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SOVEREIGN DEBT
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SOVEREIGN BORROWERS AND ISSUERS: RISKS AND RISK ASSESSMENT

Sovereigns participate in the financial markets in different ways. They issue debt securities in their domestic markets,[2] but investors who buy government securities may be domestic or foreign. US Treasury securities are particularly attractive to foreign investors.[3] The US has benefitted in the past significantly from the fact that the US dollar is the reserve currency, so US securities have been attractive to foreign investors. At the end of 2005, Alan Greenspan commented:

"The rise of the U.S. current account deficit over the past decade appears to have coincided with a pronounced new phase of globalization that is characterized by a major acceleration in U.S. productivity growth and the decline in what economists call home bias. In brief, home bias is the parochial tendency of persons, though faced with comparable or superior foreign opportunities, to invest domestic savings in the home country. The decline in home bias is reflected in savers increasingly reaching across national borders to invest in foreign assets. The rise in U.S. productivity growth attracted much of those savings toward investments in the United States. The greater rates of productivity growth in the United States, compared with still-subdued rates abroad, have apparently engendered corresponding differences in risk-adjusted expected rates of return and hence in the demand for U.S.-based assets. Home bias implies that lower risk compensation is required for geographically proximate investment opportunities; when investors are familiar with the environment, they perceive less risk than they do for objectively comparable investment opportunities in far distant, less familiar environments...
...starting in the 1990s, home bias began to decline discernibly, the consequence of a dismantling of restrictions on capital flows and the advance of information and communication technologies that has effectively shrunk the time and distance that separate markets around the world. The vast improvements in these technologies have broadened investors' vision to the point that foreign investment appears less risky than it did in earlier times....
Home bias, of course, is only one of several factors that determine how much a nation actually saves and what part of that saving, or of foreign saving, is attracted to fund domestic investment. Aside from the ex ante average inclination of global investors toward home bias, the difference between domestic saving and domestic investment--that is, the current account balance--is determined by the anticipated rate of return on foreign investments relative to domestic investments as well as the underlying propensity to save of one nation relative to that of other nations...
...What is special about the past decade is that the decline in home bias, along with the rise in U.S. productivity growth and the rise in the dollar, has engendered a large increase by U.S. residents in purchases of goods and

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[2] *See*, *e.g.*, http://www.treasurydirect.gov/indiv/products/products.htm.

[3] *See, e.g.,* Department of the Treasury, Federal Reserve Bank of New York, and Board of Governors of the Federal Reserve System, Report on Foreign Portfolio Holdings of U.S. Securities as of June 30, 2011 (Apr. 2012) at http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/shla2011r.pdf ; Wayne M. Morrison & Marc Labonte, China's Holdings of U.S. Securities: Implications for the U.S. Economy, Congressional Research Service Report for Congress (Dec. 6, 2012) at http://fpc.state.gov/documents/organization/201974.pdf

services from foreign producers. The increased purchases have been willingly financed by foreign investors with implications that are not as yet clear.

Typically, current account balances, saving, and investment are measured for a specific geographic area bounded by sovereign borders. Were we to measure current account balances of much smaller geographic divisions, such as American states or Canadian provinces, or of much larger groupings of nations, such as South America or Asia, the trends in these measures and their seeming implications could be quite different than those extracted from the conventional national measures of the current account balance.

The choice of appropriate geographical units for measurement depends on what we are trying to ascertain. I presume that in most instances, we seek to judge the degree of economic stress that could augur significantly adverse economic outcomes. To make the best judgment in this case would require current account measures obtained at the level of detail at which economic decisions are made: individual households, businesses, and governments. That level is where stress is experienced and hence where actions that may destabilize economies could originate. Debts usually represent individual obligations that are not guaranteed by other parties. Consolidated national balance sheets, by aggregating together net debtors and net creditors, accordingly can mask individual stress as well as individual strength.

Indeed, measures of stress of the most narrowly defined economic units would be unambiguously the most informative if we lived in a world where sovereign or other borders did not affect transactions in goods, services, and assets. Of course, national borders do matter and continue to have some economic significance...

...some U.S. domestic businesses previously purchasing components from domestic suppliers switched to foreign suppliers. These companies generally view domestic and foreign suppliers as competitive in the same way that they view domestic suppliers as competing with each other. Moving from a domestic to a foreign source altered international balance bookkeeping but arguably not economic stress...

If economic decisions were made without regard to currency or cross-border risks, then one could argue that current account imbalances were of no particular economic significance, and the accumulation of debt would have few implications beyond the solvency of the debtors themselves. Whether the debt was owed to domestic or foreign lenders would be of little significance.

But national borders apparently do matter. Debt service payments on foreign loans, for example, ultimately must be funded disproportionately from exports of tradable goods and services, whereas domestic debt has a broader base from which it can be serviced. Moreover, the market adjustment process seems to be less effective across borders than domestically. Prices of identical goods at nearby locations, but across borders, for example, have been shown to differ significantly even when denominated in the same currency.12 Thus cross-border current account imbalances have implications for the market adjustment process and the degree of economic stress that are likely greater than those for domestic imbalances. Cross-border legal and currency risks are important additions to normal domestic risks.

But how significant are those differences? Globalization is changing many of our economic guideposts. It is probably reasonable to assume that the worldwide dispersion of the balances of unconsolidated economic entities as a share of global GDP noted earlier, will continue to rise as increasing specialization and the division of labor spread globally.

...Regrettably, we do not as yet have a firm grasp of the implications of cross-border financial imbalances. If we did, our forecasting record on the international adjustment process would have been better in recent years. I presume that with time we will learn."[4]

At the beginning of 2011, Dominique Strauss-Kahn, then Managing Director of the IMF wrote:

"Over the last quarter century, the global economy enjoyed a remarkably long period of high growth and low and stable inflation. This extraordinary period in economic history lulled many people into a false sense of security, and made policymakers too complacent about their ability to manage the economy and cope with financial crises. Managing developed economies seemed deceptively straightforward. A simple doctrine gradually emerged, comprising a few common-sense rules (fiscal and monetary) underpinned by the idea that markets were infallible. But this illusion of stability was shattered by the global financial crisis. Almost overnight, the Great Moderation turned into the Great Recession.
In retrospect, there were many fault lines beneath the old economic model, and the financial crisis ripped them open. The global growth model turned out to be unbalanced and unsustainable. It relied too much on excess borrowing by some countries, made possible by excess saving by others. Many countries also saw large increases in inequality that tugged at the social fabric. In the United States, for example, inequality on the eve of the crisis was back where it was just prior to 1929." [5]

For a government to rely on foreign owners of its securities can be risky - even if those investors have overcome their initial home bias to make the investment they may be more nervous about holding those securities in the face of adverse economic conditions:

"The domestic government bond market has expanded rapidly in Mexico since the mid-1990s. In part, this has reflected a conscious effort by the authorities to develop domestic sources of financing as a means of reducing the country's dependence on external capital flows. The abrupt withdrawal of external capital in late 1994, in what became widely known as the "tequila crisis", resulted in a deep economic and financial crisis in Mexico. This made policymakers acutely aware of the vulnerabilities associated with a heavy reliance on external financing....
...The tequila crisis of late 1994 was a good example of the risks of relying heavily on dollar-indexed securities. The early 1990s had been characterised not only by a substantial appreciation of the Mexican peso but also by a significant deterioration of the country's current account in spite of steadily improving public sector finances ... The rapid growth in Mexico's external liabilities created rising fears among investors that the country would have

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[4] Alan Greenspan, International Imbalances, Remarks before the Advancing Enterprise Conference, London, England (December 2, 2005) *available at* http://www.federalreserve.gov/boarddocs/speeches/2005/200512022/default.htm Alan Greenspan was Chairman of the Federal Reserve of the United States from 1987 to 2006.

[5] Dominique Strauss-Kahn, New Policies for a New World (Jan. 4, 2011) at http://www.imf.org/external/np/vc/2011/010411.htm .

to devalue and/or default on its obligations. During the course of 1994, investors became increasingly reluctant to roll over their short term peso-denominated cetes and instead shifted their funds to short-term dollar-indexed tesobonos. This provided a temporary respite for the government, but the short-term nature of outstanding securities also meant that the transformation in the structure of debt towards tesobonos was extremely rapid. Whereas tesobonos had accounted for about 4% of domestic debt at the beginning of 1994, they accounted for most of that debt at the end of that year. The sudden withdrawal of foreign investment from the domestic market at the end of 1994 and the ensuing sharp drop in the Mexican peso resulted in an explosive growth in the peso value of dollar-indexed government liabilities, thereby adding a fiscal dimension to the external crisis. The withdrawal of foreign investment led to severe financial instability, followed by a protracted recession."[6]

The financial crisis meant that many banks around the world faced insolvency and governments stepped in to bail them out.[7] Financial support for banks imposed additional financial burdens on governments which were dealing with other aspects of the great recession, and other issues, such as aging populations. Private risks shifted to sovereign balance sheets:

Public interventions and fiscal stimulus packages have inevitably led to an increased supply of sovereign debt, most notably in advanced economies. So far, this has been absorbed fairly smoothly, but future conditions could prove more challenging. The risk of continuing recession poses a significant vulnerability to sovereigns, with those countries with high (current) debt-to-GDP levels and significant contingent liabilities to the financial sector most vulnerable to adverse global developments. Therefore, countries need to ensure that such policy initiatives do not pose substantial solvency risks. Anchoring medium-term expectations of fiscal sustainability should help to contain borrowing cost pressures, while ensuring continued access to global savings and underpinning investor risk appetite.[8]

In many countries governments discussed and implemented austerity measures. In some European countries the EU and IMF required the implementation of austerity measures as a condition of financial support to sovereign debtors in crisis.[9]

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[6] Serge Jeanneau & Carlos Pérez Verdia, *Reducing Financial Vulnerability: the Development of the Domestic Government Bond Market in Mexico*, BIS Quarterly Review 95 (December 2005) available at http://www.bis.org/publ/qtrpdf/r_qt0512h.pdf

[7] Although *cf, e.g.*, Michael Lewis, Beware of Greeks Bearing Bonds, Vanity Fair, (Oct. 1, 2010) at http://www.vanityfair.com/business/features/2010/10/greeks-bearing-bonds-201010?printable=true ("In Greece the banks didn't sink the country. The country sank the banks.").

[8] IMF, Global Financial Stability Report: Navigating the Financial Challenges Ahead (Oct. 2009) Chapter 1: The Road to Recovery, p. 42 at http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/chap1.pdf .

[9] For information on the IMF and Europe, *see, e.g.*, http://www.imf.org/external/region/eur/index.aspx

Sovereigns and sovereign-owned entities can be investors as well as issuers of debt securities, and this too leads to concerns. In the US there has for some time been concern about the security implications of foreign ownership of businesses. Intensified concern about this issue during 2008 led to new regulations for the review of certain foreign acquisitions of US businesses.[10] Concerns about a perceived increase in investment by sovereign wealth funds[11] also led the funds to establish an International Working Group of Sovereign Wealth Funds which developed a set of principles and practices for such funds.[12] The principles and practices have four objectives :

i. To help maintain a stable global financial system and free flow of capital and investment;
ii. To comply with all applicable regulatory and disclosure requirements in the countries in which they invest;
iii. To invest on the basis of economic and financial risk and return-related considerations; and
iv. To have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability.[13]

The OECD, issuing a Declaration on Sovereign Wealth Funds and Recipient Country Policies in 2008:

• Welcomed the constructive contribution that Sovereign Wealth Funds (SWFs) make to the economic development of home and host countries. To date they have been reliable, long-term, commercially-driven

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[10] See Department of the Treasury, Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 73 Fed. Reg. 70702 (Nov. 21, 2008) codified at.31 CFR Ch. VIII (2012).

[11] *See, e.g.*, Robert M Kimmitt, *Public Footprints in Private Markets*, 87:1 Foreign Affairs119-130 (2008) (There are also non-national-security issues associated with the potential increase in foreign public ownership of private firms. First, the U.S. economy is built on the belief that private firms allocate capital more efficiently than governments. Second, foreign governments could conceivably employ large pools of capital in noncommercially driven ways that are politically sensitive even if they do not have a direct impact on national security. Examples would include investment decisions made to promote a given foreign or social policy. Third, there is the potential for perceived or actual unfair competitive advantages relative to the private sector. For instance, a government could use its intelligence or security services to gather information that is not available to a commercial investor. With a sovereign guarantee, a SWF could also obtain or extend financing (if needed) at interest rates that a commercial investor could not.")

[12] International Working Group of Sovereign Wealth Funds, Generally Accepted Principles and Practices for Sovereign Wealth Funds (Santiago Principles) (Oct. 2008) *available at* http://iwg-swf.org/pubs/eng/santiagoprinciples.pdf . In 2009 the IWG formed an International Forum of Sovereign Wealth Funds. See http://www.ifswf.org/index.htm . See also, e.g., IFSWF Members' Experiences in the Application of the Santiago Principles (Jul. 7, 2011) at http://www.ifswf.org/pst/stp070711.pdf.

[13] Santiago Principles at 4. The principles themselves are more detailed than this, but not particularly specific. The principles set out a number of areas where the funds should disclose information about their policies and standards.

investors and a force for global financial stability.
• Recognised that if SWF investments were motivated by political rather than commercial objectives, they could be a source of concern, and that legitimate national security concerns could arise.
• Welcomed international discussions involving SWFs, their governments and recipient governments. These increase understanding, contribute to mutual trust and confidence, and help avoid protectionist responses that could undermine economic growth and development.
• Noted that the home countries of SWFs and SWFs themselves can enhance confidence by taking steps to strengthen transparency and governance in the SWFs.
• Supported the work of the IMF on best practices for SWFs as an essential contribution and the continuing coordination between the OECD and the IMF.
• Noted that the OECD for its part has been working on best practices for recipient countries. Together the IMF and OECD will help preserve and expand an open international investment environment for SWFs while safeguarding essential security interests.
• Welcomed the Report by the OECD Investment Committee on SWFs and Recipient Country Policies, which reflects inputs from both OECD and emerging economies, and looked forward to future work, including peer monitoring of policy developments and broader consideration of foreign-government controlled investments.
• Based on this Report, Ministers endorsed the following policy principles for countries receiving SWF investments. These principles reflect long-standing OECD commitments that promote an open global investment environment. They are consistent with OECD countries' rights and obligations under the OECD investment instruments.
- Recipient countries should not erect protectionist barriers to foreign investment.
- Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.
- Where such national security concerns do arise, investment safeguards by recipient countries should be:
- transparent and predictable,
- proportional to clearly-identified national security risks, and
- subject to accountability in their application.[14]

Despite the risks associated with having foreign investors, countries often want to make the securities they issue attractive to foreign investors. Countries other than the US have made their own debt securities more attractive to foreign investors than they would otherwise be by issuing them denominated in US$ rather

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[14] *See* http://www.oecd.org/officialdocuments/displaydocumentpdf/?cote=C/MIN%282008%298/FINAL&doclanguage=en . See also, e.g., OECD Guidance on Sovereign Wealth Funds at http://www.oecd.org/document/19/0,3343,en_2649_34887_41807059_1_1_1_1,00.html.

than in their own domestic currencies.[15] Issuing foreign currency denominated securities also allows countries to build their foreign exchange reserves.[16]

The currency in which a debt security is denominated is only one factor investors need to consider. Some sovereign issuers are economically more sound than others. The pricing of debt securities should reflect their risk as an investment: economically sound issuers do not need to offer as high an interest rate to attract investors as issuers in a weaker financial position. But there may be a risk that a sovereign issuer will not in fact make the payments of interest or principal it has committed to make. This risk is called "**country risk**". Investors in foreign government securities need to understand the level of risk they will be exposed to in investing. The FDIC, looking at country risk from the perspective of the banks it is involved in regulating,[17] has described country risk as: "the risk that economic, social and political conditions in a foreign country might adversely affect a bank's financial interests."[18] Country risk "includes the possibility of deteriorating economic conditions, political and social upheaval,

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[15] International organizations may also issue US$ denominated securities. The IBRD states "To raise funds, IBRD issues debt securities in a variety of currencies to both institutional and retail investors. During FY 2012, IBRD raised medium- and long-term debt of $38,406 million, an increase of $9,616 million from FY 2011, in part reflecting Management's decision to bolster IBRD's liquidity levels. IBRD raised debt in FY 2012 in 23 different currencies." Information Statement (Sep. 2012) http://treasury.worldbank.org/cmd/pdf/InformationStatement.pdf at p. 8. *See also, e.g.* Final Terms dated January 9, 2013, International Bank for Reconstruction and Development Issue of USD 1,500,000,000 Floating Rate Notes due January 14, 2015 under the Global Debt Issuance Facility at http://treasury.worldbank.org/cmd/pdf/10901.pdf. Foreign corporates issue dollar denominated debt securities. Sovereigns outside the euro area, such as Venezuela and China, have issued euro denominated debt. *See, e.g.*, European Central Bank, Review of the International Role of the Euro, 15-16 (December 2005) *available at* http://www.ecb.int/pub/pdf/other/euro-international-role200512en.pdf . Issuance of euro-denominated securities has more recently been less attractive. European Central Bank, The International Role of the Euro (Jul. 2012).

[16] Countries may use foreign exchange reserves for different purposes, including buying their own currency in the international financial markets, and thus increasing the price of their own currency. See generally Christopher J Neely, Are Changes in Foreign Exchange Reserves Well Correlated with Official Intervention?, Federal Reserve Bank of St. Louis, 17, 18 Sept/Oct 2000, *available at* http://research.stlouisfed.org/publications/review/00/09/0009cn.pdf See also, e.g., Y V Reddy, Deputy Governor of the Reserve Bank of India, India's foreign exchange reserves - policy, status and issues, available at http://www.bis.org/review/r020510f.pdf

[17] See, e.g., Donald E. Powell, Chairman, Federal Deposit Insurance Corporation, South America and Emerging Risks in Banking, Speech to the Florida Bankers Association, Orlando, Florida (Oct. 23, 2002) *available at* http://www.fdic.gov/news/news/press/2002/pr11202.html ("Florida banks alone hold almost $18 billion worth of foreign assets, most of which are from South America")

[18] http://www.fdic.gov/news/news/financial/2002/fil0223.html .. The FDIC has also noted that when banks offshore functions this "introduces an element of country risk to the outsourcing process". See FDIC, Offshore Outsourcing of Data Services by Insured Institutions and Associated Consumer Privacy Risks, 2 (Jun. 2004) at http://www.fdic.gov/regulations/examinations/offshore/offshore_outsourcing_06-04-04.pdf.

nationalization and expropriation of assets, government repudiation of external indebtedness, exchange controls, and currency depreciation or devaluation."[19] The OCC (Office of the Comptroller of the Currency), which regulates national banks in the US published a report on in the Spring of 2012 which stated:

Large banks continue to face profitability challenges from legal, operational, and reputational costs stemming from prior residential mortgage underwriting and servicing deficiencies and continued uncertainties in the housing market, as well as persistently high levels of credit stress in residential real estate loan portfolios. Meanwhile, they face fundamental changes in their business models that are dampening revenue growth, including shifts in the role of trading, securitization, and consumer fee income. Operational risk is heightened during this period of transition.
• Operational risk is the primary concern in banks with high transaction volume or high growth. A key priority for some of the largest banks is addressing identified weaknesses in the foreclosure process and mortgage servicing. Deficiencies in mortgage servicing and foreclosure practices continue to present significant reputational risk, and the cost of litigation, remediation, and penalties is dampening profitability and productivity.
• Threats to information security pose an ongoing concern as criminals challenge bank preventive controls and monitoring abilities.
• Exposures to troubled periphery countries in Europe are relatively small compared with bank capital levels. Financial market participants, however, remain sensitive to the effectiveness of efforts to address sovereign debt issues and the contagion effects that result from both counterparty risks and the economic impact of austerity measures.[20]

Ratings agencies such as Moodys, Standard & Poors[21] and Fitch Ratings assign ratings to sovereigns as they do to bonds issued by corporates:[22]

According to the theoretical literature, CRAs potentially provide information, monitoring, and certification services. First, since investors do not often know as much as issuers about the factors that determine credit quality, credit ratings address an important problem of asymmetric information between debt issuers and investors. Hence,

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[19] Guide to the Interagency Country Exposure Review Committee Process, 1 (Nov.1999). The US Federal Banking Regulators issued a revised version of the Guide In November 2008. See http://www.fdic.gov/regulations/safety/guide/Icerc.pdf .

[20] OCC, National Risk Committee, SEMIANNUAL RISK PERSPECTIVE (Spring 2012), http://www.occ.gov/publications/publications-by-type/other-publications-reports/semiannual-risk-perspective/semiannual-risk-perspective-spring-2012.pdf at p 7.

[21] *See, e.g.*, Standard & Poors, How We Rate Sovereigns (Mar. 2012) at http://www.standardandpoors.com/spf/ratings/How_We_Rate_Sovereigns_3_13_12.pdf.

[22] *See also, e.g.*, http://www.janes.com/news/security/countryrisk/ ; http://www.dnbcountryrisk.com/ .

CRAs provide an independent evaluation and assessment of the ability of issuers to meet their debt obligations. In this way, CRAs provide "information services" that reduce information costs, increase the pool of potential borrowers, and promote liquid markets. This implies that market prices are influenced by rating actions, and that CRA opinions can be important from a financial stability perspective. In theory, CRAs also provide valuable "monitoring services" through which they influence issuers to take corrective actions to avert downgrades via "watch" procedures.[23]

The European Securities Markets Authority (ESMA) plans to review sovereign ratings during 2013.[24] Credit ratings may affect the investment decisions of investors, and the pricing of sovereign debt:

Sovereign credit ratings reflect a country's willingness and ability to repay its sovereign debts. More broadly, a country's sovereign credit rating is a key indicator of its financial system development and openness. Indeed, sovereign credit ratings are strong predictors of a country's equity market returns and valuations .... And... sovereign credit ratings are (not surprisingly) also strongly related to the cost of government borrowing...
We find strong support for our views that macroeconomic, development, and legal environment variables affect country credit ratings, but little support for a "legal origin" effect. We find that, ceteris paribus, GDP per capita, inflation, foreign debt, our underdevelopment index, and each legal environment variable all have a strongly significant statistical relationship with sovereign credit ratings. Higher GDP per capita, lower inflation, lower foreign debt per GDP, better development, and higher scores for voice of the people, political stability, government effectiveness, regulatory quality, rule of law, and corruption control all relate to better credit ratings. After controlling for other factors, legal origin indicators do not have a significant impact on credit ratings.[25]

The IMF's 2010 Global Financial Stability Report focused on issues relating to sovereign debt:

Policymakers in many advanced countries will need to confront the interactions created by slow growth, rising sovereign indebtedness, and still-fragile financial institutions. In addition, the foundations underpinning the new financial regulatory regime need to be put into place.
Address legacy problems in the banking system. Confidence in the financial sector has not been fully restored. On the bright side, bank regulatory capital ratios have improved and global writedowns and loan provisions have

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[23] The Uses and Abuses of Sovereign Credit Ratings in IMF, Global Financial Stability Report (2010) http://www.imf.org/External/Pubs/FT/GFSR/2010/02/pdf/chap3.pdf at p 86.

[24] ESMA 2013 CRA Supervision and Policy Work Plan (Jan. 23, 2013) at http://www.esma.europa.eu/system/files/2013-87.pdf ("ESMA's concerns stem from the growth in their volatility over the past 12 months, as compared to historical trends, the importance of sovereign ratings from a credit market and financial stability perspective, and the cascade impact on other rated entities and products.")

[25] Alexander W. Butler & Larry Fauver, Institutional Environment and Sovereign Credit Ratings, 35(3) Financial Management 53, at 53-4 (2006).

declined. Our estimate of crisis-related bank writedowns between 2007 and 2010 has fallen slightly from $2.3 trillion in the April 2010 GFSR to $2.2 trillion now, driven mainly by a fall in securities losses. In addition, banks have made further progress in recognizing those writedowns, with more than three-quarters of them already reported, leaving a residual amount of approximately $550 billion. There has been less progress, though, in dealing with the imminent bank funding pressures: nearly $4 trillion of bank debt will need to be rolled over in the next 24 months. As a consequence, exits from extraordinary financial system support, including the removal of government guarantees of bank debt, will have to be carefully sequenced and planned. Resolving and/or restructuring weaker financial institutions—through closure, recapitalization, or merger—remains a priority so that funding markets can return to normal and the industry to better health. National and supranational backstops should be available to provide support where needed.

Strengthen the fundamentals of sovereign balance sheets. In the short term, adequate supranational support should be available to sovereign balance sheets in those countries facing immediate strains. In the medium run, sovereign balance sheets need to follow a credible path to ensure fiscal sustainability (see the October 2010 World Economic Outlook and the November 2010 Fiscal Monitor). Sovereign refinancing risks should be addressed by debt management policies that lengthen the average maturity structures as market conditions permit. Managing and reducing public contingent liabilities using price-based mechanisms should also be part of the plan.

Clarify and specify regulatory reforms. Much of the proposed financial reform agenda remains unfinished. International rule-making bodies have made progress to identify the most egregious failings of the global financial system in the run-up to the crisis, but their member countries have yet to agree on many of the details of the reforms. Dealing with too-important-to-fail entities, strengthening supervisory incentives and resources, and developing the macro-prudential framework are still under discussion. Further progress will require a willingness to suppress domestic interests in favor of a more stable and better functioning global financial system. The sooner reforms can be clarified, the sooner financial institutions can formulate their strategic priorities and business models. In the absence of such progress, regulatory inadequacies will continue for some time, increasing the chances of renewed financial instability.

As part of these ongoing efforts, we welcome the recent proposals of the BCBS, which represent a substantial improvement in the quality and quantity of capital in comparison with the pre-crisis situation. In particular, common equity will represent a higher proportion of capital and thus allow for greater loss absorption. Also, the amount of intangible and qualified assets that can be included in capital will be limited (to 15 percent). These include deferred tax assets, mortgage servicing rights, significant investments in common shares of financial institutions, and other intangible assets. Phase-in arrangements have been developed to allow banks to move to these higher standards mainly through retention of earnings. As the global financial system stabilizes and the world economic recovery is firmly entrenched, phasing out intangibles completely and scaling back the transition period should be considered.

This will raise banking sector resilience to absorb any future shocks that may lie ahead. Furthermore, it is essential to make progress with the overall reform agenda. Putting in place sound micro-prudential regulation is not sufficient. Appropriate regulation needs to be developed with a macro-prudential approach to dampen procyclicality and to limit the systemic effects of financial institutions, some of which are not banks. Overall, policymakers cannot relax their efforts to reduce refinancing risks, strengthen balance sheets, and reform regulatory frameworks. As apparent on several occasions over the past three years, conditions in the global financial system now have the potential of jumping from benign to crisis mode very rapidly. Against this backdrop, policymakers should not squander opportunities to strengthen and recapitalize banking systems, address too-important to- fail entities, reduce contingent liabilities, and place sovereigns on a credible fiscal path. With the situation still fragile, some of the public support that has been given to banks in recent years will have to be continued. Planned exit strategies from unconventional monetary and financial policies may need to be delayed until the situation is more robust. At the same time, it is important to ensure that the need for extraordinary support is temporary, as it is no substitute for repairing and reforming financial sectors, and realigning their incentives to build stronger balance sheets and reduce excessive risk taking.

For emerging markets, the policy challenges are different, with most of the financial system risks on the upside. Many will need to cope with the effects of relative success, where maintaining stability will depend on their ability to deal with surges in portfolio inflows. Traditional macroeconomic policies may need to be supplemented in some cases by macro-prudential measures as they may not be fully adequate to meet the macro-financial challenges arising from particular domestic circumstances, such as inflation pressures or asset bubbles. Policies to address high and volatile capital flows are well known ... . Moreover, emerging markets should continue to pursue policies aimed at fostering the development of local financial systems, so that they have the capacity to absorb and safely and efficiently intermediate higher volumes of capital flows.[26]

Sovereigns do default, and foreign investors in their debt suffer losses as a result. This is how **Donald Powell** (at the time Chairman of the FDIC) described Argentina's crisis:

Argentina's problems originated with overspending. After three years of rising fiscal deficits and unemployment, in 1999 foreign investors began to seriously question Argentina's ability to rein in its spending and repay its obligations under the peso-dollar peg. Argentina's country risk premium began to rise, leading domestic and foreign investors to pull money out of the country in massive country-wide bank runs. After IMF loan packages and debt swaps proved ineffective in stemming the exodus... the Argentine government resorted to restrictions on bank withdrawals and the largest sovereign default in history. Finally, in January 2002, Argentina suspended the peso-dollar peg. [27]

Where sovereign debtors find difficulty in meeting their commitments on existing debt obligations they may reschedule or restructure their debt, negotiating for changes in the terms of the debt. Ecuador

[26] IMF, Global Financial Stability Report: Sovereigns, Funding, and Systemic Liquidity, x (Oct. 2010) at http://www.imf.org/external/pubs/ft/gfsr/2010/02/pdf/text.pdf .

[27] Powell speech, note 17 above.The bank freeze was relaxed in December 2002. See, e.g., http://news.bbc.co.uk/1/hi/business/2535539.stm .

announced in December 2008 that it planned to default on debt which it regarded as immoral.[28] Some argue that such defaults should be regarded as legitimate under some circumstances, and there is a literature on “odious debt”.[29] After Argentina declared a moratorium which affected bond issues, bondholders[30] sued Argentina in federal district court in the US and moved to certify a class action.[31] Argentina argued that “the only really effective way to resolve a sovereign debt crisis ... is through voluntary debt restructuring.” and that “ to the extent bond litigation is expanded from suits by individual bondholders ... into one or more class actions, this will serve as a disincentive to participating in the debt restructuring effort and will interfere with that effort.”[32] Despite this argument the court certified the class. In 2004 Argentina announced proposed terms of a restructuring of its debt and the debt restructuring plan was carried out in early 2005.[33] Many bondholders were unhappy about Argentina’s offer.[34] A number of

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[28] Ecuador defaults on foreign debt, BBC (Dec. 13, 2008) at http://news.bbc.co.uk/2/hi/business/7780984.stm .

[29] See, e.g., Seema Jayachandran & Michael Kremer , Odious Debt, 96 Am. Econ. Rev. 82 (2006); Robert Browne, The Concept of Odious Debt in Public International Law, UNCTAD Discussion Papers No. 185 (Jul. 2007) at http://www.unctad.org/en/docs/osgdp20074_en.pdf .

[30] Or owners of beneficial interests in bonds. See *Martinez* v. *Republic of Argentina*, 2006 U.S. Dist. LEXIS 59977 (SDNY 2006): “The court notes the distinction between bonds and beneficial interests. In some previous opinions, the court has simply referred to the plaintiffs as owners of "bonds," when in fact plaintiffs are technically owners of "beneficial interests in bonds." The Republic actually issues "a bond" to a depository. The depository, in some form, issues "participations" to brokers, who sell "beneficial interests" to purchasers. These beneficial interests are identified by reference to the underlying bond (CUSIP or ISIN number or both; date of issuance and maturity; rate of interest) and the principal amount of the beneficial interest.”

[31] Many of the investors were Italian. See http://www.tfargentina.it/english.php . Italian investors have pursued claims against Argentina via ICSID. *See* http://blog.internationalpractice.org/wp-content/uploads/2011/09/ICSID-CASE-NO.-ARB-07-5.pdf .

[32] *H.W. Urban GmbH* v *Republic of Argentina* 2003 U.S. Dist. LEXIS 23363 at p 4 (SDNY 2003).

[33] *See, e.g.*, Nouriel Roubini, A Post-Mortem on the Argentine Debt Restructuring; and How to Deal with the Holdout Creditors (Nov. 14, 2005) at http://www.rgemonitor.com/roubini-monitor/107721/a_post-mortem_on_the_argentine_debt_restructuring_and_how_to_deal_with_the_holdout_creditors .

[34] One paper on the default and restructuring explains the concerns as follows:” In 2005, the government issued a take-it-or-leave-it plan with the worst terms ever offered in a sovereign debt restructuring – a bond swap worth less than 25-cents on the dollar and repudiation of all past due interest payments. When nearly one-quarter of its lenders holding $19.4 billion in Argentine bonds declined the offer, including U.S. lenders holding $2.1 billion in Argentine debt, the Argentine government repudiated its obligations to those lenders, an unprecedented act in sovereign finance.” Robert J. Shapiro & Nam D. Pham, Argentina’s 2001 Debt Default and 2005 Debt Restructuring: An Update on the Costs to Bondholders, Taxpayers and Investors (Sept. 2008).

lawsuits involving bondholders persisted after the restructuring,[35] but creditors had difficulty finding assets to attach in the US.[36] The English Court of Appeal rejected one attempt to enforce a US judgment on sovereign immunity grounds.[37] By late 2009, Argentina was still excluded from the financial markets as a result of the moratorium and restructuring, and the Argentinean Senate acted to open the debt restructuring process for holdout creditors.[38] Meanwhile, President Fernández de Kirchner issued an emergency decree for the establishment of a Bicentennial Fund to pay foreign creditors. The Governor of the Central Bank refused to agree to pay monies from the bank's reserves into this fund, and although the President sought to fire him in response the Court held that she could not do so.[39] In January 2010 creditors obtained a restraining order against the Argentinean Central Bank and Argentina in the Southern District of New York.[40] In March 2010 President Kirchner announced that she would repeal the Bicentennial decree, and in January 2011 she announced that Argentina would pay $9 billion to the Paris Club of sovereign creditors.[41]

Some of Argentina's creditors objected to Argentina's proposal to include a "most favoured creditors" clause in the restructuring documentation which would allow Argentina to pay creditors who did not join in the restructuring. The clause read as follows:

"Argentina reserves the right, in its absolute discretion, to purchase, exchange, offer to purchase or exchange, or enter into a settlement in respect of any Eligible Securities that are not exchanged pursuant to the Offer (in accordance with their respective terms) and, to the extent permitted by applicable law, purchase or offer to purchase Eligible Securities in the open market, in privately negotiated transactions or otherwise. Any such

35 As of April 2005 there were about 50 Argentina bondholder cases, involving over 285 plaintiffs, pending in the Southern District of New York.

36 *See, e.g.*, Aurelius Capital Partners v Republic of Argentina 584 F.3d 120 (2d. Cir 2009) cert. denied 130 S. Ct. 1691 (2010) (holding that Argentinean social security funds were immune from attachment by under the Foreign Sovereign Immunities Act.).

37 NML Capital Ltd v Republic of Argentina [2010] EWCA Civ 41.

38 http://en.mercopress.com/2009/11/19/argentine-senate-reopens-debt-restructuring-process-for-bond-holdouts.

39 *See* Jude Webber, Argentina woes will prove costly for comeback, FT (Jan. 14, 2009).

40 Aurelius Capital Partners v Republic of Argentina, 2010 U.S. Dist. LEXIS 3280 (SDNY 2010). News reports which refer to this decision refer to the creditors as "vulture funds" (as to which see below).

41 For the Paris Club see http://www.clubdeparis.org/ .

purchase, exchange, offer to purchase or exchange or settlement will be made in accordance with applicable law. The terms of any such purchases, exchanges, offers or settlements could differ from the terms of the Offer. Holders of New Securities will be entitled to participate in any voluntary purchase, exchange, offer to purchase or exchange extended to or agreed with holders of Eligible Securities not exchanged pursuant to the Offer as described below..."[42]

The Global Committee of Argentina Bondholders objected to this provision, saying:

"There are two important ambiguities to point out with respect to the language used in the MFC Clause. First, Argentina has deliberately left out the word "settlement" in the final sentence of the paragraph although the word appeared in a prior draft of the Prospectus Supplement. Argentina could make a strong argument that any "settlement" would not have to be extended to holders of New Securities. Given the significant amount of litigation and arbitration against Argentina, this loophole is considerable. A "settlement" would certainly include agreements reached in the context of litigation or arbitration, but Argentina also could argue for a much broader interpretation. For example, Argentina could assert that a privately negotiated exchange or purchase on more favorable terms that is labeled a "settlement" would not trigger the MFC Clause.

Second, the inclusion of the word "voluntary" in the last sentence allows Argentina broad discretion to argue that any requirement by the official sector, such as by the International Monetary Fund that Argentina enter into a subsequent exchange or purchase on terms that are more favorable than the Offer would not trigger the MFC Clause. Argentina could claim that the arrangement with the official sector is not "voluntary" and, therefore, any exchange required by the official sector - even on better terms than the Offer - is not subject to the MFC Clause.

Finally, there are practical problems with relying on the MFC Clause. There is a serious question as to how creditors will ever know of side deals. If creditors do learn of side deals, the issue arises as to whether they will have access to enough information to demonstrate that the MFC Clause should apply notwithstanding the ambiguities described above.

These ambiguities and practical challenges give Argentina the ability to enter into a wide variety of side deals without necessarily triggering the MFC Clause. ..

Even if holders of the New Securities believe that the MFC Clause has been triggered, enforceability of the MFC Clause will be very difficult and onerous. According to the Prospectus Supplement, if Argentina breaches the MFC Clause and does not cure the breach within 90 days after it receives written notice thereof, the holders of New Securities can declare an event of default. To declare an event of default, holders of at least 25% of the aggregate principal amount of the debt securities of that series may, by written notice, declare the debt securities of that series to be immediately due and payable and such amounts will become immediately due and payable provided that the event of default is materially prejudicial to the interests of the holders of the debt securities of that series. Even if holders of the New Securities organize the requisite 25% threshold, actually stating a claim may be extremely

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[42] See http://www.tfargentina.it/download/GCAB%20Most%20Favored%20Creditor%20Clause%20paper%201-31-05.pdf
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difficult because of the ambiguity of the MFC Clause. In addition, due to the difficulties in organizing holders representing at least 25% of the aggregate principal amount of the debt securities, declaring an event of default under the New Securities will be a challenging process. Furthermore, even if an event of default is declared and the New Securities are accelerated, there is no guarantee that Argentina will actually pay. Finally, even if holders of New Securities organize and can prove a violation of the MFC Clause, Argentina has already shown its willingness to render itself immune from the enforcement of judgments in all major financial jurisdictions. As a result, if Argentina refuses to pay, then the holders that participate in the Offer will end up in the same position as they are today."[43]

The example of Argentina illustrates how litigation and restructuring (contract) as mechanisms for dealing with sovereign defaults may conflict. In a restructuring, a debtor will contract to pay its creditors less than they were entitled to under the original agreement. In litigation, creditors seek to enforce their original rights.

At the end of 2005 Argentina announced that it would repay its debt to the IMF in full.[44] In mid-2006 the World Bank announced a new program of financial assistance to Argentina (adding to existing outstanding loans to Argentina). The World Bank said:

Notwithstanding the debt restructuring of June 2005 and the overall improvement in Argentina's debt profile, debt sustainability will remain a concern and an important source of risk. Even after the debt restructuring and repayment to the IMF, Argentina's total public debt remains high and the public debt service burden in the medium term significant, in the US$13 billion range per year. The US$24 billion in holdouts, US$3 billion in Paris club arrears, and contingent liabilities arising from the cases before ICSID all represent sources of potential increases in the debt service burden in the future, although the timetable for their resolution remains unclear. The 35 percent reduction in international reserves resulting from the early repayment of the IMF reduced the country's external liquidity, but reserves remain adequate to cover 100 percent of the money base and are again accumulating with continued Central Bank purchases of foreign exchange. Under the Government's medium-term macroeconomic framework, the public debt to GDP ratio is projected to decline steadily over the medium-term.[45]

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[43] *Id.*

[44] *See, e.g.*, IMF, Argentina Announces its Intention to Complete Early Repayment of its Entire Outstanding Obligations to the IMF, Dec. 15, 2005 at http://www.imf.org/external/np/sec/pr/2005/pr05278.htm ; IMF Survey, 9 (Jan 9, 2006) available at http://www.imf.org/external/pubs/ft/survey/2006/010906.pdf (Announcing Argentina's repayment of its IMF loans).

[45] World Bank, Country Assistance Strategy for the Argentine Republic 2006-2008, 66-7 (May 4, 2006) *available at* http://siteresources.worldbank.org/INTARGENTINA/Resources/1CASAr.pdf.

Some commentators have written about "catalytic finance" suggesting that "the provision of official assistance to a country undergoing a financial crisis spurs other interested parties to take actions that mitigate the crisis. In particular, it rests on the premise that, under the right conditions, official assistance and private sector funding are strategic complements. That is, the provision of official assistance galvanizes the private sector creditors into rolling over short term loans, and thereby alleviating the funding crisis faced by the debtor country."[46] Others argue that the intervention of the IMF can increase moral hazard.[47] The picture of Argentina paying off the IMF in full when private sector creditors were offered only a portion of what was owed to them raises some questions. It is worth noting that Argentina has issued some dollar denominated debt securities since the restructuring:

On July 18, the Government issued US$1 billion of dollar-denominated bonds of eight years maturity. The cut-off price of the auction was 91 cents per dollar issued, which resulted in an annualized implicit return of 8 percent on average. The total demand was 54 percent higher than the amount issued....In March 2006 the Government issued US$500 million of Bonar V bonds in a market-priced auction. The Bonar V is a bullet bond denominated in US dollars of five years of maturity. The auction resulted in an implicit annual interest yield of 8.4 percent. About 80 percent of the new bonds were acquired by foreign banks. The total amount of bonds issued in 2006 as of end of March is US$2 billion. This includes the Bonar V and an additional US$1.5 billion of Boden 2012 issued to the Venezuelan Government. [48]

Corporates may also reschedule their debt if they have financial problems, but corporates do so in the shadow of domestic insolvency and administration regimes which do not exist for sovereigns. The

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[46] Stephen Morris & Hyun Song Shin, *Catalytic Finance: When Does it Work?*, 70 J. OF INT'L ECON. 161-177, 161 (2006)

[47] *Id.* at 162. *See also e.g.*, Cary Deck and Javier Reyes, *An Experimental Analysis of Catalytic Finance,* Draft: Feb. 15, 2005 *available at* http://comp.uark.edu/~reyes/Files/Research/Deck%20and%20Reyes%20Catalytic%20Finance.pdf ("There is also the debate about how IMF support to crisis or crisis-prone countries can introduce the issues of moral hazard distortions. The resources made available (or readily available) to a country in distress may have undesired effects on the behavior and/or incentives of debtor countries and creditors. A debtor country that can avoid or alleviate a crisis by implementing costly (political or economic) reforms may decide not to do so as long as they can be substituted by readily available IMF support packages (debtor moral hazard). Also investors do not have the right incentives to diversify their risk and avoid investments in riskier countries when IMF support is readily available (creditor moral hazard)."

[48] *Id*. at 84-5.

IMF proposed an insolvency regime for sovereigns,[49] but the proposal was controversial and lapsed,[50] although attempts have recently been made to revive the idea.[51] A section of these materials describes the proposal and the market-based solution which many commentators argued for, and which a G10 working group has endorsed[52] as an alternative.[53] In 2005 some commentators suggested that another privately developed mechanism, the credit default swap, could encourage investment in sovereign debt (including the debt of emerging market economies).[54] More recently it has become apparent that credit default swaps do not necessarily function well as mechanisms for the transfer of risk.

In addition to using procedures for negotiating changes in the rights and obligations of sovereign borrowers and their creditors, some firms will invest (or speculate) in the distressed debt of sovereigns (or

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[49] This proposal is considered below at page 111 ff.

[50] *See*, *e.g.*, Communique of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, April 12, 2003, at http://www.imf.org/external/np/sec/pr/2003/pr0350.htm ("The Committee, while recognizing that it is not feasible now to move forward to establish the SDRM, agrees that work should continue on issues raised in its development that are of general relevance to the orderly resolution of financial crises. These issues include inter-creditor equity considerations, enhancing transparency and disclosure, and aggregation issues.")

[51] *See, e.g.*, Robert Kahn, Drawing the Wrong Lessons From Argentina's Debt Mess (Jan. 10, 2013) at http://www.economonitor.com/blog/2013/01/drawing-the-wrong-lessons-from-argentinas-debt-mess/ ("The Financial Times has joined the chorus of those calling for a new statutory sovereign debt restructuring mechanism (SDRM), citing Argentina's legal battle with holdout creditors as evidence of a broken system for restructuring sovereign debt. The SDRM, as most commonly understood, envisages a formal restructuring process, analogous to national bankruptcy law, to deal with the debt of distressed countries. It was an impractical and unnecessary idea when first raised by the IMF in 2001, and it remains so today.")

[52] Report of the G10 Working Group on Contractual Clauses (Sept. 26, 2002) *available at* http://www.bis.org/publ/gten08.pdf

[53] Although note that Roubini, note 33 above, argues that "the "rush to the exits" coordination problem can be unilaterally solved by a debt suspension by the sovereign debtor; one does not need statutory or contractual tools to do a "legal" debt suspension."

[54] Cristiana De Alessi Gracio et al, Capital Flows to Emerging Markets: Recent Trends and Potential Financial Stability Implications, Financial Stability Review, 94, 96 (December 2005) *available at* http://www.bankofengland.co.uk/publications/fsr/2005/fsr19art10.pdf . See also, e.g., *Eternity Global Master Fund Ltd.* v. *Morgan Guaranty Trust Co.*, 375 F.3d 168, 171 (2d. Cir. 2005) ("Banks, investment funds and other institutions increasingly use financial contracts known as "credit derivatives" to mitigate credit risk...In October 2001, in light of Argentina's rapidly deteriorating political and economic prospects, Eternity purchased CDSs to hedge the credit risk on its in-country investments.") A credit default swap entitles a protection buyer to receive a payment on the occurrence of a defined credit event from a protection seller.

corporates). These firms may be described as "vulture funds".[55] Aurelius Capital, one of the plaintiffs in the Argentina cases cited above, has been described as such a fund. The firm was established by Mark Brodsky, who previously worked at Elliot Associates and who has been visible as an investor in the defaulted debt of sovereign-related borrowers.

VULTURE FUND CASES:
Elliott Associates, L.P.* v *The Republic of Panama (see page 20)
Elliott Associates, L.P.* v *Banco De La Nacion (see page 27)

The following two cases arose out of purchases of sovereign debt by a vulture fund. The cases are included partly because they contain descriptive material on international financial activity. The Brady Plan, described in both cases was a plan to facilitate restructuring of sovereign debt.[56] The cases are also included because they illustrate behavior of holdout creditors and the debtors' attempt to block the holdout's attempt to receive payment. Notice how Elliott Associates acts in the context of this plan. Do you approve of Elliott Associates' actions? The first case (Panama) raises a number of different legal issues; the second case (Peru) is more focused. Identify the legal issues. Both cases illustrate how international financial transactions take place in a context where the relevant applicable legal rules are rules of domestic legal systems, rather than international rules. Consider the analysis of the application of the New York statute in both cases. Do you agree with the courts' interpretation of the statute? Do you agree with the Second Circuit's description of the policy reasons for allowing Elliott to enforce the debt in the Peru case? Are there any policy reasons that might point in the opposite direction?

Some of the issues raised by international financial transactions will be issues of interpretation of the contract(s) (see the Panama case), but other issues will be non-contractual (both cases). Parties to a transaction can negotiate the terms of their relationship, but their contracts exist within a legal environment which includes other rules. Parties to the transaction can negotiate which law is to be the proper law of the contract, and, if the court upholds this choice of law, that law will govern questions such

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[55] Vulture investors swoop down on financially troubled issuers or borrowers and buy up interests in their debt at a discount hoping that they will find ways to make a profit in an insolvency or otherwise.

[56] *See*, *e.g.*, Ian Vásquez, *The Brady Plan and Market-based Solutions to Debt Crises*, 16 CATO J. 233, 234 (1996) ("When the Bush administration assumed office in 1989, the new Secretary of the Treasury, Nicholas Brady, announced that the only way to address the sovereign debt crisis was to encourage the banks to engage in "voluntary" debt-reduction schemes. Countries were to implement market liberalizations in exchange for a reduction of the commercial bank debt, and, in many cases, new money from commercial banks and multilateral agencies.")

as how to interpret the contract. However rules of another legal system may apply to decide other questions (e.g. tort liability, liability for breach of fiduciary duties, statutes which disable a person from enforcing a contract under certain circumstances). So, if a firm such as Elliott Associates sued to enforce a debt in another jurisdiction (because the debtor had assets there) that other jurisdiction might have rules about champerty which were different from those in New York.

Elliott Associates, L.P. v *The Republic of Panama*[57] (Judge Chin:)

In the 1980's, a number of countries -- including the defendant Republic of Panama ... encountered serious difficulties in servicing their foreign debt. As a consequence, and because of growing concern over the continued stability of the international financial system, United States Treasury Secretary Nicholas Brady announced a plan (the "Brady Plan") in 1989 encouraging bank creditors to reduce the debt obligations of lesser developed countries by restructuring old debt and providing new loans.

Panama took advantage of the Brady Plan and restructured much of its external debt in 1995 pursuant to what became known as the "1995 Financing Plan." The restructured debt included balances due under loan agreements entered into with certain banks and financial institutions in 1978 for $ 300 million (the "1978 Agreement") and in 1982 for $ 225 million (the "1982 Agreement").

At issue in the instant case is a portion of the 1982 debt. In late 1995, two of the banks that had participated in the 1982 loan, Citibank, N.A. ("Citibank") and Swiss Bank Corporation ("Swiss Bank") (together, "the Banks"), assigned their interest in $ 12,242,018.21 of the debt to plaintiff Elliott Associates, L.P. ("Elliott") for approximately $ 8 million. After the assignments, Panama (through its Agent) made some interest payments to Elliott, but the payments eventually stopped. For its part, Elliott refused to restructure its debt in accordance with the 1995 Financing Plan, even though all the other creditors under the 1982 Agreement agreed to do so.

Instead, on July 15, 1996, Elliott commenced this breach of contract action, seeking judgment against Panama for the amounts due under the 1982 Agreement. Panama responded by asserting a counterclaim against Elliott for tortious interference with Panama's contractual relations with the Banks.

Before the Court is Elliott's motion for summary judgment, both for judgment on its breach of contract claim and for dismissal of Panama's counterclaim for tortious interference with contract. Elliott's motion is premised in part on its contention that Panama is collaterally estopped by the decision of Justice Gammerman in Elliott Assocs., L.P. v. Republic of Panama, No. 603615/96 (N.Y. Sup. Ct. May 16, 1997), a case virtually identical to this one, except that it involved the 1978 Agreement. After Panama defaulted on that loan as well, Elliott purchased some portion thereof from certain of the participating banks. Justice Gammerman granted summary judgment in favor of Elliott and entered judgment against Panama in the amount of $31,441,197. He also dismissed Panama's counterclaim.

Panama contends that summary judgment must be denied because the assignments of the loans to Elliott were improper under the terms of the 1982 Agreement and the 1995 Financing Plan. It also argues that because Elliott purchased the loans with the sole or primary intent to sue, the assignments are void under New York's

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[57] 975 F. Supp. 332 (SDNY 1997)

anti-champerty law.

Although I conclude that the doctrine of collateral estoppel does not bar Panama from asserting its defenses in this case, I also conclude that the defenses must be rejected as a matter of law. The assignments to Elliott were permitted by the agreements in question, and the assignments -- arms-length trades of foreign debt -- were not champertous. Accordingly, Elliott's motion for summary judgment is granted.

BACKGROUND

A. The Agreements

In moving for summary judgment, Elliott argues that it has a valid assignment of the Banks' interests under the 1982 Agreement, that Panama thus has a contractual obligation to Elliott, and that Panama is in breach of that obligation by failing to repay its debt. Panama argues that the 1982 Agreement has been amended by the 1995 Financing Plan (which was agreed to by both Citibank and Swiss Bank, among others) to prohibit the assignment of debt in the manner in which the loans in question were assigned to Elliott. Moreover, Panama asserts that Elliott tortiously interfered with the implementation of the 1995 Financing Agreement by knowingly seeking assignment of debt contrary to its terms.

Section 14.08 of the 1982 Agreement provides that the Agreement can be "amended, modified or waived" upon the written consent of "the Borrower, the Agent and the Majority Lenders." ... Section 1.01 defines "the Majority Lenders" as those "Lenders" who "at any time on or prior to the Commitment Termination Date . . . have more than 50% of the aggregate amount of the Commitments and, at any time thereafter, Lenders who at such time hold 50% of the aggregate unpaid principal amount of the Loans." ... According to Panama, these conditions were met when Panama and Citibank, Swiss Bank, and other participating banks entered into the 1995 Financing Plan.

In general, the 1995 Financing Plan sets forth the terms of Panama's debt restructuring, including the exchange of principal for new bonds and new arrangements for interest payments. To maintain an orderly process pending its implementation, the Plan also included "Interim Measures," by which each creditor holding debt eligible for restructuring agreed not to "recognize or record any assignment of Eligible Principal or Eligible Interest made after the Final Trading Date" of October 20, 1995... Panama was particularly concerned with establishing a "Final Trading Date" so that it would have a firm date by which it would know which creditors had committed to the Plan. The settlement of such assignments made before the Final Trading Date was to be completed on or before November 10, 1995...

The 1995 Financing Plan also required that all creditors participating in the debt restructuring submit a Commitment Letter to Panama no later than November 14, 1995, agreeing: (1) not to assign any debt eligible for restructuring after October 20, 1995; (2) to complete the settlement of all such assignments on or before November 10, 1995; and (3) not to assign any such debt after signing the Commitment Letter except to an assignee who (a) completed the settlement of the assignment on or before November 10, 1995 and (b) agreed (i) to assume the obligations under the Commitment Letter and (ii) to submit a Commitment Letter on or before November 14, 1995... The Commitment Letter also required that each Lender consent to the Interim Measures described in Part V of the Financing Plan.

According to Panama, after receiving Commitment Letters from "institutions holding more than 50 percent of the then-outstanding amounts under the 1982 Agreement," the 1982 Agreement was amended and modified retroactively to prohibit any assignments after October 20, 1995... It is undisputed that Citibank and Swiss Bank each submitted a Commitment Letter to Panama on November 14, 1995... In fact, Panama alleges that it received Commitment Letters from all of the other banks that held interests in the 1982 Agreement debt... Thus, the 1982 Agreement was amended to include the terms of the 1995 Financing Plan.

B. Procedural History

Elliott originally brought two suits in state court on July 15, 1996, one involving the 1978 Agreement and the other -- the instant case -- involving the 1982 Agreement. Panama removed both cases to this Court pursuant to 28 U.S.C. § 1441(d). Elliott moved to remand the action involving the 1978 Agreement. I granted that motion, holding that an amendment to the 1978 Agreement, which eliminated Panama's right to remove any state court action to federal court, did not apply to that case because the amendment was made after the suit was brought...The instant case had been commenced after the amendment was made and thus Elliott did not seek remand of this case.

In the remanded state court action, Elliott raised issues similar to those in this suit, alleging breach of contract and seeking approximately $ 30 million from Panama due under the 1978 Agreement... As in this case, Panama asserted a number of affirmative defenses as well as a counterclaim for tortious interference with its contractual relationships with the assignor banks. The principal defenses were: (1) the purported assignments to Elliott were void because they took effect after the Final Trading Date of October 20, 1995; (2) Elliott was not a proper assignee under the 1982 Agreement because assignments were only permitted to banks or financial institutions, and Elliott, according to Panama, was neither a bank nor a financial institution; and (3) Elliott acquired its purported interest in the 1978 Agreement in violation of New York's law against champerty. Elliott then moved for summary judgment, both with respect to its breach of contract claim as well as Panama's counterclaim.

On May 16, 1997, Justice Gammerman dismissed the counterclaim, holding that Panama had not alleged sufficient facts to substantiate a claim for tortious interference. Justice Gammerman also granted Elliott's motion for summary judgment on its breach of contract claim, holding, among other things, that (1) there was no basis to void the assignments to Elliott and (2) there was insufficient evidence to establish that Elliott acquired its interest in the 1978 Agreement in violation of New York's champerty law...

DISCUSSION

A. Collateral Estoppel

Elliott argues that Panama is collaterally estopped from asserting the champerty defense and its tortious interference with contract counterclaim because Panama has already had a full and fair opportunity to litigate these issues before Justice Gammerman and lost. This argument is rejected.

The doctrine of collateral estoppel, or issue preclusion, bars a party from relitigating in a second proceeding an issue of fact or law that was litigated and actually decided in a prior proceeding, if that party had a full and fair opportunity to litigate the issue in the prior proceeding and the decision of the issue was necessary to support a valid and final judgment on the merits... The party seeking to invoke the doctrine of collateral estoppel bears the burden of establishing the identity of issues between the prior and present actions. The opposing party has the burden of establishing the absence of a full and fair opportunity to litigate the issue in the prior action...

The state court case involved only the 1978 Agreement; hence, the issues relating to the 1982 Agreement were not directly before Justice Gammerman... as the issue of Elliott's intent with respect to the 1982 Agreement was not "actually decided" in the state court proceeding, and resolution of that issue was not "necessary to support a valid and final judgment on the merits," ... Panama is not collaterally estopped by Justice Gammerman's decision from pressing its defenses in the instant case. Nonetheless, because the issues presented are closely related, Justice Gammerman's decision must be given serious consideration.

B. Elliott's Breach of Contract Claim

Elliott's entitlement to recover the amounts due under the 1982 Agreement turns on the validity of the assignments of the debt to Elliott from the Banks. Panama contends that the assignments were invalid because: (1) they were obtained after the Final Trading Date established in the 1995 Financing Plan; (2) Elliott is not a proper assignee under the 1982 Agreement; and (3) the assignments were obtained in violation of New York's champerty law. Panama also argues that summary judgment is improper at this time because it has not had a full and fair opportunity for discovery. I address each of these arguments in turn.

1. The Timing of the Assignments

Under the 1995 Financing Plan, banks could not "recognize or record" any assignments of debt "made after the Final Trading Date" of October 20, 1995... The 1995 Financing Plan gave the banks until November 10, 1995 to complete the "settlement" of assignments made by October 20, 1995... As summarized in Annex B:

Pursuant to the Commitment Letter, each Lender will agree not to assign any of its Eligible Debt after October 20, 1995 (the "Final Trading Date") and to complete the settlement of all such assignments on or before November 10, 1995 . . . .

Hence, the 1995 Financing Agreement contemplated two different dates for trading -- or assigning -- eligible debt: the date the trade was made and the date the trade was settled.

The evidence submitted by Elliott shows unequivocally that the assignments were timely because both dates were met. That evidence includes the following: Jay H. Newman stated under oath that the Swiss Bank assignment was made on October 17, 1995 and the Citibank assignment on October 19, 1995... His sworn statement is corroborated by hand-written trade tickets and confirmatory documents... He also stated under oath that these trades were "settled" by the two "Assignment Notices" dated October 31, 1995 and November 6, 1995, respectively... In addition, Elliott submitted copies of letters written to Justice Gammerman by counsel for Citibank and Swiss Bank in the state court case confirming that the trades were made before October 20, 1995 and settled before November 10, 1995... Moreover, it is undisputed that after Panama was notified in December 1995 by the Agent that Citibank and Swiss Bank assigned their interests to Elliott, the Agent acknowledged Elliott's assignments and registered Elliott as a creditor of Panama under the 1982 Agreement... The Agent further demonstrated its acknowledgement of the validity of the assignments by subsequently paying, with Panama's knowledge, $ 973,289 in interest on the 1982 debt to Elliott... Finally, Panama has not disputed that all 48 trades involving the 1982 Agreement were settled by assignment notices that were "effective" after October 20, 1995 and that all of these assignments -- except for the two involving Elliott -- were accepted by the Agent and Panama... On this record, a reasonable factfinder could only conclude that the assignments were timely: that they were made before October 20, 1997 and that they were "settled" before November 10, 1997.

Panama's contention that the assignments to Elliott at issue in this case were not made until after October 20, 1995 is based solely on the two "Assignment Notices" submitted to Panama and the Agent from the Banks and Elliott... Both of these Assignment Notices are dated after October 20, 1995 and state that the assignments to Elliott take effect on dates after the Final Trading Date... The assignment from Swiss Bank is dated October 31, 1995 and states that the assignment "is effective October 31, 1995." The assignment from Citibank is dated November 6, 1995 and states that it "is effective from November 6, 1995." Panama argues that these documents show that Elliott and the Banks acknowledge that "they had assigned an interest in the 1982 Agreement after October 20, 1995." ... The two assignment notices are insufficient to raise a genuine issue of fact, for the record shows clearly that the dates of the assignment notices are the dates the assignments were "settled." The dates of both notices, of course, precede the November 10, 1995 "settlement" date. A reasonable factfinder could only conclude that the assignment notices merely consummated -- or made effective -- trades that were made before the Final Trading Date.

Panama also argues that the Agent was "misled" into registering Elliott as a creditor under the 1982 Agreement and paying it interest. But Panama has submitted no evidence to support this contention; rather, its argument that the Agent was misled is based solely on its contention that because the assignment was not made prior to October 20, 1995 it was misleading for Elliott to have represented otherwise. The difficulty with this argument, of course, is that it assumes the assignments were made after October 20th when clearly they were not.

Panama also alleges that even if the assignments were, completed before the Final Trading Date, Elliott would then be required to restructure because it would then be bound by the 1995 Financing Plan... This argument, however, is simply wrong, as the plain language of the Commitment Letters makes clear. Citibank and Swiss Bank both executed Commitment Letters on November 14, 1995 stating in pertinent part:

We further agree that after the date of this Commitment Letter, we will only assign our Eligible Debt to an assignee that . . . agrees . . . to assume our commitment and related obligations [under the 1995 Financing Plan]...

As the underscored language makes clear, this obligation existed only with respect to assignments made "after the date of [the] Commitment Letter[s]." Because the assignments were made to Elliott and settled before the Commitment Letters were executed, Elliott was not required to assume the Banks' obligations under the 1995 Financing Plan and thus Elliott was not bound to restructure.

2. Financial Institution

Under section 14.07 of the 1982 Agreement,

Each Lender may at any time sell, assign, transfer . . . or otherwise dispose of . . . its Loans . . . to other banks or financial institutions...

Panama argues that Elliott is not a "bank" or "financial institution" and that therefore Elliott is not a proper assignee.

Panama's contention is rejected, for two reasons. First, Elliott is a "financial institution" for purposes of the 1982 Agreement as a matter of law. The 1982 Agreement does not define the term "financial institution." As an entity that trades in securities and loans, Elliott is at least arguably a "financial institution." Moreover, Panama has accepted assignments involving similar entities that do not perform "traditional banking functions."... Likewise, as noted above, the Agent accepted Elliott as a creditor under the 1982 Agreement and paid Elliott some interest. Hence, Elliott is a "financial institution" for these purposes and the assignment was proper..

Second, even assuming Elliott was not a financial institution (or a bank), it would still have been eligible under the 1982 Agreement to be an assignee. In affirming Judge Sweet's decision in Pravin Banker, the Second Circuit held that similar language in a loan agreement expressly permitting assignments to "any financial institution," without restricting assignments "expressly in any way," did not prohibit an assignment to an entity that was not a financial institution... The court noted that New York law provides that "only express limitations on assignability are enforceable." .. Here, section 14.07 of the 1982 Agreement contains permissive language only -- it does not expressly restrict assignments to banks and financial institutions. Consequently, Elliott was a proper assignee, even assuming it was not a bank or financial institution.

3. Champerty

Panama also argues that the assignments of the 1982 debt to Elliott were void because Elliott acquired the loans with the intent and purpose of bringing suit, in violation of the New York anti-champerty statute.

Under section 489 of the New York Judiciary Law,

no corporation or association, directly or indirectly, itself or by or through its officers, agents or employees, shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of a bond, promissory note, bill of exchange, book debt, or other thing in action, or any claim or demand, with the intent and purpose of bringing an action or proceeding thereon . . . .

To void the assignments, Panama must prove that Elliott's purchases of the debt were made for the "sole" or "primary" purpose of bringing suit...

Section 489 is a criminal statute. Its purpose is to "prevent the resulting strife, discord and harassment which could result from permitting . . . corporations to purchase claims for the purpose of bringing actions thereon . . . ."... A plaintiff who acquires a claim in violation of this provision may not recover on the claim, for assignments made in violation of section 489 are void. ...

Elliott clearly had a "legitimate business purpose" in purchasing the debt... The purchases of the debt for $ 8 million from Citibank and Swiss Bank -- two established financial institutions -- were arms-length transactions. Foreign debt is actively traded in the market, and when Elliott bought the loans, there surely existed the possibility that it would re-trade them... Indeed, in opposing the motion Panama submitted a copy of a letter from Swiss Bank to Elliott offering to buy back the loan, stating that "we estimate that under current market conditions you will more than double the value of your investment." ... Hence, Elliott apparently had already doubled its investment in less than two years. Finally, there also existed the possibility that the economy of Panama would improve and that, as a consequence, Panama would have the ability to repay the loans in full or at a discount that Elliott would find acceptable.

Panama argues that the assignments are champertous because, as it contends additional discovery would show, Elliott bought the loans with the sole or primary intent to sue. Panama has submitted no evidence to support that claim, however, other than its counsel's affidavit alleging that Newman and one of Elliott's attorneys have been engaging in a "pattern and practice" of buying defaulted debt on the secondary market and bringing suit on such debt... According to Panama, Elliott first purchased the debt at issue shortly after Paul Singer, Elliott's general partner, was solicited by Newman, and Newman has an oral agreement with Elliott by which he will obtain an undisclosed percentage of any profits Elliott wins in this suit... Even if all of these allegations are true, as Justice

Gammerman held, they do not require an inference or determination that Elliott's actions were champertous...
I will assume, for purposes of this motion, that when Elliott purchased the loans, it had the intent to sue if necessary to collect on the loans. But as Judge Mukasey held in Banque de Gestion Privee-Sib v. La Republica de Paraguay, 787 F. Supp. 53, 57 (S.D.N.Y. 1992), "an intent to sue if necessary to enforce rights acquired pursuant to [an] assignment" does not by itself render the assignment champertous. Rather,

> for over a century, New York courts have recognized that the law does not prohibit discounting or purchasing bonds and mortgages and notes, or other choses in action, either for investment or profit, or for the protection of other interests, and such purchase is not made illegal by the existence of the intent . . . at the time of the purchase, which must always exist in the case of such purchases, to bring suit upon them if necessary for their collection... (quoting Moses v. McDivitt, 88 N.Y. 62, 65 (1882)...

It may be, as Panama alleges, that when Elliott purchased the loans, it had no intention of participating in the restructuring under the 1995 Financing Plan and that it hoped to gain an advantage thereby in negotiating with Panama for payment. Although one could reasonably quarrel with the seemliness of this investment strategy or the propriety in general of such "vulture fund" tactics as investing in distressed companies or loans, criminal statutes must be narrowly construed, and the purchase of a loan in the circumstances of this case surely does not rise to the level of criminal conduct.
Even assuming Elliott had no intention of participating in the 1995 Financing Plan, no reasonable factfinder could conclude that it spent $ 8 million just to enjoy the pleasures of litigation. To the contrary, clearly there were possibilities other than litigation when Elliott purchased the loans: (i) Elliott could have re-traded the loans on the market; (ii) Panama could have re-paid the loans in full; and (iii) Elliott and Panama could have agreed on a discount that would still have permitted Elliott to turn a profit. The fact that Elliott was prepared to file suit if none of these possibilities materialized did not render the assignments champertous....
Because no genuine issue of material fact exists to be tried with respect to any of Panama's defenses, Elliott's motion for summary judgment on its breach of contract claim is granted.

C. Panama's Counterclaim
The final issue is the viability of Panama's counterclaim for tortious interference with contract. Under New York law, to establish a claim of tortious interference with contract, a plaintiff must prove: (1) the existence of a contract; (2) defendant's knowledge thereof; (3) defendant's intentional inducement of a breach of that contract; and (4) damages...
Elliott argues that Panama's claim for tortious interference must be dismissed because Panama has failed, among other things, to demonstrate the existence of a genuine issue of fact with respect to the intent aspect of the third element. I agree. Hence, Elliott's motion for summary judgment is granted.
The intent required to sustain a claim for tortious interference with contract is "exclusive malicious motivation." ...The action must have been taken by the defendant "without justification, for the sole purpose of harming the plaintiffs."...
Here, a reasonable factfinder could only conclude that Elliott was not acting with "exclusive malicious motivation" or for the "sole purpose" of harming Panama. To the contrary, Elliott spent some $ 8 million. It did that not because

it wanted to hurt Panama or interfere with Panama's contracts, but because of the most basic of motivations -- it wanted to make money. Elliott invested in the foreign debt because it was hoping to turn a profit.
Hence, no genuine issue of material fact exists as to the third element of tortious interference with contract and the counterclaim must be dismissed.

In another case involving Elliott Associates the Second Circuit held that Elliott Associates' acquisition of Peru's debt was primarily to enforce it, and to resort to litigation to the extent necessary to accomplish the enforcement. The intent to litigate was incidental and contingent and did not violate § 489.

Elliott Associates, L.P. v *Banco De La Nacion*[58]

Plaintiff-Appellant Elliott Associates, L.P. ("Elliott") appeals from the amended final judgments entered by the United States District Court for the Southern District of New York on September 3 and 15, 1998. The district court, after a bench trial, dismissed with prejudice Elliott's complaints seeking damages for the non-payment of certain debt by Defendants-Appellees The Republic of Peru ("Peru") and Banco de la Nacion ("Nacion") (together, the "Debtors") because it found that Elliott had purchased the debt in violation of Section 489 of the New York Judiciary Law ("Section 489"). See Elliott Assocs. v. Republic of Peru, 12 F. Supp. 2d 328 (S.D.N.Y. 1998). Because, contrary to the district court's interpretation, the pertinent case law demonstrates that Section 489 does not preclude relief in lawsuits, such as Elliott's, seeking primarily to collect on lawful debts and only filed absent satisfaction, we reverse the judgments of the district court.

BACKGROUND

Elliott is an investment fund with its principal offices located in New York City. Elliott was founded by Paul Singer in 1977 and he remains its sole general partner. One of the primary types of instruments that Elliott invests in is the securities of "distressed" debtors, that is, debtors that have defaulted on their payments to creditors. Singer testified that he invests in debt when he believes that the true or "fundamental" value of the debt is greater than the value accorded by the market. Elliott characterizes its approach to its investments as "activist." Thus, despite sometimes accepting the terms offered to other creditors, Elliott explains that it frequently engages in direct negotiations with the debtor and argues that, as a result, it has occasionally received a greater return than other creditors.
In August or September of 1995, Singer was approached by Jay Newman to discuss investing in distressed foreign sovereign debt. Newman, an independent consultant, had worked in the emerging market debt field at major brokerage houses Lehman Brothers, Dillon Read, and Morgan Stanley, as well as managing his own offshore fund, the Percheron Fund. The secondary market for such debt first developed in the early 1980s when the original lender banks began selling the non-performing debt of countries that had ceased servicing their external debt to other investors, including brokerage firms, in order to reduce the banks' exposure and to permit them to lend additional funds to developing countries. The Debtors submitted evidence at trial that, from 1993 onwards, Newman had

[58] 194 F.3d 363 (2d. Cir, 1999).

acted with attorney Michael Straus to solicit investors and provide advice to offshore fund Water Street Bank & Trust Company, Ltd. ("Water Street"). The Debtors alleged that, at Water Street, Newman and Straus purchased the sovereign debt of Poland, Ecuador, Ivory Coast, Panama, and Congo, and filed lawsuits seeking full payment of the debt with Straus acting as the trial counsel. The Debtors' contention at trial in the instant case was that Newman and Straus moved to Elliott from Water Street because it was a good "substitute plaintiff" in that it specialized in the purchase of distressed assets, had funds available to invest, and, unlike Water Street, which had refused in discovery to disclose the names of its individual investors, was unconcerned about exposing the identity of its principals.

I.

At Newman's recommendation, in October 1995, Elliott purchased approximately $ 28.75 million (principal amount) of Panamanian sovereign debt for approximately $ 17.5 million. In July 1996, Elliott brought suit against Panama seeking full payment of the debt. Elliott obtained a judgment and attachment order and, with interest included, ultimately received over $ 57 million in payment.

At the time of Elliott's purchase of Panamanian debt, Panama was finalizing its Brady Plan debt restructuring program. The term "Brady Plan" derives from a March 1989 speech by Nicholas Brady, then Secretary of the United States Treasury, urging commercial lenders to forgive some of the debt that they were owed by less developed countries, restructure what remained, and continue to grant those countries additional loans. See generally, Ross P. Buckley, The Facilitation of the Brady Plan: Emerging Markets Debt Trading From 1989 to 1993, 21 Fordham Int'l L.J. 1802 (1998). Brady Plans contemplate that, in return for such voluntary partial debt forgiveness, the less developed country will submit to an economic austerity program supervised and monitored by the International Monetary Fund (the "IMF"). The purpose of implementing Brady Plans is to avoid the recurrence of debt defaults by less developed countries that have occurred from 1982 onwards. Typically, the terms of a Brady Plan are negotiated with the debtor country by an ad hoc committee of the nation's largest institutional creditors, generally known as the "Bank Advisory Committee." The members of the Bank Advisory Committee commit to restructuring the debt that they hold on the agreed terms and those terms are also offered to other creditors. However, while the members of the Bank Advisory Committee usually agree to be bound by the negotiated terms, the other creditors are under no such obligation to accept those terms.

In January 1996, Newman recommended that Elliott purchase Peruvian sovereign debt. Newman testified at trial that he believed that Peruvian sovereign debt was a good investment because of the sweeping economic reforms implemented by President Alberto Fujimori following his election in November 1990 in the wake of a severe six-year recession. Newman testified that he viewed Peru's Brady Plan, announced in October 1995, as undervaluing Peru's outstanding debt. In particular, Newman contended that the large commercial bank creditors that made up the Bank Advisory Committee had institutional incentives to accept reduced terms for the debt they held, such as the desire to make additional loans and to operate domestically within the country, and that he believed that the Bank Advisory Committee had not been privy to all material financial information, including Peru's rumored repurchase of a significant proportion of its debt.

Between January and March 1996, Elliott purchased from international banks ING Bank, N.V. ("ING") and Swiss Bank Corporation ("Swiss Bank") approximately $ 20.7 million (in principal amount) of the working capital debt of Nacion and Banco Popular del Peru ("Popular"), a bankrupt Peruvian bank. The debt was sold under a series of twenty-three letter agreements (the "Letter Agreements"). Elliott paid approximately $ 11.4 million for these debt obligations and all of the debt was guaranteed by Peru pursuant to a written guaranty dated May 31, 1983 (the "Guaranty"). Under their express terms, both the Letter Agreements and the Guaranty were governed by New York law. In connection with this transaction, Elliott executed two separate assignment agreements with ING and Swiss Bank, dated March 29, 1996, and April 19, 1996, respectively.

The Peruvian sovereign debt purchased by Elliott was working capital debt, rather than syndicated bank debt. Working capital debt does not involve an agent bank, but instead consists of direct loans between single lenders and borrowers, whereas syndicated bank debt is debt syndicated by a lead bank, which maintains books and records for all holders. Because the buyer has to rely upon the seller, rather than an agent bank, to convey good title, working capital debt typically trades at a discount of several percentage points from syndicated debt. The Debtors argued at trial that Elliott chose to purchase working capital debt because it sold at a greater discount to value than syndicated debt and thus would have more value in a lawsuit seeking full payment of the debt, despite being more difficult to trade on the secondary market due to its illiquidity.

The district court found that the timing of Elliott's purchases of Peruvian debt and the closing of the assignment agreements paralleled key events in Pravin Banker Assocs., Ltd. v. Banco Popular del Peru, Civ. No. 93-0094 (S.D.N.Y.). See Elliott Assocs., 12 F. Supp. 2d at 336. Pravin Banker, an investment fund, had filed suit on two 1983 letter agreements of Popular, which at that time was being liquidated under Peru's IMF austerity plan. After eighteen months of stays, on August 24, 1995, the district court entered summary judgment for Pravin Banker and, on January 19, 1996, the district court issued its damages ruling. The Debtors argued at trial in the instant case that Elliott did not begin purchasing Peruvian debt until the Pravin Banker decision in order that there would be no defense to a quick judgment. In support of this, the Debtors elicited testimony from Singer and Newman that they had followed and discussed the Pravin Banker case, although Newman claimed that Elliott's decision to purchase Peruvian debt shortly after the damages ruling was "just a coincidence." The Debtors further argued that Elliott avoided closing on the trades until after April 12, 1996, on which date a full stay pending appeal was denied by this court in the Pravin Banker case. Pravin Banker Assocs Ltd. v. Banco Popular del Peru, Order No. 96-7183 (2d Cir. Apr. 12, 1996). The Debtors supported this allegation by contending that Elliott refused to close using standard Emerging Markets Traders Association forms, but instead delayed by requesting provisions in the agreements that were not customary in the trade.

On May 1, 1996, Elliott delivered joint notices of the assignments to the Debtors' reconciliation agent, Morgan Guaranty, to register the debt it had purchased in order that it could obtain its pro rata share of the interest payments the Debtors had promised to make to all creditors. The following day, Elliott notified Nacion, Popular, and Peru by letter that it was now one of their creditors and that it wished to initiate discussions regarding repayment. Although a telephone conference call between counsel followed, no negotiations on repayment terms occurred. Rather, the Debtors took the position that Elliott was not a proper assignee because it was not a "financial institution" within the scope of the assignment provision of the Letter Agreements and that Elliott should either transfer the debt to an eligible "financial institution" or else participate in the Brady Plan with the other creditors...

On June 25, 1996, after a continued impasse in the parties' discussions, Elliott formally requested repayment by sending the Debtors a notice of default. The Debtors pointed out at trial that this notice was sent during the voting period on the Term Sheet of Peru's Brady Plan. The Debtors also noted that, although the Brady Plan negotiations took place from January to June 1996, Elliott did not contact the Bank Advisory Committee to express its views. Ultimately, Peru's Brady Plan was agreed upon by 180 commercial lenders and suppliers, and entailed, inter alia, an Exchange Agreement under which old Peruvian commercial debt, including the 1983 Letter Agreements, would be exchanged for Brady bonds and cash.

II.

On October 18, 1996, ten days before the Exchange Agreement was scheduled to be executed, Elliott filed suit against the Debtors in New York Supreme Court and sought an ex parte order of prejudgment attachment. The Debtors subsequently alleged at trial that the reason for Elliott filing suit at that time was that the collateral for the Brady bonds was United States Treasury bonds, which were held at the Federal Reserve Bank of New York, and thus made suitable assets for attachment. The Exchange Agreement was finally executed on November 8, 1996. Elliott's suit was subsequently removed to federal district court pursuant to the Foreign Sovereign Immunities Act, 28 U.S.C. § 1441(d) (1994), where the district court denied Elliott's motion for prejudgment attachment on December 27, 1996, and its motion for summary judgment on April 29, 1997. After discovery, the case was tried in a bench trial from March 17 to March 25, 1998, and final argument was heard on May 26, 1998.

On August 6, 1998, the district court issued its opinion dismissing Elliott's complaint on the ground that Elliott's purchase of the Peruvian debt violated Section 489 of the New York Judiciary Law. The district court found as a fact that "Elliott purchased the Peruvian debt with the intent and purpose to sue." ... The district court noted that Elliott had no familiarity with purchasing sovereign debt until it met Newman, who together with Straus, had "a long history" in purchasing sovereign debt and suing on it... The district court further found that Elliott intentionally "delayed closing its purchases of Peruvian debt until the Second Circuit had clarified the litigation risks."... Moreover, the district court found that "Elliott did not seriously consider alternatives to bringing an action," including holding and reselling the debt, participating in Peru's privatization program, participating in the Brady Plan, or negotiating separately with the Debtors to obtain terms more favorable than the Brady terms... The district court found that "none of these alternatives was realistically considered by Elliott when it purchased Peruvian debt" and that "from the start, Elliott intended to sue and the testimony to the contrary was not credible." .. With respect to the letters sent by Elliott to the Debtors after purchasing the debt, the court found that these letters and the other accompanying steps to negotiate "were pretextual and never demonstrated a good faith negotiating position." ...

After making its "Findings of Fact," the court set forth its "Conclusions of Law." Applying basic contract law principles, the court first concluded that Nacion had breached the Letter Agreements by failing to pay Elliott the amounts due and owing and that Peru had breached the Guaranty by not paying Elliott the amounts due and owing under the Letter Agreements following Nacion's default...

The court then turned to the Debtors' defense that Elliott's claim should be dismissed because the assignments were in violation of Section 489 of the New York Judicial Law, which prohibits the purchase of a claim "with the intent and for the purpose of bringing an action or proceeding thereon." The court explained that while "Elliott's position is strong as a matter of policy in the world of commerce . . . the Court's role here is not to make policy assessments -- to rank its preferences among contract, property, and champerty doctrines." ... The court noted the case law holding that the intent to sue must be primary, not merely contingent or incidental... Examining the legislative history, the court explained that, while Section 489 was originally aimed at attorneys, subsequent revisions indicated an intent to cover "corporations" and "associations." .... Moreover, the court observed that "[Section] 489's roots in the Medieval law of champerty and maintenance provides support for the conclusion that, while not all assignments with the intent to bring suit thereon are barred, assignments taken for the purpose, or motive, of stirring up litigation and profiting thereby are prohibited." ...

The district court then rejected Elliott's arguments that the statute was only aimed at: (1) suits which have the purpose of obtaining costs; or (2) suits where corporations engage in the unauthorized practice of law by taking claims with the intent to sue on them pro se without hiring counsel... The court also rejected Elliott's argument that the statute does not apply when all right, title, and interest are conveyed by the assignor... Finally, the court rejected as without merit Elliott's arguments that: (1) Elliott, as a limited partnership, is not an "association" within the meaning of the statute; (2) the Debtors' interpretation of the statute would render it in violation of the Commerce Clause; and (3) the Debtors lacked standing to raise the Section 489 defense because they were not parties to the assignment agreement... Consequently, because Elliott purchased the debt with the intention to bring suit thereon, the court concluded that Elliott's contracts violated Section 489 and were unenforceable...

Turning to other arguments and defenses, although Section 3 of Peru's Guaranty provided that Peru shall pay all guaranteed amounts "regardless of any law, regulation or order now or hereafter in effect in any jurisdiction," the court rejected Elliott's argument that this waived Peru's Section 489 defense, reasoning that Section 489 is a penal law directed at the public interest that cannot be waived... Finally, although not necessary to its disposition, the court rejected Nacion's argument that it was excused from performance due to impossibility as a result of a Peruvian government decree purportedly removing Nacion as a debtor under the Letter Agreements...

The district court entered its judgment dismissing Elliott's complaint on August 26, 1998. Amended judgments were then issued on September 3 and 15, 1998. Elliott timely filed its notices of appeal on September 18 and 24, 1998. After briefing from the parties, as well as the filing of five amicus curiae briefs, this appeal was submitted for our decision following oral argument on May 5, 1999. We have jurisdiction to decide this appeal under 28 U.S.C. § 1291 (1994).

DISCUSSION

I. A.

As an initial matter, while in agreement that the district court's findings of fact are reviewed for clear error... the parties dispute the appropriate level of deference to be given to the district court's interpretation of Section 489 of the New York Judiciary Law. The Debtors urge that we follow this court's statement in Ewing v. Ruml, 892 F.2d 168 (2d Cir. 1989), that "[where] the interpretation of state law is made by a district judge sitting in that state, it is entitled to great weight and should not be reversed unless it is clearly wrong.".... Both Ewing and the other case relied upon by the Debtors for this proposition, Lomartira v. American Auto. Ins. Co., 371 F.2d 550 (2d Cir. 1967), were decided before the Supreme Court's decision in Salve Regina College v. Russell, 499 U.S. 225, 113 L. Ed. 2d 190, 111 S. Ct. 1217 (1991), which resolved a split among the Circuits on this very issue. In Salve Regina College, the Supreme Court expressly held that "a court of appeals should review de novo a district court's determination of state law." ... Subsequent appeals decided by this Circuit have thus accorded no deference to district court

interpretations of state law, nor will we...
In determining the law of the State of New York, "we will consider not only state statutes but also state decisional law." ... "Where the law of the state is uncertain or ambiguous, we will carefully predict how the highest court of the state would resolve the uncertainty or ambiguity." ... Indeed, "a federal court is free to consider all of the resources to which the highest court of the state could look, including decisions in other jurisdictions on the same or analogous issues."...

B.
Besides arguing for reversal, Elliott has moved for the alternative relief of certifying the issue of the interpretation of Section 489 to the New York Court of Appeals pursuant to Second Circuit Rule § 0.27. See also New York Court of Appeals Rule 500.17 (permitting that court to accept and decide such certified questions). This court has explained that "issues of state law are not to be routinely certified to the highest court[] of New York . . . simply because a certification procedure is available... In the instant appeal... we conclude that there is sufficient case law for us to determine that Elliott's conduct, as found to have occurred by the district court, was not proscribed by Section 489 of the New York Judiciary Law. Accordingly, we deny Elliott's alternative motion for certification as moot in light of our disposition.

II. A.
The pivotal issue upon which this appeal necessarily turns is whether, within the meaning of Section 489 of the New York Judiciary Law, Elliott's purchase of Peruvian sovereign debt was "with the intent and for the purpose of bringing an action or proceeding thereon," thereby rendering the purchase a violation of law. Because the proper interpretation of Section 489 is at the heart of our decision, we quote it in its entirety below:

> § 489. Purchase of claims by corporations or collection agencies
>
> No person or co-partnership, engaged directly or indirectly in the business of collection and adjustment of claims, and no corporation or association, directly or indirectly, itself or by or through its officers, agents or employees, shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of a bond, promissory note, bill of exchange, book debt, or other thing in action, or any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon; provided however, that bills receivable, notes receivable, bills of exchange, judgments or other things in action may be solicited, bought, or assignment thereof taken, from any executor, administrator, assignee for the benefit of creditors, trustee or receiver in bankruptcy, or any other person or persons in charge of the administration, settlement or compromise of any estate, through court actions, proceedings or otherwise. Nothing herein contained shall affect any assignment heretofore or hereafter taken by any moneyed corporation authorized to do business in the state of New York or its nominee pursuant to a subrogation agreement or a salvage operation, or by any corporation organized for religious, benevolent or charitable purposes.
>
> Any corporation or association violating the provisions of this section shall be liable to a fine of not more than five thousand dollars; any person or co-partnership, violating the provisions of this

> section, and any officer, trustee, director, agent or employee of any person, co-partnership, corporation or association violating this section who, directly or indirectly, engages or assists in such violation, is guilty of a misdemeanor. ..

In interpreting Section 489, we are guided by the principle that we "look First to the plain language of a statute and interpret it by its ordinary, common meaning." Luyando v. Grinker, 8 F.3d 948, 950 (2d Cir. 1993).... "Legislative history and other tools of interpretation may be relied upon only if the terms of the statute are ambiguous." Lee v. Bankers Trust Co., 166 F.3d 540, 544 (2d Cir. 1999). Indeed, "where the language is ambiguous, we focus upon the broader context and primary purpose of the statute." Castellano v. City of New York, 142 F.3d 58, 67 (2d Cir. 1998)... At all times, we are cognizant of the Supreme Court's admonition that "statutes should be interpreted to avoid untenable distinctions and unreasonable results whenever possible." American Tobacco Co. v. Patterson, 456 U.S. 63, 71, 71 L. Ed. 2d 748, 102 S. Ct. 1534 (1982)...

B.

Parsing the plain language of Section 489 offers little helpful guidance as to the intended scope of the provision. The statutory language simply provides that certain types of people or entities are prohibited from soliciting, buying or taking by assignment, particular types of debt instruments "with the intent and for the purpose of bringing an action or proceeding thereon." On its face, this statutory command might appear to be remarkably broad in scope, forbidding essentially all "secondary" transactions in debt instruments where the purchaser had an intent to enforce the debt obligation through litigation. However, ambiguity resides in the term "with the intent and for the purpose of bringing an action or proceeding thereon." The nature of the proscribed intent and purpose is unclear. After reviewing the pertinent New York state decisions interpreting Section 489, we are convinced that, if the New York Court of Appeals, not us, were hearing this appeal, it would rule that the acquisition of a debt with intent to bring suit against the debtor is not a violation of the statute where, as here, the primary purpose of the suit is the collection of the debt acquired. Consequently we must reverse the judgment of the district court.

C.

The predecessor statute to Section 489 of the New York Judiciary Law was enacted at least as early as 1813. However, its origins are even more archaic. New York courts have recognized that " § 489 [is] the statutory codification of the ancient doctrine of champerty." Ehrlich v. Rebco Ins. Exch., Ltd., 649 N.Y.S.2d 672, 674, 225 A.D.2d 75, 77 (1st Dep't 1996)... Commentators have traced the doctrine of champerty, and its doctrinal near-cousins of maintenance and barratry, back to Greek and Roman law, through the English law of the Middle Ages, and into the statutory or common law of many of the states... As explained by the Supreme Court, "put simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty."...

While New York courts have not been unwilling to characterize Section 489 as a champerty statute, it is apparent that they have consistently interpreted the statute as proscribing something narrower than merely "maintaining a suit in return for a financial interest in the outcome." Indeed, far from prohibiting the taking of a financial interest in the outcome of a lawsuit, payment of attorneys by fees contingent upon the outcome of litigation is expressly permissible in New York by statute and court rule...

A strong indication of the limited scope of the statute is provided by several early New York cases discussing Section 489's predecessor statutes. In Baldwin v. Latson, 2 Barb. Ch. 306 (N.Y. Ch. 1847), the Court of Chancery rejected the argument that the statute was violated when an attorney purchased a bond and mortgage and brought a foreclosure suit thereupon. The court reasoned that the statute was intended to curtail the practice of attorneys filing suit merely to obtain costs, which at that time included attorney fees. As the court explained, "the object of the statute was to prevent attorneys and solicitors from purchasing debts, or other things in action, for the purpose of obtaining costs from a prosecution thereof, and was never intended to prevent the purchase for the honest purpose of protecting some other important right of the assignee."...

The statute was also at issue in Mann v. Fairchild, 14 Barbour 548 (Sup. Ct. Kings Gen. Term 1853). In what would appear to be a reference to the scourge of attorneys using such debt instruments to obtain costs, as described in Baldwin, the Mann court stated that "the main object of the statute in question was to prevent litigation by prohibiting the purchase of choses in action by those whose pecuniary interests might be peculiarly advanced by instituting suits upon them, and who, in consequence of their position, might conduct such suits upon unequal terms."....

An even clearer indiction of the limited purpose of the statute is provided by the opinions of the two justices writing in Goodell v. The People, 5 Parker Crim. R. 206 (Sup. Ct. Broome Gen. Term 1862), a case concerning whether the statute covered the situation where an attorney purchased a promissory note with the intent or purpose to bring suit in the justices' court, in which tribunal costs were not granted to the prevailing party. In discussing the purpose of the statute, Justice Campbell wrote:

> That the law of 1818, and previous laws on the subject, were intended to reach a class of men who make a practice, either directly or indirectly, of buying small notes of fifty dollars and upwards, and then prosecuting them in courts of record, in the old common pleas, or in the Supreme Court, and make the defendants pay large bills of costs, even when the suit was undefended, there can be, I think, no doubt. Hence, it was entitled an act to prevent abuses, and to regulate costs. The law was aimed at attorneys in courts of record, who were the parties receiving the costs, and who thus oppressed debtors by unexpected and unnecessary prosecutions...

Justice Parker, writing separately, agreed that the statute was intended to prevent attorneys from buying debts as an expedient vehicle for obtaining costs. As he explained:

> The purchasing of debts by attorneys, with the intent to bring suits upon them in justices' courts, does not seem to me to be within the mischief which the statute was intended to guard against. No costs being allowed to an attorney in a justice's court, he has no object in buying debts to sue in that court, and I can see neither opportunity nor temptation for him to advance his pecuniary interests by so doing. As he has no temptation to litigate, as a party, in justices' courts, no litigation is induced by his freedom from restraint in that direction . . . .

The seminal New York Court of Appeals case of Moses v. McDivitt, 88 N.Y. 62 (1882), confirmed that the mischief Section 489 was intended to remedy did not include the acquisition of debt with the motive of collecting it, notwithstanding that litigation might be a necessary step in the process... In Moses, the plaintiff, an attorney, had purchased an assignment of a bond and mortgage that had been executed by the defendant and brought suit for collection of the debt. As a defense, the defendant alleged that the plaintiff's purchase was in violation of the then-in-force predecessor statute to Section 489 because it was a purchase by an attorney of a chose in action "with the intent and for the purpose of bringing any suit thereon." ... In particular, the defendant produced evidence that the purpose of the plaintiff's purchase was

> to compel the defendant, as a condition of the extension of the time of payment, to assign to him certain stock in a publishing company in which he was interested, in order that the plaintiff might thereby control an election of directors of the company, which was about to take place, or to elect plaintiff president of the company at such election...

The trial judge charged the jury, as paraphrased by the Court of Appeals:

> that if the plaintiff purchased the bond simply for the purpose of obtaining the control of the stock, and not for the purpose of bringing suit upon it, he had not violated the statute; but that, if they found that he had bought it with the intention of bringing suit upon it, then, whatever else there might be about it, or however necessary he might have considered it that he should thus fortify himself, he violated the statute. . . . [Moreover,] if his intention in buying it was to use it to compel the defendant to do a particular thing, as to assign stock for instance, and if he would not comply with his wishes to sue [on] it, that would be a violation of the statute...

The Court of Appeals reversed, explaining that:

> a mere intent to bring a suit on a claim purchased does not constitute the offense; the purchase must be made for the very purpose of bringing such suit, and this implies an exclusion of any other purpose. As the law now stands, an attorney is not prohibited from . . . purchasing bonds . . . or other choses in action, either for investment or for profit, or for the protection of other interests, and such purchase is not made illegal by the existence of the intent on his part at the time of the purchase, which must always exist in the case of such purchases, to bring suit upon them if necessary for their collection. To constitute the offense the primary purpose of the purchase must be to enable him to bring a suit, and the intent to bring a suit must not be merely incidental and contingent. The object of the statute . . . was to prevent attorneys, etc., from purchasing things in action for the purpose of obtaining costs by the prosecution thereof, and it was not intended to prevent a purchase for the purpose of protecting some other right of the assignee...

Consequently, even though the "primary purpose" of the plaintiff was to induce the defendant to assign his stock, the court concluded that:

> this purpose, whether honest or reprehensible, was not within the prohibition of the statute. The intent to sue upon the bond was secondary and contingent . . . . Under these circumstances it cannot be said that the purpose of the purchase of the bond was to bring a suit upon it. This purpose did not enter into the purchase any more than it would have done had the plaintiff bought the bond as an investment, but with the intention of collecting it by suit if compelled to resort to that means for obtaining payment. The real question upon which the case turned was, whether the main and primary purpose of the purchase was to bring a suit and make costs, or whether the intention to sue was only secondary and contingent, and the suit was to be resorted to only for the protection of the rights of the plaintiff, in case the primary purpose of the purchase should be

frustrated...

The continuing vitality of the distinction drawn in Moses between cases involving an impermissible "primary" purpose of bringing suit and those where the intent to sue is merely "secondary and contingent" is confirmed by the post-Moses case law. There are only two Court of Appeals cases decided after Moses discussing the interpretation of Section 489 or any of its predecessors... In Sprung v. Jaffe, 3 N.Y.2d 539, 147 N.E.2d 6, 169 N.Y.S.2d 456 (1957), the Court of Appeals reversed the grant of summary judgment to the plaintiff assignee of a debt instrument on the grounds that the debtor's defense that the assignee had violated a predecessor statute to Section 489 was not a "sham or frivolous" and presented a genuine factual dispute, with respect to the intent and purpose of the assignee, that required resolution by the trier of fact... Nevertheless, the Sprung court did not say that the plaintiff, an attorney who purchased a $ 3,000 debt for one dollar and subsequently brought suit, had violated the statute; rather, it found that fact-finding at trial was necessary since, for the purpose of summary judgment, he had failed to provide sufficient proof of a purpose for acquiring the debt other than bringing suit... In so ruling, the Court of Appeals cited to Moses and reiterated its central holding that "the statute is violated only if the primary purpose of the purchase or taking by assignment of the thing in action is to enable the attorney to commence a suit thereon. The statute does not embrace a case where some other purpose induced the purchase, and the intent to sue was merely incidental and contingent." ...

The Moses approach was again followed in Fairchild Hiller Corp. v. McDonnell Douglas Corp., 28 N.Y.2d 325, 270 N.E.2d 691, 321 N.Y.S.2d 857 (1971), the most recent Court of Appeals case addressing Section 489. In Fairchild Hiller, the Court of Appeals affirmed the dismissal of a debtor's affirmative defense that an agreement between two corporations to split the proceeds of any recovery on the disputed claim was in violation of Section 489. The court cited Moses and explained that "we have consistently held that in order to fall within the statutory prohibition, the assignment must be made for the very purpose of bringing suit and this implies an exclusion of any other purpose." ... Because in Fairchild Hiller the claim was assigned as "an incidental part of a substantial commercial transaction," specifically, the acquisition of a corporation's entire assets, the Court of Appeals concluded that the assignment was not prohibited by Section 489... Thus, both Sprung and Fairchild Hiller demonstrate that the principles set forth in Moses continue to be followed by the New York Court of Appeals...

In Limpar Realty Corp. v. Uswiss Realty Holding, Inc., 492 N.Y.S.2d 754, 112 A.D.2d 834 (1st Dep't 1985) (mem.), the Appellate Division, First Department, also examined Section 489. In that case, it rejected the debtor's argument that the assignee's acquisition of a note, mortgage and guarantee followed by the commencement of foreclosure proceedings twenty-seven days later without affording the debtor an opportunity to cure constituted a violation of Section 489. The court reasoned that the debtor could have cured the default at any time during the previous eighteen months, but chose not to do so... Noting the prohibition in Moses against such acquisitions for the "primary purpose" of bringing suit, the Limpar court concluded that that was not the assignee's primary purpose, finding a "legitimate business purpose" evidenced by the acquisition of other real estate on the same city block by the real estate developer on whose behalf the assignee was acting, which negated the inference of acquisition merely to bring suit... In addition the court reasoned that the commencement of foreclosure proceedings less than a month after the acquisitions was not determinative since the debtor had the opportunity to cure the default before the assignment...The district court distinguished Limpar on the grounds that in Limpar "there was no contention that the prior debtholder had reached an agreement in principle to settle the dispute," whereas in the instant case Peru's Brady Plan was essentially finalized. Elliott Assocs., 12 F. Supp. 2d at 355. We do not find the district court's distinction compelling. First, Limpar makes no such distinction between on-going and settled or almost settled disputes. Second, Peru's Brady Plan was not binding on all creditors, such as Elliott, that were not members of the Bank Advisory Committee. Thus, given that the Brady system purposefully does not create such a binding obligation, there was no settlement and, consequently, unlike the district court, we do not condemn Elliott merely because "its purpose was to stand apart from the lenders who had agreed to the Brady restructuring, and to use judicial process to compel full payment." ....

....there would appear to be a general uniformity of precedent among the Appellate Divisions of New York's four judicial Departments with respect to the interpretation of Section 489.

D.

The cases, spread over more than a century, are not always entirely clear or plainly consistent. Thus the district court found some basis for its construction of the coverage of Section 489 to include Elliott's purchase of the Peruvian debt. We do not agree, however, with this interpretation. Furthermore, in light of the case law surveyed above, we do not agree with the district court that Moses in conjunction with later New York case law "provides little guidance for construing the statute's proper scope." ... To the contrary, New York courts have stated that Moses "undoubtedly correctly states the objects and limitations of the statute."... As Moses itself makes plain, violation of Section 489 turns on whether "the primary purpose of the purchase [was] . . . to bring a suit," or whether "the intent to bring a suit [was] . . . merely incidental and contingent."... The district court reasoned that here "Elliott intended to collect 100% of the debt not by negotiating, participating in a debt-for-equity swap, trading, or going along with the Brady Plan, but rather by suing. Unlike Moses, the intent Peru established was the intent to sue, and that intent was not contingent or incidental." ... We believe the district court misunderstood Moses. The Moses court made clear that where the debt instrument is acquired for the primary purpose of enforcing it, with intent to resort to litigation to the extent necessary to accomplish the enforcement, the intent to litigate is "merely incidental and contingent" and does not violate the statute. Indeed, the Moses court made precisely this point when it explained that "the object of the statute . . . was to prevent attorneys, etc., from purchasing things in action for the purpose of obtaining costs by the prosecution thereof, and it was not intended to prevent a purchase for the purpose of protecting some other right of the assignee." ... Elsewhere, the Court of Appeals in Moses specifically stated that conduct not prohibited by the statute included where "the plaintiff bought the bond as an investment, but with the intention of collecting it by suit if compelled to resort to that means for obtaining payment." ... While Moses does not set forth a complete taxonomy of conduct prohibited by Section 489 (and neither do we), it plainly sets forth certain conduct that is not made unlawful by Section 489.

Even accepting as correct the facts as found by the district court, we see no meaningful distinction between Elliott's conduct and the conduct Moses expressly states to be outside of the scope of the statute. Here, the district court found that Elliott was the lawful assignee of Nacion's Letter Agreements, that Peru had guaranteed those Letter Agreements, and that both Peru and Nacion are liable to Elliott as a result of Nacion's failure to pay the amounts due and owing under the Letter Agreements... Far from being a trivial claim that might serve, for example, as the illegitimate vehicle for the recovery of attorney fees, the district court expressly found that "Elliott has suffered damages in excess of $ 7,000,000 as a result [of the breach]."...

In purchasing the Peruvian debt the district court found that Elliott's principal aim was to obtain full payment. As it expressly found, "Elliott's primary goal in investing in Peruvian debt was to be paid in full." ... Moreover, the district court found that if the Debtors did not pay in full, it was Elliott's intent to sue for such payment. Thus, the district court quotes twice the statement of Singer, Elliott's president, that "Peru would either . . . pay us in full or be sued." ... The district court reasoned that Elliott's "investment strategy . . . to be paid in full or sue . . . equated to an intent to sue because [it] knew Peru would not, under the circumstances, pay in full." ... We cannot agree with the district court's equating of Elliott's intent to be paid in full, if necessary by suing, with the primary intent to sue prohibited by Section 489 as delineated by Moses and the related case law.

First, any intent on Elliott's part to bring suit against the Debtors was "incidental and contingent" as those terms are used in Moses and the New York case law. It was "incidental" because, as the district court acknowledges, Elliott's "primary goal" in purchasing the debt was to be paid in full. That Elliott had to bring suit to achieve that "primary goal" was therefore "incidental" to its achievement. Elliott's suit was also "contingent" because, had the Debtors agreed to Elliott's request for the money that the district court found Elliott was owed under the Letter Agreements and the Guaranty, then there would have been no lawsuit. Elliott's intent to file suit was therefore contingent on the Debtors' refusal of that demand. Although the district court found that Elliott "knew Peru would not, under the circumstances, pay in full," ... this does not make Elliott's intent to file suit any less contingent. As acknowledged by counsel at oral argument, the Debtors could have paid but chose not to pay in order to avoid jeopardizing Peru's Brady Plan.

Second, Moses specifically states that conduct not proscribed by the statute includes where "the plaintiff bought the bond as an investment, but with the intention of collecting it by suit if compelled to resort to that means for obtaining payment." ... Indeed, Moses categorically declares that purchase of debt obligations "is not made illegal by the existence of the intent on [the purchaser's] part at the time of the purchase, which must always exist in the case of such purchases, to bring suit upon them if necessary for their collection." .... As found by the district court, this was Elliott's intent here. Indeed, the district court characterizes Elliott's intent as "to be paid in full or sue."... This is precisely the intent that the Court of Appeals in Moses determined to be clearly not prohibited by the statute. Thus, here, Elliott possessed "a legitimate business purpose . . . [because Section 489] is 'violated only if the primary purpose of taking the assignment was to commence a suit' and not 'where some other purpose induced the purchase, and the intent to sue was merely incidental and contingent.'" Limpar ... Like that of the plaintiff in Limpar, Elliott's primary purpose in acquiring the debt was a "legitimate business purpose," ... in this case: turning a profit, rather than a collateral purpose prohibited by Section 489, as construed.

As is often the case in complex and well-argued appeals such as this, there are competing policy interests at stake. However, in Pravin Banker Associates, Ltd. v. Banco Popular del Peru, 109 F.3d 850 (2d Cir. 1997), another appeal involving an enforcement action on Peruvian sovereign debt, this court set forth and reconciled those differing interests. Although the Pravin Banker analysis was made in the context of a comity determination and so examined the interests of the United States rather than New York, those interests are equally applicable to New York's interests as a global financial center in the context of interpreting Section 489. As the court reasoned:

First, the United States encourages participation in, and advocates the success of, IMF foreign debt resolution procedures under the Brady Plan. Second, the United States has a strong interest in ensuring the enforceability of valid debts under the principles of contract law, and in particular, the continuing enforceability of foreign debts owed to United States lenders. This second interest limits the first so that, although the United States advocates negotiations to effect debt reduction and continued lending to defaulting foreign sovereigns, it maintains that creditor participation in such negotiations should be on a strictly voluntary basis. It also requires that debts remain enforceable throughout the negotiations...

The district court's statutory interpretation here would appear to be inconsistent with this analysis. Rather than furthering the reconciled goal of voluntary creditor participation and the enforcement of valid debts, the district court's interpretation of Section 489 effectively forces creditors such as Elliott to participate in an involuntary "cram-down" procedure and makes the debt instruments unenforceable in the courts once the Bank Advisory Committee has reached an "agreement in principle" in the Brady negotiations. Undermining the voluntary nature of Brady Plan participation and rendering otherwise valid debts unenforceable cannot be considered to be in New York's interest, as made plain by this court in Pravin Banker.

Given the mandate that "whenever possible, statutes should be interpreted to avoid unreasonable results," ... we also take note of the unreasonable results that might ensue were we to accept the district court's interpretation of Section 489. While the district court's rule might benefit the Debtors in the short run, the long term effect would be to cause significant harm to Peru and other developing nations and their institutions seeking to borrow capital in New York. The district court's interpretation would mean that holders of debt instruments would have substantial difficulty selling those instruments if payment were not voluntarily forthcoming. This would therefore add significantly to the risk of making loans to developing nations with poor credit ratings. The additional risk would naturally be reflected in higher borrowing costs to such nations. It could even make loans to some of them unobtainable in New York. A well-developed market of secondary purchasers of defaulted sovereign debt would thereby be disrupted and perhaps destroyed even though its existence provides incentives for primary lenders to continue to lend to high-risk countries.

The interpretation posited by the district court would also create "a perverse result" because it "would permit defendants to create a champerty defense by refusing to honor their loan obligations." Banque de Gestion Privee-SIB v. La Republica de Paraguay, 787 F. Supp. 53, 57 (S.D.N.Y. 1992). An obligor could simply declare unwillingness to pay, thereby making it plain that no payment would be received without suit. Under such circumstances, prospective purchasers would not be able to acquire the debt instruments without opening themselves up to the defense that their purchase or assignment necessarily was made "with the intent and for the purpose of bringing an action or proceeding thereon," as barred by Section 489. The risk that a debtor might seek to manufacture such a defense by making such a public pronouncement could be expected to add significantly to the cost of borrowing in New York.

Although all debt purchases would be affected by the district court's expansive reading of Section 489, high-risk debt purchases would be particularly affected because of the increased likelihood of non-payment in such transactions leading to the likely necessity of legal action to obtain payment. As ably pointed out by Elliott and the various amici curiae, such increased risks could be expected to increase the costs of trading in high-risk debt under New York law and thereby encourage potential parties to such transactions to conduct their business elsewhere. Moreover, the increased risks are particularly onerous because they premise the validity of the transaction on no more than the buyer's subjective intent, which intent is not always readily ascertainable by the seller, and can only be conclusively resolved by ex post facto litigation. While the Debtors argue that the district court's interpretation of Limpar creates an "on-going dispute safe harbor" that would limit these effects, as explained above we do not find this interpretation of Limpar compelling and, in any event, such a safe harbor would not eliminate the enhanced risks but merely reduce them...

We hold that, in light of the pertinent New York precedent and compelling policy considerations, the district court erroneously interpreted Section 489 of the New York Judiciary Law. In particular, we hold that Section 489 is not violated when, as here, the accused party's "primary goal" is found to be satisfaction of a valid debt and its intent is only to sue absent full performance. Given that, notwithstanding the Section 489 issue, the district court found the Letter Agreements and Guaranty to have been breached by the Debtors, we remand only for the purpose of calculating damages more accurately than the approximate figures given in the district court's opinion and the possible resolution of other attendant damages-related issues.

The New York champerty statute at issue in these cases became an issue in more recent litigation arising out of securitization transactions where the Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors, Inc. Mortgage Pass-through Certificates sued a loan originator for breach of a contractual provision in which the originator, Love Funding, had represented that the conveyed mortgage notes contained no default, breach, violation, or event of acceleration. Love Funding countered with a champerty defense. In a decision in January 2010, after a remand to the New York Court of Appeals,[59] the Second Circuit found that the transaction was not champertous.[60] But the case does illustrate that there has been some persistent uncertainty about the application of the statute (and I am also including the decision because it describes some features of the securitization process):

Trust v. Love Funding

Because of ambiguities in the scope of New York's statutory proscription of champerty, see N.Y. Judiciary Law § 489, we certified certain questions to the New York Court of Appeals... Having received the Court of Appeals' response, see Trust v Love Funding, 13 N.Y.3d 190 ...(2009), we now conclude, as a matter of law, that the trial record does not permit a finding of champerty...

In April 1999, Love Funding entered into a "conduit lending" arrangement with Paine Webber, which was memorialized in an April 23, 1999 mortgage loan purchase agreement (the "Love MLPA"). Under the Love MLPA, Love Funding represented to Paine Webber that no underlying mortgage loan was in default. In the event that Love Funding breached this, or any other, representation, the Love MLPA provided for certain remedies, including the "repurchase [of the] Mortgage Loan at the Repurchase Price," .. and indemnification "from and against all demands, claims or asserted claims, liabilities or
asserted liabilities, costs and expenses, including reasonable attorneys' fees, incurred by an Indemnified Party, in

[59] See Trust v. Love Funding 556 F.3d 100, 114 (2d Cir. 2009); Trust v Love Funding 918 N.E.2d 889 (Court of Appeals, NY 2009).

[60] Trust v. Love Funding 591 F.3d 116 (2d. Cir. 2010).

any way arising from or related to any breach of any representation, warranty, covenant or agreement . . . hereunder," ..

In July 1999, pursuant to the Love MLPA, Love Funding arranged a $6.4 million mortgage loan (the "Arlington Loan") to Cyrus II Partnership ("Cyrus"), which was secured by a mortgage on Louisiana property known as the Arlington Apartments. On November 1, 1999, Paine Webber sold and assigned 36 loans, including the Arlington Loan, to Merrill Lynch Mortgage Investors, Inc. ("Merrill Lynch"), pursuant to the Merrill Lynch mortgage loan purchase agreement (the "Merrill Lynch MLPA"). In the Merrill Lynch MLPA, Paine Webber represented, as Love Funding had in the Love MLPA, that none of the mortgage loans was in default.

The loans were then securitized through a process that involved the creation of the plaintiff Trust. On November 1, 1999, Merrill Lynch assigned to the Trust all of its "right[s], title and interest . . . in, to and under (i) the Mortgage Loans [including the loans sold by Paine Webber], (ii) each Mortgage Loan Purchase Agreement and (iii) all other assets included or to be included" in the Trust. .. Commercial mortgage-backed securities, entitling their holders to interest payments generated on the underlying mortgages including the Arlington Loan, were then issued and sold to investors.

B. Arlington Loan Default and Resulting Litigation

On March 8, 2002, the Trust declared the Arlington Loan to be in default and accelerated payment on the full amount of the loan. The Trust then commenced a mortgage foreclosure action in Louisiana state court, securing a ruling that Cyrus had committed fraud to obtain the Arlington Loan and that such fraud constituted an event of default. As a consequence, the Arlington Apartments were sold for approximately $6.5 million in net proceeds, of which the Trust received $5.9 million. The Trust also obtained a judgment of more than $10 million against Cyrus and its principals. In September and October 2002, the Trust brought several actions against UBS related to the sale of loans by Paine Webber to the Trust. With respect to the Arlington Loan, the Trust's theory was that, because Cyrus's fraud put the Arlington Loan in default from the outset, Paine Webber (and, therefore, its successor UBS) necessarily breached its
representation in the Merrill Lynch MLPA that "there is no material default." ... On September 13, 2004, after two years of vigorous litigation, the Trust and UBS reached a settlement releasing the Trust's claims as to 33 loans. While UBS paid the Trust $19.375 million in consideration for releases on 32 loans, the sole consideration for the Trust's release on the Arlington Loan was UBS's assignment of its
rights under the Love MLPA.

C. District Court Proceedings

In November 2004, the Trust commenced this action against Love Funding for breach of the Love MLPA. On October 11, 2005, the district court granted summary judgment in favor of the Trust on its claim that Love Funding had breached its representation that the Arlington Loan was not in default; nevertheless, it allowed Love Funding to amend its answer to assert the affirmative defense of champerty.

On February 27, 2007, after a bench trial, the district court ruled that Love Funding had proved champerty because "the Trust's primary purpose in accepting the Assignment was to buy a lawsuit against Love Funding." ... The district court relied on the fact that the Trust "carve[d] out . . . a single loan from a group of loans that were settled," ... and thereby "negotiated for itself 'a whole new lawsuit,' with the intent to 'basically . . . continu[e] a microcosm of the litigation that ha[d] already been going on for the last three years with UBS,'"... In reaching this conclusion, the district court further found that the Trust was motivated by a perception that it could recover more on the Arlington Loan by suing Love Funding than by pursuing a cash settlement because it would be able to recoup "millions of dollars in simple and default interest that have been accruing on the loan for years" and because it "could also potentially recover indemnification damages." ...

D. Certification of Questions to the New York Court of Appeals

On appeal, the Trust argued that New York's champerty law did not apply to this lawsuit because the relevant statute "was never intended to prohibit assignments in complex commercial transactions where the assignee has a substantial interest at stake." ... Recognizing ambiguities in New York law, we certified the following questions to the New York Court of Appeals:

1. Is it sufficient as a matter of law to find that a party accepted a challenged assignment with the "primary" intent proscribed by New York Judiciary Law § 489(1), or must there be a finding of "sole" intent?

2. As a matter of law, does a party commit champerty when it "buys a lawsuit" that it could not otherwise have pursued if its purpose is thereby to collect damages for losses on a debt instrument in which it holds a pre-existing proprietary interest?

3. (a) As a matter of law, does a party commit champerty when, as the holder of a defaulted debt obligation, it acquires the right to pursue a lawsuit against a third party in order to collect more damages through that litigation than it had demanded in settlement from the assignor?

(b) Is the answer to question 3(a) affected by the fact that the challenged assignment enabled the assignee to exercise the assignor's indemnification rights for reasonable costs and attorneys' fees?...

E. New York Court of Appeals' Response

The New York Court of Appeals accepted our certification and answered the second question and both parts of the third question in the negative, rendering it unnecessary to answer our first inquiry.... In responding to our second question, the Court of Appeals emphasized that New York's prohibition of champerty "has always been 'limited in scope and largely directed toward preventing attorneys from filing suit merely as a vehicle for obtaining costs.'" ... The Court of Appeals distinguished between "acquiring a thing in action in order to obtain costs," which constitutes champerty, "and acquiring it in order to protect an independent right of the assignee," which does not.... "[I]f a party acquires a debt instrument for the purpose of enforcing it, that is not champerty simply because the party intends to do so by litigation." .... Noting our observation that the Trust had a preexisting proprietary interest in the Arlington Loan, the Court of Appeals concluded that, "[i]f, as a matter of fact, the Trust's purpose in taking assignment of UBS's rights under the Love MLPA was to enforce its rights, then, as a matter of law, given that the Trust had a preexisting proprietary interest in the loan, it did not violate Judiciary Law § 489(1)."...

Our third question asked whether the Trust's intent either to recover more in damages from a lawsuit than from a potential settlement or to be indemnified for reasonable costs and attorneys' fees evidenced champerty. The New York Court of Appeals concluded that it did not.

To acquire indemnification rights to the costs of past litigation is not to acquire a thing in action in order to obtain costs from prosecution thereon. Similarly, no New York case has been brought to our attention that stands for the proposition that it is champerty to settle a dispute by accepting a transfer of rights that has the potential for a larger recovery than one had demanded as a cash settlement...

II. Discussion

Upon receipt of the New York Court of Appeals' response, the parties filed supplemental papers with this court in which they effectively agree that the district court – operating without the benefit of the Court of Appeals' recent explication of New York champerty law – applied a more expansive definition of champerty than was warranted. Love Funding urges us to remand the case to allow the district court to determine whether it nevertheless still finds champerty proved under the standard set forth in the Court of Appeals' response decision. The Trust on the other hand argues for reversal, submitting that, as a matter of law, the record will not permit a finding of champerty. We agree with the latter argument and accordingly reverse the challenged judgment in favor of Love Funding.

A. The New York Court of Appeals' Decision Effectively Rejects the District Court's Finding of Champerty

New York's statutory prohibition against champerty states, in pertinent part: [N]o corporation or association, directly or indirectly, itself or by or through its officers, agents or employees, shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of a bond, promissory note, bill of exchange, book debt, or other thing in action, or any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon . . . . N.Y. Judiciary Law § 489(1). The district court found that the challenged assignment violated this statute because "the Trust's primary purpose in accepting the Assignment was to buy a lawsuit against Love Funding." ...

In answering our second certified question, however, the New York Court of Appeals clarified that such an intent to sue is insufficient, by itself, to violate the statute. As the Court of Appeals explained, New York's champerty statute "does not apply when the purpose of an assignment is the collection of a legitimate claim." ... Thus, "if a party acquires a debt instrument for the purpose of enforcing it, that is not champerty simply because the party intends to do so by litigation." ... Applying these principles to this case, the Court of Appeals concluded that "if, as a matter of fact, the Trust's purpose in taking assignment of UBS's rights under the Love MLPA was to enforce its rights, then, as a matter of law, given that the Trust had a preexisting proprietary interest in the loan, it did not violate Judiciary Law § 489(1)." ... This effectively rejects the district court's finding of champerty.

B. Because the Trial Evidence Will Not Permit a Finding of Champerty, No Remand Is Warranted in this Case

Love Funding submits that the conditional language at the start of the last quoted passage from the Court of Appeals' decision signals a need to remand this case to permit the district court to resolve a previously unconsidered fact question: whether the Trust's intent in taking the UBS assignment of rights was, in fact, to enforce its interest in the Arlington Loan. Such a remand is warranted, however, only if the trial record presents sufficient evidence on the point to allow a factfinder to resolve it in favor of Love Funding, i.e., to find that the Trust intended to sue not to enforce rights under the Love MLPA, but rather to generate and recover the costs of such litigation.... That is not this case.

At the outset, we note that undisputed evidence establishes that, even before the challenged UBS assignment, the Trust had a significant interest in the repayment of the Arlington Loan. As this court observed in our prior decision, "[t]he Trust was not . . . a party with no interest in the loans that Love Funding had transferred to PaineWebber pursuant to the Love MLPA. To the contrary, as the end holder of the Arlington Loan, the Trust was the party that would directly suffer the damages of any default on that instrument." ... The district court recognized that, by accepting the challenged UBS assignment of rights under the Love MLPA, the Trust acquired the right directly to enforce the Arlington Loan. Nevertheless, the district court denominated the assignment champertous because it determined that the Trust intended from the start to pursue its rights through litigation in order to achieve the greatest possible recovery.... As already noted, the Court of Appeals has now clarified that an assignment "is not champert[ous] simply because the party intends to [enforce its rights] by litigation." ...

Love Funding thus shifts its argument to contend that, on remand, the district court might conclude that the Trust's purpose in accepting the UBS assignment was "not to enforce its interests in the Arlington Loan, but to engage in a speculative litigation venture against Love Funding to generate and recover costs and damages far greater than its actual Arlington losses." ... To be sure, litigation for the purpose of generating and then recovering costs is the essence of champerty under New York law.... But the record evidence will not support such a characterization where, as here, the challenged assignment allowed the Trust directly to enforce its pre-existing interest in the Arlington Loan. Love Funding asserts that an inference of champerty can be drawn from the fact that the Trust originally estimated its losses from the Arlington Loan at $3 million. After assignment of UBS's interests, however, the Trust demanded that Love Funding cure its breaches or repurchase the loan for $10 million. The discrepancy is understandable. With UBS's rights under the Love MLPA, the Trust acquired claims to indemnification as well as to actual loan losses. Even if the $10 million demand was excessive under the Love MLPA, however, that fact cannot by itself demonstrate that the Trust's intent was to employ litigation to profit from the costs and fees generated therein rather than to recoup "the full value of its . . . contractual claims." ... As the New York Court of Appeals explained in response to our certified questions, it is not champerty "to settle a dispute by accepting a transfer of rights that has the potential for a larger recovery than one had demanded as a cash settlement." ...

To the extent Love Funding insists that the Trust's champertous purpose is evidenced by its efforts to use this action to recover litigation costs and fees previously incurred by itself and UBS in connection with the disputed loans, Love Funding conflates litigation instituted for the purpose of generating costs therein, which constitutes champerty, and litigation to enforce contract rights to previously incurred costs, which is effectively an action on a debt instrument.... The Court of Appeals recognized as much in specifically rejecting Love Funding's argument that the Trust's intent to sue Love Funding "not only to be made whole on losses sustained from the Arlington Loan default, but also to profit from the past litigation" evidenced champerty. ... It explained that it is not champerty "to acquire . . . indemnification rights for reasonable costs and fees that were incurred in past legal actions."... In short, even if the Trust's entitlement to previously incurred costs and fees under the Love MLPA is sufficiently debatable to view that part of its pending claim as a "speculative litigation venture," ... the Trust's acquisition and pursuit of that claim cannot evidence champerty.

In expressing concern about the Trust's litigation to recover "millions of dollars more than the Trust had been prepared to accept from UBS on the Arlington Loan," the district court referenced only the "interest that [has] been accruing on the loan for years" and "indemnification damages from Love Funding under . . . the Love MLPA," ... neither of which can support a champerty finding in light of the Court of Appeals' responsive decision ... The district court made no finding that the Trust intended to generate new costs in this litigation. Because such cost-generation was the essence of champerty even at the time of the district court's decision ... we can hardly conclude that the district court inadvertently neglected to make such a critical finding while instead reaching for a broader construction of champerty. Because the record does not support a finding of intent to generate new costs, we conclude that remand for further factfinding is unnecessary in this case. Love Funding's champerty defense fails as a matter of law.

What scope remains for borrowers and issuers of debt securities to invoke champerty defenses after this decision? These materials have focused on issues associated with investments in assets where the prospect for a return on the assets depends on litigation. It is worth noting that litigation funding also involves issues.[61]

THE PARI PASSU CLAUSE IN BOND DOCUMENTATION

Collective action clauses may constrain bondholders from holding out in a restructuring by depriving them of the possibility of recourse through litigation. Investors have also looked to the pari passu clause as the basis for arguing that issuers should not treat some bondholders better than others by making full payment to holdout creditors when other creditors have accepted the terms of a restructuring, and even that this pari passu constraint operates on creditors and not just on the borrower. Here is an example of a pari passu clause:

> The Notes rank, and will rank, pari passu in right of payment with all other present and future unsecured and unsubordinated External Indebtedness of the Issuer.[62]

The clause was traditionally interpreted as restricting borrowers/issuers from incurring new obligations that would rank more highly than the obligations to which the clause applied, but recently investors have argued that it should be interpreted to apply not just to the creation of new obligations but to payments of money to other creditors more generally. Buchheit and Pam suggest that the pari passu clause became a feature of unsecured loan agreements with sovereign borrowers because in some jurisdictions there was a risk that other debts might end up taking precedence over the loan.[63]

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[61] *See, e.g.*, Christopher Hodges, John Peysner and Angus Nurse, Litigation Funding: Status and Issues (Jan. 2012) at http://www.csls.ox.ac.uk/documents/ReportonLitigationFunding.pdf

[62] Lee C. Buchheit, Jeremiah S. Pam, The *Pari Passu* Clause in Sovereign Debt Instruments, 1 (Working Paper 2003).

[63] Id. at 26-7

Buchheit and Pam identify other purposes of the clause:

"We now come to the most intriguing question of all: what motivated modern drafters to include a pari passu provision (of the "pari passu in priority of payment" variety) in their unsecured credit instruments with sovereign borrowers. The motivation must have been something other than a desire to protect the lender against involuntary subordination in bankruptcy, for the simple reason that sovereigns are not subject to bankruptcy regimes.

Our research suggests that had they been asked at the time (the 1970s onward) to justify the presence of a pari passu clause in an unsecured cross-border credit instrument with a sovereign borrower, contract drafters would have given three reasons: a lingering concern about the earmarking of assets, the danger that a foreign sovereign decree altering the legal ranking of existing debts might be given effect by a court outside of the debtor country and the risk of involuntary subordination through action by another lender. The opacity of the clause is explained by the fact that in the minds of the early Euromarket drafters, it was intended to protect lenders against all three, very different, risks. They thus saw a positive virtue in the vagueness of the phrase "pari passu in priority of payment."

As the decades moved on, one of these concerns (earmarking) was addressed through an expanded negative pledge clause in most cross-border credit instruments. A second risk (the effect of sovereign decrees) was addressed by judicial decisions. But the third (involuntary subordination through action by another lender) remains a serious concern for the cross-border lender, and the pari passu clause persists as the contractual mitigant for that risk."[64]

Buchheit and Pam do not find support in the history of the clause for the interpretation that some investors have argued for recently:

"...how could a fallacious interpretation of a boilerplate clause -- without a basis in law, or practice or commentary -- have taken even a shallow root in the minds of some market participants?....We believe that the ratable payment interpretation of the pari passu clause had an intuitive, almost an emotional, appeal to some people because it only seems fair that debtors not discriminate among similarly-situated creditors when faced with financial difficulties. And if a practice of differential payments just feels wrong, these people reasoned, then surely there must be something in the underlying instruments that forbids it? When a thorough search of the underlying instruments turned up no express prohibition against the making of differential payments, the last resort was to read such a prohibition into ...the pari passu clause.

The truth is that creditors do sometimes worry about cash-strapped borrowers discriminating among similarly-situated creditors in terms of payments and, when they do, there are a variety of documentary techniques for dealing with the problem. For example

• Sharing clauses are a nearly invariable feature of syndicated commercial bank loan agreements. The clauses were motivated by a concern that participating banks without an on-going business relationship with the borrower might be the first to feel a payment default, while the borrower's "house" banks continued to be paid. The sharing clause constitutes an intercreditor agreement among the banks in the syndicate to share any disproportionate payments or recoveries among themselves on a ratable basis.

• In many bond issues (including all publicly-issued corporate bond issues in the United States), the securities are

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[64] Id. at 31

issued pursuant to a trust indenture (in English practice, a trust deed). The trustee is obliged to distribute all payments or recoveries among bondholders on a strictly ratable basis. Indeed, in U.S. trust indenture practice most, and in English practice all enforcement actions against the borrower are centralized in the trustee so that the goal of ratable sharing of recoveries is preserved.
• Many project finance transactions, where several different types of lenders participate, call for an intercreditor agreement among the lenders to ensure ratable sharing of payments and losses.
• Intercreditor agreements are also frequently used in corporate debt workouts where the parties wish to keep the borrower out of a formal bankruptcy proceeding. Equal treatment of similar-situated creditors is, of course, a fundamental premise of most bankruptcy systems. Creditors desiring to replicate this feature in an out-of-court debt workout can do so by means of an intercreditor agreement that provides for ratable sharing of payments or recoveries.
• Subordination agreements are the instruments of choice when lenders to the same borrower want to establish legally-enforceable priorities that will take effect in, and sometimes out of, bankruptcy. These agreements come in many different varieties, but they all have one thing in common: they establish contractual payment priorities among creditors that would otherwise have equally-ranking claims against the borrower....”[65]

An argument that a pari passu clause could operate as a constraint on creditors requiring them, to ensure that other creditors were receiving payment when they did was rejected in the Southern District of New York in 2003 in *Nacional Financiera, S.N.C.* v. *Chase Manhattan Bank*:[66]

“Presently before the Court is a motion by the Smith Parties to amend their pleadings to assert counterclaims against Nafin for breach of contract and unjust enrichment. They allege that they own $ 9.5 million in notes issued by Tribasa under its Global Medium Term Note Program ...which was governed by a Fiscal Agency Agreement...between Tribasa, Triturades Basoltices y Derivades, S.A. de C.V. as the notes' guarantor and Chemical Bank (now JPMorgan Chase) as Fiscal Agent. They allege further that after Tribasa defaulted on their notes it issued short-term notes to Nafin under the MTN program and thereafter made payments on those notes to Nafin and provided it security that was not provided to other note holders. They contend that these actions were in violation of the FAA which provides:

> Ranking of the Notes and Guarantees. The Notes will be general unsecured and unsubordinated obligations of the Company and will rank pari passu with each other and with all other present and future unsecured and unsubordinated indebtedness of the Company ...

The problem with the Smith Parties' argument is that the above quoted provision did not create contractual rights and obligations between Nafin and the other holders of Tribasa's unsecured notes. The above provision does no more than guarantee that in any insolvency proceedings, all of the MTN creditors will share pari passu in the unencumbered assets of the estate. There is nothing in the language of the provision that would suggest that before

[65] Id. at 36-7 (footnoted omitted)

[66] 2003 U.S. Dist. LEXIS 6160

accepting payment from Tribasa, Nafin had an obligation to ensure itself that other note holders were receiving similar payments.

It may be that the FAA would have given the Smith Parties the right to obtain an injunction to bar Tribasa from making preferential payments to some of its note holders and that another note holder with notice of that injunction could be liable to Tribasa if it thereafter accepted preferential payments. See Elliot Assocs., L.P. v. Banco de la Nacion, General Docket No. 2000/QR/92 (Court of Appeals of Brussels, 8th Chamber, Sept. 26, 2000). But absent such an injunction, the FAA created no obligation on any note holder to refuse payment of money that it was owed until it had received assurances that other note holders were receiving proportionate payments."

The UK's Financial Markets Law Committee looked at the pari passu issue and wrote:

Recently an.. interpretation has found favour in court decisions in California and Belgium.. that the clause in effect requires that, once the debtor is actually insolvent, the debtor will in fact pay all its claims pro rata and could thus be prevented from paying one creditor in full if the obligations concerned went unpaid.

This report asserts that, so far as English law is concerned, the wide "payment" interpretation is incorrect and that the "ranking" interpretation is the proper construction. There are three reasons which support this assertion:

• The principal reason is that the "payment" interpretation would not be acceptable to debtors and indeed to creditors, and would be unworkable. In short, it would offend the "business commonsense" principle used by English courts when construing a contract. In particular, it would lead to the result that once the debtor actually became insolvent the debtor would not be able to make any ordinary course of business payments necessary to enable the debtor to maintain its business. Hold-out creditors in pursuit of a bargaining position against other creditors could prevent payments and bring the business to a premature halt. An action of this type could be used to seriously disrupt payment systems through which the debtor made its payments and securities settlement systems through which the debtor paid for investments. Hence if the payment interpretation were correct, the pari passu clause would be prejudicial not only to debtors but also to creditors by making it impracticable for all creditors to sustain the debtor's business if only one of them objected.

• Another reason is based on the principles of English rules of contract construction that the words used be given their ordinary and natural meaning and that they should be considered in the context of the entire transaction. The language itself on the most literal interpretation requires a "rank" of the claims, i.e. a legal rank. It does not require pari passu "payment". In addition, other provisions are typically found in debt obligations which do require equal payment and this suggests that the pari passu clause was not intended to require equal payment.

• The final reason is based on an analysis of English case law which provides persuasive authority against the payment interpretation.[67]

Note that it is possible to specify by contract that creditors who are parties to a particular contract will not

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[67] Financial Markets Law Committee, Issue 79 – Pari Passu Clauses (March 2005) *available at* http://www.fmlc.org/papers/fmlc79mar_2005.pdf .

seek to put themselves in a better position than other creditors or that they will share any benefit they obtain with other creditors.

In one of the lawsuits against Argentina investors invoked the pari passu clause:

NML Capital v. Republic of Argentina (2nd. Cir. Oct. 26, 2012)[68]

In 1994, Argentina began issuing debt securities pursuant to a Fiscal Agency Agreement ("FAA Bonds"). A number of individual plaintiffs-appellees bought FAA Bonds starting around December 1998. The remaining plaintiffs-appellees, hedge funds and other distressed asset investors, purchased FAA Bonds on the secondary market at various times and as recently as June 2010.1 The coupon rates on the FAA Bonds ranged from 9.75% to 15.5%, and the dates of maturity ranged from April 2005 to September 2031.

The FAA contains provisions purporting to protect purchasers of the FAA Bonds from subordination. The key provision, Paragraph 1(c) of the FAA, which we refer to as the "Pari Passu Clause," provides that:

> [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 .

.. ("External Indebtedness" is limited to obligations payable in non-Argentine currency..We refer to the second sentence of the Pari Passu Clause as the "Equal Treatment Provision." Following the 2001 default on the FAA Bonds, Argentina offered holders of the FAA Bonds new exchange bonds in 2005 and 2010 (the "Exchange Bonds"). Argentina continued to make payments to holders of those Exchange Bonds while failing to make any payments to persons who still held the defaulted FAA Bonds.

After Argentina defaulted, its President in December 2001 declared a "temporary moratorium" on principal and interest payments on more than $80 billion of its public external debt including the FAA Bonds. Each year since then, Argentina has passed legislation renewing the moratorium and has made no principal or interest payments on the defaulted debt. Plaintiffs estimate that, collectively, their unpaid principal and prejudgment interest amounts to approximately $1.33 billion.

The plaintiffs allege that Argentina's conduct violated the Pari Passu Clause by both subordinating their FAA Bonds to the Exchange Bonds and lowering the ranking of their FAA Bonds below the Exchange Bonds. The primary issues on appeal are whether Argentina violated the Pari Passu Clause, and if so, whether the remedy the district court ordered was appropriate.

Argentina's Restructurings

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[68] *See* http://www.zerohedge.com/news/2012-10-31/elliott-management-vs-argentina-round-2-now-its-personal.

In 2005, Argentina initiated an exchange offer in which it allowed FAA bondholders to exchange their defaulted bonds for new unsecured and unsubordinated external debt at a rate of 25 to 29 cents on the dollar. In exchange for the new debt, participants agreed to forgo various rights and remedies previously available under the FAA. To induce creditors to accept the exchange offer, Argentina stated in the prospectus under "Risks of Not Participating in [the] Exchange Offer" the following:

> Existing defaulted bonds eligible for exchange that are not tendered may remain in default indefinitely. As of June 30, 2004, Argentina was in default on approximately U.S. $102.6 billion of its public indebtedness . The Government has announced that it has no intention of resuming payment on any bonds eligible to participate in [the] exchange offer . that are not tendered or otherwise restructured as part of such transaction. Consequently, if you elect not to tender your bonds in an exchange offer there can be no assurance that you will receive any future payments in respect of your bonds....

That same year, in order to exert additional pressure on bondholders to accept the exchange offer, the Argentine legislature passed Law 26,017 (the "Lock Law") declaring that:

> Article 2—The national Executive Power may not, with respect to the bonds ., reopen the swap process established in the [2005 exchange offer].
>
> Article 3—The national State shall be prohibited from conducting any type of in-court, out-of-court or private settlement with respect to the bonds.
>
> Article 4—The national Executive Power must . remove the bonds . from listing on all domestic and foreign securities markets and exchanges.

The 2005 exchange offer closed in June 2005 with a 76% participation rate, representing a par value of $62.3 billion. Plaintiffs did not participate.

In 2010, Argentina initiated a second exchange offer with a payment scheme substantially identical to the 2005 offer. To overcome the Lock Law's prohibition against reopening the exchange, Argentina temporarily suspended the Lock Law (the "Lock Law Suspension") Like the 2005 prospectus, the 2010 exchange offer prospectus also warned of "Risks of Not Participating in the [2010 restructuring]":

> Eligible Securities that are in default and that are not tendered may remain in default indefinitely and, if you elect to litigate, Argentina intends to oppose such attempts to collect on its defaulted debt.
>
> Eligible Securities in default that are not exchanged pursuant to the Invitation may remain in default indefinitely. In light of its financial and legal constraints, Argentina does not expect to resume payments on any Eligible Securities in default that remain outstanding following the expiration of the Invitation. Argentina has opposed vigorously, and intends to continue to oppose, attempts by holders who did not participate in its prior exchange offers to collect on its defaulted debt through . litigation . and other legal proceedings against Argentina. Argentina remains subject to significant legal constraints regarding its defaulted debt.
>
> Consequently, if you elect not to tender your Eligible Securities in default pursuant to the Invitation there can be no assurance that you will receive any future payments or be able to collect through litigation in respect of your Eligible Securities in default.

..As with the 2005 exchange offer, plaintiffs did not participate in the 2010 restructuring. After the two exchange offers, Argentina had restructured over 91% of the foreign debt on which it had defaulted in 2001.

An important new feature of the Exchange Bonds was that they included “collective action” clauses. These clauses permit Argentina to amend the terms of the bonds and to bind dissenting bondholders if a sufficient number of bondholders (66 2/3% to 75% of the aggregate principal amount of a given series) agree. With the inclusion of collective action clauses, the type of “holdout” litigation at issue here is not likely to reoccur.

Argentina has made all payments due on the debt it restructured in 2005 and 2010. Under the indentures for the 2005 and 2010 Exchange Bonds, Argentina makes principal and interest payments to a trustee in Argentina that in turn makes an electronic funds transfer (“EFT”) to U.S.-registered exchange bondholders. The EFTs are made from the trustee's non-U.S. bank to the registered holder's U.S. bank, often routed through one or more intermediary banks.

Proceedings Below

Plaintiffs sued Argentina on the defaulted FAA Bonds at various points from 2009 to 2011, alleging breach of contract and seeking injunctive relief, including specific performance of the Equal Treatment Provision. The FAA is governed by New York law and further provides for jurisdiction in “any state or federal court in The City of New York.” ... However, Argentina's courts have held that the Lock Law and the moratoria on payments prevent them from recognizing New York judgments regarding the FAA Bonds. In SEC filings, Argentina has stated that it has classified unexchanged FAA Bonds as a category separate from its regular debt and that, since 2005, it has “not [been] in a legal . position to pay” that category. ..

In December 2011, the district court granted plaintiffs partial summary judgment (the “Declaratory Orders”). The court observed that the Republic violates the Equal Treatment Provision “whenever it lowers the rank of its payment obligations under [plaintiffs'] Bonds below that of any other present or future unsecured and unsubordinated External Indebtedness.” The district court then held that Argentina “lowered the rank” of plaintiffs' bonds in two ways: (1) “when it made payments currently due under the Exchange Bonds, while persisting in its refusal to satisfy its payment obligations currently due under [plaintiffs'] Bonds” and (2) “when it enacted [the Lock Law] and [the Lock Law Suspension].” ..As the court explained:

> it's hard for me to believe that there is not a violation of the [Equal Treatment Provision] accomplished by the congressional legislation in ‘05 and ‘10, simply saying that the Republic will not honor these judgments. It is difficult to imagine anything would reduce the rank, reduce the equal status or simply wipe out the equal status of these bonds under the [Equal Treatment Provision] [more than the Lock Law and the Lock Law Suspension]. [The Equal Treatment Provision] can't be interpreted to allow the Argentine government to simply declare that these judgments will not be paid, and that's what they have done...

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

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

The District Court's Injunctions

In February 2012, the district court granted injunctive relief, ordering Argentina to specifically perform its obligations under the Equal Treatment Provision (the "Injunctions")... The Injunctions provide that "whenever the Republic pays any amount due under the terms of the [exchange] bonds," it must "concurrently or in advance" pay plaintiffs the same fraction of the amount due to them (the "Ratable Payment"). We are unable to discern from the record precisely how this formula is intended to operate. It could be read to mean that if, for example, Argentina owed the holders of restructured debt $100,000 in interest and paid 100% of that amount then it would be required to pay the plaintiffs 100% of the accelerated principal and all accrued interest. Or it could be read to mean that, if such a $100,000 payment to the exchange bondholders represented 1% of the principal and interest outstanding on the restructured debt, then Argentina must pay plaintiffs 1% of the amount owed to them. We cannot tell precisely what result the district court intended. On remand the district court will have the opportunity to clarify precisely how it intends this injunction to operate.

Anticipating that Argentina would refuse to comply with the Injunctions and in order to facilitate payment, the district court ordered that copies of the Injunctions be provided to "all parties involved, directly or indirectly, in advising upon, preparing, processing, or facilitating any payment on the Exchange Bonds." These could include Argentina's agent-banks located in New York that hold money in trust for the exchange bondholders and process payments to them under the terms of those bonds. Under Rule 65(d)(2), parties, their "officers, agents, servants, employees, and attorneys," as well as "other persons who are in active concert or participation with" them, are bound by injunctions. Furthermore, the Injunctions expressly prohibit Argentina's agents from

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

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

In justifying the remedy ordered, the court reasoned that

> [a]bsent equitable relief, [plaintiffs] would suffer irreparable harm because the Republic's payment obligations to [plaintiffs] would remain debased of their contractually-guaranteed status, and [plaintiffs] would never be restored to the position [they were] promised that [they] would hold relative to other creditors in the event of default.

... Further, there was no adequate remedy at law "because the Republic has made clear—indeed, it has codified in [the Lock Law] and [the Lock Law Suspension]—its intention to defy any money judgment issued by this Court."... The court further reasoned that the balance of the equities tipped in plaintiffs' favor because of (1) Argentina's "unprecedented, systematic scheme of making payments on other external indebtedness, after repudiating its payment obligations to Plaintiffs, in direct violation of" the Equal Treatment Provision and (2) Argentina's ability to "violate [that Provision] with impunity" in the absence of injunctive relief. ..The district court also stated that "if there was any belief that the Republic would honestly pay its obligations, there wouldn't be any need for these kinds of paragraphs" in the Injunctions... The court noted that the Injunctions "require[ ] of [Argentina] only that which it promised Plaintiffs and similarly situated creditors to induce those creditors to purchase [Argentina's] bonds." The court further observed that Argentina now "has the financial wherewithal to meet its commitment of providing equal treatment to [plaintiffs] and [to the exchange bondholders].".. As to the exchange bondholders, the Injunctions do not "jeopardiz[e] [their] rights" because "all that the Republic has to do" is "honor its legal obligations." .. Finally,

> [t]he public interest of enforcing contracts and upholding the rule of law will be served by the issuance of th[ese] [Injunctions], particularly here, where creditors of the Republic have no recourse to bankruptcy regimes to protect their interests and must rely upon courts to enforce contractual promises. No less than any other entity entering into a commercial transaction, there is a strong public interest in holding the Republic to its contractual obligations....

Argentina's Appeal from the Injunctions

In March 2012, Argentina timely appealed from the Injunctions and the Declaratory Orders. We have jurisdiction over the Injunctions under 28 U.S.C. § 1292(a)(1). The Declaratory Orders are also properly before us because they are "inextricably intertwined" with the Injunctions. Lamar Adver. of Penn, LLC v. Town of Orchard Park, N.Y., 356 F.3d 365, 371 (2d Cir.2004).

Argentina advances a host of reasons as to why the district court erred. First, the Republic argues that it has not violated the Equal Treatment Provision because it has not given the exchange bondholders a legally enforceable preference over the FAA Bonds in the event of default on the Exchange Bonds—even if it has favored the exchange bondholders by honoring their payment rights while violating plaintiffs'. Argentina contends that plaintiffs' bonds have always remained "direct, unconditional, unsecured and unsubordinated obligations of the Republic" with the same legal "rank" as any other debt—which is all the Equal Treatment Provision requires. .. In any event, even if the Provision had been violated, Argentina argues the contractually agreed upon remedy is acceleration, which has already occurred.

Second, Argentina argues that the Injunctions violate the FSIA by ordering the Republic to pay plaintiffs with immune property located outside the United States...

Third, the Republic contends that the assets the Injunctions restrain are not property of the Republic, but are held in trust for exchange bondholders, and therefore, under New York law, may not be reached by creditors. Moreover, the Injunctions, which by their terms apply to "indirect facilitators" of payments on the Exchange Bonds .. violate the U.C.C., which prohibits injunctive relief against "intermediary banks" responsible for processing fund transfers. U.C.C. § 4–A–503 cmt. Since subjecting exchange bondholder money to process in U.S. courts is improper, Argentina argues, the court erroneously restricted it from utilizing other methods to service its debt.

Fourth, because the only harm plaintiffs suffer is monetary, Argentina argues that the district court incorrectly concluded that such harm was irreparable.

Fifth, Argentina argues that the hardship to exchange bondholders and to the Republic stemming from the Injunctions far outweighs the purported prejudice to "holdouts," who bought their debt at or near default with full knowledge of the limitations on their ability to collect. The Injunctions "will thrust the Republic into another economic crisis and undermin[e] the consensual [sovereign debt] restructuring process the United States has been at pains to foster for the past several decades." ..

Sixth and finally, Argentina argues that plaintiffs' claims are barred by laches.

We review a district court's decision to grant equitable relief for abuse of discretion... We review de novo a district court's grant of partial summary judgment.

DISCUSSION I. We first address Argentina's argument that the district court erred in its interpretation of the Equal Treatment Provision. The district court held that Argentina violated the Provision when it made payments currently due under the Exchange Bonds while persisting in its refusal to satisfy its payment obligations to plaintiffs and when it enacted the Lock Law and the Lock Law Suspension.

"In New York, a bond is a contract.".. Thus, the parties' dispute over the meaning of the Equal Treatment Provision presents a "simple question of contract interpretation.".. Argentina argues that the Pari Passu Clause is a boilerplate provision that, in the sovereign context, "has been universally understood for over 50 years . to provide protection from legal subordination or other discriminatory legal ranking by preventing the creation of legal priorities by the sovereign in favor of creditors holding particular classes of debt."..

We are unpersuaded that the clause has this well settled meaning. Argentina's selective recitation of context-specific quotations from arguably biased commentators and institutions notwithstanding, the preferred construction of pari passu clauses in the sovereign debt context is far from "general, uniform and unvarying," Law Debenture Trust Co. of N.Y. v. Maverick Tube Corp., 595 F.3d 458, 466 (2d Cir.2010) (quotation marks omitted). Argentina's primary authorities and Argentina itself appear to concede as much. See Appellant's Reply Br. 21 n. 9 ("[N]o one knows what the clause really means" (emphasis in Appellant's Reply Br.)); Lee C. Buchheit, The Pari Passu Clause Sub Specie Aeternitatis, 10 Int'l Fin. L.Rev. 11, 11 (1991) ("[N]o one seems quite sure what the clause really means, at least in the context of a loan to a sovereign borrower."); G. Mitu Gulati & Kenneth N. Klee, Sovereign Piracy, 56 Bus. Law 635, 646 (2001) ("[I]n the sovereign context there is at least disagreement about the meaning of the clause."); Stephen Choi & G. Mitu Gulati, Contract As Statute, 104 Mich. L.Rev. 1129, 1134 (2006) ("The leading commentators on sovereign contracts acknowledged that there exists ambiguity as to the meaning of this clause."); Philip R. Wood, Project Finance, Subordinated Debt and State Loans 165 (1995) ("In the state context, the meaning of the clause is uncertain because there is no hierarchy of payments which is legally enforced under a bankruptcy regime."). In short, the record reveals that Argentina's interpretation of the Pari Passu Clause is neither well settled nor uniformly acted upon.

Once we dispense with Argentina's customary usage argument, it becomes clear that the real dispute is over what constitutes subordination under the Pari Passu Clause. Argentina contends the clause refers only to legal subordination and that none occurred here because "any claims that may arise from the Republic's restructured debt have no priority in any court of law over claims arising out of the Republic's unrestructured debt." Appellant's Br. 47. Plaintiffs, on the other hand, argue that there was "de facto" subordination because Argentina reduced the rank of plaintiffs' bonds to a permanent non-performing status by passing legislation barring payments on them while continuing to pay on the restructured debt and by repeatedly asserting that it has no intention of making payments on plaintiffs' bonds.

We disagree with Argentina because its interpretation fails to give effect to the differences between the two sentences of the Pari Passu Clause. See Singh v. Atakhanian, 31 A.D.3d 425, 818 N.Y.S.2d 524, 526 (N.Y.App.

Div.2d Dep't 2006) ("A contract should not be interpreted in such a way as would leave one of its provisions substantially without force or effect." (internal quotation marks and citation omitted)).

Instead, we conclude that in pairing the two sentences of its Pari Passu Clause, the FAA manifested an intention to protect bondholders from more than just formal subordination. See Riverside S. Planning Corp. v. CRP/Extell Riverside, L.P., 13 N.Y.3d 398, 404, 892 N.Y.S.2d 303, 920 N.E.2d 359 (2009). The first sentence ("[t]he Securities will constitute . direct, unconditional, unsecured, and unsobrdinated obligations .") prohibits Argentina, as bond issuer, from formally subordinating the bonds by issuing superior debt. The second sentence ("[t]he payment obligations . shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness.") prohibits Argentina, as bond payor, from paying on other bonds without paying on the FAA Bonds. Thus, the two sentences of the Pari Passu Clause protect against different forms of discrimination: the issuance of other superior debt (first sentence) and the giving of priority to other payment obligations (second sentence).

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

The record amply supports a finding that Argentina effectively has ranked its payment obligations to the plaintiffs below those of the exchange bondholders. After declaring a moratorium on its outstanding debt in 2001, Argentina made no payments for six years on plaintiffs' bonds while simultaneously timely servicing the Exchange Bonds. Argentina has renewed that moratorium in its budget laws each year since then. It declared in the prospectuses associated with the exchange offers that it has no intention of resuming payments on the FAA Bonds. 2005 Prospectus, J.A. at 465; 2010 Prospectus, J.A. at 980. It stated in SEC filings that it had "classified the [FAA Bonds] as a separate category from its regular debt" and is "not in a legal . position to pay" them.... Its legislature enacted the Lock Law, which has been given full effect in its courts, precluding its officials from paying defaulted bondholders and barring its courts from recognizing plaintiffs' judgments. By contrast, were Argentina to default on the Exchange Bonds, and were those bondholders to obtain New York judgments against Argentina, there would be no barrier to the Republic's courts recognizing those judgments. Thus, even under Argentina's interpretation of the Equal Treatment Provision as preventing only "legal subordination" of the FAA Bonds to others, the Republic breached the Provision...

In short, the combination of Argentina's executive declarations and legislative enactments have ensured that plaintiffs' beneficial interests do not remain direct, unconditional, unsecured and unsubordinated obligations of the Republic and that any claims that may arise from the Republic's restructured debt do have priority in Argentinian courts over claims arising out of the Republic's unstructured debt. Thus we have little difficulty concluding that Argentina breached the Pari Passu Clause of the FAA.

We are not called upon to decide whether policies favoring preferential payments to multilateral organizations like the IMF would breach pari passu clauses like the one at issue here. Indeed, plaintiffs have never used Argentina's preferential payments to the IMF as grounds for seeking ratable payments. Far from it; they contend that "a sovereign's de jure or de facto policy [of subordinating] obligations to commercial unsecured creditors beneath obligations to multilateral institutions like the IMF would not violate the Equal Treatment Provision for the simple reason that commercial creditors never were nor could be on equal footing with the multilateral organizations.”..

Moreover, plaintiffs' claims are not barred by laches. Argentina argues that, after it sought to resolve the meaning of the Equal Treatment Provision in December 2003 (and the court deemed the issue unripe for adjudication), plaintiffs “sat silent as the Republic restructured over 91 % of its defaulted debt and made regular biannual payments to holders of its restructured debt.” ... In the face of this “inexcusable delay,” Argentina argues, “plaintiffs cannot now rely on ‘equity’ to interfere with payments to third parties who have obviously developed a reasonable expectation of that regular source of income.” ..

This contention has no merit. Under New York law, the equitable defense of laches requires: (1) conduct giving rise to the situation complained of, (2) delay in asserting a claim for relief despite the opportunity to do so, (3) lack of knowledge or notice on the part of the offending party that the complainant would assert the claim, and (4) injury or prejudice to the offending party as a consequence relief granted on the delayed claim...

Argentina's laches argument fails because it had not yet violated the Equal Treatment Provision when it sought a declaration in 2003 that plaintiffs could not invoke the Provision to impede its restructuring efforts. It violated the Provision later by persisting in its policy of discriminatory treatment of plaintiffs, for example, by passing the Lock Law. In any event, we do not see how Argentina can claim prejudice by plaintiffs' purported delay. Argentina has known since 2004 that NML retained the option to pursue the claim. Moreover, because equitable relief was not granted until 2012, Argentina was able to hold its 2005 and 2010 exchange offers unimpeded.

II. We turn now to Argentina's challenges to the Injunctions and their requirement that it specifically perform its obligations under the FAA. Specific performance may be ordered where no adequate monetary remedy is available and that relief is favored by the balance of equities, which may include the public interest...

Once the district court determined that Argentina had breached the FAA and that injunctive relief was warranted, the court had considerable latitude in fashioning the relief. The performance required by a decree need not, for example, be identical with that promised in the contract...Where “the most desirable solution” is not possible, this Court may affirm an order of specific performance so long as it achieves a “fair result” under the “totality of the circumstances.” ..

Argentina's first contention is that, even assuming it breached the Pari Passu Clause, plaintiffs are limited to the “contractually agreed upon remedy of acceleration.”.. This argument is easily dispensed with. While paragraph 12 of the FAA specifies acceleration as one remedy available for a breach of the Equal Treatment Provision, the FAA does not contain a clause limiting the remedies available for a breach of the agreement. Nor does the FAA contain a provision precluding specific performance or injunctive relief. Under New York law the absence of the parties' express intention in the FAA to restrict the remedies available for breach of the agreement means that the full panoply of appropriate remedies remains available. ..

Moreover, it is clear to us that monetary damages are an ineffective remedy for the harm plaintiffs have suffered as a result of Argentina's breach. Argentina will simply refuse to pay any judgments. It has done so in this case by, in effect, closing the doors of its courts to judgment creditors. In light of Argentina's continual disregard for the rights of its FAA creditors and the judgments of our courts to whose jurisdiction it has submitted, its contention that bondholders are limited to acceleration is unpersuasive. Insofar as Argentina argues that a party's persistent efforts to frustrate the collection of money judgments cannot suffice to establish the inadequacy of a monetary relief, the law is to the contrary... In this context, the district court properly ordered specific performance.

Next, we conclude that because compliance with the Injunctions would not deprive Argentina of control over any of its property, they do not operate as attachments of foreign property prohibited by the FSIA. Section 1609 of the FSIA establishes that “the property in the United States of a foreign state shall be immune from attachment arrest and execution.” 28 U.S.C. § 1609. Each of these three terms refers to a court's seizure and control over specific property.13 However, courts are also barred from granting “by injunction, relief which they may not provide by attachment.” ...

The Injunctions at issue here are not barred by § 1609. They do not attach, arrest, or execute upon any property. They direct Argentina to comply with its contractual obligations not to alter the rank of its payment obligations. They affect Argentina's property only incidentally to the extent that the order prohibits Argentina from transferring money to some bondholders and not others. The Injunctions can be complied with without the court's ever exercising dominion over sovereign property. For example, Argentina can pay all amounts owed to its exchange bondholders provided it does the same for its defaulted bondholders. Or it can decide to make partial payments to its exchange bondholders as long as it pays a proportionate amount to holders of the defaulted bonds. Neither of these options would violate the Injunctions. The Injunctions do not require Argentina to pay any bondholder any amount of money; nor do they limit the other uses to which Argentina may put its fiscal reserves. In other words, the Injunctions do not transfer any dominion or control over sovereign property to the court. Accordingly, the district court's Injunctions do not violate § 1609.14

Nor does the FSIA create any other impediment to the injunctive relief ordered by the district court. Argentina voluntarily waived its immunity from the jurisdiction of the district court, and the FSIA imposes no limits on the equitable powers of a district court that has obtained jurisdiction over a foreign sovereign, at least where the district court's use of its equitable powers does not conflict with the separate execution immunities created by § 1609. A “federal court sitting as a court of equity having personal jurisdiction over a party has power to enjoin him from committing acts elsewhere.” ..

Turning to Argentina's argument that the balance of equities and the public interest tilt in its favor, we see no abuse of discretion in the district court's conclusion to the contrary. The FAA bondholders contend with good reasons that Argentina's disregard of its legal obligations exceeds any affront to its sovereign powers resulting from the Injunctions.

Moreover, nothing in the record supports Argentina's blanket assertion that the Injunctions will “plunge the Republic into a new financial and economic crisis.” ... The district court found that the Republic had sufficient funds, including over $40 billion in foreign currency reserves, to pay plaintiffs the judgments they are due. ... Aside from merely observing that these funds are dedicated to maintaining its currency, Argentina makes no real argument that, to avoid defaulting on its other debt, it cannot afford to service the defaulted debt, and it certainly fails to demonstrate that the district court's finding to the contrary was clearly erroneous.

Nor will the district's court's judgment have the practical effect of enabling “a single creditor to thwart the implementation of an internationally supported restructuring plan,” as the United States contends... It is up to the sovereign—not any “single creditor”—whether it will repudiate that creditor's debt in a manner that violates a pari passu clause.16 In any event, it 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.

However, we do have concerns about the Injunctions' application to banks acting as pure intermediaries in the process of sending money from Argentina to the holders of the Exchange Bonds. Under Article 4–A of the U.C.C., intermediary banks, which have no obligations to any party with whom they do not deal directly, are not subject to injunctions relating to payment orders. See, e.g., N.Y. U.C.C. § 4–A–503 cmt. Any system that seeks to force intermediary banks to stop payments by a particular entity for a particular purpose imposes significant costs on intermediary banks and risks delays in payments unrelated to the targeted Exchange Bond payments. Grain Traders, Inc. v. Citibank, N.A., 160 F.3d 97, 102 (2d Cir.1998). Plaintiffs claim that the Injunctions do not encompass intermediaries, but they fail to offer a satisfactory explanation for why intermediary banks would not be considered "indirect[ ] . facilitat[ors]" apparently covered by the Injunctions...

Our concerns about the Injunctions' application to third parties do not end here. Oral argument and, to an extent, the briefs revealed some confusion as to how the challenged order will apply to third parties generally. Consequently, we believe the district court should more precisely determine the third parties to which the Injunctions will apply before we can decide whether the Injunctions' application to them is reasonable. Accordingly, we remand the Injunctions to the district court under United States v. Jacobson, 15 F.3d at 22, for such further proceedings as are necessary to address the Injunctions' application to third parties including intermediary banks and to address the operation of their payment formula.

CONCLUSION For the reasons stated, the judgments of the district court (1) granting summary judgment to plaintiffs on their claims for breach of the Equal Treatment Provision and (2) ordering Argentina to make "Ratable Payments" to plaintiffs concurrent with or in advance of its payments to holders of the 2005 and 2010 restructured debt are affirmed. The case is remanded to the district court pursuant to United States v. Jacobson, 15 F.3d 19, 22 (2d Cir.1994) for such proceedings as are necessary to address the operation of the payment formula and the Injunctions' application to third parties and intermediary banks. Once the district court has conducted such proceedings the mandate should automatically return to this Court and to our panel for further consideration of the merits of the remedy without need for a new notice of appeal.

Mark Weidemaier says this decision:

caused turmoil in the sovereign debt markets, raising fears that Argentina will default on its restructured debt and prompting the US government, the exchange bondholders, and a number of financial institutions to ask the court to change course and to overturn or limit the injunction. Remedies of the sort approved in NML v. Argentina may also have broader systemic consequences for the sovereign debt markets. Most notably, if made broadly available to creditors, injunctions of this sort would increase bondholders' incentives to hold out from a debt restructuring and complicate efforts to provide debt relief to financially distressed sovereigns.[69]

SOVEREIGN IMMUNITY

Sovereign states benefit from immunity in courts of other states in relation to acts of sovereign authority.[70] In the US, the **Foreign Sovereign Immunities Act** (FSIA)[71] governs foreign sovereign immunity. The statute contains a number of exceptions to the immunity which are relevant to international financial transactions.

§ 1603 Definitions
For purposes of this chapter -
(a) A "foreign state" ... includes a political subdivision of a foreign state or an agency or instrumentality of a foreign state as defined in subsection (b).
(b) An "agency or instrumentality of a foreign state" means any entity -
(1) which is a separate legal person, corporate or otherwise, and
(2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and
(3) which is neither a citizen of a State of the United States... nor created under the laws of any third country.
(c) The "United States" includes all territory and waters, continental or insular, subject to the jurisdiction of the United States.
(d) A "commercial activity" means 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.
(e) A "commercial activity carried on in the United States by a foreign state" means commercial activity carried on by such state and having substantial contact with the United States

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[69] Mark C Weidemaier, S*overeign Debt after NML v. Argentina* (January 11, 2013). Capital Markets Law Journal, Forthcoming; UNC Legal Studies Research Paper No. 2199655. Available at SSRN: http://ssrn.com/abstract=2199655 .

[70] In some cases, courts may decline to hear cases involving foreign sovereigns under the political question doctrine if the US government has decided to resolve issues through international agreements rather than through litigation. *See, e.g.*, *Whiteman* v *Dorotheum GmbH & Co.* 431 F.3d 57(2d. Cir. 2006) (claims against the Republic of Austria relating to assets confiscated by the Nazi regime). Courts may also decline to review acts of foreign sovereigns under the act of state doctrine.

[71] The National Defense Authorization Act for Fiscal Year 2008, Public Law 110-181 (110th Congress) amends the FSIA to provide for attachment of property in judgments against Iraq. Another 2008 amendment related to the settlement of terrorism claims against Libya.

§ 1604 Immunity of a foreign state from jurisdiction
Subject to existing international agreements to which the United States is a party at the time of enactment of this Act a foreign state shall be immune from the jurisdiction of the courts of the United States and of the States except as provided in sections 1605 to 1607 of this chapter.

§ 1605. General exceptions to the jurisdictional immunity of a foreign state
(a) 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;
(2) in which 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;
(3) 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...
(6) in which the action is brought, either to enforce an agreement made by the foreign state with or for the benefit of a private party to submit to arbitration all or any differences which have arisen or which may arise between the parties with respect to a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration under the laws of the United States, or to confirm an award made pursuant to such an agreement to arbitrate, if (A) the arbitration takes place or is intended to take place in the United States, (B) the agreement or award is or may be governed by a treaty or other international agreement in force for the United States calling for the recognition and enforcement of arbitral awards, (C) the underlying claim, save for the agreement to arbitrate, could have been brought in a United States court under this section or section 1607, or (D) paragraph (1) of this subsection is otherwise applicable; or
(7) not otherwise covered by paragraph (2), in which money damages are sought against a foreign state for personal injury or death that was caused by an act of torture, extrajudicial killing, aircraft sabotage, hostage taking, or the provision of material support or resources (as defined in section 2339A of title 18) for such an act if such act or provision of material support is engaged in by an official, employee, or agent of such foreign state while acting within the scope of his or her office, employment, or agency, except that the court shall decline to hear a claim under this paragraph--
(A) if the foreign state was not designated as a state sponsor of terrorism under section 6(j) of the Export Administration Act of 1979 (50 U.S.C. App. 2405(j)) or section 620A of the Foreign Assistance Act of 1961 (22 U.S.C. 2371) at the time the act occurred, unless later so designated as a result of such act or the act is related to Case Number 1:00CV03110(EGS) in the United States District Court for the District of Columbia; and

(B) even if the foreign state is or was so designated, if--
(i) the act occurred in the foreign state against which the claim has been brought and the claimant has not afforded the foreign state a reasonable opportunity to arbitrate the claim in accordance with accepted international rules of arbitration; or
(ii) neither the claimant nor the victim was a national of the United States (as that term is defined in section 101(a)(22) of the Immigration and Nationality Act [8 USCS § 1101(a)(22)]) when the act upon which the claim is based occurred.

§ 1609 Immunity from attachment and execution of property of a foreign state

Subject to existing international agreements to which the United States is a party at the time of enactment of this Act the property in the United States of a foreign state shall be immune from attachment arrest and execution except as provided in sections 1610 and1611 of this chapter

§ 1610. Exceptions to the immunity from attachment or execution

(a) The property in the United States of a foreign state, as defined in section 1603(a) of this chapter, 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 or of a State after the effective date of this Act, 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
(2) the property is or was used for the commercial activity upon which the claim is based, or
(3) the execution relates to a judgment establishing rights in property which has been taken in violation of international law or which has been exchanged for property taken in violation of international law, or
...
(6) the judgment is based on an order confirming an arbitral award rendered against the foreign state, provided that attachment in aid of execution, or execution, would not be inconsistent with any provision in the arbitral agreement, or
(7) the judgment relates to a claim for which the foreign state is not immune under section 1605(a)(7), regardless of whether the property is or was involved with the act upon which the claim is based.
(b) In addition to subsection (a), 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, or
(2) the judgment relates to a claim for which the agency or instrumentality is not immune by virtue of section 1605(a)(2), (3), (5), or (7), or 1605(b) of this chapter, regardless of whether the property is or was involved in the

act upon which the claim is based.
(c) No attachment or execution referred to in subsections (a) and (b) of this section shall be permitted until the court has ordered such attachment and execution after having determined that a reasonable period of time has elapsed following the entry of judgment and the giving of any notice required under section 1608(e) of this chapter.
(d) The property of a foreign state, as defined in section 1603(a) of this chapter, 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, or prior to the elapse of the period of time provided in subsection (c) of this section, 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. ...

§1611. Certain types of property immune from execution
(a) Notwithstanding the provisions of section 1610 of this chapter, the property of those organizations designated by the President as being entitled to enjoy the privileges, exemptions, and immunities provided by the International Organizations Immunities Act shall not be subject to attachment or any other judicial process impeding the disbursement of funds to, or on the order of, a foreign state as the result of an action brought in the courts of the United States or of the States.
(b) Notwithstanding the provisions of section 1610 of this chapter, the property of a foreign state shall be immune from attachment and from execution, if -
(1) the property is that of a foreign central bank or monetary authority held for its own account, unless such bank or authority, or its parent foreign government, has explicitly waived its immunity from attachment in aid of execution, or from execution, notwithstanding any withdrawal of the waiver which the bank, authority or government may purport to effect except in accordance with the terms of the waiver...

Although financial transactions are considered to be commercial, contracts with sovereigns should contain waivers of sovereign immunity, reducing the likelihood of disputes.[72] The following materials suggest why this is so.

In **Republic of Argentina v Weltover**[73] the US Supreme Court held:

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[72] See the example on page 126 below. A waiver of immunity in a conditional document has been held to be ineffective where the condition was not fulfilled. *Can-Am Int'l, LLC* v. *Republic of Trinidad & Tobago*, 169 Fed. Appx. 396 (5th Cir 2006) cert denied .

[73] 504 US 607 (1992). In the case two holders of Argentinian bonds (called Bonods) sued Argentina for breach of contract for failure to pay on the bonds. The Court held that the US federal courts did have jurisdiction

...when a foreign government acts, not as 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. Moreover, because the Act provides that the commercial character of an act is to be determined by reference to its "nature" rather than its "purpose," 28 U. S. C. § 1603(d), the question is not whether the foreign government is acting with a profit motive or instead with the aim of fulfilling uniquely sovereign objectives. Rather, 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," .... Thus, a foreign government's issuance of regulations limiting foreign currency exchange is a sovereign activity, because such authoritative control of commerce cannot be exercised by a private party; whereas a contract to buy army boots or even bullets is a "commercial" activity, because private companies can similarly use sales contracts to acquire goods...

The court went on to state:

The commercial character of the Bonods is confirmed by the fact that they are in almost all respects garden-variety debt instruments: They may be held by private parties; they are negotiable and may be traded on the international market (except in Argentina); and they promise a future stream of cash income. We recognize that, prior to the enactment of the FSIA, there was authority suggesting that the issuance of public debt instruments did not constitute a commercial activity. Victory Transport, 336 F.2d at 360 (dicta). There is, however, nothing distinctive about the state's assumption of debt (other than perhaps its purpose) that would cause it always to be classified as jure imperii, and in this regard it is significant that Victory Transport expressed confusion as to whether the "nature" or the "purpose" of a transaction was controlling in determining commerciality,... Because the FSIA has now clearly established that the "nature" governs, we perceive no basis for concluding that the issuance of debt should be treated as categorically different from other activities of foreign states.

Argentina contends that, although the FSIA bars consideration of "purpose," a court must nonetheless fully consider the context of a transaction in order to determine whether it is "commercial." Accordingly, Argentina claims that the Court of Appeals erred by defining the relevant conduct in what Argentina considers an overly generalized, acontextual manner and by essentially adopting a per se rule that all "issuance of debt instruments" is "commercial." .... We have no occasion to consider such a per se rule, because it seems to us that even in full context, there is nothing about the issuance of these Bonods (except perhaps its purpose) that is not analogous to a private commercial transaction.

Argentina points to the fact that the transactions in which the Bonods were issued did not have the ordinary commercial consequence of raising capital or financing acquisitions. Assuming for the sake of argument that this is not an example of judging the commerciality of a transaction by its purpose, the ready answer is that private parties regularly issue bonds, not just to raise capital or to finance purchases, but also to refinance debt. That is what Argentina did here: By virtue of the earlier FEIC contracts, Argentina was already obligated to supply the United States dollars needed to retire the FEIC-insured debts; the Bonods simply allowed Argentina to restructure its existing obligations. Argentina further asserts (without proof or even elaboration) that it "received consideration

over the case because foreign states could be subject to suits in US courts for acts in connection with a commercial activity under the FSIA..

[for the Bonods] in no way commensurate with [their] value,"... Assuming that to be true, it makes no difference. Engaging in a commercial act does not require the receipt of fair value, or even compliance with the common-law requirements of consideration.

Argentina argues that the Bonods differ from ordinary debt instruments in that they "were created by the Argentine Government to fulfill its obligations under a foreign exchange program designed to address a domestic credit crisis, and as a component of a program designed to control that nation's critical shortage of foreign exchange."... In this regard, Argentina relies heavily on De Sanchez v. Banco Central de Nicaragua, 770 F.2d 1385 (1985), in which the Fifth Circuit took the view that "often, the essence of an act is defined by its purpose"; that unless "we can inquire into the purposes of such acts, we cannot determine their nature"; and that, in light of its purpose to control its reserves of foreign currency, Nicaragua's refusal to honor a check it had issued to cover a private bank debt was a sovereign act entitled to immunity... Indeed, Argentina asserts that the line between "nature" and "purpose" rests upon a "formalistic distinction [that] simply is neither useful nor warranted." ... We think this line of argument is squarely foreclosed by the language of the FSIA. However difficult it may be in some cases to separate "purpose" (i. e., the reason why the foreign state engages in the activity) from "nature" (i. e., the outward form of the conduct that the foreign state performs or agrees to perform) ... the statute unmistakably commands that to be done, 28 U. S. C. § 1603(d). We agree with the Court of Appeals... that it is irrelevant why Argentina participated in the bond market in the manner of a private actor; it matters only that it did so. We conclude that Argentina's issuance of the Bonods was a "commercial activity" under the FSIA.

In **Capital Ventures Int'l v. Republic of Argentina** (2nd Circuit, 2009) the court said:[74]

In the offering circulars, Argentina explicitly waived its sovereign immunity to suit in U.S. courts on claims related to the German bonds. Section 13(4) of the offering circulars provides that, "[t]o 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 . . . , 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." This provision clearly and unambiguously waives Argentina's "immunity (sovereign or otherwise)" in "any court." This clear language satisfies the FSIA's requirement of an "explicit" waiver.

Argentina advances the argument that section 13(4), read in conjunction with section 13(3)[75], merely allows for judgments obtained pursuant to section 13(3) to be enforced in other courts. However, the language of subsection 4

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[74] 552 F.3d 289 (2d. Cir. 2009) cert denied 130 S. Ct. 202 (2009).

[75] Which provided: "The Republic hereby irrevocably submits to the non-exclusive jurisdiction of the District Court (Landgericht) in Frankfurt am Main and any federal court sitting in the City of Buenos Aires as well as any appellate court of any thereof, in any suit, action or proceeding against it arising out of or relating to these Bonds. The Republic hereby irrevocably waives -- to the fullest extent it may effectively do so -- the defense of an inconvenient forum to the maintenance of such suit or action or such proceeding and any present or future objection to such suit, action or proceeding whether on the grounds of venue, residence or domicile. The Republic agrees that a final judgment in any such suit, action or proceeding in the courts mentioned above shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or any other method provided by law."

is not so limited. Subsection 4 refers to "any legal process (whether through service or notice, attachment prior to judgment, attachment in aid of execution, execution or otherwise)," language that contemplates actions other than those to enforce judgments. Further, subsection 3 ends with the provision that "a final judgment in any such suit . . . in the courts mentioned above . . . may be enforced in other jurisdictions by suit on the judgment or any other method provided by law." If the Republic's interpretation of subsection 4 were adopted, this last sentence in subsection 3 would render subsection 4 superfluous, a result that should be avoided... Further, if subsection 4 were intended to discuss enforcement in other jurisdictions, we would expect that the same terms in the last sentence of subsection 3 would be repeated in subsection 4--but they are not. Accordingly, we do not read section 13(4) as applying only to the enforcement of judgments.

Argentina also argues that reading section 13(4) as a waiver of sovereign immunity in any court renders subsection 3 superfluous, a result which, as just discussed, is disfavored. See id. According to Argentina, under such a reading Argentina has "agree[d] to jurisdiction in Germany and Argentina" in subsection 3 and also "agree[d] to jurisdiction everywhere" in subsection 4. Of course, such an interpretation of section 13(4) would render subsection 3 superfluous--but that is not what subsection 4 says. Subsection 4 is a waiver of Argentina's "immunity (sovereign or otherwise)," but it does not waive other objections to suit that Argentina might have, such as objections based on lack of personal jurisdiction, improper venue, or forum non conveniens. Section 13(3), on the other hand, provides that Argentina "submits to the non-exclusive jurisdiction" of the courts in Frankfurt and Buenos Aires as well as "waives . . . the defense of an inconvenient forum . . . and any . . . objection . . . on the grounds of venue, residence or domicile." It is thus clear that reading subsection 4 as a waiver of sovereign immunity in any court does not render subsection 3 superfluous.

Argentina also presses the argument that the case law reveals a requirement that, to be explicit, a waiver must contain a reference to the United States or a specific jurisdiction within the United States. We do not find such a requirement in the cases. Of course,.a specific reference to the United States can be helpful in determining that a waiver meets the FSIA's requirement of explicitness... but the statutory requirement is only that the waiver be "explicit." There can be explicit waivers without a reference to the United States, as the waiver of immunity in "any court" in this case illustrates. ...Any other result would stray from the plain meaning of the statutory language.

Despite Argentina's argument, Argentine Republic v. Amerada Hess Shipping Corp., 488 U.S. 428...(1989), does not require a contrary result. In Amerada Hess, the Supreme Court stated that it did not "see how a foreign state can waive its immunity under § 1605(a)(1) by signing an international agreement that contains no mention of a waiver of immunity to suit in United States courts or even the availability of a cause of action in the United States." .. Argentina would have us read this language as a requirement that, for a waiver to satisfy the FSIA's explicitness requirement, it must mention the United States in some way. That is not the holding of Amerada Hess. The international agreements at issue in Amerada Hess were the Geneva Convention on the High Seas... and the Pan American Maritime Neutrality Convention...neither of which mentions waiving sovereign immunity at all, let alone in the United States. The offering circulars at issue here, which are contracts between Argentina and the bondholders, are far removed from multi-party international agreements and do discuss waiver of sovereign immunity to suit in any court, thereby indicating "waiver of immunity to suit in United States courts." .... Accordingly, Amerada Hess does not control the outcome here.

There is likewise no support in our cases for Argentina's suggestion that the mention of specific, non-United States jurisdictions in subsection 3 of the offering circulars precludes a finding that Argentina waived its sovereign immunity to suit in the United States. Of course it is true that there will be cases in which, when a document mentions a non-U.S. jurisdiction, there will be no explicit waiver for FSIA purposes because it will be clear that there is no intent to waive sovereign immunity in United States courts.... It is not true, however, that the mere mention of a non-U.S. jurisdiction will preclude a finding of waiver, because the statute requires only that the waiver be "explicit." As the waiver at issue here demonstrates, a waiver of sovereign immunity can be explicit even when other provisions of the document are applicable only to specific, non-United States jurisdictions.

DRFP LLC (dba Skye Ventures) v Venezuela[76] involved promissory notes issued by Venezuela:[77]

DRFP L.L.C., doing business as Skye Ventures, is the holder of two promissory notes allegedly issued by the government of Venezuela. Skye demanded payment on the notes, and when it was refused, Skye filed suit against Venezuela and its Ministry of Finance in the federal district court in Columbus, Ohio. Venezuela sought dismissal of the case, claiming immunity from United States federal court jurisdiction ..The district court held that dismissal was not warranted because Venezuela was not immune from jurisdiction by virtue of the Foreign Sovereign Immunities Act (FSIA)... Venezuela now appeals.
For reasons we shall explain, we will hold that Venezuela is not immune from federal court jurisdiction...

I. According to the plaintiff's complaint, on December 7, 1981, a state-owned bank in Venezuela, the Banco de Desarrollo Agropecuario, issued some no-coupon bearer promissory notes. The notes stated that they were payable to the holder ten years and one day after the date of issue, although the maturity date was later extended to December 1999. The notes also stated that the Venezuelan Ministry of Hacienda (the precursor to the Ministry of Finance) guaranteed payment of the notes, and that the government of Venezuela backed the notes.
A Panamanian corporation, Gruppo Triad-FCC SPA, acquired the two promissory notes with which we are concerned in this case, each in the amount of $ 50 million. After Gruppo demanded payment on the notes in 2001, the Venezuelan Ministry of Finance conducted an investigation into their validity. In October 2003, the Venezuelan Attorney General issued an opinion declaring that the notes were valid. Based on this opinion, the plaintiff, Skye, an Ohio limited liability company whose principal office is in Columbus, Ohio, obtained the two notes from Gruppo and demanded payment of the notes at its office in Columbus. When Venezuela refused to honor the notes on the ground that the instruments were forgeries, Skye filed suit to collect on the notes in the federal district court in Columbus.
On January 31, 2005, while continuing to insist that the notes were invalid forgeries, Venezuela filed a motion

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[76] 622 F.3d 513 (6th. Cir. 2010). Cert. Denied Jan 23, 2012 http://www.supremecourt.gov/orders/courtorders/012312zor.pdf .

[77] Venezuela also raised an issue of forum non conveniens, discussion of which is here omitted. The Court held that the district court must reconsider the forum non conveniens question.

requesting dismissal of the case on two grounds: (1) lack of jurisdiction due to sovereign immunity and (2) forum non conveniens. Without deciding the motion, the magistrate judge ordered that discovery proceed, and the motion remained undecided for four years. On July 24, 2007, Venezuela notified the district court that the Venezuelan Supreme Court had issued a decision that affected the issues in the case. The magistrate judge then modified his earlier order concerning discovery and, on May 27, 2008, directed the parties to file supplemental briefs addressing the issues of sovereign immunity and forum non conveniens.

On February 13, 2009, the district court issued an opinion denying Venezuela's motion to dismiss. Specifically, the district court held: (1) that Venezuela was not immune from suit pursuant to the FSIA's commercial activity exception and the court had jurisdiction of the case; and (2) that the doctrine of forum non conveniens did not apply.

II. Despite Venezuela's insistence that the notes are forgeries, we must assume, for purposes of deciding the jurisdictional issues before us, that they are valid....

It is undisputed that Venezuela is a foreign state normally entitled to sovereign immunity. The parties do not dispute that the activities involving the two promissory notes can be characterized as a "commercial activity." ..

The dispositive question at this stage of the case is whether the "commercial activity of the foreign state" caused a "direct effect in the United States."

There are really two aspects to the "direct effect" question. The first is whether the bearer of the notes, Skye, is restricted by contract or by the terms of the notes in selecting the United States as a jurisdiction in which to seek and enforce payment of the notes. The second is whether, if Skye is not precluded from demanding that payment be made in the United States, the defendants' refusal to honor Skye's demand for payment in Ohio is an "act [that] causes a direct effect in the United States." Our answer to the first question is no, and to the second, yes.

Both notes explicitly state that the terms and conditions of the notes are governed by the law of Switzerland and "by the regulations of the International Chamber of Commerce in Paris and the United States Council of the International Chamber of Commerce [(ICC)] Brochure '322' last revised edition." Skye introduced the affidavit of an expert, Professor Marco Villa, a Swiss lawyer, whose qualifications to testify as to Swiss law were not challenged by the defendants. Professor Villa, after examining the two promissory notes, testified that under Swiss law, and the ICC Rules on Collection which are recognized under Swiss law, the bearer of the notes may sue for collection in the jurisdiction of his choice, including the United States of America.

Another witness, Gary Post, accepted by the district court as qualified to give an opinion as to "the ICC's regulations in its Rules on Collection," stated in an affidavit that in his opinion, the ICC regulations permit Skye to seek collection on the notes in the jurisdiction of its choice, including Ohio... Therefore, it would appear that by the terms of the notes, including the provision that Swiss law govern any dispute over terms and conditions, Skye was entitled to demand and enforce payment in Ohio.

The second aspect of Venezuela's immunity argument--the question whether Venezuela's refusal to honor Skye's demand for payment in Ohio caused a direct effect in the United States--is at the heart of the parties' dispute.

In ruling that Venezuela's refusal to honor the promissory notes caused a direct effect in the United States, the district court relied on the Supreme Court case of Republic of Argentina v. Weltover, Inc... In Weltover, the Supreme Court stated that."an effect is direct if it follows as an immediate consequence of the defendant's . . .

activity.".. The Court rejected any requirement that the effect be either foreseeable or substantial.
In Weltover, Argentina issued bonds, and the bondholders designated New York as one place where payment could be made... When Argentina refused to pay and "rescheduled" the bonds, the bondholders sued to collect. The Supreme Court concluded that Argentina's refusal to pay caused a "direct effect" in the United States. The Court explained: "Because New York was thus the place of performance for Argentina's ultimate contractual obligations, the rescheduling of those obligations necessarily had a 'direct effect' in the United States: Money that was supposed to have been delivered to a New York bank for deposit was not forthcoming." ..ye argues that the analysis in Weltover can be directly applied to the circumstances of this case...
.In opposition, Venezuela argues that the commercial activity exception of Section 1605(a)(2) does not apply because the terms of the promissory notes do not create a contractual right to compel payment of the notes in the United States. Venezuela attempts to distinguish the Weltover case by arguing that the foreign state in Weltover had more connections to the United States than Venezuela had in this case: for example, the foreign state in Weltover specifically designated New York as a possible place of payment. Venezuela contends that Skye is claiming jurisdiction based solely on Skye's pre-suit demand for payment, and nothing more, and that this is insufficient to establish the commercial activity exception. We find this argument unpersuasive.
Certainly neither the terms of the notes nor any other contractual arrangement between the parties explicitly designated the United States as the place of payment of the notes. But as we have explained, under the terms of the notes, including the provision that Swiss law will be applied, the parties implicitly agreed to leave it to the bearer to demand payment of the notes anywhere, including, perforce, Columbus, Ohio, the bearer's place of business. We do not read Weltover as creating an additional requirement that the United States be specifically mentioned in the terms of the notes, as suggested by Venezuela. The Second Circuit Court of Appeals came to a similar conclusion in Hanil Bank v. PT. Bank Negara Indonesia (Persero) .. where the court found that although a letter of credit did not specifically designate New York as the place of payment, the parties had implicitly agreed that the bank could designate the place of its choice for payment...
In short, we hold that Skye had the right to designate the United States as a place of payment of the notes. Skye designated Columbus, Ohio, and when Venezuela refused to pay the promissory notes, money that was supposed to have been delivered to Skye at its office in Columbus was not forthcoming, causing a direct effect in the United States... Therefore, Skye has successfully satisfied its burden of production in establishing that the commercial activity exception of Section 1605(a)(2) of the FSIA applies, and Venezuela has not carried its burden of persuasion that the exception does not apply...

Boyce F. Martin,Jr Circuit Judge, concurring in part and dissenting in part. I must disagree with [the majority's] holding on the issue of jurisdiction over this claim.
The facts of this case are extraordinarily complicated. Essentially, Skye, an American corporation, went abroad and purchased Venezuelan notes, known as "Bandagro notes," from a Panamanian corporation, Gruppo Triad, and demanded payment from Venezuela in Columbus, Ohio. Venezuela did not pay. The district court found that this constituted a sufficient "direct effect" on United States commerce to create federal jurisdiction and defeat sovereign immunity. The majority affirms the holding of the district court, and I respectfully dissent.
The Foreign Sovereign Immunities Act of 1976 ("FSIA"),... "grants federal district courts jurisdiction over civil

actions against foreign states 'as to any claim for relief in personam with respect to which the foreign state is not entitled to immunity' under either another provision of the FSIA or 'any applicable international agreement.'" Republic of Austria v. Altmann .. Essentially, the court first presumes immunity, pursuant to section 1604, but looks for an exception, found in sections 1605-07; then, only if the court finds that the "foreign state is not entitled to immunity" will the court have subject matter jurisdiction, pursuant to section 1330(a).

Skye contends that the "commercial activity exception" to the FSIA divests Venezuela of foreign sovereign immunity.

... In Weltover, the Supreme Court held that there was a direct effect when the Argentinian bonds specified for payment locations, one of which was New York, and Argentina had begun making payments to the plaintiffs in New York before unilaterally rescheduling its debts and suspending payments.

We recently held that "the mere act of including an American company in or excluding an American company from the process of bidding on a contract, where both parties' performance is to occur entirely in a foreign locale, does not, standing alone, produce an immediate consequence in the United States, and thus does not have a direct effect in the United States. Am. Telecom Co.... We also held that, "even if [the payment of $ 30,000 from an American bank to enter a bid] produced a direct effect, that effect was not caused by [the country]. American Telecom was not required to submit payment from an American bank; it chose to do so, and to the extent that making that payment had a direct effect in the United States, the effect was the direct result of American Telecom's action, not [the country's]."

In this case, Skye, an American corporation, went abroad and purchased Venezuelan notes from a Panamanian corporation, Gruppo Triad. Skye then brought the bonds to a bank in Columbus, Ohio and demanded payment. Venezuela refused to pay. That Skye chose to use an American bank from which to request payment is not sufficient to defeat sovereign immunity under American Telecom. If it were sufficient, everyone would request payment here so as to gain access to local federal courts. Thus, I agree with the majority that the pre-suit demand for payment is not enough to create federal jurisdiction and defeat sovereign immunity.

However, this does not end the inquiry. The note itself may create federal jurisdiction in the United States and concede sovereign immunity by expressly stating a place of performance in the United States... or by not specifying a place of performance but instead expressly granting the plaintiff the right to choose the place. In that case, if the plaintiff designates the United States, then failure to pay can constitute a direct effect.... However, if the bond is silent on the place of performance, then there is no basis for United States jurisdiction over ensuing claims, even if the injury is somehow felt in the United States.

Here, it is undisputed that the Notes did not expressly state a place of performance in the United States and that they do not specifically state that their holder can demand payment in the United States. However, the parties dispute whether the Notes grant the holder the right to state the place of performance and specifically on what the concept of a "place of payment" means.

I find this issue to be most clearly crystalized in the dueling translations of a case from a Swiss court that examined Bandagro bonds, including those at issue here, to determine whether jurisdiction over Venezuela existed in Switzerland, that were submitted by the parties here. Woodsrite Investments Ltd. v. Gruppo Triad, et al., File No. OA200487 (District Court of Mendrisio Sud, Canton of Ticino, Switzerland) (R.E. 137-1 and 137-2). Venezuela purports that the relevant paragraph of Woodsrite is accurately translated:

> In addition to the above, there is no connection between the legal business regarding the promissory notes, as well as the guarantee they represent, and Switzerland; and, since the legal relationship has no connection with the Swiss territory, it would seem, according to what has been stated, that the securities can be redeemed anywhere, and paid in any requested currency. (Affidavit of Aura Colmanni, July 26, 2010, at 3).

On the other hand, Skye purports that the relevant section is most accurately translated as:

> The BANDAGRO promissory notes make express reference to the applicability of Swiss law and according to the rules of issue, which refer to the ICC rules, they may be called for payment in any part of the world. . . . Indeed, the court fails to see how the connection with Switzerland cannot be established, because payment of the notes, in accordance with the clauses they contain, is requested in the place in which they are found, by bringing an action before a Swiss court which must apply Swiss law. (Skye's letter brief, July 1, 2010, at 2).

If I did not know better, I would assume that these were translations from two different cases. As presented here, they demonstrate the fundamental difference in the understanding of payment in these cases: if it matters where the payment is demanded or from where the payment is demanded. In other words, is the fact that a noteholder may go to a bank anywhere in the world to request payment the same as designating every location as a place of payment, an action that waives sovereign immunity as to every country in which a noteholder may take a note after its purchase?

The method by which a noteholder may demand payment of the Notes at issue seems complicated. The noteholder goes to its bank and asks the bank to demand payment. Using a series of wires, the bank requests payment from a Venezuelan bank and receives the payment in that bank. The payment is then wired back to the noteholder's bank. Essentially, the bank uses wire transfers to act as the noteholder's proxy in going to Venezuela and requesting payment, which makes sense; it would be extraordinarily inefficient to require noteholders to purchase a plane ticket in order to request payment on their notes.

It seems likely that the bonds would not be easily negotiable internationally if a noteholder had to go to the country that issued the note in order to demand payment. However, it is incredible that a country issuing notes would, under any circumstances, waive its sovereign immunity in every country in the world in which a noteholder could take the notes and find a bank to act as its proxy without expressly so stating in the note. Such a waiver is far too broad to read into a document. Our laws presume sovereign immunity; unless there is an obviously implicit waiver, we ought not to create such an unwieldy exception to this important protection. To so find would gut the laws of sovereign immunity.

Thus, I disagree with the majority and would find that, while a noteholder may request that a bank anywhere in the world demand payment on its behalf, this does not waive Venezuela's sovereign immunity. The effect on the United States is not direct because it is not "an immediate consequence of the defendant's activity" as required by Weltover. It was a consequence of Skye's choice of the United States and the choice of an American bank as its proxy to acquire the payment from the Venezuelan bank--not of Venezuela's express or implied waiver of sovereign immunity.

Expropriation is a governmental rather than a commercial act. In **Yang Rong v. Liaoning**

Province Government[78] the DC Circuit affirmed the District Court's dismissal of a complaint under the FSIA on the basis that the defendant Chinese province's expropriation of the plaintiff finance company's equity interest in a holding company was a sovereign act. The facts of this case provide an illustration of country risk:

In 1991 Rong and the municipality of Shen Yang, a city in the Liaoning Province in northeast China, entered into a joint venture for automobile production.. The principal partners in the venture.. were Broadsino, a Hong Kong-incorporated company wholly owned by Yang Rong, and .. Jin Bei Shareholding., a corporation owned by the Shen Yang municipal government.... Jin Bei Shareholding had 60 per cent ownership and Broadsino had 40 per cent ownership.

To expand the venture through access to American capital the partners sought to list Shen Yang Automotive on the ...NYSE.. Yang Rong, who served as Shen Yang Automotive's chief executive and manager, incorporated Brilliance Holdings .. in Bermuda as the financing vehicle to obtain a listing on the NYSE and transferred his 40 per cent ownership interest to Brilliance Holdings. Jin Bei Shareholding also transferred 11 per cent of its interest .. to Brilliance Holdings, thereby giving the Bermuda-based company a 51 per cent interest in Shen Yang Automotive. In return for transferring 11 per cent of its interest, Jin Bei Shareholding received 21.57 per cent of Brilliance Holdings stock, thereby reducing Rong's interest in Brilliance Holdings to the remaining 78.43 per cent of its stock... In registering the stock with the Securities and Exchange Commission (SEC), preparing the initial public offering in the United States and listing the stock on the NYSE, senior Chinese government officials informed Rong that a Chinese entity rather than a Hong Kong private company should be the majority shareholder of the listed company inasmuch as the U.S. registration and listing would be the first for a China-based company in 50 years. Rong understood that the Chinese authorities would be satisfied if the majority interest in the listed company was held in the name of a Chinese non-governmental organization (NGO). ... Consequently in May 1992, Broadsino, the People's Bank of China and other Chinese governmental entities created the Chinese Financial Educational Development Foundation (Foundation), an NGO. Shang Ming, the deputy governor of the People's Bank of China (Ming), served as the Foundation's chairman while Rong served as vice chairman.

In September 1992, Broadsino transferred its Brilliance Holdings stock to the Foundation. Eventually, Rong and Ming agreed "that the Foundation would hold the shares in trust for Broadsino, in effect acting as the nominee for Broadsino," and that Rong was to have sole authority to manage, control and administer the Foundation's equity interest in Brilliance Holdings...The transferred Brilliance Holdings shares were held in the Foundation's name. As a result of this arrangement, as well as the sale of 28.75 per cent of Brilliance Holdings shares in October 2002, the Foundation held 55.88 per cent of the Brilliance Holdings shares and Jin Bei Shareholding held 15.37 per cent... At Rong's direction, Broadsino paid the costs to register and list the Brilliance Holdings stock and paid various administrative fees to the Foundation. He also managed and directed Brilliance Holdings' primary holding, Shen Yang Automotive, arranging with Toyota and General Motors to manufacture automobiles for those companies. All of Shen Yang Automotive's manufacturing facilities were located in Liaoning Province.

Meanwhile, in early 2002 the Province formed a "Working Committee," headed by the Assistant to the Governor of

[78] 452 F.3d 883 (DC Cir. 2006).

the Province. In March 2002 the Working Committee declared that all equity interests held in the name of the Foundation, including Rong's interest in Brilliance Holdings, were state assets and demanded that he transfer them to the Province... After Rong refused, the Working Committee informed Rong and the Brilliance Holdings board of directors that the Foundation no longer recognized Broadsino's beneficial interest in Brilliance Holdings. At the direction of the Province, the Brilliance Holdings board dismissed Rong as President, CEO and Director and placed Working Committee members in those positions and other management positions. In October 2002 the newly installed Brilliance Holdings board ceased paying Rong a salary, dismissed him as a director the next month and terminated his contract. The Province also formed Huachen Automotive Group Holdings Company Limited (Huachen) and appointed Province officials as officers of the new company. Approximately two months later Huachen purchased the Brilliance Holdings shares nominally held by the Foundation in trust for Broadsino for $ 18 million, about six per cent of market price. Huachen and the Brilliance Holdings board also made a tender offer for the remaining Brilliance Holdings shares, including those traded on the NYSE, resulting in the suspension of trading of Brilliance Holdings shares on the NYSE from December 18 to December 19, 2002...

As the Working Committee was executing the takeover, Rong, acting for Broadsino, sought relief in various courts... Broadsino initiated proceedings against the Foundation in the Beijing Municipal High Court seeking a determination of its interest in the assets nominally held by the Foundation, including the Brilliance Holdings stock the Foundation held in trust, but was rebuffed... Rong also filed a complaint against the Province in the District of Columbia district court, challenging the Province's "implementation of the scheme to take Plaintiffs' shares, other equity interests, and other property and then to maintain control thereof for its own commercial benefit" under FSIA... The Province moved to dismiss for lack of subject matter jurisdiction, asserting that neither FSIA's commercial activity exception.. nor its expropriation exception... applied...The district court agreed, holding that the Province's acquisition of the Brilliance Holdings shares was a sovereign act and the Province was therefore immune from suit. It dismissed the action.. This appeal followed, in which Rong challenges the district court's rejection of the commercial activity exception...

Here Rong claims that the Province's "implementation of the scheme to take Plaintiff's shares, other equity interests, and other property and then to maintain control thereof for its own commercial benefit,".. was "commercial activity" under the third clause of 28 U.S.C. §1605(a)(2), that is, 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. " In Weltover, the United States Supreme Court declared that the analysis of the third clause of section 1605(a)(2) proceeds in three parts: 1) the lawsuit must be based upon an act that took place outside the territory of the United States; 2) the act must have been taken in connection with a commercial activity, and 3) the act must have caused a direct effect in the United States. .. Here there is no dispute that the act took place outside the U.S. The questions in dispute are (1) whether the Province's act was done "in connection with a commercial activity" in China, and (2) if so, whether it caused a "direct effect in the United States." Because we answer the first question in the negative, we do not reach the second...

It may be true that in some respects the Working Committee's takeover of the Foundation and its ownership of the Brilliance Holdings shares seem commercial--for example, removing Yang Rong from the Brilliance Holdings board and placing Working Committee officials in those same positions. But all of these acts flow from the Working Committee's "state assets" declaration--an act that can be taken only by a sovereign. Rong is correct that this case has some similarity to Foremost-McKesson ..where we found the Republic of Iran's takeover of a dairy business commercial, in part because there was "no indication that Iran nationalized Pak Dairy by taking it over through a process of law," no formal declaration by the government of Iran that a takeover was to occur and no "statutory restrictions or governmental decrees or directives" referring to the takeover... In Foremost-McKesson, however, the plaintiff and various instrumentalities of Iran entered into a formal contract for an agreed-upon venture; the commercial activity there was the sovereign instrumentalities' use of their "majority position to lock the appellee out of the management of the dairy and to deny the appellee its share of the company's earnings." .. We affirmed the district court's conclusion that those allegations "sound[ed] in the nature of a corporate dispute between majority and minority shareholders"--allegations of breach of contract and of the directors' duty of care, with the only distinction being that the majority shares were held by the Iranian government and its subsidiaries rather than by a private party... Here, by contrast, there was no contractual relationship between Yang Rong and the Province regarding the Foundation. The Province did not assume control over Brilliance Holdings by purchasing the majority of Brilliance Holdings' stock from Broadsino, as a private party would; instead, it declared the Brilliance Holdings shares held by the Foundation to be state assets and claimed them as does a sovereign. A private party in the market could not have done what the Province did here--form a committee whose goal, as Rong's complaint describes it, was to "assume and exercise control over the Foundation and to acquire from it the Brilliance Holdings shares that it held in trust for Broadsino" by "advis[ing] Yang Rong that all equity interests held in the name of the Foundation . . . were state assets and demand[ing] that they be transferred to the [Province]."...These acts, initiated by the Assistant Governor of the Province and put into effect by the Working Committee, constituted a quintessentially sovereign act, not a corporate takeover.

Despite Rong's argument that the Province's use of the Brilliance Holdings shares after expropriating them independently establishes jurisdiction, the Province's subsequent acts of forming Huachen and transferring the Brilliance Holdings shares to Huachen did not transform the Province's expropriation into commercial activity. As the district court pointed out, Rong's complaint alleges that by the time of the stock transfer to Huachen, the Province had already wrested control of the shares; Huachen was not established until six months after the shares belonged to the Province... Neither Yang Rong's refusal to comply with the Working Committee's demand to transfer the Brilliance Holdings shares nor the Province's subsequent transfer of them to Huachen at a "firesale" price makes the Province's expropriation commercial activity. If Rong's interpretation of commercial activity were correct, then almost any subsequent disposition of expropriated property could allow the sovereign to be haled into a federal court under FSIA. Such a result is inconsistent with our precedent, the decisions of other circuits and the Act's purpose...

A Working Group of the ABA proposed amending the FSIA because of uncertainties about some of the terms contained in the statute.[79] For example, the Group noted uncertainty about the extent to which the statute applies to subsidiaries of corporations owned by a foreign state:

"we examine the "tiering" and "pooling" issues, that is, the question of entities indirectly owned by

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[79] Report on the U.S. Foreign Sovereign Immunities Act by a Working Group of the International Litigation Committee of the Section of International Law and Practice of the American Bar Association, (Apr. 2001)

> a foreign state and entities owned by more than one foreign state. We propose statutory language to apply the Act to an entity majority owned by more than one foreign state and to all levels of subsidiaries as long as they are ultimately majority owned by a foreign state. We combine our recommendation on tiering with a proposal to include a rebuttable presumption that an instrumentality owned by another instrumentality rather than the state itself is engaged in commercial activity."[80]

On waivers, the Group said:

> First, although questions have been raised about the absence of a requirement connecting an explicit waiver to the territory of the United States, the Working Group does not recommend any amendment to the current statutory language as long as courts satisfy themselves, using traditional methods of contract interpretation, that a foreign state or instrumentality's waiver was a consent to be sued in the United States. Second, because of the costs and uncertainties associated with implied waivers, the Working Group proposes to amend the FSIA to limit implied waivers to those situations in which a foreign state or instrumentality participates as a defendant in litigation without properly raising or preserving a defense of sovereign immunity. Third, the Working Group recommends that the statute be amended to include language specifying the governing law for determining a person's actual or apparent authority to waive sovereign immunity."[81]

On the commercial exception, the Group said:

> "The only significant change the Working Group recommends for the commercial activity exception is to require a "substantial" and direct effect in the United States when applying the third clause dealing with commercial activity and acts occurring outside of the United States. In Part V, we explain that the Supreme Court's construction of the current direct effect language has caused confusion and disagreements in the lower courts and permits U.S. courts to resolve commercial cases having only the most distant relationship with the United States."[82]

In relation to torts, the Group:

> "recommends two clarifying amendments to the tort exception. First, the U.S. connection language should be amended to specify that the Act applies only when a substantial portion of the tortious act or omission occurs in the United States and that the place of injury or damage is not relevant. Second, the Act should be amended to make clear that the types of claims that may not be brought under the tort exception, such as defamation, deceit, and malicious prosecution, may be brought

[80] Id. at p. 9.

[81] Id. at pp 10-11.

[82] Id. at p. 11.

> under the commercial activity exception. The Working Group also examined the part of the tort exception preserving immunity from tort claims for discretionary functions and determined that courts should continue to apply the current statutory language to deal with the issues that arise."[83]

The Group also recommended removing restrictions on property which could be subject to execution in the US.[84]

EMTA, a trade group for the emerging markets trading and investment community opposed these proposed amendments to the FSIA, in part because it argued that the proposed changes to the FSIA "would have a decidedly negative impact on the ability of emerging market creditors to obtain enforcement of significant categories of the external debt of sovereign borrowers following sovereign defaults."[85] In particular, the EMTA argued against the ABA Working Group's proposal that there should be a substantial and direct effect in the US in relation to the commercial activity:

> From the perspective of emerging market participants, the Working Group's recommendation would, if adopted, displace the bright-line clarity of Weltover, and introduce its own, far more damaging, "confusion and disarray" into the enforcement of financial contracts denominated in United States dollars and payable in the United States which did not contain express submissions to jurisdiction and waivers of immunity. In addition, it goes virtually without saying that introducing the word "substantial" into the jurisdictional test would make it significantly more difficult for United States contracting parties in a broad range of non-financial contracts to obtain jurisdiction in the United States over a defaulting sovereign counterparty. While the Working Group nowhere illuminates the extent to which the proposed amendment would constrict the subject matter jurisdiction of the U.S. courts, it is clear that, under the Working Group's proposal, subject matter jurisdiction would no longer extend to the full reach allowed by due process under International Shoe v. Washington, 326 U.S. 310 (1945), as intended by the Congress in enacting the FSIA in the first place... The "minimum contacts" test articulated in International Shoe can in no way be squared with the "direct and substantial effects" the Working Group would require.[86]

The EMTA pointed out that this idea of requiring substantial effects in the US was rejected by the Supreme Court in Weltover, as the following excerpt from Weltover shows:

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[83] Id.

[84] Id. at p. 12.

[85] EMTA, Opposition of EMTA to Proposed Amendments to the U.S. Foreign Sovereign Immunities Act of 1976, (Aug. 7, 2002).

[86] Id.

The remaining question is whether Argentina's unilateral rescheduling of the Bonods had a "direct effect" in the United States... In addressing this issue, the Court of Appeals rejected the suggestion in the legislative history of the FSIA that an effect is not "direct" unless it is both "substantial" and "foreseeable." ... That suggestion is found in the House Report, which states that conduct covered by the third clause of § 1605(a)(2) would be subject to the jurisdiction of American courts "consistent with principles set forth in section 18, Restatement of the Law, Second, Foreign Relations Law of the United States (1965)." .... Section 18 states that American laws are not given extraterritorial application except with respect to conduct that has, as a "direct and foreseeable result," a "substantial" effect within the United States. Since this obviously deals with jurisdiction to legislate rather than jurisdiction to adjudicate, this passage of the House Report has been charitably described as "a bit of a non sequitur," .... Of course the generally applicable principle de minimis non curat lex ensures that jurisdiction may not be predicated on purely trivial effects in the United States. But we reject the suggestion that § 1605(a)(2) contains any unexpressed requirement of "substantiality" or "foreseeability." As the Court of Appeals recognized, an effect is "direct" if it follows "as an immediate consequence of the defendant's . . . activity."...

The Court of Appeals concluded that the rescheduling of the maturity dates obviously had a "direct effect" on respondents. It further concluded that that effect was sufficiently "in the United States" for purposes of the FSIA, in part because "Congress would have wanted an American court to entertain this action" in order to preserve New York City's status as "a preeminent commercial center."... The question, however, is not what Congress "would have wanted" but what Congress enacted in the FSIA. Although we are happy to endorse the Second Circuit's recognition of "New York's status as a world financial leader," the effect of Argentina's rescheduling in diminishing that status (assuming it is not too speculative to be considered an effect at all) is too remote and attenuated to satisfy the "direct effect" requirement of the FSIA...

We nonetheless have little difficulty concluding that Argentina's unilateral rescheduling of the maturity dates on the Bonods had a "direct effect" in the United States. Respondents had designated their accounts in New York as the place of payment, and Argentina made some interest payments into those accounts before announcing that it was rescheduling the payments. Because New York was thus the place of performance for Argentina's ultimate contractual obligations, the rescheduling of those obligations necessarily had a "direct effect" in the United States: Money that was supposed to have been delivered to a New York bank for deposit was not forthcoming. We reject Argentina's suggestion that the "direct effect" requirement cannot be satisfied where the plaintiffs are all foreign corporations with no other connections to the United States. We expressly stated in Verlinden that the FSIA permits "a foreign plaintiff to sue a foreign sovereign in the courts of the United States, provided the substantive requirements of the Act are satisfied,"...

Finally, Argentina argues that a finding of jurisdiction in this case would violate the Due Process Clause of the Fifth Amendment, and that, in order to avoid this difficulty, we must construe the "direct effect" requirement as embodying the "minimum contacts" test of International Shoe Co. v. Washington... Assuming, without deciding, that a foreign state is a "person" for purposes of the Due Process Clause ... we find that Argentina possessed "minimum contacts" that would satisfy the constitutional test. By issuing negotiable debt instruments denominated in United States dollars and payable in New York and by appointing a financial agent in that city, Argentina "'purposefully availed itself of the privilege of conducting activities within the [United States].'"...

The ABA's Working Group said:

> The *Weltover* Court's discussion of "direct effect" has caused two problems. First, the Court defined direct effect too broadly, made it too easily satisfied, and therefore made U.S. courts available to resolve disputes that have only the most distant relationship with the United States. That means that cases could arise in which foreign states question or object to the application of U.S. law on foreign sovereign immunity. Second, by referring to New York as the place of performance for Argentina's contractual obligations, the Court created confusion and disarray over whether, in a case dependent on the third clause, a contract must require some performance in the United States (a situation already addressed by the first clause) or whether some other "legally significant act" must occur in the United States.[87]

What do you think the rule should be? Does it matter if it is possible to negotiate for a waiver of the immunity?

Where it is necessary to enforce a judgment against a sovereign debtor obtained in one state in another state, sovereign immunity may become an issue in the courts of the second state. So, in **Republic of Argentina v NML Capital Limited**, a creditor which was able to obtain judgment with respect to Argentine debt in the Southern District of New York encountered problems in the UK where the English Court of Appeal[88] treated Argentina's sovereign immunity as a bar to enforcement in England. The Court of Appeal held[89] that although Argentina had waived immunity with respect to the bonds at issue, it had not submitted to the jurisdiction of the English courts as required under the State Immunity Act 1978. The UK Supreme Court subsequently reversed the Court of Appeals' decision. The bonds provided:

> The republic has in the fiscal agency agreement irrevocably submitted to the jurisdiction of any New York state or federal court sitting in the Borough of Manhattan … and the courts of the republic of Argentina ('the specified courts') over any suit, action or proceeding against it or its properties, assets or revenues with respect to the securities of this series or the fiscal agency

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[87] Note 79 above, at 83.

[88] Aikens LJ gave judgment and the other two judges agreed. " Tieless and in shirtsleeves, Mr Justice Aikens (club: Groucho; recreations: music, wine, le Pays Basque) seems to typify the approach of .. judges [of the commercial court] who dislike wigs and robes, chiefly because their many foreign litigants are unused to them. In 80 per cent of all claims issued one party is from outside the jurisdiction. Most claims are for more than £1 million and can be up to £1 billion. "It's another reason why we must have a modern business court because the guys out there are right on top of it; if they think they'll have to go back to quill pens they won't like it." He adds: "It's fair to say that if left to decide we'd do away with robes altogether in commercial disputes. If there's an opportunity not to wear them we take it.""Frances Gibb, A court for the world to solve its business disputes, The Times (Sep. 5, 2006).

[89] [2010] EWCA Civ 41 at http://www.bailii.org/ew/cases/EWCA/Civ/2010/41.html .

> agreement (a 'related proceeding') … The republic has in the fiscal agency agreement waived any objection to related proceedings in such courts whether on grounds of venue, residence or domicile or on the ground that the related proceedings have been brought in an inconvenient forum. The republic agrees that a final non-appealable judgment in any such related proceeding ('the related judgment') shall be conclusive and binding upon it and may be enforced in any specified court or in any other courts to the jurisdiction of which the republic is or may be subject (the 'other courts') by a suit upon such judgment.
>
> To the extent that the republic or any of its revenues, assets or properties shall be entitled, in any jurisdiction in which any specified court is located, in which any related proceeding may at any time be brought against it or any of its revenues, assets or properties, or in any jurisdiction in which any specified court or other court is located in which any suit, action or proceeding may at any time be brought solely for the purpose of enforcing or executing any related judgment, to any immunity from suit, from the jurisdiction of any such court, from set-off, from attachment prior to judgment, from attachment in aid of execution of judgment, from execution of a judgment or from any other legal or judicial process or remedy, and to the extent that in any such jurisdiction there shall be attributed such an immunity, the republic has hereby irrevocably agreed not to claim and has irrevocably waived such immunity to the fullest extent permitted by the laws of such jurisdiction … provided further that such agreement and waiver, in so far as it relates to any jurisdiction other than a jurisdiction in which a specified court is located, is given solely for the purpose of enabling the fiscal agent or a holder of securities of this series to enforce or execute a related judgment.

The judgments in the UK Supreme Court decision[90] follow:

Lord Phillips[91]: Introduction

The appellant ("NML") is a Cayman Island Company. It is an affiliate of a New York based hedge fund of a type sometimes described as a "vulture fund". Vulture funds feed on the debts of sovereign states that are in acute financial difficulty by purchasing sovereign debt at a discount to face value and then seeking to enforce it. This appeal relates to bonds issued by the Republic of Argentina in respect of which, together with all its other debt, Argentina declared a moratorium in December 2001. Between June 2001 and September 2003 affiliates of NML purchased, at a little over half their face value, bonds with a principal value of US$ 172,153,000 ("the bonds"). On 11 May 2006, NML, as beneficial owner, obtained summary judgment on the bonds for a total, including interest, of US$ 284,184,632.30, in a Federal Court in New York. NML brought a common law action on that judgment in this jurisdiction, and succeeded before Blair J in the Commercial Court. That judgment was reversed by the Court

[90] [2011] UKSC 31 at http://www.bailii.org/uk/cases/UKSC/2011/31.html .

[91] Lord Phillips was President of the UK Supreme Court. He retired from the Supreme Court in 2012 and now works as an arbitrator. See http://www.brickcourt.co.uk/door-tenants-silks/lord-phillips.asp.

of Appeal, which held that Argentina is protected by state immunity. The question raised by this appeal is whether that finding was correct.

The bonds and the New York Judgment

The bonds were issued by Argentina in February and July 2000 pursuant to a Fiscal Agency Agreement between Argentina and Bankers Trust Company. The terms applicable to the bonds were contained in the Agreement and the bonds themselves, both of which were expressly governed by the law of New York. In November 2003, having declared events of default under the Fiscal Agency Agreement, relying on the moratorium and Argentina's subsequent failure to pay interest on the bonds, NML commenced proceedings against Argentina in the United States District Court, Southern District of New York, to recover principal and interest due under the bonds. Jurisdiction was founded on an express submission to New York jurisdiction in the Fiscal Agency Agreement. Argentina appeared and defended the proceedings. Judge Thomas P Griesa granted NML's motion for summary judgment. Argentina does not, in these proceedings, challenge that judgment.

The proceedings in this jurisdiction

In order to serve a foreign sovereign state it is necessary to obtain the permission of the court to serve the claim form out of the jurisdiction. On 14 March 2008 NML applied ex parte for this permission. The witness statement supporting this application, and the draft particulars of claim exhibited to it, alleged two reasons why Argentina was not entitled to state immunity. The first was that under clause 22 of the Fiscal Agency Agreement Argentina had waived, and agreed not to plead, any claim that it might have to state immunity. The second was that NML's claim was founded on the Fiscal Agency Agreement and the bonds, and consequently constituted "proceedings relating to a commercial transaction" for the purposes of the State Immunity Act 1978 ("the 1978 Act").

On 2 April 2008, David Steel J granted NML permission to serve Argentina out of the jurisdiction, and service was duly effected. On 5 September 2008 Argentina applied under CPR 11(1) to set the order for service aside on the ground that Argentina enjoyed state immunity from the jurisdiction of the English courts. At the hearing of this application before Blair J NML conceded that it could rely, at first instance, on neither of the grounds for alleging that Argentina did not enjoy immunity that had been advanced in support of the application to serve out. Instead NML sought to rely first on the provisions of section 31 of the Civil Jurisdiction and Judgments Act 1982 ("the 1982 Act") and secondly on alternative provisions as to waiver and jurisdiction in the bonds themselves...

Argentina contended that it was not open to NML to invoke alternative grounds for contending that immunity did not apply when these had not been relied on in the original ex parte application. NML's proper course was to make a fresh application for permission to serve Argentina out of the jurisdiction.

Blair J rejected this procedural objection and found in favour of NML on both the new substantive points [2009] EWHC 110 (Comm); [2009] QB 579. The Court of Appeal reversed Blair J on all three issues [2010] EWCA Civ 41; [2011] 1 QB 8. Aikens LJ gave the only reasoned judgment, with which Mummery and Elias LJJ agreed.

The issues

The following issues are raised by this appeal:

(1) Whether the present proceedings for the recognition and enforcement of the New York court's judgment are

'proceedings relating to a commercial transaction' within the meaning of section 3 of the State Immunity Act 1978. (As I shall explain, this issue was not open to NML in the courts below).

(2) Whether Argentina is prevented from claiming state immunity in respect of the present proceedings by Section 31 of the Civil Jurisdiction and Judgments Act 1982.

(3) Whether the bonds contain a submission to the jurisdiction of the English court in respect of these proceedings within the meaning of section 2 of the State Immunity Act 1978.

(4) Whether NML was entitled to raise at the inter partes hearing the two new points not previously relied on in the ex parte application for permission to serve Argentina out of the jurisdiction.

(5) Whether, having regard to the answers to the above questions, Argentina is entitled to claim state immunity in respect of these proceedings.

The resolution of the first two issues turns on statutory interpretation. This must be carried out in the context of simultaneous developments in the law of sovereign immunity and of the recognition of foreign judgments.

State immunity

At the beginning of the 20th century state immunity was a doctrine of customary international law, applied in England as part of the common law. Under this doctrine a state enjoyed absolute immunity from suit in the court of another state. The property of the state was also immune from execution. Because a state could not be sued, there was no procedural provision in this jurisdiction for service of process on a foreign state. The Court of Appeal had, however, occasion to consider the law of state immunity when proceedings in rem were served on a mail packet owned by Belgium which had been involved in a collision in the case of The Parlement Belge (1880) LR 5 PD 197. The Court held that the vessel, being the property of a foreign sovereign state, was immune from legal process. Giving the judgment of the court Brett LJ explained the reason for this immunity, at pp 207-208 and 220:

> "From all these authorities it seems to us, although other reasons have sometimes been suggested, that the real principle on which the exemption of every sovereign from the jurisdiction of every court has been deduced is that the exercise of such jurisdiction would be incompatible with his regal dignity – that is to say, with his absolute independence of every superior authority. By a similar examination of authorities we come to the conclusion, although other grounds have sometimes been suggested, that the immunity of an ambassador from the jurisdiction of the courts

of the country to which he is accredited is based upon his being the representative of the independent sovereign or state which sends him, and which sends him upon the faith of his being admitted to be clothed with the same independence of and superiority to all adverse jurisdiction as the sovereign authority whom he represents would be.

It has been held that an ambassador cannot be personally sued, although he has traded; and in both cases because such a suit would be inconsistent with the independence and equality of the state which he represents. If the remedy sought by an action in rem against public property is, as we think it is, an indirect mode of exercising the authority of the court against the owner of the property, then the attempt to exercise such an authority is an attempt inconsistent with the independence and equality of the state which is represented by such an owner. The property cannot upon the hypothesis be denied to be public property; the case is within the terms of the rule; it is within the spirit of the rule; therefore, we are of opinion that the mere fact of the ship being used subordinately and partially for trading purposes does not take away the general immunity."

In Mighell v Sultan of Johore [1894] 1 QB 149 leave to effect substituted service on the Sultan of Johore in an action in personam was set aside on the ground that he enjoyed sovereign immunity. To an argument that he had waived this immunity, the court held that the only way that a sovereign could waive immunity was by submitting to jurisdiction in the face of the court as, for example, by appearance to a writ. If the sovereign ignored the issue of the writ, the court was under a duty of its own motion to recognise his immunity from suit.

In Compania Naviera Vascongado v Steamship "Cristina" [1938] AC 485 the House of Lords confirmed that a state-owned ship that was used for public purposes could not be made the subject of proceedings in rem. Lord Atkin started his judgment with the following definition of state immunity, at p 490:

> "The foundation for the application to set aside the writ and arrest of the ship is to be found in two propositions of international law engrafted into our domestic law which seem to me to be well established and to be beyond dispute. The first is that the courts of a country will not implead a foreign sovereign, that is, they will not by their process make him against his will a party to legal proceedings whether the proceedings involve process against his person or seek to recover from him specific property or damages.
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> The second is that they will not by their process, whether the sovereign is a party to the proceedings or not, seize or detain property which is his or of which he is in possession or control. There has been some difference in the practice of nations as to possible limitations of this second principle as to whether it extends to property only used for the commercial purposes of the sovereign or to personal private property. In this country it is in my opinion well settled that it applies to both."

Three members of the House questioned, however, whether state immunity would protect a vessel that was used for the purposes of commercial trade. This reflected a growing recognition around the world of the "restrictive doctrine" of state immunity under which immunity related to governmental acts in the exercise of sovereign authority (acta jure imperii) but not to commercial activities carried on by the state (acta jure gestionis).

The absolute doctrine of state immunity could pose a disincentive to contracting with a state and some states attempted to avoid this disadvantage by including in contracts an agreement not to assert state immunity. The English courts held, however, that such a purported waiver was ineffective. Immunity could only be lost by a submission to the jurisdiction when it was invoked, and not earlier – see Duff Development Co v Kelantan Government [1924] AC 797 and Kahan v Pakistan Federation [1951] 2 KB 1003.

In Rahimtoola v Nizam of Hyderabad [1958] AC 379, 422 Lord Denning expressed, obiter, the view that judicial immunity should not apply to commercial transactions, but the other members of the House expressly dissociated themselves from this view, because the point had not been argued. It was not until nearly twenty years later that Lord Denning MR was able to carry the rest of the Court of Appeal with him in applying the restrictive doctrine of state immunity in Trendtex Trading Corporation v Central Bank of Nigeria [1977] QB 529. This decision was approved by the House of Lords in I Congreso del Partido [1983] 1 AC 244.

I shall deal with the intervention of Parliament in the form of the 1978 and 1982 Acts when I deal specifically with the first two issues.

Enforcement of foreign judgments

Prior to the 1982 Act the common law provided two alternative remedies to a plaintiff who had obtained a judgment against a debtor in a foreign jurisdiction. He could bring a claim on the judgment or he could bring a claim on the cause of action in respect of which he had obtained the judgment. The former did not merge in the latter.

In order to establish jurisdiction to sue on the judgment the plaintiff had to serve a writ in personam in accordance with the normal procedure. The existence of a foreign judgment was not a ground upon which permission could be obtained to serve a writ out of the jurisdiction. The plaintiff had to establish that a number of conditions were satisfied in order to claim successfully on the foreign judgment. In particular, he had to establish that the foreign court had had jurisdiction over the defendant in accordance with the English rules of private international law and the judgment had to be final and conclusive on the merits.

Part II of the Administration of Justice Act 1920 ("the 1920 Act") provides an alternative means of enforcing, in the United Kingdom, the judgment of a superior court in another part of "His Majesty's dominions". Section 9 of that Act provides that, subject to the conditions there specified, the High Court may, "if in all the circumstances of the case they think it is just and convenient that the judgment should be enforced in the United Kingdom" order the judgment to be registered. The conditions include a requirement that the foreign court should have had jurisdiction and preclude registration where the judgment is "in respect of a cause of action which for reasons of public policy or for some other similar reason could not have been entertained by the registering court". These conditions plainly preclude the registration of a judgment against a defendant who, under English law, is subject to state immunity. Prior to 1978 there is no record, so far as I am aware, of any plaintiff having attempted to register such a judgment.

The Foreign Judgments (Reciprocal Enforcement) Act 1933 was passed to make provision for the enforcement in the United Kingdom of judgments given in foreign countries that accord reciprocal treatment to judgments given in the United Kingdom. Section 2 of this Act provides for registration of such judgments on specified conditions, subject to the right of the judgment debtor to apply to have the judgment set aside. The section provides that for the purposes of execution a registered judgment is to be treated as if it were a judgment of the registering court.

Section 4 makes provision for an application to set aside a registered judgment. The section includes a provision that the judgment shall be set aside if the registering court is satisfied that the foreign court had no jurisdiction in the circumstances of the case. The section further provides by subsection (3)(c) that the foreign court shall not be deemed to have had jurisdiction

> "if the judgment debtor, being a defendant in the original proceedings, was a person who under the rules of public international law was entitled to immunity from the jurisdiction of the courts of the country of the original court and did not submit to the jurisdiction of that court. "

This last provision is significant in the present context in that it implicitly provides for the registration of a judgment against a state, a state entity or an individual who was subject to state immunity in the foreign country if there has been a submission to the foreign jurisdiction. The 1933 Act contains no provision, however, that permits enforcement of such a judgment against property owned by a state. Furthermore section 2(1)(b) of the Act precludes recognition of a judgment that cannot be enforced by execution in the country of the original court, and section 4(1)(a)(v) requires the registration of a judgment to be set aside if enforcement would be contrary to the public policy of the registering court. So long as the absolute doctrine of state immunity prevailed in the United Kingdom it is hard to envisage registration of a foreign judgment against a judgment debtor who had been entitled to state immunity, but who had submitted to the foreign jurisdiction, except perhaps a diplomat in respect of whom his state had waived diplomatic immunity. There does not seem to be any recorded instance of such a case.

Issue 1: are the present proceedings "proceedings relating to a commercial transaction" within the meaning of the State Immunity Act 1978?

The 1978 Act had its origin in the need to give effect to the ECSI, but as the Bill passed through Parliament the scope of the legislation was widened so as to make provisions in relation to state immunity having effect on all states, and not just those party to the Convention. Fox on The Law of State Immunity 2nd ed (2008), at p 241 and following, describes the genesis of the Act.

Section 3(1) of the 1978 Act provides: "A State is not immune as respects proceedings relating to – (a) a commercial transaction entered into by the state". Section 3(3)(b) defines "commercial transaction" as including "any loan or other transaction for the provision of finance…". In view of this definition it is not surprising that it is common ground that the action in respect of which NML obtained judgment in New York was a "proceeding relating to a commercial transaction" within the meaning of section 3(1)(a). Permission to effect service on Argentina out of the jurisdiction was obtained from David Steel J on the basis of an averment that the common law action that was to be brought in England on the New York judgment was also a "proceeding relating to a commercial transaction". However before Blair J and the Court of Appeal NML conceded that this averment was not open to them short of the Supreme Court. This was because of two reasoned decisions, one in the High Court and one in the Court of Appeal which, albeit that the latter was obiter, constrained NML to accept that, for the purposes of section 3(1)(a), the action that NML was seeking to bring was a proceeding "relating to" the New York judgment and not to the transaction to which that judgment related. Before this Court Mr Sumption QC has challenged these authorities. Issue 1 turns on the question of whether they were rightly decided.

The first of these cases is AIC Ltd v Federal Government of Nigeria [2003] EWHC 1357 (QB). AIC registered under the 1920 Act a judgment that they had obtained in Nigeria against the Nigerian Government in relation to what AIC alleged to be a commercial transaction. The Nigerian Government applied to have the registration set aside on the ground that registration was an adjudicative act and that Nigeria was protected by state immunity by reason of section 1 of the 1978 Act. AIC argued that their application to register the judgment was a "proceeding relating to a commercial transaction" within section 3(1)(a). Stanley Burnton J rejected this submission. His reasoning appears in the following short passage in para 24 of his judgment

> "In my judgment, the proceedings resulting from an application to register a judgment under the 1920 Act relate not to the transaction or transactions underlying the original judgment but to that judgment. The issues in such proceedings are concerned essentially with the question whether the original judgment was regular or not."

Stanley Burnton J held that this conclusion was supported by two matters. The first was that section 9 of the 1978 Act excludes immunity "as respects proceedings … which relate to [an] arbitration" where the state has entered into a written arbitration agreement. As most arbitrations relate to commercial transactions, section 9 would be unnecessary if a claim in respect of an arbitration constituted a "proceeding relating to the commercial transaction" to which the arbitration related, for that would fall within 3(1)(a). The second matter was that it would be illogical to exempt from immunity the enforcement of a judgment in relation to a commercial transaction, but not the enforcement of a judgment in relation to any of the other matters in respect of which the 1978 Act provided exceptions to immunity under sections 3 to 11 of the Act.

Stanley Burnton J remarked at para 30 that it was unsurprising that the defendants were immune from proceedings for the registration of the Nigerian judgment:

> "the underlying principle of the State Immunity Act is that a state is not immune from the jurisdiction of the courts of the United Kingdom if it enters into commercial transactions or undertakes certain activities having some connection with this jurisdiction. Purely domestic activities of a foreign state are not the subject of any exception to immunity. Sections 3(1)(b), 4, 5, 6, 7, 8 and 11 all contain territorial qualifications to the exceptions to immunity to which they relate. Section 3(1)(a) does not include any such qualification, but even there the claimant wishing to bring proceedings must establish a basis for jurisdiction under CPR Part 6.20, normally under paragraphs (5) or (6), relating to contractual claims."

Stanley Burnton J went on to observe that Lord Denning MR when advancing the restrictive doctrine of state immunity in Rahimtoola v Nizam of Hyderabad [1958] AC 379, 422, in Thai-Europe Tapioca Service Ltd v Government of Pakistan, Directorate of Agricultural Supplies [1975] 1 WLR 1485, 1491 and in Trendtex Trading v Bank of Nigeria [1977] 1 QB 529, 558 had emphasised the significance not merely of the fact that the proceedings related to a commercial transaction, but that the transaction was connected with the United Kingdom.

A similar issue to that considered by Stanley Burnton J arose in Svenska Petroleum Exploration AB v Government of the Republic of Lithuania (No 2) [2005] EWHC 2437 (Comm); [2006] 1 Lloyd's Rep 181. There the relevant issue was whether a claim to enforce an arbitration award constituted "proceedings relating to" the transaction that gave rise to the award for the purposes of section 3(1)(a). Gloster J followed Stanley Burnton J's reasoning in holding that it did not. Her decision on the point was obiter, but it received reasoned approval, also obiter, when the case reached the Court of Appeal [2006] EWCA Civ 1529; [2007] QB 886. The court held at para 137:

> "In our view the expression 'relating to' is capable of bearing a broader or narrower meaning as the context requires. Section 3 is one of a group of sections dealing with the courts' adjudicative jurisdiction and it is natural, therefore, to interpret the phrase in that context as being directed to the subject matter of the proceedings themselves rather than the source of the legal relationship which has given rise to them. To construe section 3 in this way does not give rise to any conflict with section 9, which is concerned with arbitration as the parties' chosen means of resolving disputes rather than with the underlying transaction. In our view AIC Ltd v Federal Government of Nigeria was correctly decided and Gloster J was right to follow it in the present case."

I agree with the Court of Appeal that the expression "relating to" is capable of bearing a broader or narrower meaning as the context requires. I disagree, however, with their conclusion as to the relevant context. Sections 1 to 11 of the 1978 Act are a comprehensive statement of the scope of state immunity under the law of the United Kingdom. Section 3(1)(a) makes it plain that the United Kingdom applies the restrictive doctrine of state immunity. The context in which the question of the meaning of "relating to" has arisen in this case is the issue of whether Argentina is or is not protected by state immunity against the proceedings that NML seek to bring. The object of bringing these proceedings is to enforce the New York judgment. Argentina has not suggested that (subject to the issue of immunity) these proceedings did not fall within CPR 6.20(9), which provides for service out of the jurisdiction "if a claim is made to enforce any judgment or arbitral award". The only issue is whether Argentina is immune from the claim. Whether a state is immune from such a claim should, under the restrictive doctrine of state immunity, depend upon the nature of the underlying transaction that has given rise to the claim, not upon the nature of the process by which the claimant is seeking to enforce the claim. When considering whether a state is entitled to immunity in respect of a claim to enforce a foreign judgment the question "does the claim constitute proceedings relating to a commercial transaction?" can only be given a meaning that is sensible if "relating to" is given a broad, rather than a narrow, meaning. The proceedings relate both to the foreign judgment and to the transaction underlying that judgment, but in the context of restrictive state immunity it only makes sense to focus on the latter.

The argument to the contrary accepted by Stanley Burnton J in AIC proceeds as follows. There is a distinction between the adjudicative and the executionary stages of these proceedings. First NML has to establish liability in this jurisdiction and then proceed to attempt to levy execution. The question is whether Argentina enjoys immunity from the adjudicative stage. That stage involves the conversion of the New York judgment into an English judgment. The proceedings to effect this conversion do not turn on the nature of the underlying transaction, but on whether the judgment in respect of that transaction was regularly obtained. Thus those proceedings do not relate to the underlying transaction.

The fallacy in this argument is that the issue raised in the present proceedings is not the regularity of the New York judgment but whether Argentina is immune to an action on that judgment. Mr Howard QC put the matter more accurately at para 15 of his written case:

> "It is important to bear in mind that the issue in these proceedings is not whether the English court had jurisdiction to entertain proceedings on the bonds. It is common ground that it did not. Rather, the issue is whether the present proceedings for the recognition and enforcement of the New York judgment are proceedings 'relating to' that judgment, or are, instead, proceedings 'relating to' a 'commercial transaction entered into by' Argentina within the meaning of section 3(1)(a) on the grounds that the New York proceedings on which the New York judgment was based were proceedings 'relating to' a commercial transaction entered into by Argentina (ie 'relating to' the bonds)."

The issue that Mr Howard identifies has to be answered in order to determine whether, under English law, Argentina enjoys state immunity in relation to these proceedings. That question ought to be answered in the light of the restrictive doctrine of state immunity under international law. There is no principle of international law under which state A is immune from proceedings brought in state B in order to enforce a judgment given against it by the courts of state C, where state A did not enjoy immunity in respect of the proceedings that gave rise to that judgment. Under international law the question of whether Argentina enjoys immunity in these proceedings depends upon whether Argentina's liability arises out of acta jure imperii or acta jure gestionis. This involves consideration of the nature of the underlying transaction that gave rise to the New York judgment. The fact that NML is seeking to enforce that judgment in this jurisdiction by means of an action on the judgment does not bear on the question of immunity. This leads to the conclusion that the context in which the issue of the meaning of the words "relating to" arises in this case requires one to look behind the New York judgment at the underlying transaction.

I must deal with the matters that Stanley Burnton J considered supported the narrower interpretation of "relating to" in AIC Ltd v Federal Government of Nigeria. The first is that section 9 would not be needed if section 3(1)(a) applies to proceedings to enforce an arbitration award. It is true, if "relating to" is given the wider meaning, that the circumstances covered by section 9 of the 1978 Act will often overlap with the circumstances covered by section 3(1)(a), but this will not always be the case. Not all arbitrations relate to commercial transactions. Furthermore, as Mr Sumption pointed out, section 9 relates not only to proceedings to enforce an award, but to all proceedings relating to an arbitration to which a state is party, and establishes jurisdiction of the English court in relation to all such proceedings.

In order to deal with the second matter to which Stanley Burnton J referred, it is necessary to quote the point that he made in his own words at para 26:

> "Furthermore, if Parliament had intended the State Immunity Act to include an exception from immunity relating to the registration of foreign judgments, it would have been illogical to limit it to commercial transactions entered into by the state (which is the consequence of AIC's contentions), with no provision for the registration of foreign judgments where the exception to immunity before the original court was the equivalent of one of the other exceptions to immunity in that Act."

In argument this point was, I believe, misunderstood. It was assumed that Stanley Burnton J was suggesting that if a foreign judgment relating to a commercial transaction were enforceable here, so logically should a foreign judgment dealing with one of the other matters specifically exempted from immunity under the 1978 Act. Thus, for instance, if in New York a judgment were given against Argentina in respect of personal injury caused to the claimant in the United Kingdom, one would expect that judgment to be enforceable here – see section 5 of the 1978 Act.

Mr Sumption's answer was that the judgment would in fact be enforceable here. An action on the New York judgment would be an action "in respect of" the personal injury caused in the United Kingdom.

I believe that we all misunderstood Stanley Burnton J's point. It was not that it would be logical to be able to enforce here a New York judgment dealing with a personal injury caused in the United Kingdom, but a New York judgment where there was an exemption from immunity equivalent to that provided by section 5 – ie a New York judgment in respect of a personal injury caused in New York. As to that point, I agree with Stanley Burnton J. It was illogical that the 1978 Act did not make provision for the enforcement in this country of such a judgment. This was because the draftsman of the 1978 Act did not deal generally with foreign judgments. That omission was made good by section 31 of the 1982 Act, as I shall show.

The other matter that impressed Stanley Burnton J was the desirability of giving section 3(1)(a) an interpretation which would have the effect of requiring a link between the defendant state's commercial transaction and the United Kingdom jurisdiction. He drew attention to the existence of such a link in the other exemptions to state immunity in the 1978 Act and to dicta of Lord Denning. It is true that the need for such a link receives support from dicta of Lord Denning in the judgments prior to 1978 in which he sought to introduce the restrictive doctrine of state immunity into English law. Thus in Thai-Europe Tapioca Service v Government of Pakistan he said, [1975] 1 WLR 1485, 1491-1492:

> …a foreign sovereign has no immunity when it enters into a commercial transaction with a trader here and a dispute arises which is properly within the territorial jurisdiction of our courts…By this I do not mean merely that it can be brought within the rule for service out of the jurisdiction under

> RSC Ord, 11, r 1. I mean that the dispute should be concerned with property actually situate within the jurisdiction of our courts or with commercial transactions having a most close connection with England, such that, by the presence of parties or the nature of the dispute, it is more properly cognisable here than elsewhere.

Fox on The Law of State Immunity at p 269 describes the academic criticism of what was alleged to be confusion by Lord Denning of the doctrine of state immunity with principles of extra territorial jurisdiction.
When Parliament enacted the 1978 Act the exemption from immunity under section 3(1)(a) in respect of proceedings relating to a commercial transaction entered into by the state was not qualified by any requirement for a link between the transaction and the United Kingdom. This was not accidental. The United Kingdom ratified the ECSI on the same day that the 1978 Act came into force, and the Act was designed to give effect to the Convention. The original Bill followed closely the structure of the ECSI. Its scope was, however, significantly enlarged by amendment. The ECSI only applies as between contracting states. The 1978 Act was expanded so as to apply to all states. The ECSI does not give effect to the restrictive doctrine of sovereign immunity. Article 24 provides, however, that any state may declare that

> …its courts shall be entitled to entertain proceedings against another Contracting State to the extent that its courts are entitled to entertain proceedings against States not party to the present Convention. Such declaration shall be without prejudice to the immunity from jurisdiction which foreign States enjoy in respect of acts performed in the exercise of sovereign authority (acta jure imperii).

The United Kingdom made such a declaration at the time of ratification of the Convention. In Kuwait Airways Corporation v Iraqi Airways Corporation [1995] 1 WLR 1147, 1158 Lord Goff, with whom the rest of the Committee agreed, observed that the declaration:

> "must have been intended to recognise the inapplicability in English law of the principle of sovereign immunity in cases in which the sovereign was not acting jure imperii, as had by then been recognised both in The Philippine Admiral [1977] AC 373 and in the Trendtex case [1977] QB 529, though the authoritative statement of the law by Lord Wilberforce in I Congreso del Partido [1983] 1 AC 244, 262, was not then available. At all events, the consequential exception included in section 3 of the Act of 1978 related to commercial transactions, though in section 3(3) the expression 'commercial transactions' is very broadly defined."

I can see no justification for giving section 3(1)(a) a narrow interpretation on the basis that it is desirable to restrict the circumstances in which it operates to those where the commercial transaction has a link with the United Kingdom. The restrictive doctrine of sovereign immunity does not restrict the exemption from immunity to commercial transactions that are in some way linked to the jurisdiction of the forum.
For these reasons I have concluded that Stanley Burnton J's decision on this point in AIC and the Court of Appeal's approval of it in Svenska was erroneous. By reason of section 3(1)(a) of the 1978 Act Argentina is not immune from the proceedings that NML have commenced in this jurisdiction. My conclusion accords with the decisions on the identical points of the Quebec Court of Appeal and the Supreme Court of Canada in Kuwait Airways Corporation v Republic of Iraq [2009] QCCA 728; [2010] SCC 40, [2010] 2 SCR 571. Mr Howard relied upon the approaches taken in Holland v Lampen-Wolfe [2001] 1 WLR 1573, 1587, per Lord Millett, in Australian

Competition and Consumer Commission v P T Garuda Indonesia Ltd (2010) 269 ALR 98, paras 105-137 and Bouzari et al v Attorney General of Canada et al (Bouzari v Iran (Islamic Republic)) [2004] 243 DLR (4th) 406, para 51. None of these cases concerned, however, the meaning of "relating to" in the context of an action on a foreign judgment. Such an action is sui generis and I did not find the authorities in question of assistance.

For these reasons I differ from the Court of Appeal on the answer to the first issue. My conclusion is that the present proceedings are "proceedings relating to a commercial transaction" within the meaning of section 3 of the 1978 Act.

The conclusion that I have reached resolves an issue that may not have occurred to the draftsman of the 1978 Act or to Parliament when enacting it. While section 9 of the Act makes express provision for arbitration awards, the Act makes no mention of proceedings in relation to foreign judgments against states, other than Part II, which deals with judgments against the United Kingdom in the courts of other states party to the ECSI; there have been, in fact, only 8 ratifications of that Convention. Prior to 1978 there had been no attempts to enforce in the United Kingdom foreign judgments against states. As I have explained the 1920 and the 1933 Acts gave little scope for registering foreign judgments against states and there is no recorded instance of an attempt to do this before 1978. In 1978 the Rules of Court made no provision for impleading a foreign sovereign, no doubt reflecting the previous absolute doctrine of state immunity. Section 12(1) of the 1978 Act made provision for service on a state and section 12(7) made it plain that such service required permission, which could only be granted in accordance with the rules of court governing service out of the jurisdiction. There was no provision in 1978 for service out of the jurisdiction of a claim to enforce a judgment. In these circumstances it is perhaps not surprising that the Act made no express provision in relation to proceedings to enforce foreign judgments, other than judgments against the United Kingdom covered by the ECSI.

My decision on the first issue may make the other three issues academic, but they were fully argued and I propose to deal with them, not least because other members of the Court may not agree with me on the first issue.

Issue 2: Is Argentina prevented from claiming state immunity in respect of the present proceedings by section 31 of the Civil Jurisdiction and Judgments Act 1982?

The primary object of the 1982 Act was to give effect to the Brussels Convention of 1968. This Convention made provision for the reciprocal recognition and enforcement of judgments. The application of section 31 was not, however, restricted to the states who were parties to that Convention. The following are the most significant provisions of that section:

> "(1) A judgment given by a court of an overseas country against a state other than the United Kingdom or the state to which that court belongs shall be recognised and enforced in the United Kingdom if and only if…
>
> (a) it would be so recognised and enforced if it had not been given against a state; and (b) that court would have had jurisdiction in the matter if it had applied rules corresponding to those applicable to such matters in the United Kingdom in accordance with sections 2 to 11 of the State Immunity Act 1978.
>
> (4) Sections 12, 13 and 14(3) and (4) of the State Immunity Act 1978 (service of process and procedural privileges) shall apply to proceedings for the recognition or enforcement in the United

Kingdom of a judgment given by the court of an overseas country (whether or not that judgment is within subsection (1) of this section) as they apply to other proceedings."

It is NML's case that section 31 provides comprehensively for the recognition and enforcement of the foreign judgments to which it applies. If this is correct the first issue ceases to be of relevance but for the possible impact of the fourth issue. My conclusion in relation to the first issue is, however, entirely in harmony with NML's case on the second issue. Blair J found in favour of NML on this issue, but his decision was reversed by the Court of Appeal.

If NML's interpretation of section 31 is correct, it effected an addition to the categories of exemption from state immunity set out in the 1978 Act. Aikens LJ could not accept that an extension would have been effected in this way, without any express amendment to the 1978 Act. He interpreted section 31 as imposing an additional requirement to exemption from immunity where an action was brought to enforce a foreign judgment. The claimant would first have to show that section 31 of the 1982 Act was satisfied and then that the proceedings fell within one of the exemptions from immunity set out in sections 2 to 11 of the 1978 Act.

I do not believe that Aikens LJ's analysis is correct. Section 31 provides for recognition of a foreign judgment against a state where there exists a connection between the subject matter of that judgment and the forum state that is equivalent to one that would give rise to an exception to immunity in this jurisdiction. Thus, so far as foreign judgments are concerned, section 31 both reflects and, in part, replaces the exemptions from immunity contained in the 1978 Act. The words "if, and only if" in section 31 are important. Let me revert to the example that I gave in para 32 above. Section 31 provides for the recognition and enforcement of a New York judgment against a state in respect of a personal injury caused in New York. Conversely it would not permit recognition of a New York judgment against a state in respect of a personal injury caused by the state in the United Kingdom unless, as in reality would be likely to be the case, there was an alternative basis for recognition that satisfied section 31, such as submission to New York jurisdiction by the foreign state. In short, far from providing an additional hurdle that the claimant has to cross before enforcing a foreign judgment against a state, section 31 provides an alternative scheme for restricting state immunity in the case of foreign judgments.

If Aikens LJ were correct, section 31 would be largely nugatory. Even though, according to the British view of state immunity, the state against which the foreign judgment was given would have had no entitlement to immunity, this country would be prevented from recognising or enforcing the foreign judgment unless the case also fell within one of the exceptions in the 1978 Act. If I am right on the first issue, one exception which would in practice be capable of application would be section 3(1)(a). None of the other exceptions would be likely to be capable of application, with the exception of section 2.

Both the wording of section 31(1) and the scheme to which it gives effect appear to me to be clear. State immunity cannot be raised as a bar to the recognition and enforcement of a foreign judgment if, under the principles of international law recognised in this jurisdiction, the state against whom the judgment was given was not entitled to immunity in respect of the claim. There is, however, one complication.

The complication is as to the effect of section 31(4) of the 1982 Act. The first problem that I have is reconciling the words in parenthesis in the subsection - "whether or not that judgment is within" section 31(1) - with the provision in section 31(1) that a foreign judgment shall be enforced "if, and only if" the requirements of the subsection are satisfied. The second is as to how to make sense of the provisions of section 14(3) in the context of proceedings to enforce a foreign judgment. Mr Howard QC for Argentina submitted that, with the aid of the application of a wet towel to the head, it was possible to determine that the provisions of section 14(3) were only consistent with Argentina's case on the construction of section 31(1). This argument was considered by Aikens LJ at paras 80 to 86 of his judgment. He concluded that the reference in section 31(4) of the 1982 Act to section 14(3), and so to 14(2) of the 1978 Act "tends to support" Argentina's case on the construction of section 31.

I agree with this conclusion. It is not easy to reconcile the reference in section 14(3) to the submission by a separate entity "to the jurisdiction in respect of proceedings in the case of which it is entitled to immunity" with a scheme where any relevant submission to jurisdiction will be in a foreign forum. Sections 14(2) and 14(3) are part of a particularly complex part of the 1978 Act. It is not easy to make sense of all their provisions in the context of the 1978 Act itself, let alone section 31 of the 1982 Act. Their general object is, however, clear, which is to provide the same protection for a separate entity acting in the exercise of sovereign authority as is accorded to a state, including the protection against enforcement in section 13. I do not consider that it would be right to abandon an interpretation of section 31 which I find clear and compelling in order to attempt to give a coherent role to section 14(3) of the 1978 Act, as applied by section 31(4) of the later Act.

Section 31(4) made section 12 of the 1978 Act applicable to proceedings for the recognition or enforcement of a foreign judgment and thereby made such proceedings subject to the rules of court governing service out of the jurisdiction. These rules were significantly amended in consequence of the passing of the 1982 Act by Rules of the Supreme Court (Amendment No 2) 1983 (SI 1983/1181). In particular the following new provision was introduced into RSC, Ord 11, r (1)(1):

> "…service of a writ out of the jurisdiction is permissible with the leave of the court if in the action begun by the writ- …(m) the claim is brought to enforce any judgment or arbitral award."

It thus became possible to obtain leave to serve out of the jurisdiction proceedings in respect of an action on a foreign judgment in circumstances where this was not governed by any Convention. No question appears to have been raised as to the fact that this opened the door to enforcement proceedings in this country of overseas judgments given against states.

For these reasons, in agreement with Blair J at para 26 of his judgment, and disagreement with Aikens LJ, I conclude that the effect of section 31 of the 1982 Act, together with the addition to RSC, Order 11 was accurately summarised by Dicey, Morris & Collins, The Conflict of Laws, 14th ed (2006), vol 1, para 14-095, as follows:

> "The effect of [section 31] is that a foreign judgment against a state, other than the United Kingdom or the state to which the court which pronounced the judgment belongs, is to be recognised and enforced in the United Kingdom if [the judgment] would be so recognised and enforced if it had not been given against a state and the foreign court would have had jurisdiction in the matter if it had applied rules corresponding to those applicable to such matters in the United Kingdom in accordance with sections 2 to 11 of the [1978 Act].
>
> … A foreign judgment against a state will be capable of enforcement in England if both of the following conditions are fulfilled: first, that the foreign court would have had jurisdiction if it had applied the United Kingdom rules on sovereign immunity set out in sections 2 to 11 of the [1978 Act], the effect of which is that a state is not immune (inter alia) where it submits to the jurisdiction or where the proceedings relate to a commercial transaction; second, that under United

> Kingdom law the state is not immune from the processes of execution. Section 31(4) of the 1982 Act gives to judgments against foreign states the benefit of (inter alia) the immunities from execution contained in sections 13 and 14(3), (4) of the 1978 Act; their effect is that there can be no execution against sovereign property without the written consent of the foreign state unless the property is in use or intended for use for commercial purposes. "

Issue 3: Do the Bonds contain a submission to the jurisdiction of the English court in respect of these proceedings within the meaning of section 2 of the 1978 Act?
Section 2(2) of the 1978 Act varied the law of what was capable of amounting to a submission by a state to the jurisdiction of the English court, as I have described it at paras 9 and 11 above, in that it provided that a state could submit to the jurisdiction by a written agreement prior to any dispute arising. The issue on this appeal is simply whether, on the true construction of the relevant provisions of the bonds, Argentina submitted to the jurisdiction of the English court. The bonds were governed by New York law and that law applies a narrow construction in favour of the state to the construction of a term which is alleged to waive state immunity.
The relevant provisions of the bonds are set out in appendix 3 in two paragraphs. Blair J at paras 32 to 38 of his judgment concluded that the first paragraph contained a submission to the jurisdiction of the English court. Before Aikens LJ, NML relied on the second paragraph as supporting the conclusion that Blair J had drawn from the first. They were, however, unsuccessful, for Aikens LJ ruled that, even when the two paragraphs were read together, they did not constitute a submission to the jurisdiction of the English court.
There was and is a degree of common ground. It is accepted that the judgment of the New York court is a "related judgment", that is a judgment in "related proceedings". The issue in relation to the provisions of the first paragraph is whether the following provision constitutes a submission to the jurisdiction of the English court:

> "…the related judgment shall be conclusive and binding upon [Argentina] and may be enforced in any specified court or in any other courts to the jurisdiction of which the republic is or may be subject (the 'other courts') by a suit upon such judgment…"

Blair J considered at para 38 that this provision constituted a submission to the jurisdiction of the English court inasmuch as

> "Argentina unambiguously agreed that a final judgment on the bonds in New York should be enforceable against Argentina in other courts in which it might be amenable to a suit on the judgment."

Aikens LJ did not agree. He held at para 101 that the agreement that the New York judgment could be enforced in any courts to the jurisdiction "of which Argentina is or may be subject by a suit upon such judgment" was neither a waiver of jurisdiction nor a submission to the jurisdiction of the English court. I do not follow this reasoning. It seems to rob the provision of all effect. Blair J held that this agreement was more than a mere waiver, and I agree. If a state waives immunity it does no more than place itself on the same footing as any other person. A waiver of immunity does not confer jurisdiction where, in the case of another defendant, it would not exist. If, however, state immunity is the only bar to jurisdiction, an agreement to waive immunity is tantamount to a submission to the jurisdiction. In this case Argentina agreed that the New York judgment could be enforced by a suit upon the judgment in any court to the jurisdiction of which, absent immunity, Argentina would be subject. It was both an agreement to waive immunity and an express agreement that the New York judgment could be sued on in any country that, state immunity apart, would have jurisdiction. England is such a country, by reason of what, at the material time, was CPR 6.20(9). The provision in the first paragraph constituted a submission to the jurisdiction of the English courts.

If consideration of the first paragraph alone left any doubt that the terms of the bonds included a submission to this jurisdiction, this would be dispelled by the second paragraph. Omitting immaterial words, this reads:

> "To the extent that the republic … shall be entitled, in any jurisdiction … in which any … other court is located in which any suit, action or proceeding may at any time be brought solely for the purpose of enforcing or executing any related judgment, to any immunity from suit, from the jurisdiction of any such court … from execution of a judgment or from any other legal or judicial process or remedy, and to the extent that in any such jurisdiction there shall be attributed such an immunity, the republic has irrevocably agreed not to claim and has irrevocably waived such immunity to the fullest extent permitted by the laws of such jurisdiction … solely for the purpose of enabling … a holder of securities of this series to enforce or execute a related judgment."

The words "may at any time be brought" which I have emphasised once again constitute Argentina's agreement that the waiver of immunity applies in respect of any country where, immunity apart, there is jurisdiction to bring a suit for the purposes of enforcing a judgment on the bonds. England is such a jurisdiction. Thus the second paragraph constitutes an independent submission to English jurisdiction. Both jointly and severally the two paragraphs amount to an agreement on the part of Argentina to submit to the jurisdiction of the English (no doubt among other) courts.

This conclusion does not involve a departure from the narrow approach to construction required by the law of New York. It gives the provisions as to immunity in the bonds the only meaning that they can sensibly bear. Neither Aikens LJ nor Mr Howard suggested any alternative meaning for the words. The reality is that Argentina agreed that the bonds should bear words that provided for the widest possible submission to jurisdiction for the purposes of enforcement, short of conferring jurisdiction on any country whose domestic laws would not, absent any question of immunity, permit an action to enforce a New York judgment. No doubt those responsible were anxious to make the bonds as attractive as possible.

Aikens LJ held at para 103 that because, in the present proceedings, NML had to bring an action in this jurisdiction to obtain recognition of the New York judgment, the proceedings here were not "brought solely for the purpose of enforcing or executing any related judgment". This was to confuse the means with the ends. Obtaining recognition of the New York judgment is no more than an essential stepping stone to attempting to enforce it. No suggestion has been made that there is any other purpose in bringing these proceedings.

For this reason I would reverse the decision of the Court of Appeal on the third issue also.

Issue 4: Were NML entitled to raise at the inter partes hearing the two new points not relied on in the ex parte application to serve Argentina out of the jurisdiction?

This issue has been described as the "gateway issue". It involves consideration of the effect of what I shall describe as the rule in Parker v Schuller (1901) 17 TLR 299.

A claimant has always been required by rules of court to include in the application for permission to serve proceedings out of the jurisdiction a statement of the ground for doing so. This requirement is currently to be found in CPR 6.37 (1)(a), which expressly requires an application for permission to serve a claim form out of the jurisdiction to set out which of the grounds for service out (now contained in paragraph 3.1 of Practice Direction B) is relied on.

CPR 6.37 (3) provides:

> "The court will not give permission unless satisfied that England and Wales is the proper place in which to bring the claim."

In Parker v Schuller the plaintiffs obtained leave to serve a writ out of the jurisdiction under Order 11, r 1(e) of the RSC on the ground that the claim was for breach of a contract within the jurisdiction. The breach alleged was of a CIF contract, and the allegation was that the contract was broken by reason of a failure to deliver in Liverpool the goods that were the subject of the contract. Leave was given ex parte and upheld inter partes. In the Court of Appeal the plaintiffs conceded that the way that their claim had been advanced had been misconceived in that a CIF contract involves an obligation to deliver documents, not the goods to which the documents relate. The plaintiffs sought to persuade the Court of Appeal to uphold the leave given to serve out on the basis of substituting for the original claim a claim for failure to deliver the relevant documents in Liverpool. The Court of Appeal refused to permit this. At p 300 A L Smith MR is reported as saying:

> Romer LJ added: "…an application for leave to issue a writ for service out of the jurisdiction ought to be made with great care and looked at strictly. If a material representation upon which the leave was obtained in the first instance turned out to be unfounded, the plaintiff ought not to be allowed, when an application was made by the defendant to discharge the order for the issue of the writ and the service, to set up another and a distinct cause of action which was not before the judge upon the original application."

It should be noted that in this case the plaintiffs sought to rely upon different facts and not merely upon a different cause of action.

Parker v Schuller was soon lost from sight until it was applied with obvious reluctance by Sir Nicolas Browne-Wilkinson V-C in Re Jogia (A Bankrupt) [1988] 1 WLR 484. Since then it has been referred to or applied in a significant number of decisions at first instance or in the Court of Appeal. The most significant of these, for it expanded the scope of the original decision, was Metall und Rohstoff A G v Donaldson Lufkin & Jenrette Inc [1990] 1 QB 391. The facts of that case are complex, but it suffices to record the response, at p 436, of Slade LJ, giving the judgment of the court, to one of the submissions of counsel for the plaintiffs:

> "One of Mr Waller's responses to this contention has been to refer us to the general observations made by Lord Denning MR in In re Vandervell's Trusts (No 2) [1974] Ch 269, 231, as to the modern practice concerning pleadings:
>
> "It is sufficient for the pleader to state the material facts. He need not state the legal result. If, for convenience, he does so, he is not bound by, or limited to, what he has stated."

We respectfully agree with this statement as a general proposition. However, it was not made in the context of a pleading intended to be served out of the jurisdiction, to which we think rather different considerations apply. In our judgment, if the draftsman of a pleading intended to be served out of the jurisdiction under Ord 11, r 1(1)(f) (or indeed under any other sub-paragraph) can be reasonably understood as presenting a particular head of claim on one specific legal basis only, the plaintiff cannot thereafter, for the purpose of justifying his application under Ord 11, r 1(1)(f), be permitted to contend that that head of claim can also be justified on another legal basis (unless, perhaps, the alternative basis has been specifically referred to in his affidavit evidence, which it was not in the present case). With this possible exception, if he specifically states in his pleading the legal result of what he has pleaded, he is in our judgment limited to what he had pleaded, for the purpose of an Order 11 application. To permit him to take a different course would be to encourage circumvention of the Order 11 procedure, which is designed to ensure that both the court is fully and clearly apprised as to the nature of the legal claim with which it is invited to deal on the ex parte application, and the defendant is likewise apprised as to the nature of the claim which he has to meet, if and when he seeks to discharge an order for service out of the jurisdiction. "

No rule of court requires a claimant, when seeking to serve a state out of the jurisdiction, to make clear, in the application for permission, the basis upon which it is alleged that the state does not enjoy immunity from suit. The Practice Note at CPR para 6.37.24, repeating what at the material time was 6.21.24, states that the claimant "must show distinctly (a) why the prospective defendant is not absolutely immune from suit."

It is Argentina's case that if the grounds relied upon in the application for permission for contending that the defendant state is not immune from suit prove to be unfounded, the rule in Parker v Schuller precludes the subsequent grant of permission to the claimant to rely on alternative valid grounds. Blair J did not accept this submission. He held that it involved an extension of the rule in Parker v Schuller, which he declined to make. He held at para 48 that where permission to serve out is given on the basis of a mistaken legal analysis of the absence of state immunity, but on a correct legal analysis the state is not in fact immune from the jurisdiction, the court has a discretion whether or not to set aside the order giving permission to serve out. He exercised that discretion in favour of NML because this involved no prejudice to Argentina, and to require NML to start proceedings afresh would be pointless and involve a waste of costs – para 49.

Aikens LJ reversed this decision. He held at para 61:

> "…the order of Steel J was made upon an incorrect basis of the court having jurisdiction in respect of the proposed claim against Argentina. Logically therefore, that order has to be set aside for want of jurisdiction, just as it must when a claimant has relied on an incorrect cause of action or an incorrect ground for permission to serve out of the jurisdiction. There can be no question of exercising a discretion to correct the error (in the absence of a new application on a different basis) because the lack of jurisdiction is fatal".

He added at para 66

> "…if NML incorrectly identified the basis on which it asserted that Argentina was subject to the 'adjudicative jurisdiction' of the English court, then the basis for the exercise of the jurisdiction was incorrect. It is not a mere procedural error, because it goes to the very basis for invoking the jurisdiction against a sovereign state. It is, qualitatively speaking, in the same position as a failure to identify the correct cause of action or the correct ground for obtaining permission to serve out of the jurisdiction".

Strictly, Aikens LJ's decision involves an extension of the rule in Parker v Schuller, inasmuch as the requirement to identify the reason why a state is not immune when seeking permission to serve out is not found in the rules, but only in a Practice Note. But I think that Aikens LJ was correct to find that there was no difference in principle between the two situations. Mr Sumption sought to persuade the Court to distinguish Parker v Schuller, but at the same time he invited this Court to hold that there is no longer any justification for following that decision, if indeed there ever was.

I believe that Mr Sumption is correct. Procedural rules should be the servant not the master of the rule of law. Lord Woolf, by his Reports on Access to Justice, brought about a sea change in the attitude of the court to such rules. This included the adoption of the "overriding objective" with which the new CPR begins. CPR 1.1 states that the overriding objective of the Rules is to enable the court to deal with cases justly, and that this involves saving expense and ensuring that cases are dealt with expeditiously.

Where an application is made to amend a pleading the normal approach is to grant permission where to do so will cause no prejudice to the other party that cannot be dealt with by an appropriate order for costs. This accords with the overriding objective. Where all that a refusal of permission will achieve is additional cost and delay, the case for permitting the amendment is even stronger. I can see no reason in principle why similar considerations should not apply where an application is made for permission to serve process out of the jurisdiction. It is, of course, highly desirable that care should be taken before serving process on a person who is not within the jurisdiction. But if this is done on a false basis in circumstances where there is a valid basis for subjecting him to the jurisdiction, it is not obvious why it should be mandatory for the claimant to be required to start all over again rather than that the court should have a discretion as to the order that will best serve the overriding objective.

Before Parker v Schuller there had been a relevant decision of a powerful Court of Appeal, of which A L Smith LJ was a member, which was not referred to and does not seem to have been cited in the later case. In Holland v Leslie [1894] 2 QB 450 leave to serve out of the jurisdiction had been granted in relation to a bill of exchange which had been erroneously described in the statement of claim indorsed on the writ. The Court of Appeal upheld an order giving leave to amend the writ. In doing so Lord Esher MR said this at p 451:

> "Leave was given for the issue of the writ so indorsed, and service of notice of it out of the jurisdiction; such notice was duly served upon the defendant abroad; and the defendant has in due course appeared in this country. It is argued that, under these circumstances, the writ cannot be amended. Why not? The rules with regard to amendments appear in terms to apply to such a case. It is contended, nevertheless that there cannot be an amendment, because the writ was for service, and has been served, out of the jurisdiction. But the defendant has now appeared in this country; and I can see no reason why an amendment such as this should not be made, just as in the case of a writ served within the jurisdiction. We were pressed with the possibility that, if such a writ could be amended, it might be amended so as to introduce a cause of action in respect of which leave could not have been originally given for service out of the jurisdiction. That is not the present case. When that case arises, there may be good reason for refusing to allow the amendment."

The other two members of the Court agreed. It is not easy to reconcile the approach in this decision with Parker v Schuller. Certainly it is good reason to confine the latter decision to its particular facts.

There are a number of authorities which follow the approach of Lord Esher in suggesting that there is, in principle, no objection to amending a pleading which has been served out of the jurisdiction unless the effect will be to add a claim in respect of which leave could not, or would not, have been given to serve out: Waterhouse v Reid [1938] 1

KB 743, 747, 749; Beck v Value Capital Ltd (No 2) [1975] 1 WLR 6,15; Bastone & Firminger Ltd v Nasima Enterprises (Nigeria) Ltd [1996] CLC 1902, 1907; Donohue v Armco Inc [2001] UKHL 64; [2002] 1 All ER 749. Masri v Consolidated Contractors International (UK) Ltd (No 3) [2008] EWCA Civ 625; [2009] QB 503, para 74. While most of these cases involved proceedings which had progressed beyond the initial leave stage, I can see no reason for adopting a less generous approach to amendment at the earlier stage. While amending to add a cause of action is not the same as amending to substitute one, in either case the amendment involves subjecting the overseas party to a claim other than the one that he entered an appearance to meet, and similar principles should apply in each case.

For all these reasons I would hold that the rule in Parker v Schuller should no longer be applied. The same approach should be taken to an application to amend a pleading that has been served out of the jurisdiction as is adopted to any other application to amend a pleading.

If this conclusion is not shared by the majority, I would confine the rule in Parker v Schuller and not extend it to cover the different facts of the present case. There is no question here of relying on a different cause of action to that in respect of which leave was obtained to serve out. Nor is there any question of relying on facts that were not before David Steel J when he gave permission to serve Argentina out of the jurisdiction. Nor is there any failure to comply with a rule of court.

It follows that I consider that the application to rely on alternative reasons why Argentina has no immunity was one to be determined by Blair J in the exercise of his discretion. There are no valid grounds for challenging his decision. It has not been suggested that Argentina will be any better off if NML is required to start proceedings afresh. To require them to do so would be a waste of time and money. Argentina agreed when the bonds were issued to a wide ranging waiver of immunity and submission to jurisdiction. The court had an independent obligation to satisfy itself that Argentina is not entitled to immunity. It had before it all the relevant material. Any initial mistake on the part of NML in identifying the correct reason why Argentina enjoys no immunity should not preclude NML from proceeding with its action.

For these reasons, I would reverse the Court of Appeal on the fourth issue also.

Issue 5: Is Argentina entitled to claim state immunity in respect of these proceedings?

My answer is no. I would allow this appeal.

Lord Mance[92]

Lord Phillips has set out the facts and, in para 7 identified the five issues to which they give rise. I agree with his judgment on the second and third issues; that is, the effect of section 31 of the Civil Jurisdiction and Judgments Act 1978 and whether the bonds contain a submission to the English jurisdiction. I also agree that NML was entitled to raise these two new issues, not having relied upon them on the ex parte application for permission to serve the Republic of Argentina out of the jurisdiction. For reasons which Lord Collins has given, I do not think that the rule in Parker v Schuller (1901) 17 TLR 299 should be treated as extending to the present case, but I also

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[92] *See* http://judicialintegritygroup.org/index.php/jig-group/group-members?showall=&start=8.

agree that it should, in any event, no longer be followed. In the result, I also agree with Lord Phillips' answer to the fifth issue, namely that the Republic is not entitled to claim state immunity in the present proceedings to enforce against it the judgment obtained in New York proceedings. But I do so by a different route to his primary route. This is because I am unable to agree with Lord Phillips on the first issue: the scope of section 3 of the State Immunity Act 1978. This represents his preferred basis for his answer to the fifth issue. I do not consider that the drafters of that Act or Parliament contemplated that section 3(1)(a) of the 1978 Act had in mind that it would or should apply to a foreign judgment against a foreign state. I understand Lord Phillips effectively to accept that (para 42), but, nonetheless, he and Lord Clarke treat the words as wide enough to cover such a judgment. I do not consider this to be justified.

The pursuit of a cause of action without the benefit of a foreign judgment is one thing; a suit based on a foreign judgment given in respect of a cause of action is another. In the present case, the only issue arising happens to be the issue of state immunity with which the Supreme Court is concerned. But a claim on a cause of action commonly gives rise to quite different issues from those which arise from a claim based on a judgment given in respect of a cause of action. A claim on a cause of action normally involves establishing the facts constituting the cause of action. A suit based on a foreign judgment normally precludes re-investigation of the facts and law thereby decided. But it not infrequently directs attention to quite different matters, such as the foreign court's competence in English eyes to give the judgment, public policy, fraud or the observance of natural justice in the obtaining of the judgment. These are matters discussed in rules 42 to 45 of Dicey, Morris & Collins, The Conflict of Laws 14th ed (2009) vol 1. A recent example of their potential relevance is, in a Privy Council context, AK Investment CJSC v Kyrgyz Mobil Tel Ltd [2011] UKPC 7, paras 48 and 109 to 121.

The exceptions from immunity provided by sections 2 to 11 of the 1978 Act focus on specific conduct (submission) in the domestic UK proceedings or on specific transactions, contexts or interests in relation to which causes of action may arise. The recognition and enforcement of foreign judgments has long been recognised as a special area of private international law. Careful statutory attention was given to it in the Administration of Judgments Act 1920 (judgments of courts from other parts of Her Majesty's dominions) and the Foreign Judgments (Reciprocal Enforcement) Act 1933 (judgments from certain other countries) in terms which (as Lord Phillips points out in paras 16 to 18) respect the existence of state immunity, as well as in Part II of the 1978 Act itself (judgments against the United Kingdom in other states party to the European Convention on State Immunity, now Regulation EC44/2001) in terms specifically addressing state immunity. In this context, it stretches language beyond the admissible to read "proceedings relating to … a commercial transaction" as covering proceedings relating to a judgment which itself relates to a commercial transaction. The improbability of so extended a construction is underlined by the extreme care that the drafters of the Act took to define in s.3, in the widest terms, the concept of "commercial transactions".

I do not however agree with the view (expressed by Stanley Burnton J in AIC Ltd v The Federal Government of Nigeria [2003] EWHC 1357 (QB), paras 30-32) that the improbability can be supported on the basis of an implied limitation of section 3(1)(a) of the 1978 Act to commercial transactions with a domestic nexus. That view ignores the clear contrast between the wording of section 3(1)(a) and (b). If there were any doubt about the point (which there is not), it would be dispelled by the Parliamentary history. In the original bill, clause 3(1), the precursor to section 3(1)(a), was territorially limited to commercial activity by a State "through an office, agency or establishment maintained by it for that purpose in the United Kingdom". Following strong criticism of this limitation by Lords Wilberforce and Denning (Hansard HL Deb 17 January 1978 vol 388 cc51-78), the Lord Chancellor moved an amendment inserting a clause in the form which became section 3(1), making expressly clear that this was to ensure that "No qualifications, no jurisdictional links with the United Kingdom are to be required" under sub-clause (a) as distinct from sub-clause (b): Hansard HL Deb 16 March 1978 vol 389 cc1491-540.

Even before the enactment of section 34 of the Civil Jurisdiction and Judgments Act 1982, it is extremely doubtful whether the principle that a cause of action did not merge in a foreign judgment survived in English law: Carl Zeiss Stiftung v Rayner & Keeler Ltd [1967] 1 AC 853, 966 per Lord Wilberforce. This, to my mind, also makes unconvincing a reading of "proceedings relating to (a) a commercial transaction" which covers proceedings to enforce a judgment based on a cause of action arising from a commercial transaction.

Where a state has agreed in writing to submit a dispute to arbitration, section 9 of the 1978 Act provides that the state is not immune as respects proceedings in United Kingdom courts which relate to the arbitration. This subsection addresses the consequences of submission, and leaves it to the court to determine whether such has occurred. The subsection also covers ancillary or interlocutory applications relating to arbitration, and is not limited to arbitration relating to commercial transactions. But very many arbitrations are commercial; and a major purpose of section 9 must on any view have been to lift state immunity in respect of the enforcement of arbitration awards against states, including foreign arbitration awards since the subsection is in general terms (see further on this last point para 90 below). Section 9 thus reversed the effect of the House of Lords reasoning in Duff Development Co Ltd v Government of Kelantan [1924] AC 797 on the concept of submission as understood in Kahan v Federation of Pakistan [1951] 2 KB 1003, although section 13(2) to (4) restricts the issue of process against state property (principally, to property for the time being in or intended for use for commercial purposes). I would endorse on these aspects what is said in paragraphs 117 to 122 of the judgment of the Court of Appeal handed down by Moore-Bick LJ in Svenska Petroleum Exploration AB v Government of the Republic of Lithuania (No 2) [2007] QB 886. In case there were any room for doubt, paras 119 and 120 set out extracts from Hansard (HL Debs16 March 1978 vol 389 cc1516-1517 and 28 June 1978 c316), where the Lord Chancellor confirmed expressly the intention to remove state immunity in respect of the enforcement of arbitration awards. On NML's case, there is, as a result, an unlikely dichotomy between the express treatment of arbitration in Part I of the 1978 Act and the suggested tacit, but nonetheless (if achieved) very important, removal of state immunity in respect of judgments relating to commercial transactions.

At the time of the 1978 Act, the rules of court provided no basis for obtaining leave to serve out of the jurisdiction in respect of a claim to enforce any judgment or arbitral award. Such a basis was only introduced, as what was then RSC O.11 r.1(1)(m), from 1 January 1984. Section 12(7) of the 1978 Act maintained the need for leave to serve out of the jurisdiction where required by the rules of court. The lifting by section 9 of the 1978 Act of state immunity in respect of arbitration awards had obvious relevance in a case, like Duff Development Co Ltd v Government of Kelantan itself, where a foreign state had by an English arbitration agreement undertaken to submit to the English jurisdiction in respect of an application to enforce any award as a judgment. Indeed, as appears from the original bill and from the passages in Hansard quoted in the Svenska Petroleum Exploration case at paras 119 and 120, the clause in the original bill which became section 9 in the 1978 Act was confined to "arbitration in or according to the law of the United Kingdom", and this phrase was only deleted in the House of Commons. In relation to foreign judgments there was, however, no equivalent problem to that raised by the Duff Development and Kahan cases, and the absence when the 1978 Act was passed of any basis for obtaining leave to serve out in respect of a foreign judgment or award also points, I think, against a construction stretching the wording of section 3(1) to cover suits to enforce such judgments.

It is true that the 1978 Act adopted the restrictive theory of state immunity, but the question before the Supreme Court now is: how far and in respect of what transactions. It is true that it is now well-recognised that no principle of international law renders state A immune from proceedings brought in state B to enforce a judgment given against it in state C. But the question is how far the drafters of the 1978 Act appreciated or covered the full possibilities allowed by international law, or, putting the same point in a different way, how far these were only covered a little later by section 31 of the 1982 Act. As Lord Phillips records at para 12, English common law was at the time itself in development and not finally settled, on the point that states were not immune in respect of commercial transactions, until the House of Lords decision in I Congreso del Partido [1983] AC 244, some years after the 1978 Act. The question whether a claim to enforce a judgment "constitute[s] proceedings relating to a commercial transaction" simply does not arise, unless one assumes that the wording of section 3(1)(a) of the 1978 Act covers proceedings on judgments. But that is the very issue which is before the Supreme Court.

On NML's case, which Lord Phillips favours, Parliament by section 3(1) of the 1978 Act achieved a partial and oddly imbalanced lifting of state immunity in respect of foreign judgments against foreign states. First, it omitted to introduce any analogue of a most obvious situation in which a foreign judgment might be rendered against a state. Under section 2, a state is not immune as respects proceedings in respect of which it has submitted to United Kingdom courts; but nothing in the 1978 Act lifts state immunity in the United Kingdom in respect of a foreign judgment on the basis of its submission in proceedings abroad.

Secondly, the Act either fails to lift immunity or, if it lifts immunity at all, does so in a partial and illogical way, in situations paralleling those covered by sections 4 to 11 of the Act. To this, Mr Sumption QC responds on behalf of NML that, if "relating to a commercial transaction" can be read widely enough to cover "relating to a foreign judgment relating to a commercial transaction", then phrases in other sub-sections such as "in respect of death or personal injury" (section 5(a)) can be read widely enough to mean "in respect of a foreign judgment in respect of death or personal injury" caused by an act or omission in the United Kingdom.

However, as Mr Mark Howard QC points out on behalf of the Republic, even if this persistent stretching of words were to be accepted, it does not remove the anomalies which flow from NML's case. It does not, in particular, address the cases of a foreign judgment against a state where the contract of employment was not made in the United Kingdom or the work was not wholly or to be performed here (cf section 4); or in respect of death or personal injury or damage or loss of tangible property caused by an act or omission not occurring in the United Kingdom (cf section 5); or relating to immovable property not in the United Kingdom (cf section 6); or relating to any patent not registered in the United Kingdom (cf section 7); or relating to membership of any body corporate not incorporated or constituted under United Kingdom law (cf section 8). Lord Phillips acknowledges the illogicality (para 34). The territorial limits involved in these sections are understandable in proceedings actually relating to such contexts or interests. But they make no real sense as a basis for distinguishing between foreign judgments in respect of which state immunity is and is not said to exist.

On NML's analysis, section 3 of the 1978 Act therefore gave a very partial and haphazard mandate for enforcement of foreign judgments, while section 31 of the 1982 Act was necessary, though only necessary, to restore the comprehensive harmony which in that respect the 1978 Act had singularly failed to achieve. There is however no trace of that in the 1982 Act itself. On the contrary, section 31(1)(b) refers to sections 2 to 11 of the 1978 Act without discrimination and evidently without recognising that (on NML's analysis) the legislator must, by reason of the words "if and only if", have been replacing a partial scheme of enforcement of foreign judgments under the 1978 Act with a new scheme provided by section 31(1) of the 1982 Act.

Further, section 31(1) makes clear that the scheme it introduces is to apply to judgments by a foreign court "against a state other than the United Kingdom or the state to which that court belongs". Mr Sumption submits that this would, in consequence of the words "if and only if", supersede section 3(1) as regards judgments "against the state to which that court belongs". If that were so, then the 1982 Act would for some unexplained reason be cutting down what is, on Mr Sumption's case, the width of section 3(1). But I do not think that Mr Sumption's submission is correct. All that the words "if and only if" achieve is the exclusion of judgments "against the state to which that court belongs" from the scheme of section 31. They do not overrule or affect any provision of section 3(1) which, on NML's case, already covered such judgments. The patchwork provision of the two statutes, which arises on NML's case, and which Lord Phillips and Lord Clarke are minded to accept, becomes even less probable as a matter of imputed Parliamentary intention.

I see no basis for giving the phrase "relating to" in section 3(1)(a) what is described as an "updated" meaning. What constitutes a family or cruel or inhuman treatment or a "true and fair view" (to take three well-known examples) may vary, and has varied, with social or professional attitudes from time to time. But a connecting factor like "relating to" is most unlikely to have this elasticity, and it is implausible to suggest that Parliament intended that its meaning or application in or under section 3(1)(a) could, over time, expand to remove immunity in respect of judgments. This would amount to altering the scope of the Act in a way not falling within the principles originally envisaged, contrary to the rule stated in Bennion on Statutory Interpretation (5th ed) section 288, para (6). Further, even if (contrary to my view) any expansion were theoretically possible, no legal, social or other developments have been identified justifying it in this case. On the contrary: the enactment of section 31(1) of the 1982 Act argues strongly against any such expansion of the ambit of "relating to" in section 3(1)(a) of the 1978 Act; and the only effect of expanding the scope of section 3(1)(a) would be partially to create an overlap with that section and/or the illogical patch-work effect referred to in preceding paragraphs.

It is for these reasons that I am unable to follow Lord Phillips' and Lord Clarke's answer to the first issue. In my view, section 31 is the means by which the United Kingdom legislator achieved, for the first time, a comprehensive and coherent treatment of the issue of state immunity in respect of foreign judgments, and it enables the enforcement of the New York judgment in this case. But the bonds also contain a comprehensive submission to the English jurisdiction in respect of the enforcement of the New York judgment, and this leads to the same result. I would, on this basis, therefore allow the appeal.

Lord Collins[93] (with whom Lord Walker agrees)

I agree with Lord Phillips that the appeal should be allowed, but, in agreement with Lord Mance, I would rest my

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[93] *See* http://www.law.columbia.edu/magazine/5365/lord-collins-of-mapesbury .

conclusion on section 31 of the 1982 Act and on Argentina's submission and waiver of immunity, and not on section 3 of the 1978 Act. Although I agree with Lord Phillips' observations on the so-called rule in Parker v Schuller (1901) 17 TLR 299, in my judgment the point does not, and did not, arise in these proceedings because there has never been a rule (as distinct from good practice) that the grounds for absence of immunity must be set out once and for all at the stage when an application for permission to serve the foreign State is made; and there is no analogy between the rules for applications for service out of the jurisdiction in general and good practice in relation to service on foreign States.

Introduction

The first widespread defaults on sovereign debt occurred in the early 19th century. The newly independent former Spanish American colonies "besieged London for loans" in the years 1822-1825 and the proceeds were "quickly expended on armaments, or otherwise wastefully dissipated, with little regard to the quite different purposes for which, in many instances, the loan had been ostensibly raised:" see Borchard, State Insolvency and Foreign Bondholders, Vol 1 (1951), pp xx-xxi, quoting Wynne (1935) 42 J Can. Bankers' Assn 472. The Province of Buenos Aires defaulted in 1827 on loans raised for it by Baring Brothers: see Ferns, Britain and Argentina in the Nineteenth Century (1960), pp 141 et seq; Marichal, A Century of Debt Crises in Latin America (1989), p 59. National courts of the debtor state and of the creditors were unable to secure the rights of unpaid bondholders. In Twycross v Dreyfus (1877) LR 5 Ch D 605, a case concerning Peruvian bonds, Sir George Jessel MR said (at 616):

> "… [T]he municipal law of this country does not enable the tribunals of this country to exercise any jurisdiction over foreign governments as such. Nor, so far as I am aware, is there any international tribunal which exercises any such jurisdiction. The result, therefore, is that these so-called bonds amount to nothing more than engagements of honour, binding, so far as engagements of honour can bind, the government which issues them, but are not contracts enforceable before the ordinary tribunals of any foreign government… without the consent of the government of that country."

By the beginning of the 20th century only a few countries (including Belgium and Italy) had adopted a restrictive theory of sovereign immunity, but only with regard to jurisdiction, and not to execution: see Borchard, Diplomatic Protection of Citizens Abroad (1915), p 307. The only remedy for countries whose citizens were affected by sovereign default was force, and in response to the blockade of Venezuelan ports by the United States, Italy, Germany and Britain, the Minister of Foreign Affairs of Argentina, Dr Drago, enunciated in 1902 what became known as the Drago doctrine, namely that "the public debt [of an American nation] cannot occasion armed intervention … by a European power": Hackworth, Digest of International Law, vol 5 (1927), p 625. Venezuelan bond claims were subsequently submitted to mixed claims commissions: Borchard, op cit, pp 322-325.

But law and practice was revolutionised in the second half of the 20th century by the widespread (but by no means uniform) adoption of the restrictive theory of sovereign immunity, and the modern law now depends on the application of the restrictive theory of immunity and on the almost invariable use in international loan agreements and bond issues since the 1970s of clauses providing for submission to national jurisdiction and waivers of immunity.

NML is one of several bondholders who have obtained judgments in the New York Federal District Court against

Argentina on the bonds: see also Lightwater Corp v Republic of Argentina, 2003 WL 1878420 (SDNY 2003); NW Global Strategy v Republic of Argentina, 2011 WL 1237538 (SDNY 2011). The idea behind "vulture funds" is not new. Borchard State Insolvency and Foreign Bondholders, Vol 1 (1951), pp.xx-xxi, quotes Wynne, op cit, in relation to the early South American defaults:

> "Meanwhile, however, the bonds had largely passed out of the hands of the original purchasers into the possession of speculators who bought them up at next to nothing and, in due time, reaped a handsome profit."

So also in the famous Greek bond cases in England in the 1960s and 1970s, the bondholders were speculators who had bought cheaply bonds issued by the Greek Government in the 1920s and unpaid since 1941: see eg National Bank of Greece SA v Westminster Bank Executor and Trustee Co (Channel Islands) Ltd [1971] AC 945; UGS Finance Ltd v National Mortgage Bank of Greece [1964] 1 Lloyd's Rep 446.

So-called vulture funds have given rise to at least two problems. First, the ability of investors to acquire defaulted debt can be abused: see, eg, the Barcelona Traction case (Belgium v Spain), 1970 ICJ Rep 3; Highberry Ltd v Colt Telecom Group plc (No 1) [2002] EWHC 2503 (Ch), [2003] 1 BCLC 290; (No 2) [2002] EWHC 2815 (Ch), [2003] BPIR 324.

Second, particular attention has focussed on the ability of vulture funds to thwart loan re-structuring by "highly indebted poor countries": see Lumina, Report to the UN Human Rights Council on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social, and cultural rights, April 29, 2010 (A/HRC/14/21); Donegal International Ltd v Republic of Zambia [2007] EWHC 197 (Comm), [2007] 1 Lloyd's Rep 397; and the Debt Relief (Developing Countries) Act 2010.

Argentina declared a sovereign debt moratorium in December 2001 and has restructured much of its debt through debt exchange, but that has no effect on these proceedings because (a) there is no international insolvency regime for States; and (b) the bonds are governed by New York law and are unaffected by any Argentine moratorium.

Issue 1: "proceedings relating to a commercial transaction" and the State Immunity Act 1978, section 3

The proceedings in the present appeal are proceedings at common law for the enforcement of the New York judgment. None of the statutory methods of enforcement is available for judgments rendered in the United States. On this part of the appeal the only relevant question is whether the proceedings in England at common law on the New York judgment are "proceedings relating to … a commercial transaction entered into by the State," where "commercial transaction" includes "any loan or other transaction for the provision of finance…": section 3(1)(a); section 3(3)(b). Whether the New York proceedings were themselves "proceedings relating to a commercial transaction" is not the relevant question.

The question on this issue is whether the expression "relating to" is to be given the meaning ascribed to it (in proceedings different from the present ones) by Stanley Burnton J in AIC Ltd v Federal Government of Nigeria [2003] EWHC 1357 (QB) (registration of a Nigerian judgment under the Administration of Justice Act 1920) and by Gloster J and the Court of Appeal in Svenska Petroleum Exploration AB v Government of the Republic of Lithuania (No 2) [2005] EWHC 2437 (Comm), [2006] 1 Lloyd's Rep 181, [2006] EWCA Civ 1529; [2007] QB 886 (enforcement of Danish arbitral award under Arbitration Act 1996, section 101).

The question, to what do the proceedings for enforcement of the New York judgment "relate," can be given a narrow or a wide answer. The narrow meaning would result in a conclusion that they "relate" to the enforceability of the New York judgment, which would involve such matters (not likely to be the subject of dispute in a case such as the present one) as whether the New York court had in personam jurisdiction (here there was a clear submission to the jurisdiction of the New York courts) or whether enforcement could be resisted on any of the traditional grounds (such as want of natural justice, fraud, or public policy), none of which has any arguable application. The wider meaning would give effect to the practical reality that the proceedings relate to liability under the bonds, the issue of which was plainly a commercial transaction for the purposes of section 3.

My conclusion that the narrower meaning is the one which must be ascribed to Parliament rests on considerations somewhat different from the reasons articulated by Stanley Burnton J in AIC. I do not consider that a potential overlap with the arbitration provision in section 9 supports a narrow interpretation of section 3. The overlap would not be complete, and it would be artificial and over-technical to use the potential overlap to cut down the scope of section 3. Nor do I consider that the narrow construction is supported by an argument that section 3(1)(a) should be interpreted so as to require a link with the territorial jurisdiction of the United Kingdom. No such link is required in the 1978 Act in relation to the head of commercial transactions covered by section 3(3)(b).

Both the Quebec Court of Appeal and the Supreme Court of Canada in Kuwait Airways Corporation v Republic of Iraq [2009] QCCA 728; revd [2010] SCC 40, [2010] 2 SCR 571, although reaching different conclusions on the facts, decided that, in an action to enforce an English judgment, the question whether the proceedings in Canada "relate[d] to any commercial activity of the foreign state" (State Immunity Act RSC 1985, c-18, section 5) depended on the nature of the underlying proceedings in England. But neither judgment articulates the reasons for that conclusion, and they are therefore unhelpful on this appeal.

What is not likely to be in doubt is that at the time the 1978 Act was enacted it would not have been envisaged that section 3 would have applied to the enforcement at common law of a foreign judgment against a foreign State based on a commercial transaction. That was because until RSC Order 11, r 1(1)(m) (now CPR PD6B, para 3.1(10)) was enacted in 1982 (and came into force on January 1, 1984) a defendant outside the jurisdiction could not be served in an action on a foreign judgment even if there were assets within the jurisdiction to satisfy the judgment (and consequently no freezing injunction could be made in relation to those assets: Perry v Zissis [1977] 1 Lloyd's Rep 607). Nor is it likely that section 31 of the Civil Jurisdiction and Judgments Act 1982 would have been enacted in the form that it was enacted if Parliament had thought that the 1978 Act already applied to a class of foreign judgments.

I accept that neither of those points is conclusive as to the meaning of section 3. There is no impediment in public international law to the institution of proceedings to enforce a foreign judgment based on commercial transactions. It is now possible to serve a foreign sovereign out of the jurisdiction in such proceedings, and the 1978 Act could be construed in the light of present circumstances: Fitzpatrick v Sterling Housing Association Ltd [2001] 1 AC 27, 49; Yemshaw v Hounslow London Borough Council (Secretary of State for Communities and Local Government intervening) [2011] UKSC 3, [2011] 1 WLR 433, paras 5-27.

But for section 31 of the 1982 Act, and the almost invariable employment of wide express waivers of immunity, it might have been desirable as a matter of policy to give section 3 the wider meaning. There would, however, be no principled basis on which to found such a conclusion. The proceedings in England relate to the New York judgment and not to the debt obligations on which the New York proceedings were based.

Issue 2: section 31 of the Civil Jurisdiction and Judgments Act 1982
This is a very short point. If the Court of Appeal was right to accept Argentina's argument, the section has such limited effect that it would not have been worth enacting, and certainly would not have justified the attention that it was given in the Parliamentary process: see Fox (2009) 125 LQR 544, at 547-548 for some of the history.
The natural meaning of section 31(1) is that it requires recognition and enforcement of a foreign judgment against a foreign State (other than the United Kingdom or the State in which the foreign proceedings were brought) if (a) the normal conditions for recognition and enforcement of judgments are fulfilled, and (b) mutatis mutandis the foreign State would not have been immune if the foreign proceedings had been brought in the United Kingdom. That meaning is the one which text writers have propounded since the section was enacted: Collins, Civil Jurisdiction and Judgments Act 1982 (1983), p 140; Dicey & Morris, Conflict of Laws 11th ed (1987), pp 454-455 (now Dicey, Morris & Collins, 14th ed (2006), para 14-095); Cheshire, North & Fawcett, Private International Law, 14th ed (2008), pp 588-589.
It is true that there are some drafting infelicities, including the reference to "such matters" in section 31(1)(b), and the words in parentheses in section 31(4), but they give no support to the Court of Appeal's surprising conclusion that, in the absence of an express amendment to the 1978 Act, section 31 does not affect the law of immunity, and therefore has no discernible purpose.

Issue 3: submission
As late as 1957 Delaume, Jurisdiction of Courts and International Loans (1957) 6 Am J Comp L 189, 203, said "there was no consensus of opinion as to whether contractual waivers of immunities are valid and binding upon a foreign sovereign or as to what acts are necessary to constitute such a waiver." In 1965 the Restatement Second, Foreign Relations Law of the United States, section 70(1) stated that a foreign State might waive its immunity by agreement with a private party, including an agreement made before the institution of proceedings. The Reporters' Note accepted that there had been no judicial decision to this effect, but that it was believed that United States courts would apply a waiver rule. As indicated above (para 103), it was only in the 1970s that it became almost invariable practice for syndicated bank loans to States and international bonds issued by States to contain wide submissions to the jurisdiction of national courts and express waivers of immunity.
The position in English law prior to the enactment of the 1978 Act was that it was thought that a prior contractual submission to the jurisdiction of the court was ineffective to amount to a waiver of immunity and that nothing less than an appearance in the face of the court would suffice: Duff Development Co v Government of Kelantan [1924] AC 797 and Kahan v Federation of Pakistan [1951] 2 KB 200, relying on Mighell v Sultan of Johore [1894] 1 QB 149, 159, 160.
In Mighell v Sultan of Johore [1894] 1 QB 149 the argument for the unfortunate Miss Mighell was that the Sultan had waived his immunity by coming to England as Albert Baker and making contracts as a private individual. That argument was rejected. Submission had to be "when the Court is about or is being asked to exercise jurisdiction over him and not any previous time" (Lord Esher MR at 159); "the only mode in which a sovereign can submit to the jurisdiction is by a submission in the face of the court, as, for example, by appearance to a writ" (Lopes LJ at

161); or "unless upon being sued he actively elects to waive his privilege and to submit to the jurisdiction" (Kay LJ at 164).

In Duff Development Co Ltd v Government of Kelantan [1924] AC 797 the question was whether the Government had waived immunity in relation to an application to the court to enforce an arbitration award by agreeing to the arbitration clause in the deed of concession and by applying to the court to set aside the award. The effect of the decision was that a submission to arbitration was not a submission to enforcement. Only Viscount Cave and Lord Sumner relied on the approach in Mighell. Cf Lord Dunedin at 821.

In Kahan v Federation of Pakistan [1951] 2 KB 1003, in a contract for the supply of Sherman tanks Pakistan agreed "to submit for the purposes of this agreement to the jurisdiction of the English courts" and agreed a method of service within the jurisdiction. Relying on three of the speeches in Duff Development and the decision in Mighell, the Court of Appeal held that there was no submission in the absence of an undertaking given to the court at the time when the other party asked the court to exercise jurisdiction over it.

As Dr F A Mann said, "the proposition that a waiver or submission had to be declared in the face of the court was a peculiar (and unjustifiable) rule of English law": (1991) 107 LQR 362, at 364. In a classic article (Cohn, Waiver of Immunity (1958) 34 BYIL 260) Dr E J Cohn showed that from the 19th century civil law countries had accepted that sovereign immunity could be waived by a contractual provision, and that the speeches in Duff Development on the point were obiter (and did not constitute a majority) and that both Duff Development and Kahan v Federation of Pakistan had overlooked the fact that submission in the face of the court was not the only form of valid submission since the introduction in 1920 in RSC Ord 11, r 2A (reversing the effect of British Wagon Co Ltd v Gray [1896] 1 QB 35) of a rule that the English court would have jurisdiction to entertain an action where there was a contractual submission. In particular, in Duff Development Lord Sumner had overlooked the fact that British Wagon Co v Gray was no longer good law.

The principle enunciated in Kahan v Federation of Pakistan was reversed by section 2(2) of the 1978 Act, which provided that a State could submit to the jurisdiction "by a prior written agreement." This is consistent with international practice: United States Foreign Sovereign Immunities Act 1976, section 1605(a)(1) (State not immune if it has "waived its immunity either explicitly or by implication, notwithstanding any withdrawal of the waiver ..."); European Convention on State Immunity 1972, Art 2(b) (no immunity if "it has undertaken to submit to the jurisdiction of [the] court … by an express term contained in a contract in writing"); UN Convention on Jurisdictional Immunities of States and their Property 2004, Art 7(1)(b) (no immunity if the State has "expressly consented to the exercise of jurisdiction by the court with regard to the matter or case … in a written contract").

The "Waiver and Jurisdiction Clause" in the bonds provided that a related judgment:

> "…shall be conclusive and binding upon [Argentina] and may be enforced in any Specified Court or in any other courts to the jurisdiction of which the Republic is or may be subject (the 'Other Courts') by a suit upon such judgment."

The New York judgment was on any view a "related judgment." Argentina agreed that it could be enforced in any other courts "to the jurisdiction of which the Republic is or may be subject." This was the clearest possible waiver of immunity because Argentina was or might be subject to the jurisdiction of the English court since the English court had a discretion to exercise jurisdiction in an action on the New York judgment by virtue of CPR 6.20(9) (now CPR PD6B, para 3.1(10)).

The waiver is confirmed by the second paragraph of the clause, which provides:

> "To the extent that the Republic… shall be entitled, in any jurisdiction…in which any…Other Court is located in which any suit, action or proceeding may at any time be brought solely for the purpose of enforcing or executing any Related Judgment, to any immunity from suit, from the jurisdiction of any such court…from execution of a judgment or from any other legal or judicial process or remedy, and to the extent that in any such jurisdiction there shall be attributed such an immunity, the Republic has hereby irrevocably agreed not to claim and has irrevocably waived such immunity to the fullest extent permitted by the laws of such jurisdiction …solely for the purpose of enabling the Fiscal Agent or a holder of Securities of this Series to enforce or execute a Related Judgment."

Again England is a jurisdiction in which an action "may … be brought" to enforce the New York judgment and Argentina agreed not to claim any immunity in that jurisdiction. The contrary conclusion of the Court of Appeal is not readily explicable.

Issue 4: The Parker v Schuller point

As I have said, in my judgment the point in Parker v Schuller (1901) 17 TLR 299 does not arise. As Lord Walker said in Roberts v Gill & Co [2010] UKSC 22, [2011] 1 AC 240, at [94], the law of procedure and practice has traditionally been regarded as the province of the Court of Appeal rather than the House of Lords (or, now, the Supreme Court), and this court should be especially hesitant to decide points of procedure in appeals in which they do not even arise.

The reason why the point does not arise is as follows. The current CPR 6.37(1)(a) provides that an application for permission to serve a claim form out of the jurisdiction must set out which ground in paragraph 3.1 of Practice Direction 6B is relied on. There was substantially the same rule under the RSC, where Order 11, r 4(1) provided that an application for the grant of leave to serve a writ out of the jurisdiction had to be supported by an affidavit stating the "grounds on which the application is made". If there is such a rule as the so-called rule in Parker v Schuller (1901) 17 TLR 299 it is a rule that the court must decide an application for permission to serve out of the jurisdiction on the basis of the cause or causes of action expressly mentioned in the pleadings and the claimant will not be allowed to rely on an alternative cause of action which he seeks to spell out of the facts pleaded if it has not been mentioned: see now Civil Procedure 2011, vol 1, para 6.37.15.1 (or under the RSC, Supreme Court Practice 1999, para 11/1/10).

But there is no analogous rule relating to the exceptions to State immunity. There is simply a note in Civil Procedure, vol 1 (now para 6.37.24, and formerly, eg at Supreme Court Practice 1999, Vol 1, para 11/1/17) indicating that the practitioner should note that an application for permission to serve the foreign State should show distinctly why the prospective defendant is not absolutely immune from suit. This is neither a rule nor a Practice Direction nor has it ever been. There is no analogy between the specific rule for service out of the jurisdiction and the good practice note and therefore no basis for the conclusion of the Court of Appeal that because the basis for absence of immunity was incorrectly identified the English court had no jurisdiction. That is why the point simply does not arise.

If it had arisen, I would have agreed with the general approach of Lord Phillips. It is to be noted in particular that in

Parker v Schuller itself Romer LJ (at 300) based his decision on the ground very close to that of non-disclosure. He said

> "…an application for leave to issue a writ for service out of the jurisdiction ought to be made with great care and looked at strictly. If a material representation upon which the leave was obtained in the first instance turned out to be unfounded, the plaintiff ought not to be allowed, when an application was made by the defendant to discharge the order for the issue of the writ and the service, to set up another and a distinct cause of action which was not before the judge on the original application."

It was on the representation that the defendants were bound to deliver the goods in England that leave had originally been granted.

In cases of non-disclosure, the court has a discretion (a) to set aside the order for service and require a fresh application; or (b) to treat the claim form as validly served, and deal with the non-disclosure if necessary by a costs order: Macaulay (Tweeds) Ltd v Independent Harris Tweed Producers Ltd [1961] RPC 184; Kuwait Oil Co (KSC) v Idemitsu Tankers KK, The Hida Maru [1981] 2 Lloyd's Rep 510.

By analogy, where the so-called rule in Parker v Schuller (1901) 17 TLR 299 might apply in a case where the ground for service out has been incorrectly identified, the court would also have power to grant permission to serve out on a fresh basis and dispense with re-service.

Lord Clarke[94]

I agree that the appeal should be allowed for the reasons given by Lord Phillips. I add a short judgment of my own because of the difference of opinion between Lord Phillips and Lord Mance, Lord Collins and Lord Walker on the first issue. As to the fourth issue, I agree with Lord Collins that the point does not arise but, if it does, like him I agree with Lord Phillips' observations on the so-called rule in Parker v Schuller (1901) 17 TLR 299.

The question raised by the first issue is whether these proceedings are "proceedings relating to … a commercial transaction entered into by the state" of Argentina within the meaning of section 3(1)(a) of the State Immunity Act 1978 ("the 1978 Act"). The Court of Appeal held that they are not. As Lord Phillips observes at para 20, it is common ground that the New York proceedings in which NML obtained judgment against Argentina were such proceedings. The contrary would have been unarguable because they were brought in order to establish Argentina's liability under the bonds described by Lord Phillips. NML's argument is that, if the New York proceedings related to a commercial transaction, it is but a short step to hold that these proceedings, which were brought in order to enforce a judgment in respect of a liability under the bonds, are also proceedings "relating to a commercial transaction". I agree. As ever, all depends upon the context, but it seems to me to follow naturally from the conclusion that the New York proceedings were such proceedings that the same is true of these. Both have the same purpose, namely to enforce Argentina's liabilities under commercial bonds. There is nothing in the language of section 3(1) to lead to any other conclusion.

The Court of Appeal reached its conclusion in the light of the decision of Stanley Burnton J in AIC Ltd v Federal Government of Nigeria [2003] EWHC 1357 (QB) and in the light of dicta in the Court of Appeal in Svenska

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[94] *See* http://www.supremecourt.gov.uk/about/biographies-of-the-justices.html.

Petroleum Exploration AB v Government of the Republic of Lithuania (No 2) [2006] EWCA Civ 1529, [2007] QB 886. Lord Phillips has set out the relevant parts of the judgments in those cases at paras 21 and 23 and para 25 respectively. In Svenska the judgment of the court was given by Moore-Bick LJ. Scott Baker LJ and I were the other two members of the court. I have now reached the conclusion that the decision in AIC and the dicta in para 137 of Svenska (to which I was a party) were wrong, essentially for the reasons given by Lord Phillips at paras 26 to 41 which I adopt without repeating.

Lord Mance has reached a different view. He notes in para 84 that in para 42 Lord Phillips recognises that the conclusion that he has reached may not have occurred to the draftsman of the 1978 Act or to Parliament. Lord Mance concludes that Lord Phillips' approach and conclusions are not justified. He does so principally by looking at circumstances as they existed at the time the 1978 Act was enacted. However, in my opinion, that is to approach the construction of section 3(1)(a) of the Act too narrowly.

It is stated in Bennion on Statutory Interpretation, 5th ed (2008) at section 288 that, unless a contrary intention appears, an enactment is intended to develop in meaning with developing circumstances and should be given what Bennion calls an updating construction to allow for changes since the Act was initially framed. Bennion distinguishes that case, which he calls the usual case, from the comparatively rare case of the Act which is intended to be of unchanging effect. The commentary to section 288 states that the court must, in interpreting an Act, make allowances for the fact that the surrounding legal conditions prevailing on the date of its passing have changed. That approach seems to me to be entirely consistent with that of Lady Hale in Yemshaw v Hounslow London Borough Council (Secretary of State for Communiteis and Local Government intervening) [2011] UKSC 3, [2011] 1 WLR 433, paras 25 to 28, where she was considering whether words such as "violence" in a statute could be given an updated meaning. She concluded that the question was whether an updated meaning was consistent with the statutory purpose. See also Fitzpatrick v Sterling Housing Association Ltd [2001] 1 AC 27, per Lord Clyde at 49-50, where he said in the context of the meaning of "family" in the Rent Acts:

> "The judges in Helby v. Rafferty [1979] 1 WLR 13 had difficulty in accepting that a word which had been repeated throughout the successive Rent Acts could change its meaning from time to time. But as a matter of construction I see no grounds for treating the provisions with which we are concerned as being in the relatively rare category of cases where Parliament intended the language to be fixed at the time when the original Act was passed. The rule of contemporary exposition should be applied only in relation to very old statutes (Governors of Campbell College, Belfast v Commissioner Northern Ireland Valuation [1964] 2 All ER 705). The general presumption is that an updating construction is to be applied (Bennion on Statutory Interpretation, 3rd ed p 686). Such an approach was recently adopted by this House in Reg v Ireland [1988] AC 147..."

In my opinion it is appropriate and consistent with the statutory purpose of the 1978 Act to give it an updated meaning. The question is whether, viewed at the time the question arises, particular proceedings for the enforcement of a particular foreign judgment are proceedings "relating to a commercial transaction". At the time the 1978 Act was enacted there was no machinery for seeking permission to serve proceedings out of the jurisdiction in respect of a claim to enforce either an arbitration award or a foreign judgment. It could thus be said with force that at that time it was not contemplated that proceedings could be brought in England on a foreign judgment, at any rate unless the defendant accepted service of them.

I note that section 12(6) of the 1978 Act permits a state to accept service of proceedings against it in a particular manner, including no doubt proceedings to enforce a foreign judgment. As Lord Phillips says at para 42, prior to 1978 there had been no attempts to enforce in the United Kingdom judgments against states. However, he adds that section 12(7) makes it plain that service on a sovereign state requires permission, which could only be granted in accordance with the rules of court governing service out of the jurisdiction.

In my opinion, Parliament must have recognised that those rules, then RSC Order 11, would be likely to be amended from time to time and, indeed, may well have contemplated that at some future date a rule would be introduced permitting permission to be given allowing service out of the jurisdiction. As Lord Collins explains at para 114, such a rule was introduced with effect from January 1 1984 in RSC Order 11 r 1(1)(m). It subsequently became CPR 6.20(9) and is now CPR 6BPD para 3.1(10), which provides for service of proceedings out of the jurisdiction where "a claim is made to enforce any judgment or arbitral award." As I see it, the question is whether such proceedings are proceedings "relating to a commercial transaction" within section 3(1)(a) in circumstances where such proceedings are contemplated by the present rules of court. I would answer that question in the affirmative.

As Lord Phillips has explained, there was during the 20th century a growing recognition round the world of the restrictive doctrine of state immunity under which immunity related to government acts in the exercise of sovereign authority (acta jure imperii) but not to commercial activities carried on by the state (acta jure gestionis). As I see it, the conclusion that these proceedings are proceedings relating to a commercial transaction is no more than a further example of that growing recognition.

The question arises in the context of the particular proceedings in this case. As Lord Phillips observes at para 29, the question in these proceedings is whether Argentina enjoys state immunity. I agree with him that, there being no principle of international law under which state A is immune from proceedings brought in state B in order to enforce a judgment given against it by the courts of state C where state A did not enjoy immunity in respect of the proceedings that gave rise to that judgment, under international law the question whether Argentina enjoys immunity in these proceedings depends upon whether its liability arises out of acta jure imperii or acta jure gestionis. That involves a consideration of the nature of the underlying transaction and demonstrates that the proceedings, at any rate on the facts of this case, relate to a commercial transaction.

I agree with Lord Collins that the expression "relating to" in section 3(1)(a) can be given a narrow or wide meaning. I also agree with him that these are proceedings relating to the foreign judgment. The question is whether they are also proceedings "relating to a commercial transaction" entered into by Argentina. I agree with Lord Collins in para 111 that the wider meaning would give effect to the practical reality that the proceedings relate to liability under the bonds, the issue of which was plainly a commercial transaction for the purposes of section 3. For my part, I see no reason why, in construing the meaning of "relating to", the court should not reflect that practical reality.

I agree with Lord Collins in para 112 that a potential overlap with the arbitration provision in section 9 does not support a narrow interpretation and that there is no warrant for holding that section 3(1)(a) should be interpreted as requiring a link with the territorial jurisdiction of the United Kingdom. I also agree with him that the absence of reasoning in the Canadian case to which he refers in para 113 makes it of little assistance. In para 114 Lord Collins notes that it was decided in Perry v Zissis [1977] 1 Lloyd's Rep 607 that, since a defendant could not be served out of the jurisdiction in an action on a foreign judgment, no freezing injunction could be granted in respect of assets within the jurisdiction. I agree that that was indeed the position at that time. The position would surely be different now that the rules have been changed. Finally I agree with Lord Collins that it is not likely that section 31 of the Civil Jurisdiction and Judgments Act 1982 would have been enacted in the form in which it was if Parliament had thought that the 1978 Act already applied to a class of foreign judgments.

However, Lord Collins accepts at para 115 that neither of those points is conclusive as to the meaning of section 3. That is because there is no impediment in international law to the institution of proceedings to enforce a foreign judgment. Lord Collins adds that it is now possible to serve a foreign sovereign out of the jurisdiction and that the 1978 Act could be construed in the light of present circumstances. He cites Fitzpatrick v Sterling Housing Association Ltd [2001] 1 AC 27, 49 and Yemshaw [2011] 1 WLR 433, paras 5 to 27 for that proposition. As stated in para 144 above, I would go further and hold that it should be given an updated meaning. As Lord Clyde said in Fitzpatrick in the passage quoted above, the general presumption is that an updating construction is to be applied. As I see it, once it is concluded that an updating construction should be applied, the wider meaning would give effect to the practical reality that the sole purpose of the proceedings is to enforce Argentina's liability under a commercial transaction and that there is no impediment to such a construction in international law, both policy and principle lead to the conclusion that the wider interpretation is to be preferred.

Lord Collins suggests at para 116 that, but for section 31 and the almost invariable employment of wide express waivers of immunity, it might have been desirable as a matter of policy to give section 3 the wider meaning. He adds that there would, however, be no principled basis for doing so. I respectfully disagree. I do not think that either the enactment of section 31 or the fact that some parties use wide submission and waiver clauses points to a narrow meaning of "relating to", whether as a matter of policy or as a matter of principle. In my opinion, viewed as at the time the question has to be decided these proceedings relate both to the New York judgment and to the underlying commercial transaction

Even where there is no immunity it may be difficult to obtain payment from a sovereign debtor:

The Court make take judicial notice of the fact that the Congo is a oil-rich nation with more than sufficient assets to pay its debts but one of the world's most notorious debtors...Congo has repeatedly refused to honor court judgments, not only the judgments entered in London, but judgments entered in New York courts as well.[95]

An attempt by creditors of Argentina to seize an Argentinean naval training ship, ARA Libertad, in Ghana was impeded by the International Tribunal for the Law of the Sea (ITLOS) in December 2012.[96]

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[95] *Kensington Int'l, Ltd.* v. *Republic of Congo*, 2005 U.S. Dist. LEXIS 4331 (SDNY 2005).

[96] The "ARA Libertad" Case (Argentina v Ghana), ITLOS, Case No. 20, Order (Dec. 15, 2012) at http://www.itlos.org/fileadmin/itlos/documents/cases/case_no.20/C20_Order_15.12.2012.corr.pdf

RESTRUCTURING OR AN INTERNATIONAL BANKRUPTCY PROCEDURE FOR SOVEREIGNS?

Sovereign defaults have often led to restructuring transactions. Two proposals for how to deal with problems associated with sovereign defaults surfaced.[97] One set of proposals focused on developing formal procedures for states' financial problems which would be analogous to domestic insolvency regimes (a Sovereign Debt Restructuring Mechanism or SDRM);[98] the other focused on developing contractual provisions which financial institutions can include in contracts with sovereigns (collective action clauses (CACs)).[99] Although there is academic writing which critiques the emphasis on CACs as a solution to problems of sovereign debt,[100] considering the SDRM/CAC debate illustrates a more general phenomenon. Some people prefer regulatory solutions to problems, others prefer negotiated solutions. Read the descriptions of both sets of proposals and decide whether you think that formal solutions or market solutions are likely to be more effective. Are there other reasons than effectiveness for preferring one type of solution over another?

You will need to read the collective action clauses carefully if you are not familiar with complex contracts. The definition provisions are very important. Note the words you do not understand (we can discuss these in class (be sure they are not words defined in the definition provisions)). Also think about how the various clauses fit together. Read the waiver of sovereign immunity carefully in the light of the material on sovereign immunity above. Notice the provision referring to the governing law.

A significant proportion of sovereign bond issues now includes collective action clauses. Rodrigo de Rato, at the time the Managing Director of the IMF, stated in 2005: "As of end-February 2005, over 45 percent of sovereign bond issues in international markets contained CAC's. This increasing use of CAC's is

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[97] *See, e.g.*, Thomas I. Palley, Sovereign Debt Restructuring Proposals: A Comparative Look, 17 Ethics & International Affairs (2003) *available at* http://www.thomaspalley.com/docs/articles/international_markets/sovereign_debt_restructuring.pdf.

[98] Steven Schwarcz suggests a Model SRDM Convention in Steven L. Schwarcz, *Sovereign Debt Restructuring Options: an Analytical Comparison*, 2 HARV. BUS. L. REV. 95 (2012).

[99] Such provisions have been traditional in English law governed bonds, but not in those governed by New York law.

[100] *See, e.g.*, Anna Gelpern & G. Mitu Gulati, *Of Lawyers, Leaders, And Returning Riddles in Sovereign Debt*, 73 L. & CONTEMP. PROBS. i (2010) (foreword to a special issue on sovereign debt).

contributing to fill an important gap in the international financial architecture."[101] The UK adjusted the collective action clauses it uses to reflect the G10 Working Group's recommendations (see below):

"The inclusion of collective action clauses (CACs) in international bond issues can help strengthen the international financial system by facilitating debtor-creditor negotiations in cases where sovereign debt restructuring is necessary. While there is no intention to restructure any UK government or Bank of England debt, the UK authorities have included these CACs as part of their commitment to promoting wider adoption of appropriate contractual clauses in bond documentation. Other EU member states have also undertaken to include CACs in their international bonds and the aim is for these clauses to become the generally accepted standard in sovereign bonds issues...

While previous HMG foreign currency issues and Bank of England Euro Notes already included CACs, the UK authorities have chosen to update the CACs included in their foreign currency debt to reflect recent international initiatives in this area. The G10 Working Group on Contractual Clauses considered how sovereign debt contracts could be modified in order to make the resolution of debt crises more orderly, and has published a Report with its recommendations. The key features of the new UK CACs reflect these recommendations, and they are outlined in the attached table.

Some of the provisions are new compared with previous UK government foreign currency issues and Bank of England Euro Notes. For example, the new debt is issued under a Trust Deed where the trustee acts as a permanent representative of noteholders. The Trust Deed also includes features that should limit disruptive legal action: there are restrictions on individual noteholders initiating litigation, and any litigation proceeds would be distributed pro rata across noteholders.

Another change is that voting on any proposed amendments to the terms of the debt would be based on total outstanding principal, rather than principal held by noteholders represented at a duly convened meeting. Amendments on "reserved matters" would require consent from noteholders holding 75% of outstanding principal, while changes to non-reserved matters could be agreed by noteholders representing 66 2/3 % of outstanding principal. All votes could be conducted in writing without a meeting, but there are also provisions enabling noteholders, the issuer, or trustee to organise meetings. The new debt also excludes from voting any notes owned or controlled, directly or indirectly, by the issuers."[102]

The Idea of a Sovereign Debt Restructuring Mechanism

The following speech by Anne Krueger of the IMF described the IMF's SDRM proposal (as well as collective action clauses):

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[101] Rodrigo de Rato, Managing Director of the International Monetary Fund, Capital Markets in a Global Economy—Recent Developments, Remarks at the Institute of International Finance Spring Membership Meeting, Madrid, Spain (April 1, 2005) *available at* http://www.imf.org/external/np/speeches/2005/040105.htm .

[102] http://www.bankofengland.co.uk/publications/other/financialstability/cac/cac_information.pdf

Ever since the Mexican, Asian and Russian crises of the mid-l990s, efforts have been underway to find means for more effective prevention and resolution of currency-financial crises. Much has been done with respect to crisis prevention: exchange rate flexibility is much greater than it was; there is increased transparency and improved oversight of the financial system; and greater attention is paid to unsustainable policy stances. Work continues to strengthen economies' immunity to crises.

But no matter how much is done, there will inevitably be a crisis or crises. Much has already been learned with respect to crisis resolution and the international financial community is better equipped to cope with crises than was the case earlier. But, as with prevention, more can be done.

One item on the agenda, which should contribute both to prevention and to resolution, is dealing with unsustainable debt burdens of sovereigns. Two of the hallmarks of most of the l990s crises were, first, the importance of private capital flows, and their reversals, in triggering the crises and in intensifying their severity; and second, the involvement of the financial systems in them.

The countries afflicted by these crises were ones that had succeeded in raising per capita incomes and rates of economic growth. That success hinged in significant part on their having put in place economic policies that are conducive to economic growth, including a predictable legal framework, respect for property rights, openness to the international economy, and much more.

The fact that the policy framework was generally appropriate implied, among other things, that there were relatively high real returns to investment in these economies. That is of course the main reason why private investors were interested in them. At the same time, capital inflows permitted more rapid development than would otherwise be possible.

These associations of high real returns, growth, and appropriate policy stances continue. For these reasons, there is typically a strong stake for emerging markets to maintain international creditworthiness and policy makers go to great lengths to maintain their international reputations and market standings. An efficient private international capital market benefits both developing countries able to invest more than domestic savings at high real rates of return and investors in high-income countries realizing higher real returns and greater portfolio diversification than they could achieve without these investment opportunities.

Because countries are sovereign, their high stakes in maintaining creditworthiness are crucial for attracting international capital flows. For foreign creditors do not have the rights they do in domestic courts and hence must have other protections against default on the part of borrowers. This is especially true for sovereign borrowers; international lenders to private entities in emerging markets normally have the same protection as is afforded to domestic lenders. For sovereign borrowing, however, the chief protection foreign creditors have is the losses that would accrue to the sovereign debtor (both directly, through the future reduction in access to international credit markets, and through the effects on private economic activity of a sovereign default) in the event of failure to fulfill obligations. And these losses are heavy.

Failure of a sovereign to carry out debt-servicing obligations in accordance with contracts is therefore a last resort in emerging markets. The explosive growth of private international capital flows to sovereigns is one piece of evidence that private creditors believe that sovereigns will in general exert every effort to service their debts. And this belief appears to be well-founded.

However, there arises the occasional instance in which servicing debt according to existing contracts is not possible and debt is unsustainable. This can happen because of changes in external circumstances (a sharp and unanticipated permanent drop in the price of a key export, for example) or for other reasons. Often, all that is required is a flow rescheduling of existing debts, maintaining net present value. But in some circumstances, a rescheduling that maintains net present value can leave a country with a debt overhang. Then, a reduction in debt and debt service, reducing the net present value of outstanding obligations is necessary. Henceforth, I refer to rescheduling as a circumstance in which net present value is maintained (and which can therefore generally be undertaken by the sovereign under existing international institutional arrangements) and a reduction in debt when net present value is reduced.

It is important to bear in mind the definition of unsustainability: it is a circumstance when, regardless of the sovereign's efforts, debt relative to GDP (and therefore debt servicing relative to GDP) will grow indefinitely. In those circumstances, the economic net present value of the sovereign's debt is less than the face value of the debt; moreover, it will likely continue to fall until a restructuring is undertaken and growth resumes.

In reality, of course, a judgment as to unsustainability must be made on a probabilistic basis: there is always a chance, however remote, that new natural resources will be discovered, that the terms of trade will shift in a country's favor by an exceptional amount, or that some other very low-probability event will change the outlook. However, as borrowing continues and debt servicing obligations as a percentage of GDP rise, the probability of the sovereign being able to honor the net present value of all existing contracts falls. As that happens, growth rates drop, real interest rates rise, and probabilities drop still further. The process can continue until the sovereign recognizes that further efforts to maintain debt service will not begin to address the problem.

Even when the authorities in an overly-indebted country begin to recognize their difficulties, there are disincentives for instigating the restructuring. There is always the hope that the highly improbable favorable shock will materialize. Meanwhile, the consequences of announcing an inability to continue voluntary debt servicing are immediate and negative. A turnaround in the economy will take place after restructuring only after some time. Given political time preferences, that may in itself induce the authorities to delay facing the inevitable. But, in addition, there are significant uncertainties as to how to proceed to deal with creditors.

This was always true, but the problem has intensified as private capital flows have increased relative to official flows. In the l980s debt crisis, private creditors held less than half of outstanding sovereign debt. In Latin America, for example, 66 per cent of debt was to official creditors in the l980-85 period. Many of the private creditors were banks, and usually fewer than 20 banks that represented a very high percentage of outstanding loans to sovereigns. Even then, it was not until the Brady plan in effect orchestrated a debt reduction, and economic policies had been altered, that growth resumed in many countries. By the late l990s, private creditors accounted for over two thirds of outstanding Latin American debt, with official debt only 28 percent. Moreover, the private creditor base was more diffuse, among both banks and bond holders.

While this has been helpful in terms of bringing additional sources of capital to the table and facilitating the diversification of risk, it has increased significantly the collective action problem.

Just as a bank run might be avoided if all depositors refrained from withdrawing, but occurs when each depositor has an incentive to be the first in line, so there is a danger that individual creditors will decline to participate in a voluntary restructuring in the hope of recovering payment on the original contractual terms, even though creditors - as a group - would be best served by agreeing to a restructuring.

The problem of collective action is most acute prior to a default, where creditors may have some reasonable hope of continuing to receive payments. A debtor that had reached agreement with the bulk of its creditors on a restructuring would doubtless hesitate to default on a small amount of the original debt to secure unanimity. Recognizing this, holdout creditors may seek full payment once agreement has been reached with most.

Following a default, the options facing creditors, particularly those without an interest in litigation, are more limited and the problems of collective action may be less acute. There is no doubt that agreement on a restructuring would eventually be reached following a default. But there is substantial merit in trying to secure agreement on restructuring prior to default. A default, and the associated uncertainties regarding creditor-debtor relations, tends to be associated with widespread economic dislocation. This amplifies the costs that must be borne by debtors and their creditors.

If ways could be found for maintaining creditor rights and simultaneously reducing the duration and severity of the economic downturn associated with delays in debt reduction once it is evident to all that it must occur, there are potential gains for both creditors and debtor, and hence for the international economy.

There are two groups of proposals currently under consideration.1 The first calls for more widespread use of collective action clauses (CACs). A second calls for a statutory approach, providing a legal framework against or through which sovereign debt restructuring could take place. CACs would be placed in individual bond issues, and would bind all bond holders to accept debt reduction and restructurings where a specified super majority of holders consented to it. This already happens under English law, and recently the European Union has decided to call for CACs in contracts issued in member countries. The United States Treasury has also called for CACs in individual sovereign bond contracts.

The advantages of CACs include the ability to prevent holdout creditors of individual bond issues and the greater ease of solving the collective action problem (especially if a trustee structure is used) when any form of change in the terms, including rescheduling, may be necessary. Inclusion of clauses in all new contracts would not, however, address issues associated with the existing stock of bonds; the full force of CACs would therefore not be felt for some period into the future. Moreover, each bond issue would constitute a separate class and CACs would thus not solve intercreditor equity concerns and collective action problems across bond issues or between bonds and other creditors (most importantly banks).

The proposal put forth by the IMF calls for a Sovereign Debt Restructuring Mechanism (SDRM), which is a statutory approach. The design of the SDRM has been guided by a number of principles. First, the mechanism should only be used to restructure debt that is judged unsustainable. Second, it should neither increase the likelihood of restructuring nor encourage defaults. Third, any interference with contractual relations should be limited to measures needed to resolve the most important collective action problems.

The principal feature of the SDRM is that it would allow a sovereign and a qualified majority of creditors to reach an agreement that would then be binding on all creditors subject to the restructuring, paying due regard to seniority among claims and the diversity of creditor interests. Giving creditors the ability to make this decision does not shift the legal leverage from creditors to the debtor; rather it increases the leverage of creditors over potential holdouts and free riders, enabling an agreement to be secured more rapidly.

The proposal does not contemplate an automatic stay on creditor enforcement or a general suspension of contractual provisions. Thus, it would not provide a debtor in default with the same type of legal protection found in corporate insolvencies. In ideal circumstances, a sovereign with unsustainable debt would use the SDRM before default, which is when there is greatest amount of value to be preserved but where collective action problems are most acute.

The proposal envisages that sovereign debt governed by foreign law would be covered by the SDRM; sovereign debt subject to domestic law would not be included. However, since foreign creditors would be entitled to vote upon proposed debt reductions, they would clearly take into account issues of intercreditor equity between sovereign debt issued under domestic and foreign law.

The proposal is designed to promote greater transparency in the restructuring process. Under the SDRM, procedures would be established to enable creditors to have adequate access to information regarding the debtor's general situation, including its treatment of all creditors, including those not subject to the mechanism. The sovereign would provide the information at the time of activation of the mechanism.

Given the ability to invoke the SDRM on the part of the sovereign (or to convene creditors' groups "in the shadow of the SDRM"), there would be early and active participation of creditors during the restructuring process. The SDRM framework would enable creditors to play an active role at earlier stages than is now possible, including through the formation of creditors' committees. Creditors would have the right to declare that the debtors were not acting in good faith, which would terminate the SDRM. Once that happened, creditors' rights would be just the same as they are under existing practices.

In discussions of the SDRM proposal, some have argued that the existence of such a framework would alter, and presumably weaken, creditor rights. In fact, the design of the proposal has been structured in an effort to increase creditor value for reasons already discussed, by aggregating rights now held by individual creditors. This would, at least to some degree, address the collective action problem. In addition, the possibility, that incentives for delay when restructuring is inevitable would be reduced, should cut the losses that occur in the time prior to the sovereign's decision.

As currently discussed (and it is still a work in progress), creditors could, under the mechanism, declare the sovereign to be failing to negotiate in good faith, and could vote to disband the mechanism. In such an instance, creditors' rights would be just as they are under existing practices.

Creditors and the sovereign would negotiate once the SDRM was invoked and claims registered. When a supermajority reached agreement, it would be binding on all creditors. To be sure, creditors holding sovereign debt under foreign law would want to know the sovereign's treatment of domestic debt, but that would not be subject to the mechanism since it would be handled under domestic law. However, as already noted, to enable creditors to form a judgment as to intercreditor equity, the SDRM procedures would require sovereigns to disclose sufficient information about their outstanding debt, both foreign and domestic. Full disclosure could in itself constitute a significant improvement for creditors as they attempt to evaluate the needed degree of restructuring.

It should be evident that debt restructuring negotiations under the SDRM could begin more rapidly if there were CACs in individual bond contracts, as the problems of identifying creditors could be more rapidly resolved. Thus, proposals for CACs and SDRM are complementary, as is recognized by the international community.

The role of the International Monetary Fund (IMF) in the SDRM as currently proposed is minimal. Amending the Fund's Articles of Agreement appears to be a simple way of binding all IMF member countries to the SDRM framework, and thereby avoid the problems that could arise if the same structure were proposed under a new international treaty. This is because the failure of even a few countries to adopt the new treaty could enable creditors to issue debt outside the jurisdictions in which SDRM could be used, thus giving rise to circumvention. However, the proposed Sovereign Debt Dispute Resolution Forum (SDDRF-a legal body whose functions would be to register claims and resolve disputes) would be independent of the Fund and its Executive Board, in parallel with approaches used in other organizations.

One of the questions that has been raised with regard to the SDRM and CAC proposals is how they would affect the volume of private capital flows to sovereigns in emerging markets. There are two parts to the answer. First, provision of a more predictable framework should provide incentives for lenders to assess credit risks even more closely than is currently the case, thus increasing the spread differential between countries with differing soundness of economic policies and hence prospects. As such, countries confronting the lowest spreads might borrow somewhat more, but countries confronting high spreads would borrow less (and might even avoid debt unsustainability). However, insofar as the framework is more orderly and predictable, and the time period during which sovereigns are delaying the inevitable is reduced, creditors should expect on average to confront smaller losses in net present value than they can expect under current circumstances. To the degree that economic losses (in terms of foregone output in the period prior to the decision to restructure) are smaller, there are potentially higher returns, and total capital flows to emerging markets as a whole should increase. Given the infrequency of need for restructurings, however, it is not evident how quantitatively important this phenomenon would be.

To conclude, brief mention should be made of the current status of the CAC and SDRM proposals. The IMF is encouraging individual countries to put CAC clauses in their new bond issues, and, as already mentioned, in some countries they are now the established practice. For the SDRM, the International Monetary and Finance Committee has asked the IMF to bring a concrete proposal to its spring meetings...At that time, the international community will decide on what steps forward should be taken.[103]

Critics of the IMF proposal argued against an expanded role for the IMF:

Critics came from many quarters--from banks and funds, from economists and legal experts, from emerging nations and finally from the US Treasury. There was one common denominator in the protests: this is an expanded role for the IMF, whether by the institution itself or by the courts and committees it might control behind the scenes. And it is one that will increase--not decrease as claimed--the uncertainty that leads to volatility in markets and will result in less lending at higher costs for emerging economies.
There is fear that the policy objectives of dominant IMF members will influence decisions. There is anticipation of conflict of interest since the IMF and other multilateral agencies are large creditors that may not be forever immune to sharing in losses when debt is restructured. There is hostility to a rigid and static bureaucracy whose decisions are imposed by fiat and are difficult to predict. In sum, we are seeing another episode in the classic confrontation between regulation and free markets.

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[103] Anne Krueger, IMF First Deputy Managing Director, Sovereign Debt Restructuring: Messy or Messier?, Speech to the Annual Meeting of the American Economic Association,January 4, 2003, Washington, D.C., *available at* http://www.imf.org/external/np/speeches/2003/010403.htm

As the debate continues, the IMF is weakening its rhetoric but not its grip. Much is being made of the free will of debtors and creditors to determine outcomes. Little is being said about the expanded reach that the plan would invest in the IMF or in the allegedly independent courts and committees it would create. The IMF is counting on money, on its ability to grant or withhold massive amounts of desirable subsidized funding, to force debtors and creditors to comply with Fund wishes at every stage of the restructuring process.
Whether directly or indirectly, the IMF would be empowered to:
• Decide how long creditors can be prevented from suing a defaulted borrower.
• Rule on whether a nation's economic policies are sound and whether it is negotiating in good faith.
• Control access to interim financing while existing debt payments are suspended.
• Hold a veto over restructuring agreements reached by the debtor and its creditors.[104]

Collective Action Clauses

Report of the G10 Working Group on Contractual Clauses[105]

Model New York Law Collective Action Clauses

The model clauses annexed to this report were prepared at the direction of the Working Group on Contractual Clauses in the autumn of 2002 by a group of lawyers experienced in representing sovereign debtors and their creditors from the key issuing jurisdictions for sovereigns. The clauses, which are being published for illustrative purposes, were drafted for use in sovereign bonds governed by the laws of a U.S. jurisdiction and can be used as the basis for the development of clauses in specific issuances in the U.S. and in other jurisdictions in accordance with the laws of those jurisdictions. The clauses attempt to take into account existing market practice (particularly with respect to sovereign bonds issued under English law) and market acceptability at the time of their drafting. Use of the clauses in any particular jurisdiction will require consideration of the views of sovereign issuers and their creditors as to their acceptability in that jurisdiction, their compatibility with applicable law, and other important matters, such as the characteristics of a sovereign's investor base.

Proposed Insert to Terms and Conditions Governing the Bonds

___. Meetings of Holders; Modifications and Amendments

(a) Modifications and Amendments. Modifications, amendments and supplements to the Trust Indenture or the terms and conditions of the Bonds may be made pursuant to a written action of the Holders without the need for a meeting of Holders, or, in the circumstances described below, by vote of the Holders taken at a meeting of Holders, in each case in accordance with the terms of this Section ___ and the related provisions of the Trust Indenture.
(b) Meetings. The Issuer or the Trustee at any time may, and upon a request in writing made by Holders holding not less than 10% in aggregate principal amount of the Bonds at the time Outstanding the Trustee1 shall, convene a meeting of Holders of the Bonds. Any such request in writing by the Holders shall be delivered to the Trustee.

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[104] *See, e.g.*, Adam Lerrick and Allan H. Meltzer, Sovereign Default the Private Sector Can Resolve Bankruptcy Without a Formal Court, Carnegie Mellon Quarterly International Economics Report, April 2002.

[105] http://www.bis.org/publ/gten08.pdf

Further provisions concerning meetings of the Holders are set forth in Section ___ of the Trust Indenture.

(c) Non-Reserve Matters. Any modifications, amendment, supplement or waiver of the Trust Indenture or the terms and conditions of the Bonds requiring the consent of Holders, other than a modification or amendment constituting a Reserve Matter (as defined below), may be made, and future compliance therewith may be waived, with the consent of the Issuer and the Holders of more than 66-2/3% in aggregate principal amount of the Bonds at the time Outstanding pursuant to a written action of the Holders[, or with the consent of the Issuer and more than 66-2/3% in aggregate principal amount of the Bonds at the time Outstanding entitled to vote at a meeting of Holders convened and conducted in accordance with this Section ___].

(d) Reserve Matters. Any modification, amendment, supplement or waiver of the Trust Indenture or the terms and conditions of the Bonds that would:

(i) change the date for payment of principal of, or any instalment of interest on, the Bonds;

(ii) reduce the principal amount or redemption price or premium, if any, payable under the Bonds;

(iii) reduce the portion of the principal amount which is payable in the event of an acceleration of the maturity of the Bonds;

(iv) reduce the interest rate on the Bonds;

(v) change the currency or place of payment of any amount payable under the Bonds;

(vi) change the obligation of the Issuer to pay Additional Amounts in accordance with the Trust Indenture,

(vii) change the definition of Outstanding or reduce the quorum requirements or the percentage of votes required for the taking of any action pursuant to this Section ___;

(viii) authorize the Trustee, on behalf of all Holders, to exchange or substitute the Bonds for, or convert the Bonds into, other obligations or securities of the Issuer or any other person;

(ix) instruct the Trustee, on behalf of all Holders, to settle or compromise any proceeding or claim asserted by the Trustee pursuant to Section ___;

(x) give to any person or group of persons, other than the Trustee, the exclusive right to enforce any provision of the Trust Indenture or the Bonds on behalf of all Holders; or

(xi) appoint any person or group of persons to represent the interests of the Holders in any discussions with the Issuer or any other creditors of the Issuer in connection with any proposed restructuring of the Bonds or other indebtedness of the Issuer. may be made with the consent of the Holders of more than 75% (or in the case of paragraph

(x) or (xi), 66-2/3%) in aggregate principal amount of the Bonds at the time Outstanding pursuant to a written action of the Holders; provided that modifications, amendments, supplements or waivers pursuant to paragraph (xi) of this subsection may also be made with the consent of the Holders of more than 66-2/3% in aggregate principal amount of the Bonds at the time Outstanding entitled to vote at a meeting of Holders convened and conducted in accordance with Section ___; provided further that modifications, amendments, supplements or waivers pursuant to paragraphs (i) through (vii) of this subsection also shall require the consent of the Issuer.

(e) Binding Effect. Any modification, amendment, supplement or waiver consented to or approved pursuant to this Section ___ will be conclusive and binding on all Holders of Bonds, whether or not they have given such consent or were present at a meeting of Holders at which such action was taken, and on all future Holders of Bonds whether or not notation of such modification, amendment, supplement or waiver is made upon the Bonds. Any instrument given by or on behalf of any Holder of a Bond in connection with any consent to or approval of any such modification, amendment, supplement or waiver will be irrevocable once given and will be conclusive and binding on all subsequent Holders of such Bond.

(f) Quorum. At a meeting (or at any reconvening of a meeting) of the Holders of the Bonds called for any purpose in accordance with Section ___ of the Trust Indenture, persons entitled to vote a majority in aggregate principal amount of the Bonds at that time Outstanding shall constitute a quorum.

(g) Non-Material Amendments. The Trust Indenture and the terms and conditions of the Bonds may be modified, amended, supplemented or waived by the Issuer and the Trustee, without the consent of the Holder of any Bond, for the purpose of adding to the covenants of the Issuer for the benefit of the Holders, surrendering any right or power conferred upon the Issuer, securing the Bonds, curing any ambiguity, correcting or supplementing any defective provision therein, or in any other manner which the Issuer and the Trustee may mutually deem necessary or desirable and which shall not adversely affect
the interests of the Holders of the Bonds in any material respect, to all of which each Holder of any Bond shall, by acceptance thereof, consent.

(h) Supplemental Indenture. The Trustee, on behalf of the Holders, and the Issuer may execute a Supplemental Indenture to reflect any modification, amendment, supplement or waiver consented to or approved in accordance with this Section ___.

Proposed Insert to the Events of Default Section

___. Acceleration. If an Event of Default occurs and is continuing, then, and in every such case, the Trustee may, or shall upon the instruction of the Holders of not less than 25% in aggregate principal amount of the Bonds Outstanding at that time, declare the principal of, and any interest accrued on, all the Bonds to be due and payable immediately by a notice in writing to the Issuer, and upon any such declaration such principal and interest shall become immediately due and payable.

___. Rescission of Acceleration. If any and all existing Events of Default hereunder, other than the non-payment of the principal of the Bonds which shall have become due solely by acceleration, shall have been cured, waived or otherwise remedied as provided herein, then, and in every such case, the Holders of 66-2/3% in aggregate principal amount of the Bonds Outstanding at that time, by written notice to the Issuer and to the Trustee as set forth in the Trust Indenture, may, on behalf of all the Holders, rescind and annul any prior declaration of the acceleration of the principal of and interest accrued on the Bonds and its consequences, but no such rescission and annulment shall extend to or affect any subsequent default, or shall impair any right consequent thereon. Actions by Holders pursuant to this Section ___ may be taken by written action of the Holders.

Proposed Insert to the Remedies Section

___. Limitations on Suits

(a) Collection of Indebtedness and Suits for Enforcement by Trustee

The Trustee, in its own name and as a trustee of an express trust, may institute a judicial proceeding for the collection of the sums due and unpaid under this Trust Indenture or the Bonds, and may prosecute such proceeding to judgment or final decree, and may enforce the same against the Issuer or any other obligor and collect the moneys adjudged or decreed to be payable in the manner provided by law out of the property of the Issuer or any other obligor upon the Bonds, wherever situated.

If an Event of Default occurs and is continuing, the Trustee may in its discretion proceed to protect and enforce its rights and the rights of the Holders by such appropriate judicial proceedings as the Trustee shall deem most effectual to protect and enforce any such rights, whether for the specific enforcement of any covenant or agreement in this Indenture or in aid of the exercise of any power granted herein, or to enforce any other proper remedy. All rights of action and claims under this Indenture or the Bonds or coupons may be prosecuted and enforced by the Trustee without the possession of any of the Bonds or

coupons or the production thereof in any proceeding relating thereto, and any such proceeding instituted by the Trustee shall be brought in its own name as trustee of an express trust, and any recovery of judgment shall, after provision for the payment of the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel, be for the rateable benefit of the Holders of the Bonds and coupons in respect of which such judgment has been recovered.

(b) Control by Holders

The Holders of a majority in principal amount of the Outstanding Bonds shall have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or exercising any trust or power conferred on the Trustee; provided that

(i) such direction shall not be in conflict with any rule of law or this Indenture;

(ii) the Trustee shall not determine that the action so directed would be unjustly prejudicial to the Holders not taking part in such direction, and

(iii) the Trustee may take any other action deemed proper by the Trustee that is not inconsistent with such direction.

(c) Limitation on Suits

No Holder of any Bond or coupon shall have any right to institute any proceeding, judicial or otherwise, with respect to the Bonds or this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder, unless

(i) such Holder has previously given written notice to the Trustee of a continuing Event of Default;

(ii) the Holders of not less than 25% in aggregate principal amount of the Bonds Outstanding at that time shall have made written request to the Trustee to institute proceedings in respect of such Event of Default in its own name as Trustee hereunder;

(iii) such Holder or Holders shall have offered to the Trustee reasonable indemnity against the costs, expenses and liabilities to be incurred in compliance with such request;

(iv) the Trustee for 90 days after its receipt of such notice, request and offer of indemnity shall have failed to institute such a proceeding; and

(v) no direction inconsistent with such written request has been given to the Trustee during such 90 day period by the Holders of a majority in principal amount of the Bonds Outstanding at that time;

it being understood and intended that no one or more Holders of Bonds or coupons shall have any right in any manner whatever by virtue of, or by availing of, any provisions of this Indenture to affect, disturb or prejudice the rights of any other Holders of Bonds or coupons, or to obtain or seek to obtain priority or preference over any other

Holders or to enforce any right under this Indenture, except in the manner herein provided and for the equal and rateable benefit of all the Holders of Bonds and coupons.

Proposed Insert to Covenants of the Issuer

___. Provision of Information. Following occurrence of any Event of Default of the kind referred to in subsection [payment default] or [declaration of moratorium], the Issuer shall provide to the Trustee (for onward dissemination to each Holder) on a regular basis information in reasonable detail concerning the Issuer's economic and financial position.

Under these circumstances, the Issuer shall also in a similar manner provide information concerning (i) the Issuer's proposed treatment of its other material creditor groups, including, where appropriate, bilateral (Paris Club) creditors, (ii) information concerning any standby or similar program negotiated with the International Monetary Fund (including a copy of the related Technical Memorandum) and (iii) such other information as the Trustee (on its own or at the instruction of the Holders of not less than 10% in aggregate principal amount of the Bonds Outstanding at that time) may from time to time reasonably request. [Issuers and underwriters to discuss in the context of particular transactions whether additional periodic information should be provided prior to default, and if so, what the scope and frequency of such reporting should be.]

Proposed Insert to the Modifications and Amendments Section

___. "Outstanding" Defined. For purposes of the provisions of this Trust Indenture and the Bonds, any Bond authenticated and delivered pursuant to this Trust Indenture shall, as of any date of determination, be deemed to be "Outstanding", except:

(i) Bonds theretofore cancelled by the Trustee or delivered to the Trustee for cancellation or held by the Trustee for reissuance but not reissued by the Trustee;

(ii) Bonds that have been called for redemption in accordance with their terms or which have become due and payable at maturity or otherwise and with respect to which monies sufficient to pay the principal thereof (and premium, if any) and any interest thereon shall have been made available to the Trustee; or

(iii) Bonds in lieu of or in substitution for which other Bonds shall have been authenticated and delivered pursuant to this Trust Indenture; provided, however, that in determining whether the Holders of the requisite principal amount of Outstanding Bonds are present at a meeting of Holders of Bonds for quorum purposes or have consented to or voted in favour of any request, demand, authorisation, direction, notice, consent, waiver, amendment, modification or supplement hereunder, Bonds owned or controlled, directly or indirectly, by the Issuer or by any public sector instrumentality of the Issuer shall be disregarded and deemed not to be Outstanding, except that in determining whether the Trustee shall be protected in relying upon any such request, demand, authorization, direction, notice, consent, waiver, amendment, modification or supplement, only Bonds which the Trustee knows to be so owned or controlled shall be so disregarded

EMCA Model Covenants for New Sovereign Debt Issues [106]

Amendments

"Amendments." No amendment or waiver of any provision of the Bonds or the Fiscal Agency Agreement, nor consent to any departure by the Issuer therefrom, shall in any event be effective unless in writing and consented to (including by electronic mail) by Bondholders holding at least 75% in principal amount of the Bonds then outstanding, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given; provided that no amendment, waiver or consent shall, unless in writing and consented to by Bondholders holding at least 95% in principal amount of the Bonds then outstanding, do any of the following: (a) subject the Bondholders to any additional obligations, (b) reduce the principal of, or interest on any of the Bonds, (c) change the currency of payment of the principal or interest on any Bond; (d) change any date fixed for any payment in respect of principal of, or interest on, any of the Bonds, or (e) waive, modify or otherwise affect [insert cross-references to any Sections containing provisions relating to: pari passu protection, negative pledge covenant, cross-default and cross-acceleration, requirement that Issuer cancel any exchanged indebtedness, eligibility for debt conversion programs, restrictions on incurrence of additional indebtedness, requirement of listing on stock exchange, waiver of immunities, choice of law, consent to jurisdiction and service of process],; provided further that no amendment, waiver or consent shall, unless in writing and consented to by all of the Bondholders, change this Section; provided further that no amendment, waiver or consent shall, unless in writing and consented to by the Fiscal Agent in addition to the Bondholders required hereinabove to take such action, affect the rights or duties of the Fiscal Agent under the Fiscal Agency Agreement.

For purposes of calculating the percentage of principal amount of Bonds outstanding under this Section, there shall be excluded any Bonds held by the Issuer or any governmental or quasigovernmental agency, instrumentality or entity under the jurisdiction of or formally affiliated with, or under the control of, the Issuer or the Central Bank of the Issuer.

Assets

"Assets" means assets, property and rights in property of any kind whatsoever. For the avoidance of doubt, the term "Assets" as used in this Agreement means property and property rights in their broadest senses, including all forms of tangible property (including without limitation both personal and real property, regardless of its use or intended use) and all forms of intangible property (including without limitation claims, causes of action and rights to receive any form of payments, whether described as revenues, cash or in-kind royalties, concession fees, taxes,

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[106] *See, e.g.*, Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L. REV. 1627, 1686 (2006)("Publicly, EMCA styled itself as the voice of the bondholder grassroots, and had initially distanced itself from the older, more professionalized trade groups with significant sell-side membership and roots in the 1980s debt crisis. EMCA's penchant for public purity positioned it as the enemy of both SDRM and CACs. Yet the group was the first on the investor side to propose a package of clauses that included majority amendment. EMCA's "Model Covenants for New Sovereign Debt Issues" circulated informally as early as May 2002, four months before the G-10 clauses and eight months before the consensus clauses later endorsed by seven market associations, including EMCA itself.")

income, or the proceeds of sales of natural resources). Further, the term "Assets" as used in this Agreement includes any International Monetary Assets as defined herein; and further includes any assets, property and rights in property of any kind whatsoever held in the name of or otherwise under the control of any agency or instrumentality of the Issuer, including without limitation any such assets, property or rights in property held in the name, or on behalf, of the Issuer or the Central Bank of Issuer.

Event of Default; Acceleration

Each of the following constitutes an event of default:

1. Non-Payment: the Issuer does not pay principal or interest in respect of the Bonds when due and such failure continues for 30 calendar days.
2. Breach of Other Obligations : the Issuer fails to perform any other material obligation contained in the Bonds or Fiscal Agency Agreement (including but not limited to [crossreference section of Fiscal Agency Agreement regarding Bondholder representatives' fees and expenses]) and that failure continues for 30 calendar days after any holder gives written notice to the Issuer to remedy the failure and gives a copy of that notice to the Fiscal Agent.
3. Cross Acceleration: any External Public Indebtedness of the Issuer in principal amount equal to or greater than $25,000,000 or its equivalent in other currencies is accelerated, other than by optional or mandatory prepayment or redemption.
4. Moratorium: the Issuer declares a general moratorium on the payment of its External Public Indebtedness.
5. Validity: the Issuer contests the validity of any Bonds in a formal administrative, legislative or judicial proceeding.
6. Failure of Authorization: any legislative, executive or constitutional authorization necessary for the Issuer to perform its material obligations under any Bond ceases to be in full force and effect or is modified in a manner which adversely affects the rights and claims of any of the holders.
7. Material Adverse Change : any event or condition (including, but not limited to, any material adverse change in the economic or financial condition of the Issuer or its Central Bank) that gives reasonable grounds to apprehend, in the reasonable judgment of the holders of at least [25%] of the principal amount of Bonds then outstanding, that the Issuer will not, or will be unable to, perform or observe in the normal course its obligations under the Bonds and the Fiscal Agency Agreement.

If any of the above events of default occurs and is continuing, holders of Bonds representing at least 25 % in principal amount of the Bonds then outstanding may declare the principal amount of the Bond to be due and payable immediately by giving written notice to the Issuer and to the Fiscal Agent. Upon such declaration, the Fiscal Agent shall promptly give notice thereof to the holders of Bonds. Such an acceleration may only be rescinded with the consent of holders of Bonds representing at least 75 % in principal amount of the Bonds then outstanding.

External Indebtedness

"External Indebtedness" means (i) each obligation to repay a loan, deposit, advance or similar extension of credit (including without limitation any extension of credit under a refinancing or rescheduling agreement), (ii) each obligation evidenced by a Bond, bond, debenture or similar written evidence of indebtedness and (iii) each guarantee of an obligation constituting External Indebtedness of another; provided in each case that such obligation is governed by the law of a country other than that of the Issuer.

Governing Law
"Governing Law." The Bonds and the Fiscal Agency Agreement are governed by, and shall be construed in accordance with, the laws of the State of New York. In the event of any doubt or uncertainty as to the state of the applicable law, all such doubts and uncertainties shall be resolved so as to give effect to the plain language of this Agreement.

Internal Indebtedness
"Internal Indebtedness" means (i) each obligation to repay a loan, deposit, advance or similar extension of credit (including without limitation any extension of credit under a refinancing or rescheduling agreement), (ii) each obligation evidenced by a Bond, bond, debenture or similar written evidence of indebtedness and (iii) each guarantee of an obligation constituting Internal Indebtedness of another; provided in each case that such obligation is governed by the domestic law of the Issuer.

International Monetary Assets
"International Monetary Assets" means all (i) gold, (ii) Special Drawing Rights, (iii) Reserve Positions in the Fund, and (iv) Foreign Exchange, which is owned or held by the Issuer or the Central Bank of Issuer in their own names or for their benefit. For purposes of this definition, the terms "Special Drawing Rights," "Reserve Positions in the Fund" and "Foreign Exchange" have, as to the types of assets included, the meanings given to them in the IMF's publication entitled "International Financial Statistics," or such other meanings as shall be formally adopted by the IMF from time to time.

Jurisdiction, Waiver, etc.
"Consent to Jurisdiction; Service of Process; Waiver of Immunities."
(a) The Issuer hereby irrevocably submits itself and its Assets to the non-exclusive jurisdiction of the High Court of Justice in London and any New York State or United States Federal court sitting in New York State and any appellate court in any action or other proceeding arising out of or relating to the Bonds or the Fiscal Agency Agreement. The Issuer hereby irrevocably agrees that all claims in respect of any such action or proceeding may be heard and determined in the High Court of Justice in London or such New York State or United States Federal court or any such appellate court. The Issuer hereby irrevocably appoints (i) The Law Debenture Corporation, Limited (the "London Process Agent"), at its offices in London, England, as its agent to receive on behalf of itself and its Assets service of copies of the summons and complaint and any other process which may be served in any such action or proceeding before the High Court of Justice in London and (ii) CT Corporation System (the "New York Process Agent", and together with the London Process Agent being collectively the "Process Agents" and each a "Process Agent"), at its offices in New York, New York, United States, as its agent to receive on behalf of itself and its Assets service of copies of the summons and complaint and any other process which may be served in any such action or proceeding before any such New York State or United States Federal Court. Further, in the

event of any proceeding brought in any court in the United Kingdom or in any State or Federal Court in the United States to enforce any judgment rendered in any such action, service of any process, pleadings, discovery requests or any other materials shall be validly made by delivery to the London or New York Process Agents respectively, regardless whether the proceeding is lodged in London or New York. Service of process in accordance with this Section may be made by delivering a copy of such process to the Issuer in care of the appropriate Process Agent at such Process Agent's then-current address, and the Issuer expressly and irrevocably authorizes and directs each Process Agent to accept such service on its behalf. Service upon such Process Agents shall be valid service on the Issuer or with respect to its Assets regardless whether the Issuer shall have ceased to pay any fees of such Process Agent and regardless whether the Issuer shall have purported unilaterally to withdraw its consent to such service.

(b) The Issuer agrees that a final judgment in any action or proceeding to determine any of the rights of the parties to this Agreement shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law.

(c) Nothing in this Section shall be deemed to limit or otherwise affect the right of any Bondholder or the Fiscal Agent to serve legal process in any other manner permitted by law or affect the right of any Bondholder or the Fiscal Agent to bring any action or proceeding against the Issuer or any of its Assets in the courts of any jurisdictions.

(d) The Issuer irrevocably agrees with respect to itself and its Assets not to claim or assert in any pleading, and irrevocably waives, any and all immunity from suit, from the personal or subject matter jurisdiction of any court (including without limitation any court of the United States of America, the State of New York or the United Kingdom), from attachment prior to judgment, from attachment in aid of execution on a judgment, from execution on a judgment, from discovery proceedings, from injunctive proceedings (including without limitation proceedings for the specific enforcement of any covenants of the Issuer), or from the giving of any other relief or issue of any process. To the extent that in any jurisdiction there may be attributed such an immunity (whether or not claimed) with respect to the Bonds or the Fiscal Agency Agreement or any judgment based on its obligations hereunder, the Issuer irrevocably agrees not to assert or claim any such immunity for itself or its Assets. The Issuer expressly and irrevocably consents to discovery of any documents and to the giving of testimonial evidence in any prejudgment or post-judgment proceeding with respect to the nature and location of its Assets worldwide. Without limitation of the foregoing, the Issuer's waiver of immunity from execution with respect to itself and its Assets is, and shall be construed as, a knowing, voluntary and intentional waiver and relinquishment of any form of immunity purportedly recognized or conferred by the laws of any country, including without limitation by Section 1609 of the Foreign Sovereign Immunities Act of 1976, and shall further be construed to subject any of the Issuer's Assets to seizure and execution in aid of any judgment entered under the Bonds or the Fiscal Agency Agreement against the Issuer, regardless whether such property is deemed or characterized by any person as "commercial" or not, regardless whether such property is held in the name of the Central Bank of Issuer or of any other agency or instrumentality of the Issuer, regardless of the purportedly separate juridical status of the Central Bank of Issuer or any other agency or instrumentality of the Issuer, and notwithstanding any immunities from execution purportedly recognized or conferred by the laws of any country, including without limitation
Sections 1610-11 of the Foreign Sovereign Immunities Act of 1976.

(e) Without limitation of any of the foregoing, the Issuer expressly and irrevocably agrees that performance of its covenants and obligations under the Bonds or the Fiscal Agency Agreement (including without limitation its obligations under [insert cross-references to Sections concerning pari passu and negative pledge covenants]) may be enforced by injunction. The Issuer hereby consents with respect to itself and its Assets to the jurisdiction of any court where any proceeding to obtain such injunctive or other relief may be brought. The Issuer further agrees that its covenant herein not to plead or otherwise assert any such immunity may be specifically enforced against it by injunction and that no third party, including without limitation any garnishees, any government entities or officials of any country, or any entities or officials of any inter-governmental or supra-national agency, shall be entitled to assert such immunity on behalf of the Issuer or its Assets.

(f) In the event that notwithstanding the waivers of immunity set forth herein (and thus contrary to the parties' intent that such waivers be enforced as written), any court in any jurisdiction denies an attachment, execution, injunction or other relief on grounds of any alleged or imputed immunity of the Issuer or its Assets from such proceedings, such denial shall not have and shall not be given effect in any other enforcement proceedings in any other jurisdiction, whether by collateral estoppel, res judicata, as a matter of comity, or otherwise.

Lien

"Lien" means any lien, mortgage, deed of trust, charge, pledge, security interest or other encumbrance on or with respect to any Asset, or any preferential arrangement which has the practical effect of constituting a security interest, including without limitation rights of set off, with respect to the payment of any obligation with or from the proceeds of any Asset.

Negative Pledge

"Negative Pledge." So long as any Bond shall remain outstanding, the Issuer will not create or permit to be created and continue, nor permit the Central Bank of Issuer, or any other agency or instrumentality of the Issuer, to create or permit to be created and continue, (a) any Lien for any purpose upon or with respect to any International Monetary Assets;

(b) any Lien upon or with respect to any Asset of the Issuer, the Central Bank of Issuer, or any agency or instrumentality of the Issuer, to secure or provide for the payment of External Indebtedness of any person; or

(c) any Lien upon or with respect to any Assets of any person to secure or provide for the payment of External Indebtedness incurred or guaranteed by the Issuer, the Central Bank of Issuer, or any agency or instrumentality of the Issuer, other than Permitted Liens [to be separately defined and itemized on a Schedule].

(i) Enter into any credit agreement or other contract for External Indebtedness, nor permit the Central Bank of Issuer or any agency or instrumentality of Issuer, to enter into any credit agreement or other contract for External Indebtedness, which grants by contract to any other person any right of set off, banker's lien, counter-claim or similar contractual right, or otherwise has the practical effect of granting such person preferential access over the creditors hereunder to the Assets of Issuer, the Central Bank of Issuer, or any agency or instrumentality of Issuer, or granting such person payment rights in derogation of the pari passu treatment set forth in Section ___ of the Bonds or the Fiscal Agency Agreement.

(ii) Restructure, redenominate or recharacterize any existing credit agreement or other contract for External Indebtedness as a loan or other contract for Local Indebtedness, with the legal or practical effect of granting local creditors preferential or other payment rights senior to the creditors hereunder or in derogation of the pari passu treatment set forth in Section ___ of the Bonds or the Fiscal Agency Agreement.

Pari Passu and other Affirmative Covenants

"Affirmative Covenants." So long as any Bond shall remain outstanding, the Issuer will: (a) Undertake to include in its budget for each of its fiscal years amounts sufficient to repay principal of and interest on the Bonds and all other amounts payable by the Issuer hereunder in accordance with the terms hereof.

(b) Duly obtain and maintain in full force and effect all governmental approvals (including any exchange control approvals) which may be necessary under the laws of Issuer for the execution, delivery and performance of the Bonds and the Fiscal Agency Agreement by the Issuer or for the validity or enforceability hereof and duly take all necessary and appropriate governmental and administrative action in Issuer in order to make all payments to be made hereunder as required by the Bonds and the Fiscal Agency Agreement.

(c) Ensure that at all times its payment obligations hereunder constitute unconditional general obligations of the Issuer ranking at least pari passu in priority of payment with all other External Indebtedness of the Issuer or any of its agencies or instrumentalities now or hereafter outstanding, and will be paid as such. For the avoidance of doubt, the Issuer's covenant to maintain the pari passu status of the Bonds and its payment obligations hereunder means that the Issuer will service the Bonds on a pari passu basis. Accordingly, if an event of default under the Bonds or any other External Indebtedness of the Issuer or of any of its agencies or instrumentalities has occurred and is continuing, the Issuer shall not make (or authorize) any payment of principal or interest in respect of any other such External Indebtedness (whether regularly scheduled or otherwise) without simultaneously making a proportionate payment of principal and/or interest in respect of the Bonds.

(d) Furnish to the Fiscal Agent in sufficient copies for distribution to each Bondholder:

i. Semiannually, a reasonably detailed report and analysis of the financial condition of the Issuer as of the end of each prior calendar year or halfyear, as the case may be;

ii. Within 30 days after delivery to the Issuer, each annual report prepared by the IMF staff after the date hereof on the economy and international balance of payments of the Issuer or any report prepared by the IMF staff in lieu of such an annual report;

iii. Promptly after it is entered into, each agreement, undertaking and understanding reached by the Issuer, the Central Bank of Issuer, or any agency or instrumentality of Issuer after the date hereof with the IMF or any international development banks;

iv. Within 30 days after the transmittal to the IMF or any international development banks, copies of all economic or financial reports on the performance of the economy or financial condition of the Issuer;

v. Such other financial, statistical and general information as may be requested by the Fiscal Agent on behalf of the Bondholders or by Bondholders holding at least 5% in principal amount of the Bonds then outstanding.

(e) To assure performance of the foregoing subparagraphs, Issuer shall at the closing execute (and whether or not so executed this Agreement shall constitute) an irrevocable instruction to the IMF and any multinational development banks directing them to provide to the Fiscal Agent and the Bondholders any information required hereunder to the extent not provided by Issuer.

Purchase and Cancellation
The Issuer, the Central Bank of Issuer, and any agencies or instrumentalities of Issuer may, if an event of default has not occurred, purchase any Bonds in the open market or otherwise and at any price. Any Bonds so purchased may be cancelled or held and resold. Any Bond so purchased, while held by or on behalf of the Issuer, Central Bank of Issuer, and any agencies or instrumentalities of Issuer, shall be deemed not to be outstanding. The Issuer must inform the Fiscal Agent of any Bond that is held by itself, Central Bank of Issuer, and any agencies or instrumentalities of Issuer. Any Bonds so cancelled will not be reissued.

[In the Form of Bond]
Meetings of Bondholders.
(a) The Issuer at any time may, and (i) upon a request in writing to the Fiscal Agent made at any time by Bondholders holding not less than 10% of the aggregate outstanding principal amount of the Bonds or (ii) following receipt of notice from Bondholders holding not less than [5%] of the aggregate outstanding principal amount of the Bonds that an even of default has occurred and is continuing, the Fiscal Agent shall promptly, convene a meeting of Bondholders.
(b) At a meeting of the holders of the Bonds called for any of the above purposes, persons entitled to vote 75% in aggregate principal amount of the Bonds at the time outstanding shall constitute a quorum.
(c) Further provisions concerning meetings of Bondholders are set forth in the Fiscal Agency Agreement.

Notices.
(a) All notices to Bondholders will be given by publication in The Wall Street Journal, The Financial Times and, so long as the Bonds are listed on the Luxembourg Stock Exchange and it is so required for continued listing thereon, in the Luxemburger Wort.
(b) In addition, all notices to Bondholders will be given to EMTA for publication on its website (www.emta.org) and to EMCA for publication on its website (www.emcreditors.com) and for other distribution to their members.

[In the Fiscal Agency Agreement]
Meetings of Bondholders.
(a) The Issuer may at any time call a meeting of the Bondholders, such meeting to be held at such time and at such place in [New York City] as the Issuer shall determine, for any purpose referred to in the Bonds. (i) Upon a request in writing to the Fiscal Agent made at any time by holders of not less than 10% of the aggregate outstanding principal amount of the Bonds, or (ii) following receipt of notice from Bondholders holding not less than [5%] of the aggregate outstanding principal amount of the Bonds that an event of default under the Bonds has occurred and is continuing, the Fiscal Agent shall convene a meeting of Bondholders and such meeting shall be held at such time and at such place in [New York City] as the Fiscal Agent shall determine. Prior to any such meeting, the Fiscal Agent shall distribute to the Bondholders such written materials or proposals as may be delivered to it by holders of not less than 10% of the aggregate outstanding principal amount of the Bonds. Notice of any meeting of Bondholders, setting forth the time and place of such meeting and in general terms the action proposed to be taken at such meeting, shall be given by the Fiscal Agent to the Bondholders at least twice by publication in accordance

with the notice provisions contained in the Bonds, the first notice to be given not less than 15 nor more than 45 days before the date fixed for the meeting. [To be entitled to vote at any meeting of Bondholders, a person must be (x) a holder of one or more Bonds or (y) a person appointed by an instrument in writing as proxy by the holder of one or more Bonds. The only persons who shall be entitled to be present or to speak at any meeting of Bondholders shall be the persons entitled to vote at such meeting and their counsel and any representatives of the Fiscal Agent and their counsel and, in the case of any such meeting called by (or to which the Issuer is otherwise invited), representatives of the Issuer and its counsel.]

(b) The quorum requirements at any meeting of Bondholders are set forth in the Bonds.

No business shall be transacted in the absence of a quorum, unless a quorum is present when the meeting is called to order. In the absence of a quorum within 30 minutes of the time appointed for any such meeting, the meeting may be adjourned for a period of not less than ten days as determined by the temporary chairman of the meeting appointed pursuant to paragraph (d) below. Notice of the reconvening of any adjourned meeting shall be given as provided above except that such notice need be given only once but must be given not less than five days before the date on which the meeting is scheduled to be reconvened.

(c) Any Bondholder who has executed an instrument in writing appointing a person as proxy shall be deemed to be present for the purposes of determining a quorum and be deemed to have voted in accordance with the vote of the person appointed as such proxy; provided that such Bondholder shall be considered as present or voting only with respect to the matters voted on by such person in accordance with such instrument in writing. Any resolution passed or decision taken at any meeting of Bondholders duly held in accordance with this Section shall be binding on all the Bondholders whether or not present or represented at the meeting.

(d) The Fiscal Agent shall appoint a temporary chairman of the meeting. A permanent chairman and a permanent secretary of the meeting shall be elected by vote of the holders of a majority in principal amount of the Bonds represented at the meeting. At any meeting of Bondholders, each Bondholder or proxy shall be entitled to one vote for each U.S. $1,000 in principal amount of Bonds held or represented by him; provided that no vote shall be cast or counted at any meeting in respect of any Bond challenged as not outstanding and ruled by the chairman of the meeting to be not outstanding. The chairman of the meeting shall have no right to vote except as a Bondholder or proxy. Any meeting of Bondholders duly called at which a quorum is present may be adjourned from time to time, and the meeting may be held as so adjourned without further notice.

(e) At any Bondholder meeting after an event of default held pursuant to paragraph (a) (ii) above, the Bondholders may appoint a representative and/or Bondholder committee, which in turn may engage independent legal counsel and/or financial advisors to represent the collective interests of the Bondholders. Any such Bondholder committee shall meet at such times and places, adopt such internal rules to govern its meetings, engage in such discussions with the Issuer, and coordinate with such other creditor groups, as it deems appropriate. The Issuer shall pay the fees of any such representative and the expenses of any such representative and/or Bondholder committee (including the fees and expenses of any such legal counsel or financial advisors within 30 calendar days after delivery to the Issuer of an invoice (with appropriate supporting documentation) itemizing such fees and expenses).

(f) The holding of Bonds shall be proved by the registry books maintained in accordance with [Section hereof] or by a certificate or certificates of the Registrar. The Issuer may, at its option, fix a record date (not less than 15 nor more than 45 days before the date fixed for such meeting) for the determination of holders entitled to vote at any meeting, but shall have no obligation to do so.

[Incurrence of Indebtedness Covenants]
Without proposing specific language at this time, it is EMCA's position that Issuers should agree to so-called "incurrence" covenants modeled on those common in high yield debt instruments, whereby the Issuer is permitted to engage in future borrowings and privatizations or other sales of assets, but only when it is in compliance with certain financial ratios, or the action is otherwise permitted by certain well-defined criteria to be negotiated on a country-by-country basis.

Here is one argument from Federico Weinschelbaum and Jose Wynne that a SDRM-type procedure might be preferable to CACs:

CACs introduce flexibility in situations of financial distress by facilitating renegotiation. In their absence, bondholders have no incentives to enter into the renegotiation process since, individually, they are unable to affect the probability of repayment (as long as the debt is not held by a large lender). CACs solve the problem of free riding among creditors within a legal jurisdiction because a supermajority of bondholders can make the outcome of the renegotiation mandatory for all. But the existence of CACs does not always imply a friendly restructuring process. Sovereigns tend to issue debt in different jurisdictions, and while CACs coordinate creditors within each one, the free riding problem between jurisdictions remains. This is a feature of the 1990s not present in the 1980s, when few banks concentrated most of the sovereign bonds. To attend to this problem, the idea of an international bankruptcy procedure (or an SDRM), to coordinate creditors in different jurisdictions, has been put forward.
It has been argued that facilitating renegotiation can have both positive and negative consequences. Because renegotiation relieves countries from debt overhang, governments might run reckless fiscal policies that increase the likelihood of financial crisis. Since lenders anticipate this behavior, the cost of the lack of commitment to run responsible fiscal policies is borne by the country itself. In the end, the severity of the moral hazard problem determines whether facilitating renegotiation, by creating an SDRM, make countries worse or better off. The debate about the value of an SDRM lies precisely on this trade off.[107]

[107] Federico Weinschelbaum & Jose Wynne, *Renegotiation, Collective Action Clauses and Sovereign Debt Markets,* 67 J. OF INT'L ECON. 47-72 (2005) *available at* http://faculty.fuqua.duke.edu/~josew/Jose_archivos/Collective_Action.pdf