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Stopping the Circling Vultures: Restructuring a Solution to Sovereign Debt Profiteering

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Stopping the Circling Vultures: Restructuring a Solution to Sovereign Debt Profiteering

ABSTRACT

When a sovereign state becomes unable to repay its debts and enters into default, an ideal outcome involves a quick and mutually agreeable resolution with creditors, allowing the country to reenter the international markets and continue its recovery with limited impediments. However, the situation in Argentina, unfolding since 2001, has provided a stark example of why change is needed at the domestic and international level to address the growing problem of vulture funds' presence in the sovereign debt markets. These aggressive hedge funds have demonstrated an uncanny ability to hijack the sovereign debt restructuring process. Vulture funds purchase discounted debt on the secondary market and pursue private litigation against sovereign states in an attempt to recover large profits off the sovereign default. The vulture funds' actions pose significant threats to the sovereign debt restructuring process. These threats are poised to continue if steps are not taken to limit the funds' power.

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I. INTRODUCTION

Sovereign defaults are inevitable occurrences, especially for developing and emerging economies.¹ Defaults are rarely sudden events but rather are many years in the making—generally resulting from a series of ill-conceived economic policy decisions and larger global economic instability.² Argentina alone has defaulted eight times throughout its history, most recently in 2001.³ It went through a related technical default in 2014—triggered by U.S. District Court for the Southern District of New York Judge Thomas Griesa’s decision to prohibit Argentina’s repayment to restructured bondholders until the creditors who had refused to participate in restructuring (holdouts) were also paid.⁴ The Great Recession, which played a role in the Argentine crisis, has also caused a marked increase in the frequency with which countries are forced into default.

However undesirable and unfortunate it may be, a sovereign state may at some point be unable to repay its obligations to its creditors.⁵ The best hope in such a situation is that the sovereign state will be able to reach a compromise with its creditors and restructure its debt, offering a reduced return on the creditors’ original investment (or a “haircut”). Restructuring the debt allows the state to recover from the default and reenter the international capital market. In the past, this process has been a fairly reliable cycle that balances the interests of the creditors in maximizing repayment with the interests of the sovereign state in being able to continue to provide essential services to its citizens and return to the international capital market as soon as possible.⁶

However, in recent years, the prevalence of “vulture funds”—hedge funds that purchase distressed debt at a deep discount only to demand full repayment after the country has defaulted and restructured most of its debt—has been steadily increasing.⁷ Vulture funds often use litigation and aggressive pursuit of sovereign assets

1. See J. F. HORNBECK, CONG. RESEARCH SERV., R41029, ARGENTINA’S DEFAULTED SOVEREIGN DEBT: DEALING WITH THE “HOLDOUTS” 4 (2013).

2. See, e.g., *id.* at 2.

3. *Argentina Defaults: Eighth Time Unlucky*, ECONOMIST (Aug. 2, 2014), <http://www.economist.com/news/leaders/21610263-cristina-fern-ndez-argues-her-countrys-latest-default-different-she-missing> [<http://perma.cc/T84K-TDT5>] (archived Oct. 11, 2015).

4. *Id.*

5. HORNBECK, *supra* note 1, at 4.

6. Nouriel Roubini, *From Argentina to Greece: Crisis in the Global Architecture of Orderly Sovereign Debt Restructurings*, ROUBINI GLOB. ECON. (Nov. 28, 2012), <http://www.mauldineconomics.com/images/uploads/overmyshoulder/analysis-c3015acd70d3a58f259057daeba21eb5.pdf> [<http://perma.cc/7CT5-HRL4>] (archived Oct. 11, 2015).

7. HORNBECK, *supra* note 1, at 8.

to accomplish their goals.⁸ The entrance of these types of vulture funds onto the sovereign debt scene has unsettled what was previously a fairly stable and predictable process of default followed by restructuring and recovery.⁹ In the past, funds that refused to participate in restructuring and demanded full repayment were merely an annoyance to the sovereign state and had limited leverage to force full repayment if they refused to take part in the restructuring process.¹⁰ This all changed drastically, however, following Judge Griesa's recent ruling that the *pari passu* clause¹¹ of the sovereign bond agreement should be interpreted to mean that Argentina cannot make any payments to bondholders who had previously restructured their debt as part of the 2005 and 2010 bond exchanges unless the country also repaid the holdout funds in full at the same time.¹²

This ruling has threatened to seriously disrupt the sovereign debt restructuring process, especially considering that many, if not most, sovereign bond agreements include a clause giving jurisdiction to New York courts, regardless of the nationality of the parties.¹³ The ruling caused immediate problems for Argentina—forcing the country into technical default in August of 2014, despite Argentina's continued ability and willingness to repay the vast majority of its bondholders.¹⁴ However, the ramifications of the ruling extend far beyond the borders of Argentina.

In Part II, using the Argentine default and subsequent U.S. District Court ruling as a framework, this Note will discuss the role of holdout funds in the Argentine default and sovereign defaults in general. Part III will analyze the implications of the vulture funds' litigation tactics and the U.S. district court ruling in their favor, both within Argentina and beyond. Part IV will discuss three solutions, none of which are mutually exclusive. First, the Argentine presidential election in fall 2015 opened the door for the country to finally reach a resolution to this saga. The newly elected president, Mauricio Macri, has reopened talks with the vulture funds through a mediator. Second, the U.S. Congress has the opportunity to provide

8. *Id.*

9. *Id.* at 12.

10. Roubini, *supra* note 6, at 5.

11. A *pari passu* clause is common in most sovereign debt instruments and translates literally to "with equal step." Rodrigo Olivares-Caminal, *The Pari Passu Clause in Sovereign Debt Instruments: Developments in Recent Litigation*, 72 BIS PAPERS 121, 121 (2013). *Pari passu* refers to the concept that no debt should be made subordinate to other debt. *See id.* at 123 (explaining *pari passu* in the context of the Argentine sovereign debt litigation).

12. Roubini, *supra* note 6.

13. W. Mark C. Weidemaier, *Sovereign Immunity and Sovereign Debt*, 2014 U. ILL. L. REV. 67, 69 (2014).

14. *Argentina Defaults: Eighth Time Unlucky*, *supra* note 3.

better protection against vulture funds for developing and emerging economies like Argentina that act in good faith to repay bondholders but are held hostage by a small number of creditors. Third and most importantly, the Note will address how the Argentine situation has reemphasized the need for a better international framework to deal with sovereign debt defaults and suggests an increased use of international arbitration under the United Nations.

A growing number of sovereign states are facing default following the Great Recession. With the novel legal interpretation of the *pari passu* clause by the District Court of the Southern District of New York and the increased prevalence of vulture hedge funds, sovereign debt has reached a turning point. The international community faces a stark need for a new approach to sovereign defaults and restructuring.

II. VULTURE FUNDS: FEEDING OFF OF THE CARCASS OF ARGENTINA'S SOVEREIGN DEBT CRISIS

Due to an unfortunate combination of years of questionable domestic economic policies, a growing global recession, and perverse incentives for high-risk lending, Argentina suffered rampant inflation quickly followed by a devastating default on the country's sovereign debt in the late 1990s and early 2000s.¹⁵ Argentina's stunning default on \$82 billion of debt in December 2001 was the single largest sovereign debt default in history up to that point.¹⁶ However, that dubious distinction was later taken over by Greece, when it defaulted on \$138 billion in 2012.¹⁷ Among others, Jamaica and Ecuador also saw large defaults in the 2000s, though both were thoroughly overshadowed by the massive scale of the Argentine and Greek defaults.¹⁸

Seeing an opportunity for profit in the midst of the Argentine crisis, vulture funds began purchasing the deeply devalued Argentine debt, even after it became clear that the country would be forced to default.¹⁹ The term vulture fund is generally used to describe hedge funds whose strategy involves purchasing debt on the secondary market at deeply discounted rates, refusing restructuring deals, and then pursuing litigation to demand full repayment on the original

15. HORNBECK, *supra* note 1, at 2–3.

16. *Id.* at 1.

17. Daniel Huang, *Don't Cry for Them: The World's Biggest Sovereign Defaults Since 2000*, WALL ST. J. BLOG (July 2, 2014, 1:59 PM), <http://blogs.wsj.com/moneybeat/2014/07/02/dont-cry-for-them-the-worlds-biggest-sovereign-defaults-since-2000/> [<http://perma.cc/7TX4-HEA8>] (archived Oct. 11, 2015).

18. *Id.* (valuing Ecuador's default at \$3.2 billion in 2008, and Jamaica's at \$7.9 billion in 2010).

19. HORNBECK, *supra* note 1, at 4.

value of the bond, with the possibility of massive profits.²⁰ On average, these types of funds see returns of between three and twenty times the amount they originally invested on the discounted bonds.²¹ Vulture funds, as the name implies, tend to target financially distressed countries—particularly countries likely to default in the near future.²² Vulture funds also tend to be extremely tenacious and aggressive, as well as patient, in pursuing repayment, making resolution of conflicts more protracted—and thus more costly and difficult.²³

Argentina first began the debt restructuring process in 2002 with the help of the International Monetary Fund (IMF) but was unable to reach a viable solution to repay its creditors.²⁴ Abandoning its previous attempts, Argentina decided to act independently—without the IMF’s help and thus without requiring the IMF’s approval—and opened a bond exchange.²⁵ The exchange was ultimately very successful in restructuring over 75 percent of the old bonds.²⁶ The exchange involved a fairly large haircut, resulting in a 66 percent reduction on the bond repayments to creditors.²⁷ After the first bond exchange, \$18.6 billion in debt remained un-exchanged, along with \$6.3 billion owed to Paris Club countries and \$9.5 billion owed to the IMF.²⁸ Argentina was eventually successful in repaying the debt to the IMF in full and made plans to repay the Paris Club countries as well.²⁹ The majority of the debt left in flux was that owed to the holdouts that had turned down the opportunity to participate in the bond exchange in hopes of forcing Argentina to repay on terms more favorable to creditors.³⁰

In 2006, a group of Italian debt holders requested arbitration to settle their dispute over the restructuring with the International Centre for Settlement of Investment Disputes (ICSID).³¹ Since 2006,

20. “Vulture Funds,” JUBILEE USA NETWORK, <http://www.jubileeusa.org/ourwork/vulturefunds.html> [<http://perma.cc/GFQ7-XD77>] (archived Oct. 11, 2015).

21. John Muse-Fisher, *Starving the Vultures: NML Capital v. Republic of Argentina and Solutions to the Problem of Distressed-Debt Funds*, 102 CAL. L. REV. 1671, 1674 (2014).

22. “Vulture Funds,” *supra* note 20.

23. John A. E. Pottow, *Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign-Debt Restructurings*, 49 TEX. INT’L L.J. 221, 225 (2014).

24. HORNBECK, *supra* note 1, at 5.

25. *Id.* at 5; Marcus Miller & Dania Thomas, *Sovereign Debt Restructuring: The Judge, the Vultures and Creditor Rights*, 30 THE WORLD ECON. 1491, 1491 (2007).

26. Miller & Thomas, *supra* note 25, at 1498.

27. *Id.*

28. HORNBECK, *supra* note 1, at 5.

29. *Id.*

30. *Id.* at 8.

31. Karen Halverson Cross, *Arbitration as a Means of Resolving Sovereign Debt Disputes*, 17 AM. REV. INT’L ARB. 335, 335 (2006).

two more groups have filed similar requests, and, in all three cases, the tribunal found that the claims were admissible under the Italy-Argentina bilateral investment treaty.³² However, these arbitrations have largely stalled or have been abandoned.³³

In 2009, the Argentine legislature began taking steps to offer a new bond deal in hopes of exchanging its remaining debt and finally reentering the international capital market.³⁴ The 2010 bond offer was again highly successful—resulting in the exchange of 68 percent of the remaining debt, which meant the total success rate between the 2005 and 2010 exchanges was ultimately over 91 percent.³⁵ Generally, under normal circumstances, once a country has exchanged at least 90 percent of its debt following a default, the restructuring process is deemed successful, and the country is allowed to participate in international bond markets.³⁶ However, even with the successful exchange of over 90 percent of its debt, this has not been the case for Argentina.³⁷

Despite the vast participation of most of the bondholders in the largely successful bond exchange programs, one of the holdout funds, NML Capital, declined to participate and instead brought suit against Argentina in the U.S. District Court for the Southern District of New York.³⁸ NML argued that the *pari passu* clause in the original bond document should be interpreted to prohibit Argentina from repaying debt to the over 90 percent of creditors who participated in the bond exchanges unless it also fully repays the holdout funds at the same time.³⁹

32. See *Alemanni Tribunal Unanimous That Collective Claim in ICSID Arbitration Against Argentina Can Continue*, ALLEN & OVERY (Dec. 15, 2014), <http://www.allenoverly.com/news/en-gb/articles/Pages/Alemanni-tribunal-unanimous-that-collective-claim-in-ICSID-arbitration-against-Argentina-can-continue.aspx> [<http://perma.cc/7QU8-CLEF>] (archived Oct. 11, 2015) (discussing the unique nature of the arbitration because it was brought by a class of over 60,000 parties).

33. Diego Brian Gosis, *Investment Arbitration of Financial Claims: The Uncharted Crossroads of Two Trodden Paths*, FINANCIER WORLDWIDE (Sep. 2015), <http://www.financierworldwide.com/investment-arbitration-of-financial-claims-the-uncharted-crossroads-of-two-trodden-paths/#.VfMsy2RViko> [<http://perma.cc/PSA6-2BUF>] (archived Oct. 11, 2015).

34. HORNBECK, *supra* note 1, at 7.

35. *Id.*

36. *Id.*

37. *Id.*

38. *A Good Week for Some Investors*, ECONOMIST (June 21, 2014), <http://www.economist.com/news/americas/21604612-vulture-funds-win-legal-victory-over-argentinas-government-good-week-some-investors> [<http://perma.cc/RR72-JAD3>] (archived Oct. 11, 2015) (discussing the implication of the *pari passu* clause).

39. *Id.*

This suit, however, was not the first time vulture funds have pursued litigation in American courts to recover on defaulted bonds.⁴⁰ In fact, Paul Singer, who runs NML Capital, successfully executed a nearly identical strategy against Peru in the 1990s.⁴¹ Mr. Singer's fund purchased \$20.7 million worth of defaulted Peruvian loans for only \$11.4 million and then sued in the New York courts for the full amount of the original loan plus interest, eventually winning a \$58 million settlement, a staggering return rate of 400 percent.⁴² Additionally, similar lawsuits were filed by other vulture funds in Liberia in 2009, as well as in Cameroon and Zambia.⁴³

In contrast, a few years later, when Greece surpassed Argentina's record for the largest sovereign debt default, the country had greater success in its restructuring process.⁴⁴ Unlike Argentina, Greece passed domestic legislation that made the debt-restructuring offer compulsory for all bondholders if it gained the approval of two-thirds of creditors.⁴⁵ But Greece did not rely solely on the legal compulsion of the legislation—which was only applicable to domestically held bonds—it also offered large incentives for creditors to participate by providing an “unusually high cash pay-out.”⁴⁶ While Greece has also experienced a continuing debt crisis, it is due to larger economic factors rather than the actions of a few stubborn holdout creditors.⁴⁷

In the highly contentious Argentine litigation, the New York District Court granted a permanent injunction in 2012 that prevented Argentina from making payments to bondholders who participated in the exchange without also making payments to vulture funds.⁴⁸ The Second Circuit Court of Appeals upheld the decision, and the Supreme Court declined to hear Argentina's appeal in June 2014.⁴⁹

40. See *Vulture Fund Case Studies*, JUBILEE USA NETWORK, <http://www.jubileusa.org/vulturefunds/vulture-fund-country-studies.html> [<http://perma.cc/Z5S4-MCC5>] (archived Oct. 11, 2015).

41. *Id.*

42. *Id.*

43. *Id.*

44. Jeromin Zettelmeyer et al., *The Greek Debt Restructuring: An Autopsy*, 28 *ECON. POL'Y* 513, 515–16 (2013) (crediting success in part to the use of novel legal techniques); John Geddie & Marius Zaharia, *Greek Debt Better Shielded from Vultures Than Argentina's*, *REUTERS* (July 3, 2015, 8:09 AM), <http://www.reuters.com/article/2015/07/03/euro-zone-greece-vultures-idUSL8N0ZI23B20150703> [<http://perma.cc/82KE-EGQE>] (archived Oct. 11, 2015) (discussing the use of collective action clauses in Greek bond instruments).

45. Zettelmeyer, *supra* note 44, at 517.

46. *Id.*

47. *Greece's Debt Crisis Explained*, *N.Y. TIMES* (Sept. 21, 2015), <http://www.nytimes.com/interactive/2015/business/international/greece-debt-crisis-euro.html> [<http://perma.cc/7VME-ECXY>] (archived Oct. 11, 2015).

48. Muse-Fisher, *supra* note 21, at 1690.

49. Ken Parks, *Argentina Sues U.S. in International Court of Justice over Debt Dispute*, *WALL ST. J.* (Aug. 7, 2014, 6:26 PM), <http://www.wsj.com/articles/argentina->

The decision in this case holds particular weight. In addition to ruling in favor of the holdout funds, the court also threatened to hold anyone who attempts to assist Argentina in continuing payment to the restructured bondholders (i.e., U.S. financial institutions) in contempt of court, making it almost impossible for Argentina to ignore the court's order.⁵⁰ Due to the ongoing litigation and the court order preventing any repayment of restructured debt, Argentina was forced into a technical, or "selective," default in August 2014 and, as a result, remains unable to participate in international markets and return to normalcy.⁵¹

Following its successful litigation, NML Capital took some interesting steps to recover the debt owed to it by Argentina under Judge Griesa's order, even going so far as to seize an Argentine naval vessel.⁵² The boat, a training ship named the ARA Libertad, was docked in Ghana when NML successfully obtained an injunction from the government of Ghana allowing seizure of the vessel.⁵³ Argentina disputed the legality of the seizure in the International Tribunal for the Law of the Sea, securing the eventual return of the ship, with much fanfare, to Argentina.⁵⁴ However, the fund's seizure of the boat raised fears of additional attempts to seize Argentine property and prompted the government to ground the presidential plane, Tango 01, temporarily replacing it with a leased jet.⁵⁵ These aggressive seizure techniques do not appear to be aimed at actually recovering significant assets, but rather are meant to send a message that the

sues-us-in-international-court-of-justice-over-debt-dispute-1407431003 [http://perma.cc/ZUJ8-3Z6P] (archived Oct. 11, 2015).

50. See *A Good Week for Some Investors*, *supra* note 38 (explaining that many of the current trustees of the debt are American banks, who will be unwilling to risk being held in contempt of the court).

51. See HORNBECK, *supra* note 1, at 7 (noting that in spite of the high bond exchange participation rate, the remaining untendered bonds presented a problem for Argentina given ongoing litigation).

52. See Joe Weisenthal, *A Hedge Fund Has Physically Taken Control of a Ship Belonging to Argentina's Navy*, BUSINESS INSIDER (Oct. 4, 2012), <http://www.businessinsider.com/hedge-fund-elliott-capital-management-seizes-ara-libertad-ship-owned-by-argentina-2012-10> [http://perma.cc/M9AU-MJ2W] (archived Oct. 11, 2015) (providing the background of the ship's seizure and its connection to Argentina's legal battle with Elliot Capital Management—of which NML Capital is a subsidiary).

53. *Id.*

54. See Ed Stocker, *Argentina Welcomes Home Ship Held in Ghana by US 'Vulture Fund'*, INDEPENDENT (Jan. 9, 2013), <http://www.independent.co.uk/news/world/americas/argentina-welcomes-home-ship-held-in-ghana-by-us-vulture-fund-8445151.html> [http://perma.cc/KK2Y-HFCD] (archived Oct. 11, 2015) (explaining how the ship was returned).

55. See Celina Andreassi, *Government to Hire Plane to Avoid Seizure of Tango 01 on Asia Trip*, ARGENTINA INDEPENDENT, (Jan. 7, 2013), <http://www.argentina-independent.com/currentaffairs/newsfromargentina/government-to-hire-plane-to-avoid-seizure-of-tango-01-on-asia-trip/> [http://perma.cc/SC88-DNCF] (archived Oct. 11, 2015) (explaining that the government hired a private jet to fly Argentina's President so as to avoid capture of the official presidential jet, Tango 01, by "vulture funds").

vulture funds will create a nuisance and not stop their pursuit until their claims are fully satisfied.

After the court ruling requiring repayment to the holdouts under the *pari passu* clause, Argentina offered the holdouts a repayment at essentially the same rates that it offered to other bondholders during previous exchanges.⁵⁶ This deal was estimated to result in a return of \$120.6 million to the holdouts, a substantial increase from their original investment of only \$48.7 million.⁵⁷ Surprisingly, or perhaps unsurprisingly, the holdouts rejected the proposal.⁵⁸

III. ARGENTINA'S FIFTEEN YEAR (AND COUNTING) DEBT CRISIS

A. *The \$100 Billion Catch-22*

Argentina remains at an impasse. By continuing to refuse to deal with holdout funds, Argentina is still locked into a technical default and is unable to raise capital on the international markets due to the threat of seizure under Judge Griesa's order.⁵⁹ However, if Argentina acquiesced to the holdouts, it risked encouraging more copycat lawsuits by other holdouts. Even more devastating, up until the end of 2014, any creditor who took a haircut in one of the bond exchanges could have demanded full repayment due to a "Rights Upon Future Offers" (RUFO) clause in Argentine law. Fortunately for Argentina, these RUFO clauses expired at the end of 2014.⁶⁰ Both paths would lead to unsavory economic consequences for Argentina.⁶¹ Additionally, Argentina passed legislation, a "lock law," that bars any

56. See Muse-Fisher, *supra* note 21, at 1692–93 ("The proposed payment formula essentially followed the payment structure accepted by exchange bondholders in 2013.").

57. See *id.* at 1715 ("In its filing, Argentina speculated NML Capital purchased the bonds for approximately \$48.7 million, and Argentina's payment scheme would entitle the fund to \$120.6 million—a fairly impressive return by any standard.").

58. See *id.* at 1693 (noting that the holdouts ultimately rejected the proposal in April 2013).

59. See *id.* at 1695 (noting that Argentina's inability to raise money in traditional sovereign debt marks since 2002, the year of its default, is partially because any efforts to raise funds would result in seizure by holdout creditors under the terms of Judge Griesa's order).

60. See *Argentina's 'Vulture Fund' Crisis Threatens Profound Consequences for International Financial System*, UNCTAD, http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=783&Sitemap_x0020_Taxonomy=UNCTAD%20Home [<http://perma.cc/Z8RN-C93Y>] (archived Oct. 11, 2015) (noting the impact of the Rights upon Future Offer's Clause on Argentine law and how two hedge fund-friendly U.S. holdings could lead to future Argentine bond requests).

61. See *id.* (noting that, under RUFO, if Argentina were to pay the holdout bond holders, it would have to extend full payment to the bondholders of the 2005 or 2010 debt swaps at an estimated cost of over U.S. \$120 billion).

further attempts to offer deals to holdout creditors.⁶² However, this restriction was lifted in order to initiate the 2010 bond exchange, and it could potentially be lifted again, if necessary.⁶³

Though it is unlikely Argentina will face economic consequences that rise to the level of the 2000–2002 economic crisis, the actions of the vulture funds and the ruling by the U.S. court have undoubtedly pushed Argentina into a deeper recession.⁶⁴ Despite good faith efforts and considerable success in staying current on repayment of nearly all of its debt, Argentina remains locked out of international markets and faced censure by the IMF when it was forced into technical default in 2014.⁶⁵ In a catch-22, Argentina would potentially have been liable for the entire sum of its original debt to all of the creditors who restructured in the earlier bond exchanges if forced to repay the vulture funds in whole.⁶⁶ This threat dissipated when the RUFO clauses expired at the end of 2014. Some argue that Argentina merely used the specter of the RUFO clauses as an excuse not to deal with the holdouts.⁶⁷ Many, though not all, of the creditors who participated in the bond exchanges had agreed to waive the RUFO clauses to allow Argentina to negotiate more freely with the holdout funds.⁶⁸ Though the potential waiver deal never materialized, the expiration of the clauses at the end of 2014 removed at least one of the more dire consequences Argentina would have faced if it had

62. See *id.* (“The Congress of Argentina passed a law in February 2005 that forbade the Government to make payments on any bonds not tendered, to later reopen the exchange or to settle with non-participating creditors one by one on the side.”).

63. See HORNBECK, *supra* note 1, at 7 (noting that as part of the new bond exchange process, the Argentine legislature temporarily suspended the “Lock Law” on November 18, 2009).

64. See Ambrose Evans-Pritchard, *Argentina Accuses US of Judicial Malpractice for Triggering Needless Default*, TELEGRAPH (Jul 31, 2014), <http://www.telegraph.co.uk/finance/financialcrisis/11004486/Argentina-accuses-US-of-judicial-malpractice-for-triggering-needless-default.html> [http://perma.cc/BY45-ASX4] (archived Oct. 11, 2015) (explaining that the New York court’s actions have pushed the Argentine state into default, which in turn will push the country into a deeper recession).

65. See Jude Webber, *Argentina Proposes New Debt Swap*, FINANCIAL TIMES (Feb. 3, 2013), <http://www.ft.com/intl/cms/s/0/d809c45a-6e1b-11e2-983d-00144feab49a.html#axzz3RwjSgKb8> [http://perma.cc/N99H-5FGC] (archived Oct. 11, 2015) (discussing the possibility of reopening the bond exchanges in light of the U.S. Court rulings in favor of the holdout funds).

66. See *id.* (“The judge said the clause required payment in one lump sum to the holdouts at the same time as when holders of restructured debt are paid.”).

67. See Nicole Hong & Matt Wirz, *Bondholders in Talks with Argentina on Legal Strategies*, WALL ST. J. (Sep. 4, 2014), <http://www.wsj.com/articles/bondholders-in-talks-with-argentina-on-legal-strategies-1409867227> [http://perma.cc/267Q-K2K4] (archived Oct. 11, 2015) (“The holdout creditors have said Argentina is using the RUFO clause as a distraction and an excuse to avoid a settlement.”).

68. See *id.* (discussing how some hedge funds that own restructured Argentine bonds are offering to waive the RUFO clause and are trying to get other bondholders to do the same).

struck a deal or agreed to pay back the holdout funds in full.⁶⁹ However, the acrimony of the proceedings meant that even without the RUFO clauses in place, former President Cristina Fernandez de Kirchner was unwilling to offer an amount that would satisfy the vulture funds.

Following the district court decision, Argentina, mostly for show, attempted to take the United States to the International Court of Justice (ICJ), accusing the United States of judicial malpractice for allowing courts to aid the vulture funds in their sovereign debt profiteering.⁷⁰ However, the United States would have had to consent to jurisdiction in order for the ICJ to hear the case, which was incredibly unlikely.⁷¹ Though President Kirchner likely knew the suit was futile, she may have hoped that it would position Argentina favorably for some other diplomatic solution in the future.⁷² Argentina has received the support of many of its fellow Latin American countries in its protracted battle with the vulture funds, including the Organization of American States, which met in July of 2014 to show its support for Argentina and stressed the need for a better international system for restructuring debt.⁷³

President Kirchner and her administration were also fairly vocal with strong reactions to the holdouts and the court decision, comparing the conflict to Israel's battle with Gaza and referring to Judge Griesa's decision as an act of violence against the Argentine people.⁷⁴ The Argentine Economic Minister referred to the holdout funds as the "Ebola of the international financial system."⁷⁵ Kirchner

69. See *id.* (noting that the clause expires at the end of 2014).

70. See Evans-Pritchard, *supra* note 64 (discussing Argentina's threat to take the United States to the International Court of Justice).

71. See Ken Parks, *Argentina Sues U.S. in International Court of Justice over Debt Dispute*, WALL ST. J. (Aug. 7 2014), <http://www.wsj.com/articles/argentina-sues-us-in-international-court-of-justice-over-debt-dispute-1407431003> [<http://perma.cc/EL5U-KCUD>] (archived Oct. 11, 2015) (noting that the United States is unlikely to accept jurisdiction given that this has only happened in twenty-two cases since the tribunal began working in 1946).

72. See *id.* (speculating that that the Kirchner administration probably knew the futility of inviting suit).

73. See Press Release, Organization of American States, Meeting of Consultation of Ministers of Foreign Affairs of the OAS Supports Argentina in the Restructuring of its sovereign debt July 3, 2014, http://www.oas.org/en/media_center/press_release.asp?sCodigo=E-286/14 [<http://perma.cc/E5KY-VTX4>] (archived Oct. 11, 2015) (discussing the Organization of American States' Declaration, which expressed "its support to the Argentine Republic so that it can continue to meet its obligations, pay its debt, honor its financial commitments and . . . arrive at a fair, equitable and legal arrangement with 100% of its creditors").

74. See Jamila Trindle, *Preventing the Next Argentina*, FOREIGN POLICY (Sep. 11, 2014), <http://foreignpolicy.com/2014/09/11/preventing-the-next-argentina/> (discussing President Kirchner's characterization of the investors who took the Argentine government to court as "vultures").

75. Jonathon Gilbert, *Debt Dispute Between Hedge Funds and Argentina at Impasse*, N.Y. TIMES DEALBOOK (Jan. 5, 2015), <http://dealbook.nytimes.com/2015/01/>

essentially refused to acknowledge that the country had been forced into default, stating that the failure to pay bondholders, because the court forced it, is not a default.⁷⁶ Such heightened rhetoric only reinforced the unlikelihood of a deal being reached while the Kirchner government was still in power.

B. *Ramifications Beyond Argentina*

The implications of the U.S. court ruling and the subsequent technical default will be felt far beyond the Argentine economy. The vulture fund's actions and the ruling have raised concerns about the erosion of sovereign immunity.⁷⁷ In response to the ruling, the Argentine Minister of Foreign Relations expressed concerns, which were echoed at the Organization of American States' July 2014 meeting, that the vulture funds and the court ruling have negatively impacted Argentina's ability to provide education, health care, and other vital services to its citizens, and that the ruling will have a lasting impact on employment and poverty levels for the Argentine people.⁷⁸

While, until fairly recently in history, a country like Argentina would have had full sovereign immunity from the NML Capital lawsuit or similar litigation, it has since become more common for sovereign debt bond agreements to include a waiver of sovereign immunity.⁷⁹ Just over fifty years ago, suing a sovereign state in a court of law to enforce a bond contract would have been an impossible task, as sovereign immunity provided a "nearly insurmountable barrier" to such suits.⁸⁰ The barrier to a lawsuit against a sovereign state was so insurmountable that even if a country had waived its immunity in its bond contract, a court could still refuse to hear the case for lack of jurisdiction.⁸¹ However, throughout the twentieth century, a variety of treaty, statutory, and non-statutory actions taken by nations and international bodies have slowly been eroding the notion of sovereign immunity, particularly in relation to sovereign

05/debt-dispute-between-argentina-and-hedge-funds-at-impasse/?_r=0 [http://perma.cc/HL7G-BL7W] (archived Oct. 11, 2015).

76. Trindle, *supra* note 74.

77. See *Argentina's 'Vulture Fund' Crisis*, *supra* note 60 ("The ruling does not only impact the financial service providers involved, it also severely erodes sovereign immunity and is not in compliance with the United States Foreign Sovereign Immunities Act.").

78. See Press Release, Organization of American States, *supra* note 73 (describing the comments of Minister of Foreign Relations of Argentina, Héctor Timerman).

79. See Weidemaier, *supra* note 13, at 73 (noting that up until the middle of the twentieth century, even where the sovereign had previously consented to be sued and waived its immunity, courts might still decline jurisdiction over a lawsuit).

80. *Id.*

81. *Id.*

loan contracts.⁸² In the United States, the true end to sovereign immunity came in the form of the Foreign Sovereign Immunities Act (FSIA), which “codified the restrictive theory of sovereign immunity” and placed the responsibility of determining sovereign immunity with the courts, instead of with the State Department, where it had previously resided.⁸³ The FSIA further restricted sovereign immunity by guaranteeing that a country would not be immune if it had previously waived its immunity in a contract, thereby removing a judge’s ability to reinstate previously waived immunity.⁸⁴

While the district court in the Argentine case had sufficient jurisdiction under the FSIA because of just such a waiver clause in the Argentine bond contracts, the United States argued in its amicus brief in support of Argentina that the injunction preventing repayment to the bondholders was a violation of sovereign immunity because it “constrain[ed] Argentina’s use and disposition of sovereign property that is immune from execution.”⁸⁵ The brief expressed additional concern regarding the potential adverse effects the court’s ruling could have on U.S. foreign relations.⁸⁶ Despite the recent erosions of sovereign immunity, many believe the court’s injunction invaded the realm in which a sovereign state should be protected from a private citizen’s legal action.

C. *Ruling Bad for Both Creditors and Debtors*

The court ruling has allowed for the use of litigation as an enforcement method for a private hedge fund to force the repayment of sovereign debt. However, it is unclear if this added power provides much benefit in practice. Even in the absence of litigation and court orders, sovereign states will still have an incentive to repay debts for reputational reasons.⁸⁷ A sovereign state, with a much longer life span than any individual person, will likely need to borrow from the same creditors again and again in the future and risks informal sanctions by those they do not repay.⁸⁸ Additionally, while litigation allows individual funds to receive a judgment against a sovereign

82. See *id.* at 74 (describing the actions taken by nations and international law bodies to erode sovereign immunity law and promote formal adjudication).

83. See *id.* at 78 (describing how the FSIA changed the law).

84. *Id.*

85. Brief for the United States of America as Amicus Curiae Supporting Petitioners at 6, *NML Capital v. Republic of Argentina*, 892 F. Supp 2d. 530, No. 12-105 (2d Cir. December 28, 2012).

86. See *id.* at 7–8 (explaining how a holding constraining a foreign nation’s use of its property outside the United States could have adverse consequences for the treatment of U.S. property under principles of reciprocity).

87. See Weidemaier, *supra* note 13, at 103 (discussing the incentives, both reputational and sanction-based, that sovereigns have to repay their debts).

88. *Id.*

state, enforcement remains difficult.⁸⁹ However, the FSIA also provided more favorable remedies by removing immunity for foreign assets used for commercial purposes within the United States, thereby allowing for the execution of judgments.⁹⁰ Prior to the NML Capital decision, it was largely assumed that a judgment creditor would only be able to recover if the sovereign state willingly paid.⁹¹ In light of Judge Griesa's decision, however, this is no longer a safe assumption, though Argentina has continued to refuse to pay, despite the judgment.

There is, of course, an important balance maintained by making restructuring a difficult process—creditors retain bargaining power against the sovereign state, giving them a greater ability to protect their rights. In some ways, the U.S. court ruling has only been a disservice to creditors, pitting some creditors against each other—those creditors who participated in the bond exchange against those chose to holdout.⁹² However, some argue that in fact, vulture funds—and their aggressive willingness to litigate against sovereign states—serve an important monitoring role in the sovereign debt restructuring process.⁹³ Vulture funds—by refusing to participate in an unfair restructuring process—can potentially serve to expose mistreatment of creditors.⁹⁴

The court ruling in *NML Capital v. Republic of Argentina* also caused a shift from the view that holdouts are merely a small problem—like a tax—that sovereigns pay during the restructuring process to a much larger problem: namely that the enhanced power they hold can completely arrest the process.⁹⁵ Perhaps more importantly, the court's ruling in favor of the vulture funds creates perverse incentives for the holders of sovereign debt. Funds have greater incentive to refuse to take part in the necessary process of

89. See *id.* at 106 (noting that investors need more than a legal judgment but a means to enforce it).

90. See *id.* at 79 (noting that following FISA, property used for commercial activity in the United States was "no longer immune from execution if the foreign sovereign waived immunity from execution").

91. See *id.* at 89 (explaining that it makes little sense for a financially-distressed sovereign to pay a judgment voluntarily because the sovereign will need to persuade individual bondholders to accept a restructuring plan, which may be frustrated if individual creditors hold out for a better deal).

92. See Roubini, *supra* note 6, at 7 ("[W]hile traditionally, inter-creditor conflicts have pitted private creditors against official-sector creditors, we are now in a situation where inter-creditor tensions occur even among official-sector ones.").

93. See Pottow, *supra* note 23, at 232 (noting that policy proposals seeking to curtail the ability of private funds to sue for enforcement of sovereign debt upon default may not be wise because sometimes these funds do provide a valuable monitoring function).

94. See *id.* (noting the enforcement function of vulture funds).

95. See Roubini, *supra* note 6, at 5 (noting the radical impact of Judge Griesa's decision).

restructuring debt following a default, even when the terms of the restructuring are favorable.⁹⁶ But the ruling does more than simply give future holdouts a greater chance of full recovery through litigation, it also discourages funds that normally would not holdout to do so with the knowledge that they could get more money by suing than restructuring. Funds may also be hesitant to restructure because of the risk that they may not get paid at all if a future court hands down a similar injunction to the one in this case.⁹⁷ Those in the global financial market, including the IMF, have expressed serious concerns about the implications of the court's ruling in the NML case, especially relating to the vastly increased leverage that holdout funds now have during sovereign defaults.⁹⁸

One suggested method to prevent these types of lawsuits and rulings in the future is to increase the use of collective action clauses (CAC) in sovereign bond agreements, which would allow a majority of bondholders to bind a dissenting minority to an agreement, thereby preventing vulture funds from holding out in the first place.⁹⁹ However, there are countless bonds that currently exist without these types of collective actions clauses, and in the event of default, funds will be incentivized to holdout rather than participate in restructuring where they will take a haircut on their returns.¹⁰⁰

The strict legal order handed down by the district court and upheld by the U.S. court of appeals demonstrates the harmful impact that can result from a court ruling that relies on rule of law and textual interpretation, but fails to account for broader policy and global economic ramifications when dealing with a complex issue that typically falls outside of a domestic court's expertise.¹⁰¹ Other countries, including Grenada and the Democratic Republic of Congo, subsequently faced litigation in U.S. courts initiated by holdout investors who hoped that the ruling in the Argentine case would benefit their attempts to recover a full repayment on defaulted bonds,

96. See *Argentina's 'Vulture Fund' Crisis*, *supra* note 60 (noting that by removing financial incentives for orderly debt workouts, the rulings will make future debt restructuring even more difficult); Pottow, *supra* note 23, at 231 (noting the increased incentive for holdouts as a result of naive legal outcomes).

97. *Id.* at 230 ("The most troubling policy outcome with [NML v. Argentina] is the perverse holdout incentive it creates by paying the holdouts more than the cooperators.").

98. *Id.* at 231 (noting the financial incentives for holding out).

99. See *Argentina's 'Vulture Fund' Crisis*, *supra* note 60 (noting different sovereign debt workout mechanisms).

100. See *id.* (noting that the existing Collective Action Clauses will take years to expire).

101. See *Muse-Fisher*, *supra* note 21, at 1678 (discussing the Argentine experience where "strict adherence to the rule of law, a hallmark of modern development theory, can actually undermine moral and economic concerns").

a clear demonstration of the damaging effect beyond Argentina.¹⁰² While on its face the court ruling seems pro-creditor, in reality it may be the opposite. By incentivizing holding out, the ruling makes restructuring less appealing to creditors, which raises the risk that defaults will occur without the opportunity for an organized restructuring deal. This result is good for neither the creditors nor the debtors.¹⁰³

There is also a concern that the lack of an international mechanism for resolving sovereign debt defaults leads to the use of fragmented legal forums across states and nations, resulting in inconsistent outcomes and less predictability. Such uncertainty could cripple the restructuring process. In the wake of the Argentine crisis, a lead economist at the IMF expressed concern that the Argentine case is going to cause much more uncertainty in future sovereign defaults and restructuring attempts.¹⁰⁴ Despite the problems with such fragmented adjudication, there remains a roadblock stemming from the unwillingness of countries with major financial systems to participate in a supranational adjudicatory body.¹⁰⁵ However, with different courts in different countries handing down inconsistent interpretations on key clauses integral to sovereign debt restructuring, the entire process is plagued with uncertainty and will undoubtedly lead to greater difficulty in restructuring sovereign debt in the future.¹⁰⁶

IV. A CURE FOR THE VULTURE PROBLEM: A CALL FOR A SOLUTION AT BOTH THE NATIONAL AND INTERNATIONAL LEVEL

A. A Changing Landscape Makes Settlement More Likely

Since the issuance of Judge Griesa's ruling, Argentina has held only a limited number of equally unattractive options, including repaying the vulture funds in whole, attempting to reach a settlement with the funds, or moving all restructured bonds out of the United

102. See Trindle, *supra* note 74 (highlighting the importance of a solution that can keep poverty-ridden countries from further economic troubles).

103. See Roubini, *supra* note 6 (identifying the new serious risk that "orderly debt restructurings that are beneficial to both the sovereign debtor and its creditors may unravel and fail" because creditors may now hold out).

104. See Trindle, *supra* note 74 (warning that uncertainty in restructuring may affect the global financial system).

105. See *id.* (noting that eleven countries, including the United States, voted against the UN resolution calling for an intergovernmental framework to arbitrate debt disputes).

106. See *Argentina's 'Vulture Fund' Crisis*, *supra* note 60 (noting the fragmented nature of legal forums and the array of politics and special interest groups that can influence the outcome of rulings).

States in order to limit the U.S. courts' ability to force repayment to the vulture funds.¹⁰⁷ Paying the vulture funds in full or moving the restructured bonds out of the U.S. court's jurisdiction are both infeasible. Argentina simply does not have the capital—or the willingness—to repay the entire debt owed to the holdout funds, and moving the restructured bonds to avoid U.S. jurisdiction would be logistically impossible.¹⁰⁸ In fact, NML Capital actually filed subpoenas in China in order to preemptively block any attempts by Argentina to circumvent the New York district court injunction.¹⁰⁹

There are some stark political obstacles to a settlement deal between Argentina and NML Capital, as well as the fear that any deal struck with NML would trigger copycat lawsuits by other holdout funds seeking a similar windfall.¹¹⁰ In one bright spot for Argentina, the RUFO clauses that would have allowed the creditors who previously restructured in the two prior bond exchanges to demand full repayment if Argentina repaid the holdouts in full expired at the end of 2014 and removed one of the most serious potential monetary liabilities previously faced by Argentina.¹¹¹ The expiration of the RUFO clauses helps lessen the barriers to a settlement with NML, which now seems to be the only viable option for Argentina moving forward.¹¹²

While President Kirchner was fairly adamant that Argentina would not repay the vulture funds, newly elected President Macri has already taken steps to reopen negotiations.¹¹³ With a presidential election in October 2015, Kirchner, though not up for re-election

107. See *A Good Week For Some Investors*, *supra* note 38 (detailing Argentina's "four ugly options").

108. See *id.* (explaining that moving the bonds presents insurmountable challenges because a majority of the creditors cannot hold assets under a foreign jurisdiction, and any intermediary, e.g., the bank acting as current trustee, would be in contempt of NY courts).

109. See Davide Scigliuzzo, *Elliot Unit Extends Legal Fight to China*, REUTERS (Aug. 28, 2014), <http://www.reuters.com/article/2014/08/28/argentina-debt-subpoenas-idUSL1N0QY2IO20140828> [<http://perma.cc/V6VB-FTZ7>] (archived Oct. 1, 2015) (indicating that the subpoenas were in an effort to determine whether any of Argentina's assets would surface in jurisdictions where NML Capital could attach them).

110. See *A Good Week For Some Investors*, *supra* note 38 (noting that pursuing a settlement would be seen as a complete reversal of President Kirchner's adamant refusal to pay).

111. See Evans-Pritchard, *supra* note 64 (explaining the enormity of the liability that Argentina would face if restructured bond holders sought the same terms as the holdout bond holders).

112. See *A Good Week For Some Investors*, *supra* note 38 (identifying settlement as the only viable, albeit "ugly option").

113. See *Gov't Restarts Talks with 'Vulture' Funds*, BUENOS AIRES HERALD, (Jan. 13, 2016), <http://www.buenosairesherald.com/article/206654/gov%E2%80%99t-restarts-talks-with-%E2%80%98vulture%E2%80%99-funds> [<http://perma.cc/T3G6-FESQ>] (archived Jan. 13, 2016) (stating that talks have resumed with high expectations that a settlement will be reached).

herself, may have been hesitant to strike any deal that would reflect weakness on her political party in the face of the vulture funds and hurt the party in the election.¹¹⁴ However, President Macri—an opposition candidate—took steps almost immediately upon assuming office to “resolve all outstanding issues” by working with a mediator in New York.¹¹⁵ While neither side had an immediate incentive to negotiate in 2015, the election provided an opportunity to finally reach a settlement and move Argentina out of default.¹¹⁶ President Kirchner felt less pressure to settle with the holdouts as her term wore on because Argentina was able to stabilize its reserves through a currency swap with China, but high inflation and capital flight have created an incentive for President Macri to negotiate.¹¹⁷

President Kirchner offered to settle with NML at the same terms as the 2005 and 2010 deals that the other bondholders accepted, plus accrued interest, but the holdout funds determined that there is no incentive to accept such terms and remained confident they would be able to recover a greater amount by continuing to holdout.¹¹⁸ The funds’ strategy may prove successful, as President Macri has already expressed a greater willingness to do whatever it takes to move Argentina out of default.¹¹⁹ Ironically, Argentina saw some of the highest returns on bonds in 2014, posting the second-best returns among emerging markets, trailing only Turkey.¹²⁰ As Argentine bonds have risen to their highest level in eight years,¹²¹ President

114. See Sonia Avalos, *The New Year Could Resolve the Argentina Debt Debacle*, BUSINESS INSIDER (Jan. 1, 2015), <http://www.businessinsider.com/afp-new-year-could-resolve-argentine-debt-debacle-or-not-2014-12> [<http://perma.cc/HN7E-82EW>] (archived Oct. 1, 2015) (“Waiving the flag of ‘the nation versus the vultures’ has benefited the government, and retreating a step could cost it dearly.”).

115. See *Gov’t Restarts Talks with ‘Vulture’ Funds*, *supra* note 113 (noting that this is already the third trip to New York for Finance Secretary Luis Caputo since President Macri took office).

116. See *id.* (quoting President Macri: “We don’t want to remain listed as a defaulter”).

117. See Gilbert, *supra* note 75 (disagreeing with the predictions of some analysts that Argentina would budge because it needed “access to global debt markets to increase foreign currency reserves”); Linette Lopez, *Argentina Says It’s Finally Coming to the Table*, BUSINESS INSIDER (Jan. 13, 2016) (expressing some skepticism about whether Argentina will stay at the table and reach a settlement).

118. See Camila Russo, *Argentina Bond Bulls Predict World-Beating 2015 Returns*, BLOOMBERG BUSINESS (Jan. 6, 2015), <http://www.bloomberg.com/news/2015-01-06/argentina-bond-bulls-predict-world-beating-2015-returns.html> [<http://perma.cc/3APT-J9CW>] (archived Oct. 1, 2015) (indicating that one of the candidates’ likely proposal for settlement will offer less than 100 percent, but more than the 2005 and 2010 debt swaps).

119. See Lopez, *supra* note 117 (observing that President Macri “ran on a platform of economic reform”).

120. See Russo, *supra* note 118 (noting that Argentine bonds “gained almost three times the average 7.5 percent for developing nations”).

121. See Charlie Devereux, *How Dwindling Reserves are a Positive for Argentine Bondholders*, Bloomberg Business (Sep. 7, 2015),

Macri could use Argentina's stronger position in the market to offer the best deal possible to the holdouts, but should avoid repaying the full 100 percent so that he does not set a precedent that would encourage future funds to refuse to participate in restructuring in hopes of successfully recouping the full amount later.

B. A Chance to Revive Congressional Action

Regardless of any settlement deal between Argentina and the vulture funds, the U.S. Congress should take action to counteract what some might consider an incorrect interpretation of the *pari passu* clause by the courts.¹²² In an amicus brief filed in the NML appeal, the United States expressed concern regarding how the ruling forces repayment to the vulture funds and stressed the importance of cooperative solutions to sovereign debt crises.¹²³ In the brief, the United States contended that the court's interpretation of the *pari passu* clause "contradicts the settled market understanding" of such clauses.¹²⁴ Further, the court's interpretation "threatens core U.S. policy regarding international debt restructuring" and drastically shifts incentives away from cooperation and towards hostile holdout negotiations.¹²⁵ The brief also argued for the importance of a sovereign state's ability to resist paying back creditors who do not participate in the debt exchanges because it incentivizes cooperative participation and quick resolutions.¹²⁶ *Pari passu* clauses in sovereign bond contracts are generally boilerplate and are intended to ensure that no creditor's debt is legally subordinate to another's.¹²⁷ The court's ruling, however, arguably produces the opposite effect, giving the vulture funds' debt legal superiority to those creditors who restructured their debt on the bond exchange.¹²⁸

<http://www.bloomberg.com/news/articles/2015-09-08/how-dwindling-reserves-are-a-positive-for-argentine-bondholders> [<http://perma.cc/WM2M-YQ6Y>] (archived Oct. 1, 2015) ("Argentina's dollar-dominated bonds due in 2033 have risen to their highest level in eight years.").

122. See Stephen Lubben, *Possible Ripples from the Argentine Bond Litigation*, N.Y. TIMES (Dec. 13, 2012), http://dealbook.nytimes.com/2012/12/13/possible-ripple-effects-from-the-argentina-hedge-fund-court-fight/?_r=0 [<http://perma.cc/57NL-6MF8>] (archived Oct. 1, 2015) (arguing that the *pari passu* clause might even be a vestigial limb from corporate bonds that holds no significance in the sovereign debt setting).

123. See Muse-Fisher, *supra* note 21, at 1690 (arguing that the lower court's decision "could 'undermine the decades of effort the United States has expended to encourage a system of cooperative resolution'").

124. Brief for the United States of America, *supra* note 85 at *1.

125. *Id.* at *3-4.

126. See *id.* at *4.

127. See Muse-Fisher, *supra* note 21, at 1713 (explaining that the *pari passu* clause has been a feature of sovereign debt contracts since the 1970s, and is generally regarded as "boilerplate").

128. See *id.* (arguing that the "ratable payments" interpretation incentivizes "sovereign piracy" because it is inconsistent with market expectations).

In addition to the United States' amicus brief, both the New York Clearing House Association and the Federal Reserve Bank of New York have expressed similar concerns about the broad interpretation of the *pari passu* clause as a means of debt repayment enforcement through injunctive relief.¹²⁹ The court's approach in applying the *pari passu* clause may have been a result of it being largely unfamiliar with sovereign debt proceedings, an area that previously would have been foreclosed because of sovereign immunity.¹³⁰ The outcome of the NML litigation signals the need for Congress to step in and appropriately limit vulture funds' ability to use U.S. courts to pursue sovereign debtors.

To help remedy the situation and build stronger protections moving forward, Congress should follow the example of the United Kingdom and pass a law that regulates the vulture funds' use of the domestic court system to demand repayment. The UK law, passed in 2010 and the first of its kind, focuses on preventing "harsh and inequitable payments" forced through judicial action in the UK courts and recognizes that a small number of vulture funds can have a disproportionately large impact on developing countries during sovereign debt proceedings.¹³¹ After its initial implementation, a review of the legislation's impact noted that it showed signs of creating some benefit to developing countries without presenting any evidence of adverse or unintended effects.¹³² The UK law works by placing a cap on the amount that any commercial creditor could recover during a default involving a "Highly Indebted Poor Country" (HIPC).¹³³ This cap creates a strong disincentive for funds to resist participating in a restructuring process, since they know they will be unable to seek exceptionally large profits by holding out.¹³⁴ While the law in the United Kingdom only applies to about forty countries that have been designated as HIPCs, the reality of the situation is that vulture funds can and do take advantage of "emerging" countries like Argentina or Greece, and their actions can be just as damaging, even

129. See Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299, 314 (2005) ("[T]he U.S. government, the New York Clearing House Associations, and the Federal Reserve Bank of New York have emerged as critics of this expansive definition of the *pari passu* provision.").

130. See Pottow, *supra* note 23, at 230 (suggesting the court's interpretation was unintentionally novel due to its lack of familiarity with the subject matter).

131. Press Release, HM Treasury, *Government Acts to Halt Profiteering on Third World Debt Within the UK* (May 16, 2011), <https://www.gov.uk/government/news/government-acts-to-halt-profiteering-on-third-world-debt-within-the-uk> [<http://perma.cc/F9VF-PZJF>] (archived Oct. 1, 2015).

132. See *id.* (enacting permanent legislation before the sunset date because the evidence suggested that there was a benefit for HIPCs with no adverse effects).

133. *Id.*

134. See *id.* ("This Act will make sure that Vulture Funds will never again be able to exploit the poorest countries in the world within the UK's courts.").

to countries that do not qualify as HIPCs.¹³⁵ After twelve years of being locked out of the international markets, Argentina was poised to reenter, only to be thwarted by the vulture funds' litigation.¹³⁶ The ability of a small minority of bondholders to hijack the debt restructuring process after a vast majority agreed to its terms is a clear sign that the process deserves the attention of lawmakers.¹³⁷

A bill proposed in the House of Representatives in 2008¹³⁸ would have criminalized "sovereign debt profiteering" but, like the UK law, would only have applied to "qualified poor countries," which would not include Argentina despite its tumultuous economic history involving numerous sovereign defaults. The proposed bill expressed concern that vulture funds were forcing repayment in amounts far surpassing those repaid to regular creditors who participate in the debt restructuring process.¹³⁹ The bill would have made it illegal for vulture funds to use U.S. courts in furtherance of their sovereign debt profiteering.¹⁴⁰ Such a bill, if expanded to all countries involved in a sovereign default, could nullify the court's ability to force repayment by Argentina to the vulture funds.

It would be important to include a limiting aspect of the bill, only applying it to secondary creditors who purchase defaulted debt at a discount, not to the original creditor. Because vulture funds purchase distressed debt on the secondary market, this type of limitation ensures that the caps on profits are tailored to those who purchased debt with the intention of holding out to seek exorbitant returns that vastly exceed the amount spent on the investment.¹⁴¹

While the failed 2008 bill acknowledged the fundamental differences between sovereign debt and individual debt from the standpoint of debtor protections, it is also important to note the different impacts of a sovereign default, where the losses affect public

135. See Muse-Fisher, *supra* note 21, at 1696 (explaining that, unlike Zambia and Liberia, Argentina does not qualify as an HIPC and thus would not be protected by UK-like legislation).

136. See HORNBECK, *supra* note 1, at 7 (noting that the litigation posed a problem because the attachment orders allowed for "confiscation of proceeds from any new international bond offer").

137. See Pottow, *supra* note 23, at 223 (expressing concern that holdouts in this situation could resist the supermajority consensus to engage in the bond exchanges because there is no bankruptcy-like court).

138. Stop VULTURE Funds Act, H.R. 6796, 110th Cong. (2008).

139. H.R. 6796 § 2(7) ("The vulture creditors seek payments far in excess of the rates of payment made to other similarly situated creditors . . . working through the London Club mechanism of sovereign debt restructuring.").

140. *Id.* § 5(a) ("In General.-- A court in or of the United States may not issue a summons, subpoena, writ, judgement, attachment, or execution, in aid of a claim . . . which would be furthering sovereign debt profiteering.").

141. *Id.* § 3(1) (defining a "vulture creditor" as "any person who directly or indirectly acquires defaulted sovereign debt at a discount to the face value of the obligation").

services like education, health care, and infrastructure.¹⁴² Another important difference between sovereign default and individual bankruptcy is that in bankruptcy there is an ability to bind all the bondholders to a deal, limiting the power of holdouts; such an option does not currently exist for sovereign default proceedings in the absence of CAC clauses.¹⁴³ While a bankruptcy court can reallocate a debtor's assets to settle creditor claims, in a sovereign default, a court can only enforce the bond contract—without consideration to fairness across all creditors affected by the default.¹⁴⁴ Additionally, while the common understanding in the investment world is that high risk equals high reward, the combination of the erosion of sovereign immunity and the litigation success of holdout funds in recent years has reduced much of the risk for vulture funds participating in the sovereign bond market, while still opening the door for excessive reward.¹⁴⁵

Some argue that a bill foreclosing the litigation route for holdout creditors is inappropriate, because litigation can be used to blow the whistle on a sovereign's unfair treatment of creditors.¹⁴⁶ However, such a bill does not prevent funds from refusing to take part in a restructuring that they see as unfair; it simply limits the amount they can profit if they choose to litigate instead of take part in the restructuring process. If the sovereign's restructuring offer is truly unfair, it is likely a fund could still recover higher amounts through litigation, ensuring that the incentive to blow the whistle still exists.

Any fund is free to take on a high-risk bond, but if that risk does not bear profit, then the fund should not be able to use a U.S. court to demand a repayment far exceeding the original investment to profit off a sovereign default—a default that, in all likelihood, the fund anticipated when it purchased the debt. However, another criticism of the bill is that it removes one of the core characteristics of the debt market: that “obligations can be traded.”¹⁴⁷ Critics believe that laws limiting vulture fund profiteering through litigation will disincentive the buying and selling of bonds on the secondary market and will result in developing countries having less access to international

142. See *id.* § 2(12).

143. See Pottow, *supra* note 23, at 221–22 (referring to collective action clauses that allow supermajorities to determine the repayment terms for all creditors).

144. See *id.* at 223 (quoting Judge Griesa) (“Unlike bankruptcy courts . . . the court in this case is limited to enforcing the terms of the specific contracts before it.”).

145. See Weidemaier, *supra* note 13, at 96 (discussing the role of FSIA in reducing the risk involved in investing in sovereign bonds by limiting sovereign immunity).

146. See Pottow, *supra* note 23, at 235 (noting Judge Griesa's framing of Argentina as less of a victim and more of an “abusive . . . juggernaut[] stampeding over the rights of creditors”).

147. See Felix Salmon, *The Silly War on Vulture Funds*, REUTERS (May 7, 2009), <http://blogs.reuters.com/felix-salmon/2009/05/07/the-silly-war-on-vulture-funds/> [<http://perma.cc/WEW6-35FV>] (archived Oct. 2, 2015).

capital.¹⁴⁸ Meanwhile, the holdouts stand to receive unbelievable returns on their investment, which raises the question of whether that is a proper use of sovereign debt investment.¹⁴⁹ Many, if not most, of the holdout bonds were purchased after it was clear that Argentina would default, and some were even purchased as recently as 2010, after the second bond exchange option.¹⁵⁰ Some of these funds were purchased for as little as fifteen cents on the dollar, which would mean that even a settlement that mirrored the terms of the restructured debt in the bond exchanges would result in a high yield for the holdout funds.¹⁵¹ One proposed solution to rein in sovereign debt profiteering through congressional action is to limit vulture fund profits, perhaps by linking the amount awarded to the holdouts to the country's gross domestic product, or as a percentage of trade exports.¹⁵² Alternatively, in the spirit of the *pari passu* clause that the vulture funds relied on in their litigation seeking payment, another option is to limit vulture fund repayment to the most favorable rates offered under the initial bond exchange, thereby ensuring true equal treatment for all creditors and fully disincentivizing holding out.

Legislation limiting vulture fund recoveries is in part a step back from the broad erosion of sovereign immunity that has occurred in recent history, putting a small piece of protection back in place.¹⁵³ Providing a layer of protection for sovereign debtors against vulture funds is not uncontroversial.¹⁵⁴ However, the vulture fund's tactic of attempting to seize an Argentine warship shows that the fund is not necessarily interested in seizing assets to recover their judgment, but rather using such tactics to bully the debtor country—and future debtor countries—to settle in full.¹⁵⁵ Further, defending against a vulture fund's seizure of assets presents its own costs, independent of the repayment of bonds, putting further pressure on the debtor

148. See *id.* (arguing that developing countries would not want legislation that might hinder access to capital).

149. See HORNBECK, *supra* note 1, at 12 (discussing the holdouts' potential for large reward if their patience pays off with a settlement with Argentina).

150. See Muse-Fisher, *supra* note 21, at 1689 (discussing the purchasing of bonds on the secondary market).

151. *Id.*

152. *Id.* at 1699.

153. See Pottow, *supra* note 23, at 224 (suggesting that vulture funds have in part become a scapegoat for the financial crisis, though the blame is not entirely unfounded).

154. See *id.* at 223 (discussing the need for a sovereign debt restructuring mechanism).

155. See *id.* at 227 (positing that the value of the seized vessel was only one percent of the value of NML's judgment against Argentina, making the act more for show than actual recovery of assets).

country to pay in full rather than face litigation—not to mention the costs that are external to the parties involved.¹⁵⁶

C. A Pressing Need for a Better International Framework

Because the sovereign debt restructuring process lacks some of the protections provided to private debtors during bankruptcy proceedings, it creates an environment ripe for vulture funds to engage in profiteering.¹⁵⁷ In a standard bankruptcy system, there is an ability to bind all the parties to a restructuring solution, ensuring fair outcomes for all creditors.¹⁵⁸ Courts involved in sovereign debt litigation are more limited in their ability to allocate the debtor's resources to satisfy all creditors, instead reacting on a creditor-by-creditor basis despite the existence of a larger restructuring scheme.¹⁵⁹ Because of the limited resources and lack of experience of most courts in sovereign default litigation, the court is often left with no better option than to enjoin any repayment to other creditors unless the holdouts' claims are satisfied, which is a less than ideal outcome for most of the parties involved.¹⁶⁰ There is little precedent to guide good policy-based court decisions.¹⁶¹

Quick and mutually agreed-upon solutions to debt crises tend to be more favorable to all those involved—both creditors and debtors—and should be encouraged and supported by the entities with the power to do so.¹⁶² While sovereign debt defaults are relatively rare, and many do not rise to the levels of acrimony seen in the Argentine case, the frequency with which they occur is only expected to increase. There is a clear need for a better system in which to resolve the conflicts between sovereign debtors and holdout funds.¹⁶³ While the creation of such a framework would likely have no impact on Argentina's need to find a resolution for the vulture funds in its present default, this case has demonstrated the critical need for an international debt restructuring mechanism to regulate the power of vulture funds in future sovereign debt defaults.¹⁶⁴

156. See *id.* (discussing the costs of defending against NML's actions in the International Tribunal of the Law of the Sea).

157. Muse-Fisher, *supra* note 21, at 1708.

158. Pottow, *supra* note 23, at 222.

159. See *id.* (discussing the concerns of holdouts in sovereign debt proceedings).

160. See *id.*

161. *Id.* at 229.

162. See HORNBECK, *supra* note 1, at 12 (discussing the benefits of quick and mutually agreed upon solutions to sovereign debt crises).

163. Pottow, *supra* note 23, at 223.

164. See Muse-Fisher, *supra* note 21, at 1708 (discussing the effects of new solutions on the current litigation in Argentina).

In December 2014, the United Nations voted to create an ad hoc committee to discuss the creation of a new international legal framework to deal with sovereign debt restructuring, providing a prime opportunity to address this gap in the sovereign debt restructuring process.¹⁶⁵ The proposal was supported by a vast majority of countries, lead primarily by China and a coalition of developing countries.¹⁶⁶ However, the United States, the United Kingdom, Germany, and Japan opposed the move.¹⁶⁷ The United States argued that the United Nations was not the appropriate venue for the creation of such a body and that such work more appropriately falls under the oversight of the IMF.¹⁶⁸ However, while the IMF has clear advantages, it is unclear whether it is truly the best organization to establish and operate an international restructuring system because, as a creditor itself, it cannot be a truly neutral third party in sovereign default proceedings.¹⁶⁹ In contrast, the United Nations provides the best of both worlds; it allows a centralized body that already holds a high level of international legitimacy to be a neutral third party in overseeing the sovereign debt restructuring process.¹⁷⁰

The IMF did discuss the possibility of creating an international sovereign debt restructuring mechanism (an SDRM) in the early 2000s; however, no further action has been taken to implement such a body.¹⁷¹ In part, the plan for a comprehensive international cooperative structure failed due to insurmountable political constraints that stem from getting sovereign states and the global financial market, all with various and sometimes competing interests, to agree on a “vast global legal scheme.”¹⁷² It is quite possible that a plan would fail again today, and some argue that an ambitious “macrolevel policy proposal” should be scrapped in favor of smaller piecemeal steps.¹⁷³ The same political constraints exist today that prevented the implementation of the SDRM before, but the need for a

165. Press Release, General Assembly, Proposal for Sovereign Debt Restructuring Framework Among 6 Draft Texts Approved by Second Committee, U.N. Press Release GA/EF/3417 (Dec. 5, 2014).

166. Trindle, *supra* note 74.

167. *Id.*

168. Press Release, General Assembly, Proposal for Sovereign Debt Restructuring Framework Among 6 Draft Texts Approved by Second Committee, *supra* note 165.

169. See Hagan, *supra* note 129, at 344–45 (discussing the benefits of basing a structure in the IMF, including the fact that a large number of countries are already signatories).

170. See Pottow, *supra* note 23, at 239 (discussing the benefits of the United Nations staffing an international sovereign debt board).

171. Muse-Fisher, *supra* note 21, at 1708.

172. Roubini, *supra* note 6, at 8.

173. Pottow, *supra* note 23, at 235–36 (proposing the creation of a certification board for sovereign debt restructuring).

framework has reached critical heights in the face of strong holdouts and developing and emerging democracies' continued risk of default.¹⁷⁴

In September of 2014, the IMF released other limited proposals to constrain holdout funds' power to block sovereign debt restructuring.¹⁷⁵ The proposals mainly focused on changes that could be made to the contractual framework of sovereign debt restructuring, suggesting reliance on stronger collective action clauses and modifying the boilerplate *pari passu* clauses that caused so much trouble for Argentina.¹⁷⁶ Although contractual clauses may improve the situation marginally, these *ex-ante* solutions will not drastically change the restructuring process itself—the stage at which the problems with holdouts tend to arise.¹⁷⁷ No sovereign debt restructuring process is the same, so any solution that is purely *ex-ante* will be insufficient because any determination about what is fair or just in one restructuring may not be applicable to another—there are simply too many variables to fully correct the vulture fund problem in sovereign debt restructuring through changes to contract language.¹⁷⁸ Contract clauses are written long before there is any shadow of a default looming and cannot fully capture the needs and unique circumstances of each individual sovereign default. While these suggestions can serve to reduce future conflicts, they do not address the need for an international framework, which would resolve disputes that do arise from holdout fund litigation after a restructuring has failed.¹⁷⁹

Similar to the IMF's proposals, the International Capital Markets Association, a trade group of banks, brokers, and investors, has proposed contractual terms that would erect barriers to vulture fund attempts to impede the restructuring process.¹⁸⁰ These include updated model collective action clauses and *pari passu* clauses for use

174. Roubini, *supra* note 6, at 8.

175. See generally INT'L MONETARY FUND, STRENGTHENING THE CONTRACTUAL FRAMEWORK TO ADDRESS COLLECTIVE ACTION PROBLEMS IN SOVEREIGN DEBT RESTRUCTURING (Oct. 2014), <https://www.imf.org/external/np/pp/eng/2014/090214.pdf> [<https://perma.cc/GK9V-U65T>] (archived Oct. 4, 2015) (discussing some of the proposed solutions to the sovereign debt crisis).

176. See generally *id.* (describing the proposed policies of the IMF).

177. See Roubini, *supra* note 6, at 8 (evaluating proposed solutions to the sovereign debt restructuring problem).

178. See Pottow, *supra* note 23, at 240–41 (discussing the role of a board in sovereign debt restructuring).

179. See generally Roubini, *supra* note 6 (discussing the global crisis in sovereign debt restructuring).

180. See *Sovereign Debt Information*, INT'L CAPITAL MK'T ASS'N, <http://www.icmagroup.org/resources/Sovereign-Debt-Information/> [<http://perma.cc/NL2L-VDD5>] (archived Oct. 4, 2015) (providing proposals for sovereign debt restructuring).

in sovereign bonds, with the goal of facilitating restructuring when necessary and preventing holdouts from blocking the process.¹⁸¹

In September 2015, the UN General Assembly took an important step by passing a resolution listing basic principles for the restructuring of sovereign debt.¹⁸² Among those principles is the idea that sovereign states should be immune from litigation in domestic courts over sovereign debt.¹⁸³ The United States, again demonstrating an unwillingness to support any sort of international mechanism to address sovereign defaults, voted against the resolution.¹⁸⁴

While the General Assembly's principles demonstrate a commitment to the idea that the current approach to sovereign debt restructuring needs to be changed, these types of resolutions are not binding. An international authority is necessary to implement these principles. The need for an international body is most pressing in cases involving developing countries that cannot afford drawn-out litigation with holdout funds to resolve disputes over the meaning of those contract terms.¹⁸⁵ Both creditors and debtors would greatly benefit from the predictability and organization of an international sovereign debt restructuring mechanism, and the mere existence of such a body would likely encourage parties to create mutually agreeable deals without the need for the body to intervene.¹⁸⁶ One possibility is that such a body could take the form of an international sovereign debt arbitration court, similar to the Permanent Court of Arbitration or the International Court of Arbitration.

One of the initial problems with sovereign defaults is that—while a quick resolution would be the preferred outcome—countries often postpone entering default longer than they should.¹⁸⁷ Due to the nature of sovereign assets, it is not always immediately clear when a sovereign state's debt has exceeded its assets.¹⁸⁸ Additionally, sovereign states will be hesitant to enter into the restructuring process out of fear that it will be uncertain and chaotic. A quick and early restructuring is preferable because it results in a more predictable and orderly process.¹⁸⁹ Many experts believe that, in

181. See *id.* (describing the new proposals for restructuring).

182. Louis Charbonneau, *U.N. Nations Approve Principles for Sovereign Debt Restructuring*, REUTERS (Sep. 10, 2015), <http://uk.reuters.com/article/2015/09/10/uk-un-sovereign-debt-idUKKCN0RA2KU20150910> [<http://perma.cc/4FJC-D7H4>] (archived Oct. 4, 2015).

183. *Id.*

184. *Id.*

185. Trindle, *supra* note 74.

186. Muse-Fisher, *supra* note 21, at 1709.

187. See Hagan, *supra* note 129, at 307 (discussing the collective action problem in sovereign debt restructuring).

188. *Id.*

189. *Id.* at 338.

Argentina's case, the situation would have been better if the IMF had "ended its support and pushed for debt restructuring much earlier."¹⁹⁰ An important first step in an international system should include a triggering mechanism that would allow a neutral third party to determine when default and restructuring are necessary.

Some important key characteristics of any international system include the ability to stay any pending litigation that has been initiated in a nation's court system and an emphasis on impartiality, transparency, and equity among creditors.¹⁹¹ The benefit of an arbitration court is that it removes the potential for "home court" advantage that exists when these types of claims are litigated in a particular nation's domestic courts.¹⁹² Another way to mitigate holdout funds' power would be to enact a policy allowing a "qualified majority" of the creditors to bind a dissenting minority to the terms of a restructuring deal, like an ex post CAC clause.¹⁹³

An international adjudicatory system would not only serve as a check on creditors but would also ensure fair dealing by the sovereign debtor. Particularly, there is a moral hazard concern with sovereign restructuring, namely that a country may actually have the ability to pay its debts but is unwilling to do so.¹⁹⁴ An international body could also address the problems that arise when the debtor wholly controls the terms of the restructuring, an issue highlighted by critics during the Argentine restructuring.¹⁹⁵ Because it restructured its debt independently, without IMF oversight, Argentina was able to essentially demand acceptance of its unfavorable terms as a take-it-or-leave-it proposition.¹⁹⁶ An international framework, however, could empower creditors—through collective action—to structure the terms of bond exchanges. Such terms would be binding on all creditors and help to alleviate the risk of harm from vulture funds.¹⁹⁷ Because of the nature of sovereign debt, creditors are largely forced to be passive observers rather than active participants, which presents a large problem when a few particularly active creditors (like holdout funds) take control and impede other creditors' access to their restructured debt payments.

190. HORNBECK, *supra* note 1, at 3.

191. *Argentina's 'Vulture Fund' Crisis*, *supra* note 60.

192. Pottow, *supra* note 23, at 242.

193. See Muse-Fisher, *supra* note 21, at 1709 (discussing important features of a sovereign debt framework).

194. Pottow, *supra* note 23, at 241.

195. HORNBECK, *supra* note 1, at 5.

196. *Id.*

197. See Hagan, *supra* note 129, at 336 (discussing this feature's integral role in the IMF's 2001 proposal for a sovereign debt restructuring mechanism).

V. CONCLUSION

Judge Griesa's ruling in favor of the holdout funds came as somewhat of a surprise to many in the international community. However, the full ramifications are yet to be seen. The ruling triggered fears of a weakened restructuring system, with creditors finding a greater incentive to holdout and fewer reasons to participate in an orderly and timely restructuring process. Furthermore, it triggered concerns about the erosion of sovereign immunity with more countries facing private litigation in domestic courts.

Argentina has been in sovereign debt limbo for a long time, and this is unlikely to be the last time that vulture funds hijack a sovereign debt restructuring process. Congress should take Judge Griesa's ruling as an opportunity to enact legislation that places limits on a vulture funds' power to disrupt the sovereign debt restructuring process. With ramifications beyond Argentina's economy, the ruling has demonstrated the pressing need for a better international framework for debt restructuring, which the United Nations has the opportunity to finally address, after previous failed attempts by the IMF and others.

Sovereign defaults are incredibly costly and disruptive, and not as easily coordinated as private bankruptcy in a corporate or individual setting. However, the process can be made more efficient and effective through a number of legislative and structural improvements that will limit the ability of a small number of holdout creditors to hijack the restructuring process for profit. Congressional action prohibiting the use of U.S. courts for sovereign debt profiteering, as well as the implementation of an international debt-restructuring framework, will serve to facilitate more predictable and less chaotic sovereign debt restructuring in the future. While both of these solutions require overcoming significant political obstacles—at the national and international level—the fifteen years and counting Argentine default saga has provided a stark example of why change is necessary. Indeed, it has created an environment where the international community is poised to finally take action.

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