof, and

(iv) which is neither a citizen of a State of the United States as defined in section 1332(c) and (e) of this title. . .

*See* 28 U.S.C. § 1603(b). The U.S. Supreme Court in *Dole Food Co. v. Patrickson*, 538 U.S. 468 (2003), held that "only direct ownership of a majority of shares by the foreign state satisfies the statutory requirement." In its ruling, the Court emphasized the wording of the statute as

[*] This Technical Paper is designed to provide practical and useful information on the subject matter covered. However, it is being provided with the understanding that the author is not engaged in rendering any specific legal, accounting or other professional services on the subject matter covered. If legal advice or other expert assistance is required concerning any particular matter, individualized and tailored advice should be sought. The views and opinions expressed herein are exclusively the personal views and opinions of the author and do not necessarily represent the views of Curtis, Mallet-Prevost, Colt & Mosle LLP, its attorneys or its clients, or INSOL International.

[**] L. P. Harrison 3rd (lharrison@curtis.com) is a member of Curtis, Mallet-Prevost, Colt & Mosle LLP in the firm's New York office. Mr. Harrison gratefully acknowledges the assistance of Dienna Ching, an associate of Curtis, Mallet-Prevost, Colt & Mosle LLP. Curtis also has offices in Washington, D.C. and Houston, Texas, as well as Almaty, Ashgabat, Astana, Buenos Aires, Dubai, Frankfurt, Istanbul, London, Mexico City, Milan, Muscat and Paris.

requiring "majority ownership" rather than "control" as the "benchmark of instrumentality status." Thus, where an entity is only indirectly owned by a foreign state, separated by other intermediate corporate tiers, such entity is not considered an instrumentality of a foreign state under the FSIA. *Id.* at 474; *see also* 28 U.S.C. § 1603(b)(ii).

## A. Sovereign or Jurisdictional Immunity

The FSIA provides that "a foreign state *shall* be immune from the jurisdiction of the courts of the United States and of the States" unless one of several statutorily defined exceptions applies. 28 U.S.C. § 1604 (emphasis added). Examples of some of the statutorily defined exceptions to sovereign or jurisdictional immunity include:

- **Waiver.** Where the foreign state has waived sovereign immunity either explicitly or by implication. 28 U.S.C. § 1605(a)(1).

- **Commercial Activity.** Where the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States. 28 U.S.C. § 1605(a)(2).

- **Expropriation.** Where rights in property taken in violation of international law are in issue and that property or any property exchanged for such property is present in the United States in connection with a commercial activity carried on in the United States by the foreign state; or that property or any property exchanged for such property is owned or operated by an agency or instrumentality of the foreign state and that agency or instrumentality is engaged in a commercial activity in the United States. 28 U.S.C. § 1605(a)(3).

### 1. *Waiver of Sovereign Immunity*

A foreign state may waive sovereign immunity either explicitly or by implication. 28 U.S.C. § 1605(a)(1).

*(a) Express Waiver*

If a sovereign bond contract contains a provision clearly and unambiguously waiving sovereign immunity, then the bondholder may be able to bring suit in the U.S. against the foreign state, even if the provision does not specifically refer to the U.S. or a court in the U.S.

In *Capital Ventures International v. Republic of Argentina*, 552 F.3d 289 (2d Cir. 2009), *cert. denied*, 130 S. Ct. 202 (2009), the beneficial owner of certain bonds issued by the Republic of Argentina brought an action in the U.S. after Argentina declared a moratorium on the payment of principal and interest on the bonds. Argentina moved to dismiss for lack of subject matter jurisdiction. The district court held that Argentina was entitled to sovereign immunity and therefore dismissed the case. However, the Second Circuit Court of Appeals found that, in the offering circulars under which the bonds were issued, Argentina waived sovereign immunity pursuant to the following provision:

> To the extent that the Republic has or hereafter may acquire any immunity (sovereign or otherwise) from jurisdiction of *any court* or from any legal process (whether through service or notice, attachment prior to judgment, attachment in aid of execution, execution or otherwise), with respect to itself or its revenues, assets or properties, the *Republic hereby irrevocably waives such immunity in respect of its obligations under the Bonds* to the extent it is permitted to do so under applicable law.

*Capital Ventures*, 552 F.3d at 291-92 (emphasis added).

The Second Circuit concluded that this provision clearly and unambiguously waived Argentina's immunity in "*any* court" (emphasis added) and satisfied the FSIA's requirement of an explicit waiver. The court also rejected Argentina's argument that immunity was not waived because the provision did not specifically make reference to the U.S. or a specific jurisdiction within the U.S. *Id.* at 295 ("There can be explicit waivers without a reference to the United States, as the waiver of immunity in 'any court' in this case illustrates"); *see also World Wide Minerals, Ltd. v. Republic of Kazakhstan*, 296 F.3d 1154, 1163 n.13 (D.C. Cir. 2002) (finding express waiver where the contract stated: "In respect of any arbitration or legal action or proceedings arising out of or in connection with this Agreement, ... [the Kazakhstan State Committee] hereby irrevocably agrees not to claim and hereby irrevocably waives ... immunity for itself and the assets of the Republic of Kazakhstan to the full extent permitted by the laws of such jurisdiction.").

Moreover, explicit waivers of sovereign immunity are narrowly construed in favor of the sovereign and are not enlarged beyond what the language requires. For example, in *World Wide*, the plaintiff brought a breach of contract action against the Republic of Kazakhstan which included claims for fraudulent inducement, tortious interference and conversion. The waivers of sovereign immunity were located in two of the four contracts at issue and, thus, the court held that the Republic of Kazakhstan waived sovereign immunity with respect to claims alleging breach of those two contracts. However, the court declined to extend the waivers of immunity to the remaining claims and dismissed those for lack of subject matter jurisdiction because there was nothing in the waivers to indicate that they extended to the entire lawsuit. *World Wide Minerals*, 296 F.3d at 1162-64.

*(b) Waiver by Implication*

Federal courts hold that the implied waiver provision in 28 U.S.C. § 1605(a)(1) must be construed narrowly. *See Drexel Burnham Lambert Group Inc. v. Committee of Receivers for A.W. Galadari*, 12 F.3d 317, 325 (2d Cir. 1993); *In re Shapiro v. Republic of Bolivia*, 930 F.2d 1013, 1017-18 (2d Cir. 1991) (rejecting argument that suit by a foreign sovereign in a U.S. court with respect to a particular matter constitutes a waiver of immunity with respect to other associated claims).

The legislative history of the FSIA provides three examples of implied waiver:

(1) a foreign state has agreed to arbitration in another country;

(2) a foreign state has agreed that a contract is governed by the law of a particular country; and

(3) a foreign state has filed a responsive pleading in a case without raising the defense of sovereign immunity.

*See* H.R. Rep. No. 1487, 94th Cong., 2d Sess. 18, *reprinted in* 1976 U.S. Code Cong. & Ad. News 6604, 6617; S. Rep. No. 1310, 94th Cong., 2d Sess. 18.

The examples listed above "involve circumstances in which the waiver was unmistakable, and courts have been reluctant to find an implied waiver where the circumstances were not similarly ambiguous." *Shapiro*, 930 F.2d at 1017. Thus, when examining whether a sovereign has implicitly waived immunity, a court should bear in mind that Section 1605(a)(1) must be construed narrowly and any waiver must be "unmistakable" and "unambiguous." *Drexel*, 12 F.3d at 326 (citing *Shapiro*, 930 F.2d at 1017); *see also Fir Tree Capital Opportunity Master Fund, LP v. Anglo Irish Bank Corp. Ltd.*, No. 11 Civ. 0955(PGG), 2001 WL 61877077 (S.D.N.Y. Nov. 28, 2011) (where foreign state nationalized a bank that had previously entered into an agreement consenting to the jurisdiction of New York courts and the application of New York law, court held that the foreign sovereign did not impliedly waive sovereign immunity when it nationalized the bank).

In *Drexel*, the Emirate of Dubai (the "Emirate") and a committee organized by the Emirate (together, the "Defendants") filed answers to complaints in litigation commenced by plaintiffs but did not assert sovereign immunity as a defense. *Drexel*, 12 F.3d at 326. As a result, the district court held that the Defendants waived the sovereign immunity defense. *Id.* at 325. However, the Second Circuit Court of Appeals found it significant that, after filing the answers, the Defendants immediately filed a motion to dismiss which did assert sovereign immunity as a defense. *Id.* at 326. Moreover, the Defendants had previously raised sovereign immunity as a defense in a number of pleadings in state court before the case was removed to federal court. *Id.* The Second Circuit held that where the filing of the answers were preceded by several invocations of sovereign immunity and almost immediately followed by a motion to dismiss asserting sovereign immunity, the court could not find that there was an "unmistakable" or "unambiguous" waiver. *Id.*

*(c) Withdrawal of Waiver*

The FSIA provides that once a foreign sovereign has waived immunity, it may withdraw such waiver *only* as provided by the terms of the original waiver:

> A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case[:] (1) in which the foreign state has waived its immunity either explicitly or by implication, *notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver*.

28 U.S.C. § 1605(a)(1) (emphasis added).

Thus, where a proper waiver does not contain a mechanism for withdrawal or revocation of such waiver in the future, the foreign state's waiver of immunity is irrevocable. *Themis Capital, LLC v. Democratic Republic of Congo*, No. 09 Civ. 1652 (PAE), 2012 WL 3114732, at *5 (S.D.N.Y. July 26, 2012).

**2. *Commercial Activity Exception***

A foreign state will not be immune from suit if the action is based upon: (i) a commercial activity carried on in the U.S.; (ii) an act performed in the U.S. in connection with a commercial activity of the foreign state elsewhere; or (iii) an act *outside* the territory of the U.S. in connection with a commercial activity of the foreign state elsewhere and that act *causes a direct effect* in the U.S. 28 U.S.C. § 1605(a)(2). Since a foreign sovereign's issuance of bonds generally takes place within its own jurisdiction, bondholders seeking to bring suit in the U.S. will likely argue that the third category of the commercial activity exception to sovereign immunity is applicable. In order to be within this exception, a bondholder will need to demonstrate that the issuance of the bonds outside the U.S. is a "commercial activity" that causes a "direct effect" in the U.S.

*(a) Commercial Activity*

The FSIA defines "commercial activity" to mean:

> either a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose.

28 U.S.C. § 1603(d).

The U.S. Supreme Court has held that "when a foreign government acts, not as a regulator of a market, but in the manner of a private player within it, the foreign sovereign's actions are 'commercial' within the meaning of the FSIA." *Weltover,* 504 U.S. 607, 614. Furthermore, because the FSIA provides that the commercial character of an act is determined by its "nature" rather than "purpose," the question is not whether the foreign government is acting with a profit motive or with the aim of fulfilling uniquely sovereign objectives. Rather, the issue is whether the particular act that the foreign state performs is the type of action by which a private party engages in “trade and traffic or commerce,” regardless of motive. *Id.*

Significantly, the issuance of bonds by a foreign state has been held by the U.S. Supreme Court to constitute a “commercial activity” under the FSIA such that a foreign state will not be immune from suit in connection with that activity. *Id.* at 616; *see also Shapiro*, 930 F.2d at 1018-19 (holding that issuance of public debt is a commercial activity within the meaning of Section 1605(a)(2)). In *Weltover,* bond holders brought breach of contract actions against the Republic of Argentina for defaulting on certain bonds and unilaterally extending the time for payments. The plaintiffs refused to accept the rescheduling of repayment on the bonds and brought the breach of contract action in the district court for the Southern District of New York. Argentina moved for lack of subject-matter jurisdiction and personal jurisdiction which was denied by the district court and affirmed by the Court of Appeals for the Second Circuit. The issue presented was whether the unilateral refinancing of the bonds was taken “in connection with a commercial activity” of Argentina, and whether “it had a direct effect in the United States.” *Id.* at 612.

The U.S. Supreme Court held that the commercial character of the bonds was confirmed by the fact that they are in almost all respects garden-variety debt instruments. The bonds may be held by private parties, are negotiable and may be traded on the international market, and promise a future stream of cash income. *Id.* at 616. Moreover, the Supreme Court emphasized that it was irrelevant why Argentina participated in the bond market in the manner of a private actor; it matters only that it did so. *Id.* at 617; *see also Global Index, Inc. v. Mkapa*, 290 F. Supp. 2d 108, 112 (D.C. 2003) (Zanzibar’s issuance of promissory notes was a “commercial activity” under the FSIA); *Wolf v. Banco Nacional de Mexico, S.A.*, 739 F.2d 1458, 1460 (9th Cir. 1984) (holding that sale of certificate of deposit by nationalized bank to plaintiff was “clearly a commercial activity carried on in the U.S.” within the meaning of the FSIA).

*(b) “Direct Effect” in the U.S.*

The Supreme Court in *Weltover* also held that Argentina’s unilateral rescheduling of the bonds had a direct effect in the U.S. because the bondholders had designated their accounts in New York as the place of payment and Argentina had already made some payments into such accounts prior to the rescheduling of the payments. As a result, the Supreme Court held that New York was the place of performance for Argentina’s ultimate contractual obligations and therefore Argentina’s rescheduling of the payments “necessarily had a ‘direct effect’ in the U.S.” *Id.* at 619. Therefore, Argentina was not immune from the breach of contract suit brought by the bondholders for payment on the bond debt. *Id. See also Dar El-Bina Engineering & Contracting Co, Ltd. v. Republic of Iraq*, 79 F. Supp. 2d 374, 382 (S.D.N.Y. 2000) (concluding that nonpayment of a commercial obligation by a foreign state has a direct effect in the U.S. if the defaulting party was contractually obligated to make payment in the U.S. and failed to do so); *DRFP L.L.C. v. Republica Bolivariana de Venezuela*, 622 F.3d 513, 519 (6th Cir. 2010) (holding that “direct effect” prong under commercial activity exception was satisfied where Ohio was designated as place of payment under promissory notes issued by Venezuela and Venezuela failed to pay); *Global Index*, 290 F. Supp. 2d at 113 (holding that there “is no direct effect unless payment was supposed to have been made in the United States”); *Hanil Bank v. PT. Bank Negara Indonesia*, 148 F.3d 127, 132-33 (2d Cir. 1998) (where New York was designated as the place of payment on letter of credit, failure to pay by Indonesian Bank caused “direct effect” in the U.S.); *In re Commercial Bank of Kuwait v. Rafidain Bank*, 15 F.3d 238, 241 (2d Cir. 1994) (holding that failure of Rafidain Bank, which was wholly owned by the Republic of Iraq, to remit payment in New York, as they were contractually bound to do, had a “direct effect” in the U.S.).

Conversely, if the sovereign is entitled to make payment in a country other than the U.S., the failure to receive those funds does not cause a direct effect in the U.S. *Westfield v. Federal Republic of Germany*, 633 F.3d 409, 416 (6th Cir. 2011) (stating that when “funds are due abroad and not paid, the direct effects occur abroad”). Furthermore, if a bondholder can not show that payment was, either expressly or impliedly, supposed to be made in the U.S., a court may not find there is a "direct effect" and therefore sovereign immunity applies. *See Global Index*, 290 F. Supp. 2d at 116 (finding sovereign immunity because plaintiff could not show that promissory note issued by Zanzibar was supposed to have been made in the U.S.); *Pons v. People's Republic of China*, 666 F. Supp. 2d 406 (S.D.N.Y. 2009) (concluding that there was no "direct effect" in the U.S. where bonds called for payment in several possible cities, all outside the U.S.); *Morris v. People's Republic of China*, 478 F. Supp. 2d 561, 570-71 (S.D.N.Y. 2007) (same); *Croesus EMTR Master Fund L.P. v. Federative Republic of Brazil*, 212 F.Supp.2d 30, 36 (D.D.C. 2002) (holding that there was no "direct effect" because, under the terms of the bonds, the bondholder had no right to designate a place of payment in the U.S.).

**3. *Expropriation Exception***

The expropriation exception provides that a foreign sovereign is not immune in any case

> "in which rights in property taken in violation of international law are in issue and that property or any property exchanged for such property is present in the United States in connection with a commercial activity carried on in the United States by the foreign state; or that property or any property exchanged for such property is owned or operated by an agency or instrumentality of the foreign state and that agency or instrumentality is engaged in a commercial activity in the United States."

28 U.S.C. § 1605(a)(3). Thus, in order to establish jurisdiction pursuant to the FSIA expropriation exception, a plaintiff must show that (1) rights in property are in issue; (2) that the property was "taken"; (3) that the taking was in violation of international law; and (4) that one of the two nexus requirements is satisfied. For the nexus requirements, the plaintiff could show either that: (i) property or any property exchanged for such property is present in the U.S. in connection with a commercial activity in the U.S. by the foreign state; or (ii) property or any property exchanged for such property is owned or operated by an agency or instrumentality of the foreign state and that agency or instrumentality is engaged in a commercial activity in the U.S. *Zappia Middle East Constr. Co., v. Emirate of Abu Dhabi*, 215 F.3d 247, 251 (2d Cir. 2000); *Abelesz v. Magyar Nemzeti Bank*, 692 F.3d 661, 686 (7th Cir. 2012).

*For bondholders bringing actions against foreign sovereigns for payment on sovereign debt, this exception may not be applicable to remove a foreign sovereign's cloak of immunity. This is because courts are divided regarding whether the term "property" for expropriation purposes is limited to "tangible" property.* Universal Trading & Inv. Co. v. Bureau for Representing Ukrainian Interests in International and Foreign Courts*, No. 10-12015-DPW, 2012 WL 4324062 (D. Mass. Sept. 19, 2012) (noting court split regarding whether property under the expropriation exception must be tangible or can be intangible as well).*

A bondholder's contractual right to repayment constitutes intangible property*. Nemariam v. Federal Democratic Republic of Ethiopia,* 491 F.3d 470, 476 (D.C. Cir. 2007) (stating that a contractual right to payment constitutes intangible property). Thus, if the term "property" is limited to tangible property, then a bondholder seeking to recover payment under a contract would likely not be able to rely on this exception to rebut the presumption of sovereign immunity*. Canadian Overseas Ores Ltd. v. Compania de Acero del Pacifico S.A*., 528 F. Supp. 1337, 1346 (S.D.N.Y. 1982) (holding that the language of the expropriation exception in 28 U.S.C. § 1605(a)(3) was "applicable to tangible property, [and] is on its face inapplicable to a contractual right to be paid"), *aff'd,* 727 F.2d 274 (2d Cir. 1984*); Daventree Ltd. v. Republic of Azerbaijan*, 349 F. Supp. 2d 736, 749, 751 (S.D.N.Y. 2004) (finding that expropriations exception to FSIA was not applicable to claims that "pertain to contract rights or the right to receive payments" and therefore the foreign sovereign was entitled to immunity as to those claims under the FSIA).

Notwithstanding this uncertainty among the courts, however, bondholders suing to recover payment of sovereign debt will likely be successful in arguing that the commercial activity exception applies, especially since the Supreme Court has already held that the issuance of bonds is a commercial activity*.* See *Carl Marks & Co. v. Union of Soviet Socialist Republics,* 665 F. Supp. 323, 335 (S.D.N.Y. 1987) (holding that court would not address expropriation exception because Soviet Union's issuance of debt instruments constituted a commercial activity).

## B. Immunity from Attachment

After establishing jurisdiction over the sovereign (and assuming the foreign sovereign is found liable for the bond obligation), the successful bondholder will seek to collect on its judgment, typically through attachment and execution on property held by the foreign state in the U.S. While Section 1609(a) of the FSIA provides that property belonging to the foreign state is immune from attachment or execution, similar to jurisdictional immunity, the foreign state may waive immunity either explicitly or by implication. 28 U.S.C. § 1610(a)(1). As with sovereign immunity, the FSIA provides the sole basis for attaching a foreign state's property in the U.S. *NML Capital, Ltd. v. Spaceport Systems Int'l, L.P.*, 788 F. Supp. 2d 1111, 1119 (C.D. Cal. 2011). Furthermore, like sovereign immunity, if a proper waiver does not contain a procedure for withdrawal or revocation of such waiver in the future, the foreign state's waiver of immunity from attachment is irrevocable. *Themis Capital, LLC v. Democratic Republic of Congo*, No. 09 Civ. 1652 (PAE), 2012 WL 3114732, at *7 (S.D.N.Y. July 26, 2012).

Specifically, Section 1610 of the FSIA provides, in relevant part, that:

> The property in the United States of a foreign state . . . used for a commercial activity in the United States, shall not be immune from attachment in aid of execution, or from execution, upon a judgment entered by a court of the United States . . . if –
>
> (1) the foreign state has waived its immunity from attachment in aid of execution or from execution either explicitly or by implication, notwithstanding any withdrawal of the waiver the foreign state may purport to effect except in accordance with the terms of the waiver, or

28 U.S.C. § 1610(a)(1). The property of the foreign state that is subject to attachment and execution must be "property in the United States" and "must have been used for a commercial activity at the time the writ of attachment or execution is issued." *Aurelius Capital Partners, LP v. Republic of Argentina*, 584 F.3d 120 (2d Cir. 2009) (holding that funds sought to be attached were not used for any commercial activity and therefore were immune from attachment under Section 1610(a)); *NML Capital, Ltd. v. Republic of Argentina*, 680 F.3d 254, 257-58 (holding that account used solely to arrange pre-arranged payment to sellers of scientific equipment for use by grant beneficiaries was subject to attachment because the account was used for commercial activity), *cert. denied*, 133 S. Ct. 273 (2012); *EM Ltd. v. Republic of Argentina*, 389 Fed. Appx. 38, 43 (2d Cir. 2010), *cert. denied*, 131 S. Ct. 1474 (2011); *see also Aurelius Capital Partners, LP v. Republic of Argentina*, No. 07 Civ. 2715(TPG), 2012 WL 983564, at *5 (S.D.N.Y. Mar. 22, 2012) (concluding that what matters under Section 1610(a) is whether the property sought to be attached is "used for" a commercial activity, "not how it was generated or produced") (internal quotations omitted).

Thus, if the foreign state has immunity from attachment or execution, the bondholder must consider whether obtaining a judgment against the foreign state would be a practical course of action. For instance, in *NML Capital, Ltd. v. Spaceport Systems Int'l, L.P.*, the district court denied the plaintiff's application to place a temporary lien on property owned by Argentina where plaintiff failed to demonstrate that the property was not immune from attachment. 788 F. Supp. 2d at 1124-25.

There is a statutory presumption that, if the defendant is a foreign state, that defendant has immunity under the FSIA. *NML Capital, Ltd. v. Spaceport Systems Int'l, L.P.*, 788 F. Supp. 2d at 1119. Therefore, with respect to attachment of property, the plaintiff has the burden of proving that the property is not subject to immunity from attachment or execution. *Id.* As a result, foreign states may have immunity from attachment of its property in the U.S. without having to even appear in the U.S. *Rubin v. The Islamic Republic of Iran*, 637 F.3d 783, 801 (7th Cir. 2011); *Peterson v. Islamic Republic of Iran*, 627 F.3d 1117, 1126-28 (9th Cir. 2010);

*Walker Intern. Holdings Ltd. v. Republic of Congo*, 395 F.3d 229 (5th Cir. 2004), *cert. denied*, 125 S. Ct. 1841 (2005) (holding that foreign state's "presence is irrelevant" to the issue of whether the property is excepted from presumptive immunity under § 1609); *Walters v. Industrial and Commercial Bank of China, Ltd.*, 651 F.3d 280, 290 (2d Cir. 2011) ("where a judgment creditor seeks to enforce a judgment rendered against a foreign sovereign by attaching or executing upon its property, a district court may apply the FSIA's execution immunity provisions regardless of whether the foreign sovereign enters an appearance").

The Seventh Circuit Court of Appeals recently stated in *Rubin* that:

> [U]nder § 1609 of the FSIA, the property of a foreign state in the United States is presumed immune from attachment and execution. The immunity inheres in the property and does not depend on an appearance and special pleading by the foreign state itself. The party in possession of the property may raise the immunity or the court may address it *sua sponte*. Either way, the court must independently satisfy itself that an exception to § 1609 immunity applies before ordering attachment or other execution on foreign-state property in the United States.

*Rubin v. The Islamic Republic of Iran*, 637 F.3d at 801.

Significantly, it is not sufficient simply to demonstrate that the foreign state has property located in the U.S. The bondholder must also demonstrate that such property is "used for a commercial activity in the United States." As stated above, "commercial activity" has been construed by the U.S. Supreme Court to mean that "when a foreign government acts, not as a regulator of a market, but in the manner of a private player within it, the foreign sovereign's actions are 'commercial' within the meaning of the FSIA." *Weltover*, 504 U.S. at 614. Thus, the "question is not whether the foreign government is acting with a profit motive . . . [r]ather, the issue is whether the particular actions that the foreign state performs (whatever the motive behind them) are the *type* of actions by which a private party engages in 'trade and traffic or commerce.'" *Id.* (emphasis added).

For instance, in *NML Capital, Ltd. v. Spaceport Systems Int'l, L.P.*, Argentina suspended interest and principal payments on $80 billion of bond debt. The plaintiff brought suit against Argentina and obtained a money judgment of approximately $284 million and another $66 million in post-judgment interest that had accrued on that judgment. The plaintiff then brought suit in federal district court to place a temporary lien on a satellite owned by Argentina[1] to prevent Argentina from transferring or launching it for at least 40 days. 788 F. Supp. 2d at 1115-17. The satellite was used as part of Argentina's participation in a joint program with other countries to conduct a scientific and humanitarian mission, whereby data on the earth's ocean would be collected from space and be disseminated for free to the scientific community. *Id.* at 1117.

Applying the standard set forth by the Supreme Court in *Weltover*, discussed above, the district court in *NML Capital* held that Argentina's conduct and relationship with the space agencies of other countries in connection with the joint science program was not "commercial" and therefore the satellite was immune from attachment. The district court concluded that Argentina was exercising its "powers peculiar to sovereign" while it participated in the mission of "international cooperation" to collect data on the earth's ocean salinity with other government bodies. A private party simply could not be a party of this intergovernmental relationship established around the satellite. *Id.* at 1124.

Similarly, in *EM Ltd. v. The Republic of Argentina*, 473 F.3d 463 (2d Cir. 2007), the Second Circuit Court of Appeals held that certain of Argentina's funds held at the Federal Reserve Bank of New York to be used for repayment of Argentina's debt to the International Monetary Fund (the "IMF") was not an attachable asset of Argentina. This was because such property was not "used for a commercial activity in the United States." *Id.* at 465-66. Argentina's borrowing relationship with the IMF was not "commercial" because: (1) when Argentina borrowed from the IMF, it was exercising powers peculiar to sovereigns (since

[1] The satellite was comprised from instruments contributed by a number of groups, including the Argentine National Space Activities Commission. Since no one argued otherwise, the court assumed that this Commission is the same entity as Argentina. *NML Capital*, 788 F. Supp. 2d at 1118 ("the Court assumes Plaintiff's proposition is correct, that [the Commission] *is* Argentina") (emphasis in original).

only sovereigns can become members of the IMF); (2) Argentina was required to implement regulatory actions when borrowing with the IMF; (3) the terms and conditions of Argentina's borrowing were not governed by a "garden-variety debt instrument", rather it was governed by treaty obligations; and (4) the IMF loans were structured in a manner that was unique to the international organization and were not available on the commercial market. *Id.* at 482-84; *see also Colella v. Republic of Argentina*, No. C 07-80084 WHA, 2007 WL 1545204, at *5 (N.D. Cal. May 29, 2007) (holding that airplane owned by Argentina used to transport the president of Argentina in his official capacity was not used for "commercial activity" and therefore was immune from attachment).

**1. *Prejudgment Attachment***

Section 1610(d) of the FSIA provides that:

> The property of a foreign state used for a commercial activity in the United States, shall not be immune from attachment prior to the entry of judgment in any action brought in a court of the United States or of a State . . . if –
>
> (1) the foreign state has explicitly waived its immunity from attachment prior to judgment, notwithstanding any withdrawal of the waiver the foreign state may purport to effect except in accordance with the terms of the waiver, and
>
> (2) the purpose of the attachment is to secure satisfaction of a judgment that has been or may ultimately be entered against the foreign state, and not to obtain jurisdiction.

Thus, prejudgment attachment of a foreign state's property is permitted only if such property is used for a commercial activity and the foreign state has *explicitly* waived immunity from attachment prior to judgment. *See EM Ltd. v. The Republic of Argentina*, 473 F.3d at 481 n.19 (emphasis added).

**2. *Different Standard for Attaching Property of Agency or Instrumentality of Foreign State***

The protections under the FSIA against attachment and execution extend to the instrumentalities of a foreign state. However, the protections applicable to assets of instrumentalities are different from those applicable to the assets of the foreign states themselves. *See EM Ltd. v. The Republic of Argentina*, 473 F.3d at 472-73. As described above, Sections 1610(a) and 1610(d) of the FSIA provide that "assets of a foreign state can be attached *only if the assets sought to be attached are used for commercial activity in the United States*." *Id.* (emphasis added) (internal citations omitted). Thus, in order for the assets of the foreign state to be attached, such assets must be used for commercial activity in the U.S. *Id.*

However, for assets of agencies or instrumentalities, Section 1610(b) of the FSIA provides, in relevant part, that

> any property in the United States of an agency or instrumentality of a foreign state engaged in commercial activity in the United States shall not be immune from attachment in aid of execution, or from execution, upon a judgment entered by a court of the United States or of a State after the effective date of this Act, if -
>
> (1) the agency or instrumentality has waived its immunity from attachment in aid of execution or from execution either explicitly or implicitly, notwithstanding any withdrawal of the waiver the agency or instrumentality may purport to effect except in accordance with the terms of the waiver . . .

28 U.S.C. § 1610(b). The distinction for property of agencies and instrumentalities of foreign states is that "creditors may attach *any property in the United States* of an

agency or instrumentality of a foreign state engaged in commercial activity in the United States." 28 U.S.C. § 1610(b); *EM Ltd. v. The Republic of Argentina*, 473 F.3d at 473.

## III. Act of State Doctrine

In addition to issues of sovereign immunity, bondholders may face arguments based on the act of state doctrine. The act of state doctrine operates to confer presumptive validity on certain acts of foreign sovereigns by rendering claims challenging such acts non-justiciable, or unable to be heard by a federal court in the U.S. The policy underlying the doctrine is to avoid having the judicial branch undermine the acts of the political branches of government (especially the executive branch) in the realm of foreign policy. Therefore, the applicability of the doctrine focuses on the likely impact on international relations if a U.S. court were to consider whether a foreign sovereign's actions are valid. If adjudication would embarrass or hinder the executive with respect to foreign relations, then the court should refrain from inquiring into the validity of the foreign state's acts. *Allied Bank Int'l v. Banco Credito Agricola de Cartago*, 757 F.2d 516, 520-21 (2d Cir. 1985); see also *Libra Bank Ltd. v. Banco Nacional de Costa Rica*, S.A., 570 F. Supp. 870, 883 (S.D.N.Y. 1983) (explaining that "the underlying rationale of the act of state doctrine is that the judicial branch may not pass upon the validity of foreign acts when to do so would vex the harmony of our international relations with that foreign nation . . . Rather, it is the political branch, in the exercise of its considered judgment, to engage in acts which may have the possible consequence of significantly altering our relationship with a foreign nation").

The first statement of this doctrine was in *Underhill v. Hernandez*, 168 U.S. 250, 252 (1897), where the U.S. Supreme Court stated:

> Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory.

Thus, the act of state doctrine will operate to bar U.S. courts from examining the validity of an act by a foreign sovereign within its own territory. *W.S. Kirpatrick & Co. v. Envtl. Tectonics Corp., Int'l*, 493 U.S. 400, 405 (1990) (declaring that the act of state doctrine applies when "the relief sought or the defense interposed would . . . require" a court in the United States to declare invalid the official act of a foreign sovereign performed within its own territory"); see also *Braka v. Bancomer, S.N.C*., 762 F.2d 222 (2d Cir. 1985) (holding that act of state doctrine applied where the situs of the obligation suspended by the government, payment on certificates of deposit, existed wholly within the boundaries of the foreign sovereign).

However, if a foreign sovereign engages in "extraterritorial takings," then the act of state doctrine would not bar a U.S. court from hearing the case to determine whether such taking was valid. See 28 U.S.C. § 2370(e)(2); see *Allied Bank*, 757 F.2d at 521; *Lightwater Corp., Ltd. v. Republic of Argentina,* No. 02 Civ. 3804(TPG), 2003 WL 1878420, at *5 (S.D.N.Y. Apr. 14, 2003*); Libra Bank Ltd. v. Banco Nacional de Costa Rica, S.A*., 570 F. Supp. 2d 870 (S.D.N.Y. 1983) (holding that act of state doctrine did not apply where the situs of the payment obligation was to a bank located in New York City and therefore court would examine the validity of the Costa Rican decrees that caused suspension of payment).

In Allied Bank, the plaintiff, an agent for a syndicate of thirty-nine creditor banks, brought an action on behalf of the syndicate against three Costa Rican banks. The banks were wholly owned by the Republic of Costa Rica and were subject to the direct control of the Central Bank of Costa Rica. The action was brought to recover on promissory notes issued by the Costa Rican banks, payable in U.S. dollars in New York City. The promissory notes were in default solely due to the actions of the Costa Rican government which had issued regulations to suspend all external debt payments as a result of escalating national economic problems. The defendants and the syndicate of banks engaged in negotiations to reschedule the debt and ultimately thirty-eight out of the thirty-nine banks agreed to dismiss the suit. Despite there being only one creditor who refused to participate in the restructuring (the party appealing to the Second Circuit), the refinancing went into effect.[2] Allied Bank, 757 F.2d at 519. The issue

[2] In a previous decision, the Second Circuit held that it would extend international comity to the Costa Rican government and therefore did not analyze whether the act of state doctrine was applicable. The court did so under the assumption that executive and legislative branches of the U.S. government fully supported Costa Rica's actions. However, on rehearing, the Executive Branch of the U.S. joined the litigation as *amicus curiae* and filed a brief explaining that the U.S. supported debt resolution procedures through the International Monetary Fund that encourages

before the court was whether the act of state doctrine barred the court from adjudicating the validity of Costa Rica's actions.

Given that the U.S. Supreme Court had limited the act of state doctrine to actions or takings by a foreign sovereign "within its own territory," the Second Circuit focused on the situs of property at the time of the purported taking in Allied Bank. 757 F.2d at 521. The "property" in this case was the creditor's right to receive repayment from the Costa Rican banks. The Costa Rican decree suspending all external debt payments constituted a "taking." Id. The Second Circuit held that the situs of the creditor's property, the right to receive payments, was in the U.S. and, therefore, the act of state doctrine did not apply. Moreover, giving effect to the Costa Rican decree would be contrary to the principles of contract law because the decree vitiates an express provision in the contract between the parties regarding payment of interest and principal. Id. at 522.

### A. Expropriation Exception to Act of State Doctrine

***(The Hickenlooper Amendment*)**

Analogous to the expropriation exception for sovereign immunity, Congress enacted an expropriation exception under the act of state doctrine in response to the 1964 U.S. Supreme Court decision *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 428 (1964), where it held that the judicial branch "will not examine the validity of a taking of property within its own territory by a foreign sovereign government, extant and recognized by this country at the time of suit, in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, *even if the complaint alleges that the taking violates customary international law*." *Id.* (emphasis added). In response to *Sabbatino*, Congress enacted the "Hickenlooper Amendment" which parallels the expropriation exception for sovereign immunity.

The Hickenlooper Amendment provides, in relevant part, that

> Notwithstanding any other provision of law, no court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a claim of title or other right to property is asserted by any party including a foreign state (or a party claiming through such state) *based upon (or traced through) a confiscation or other taking* after January 1, 1959, by an act of that state *in violation of the principles of international law* . . .

22 U.S.C. § 2370(e)(2) (emphasis added). Therefore, courts should *not* apply the act of state doctrine to bar hearing cases where a foreign sovereign has taken or confiscated property in violation of international law. *West v. Banco Nactional de Mexico, S.A.*, 807 F.2d 820, 829 (9th Cir. 1987).

Courts have interpreted this amendment narrowly to be "limited to cases involving claims of title with respect to American owned property nationalized by a foreign government in violation of international law, *when the property or its assets were subsequently located in the United States*." *Compania de Gas de Nuevo Laredo, S.A. v. Entex, Inc.*, 686 F.2d 322, 327 (5th Cir. 1982) (emphasis added); *Empresa Cubana Exportadora de Azucar y Sus Derivados v. Lamborn & Co.*, 652 F.2d 231, 237 (2d Cir. 1981) (holding that Hickenlooper Amendment applies "only to cases in which the expropriated property has found its way back into the United States"); *Hilsenrath v. Swiss Confederation*, No. C 07-02782 WHA, 2007 WL 3119833, at *6 (N.D. Cal. Oct. 23, 2007) (holding that the Hickenlooper Amendment only applies to property located in the U.S.).

Moreover, as with the expropriation exception under sovereign immunity, there is a split within the U.S. courts over whether the Hickenlooper Amendment applies only to taking of "tangible" property. *Compare Canadian Overseas Ores Ltd. v. Compania de Acero del Pacifico S.A.*, 528 F. Supp. 1337, 1346 (S.D.N.Y. 1982) (Hickenlooper Amendment applies

cooperative resolution of international debt problems between sovereigns and their creditors. This framework is grounded in the understanding that the underlying obligations continue to be valid and enforceable while the parties renegotiate terms and conditions for repayment. In contrast, Costa Rica's attempt to unilaterally restructure private obligations was inconsistent with this framework and therefore inconsistent with U.S. policy. *Allied Bank*, 757 F.2d at 519-20 (explaining procedural history).

to tangible property), *with West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 830 (9th Cir. 1987) (finding that the tangible/intangible characterization of property interests is not a distinction generally recognized in international law and holding that certificates of deposit may be characterized as intangible property or contracts that are "property interests" protected under international law from expropriation), *cert. denied*, 482 U.S. 906 (1987).

**B. Application of Hickenlooper Amendment to Bondholder Suits**

While research has not revealed a case whereby the Hickenlooper Amendment is applied in the context of a bondholder suit, the Ninth Circuit Court of Appeals has held that a certificate of deposit constitutes a "property interest" that is protected under international law from expropriation and thus applied the Hickenlooper Amendment to analyze the merits of the claims brought by the plaintiff. *See West*, 807 F.2d at 830-31. Thus, it could be argued that a similar type of debt instrument, such as bonds, also constitutes a "property interest" protected under international law from expropriation such that a U.S. court may hear and adjudicate claims brought by a bondholder seeking to recover on sovereign debt.

In *West*, individual U.S. investors (the "Investors") purchased peso- and dollar-denominated certificates of deposit issued by Mexican banks. At the time the Investors purchased the certificates of deposit, the Mexican banks were privately owned. In 1982, the Mexican government experienced a serious deficiency in its foreign currency reserves needed to pay its debts. Consequently, the Mexican government instituted a program of exchange control regulations designed to provide greater ability to monitor and maintain the exchange value of the peso. *West*, 807 F.2d at 822. During that time, the Mexican government issued a number of decrees that affected certificates of deposit in Mexican banks. Specifically, exchange control regulations prevented holders of certificates of deposit from receiving payment in anything other than the peso. Moreover, the Mexican government nationalized the entire private banking system and issued more comprehensive exchange controls, including a provision that eliminated all bank deposits in foreign currency and specifying that repayment of those deposits were to be made in pesos at a rate of exchange to be determined by Banco de Mexico, Mexico's central bank. *Id.* at 823.

When the dollar certificates of deposit matured, the Mexican banks converted those accounts at a specified rate of 70 pesos to the dollar. While the peso accounts remained in domestic currency, the value of the peso declined substantially in the world market, causing the Investors to suffer losses when the pesos were later converted to dollars in the U.S. The Investors brought suit in the district court for the Northern District of California asserting, among other things, that the taking of property (the dollar-denominated certificates of deposit) by the Mexican government violated international law. The district court held that this claim was barred because of the act of state doctrine. *Id.* at 823.

The Investors appealed, arguing that the Mexican government's conversion of the dollar-denominated certificates of deposit to pesos at a rate less than market was a "taking" of property in violation of international law. Therefore, the Investors argued, the Hickenlooper Amendment applied to bar the act of state doctrine from preventing the court from hearing the case. The defendants argued that the Hickenlooper Amendment did not apply because the right to payment arising out of ownership of the certificates of deposit was contractual, "intangible" property that falls outside the scope of the type of property that can be expropriated. *Id.* at 829.

As a threshold matter, the Ninth Circuit Court of Appeals held that the defendants engaged in "commercial activity" in the U.S. by soliciting, marketing and encouraging U.S. investors to deposit monies in their banks. Therefore, the commercial activity exception to sovereign immunity applied. *Id.* at 825. The Ninth Circuit then held that the tangible versus intangible characterization of property interests was a "distinction without a difference" because there is no such distinction recognized in international, federal or state law. *Id.* at 830. Although the "certificates of deposit may be characterized as intangible property or contracts, they are 'property interests' that are protected under international law from expropriation." *Id.* Notably, the court recognized that, in this case, the citizens who purchased certificates of deposit had contracts that were "*properly understood as investments and therefore the type of property that Hickenlooper sought to protect*." *Id.* (emphasis added).

After finding that the Hickenlooper Amendment applied, the court then analyzed the merits of whether this was in fact a taking in violation of international law. Under international law, the legislature is generally free to impose exchange controls because a state has a strong interest in its monetary policy. *Id.* at 831. The court ultimately concluded that the decrees issued by the Mexican government did not constitute "takings" under international law because a "state has the right to make every effort to stabilize its currency in time of financial stress." *Id.* at 832.

The *West* case is significant for investors seeking to recover on sovereign bond debt because, although a court may find that there was a taking of intangible property, such as a contractual right to payment, a court may still rule against the investor if the court finds that the action of the foreign sovereign is consistent with international law which justifies the taking.

## IV. International Comity

International comity is the recognition of a nation to allow within its territory the legislative, executive or judicial acts of another nation. Pravin Banker Assocs., Ltd. v. Banco Popular Del Peru, 109 F.3d 850, 854 (2d Cir. 1997). Under the principles of international comity, courts in the U.S. will ordinarily refuse to review acts of foreign governments and instead defer to proceedings taking place in such countries and allow those proceedings and acts to have extraterritorial effect in the U.S. However, courts in the U.S. will not extend comity to foreign governments or proceedings when doing so would be contrary to U.S. policies or prejudice the interests of the U.S. Id. at 854.

For bondholders seeking repayment on debt issued by foreign states, issues of international comity may arise, particularly if the foreign state is in the process of negotiating a restructuring of its bond payments with a larger group of creditors. The court must evaluate whether it should, under principles of comity and consideration of U.S. policies, defer to the foreign government in their efforts to renegotiate their debt. U.S. courts have held that a foreign sovereign's unilateral imposition of international restructuring agreements on unwilling private creditors is inconsistent with U.S. policy and interests. *Allied Bank Int'l v. Banco Credito Agricola de Cartago*, 757 F.2d 516, 522 (2d Cir. 1985) (stating that Costa Rican government's "unilateral attempt to repudiate private, commercial obligations is inconsistent with the orderly resolution of international debt problems" and against the interests of the U.S. and counter principles of contract law); *Nat'l Union Fire Ins. Co. of Pittsburgh v. The People's Republic of the Congo*, 729 F. Supp. 936, 944 (S.D.N.Y. 1989) ("depriving a creditor of its right to choose whether to reschedule a debt or to enforce the underlying obligation to pay" is contrary to U.S. policy).

For instance, *in Pravin Banker Assocs., Ltd. v. Banco Popular Del Peru,* 109 F.3d 850 (2d Cir. 1997), a creditor brought suit against the Republic of Peru ("Peru") and its bank, Banco Popular (together, the "Defendants"), for the payment of debt in the district court for the Southern District of New York and moved for summary judgment. At the time the suit was brought, Peru was in negotiations with its creditors for the restructuring of its debt under the Brady Plan[3] and Banco Popular was placed in liquidation proceedings for being unable to pay its creditors. Id. at 853. The creditor had refused to participate in the Brady Plan negotiations or Banco Popular's liquidation proceedings.

The Defendants moved to dismiss, stay or deny the creditor's summary judgment motion and argued that allowing the case to proceed would "reawaken" all of the other lawsuits with its other creditors that had been stayed in order to promote negotiations under the Brady Plan. This would cause a "creditor stampede" to find and attach Peruvian assets which would disrupt Peru's reform efforts. The district court granted a six-month stay to allow the orderly completion of Banco Popular's liquidation proceedings and then granted another two-month stay for the parties to submit information in connection with Peru's debt problems and the efforts to resolve such problems. When this further stay expired, the creditor renewed its summary judgment motion and Peru renewed its motion for a stay or dismissal. The district court granted the creditor's motion for summary judgment and the Defendants appealed, arguing that the district

[3] The "Brady Plan" was a framework proposed in 1989 by Nicholas Brady, then U.S. Treasury Secretary, that encouraged banks to voluntarily (1) reduce foreign countries' debt burdens; (2) restructure old debts; and (3) provide additional loans. *Pravin*, 109 F.3d at 853. Countries that entered into Brady Plan negotiations were expected to conform to the requirements set by the International Monetary Fund ("IMF") for restructuring their economy. Furthermore, the IMF was charged with overseeing the negotiations between each country and its creditors. *Id.*

court erred in failing to extend international comity to Peru's negotiations with its creditors. Id. at 853.

In determining whether to grant international comity, the district court recognized two important U.S. policies. First, the U.S. encourages participation in (and advocates the success of) the Brady Plan. Second, the U.S. has a strong interest in ensuring that valid debts are enforceable under principles of contract law and specifically the continuing enforceability of foreign debts owed to U.S. lenders. Thus, while the U.S. advocates voluntary creditor participation in restructuring negotiations, debts should remain enforceable throughout the negotiations. Id. at 855.

The Second Circuit Court of Appeals affirmed the district court's grant of the summary judgment motion and denial of the Defendants' motions for dismissal or a stay. The Second Circuit held that to deny the creditor's summary judgment motion would be to deny the creditor's right to enforce the underlying debt until the completion of the Brady Plan negotiations, which has no obvious or reasonably proximate termination date. Furthermore, denial of summary judgment would have the effect of converting the voluntary negotiating framework under the Brady Plan to the equivalent of a judicially enforced bankruptcy proceeding whereby creditors could not exercise legal rights outside of the negotiations. *Id.* at 855. Under these circumstances, the Second Circuit affirmed the district court's decision to grant summary judgment.

## V. Significant Contractual Provisions Affecting Recovery

### A. *Pari Passu* Clauses

A *pari* passu clause is a provision in lending instruments whereby the borrower or debtor promises that the obligations to the lender will always rank equally in right of payment with all of the borrower's other unsubordinated debts. *See* Lee C. Buchheit & Jeremiah S. Pam, The Pari Passu Clause in Sovereign Debt Instruments*, 53 EMORY L. J. 869 (2004). Pari passu* clauses have become a significant provision in sovereign debt instruments, particularly in light of the current sovereign debt crisis where sovereigns are engaging in negotiations to restructure their debt.

One noteworthy decision was issued recently by the Second Circuit Court of Appeals in *NML Capital, Ltd. v. Republic of Argentina,* 699 F.3d 246 (2d Cir. 2012), whereby the Second Circuit held that Argentina could not make payment on new bonds issued from Argentina's 2005 and 2010 restructurings without also making payments on the old bonds due to the *pari passu* clause in its sovereign bond issuance. Id. *at 260.* For bondholders deciding whether it would be prudent to enter into a voluntary restructuring and / or bond exchange, the *NML Capital* case may actually encourage creditor hold-outs due to the existence of a pari passu clause. *See also* William W. Bratton, Pari Passu and a Distressed Sovereign's Rational Choices, 53 EMORY L.J. 823, 828-36 (2004) (explaining the disruptive role of the *pari passu* clause in sovereign debt restructurings).

In *NML Capital,* Argentina issued debt securities in 1994 pursuant to a Fiscal Agency Agreement ("FAA") *which* contained the following provision purporting to protect purchasers of the FAA bonds from subordination:

> [t]he 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 . . .*

*Id.* at 252 (emphasis in original).

After defaulting on the bonds in 2001, Argentina's president declared a "temporary moratorium" on principal and interest payments on the FAA bonds and every year since then Argentina has renewed the moratorium. In 2005, Argentina initiated an exchange offer allowing holders of the defaulted FAA bonds to exchange their bonds for new unsecured and unsubordinated debt at a rate of 25 to 29 cents on the dollar. In order to induce holders of the defaulted FAA bonds to participate in the exchange, Argentina stated in the prospectus that the government had no intention of resuming payment on the FAA bonds.

That same year, the Argentine legislature passed a law declaring, among other things, that Argentina "shall be prohibited from conducting any type of in-court, out-of-court or private settlement with respect to the bonds." Argentina then conducted an identical exchange offering in 2010. *Id.* at 251-252. These two exchange offers restructured over 91% of Argentina's debts on which it had defaulted in 2001. Argentina made all payments due on the bonds issued in 2005 and 2010 but continued to withhold principal and interest due on the FAA bonds. The plaintiffs were holders of the FAA bonds who did not participate in either the 2005 or 2010 exchange offering and sued for payment on the defaulted FAA bonds. *Id.* at 253.

The Second Circuit held that the *pari passu* clause in the FAA manifested an intention to protect bondholders from two different forms of discrimination: (i) the issuance of superior debt; and (ii) the giving of priority to other payment obligations. Specifically,

(i) The first sentence of the *pari passu* clause which states that "[t]he Securities will constitute ... direct, unconditional, unsecured and unsubordinated obligations of the Republic" means that Argentina, as bond issuer, will not formally subordinate the FAA bonds by issuing superior debt; and

(ii) The second sentence which states that "[t]he 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" means that Argentina, as bond payor, will not pay other bonds without paying on the FAA bonds.

*Id.* at 253.

The court reasoned that the latter constraint on Argentina makes sense in the context of sovereign debt because sovereigns do not enter into bankruptcy or insolvency proceedings where there is a ranking system for priority of payment of debt. Therefore, this contractual provision prevents Argentina from discriminating against the FAA bonds in favor of paying other unsubordinated bonds. The court held that the combination of Argentina's declaration of the moratorium on payment of the FAA bonds and the legislative enactments ensured that payment of the 2005 and 2010 bonds had priority over the FAA bonds, and therefore, the court affirmed the lower court's decision that Argentina breached the *pari passu* clause. *Id.* at 259-60.

The lower court had also issued an injunction preventing Argentina from making any payments on the 2005 and 2010 bonds without making comparable payments on the defaulted FAA bonds. The Second Circuit remanded back to the lower court to clarify how the injunctions' payment formula was intended to function and how such injunctions apply to third-party intermediary banks. *Id.* at 250-51.[4]

### B. Collective Action Clauses

Collective action clauses are contractual provisions that are finding their way into new sovereign debt instruments in order to avoid incentivizing creditor hold-outs from a debt restructuring. See Ronald J. Silverman & Mark W. Deveno, Distressed Sovereign Debt: A Creditor's Perspective, 11 AM. BANKR. INST. L. REV. 179 (2003) (explaining that one of the proposals considered by the International Monetary Fund is the institution of collective action clauses within all future sovereign bond documents). Due to the relatively new inclusion of these types of provisions in bonds, case law on the treatment, interpretation and enforceability of collective action clauses is sparse.

[4] On remand, the District Court for the Southern District of New York issued a decision, *NML Capital, Ltd. v. Republic of Argentina*, No. 08 Civ. 6978 (TPG), 2012 WL 5895786 (S.D.N.Y. Nov. 21, 2012), affirming its prior order regarding the ratable payment amounts to be made and the imposition of the injunction to bind Argentina and its agents (including banks) from making payments on the 2005 and 2010 bonds without also making payments on the FAA bonds. This order was affirmed on appeal in *NML Capital, Ltd. v. Republic of Argentina*, No. 12-105, 2013 WL 4487563, at *11 (2d Cir. Aug. 23, 2013), but the Second Circuit stayed enforcement of the District Court's injunction pending the resolution by the U.S. Supreme Court of a timely petition for a writ of certioriari.

One type of a collective action clause is the "majority action" clause which allows the terms of the bonds (including payment provisions) to be amended if a requisite majority or percentage of the bondholders agree to such amendment. See In re Board of Directors of Multicanal S.A., 307 B.R. 384 (Bankr. S.D.N.Y. 2004) (noting that "an increasingly accepted procedure for promoting the consensual restructuring of foreign sovereign debt–and the one that the United States government encourages–is for sovereign debt issuers to include a provision in a governing indenture that would permit a super-majority of bondholders to amend a debt instrument–e.g., to reduce the amount of principal or interest owing–even when a minority creditor refuses to agree to the amendment.") (internal citations omitted).

For instance, in the NML Capital case described above, the 2005 and 2010 bonds issued by Argentina contained collective action clauses which permit Argentina to amend the terms of the bonds and to bind dissenting bondholders if a sufficient number of bondholders agree. NML Capital, 699 F.3d at 253. For example, the collective action clause in the 2010 bonds issued by Argentina provided that certain

> modification[s] to the terms and conditions of [the Exchange Bonds] . . . may generally be made, and future compliance therewith may be waived, with the consent of Argentina and the holders of not less than 75% in aggregate principal amount or notional amount . . . of the [Exchange Bonds] at the time outstanding.

*Id.*

Thus, a dissenting bondholder who does not agree to amendment of bond payment terms may nevertheless still be contractually bound if the bonds contain a collective action clause and the requisite amount or percentage of bondholders agree. See also Greylock Global Opportunity Master Fund Ltd. v. Province of Mendoza, No. 04 Civ. 7643(HB), 2005 WL 289723 (S.D.N.Y. Feb. 8, 2005), aff'd, 162 Fed. Appx. 85 (2d Cir. 2006) (finding that bond provisions explicitly permitted various amendments to bond terms under exchange offer without obtaining unanimous consent from all bondholders).

## VI. Conclusion

Bondholders should be aware of the legal as well as contractual issues that may arise when considering whether to proceed against a foreign sovereign to recover on bond debt in the U.S. Threshold issues regarding sovereign immunity, the application of the act of state doctrine and international comity will likely arise and may determine whether a U.S. court will even reach the merits of the underlying action and undertake an analysis of the governing contractual provisions.