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Robert A. Cohen

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## “SOMETIMES A CIGAR IS JUST A CIGAR”: THE SIMPLE STORY OF *PARI PASSU*

*Robert A. Cohen\**

### I. INTRODUCTION

In an oft-told, but perhaps apocryphal, story, a student of Sigmund Freud, the father of psychoanalysis, asked Freud the significance of his fondness for cigars. Freud allegedly responded that “[s]ometimes a cigar is just a cigar,”<sup>1</sup> suggesting that some things should be taken at face value, without delving for other meanings. Like Freud’s cigars, a *pari passu*<sup>2</sup> clause in a sovereign debt instrument is best understood by taking it at face value and accepting the clause’s plain language meaning.

Focus on *pari passu* began in 2000 when Elliott Associates, L.P. (“Elliott”), then a holder of Peruvian debt, obtained a ruling from the Court of Appeal of Brussels<sup>3</sup> adopting its plain language interpretation of the *pari passu* clause contained in loan documents issued by the Republic of Peru.<sup>4</sup> The court, accepting Elliott’s argument that the clause

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\* Robert A. Cohen is a partner at Dechert LLP who has represented Elliott Management and its affiliates in sovereign debt litigation since 1998. Mr. Cohen is currently litigating the meaning of the *pari passu* clause on behalf of NML Capital, Ltd., an Elliott-affiliated company, in *NML Capital, Ltd. v. Republic of Argentina*, No. 08 Civ. 6978 (TPG), 2011 WL 4529332 (S.D.N.Y. Feb. 23, 2012).

1. JOHN BARTLETT, BARTLETT’S FAMILIAR QUOTATIONS 608 (Justin Kaplan ed., Little, Brown & Co. 17th ed. 2002) (attributing the quotation to Freud).

2. MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (forthcoming 2012) (manuscript at 21) (on file with the Hofstra Law Review).

3. Elliott Assocs., L.P., General Docket No. 2000/QR/92 (Court of Appeal of Brussels, 8th Chamber, Sept. 26, 2000) (unofficial translation on file with the Hofstra Law Review).

4. The clause in the Peruvian case provided: “The obligations of [Peru] hereunder do rank and will rank at least *pari passu* in priority of payment with all other External Indebtedness of [Peru], and interest thereon.” Affidavit of Jay H. Newman in Support of Plaintiff’s Motion for Summary Judgment, *Elliott Assocs., L.P. v. Banco de la Nacion*, 194 F.R.D. 116 (S.D.N.Y. 2000) (No. 96 Civ. 7916 (RWS)). *Black’s Law Dictionary* defines *pari passu*—“Latin [for] ‘by equal step’”—as “[p]roportionally; at an equal pace; without preference.” BLACK’S LAW DICTIONARY 1225 (9th ed. 2009).

required ratable payment<sup>5</sup> to Peru's creditors, issued an injunction prohibiting the payment of interest to Peru's Brady bondholders<sup>6</sup> because no payment was made to Elliott.<sup>7</sup> This decision has generated debate amongst a number of practitioners, commentators, and scholars. The debaters generally fall into two camps: (1) those who oppose the equal treatment of creditors and as a result ignore or distort the terms of the contract, and (2) those who believe that the starting place for interpreting contractual provisions is the language of the contract and that covenants providing for equal treatment offer creditors important protections.<sup>8</sup> As this Article points out, when it comes to contractual analysis, there is no real choice: the *pari passu* clause must be accepted at face value—as a provision bargained for by the parties to a sovereign debt transaction—as a provision that means just what it says.

## II. HEDGE FUNDS AND THE VALUE OF THE SECONDARY MARKET

A variety of institutions, including hedge funds like Elliott and proprietary trading divisions of investment and commercial banks, invest in distressed sovereign (and corporate) debt. Frequently, they invest after original creditors have either wearied of the restructuring process or have despaired of recovering an acceptable, or any, return on their investment. Those investors may recoup some of their capital by selling their interests in the secondary capital market. Distressed-debt investors select and purchase defaulted debt at a discount, reflecting the significant risk of not receiving full payment.

The existence of the secondary market in distressed sovereign debt is a benefit to all the parties involved and to the entire sovereign debt

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5. Ratable payment means that the debtor is obliged to pay its creditors equally. When the debtor cannot pay everything it owes to all of its creditors, *pro rata* payments are required. A creditor protected by a *pari passu* clause may seek to enforce its *pari passu* right to be paid the same percentage of the amount it is currently due as the debtor pays to other creditors.

6. Brady bonds were developed by former U.S. Treasury Secretary Nicholas Brady to restructure the debt of developing countries. Brady bonds are restructured bank loans—the banks agreed to exchange their old bonds for new bonds and sold the new bonds in the market. FED. RESERVE BD. OF GOVERNORS, TRADING & CAPITAL-MARKETS ACTIVITIES § 4255.1 (1998), available at <http://www.federalreserve.gov/Boarddocs/SupManual/trading/4000p2.pdf>; Roy C. Smith, *Geithner Revisits Brady Bonds*, FORBES.COM (Mar. 24, 2009, 4:40 PM EST), <http://www.forbes.com/2009/03/24/brady-bonds-fed-opinions-contributors-geithner.html>.

7. *Elliott Assocs.*, ¶¶ 1, 5, 8.

8. In a soon to be published book, *The Three and a Half Minute Transaction*, Mitu Gulati and Robert E. Scott discuss the meaning of *pari passu* and explore possible reasons why attorneys representing sovereign clients have failed to adjust the *pari passu* clause to meet new litigation realities after courts endorsed the plain-meaning construction requiring ratable payments. The fact that the authors interviewed many attorneys and found no consensus for any alternate meaning of *pari passu* further supports the plain-language approach. See GULATI & SCOTT, *supra* note 2 (manuscript at 39-41, 65-67).

market. The original investors in the debt recoup some of their investment and are able to use that money for new investments. New investors acquire the opportunity to realize a profit above the discounted price; and issuers benefit by having a market into which they can sell new debt to investors who are comforted by the knowledge that investment in sovereign debt need not be an all or nothing proposition. Indeed, even the U.S. government now opposes lending by multilateral development banks ("MDBs") to the Republic of Argentina, one of the most notoriously recalcitrant sovereign debtors.<sup>9</sup> Congressman Robert Dold stressed, "I certainly hope that that message is getting through loud and clear to Argentina *and other nations that are not standing up to their obligations.*"<sup>10</sup>

The willingness of investors in distressed or defaulted sovereign debt to diligently pursue their right to recover on the debt helps to maintain balance in the sovereign debt market. The threat of enforcing the terms of the contract, including the promise of equal treatment, gives private creditors some leverage against a sovereign state that is cocooned in immunity,<sup>11</sup> supported or pressured by international organizations, and capable of engaging in strategic defaults or promoting one-sided exchange offers.<sup>12</sup> The existence of a *pari passu* or equal treatment provision is an important protection to creditors. As the plain language of a *pari passu* clause provides: when a sovereign will not pay 100 percent of its obligations to all its creditors, creditors covered by a *pari passu* clause are entitled to seek their proportional share of whatever

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9. U.S. Treasury Assistant Secretary Marisa Lago testified that in light of Argentina's "particularly troubling" refusal to pay its debts:

[T]he U.S. will oppose lending to Argentina in the two MDBs in which Argentina participates. That's the World Bank and the Inter-American Development Bank. . . . We already put this policy into practice. On the 14th of September, a proposal came before the Inter-American Development Bank . . . for a \$230 million loan . . . , [a] pretty traditional type of loan program for the [Inter-American Development Bank] . . . that would have been focused on boosting productivity in the agricultural sector. We voted "no" to send the message of our concerns about this. We will continue to vote no for loans to Argentina in the MDBs.

*The Impact of the World Bank and Multilateral Development Banks on National Security: Hearing Before the Subcomm. on Int'l Monetary Policy & Trade, 112th Cong. (2011) (statement of Marisa Lago, Assistant Secretary, U.S. Department of the Treasury), available at <http://mfile3.akamai.com/65722/wmv/sos1467-1.streamos.download.akamai.com/65726/hearing0921112pm.asx>.*

10. *Id.* (statement of Robert J. Dold, Vice Chairman, Subcomm. on Int'l Monetary Policy & Trade) (emphasis added).

11. The Foreign Sovereign Immunities Act defines the circumstances under which a sovereign may be sued and those under which its assets may be attached or execution obtained. Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1602–1611 (2006 & Supp. III 2010).

12. William W. Bratton, *Pari Passu and a Distressed Sovereign's Rational Choices*, 53 EMORY L.J. 823, 843 (2004).

resources the sovereign makes available for repayment.<sup>13</sup> In short, sovereigns may not ignore some creditors while giving preference to others, for example, those willing to accept very low recovery values, either in cash or in the form of new bonds. The promise that the equal treatment protection of a *pari passu* clause can be made a reality encourages investors to continue to participate in the sovereign debt market.<sup>14</sup> This simple promise of equality is understood by the original investors in the sovereign debt, is understood by today's investors, and is recognized by the courts that have been asked to enforce *pari passu*'s plain language.

### III. COURTS ENFORCE THE PLAIN MEANING OF *PARI PASSU*

It is well-established that courts rely upon plain-meaning constructions of contracts in giving effect to the intentions of the parties.<sup>15</sup> The parties' intentions are presumed to be expressed by the plain meaning of the words of the contract.<sup>16</sup>

Using a plain-language reading of the term, a *pari passu* provision means what it says: the sovereign debtor in default must pay similarly situated creditors equally, at the same time and to the same extent, in all payment situations.<sup>17</sup> In other words, a sovereign debtor cannot refuse to

13. Declaration of Professor Andreas F. Lowenfeld at 11-12, *Elliott Assocs., L.P. v. Banco de la Nacion*, 194 F.R.D. 116 (S.D.N.Y. 2000) (No. 96 Civ. 7916 (RWS)).

14. Without *pari passu*, lenders have precious little leverage over defaulting sovereign borrowers who sometimes go to extraordinary efforts to avoid paying their debts. For example, as the U.S. Court of Appeals for the Second Circuit stated:

One need not have what Argentina's great gift to literature [Jorge Luis Borges] termed a "case[] of prodigious memory" to recall the Republic's appalling record of keeping its promises to its creditors. Argentina's record in global bond markets has given new meaning to the concept of *caveat emptor*. Even when the Argentine people offer a substantial premium to those adventurous souls who risk a loan to the country, for many investors, the experience of being a creditor to the Republic has been a profile in disappointment.

*NML Capital, Ltd. v. Banco Cent. de la Republica Arg.*, 652 F.3d 172, 196 (2d Cir. 2011) (second alteration in original) (footnote omitted) (citation omitted).

15. See, e.g., *MHR Capital Partners LP v. Presstek, Inc.*, 912 N.E.2d 43, 47 (N.Y. 2009) ("[A] written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms." (citation omitted)).

16. *Id.*; *Malbone Garage, Inc. v. Minkin*, 72 N.Y.S.2d 327, 331 (App. Div. 1947), *aff'd*, 76 N.E.2d 331, 332 (N.Y. 1947); cf. *LaSalle Bank Nat'l Ass'n v. Nomura Asset Capital Corp.*, 424 F.3d 195, 206 (2d Cir. 2005) (holding that a contract should be interpreted to give full meaning and effect to all provisions, and any interpretation that renders a clause meaningless or superfluous should be avoided).

17. See *supra* note 5. See also *Hudson Valley Bank v. Kissel*, No. FSTCV054006330S, 2009 WL 3644837, at \*10 (Conn. Super. Ct. Sept. 29, 2009) ("In finance, the phrase 'pari passu' refers to two or more loans, bonds, or series of preferred stock having equal rights of payment or level of seniority being paid at an equal pro rata basis."). *Black's Law Dictionary's* definition of *pari passu*

pay a particular creditor while, at the same time, offering payment to other creditors. As noted New York University law professor Andreas Lowenfeld has explained,<sup>18</sup> the *pari passu* clause has a plain and obvious meaning:

I have no difficulty in understanding what the *pari passu* clause means: it means what it says—a given debt will rank equally with other debt of the borrower, whether that borrower is an individual, a company, or a sovereign state. A borrower from Tom, Dick, and Harry can't say "I will pay Tom and Dick in full, and if there is anything left over I'll pay Harry." If there is not enough money to go around, the borrower . . . must pay all three of them on the same basis . . . .<sup>19</sup>

Likewise, Professor Hal S. Scott, the Nomura Professor and Director of the Program on International Financial Systems at Harvard Law School,<sup>20</sup> has explained:

The language of the *pari passu* clause has a "plain meaning." The clause provides that lenders will have at least equal rights to payment and priority as all other External Indebtedness. This prevents the sovereign from discriminating against the Banks in favor of other creditors. Thus, the clause prohibits paying other creditors and not paying the Banks. If the Debtor cannot honor all of its payment obligations, it must honor them pro-rata.<sup>21</sup>

Given the sensibleness of this construction, it is no surprise that every court that has interpreted a *pari passu* provision in a sovereign debt instrument has adopted a plain-language interpretation to require that all creditors be treated equally. For example, in *Elliott Associates, L.P. v. Banco de la Nacion*,<sup>22</sup> Elliott was owed money by Peru.<sup>23</sup> As part

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is consistent with this plain-language interpretation. See BLACK'S LAW DICTIONARY, *supra* note 4, at 1225.

18. Professor Lowenfeld, a Professor of International Law at New York University Law School, provided a Declaration on which the Court in Brussels relied in issuing its *pari passu* injunction in *Elliott*. See *Elliott Assocs., L.P.*, General Docket No. 2000/QR/92, ¶¶ 5-6 (Court of Appeal of Brussels, 8th Chamber, Sept. 26, 2000) (unofficial translation on file with the Hofstra Law Review) ("On the basis of the exhibits submitted to the court . . . [I]t should be concluded that the plaintiff in appeal has an enforceable claim against the State of Peru . . .").

19. Declaration of Professor Andreas F. Lowenfeld, *supra* 13, at 11-12 (discussing the *pari passu* clause in the Peru case).

20. Professor Scott provided a Declaration on which the court in Brussels relied in *Republic of Nicaragua v. LNC Investments LLC*. General Docket No. 2003/KR/334, at 17-19 (Court of Appeal of Brussels, 9th Chamber, Mar. 19, 2004) (unofficial translation on file with the Hofstra Law Review). See *infra* note 21 and accompanying text.

21. Declaration of Hal S. Scott at 4, *LNC Invs. LLC*, General Docket No. 2003/KR/334 (discussing the *pari passu* clause in the *LNC Investments LLC* case).

22. 194 F.R.D. 116 (S.D.N.Y. 2000).

23. 194 F.R.D. at 117-19, 122 (explaining the procedural and factual history of the case,

of its efforts to collect on its judgment, Elliott sought a judicial order in Belgium restraining Morgan Guaranty, which operated the clearinghouse Euroclear and processed Peru's payments of interest, from accepting or paying out any money received from Peru to pay interest to holders of Peru's bonds, on the theory that any payments to Peru's creditors without *pro rata* payment to Elliott would violate a *pari passu* provision in the relevant loan document.<sup>24</sup> After the Commercial Court of Brussels denied the *ex parte* application, the Court of Appeal of Brussels reversed. Agreeing that the *pari passu* clause mandated *pro rata* treatment for creditors, the court held:

The basic agreement regulating the reimbursement of the Peruvian foreign debt, also indicates that the different creditors enjoy a "*pari passu* clause", which has as a result that *the debt should be paid down equally towards all creditors in proportion to their claim*. From this, one seems to have to conclude that, in case of the payments of interests, *no creditor can be excluded from its proportional part*.<sup>25</sup>

The Commercial Court of Brussels revisited the *pari passu* issue in *Republic of Nicaragua v. LNC Investments LLC*,<sup>26</sup> and held that Nicaragua's payments to other external creditors "constitute[d] blatant violations of the *pari passu* clauses since the Republic of Nicaragua consistently excludes [the plaintiff] from them, although the latter has the right to receive an egalitarian payment or at least a payment that is proportionate to the ones made to the" other creditors.<sup>27</sup>

Similarly, in *Red Mountain Finance, Inc. v. Democratic Republic of Congo*,<sup>28</sup> a holder of sovereign debt sought an order barring payments to other creditors unless it was paid *pro rata* in accordance with a *pari passu* clause. The California district court enjoined the defendants from "making any payments or authoriz[ing] any payments to be made on

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granting summary judgment for plaintiff, and entering judgment against Peru).

24. Elliott Assocs., L.P., General Docket No. 2000/QR/92, ¶ 1 (Court of Appeal of Brussels, 8th Chamber, Sept. 26, 2000) (unofficial translation on file with the Hofstra Law Review). For the text of the clause in the Peruvian case, see *supra* note 4.

25. Elliott Assocs., ¶¶ 1-2, 6 (emphasis added). At least one U.S. district court, in *Nacional Financiera, S.N.C. v. Chase Manhattan Bank, N.A.*, has favorably cited the Belgian Court of Appeal decision in *Elliott. Nacional Financiera, S.N.C.*, No. 00 Civ. 1571 (JSM), 2003 WL 1878415, at \*2 (S.D.N.Y. Apr. 14, 2003) (noting that although a *pari passu* clause did not itself create contractual rights and obligations between different holders of certain debt, the clause may "have given [certain creditors] the right to obtain an injunction to bar [the debtor] from making preferential payments to some of its note holders").

26. General Docket No. 240/RK/03, at 16-17 (Commercial Court of Brussels Sept. 11, 2003), *rev'd in part on other grounds*, General Docket No. 2003/KR/334 (Court of Appeal of Brussels, 9th Chamber, Mar. 19, 2004) (unofficial translation on file with the Hofstra Law Review).

27. *LNC Invs. LLC*, at 16-17.

28. No. CV 00-0164 R (BQRx), 2000 WL 34479543 (C.D. Cal. June 10, 2002).

their behalves with respect to any [debt] . . . unless and until [the defendants] make or cause to be made a proportionate payment to [the plaintiff] at the same time."<sup>29</sup>

In short, the only three courts to have interpreted *pari passu* covenants have consistently and uniformly mandated equal treatment of all creditors.

The plain-meaning interpretation of *pari passu* provisions comports with common sense and business realities. It makes eminent business sense for a lender to a sovereign to demand equal treatment protection.<sup>30</sup> A mere right not to be legally subordinated is of limited value in the context of a defaulting sovereign. Because a sovereign cannot be forced into a judicially-supervised insolvency proceeding, ranking among creditors cannot be judicially enforced.<sup>31</sup> Thus, a *pari passu* clause provides essential protection to creditors and promotes stability in the sovereign bond market by shielding creditors from any attempts by the sovereign debtor to functionally subordinate the debt by simply choosing to pay favored creditors.

In sum, there is a plain meaning to *pari passu* provisions. Sometimes, a cigar is just a cigar.

#### IV. SOVEREIGN COUNSEL'S SHIFTING EXPLANATIONS OF WHAT *PARI PASSU* MEANS

In contrast to the straightforward, plain-meaning interpretation of the clause, some commentators and counsel to sovereigns have struggled to devise an interpretation that avoids equal treatment, but they have been unable to provide a consistent, reasonable interpretation of what the *pari passu* clause means. Indeed, Lee C. Buchheit, a partner with Cleary Gottlieb Steen & Hamilton LLP ("Cleary"),<sup>32</sup> has stated that "[t]he fact

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29. Order Granting Motion for (1) Specific Performance in Aid of Execution; and (2) Assignment of Assets at 2, *Red Mountain Fin., Inc.*, No. CV 00-0164 R (BQRx) (C.D. Cal. May 29, 2001) (injunction order). The order in *Red Mountain Finance, Inc.* was later vacated under the terms of a settlement. Stipulation and Order (a) Dismissing Entire Action with Prejudice; (b) Releasing Supersedeas Bond; (c) Vacating District Court Orders Entered January 9, 2001, October 2, 2001 and December 5, 2001; and (d) Vacating Clerk's Assignment at 2, *Red Mountain Fin., Inc.*, No. CV 00-0164 R (BQRx) (C.D. Cal. June 10, 2002).

30. Gulati and Scott report that some sovereign debt lawyers admit the importance of *pari passu* to lenders. They "suggested that Elliott may have interpreted the clause correctly" because smaller lenders, fearful of being treated less equitably than larger lenders during sovereign debt restructuring, "demanded that the new bonds include *pari passu* clauses." GULATI & SCOTT, *supra* note 2 (manuscript at 128-29).

31. Bankruptcy protections are not available when the debtor is a sovereign. *See, e.g., In re Bd. of Dirs. of Multicanal S.A.*, 307 B.R. 384, 393 (Bankr. S.D.N.Y. 2004) (stating that bankruptcy proceedings are not available when the debtor is a sovereign).

32. Cleary is counsel for Argentina and other sovereigns in connection with sovereign debt



that no one seems quite sure what the [*pari passu*] clause really means, at least in the context of a loan to a sovereign borrower, has not stunted its popularity among drafters of loan agreements and debt restructuring agreements.”<sup>33</sup>

In the same 1991 article, Buchheit went on to propose that a “good case can be made that” *pari passu* provides a more limited protection to “prevent the sovereign from attempting to legitimise . . . discrimination by enacting laws or decrees [that] purport to bestow a senior status on certain indebtedness or give a legal preference to certain creditors over others.”<sup>34</sup> Other commentators have suggested that the clause is “intended to prevent the earmarking of revenues of the government or the allocation of its foreign currency reserves to a single creditor and generally is directed against legal measures which have the effect of preferring one set of creditors over the others or discriminating between creditors.”<sup>35</sup> Such “legal ranking” interpretations have no support in the actual text of the provision, which does not speak to: (1) preventing only attempts “to legitimize discrimination” against creditors; (2) prohibiting only the “enactment of laws or decrees” that formally subordinate a

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issues.

33. Lee C. Buchheit, *The Pari Passu Clause Sub Specie Aeternitatis*, INT’L FIN. L. REV., Dec. 1991, at 11, 11. In point of fact, creditors have a very clear understanding of *pari passu*, recognizing that it is of vital commercial interest to investors in sovereign debt. Even Buchheit himself acknowledges that some consensus exists in regard to Elliott’s plain-meaning interpretation of *pari passu*:

[A] goodly number of bankers (and more than a few sovereign borrowers) seem to believe that the *pari passu* covenant is there to compel the borrower to pay all of its external debt on a ratable basis (either in terms of the amount, or the timing, of debt service payments), or at least to prevent the borrower from giving a practical preference (such as pledging an asset) to one creditor that it does not also give to the others.

*Id.* at 11-12. Likewise, although Gulati and Scott themselves never reach any firm conclusion about what the *pari passu* clause means, a number of sovereign debt attorneys whom they interviewed thought that the Brussels court in *Elliott* got it right. GULATI & SCOTT, *supra* note 2 (manuscript at 128-29) (noting that some respondents had “suggested that Elliott may have interpreted the clause correctly” because smaller lenders—fearful of being treated less equitably than larger lenders during sovereign debtors’ restructuring requests—“demanded that the new bonds include *pari passu* clauses” that would empower them to “refuse to participate in a restructuring and then sue those who did for a ratable share of their payments”). Prior to the 2000 Brussels decision, Philip Wood of Allen & Overy in London speculated that even if the “meaning of the clause is uncertain[.] . . . [p]robably the clause means that on a de facto inability to pay external debt as it falls due, one creditor will not be preferred by a method going beyond contract; and (perhaps) that there will be no discrimination against the same class in the event of insolvency.” *Id.* (manuscript at 61-62) (emphasis omitted). To explain why the use of *pari passu* provisions increased after the Brussels decision, Gulati and Scott wrote that “[a]s one colleague put it, ‘Ex post, [sovereign borrowers] may not have liked what happened in Peru. But ex ante, maybe the Brussels interpretation of the clause is precisely what everyone wanted.’” *Id.* (manuscript at 185).

34. Buchheit, *supra* note 33, at 12.

35. PHILIP WOOD, LAW AND PRACTICE OF INTERNATIONAL FINANCE 156 (1980).

creditor; (3) banning only the provision of "a legal preference;" (4) applying only to "legislative earmarking" or "legislative allocation" of reserves; or (5) involving only the enactment of "legal measures" establishing preference of one group of creditors over others.

Despite the lack of consensus among counsel to sovereigns and commentators about what *pari passu* means, and notwithstanding Buchheit's own insistence that "no one seems quite sure what the [*pari passu*] clause really means,"<sup>36</sup> at least some sovereigns have claimed that *pari passu* has a widely-accepted meaning, supposedly well-known to "generations of counsel" for centuries. For example, in 2003, Argentina articulated its interpretation of *pari passu*<sup>37</sup> in *Macrotecnic International Corp. v. Republic of Argentina*<sup>38</sup> in the U.S. District Court for the Southern District of New York:

The plain language of the Pari Passu Clause, understood by generations of lawyers drafting credit agreements, precludes the Republic from creating new classes of debt that are legally senior to the bonds held by plaintiffs; however, it does *not* regulate the amount or timing of the Republic's payments to creditors, or permit one unpaid creditor to bar payment to other creditors.<sup>39</sup>

According to this interpretation, *pari passu* only "prevents the [legal] creation of senior debt, i.e., debt with a legal priority to payment before the debt that the clause protects."<sup>40</sup> The premise of such an interpretation requires that the actual words and commercial context be ignored.

But Argentina itself had to jettison this supposedly well-accepted understanding of *pari passu* when its actions in connection with its 2005 and 2010 bond exchanges violated even this narrow interpretation. In 2005, having defaulted on its sovereign debt years earlier, Argentina made a unilateral bond exchange "offer"—giving bondholders a

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36. Buchheit, *supra* note 33, at 11.

37. The *pari passu* provision reads:

The Securities will constitute . . . direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank *pari passu* and 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 . . . .

Fiscal Agency Agreement between the Republic of Argentina and Bankers Trust Company, ¶ 1(c), Oct. 19, 1994.

38. No. 02 Civ. 5932 (TPG), 2004 WL 445131 (S.D.N.Y. Mar. 12, 2004).

39. Memorandum of Law of the Republic of Argentina in Support of Its Motion Pursuant to CPLR § 5240 to Preclude Plaintiff Judgment Creditors from Interfering with Payments to Other Creditors at 15, *Macrotecnic Int'l Corp.*, 2004 WL 445131 (No. 02 CV 5932 (TPG)) (emphasis added).

40. *Id.* at 1.

Hobson's choice: either exchange their defaulted bonds for newly issued bonds paying approximately thirty cents on the dollar—the largest haircut in sovereign debt history—or receive nothing.<sup>41</sup> To put pressure on the unhappy bondholders, Argentina passed the so-called “Lock Law,” which prohibits the “national Executive Power” from “reopen[ing] the swap process” and bars “any type of in-court, out-of-court or private settlement” with non-participating creditors.<sup>42</sup> By law, Argentina created two classes of bondholders: a higher rank (bondholders who accepted new, discounted bonds that Argentina would actually pay) and a lower rank (non-participating bondholders who were barred by Argentine law from being paid)—thereby violating its own professed understanding of the *pari passu* provision. As Professor Lowenfeld might have put it, Tom and Dick would get paid and Harry would, by law, get nothing.

At the end of the exchange, a quarter of the bondholders—including NML Capital, Ltd. (“NML”)—refused to participate.<sup>43</sup> In 2009, hoping to attract additional bondholders, the Republic passed Law 26,547, which temporarily suspended the “Lock Law,” and allowed Argentina to reopen the exchange and create another group of preferred bondholders in the 2010 exchange.<sup>44</sup> The law also forbids the executive to offer to the holders of public debt that have brought judicial, administrative, or arbitration proceedings treatment more favorable than the treatment afforded to holders who did not bring such proceedings.<sup>45</sup>

In response, NML sought specific performance of the *pari passu* clause—arguing that even if the court were to apply Argentina's narrow view of *pari passu*, Argentina violated the provision by formally and legally diminishing the status of NML's bonds with the enactment of the Lock Law and Law 26,547.<sup>46</sup> Argentina's counsel scrambled to provide a new meaning of *pari passu*. This time, they asserted that *pari passu*

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41. Argentina's unilateral “offer” to its creditors—take thirty cents on the dollar or get nothing—illustrates why the *pari passu* clause is such an important shield for creditors. It allows a creditor to reject an unfair restructuring offer with the assurance that its rights will rank *pari passu* with respect to the sovereign's other external debt.

42. See Law No. 26,017, arts. 1-3, Feb. 10, 2005 (Arg.) (unofficial translation on file with the Hofstra Law Review).

43. See *NML Capital, Ltd. v. Banco Cent. de la Republica Arg.*, 652 F.3d 172, 176 & n.4 (2d Cir. 2011).

44. See Law No. 26,547, art. 1, Dec. 9, 2009 (Arg.) (unofficial translation on file with the Hofstra Law Review).

45. See Law No. 26,547, art. 5.

46. See Memorandum of Law in Support of the Motion by NML Capital, Ltd. for Partial Summary Judgment and for Injunctive Relief Pursuant to the Equal Treatment Provision at 14-15, *NML Capital, Ltd. v. Republic of Argentina*, 2011 WL 4529332 (S.D.N.Y. Feb. 23, 2012) (No. 08 Civ. 6978 (TPG)).

"only prohibits the creation of a preferred class of creditor *claims* after default, not the cancellation of existing claims and subsequent issuance of additional performing debt."<sup>47</sup> Argentina argued with a straight face that even though the non-participating bondholders were legally barred (by Argentina) from being paid, there was no "legal preference" granted to the higher ranking bondholders because the Argentine Congress has "the ability to permit future exchange offers" if it were to pass another law that enabled such action.<sup>48</sup> Thus, Argentina concluded, the Lock Law was not "a legal subordination" of creditors like NML;<sup>49</sup> such creditors could still get paid *if* the recalcitrant debtor for some reason decided to *pass a law* allowing itself to pay up.

At a hearing on September 28, 2011, the district court flatly rejected Argentina's position. It concluded that Argentina's legislative repudiation of its payment obligations unquestionably violated the *pari passu* provision—leading Argentina's counsel to scurry to come up with yet another supposed "meaning" of *pari passu*.<sup>50</sup> The court subsequently issued written orders declaring that: (1) the *pari passu* clause required Argentina "at all times to rank its payment obligations pursuant to NML's bonds at least equally with all the Republic's other . . . External Indebtedness,"<sup>51</sup> (2) Argentina violates the clause "whenever it lowers

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47. Memorandum of Law in Opposition to Plaintiff's Motions for Partial Summary Judgment and for Injunctive Relief Pursuant to the Pari Passu Clause at 30, *NML Capital, Ltd.*, 2011 WL 4529332 (S.D.N.Y. Feb. 23, 2012) (No. 08 Civ. 6978 (TPG)).

48. *Id.* at 30-31.

49. *Id.*

50. Transcript of Oral Argument at 41, *NML Capital, Ltd.*, 2011 WL 4529332 (No. 08 Civ. 6978 (TPG)). The court reasoned:

I have studied the matter—I say to both sides—and it's hard for me to believe that there is not a violation of the *pari passu* clause accomplished by [Argentina's] congressional legislation in '05 and '10, simply saying that the Republic will not honor these judgments. It is difficult to imagine anything [that could more blatantly] reduce the rank, reduce the equal status or simply wipe out the equal status of these bonds under the *pari passu* clause. I have to say, I don't think it is a terribly hard question. . . . [T]here's simply no doubt at all that what the Republic has done is to violate the *pari passu* clause, no matter what interpretation. It 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.

*Id.* at 8; *see also id.* at 27 ("The [*pari passu*] clause exists, it has meaning, and it, in my view, has been violated by the Republic in the worst, most blatant, way you could violate it, and that is, to have a congressional declaration that these judgments and these obligations will not be paid. How could you reduce the rank, the status, how could you take away the *pari passu* treatment in any way that is more blatant than that?"). Struggling to create yet another supposed (though somewhat indecipherable) meaning of *pari passu* that would evade the district court's rationale, Argentine counsel Carmine Boccuzzi, Jr. a partner of Cleary's Lee Buchheit, contended, "[w]hat the *pari passu* clause means is that we can't use a law made in Argentina to say, no, your Honor, don't give them a judgment, they don't have a right." *Id.* at 32-33. The district court was not persuaded.

51. Order at 4, *NML Capital, Ltd.*, 2011 WL 4529332 (Dec. 7, 2011) (No. 08 Civ. 6978 (TPG)).

the rank of its payment obligations . . . by relegating NML's bonds to a non-paying class by failing to pay the obligations currently due under NML's Bonds while at the same time making payments currently due to holders of other . . . External Indebtedness,"<sup>52</sup> (3) Argentina violated the clause when it made payments to the bondholders who participated in the exchange offers while refusing to make payments to NML,<sup>53</sup> and (4) Argentina violated the clause "when it enacted Law 26,017 and Law 26,547."<sup>54</sup> The court also temporarily restrained Argentina from altering or amending the mechanisms by which it makes payments to bondholders pending a February 23, 2012 hearing.<sup>55</sup>

At that hearing, the court adopted NML's proposed ratable payment remedy for Argentina's *pari passu* violations, ordering that: (1) Argentina specifically perform its obligations under the *pari passu* clause, (2) whenever Argentina pays its preferred bondholders, it must make a "Ratable Payment" to NML, such that NML and the bondholders both receive the same percentage of the amount currently due to them, and (3) Argentina is enjoined from making any payments that violate the *pari passu* clause.<sup>56</sup>

Whereas Cleary's own Lee Buchheit said years ago that no one quite knew what *pari passu* meant, counsel to sovereigns have struggled to concoct *any* interpretation—no matter how strained—always avoiding a plain meaning of the text. In contrast to these shifting, atextual interpretations, the straightforward view—that the *pari passu* clause means what it says and that the protection it provides is valued by creditors, who would be likely to resist efforts by sovereigns to remove or fundamentally weaken the protections of the clause—may well explain why the provision has been so little changed after the Brussels decision. As one sovereign debt attorney put it: "Can you imagine the negotiation dynamic? . . . How do I go to the creditors and say that I want to remove a clause that says that all of you will be treated equally?"<sup>57</sup>

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52. *Id.*

53. *Id.*

54. *Id.* at 5.

55. Order to Show Cause Why a Preliminary Injunction Should Not Issue, With Temporary Restraining Order at 2, *NML Capital, Ltd.*, 2011 WL 4529332 (Jan. 5, 2012) (No. 08 Civ. 6978 (TPG)).

56. Order at 2-5, *NML Capital, Ltd.*, 2011 WL 4529332 (Feb. 23, 2012) (No. 08 Civ. 6978 (TPG)) (internal quotation marks omitted).

57. GULATI & SCOTT, *supra* note 2 (manuscript at 173).

## V. CONCLUSION

The plain language interpretation of *pari passu* comports with business realities and meets the needs of the sovereign debt market. Notwithstanding the vociferous responses to the Brussels court's *pari passu* decision, the *pari passu* provision means just what it says.

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