No. 13-990

IN THE

Supreme Court of the United States

REPUBLIC OF ARGENTINA,
Petitioner,

v.

NML CAPITAL, LTD., *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE FEDERATIVE REPUBLIC OF BRAZIL AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE* [1]

The Federative Republic of Brazil (Brazil) is a sovereign state. Brazil is the world's seventh largest economy and a member of the Group of Twenty leading advanced and emerging economies. Brazil is also a key foreign relations and economic partner of the United States. In 2011 alone, United States goods and services trade with Brazil totaled $103 billion.

Brazil has an immediate and direct interest in this case. Brazil has long issued bonds that, like the Argentine bonds at issue, are governed by New York law. As of December 2012, Brazil had over $36 billion of outstanding New York law bonds. And Brazil's bonds contain a pari passu clause, also referred to as an equal ranking clause, similar to the clause in Argentina's bonds.

Based on the similarity between Brazil's and Argentina's pari passu clauses, Brazil, in recent filings with the U.S. Securities and Exchange Commission ("SEC"), explained that it "has always intended that the equal ranking provision would permit it to redeem or to make principal and interest payments in respect of some of its external debt without making ratable payments in respect of other external debt." *Federative Republic of Brazil Prospectus Supplement*, U.S. Securities and Exchange Commission S-7 (Oct. 23, 2013), http://www.sec.gov/Archives/edgar/

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[1] No counsel for a party authored this brief in whole or in part, and no party or counsel for a party made a monetary or other contribution intended to induce or fund the preparation and submission of this brief. No one other than *amicus curiae* made a monetary contribution to the preparation or submission of this brief. Letters from the parties consenting to the filing of *amicus curiae* briefs have been filed with the Clerk of the Court.

data/205317/000119312513407322/d615647d424b5.htm#supptoc615647_2. But the Second Circuit adopted the opposite interpretation of Argentina's pari passu clause and enjoined Argentina from paying exchange bondholders without making "ratable payments" on defaulted bonds. In the same SEC filing, Brazil thus warned that the Second Circuit's decision "create[s] uncertainty regarding the meaning of ranking provisions and could potentially reduce or hinder the ability of sovereign issuers, including Brazil, to restructure their debt"—in particular, "by affecting the voting decisions of bondholders." *Id.* This deeply troubling development directly impacts the global sovereign bond market.

Brazil additionally maintains a direct interest in the Second Circuit's assertion that "collective action clauses," which have become a standard feature in newer bonds, will prevent cases like this one from happening again.[2] Contrary to the Second Circuit's erroneous theory, collective action clauses manifestly would not prevent entities like respondents from impeding a future restructuring by capturing a minority stake in just a single series of bonds and thereby affecting a debt restructuring, were one needed. This case accordingly remains of paramount importance prospectively for sovereign issuers, including Brazil, and for the global financial markets.

No nation has an interest in defaulting on its debt, given the negative consequences that it entails; yet no nation is immune from a risk of default. Recent experience shows that financial crises can afflict even highly developed states. In the mid-1990s, when

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[2] Since 2003, Brazil's bonds have included collective action clauses.

Brazil voluntarily restructured its debt, it faced a similar holdout who refused to exchange defaulted loans and instead filed litigation in the same courts that produced the decisions below. Pari passu was no issue then, because no one at that time could have imagined, much less advocated, the novel interpretation adopted by the courts below in this case. But if that interpretation had then prevailed, a threat of injunctions like the ones in this case could have torpedoed Brazil's restructuring and economic recovery. This Court's review is urgently needed to correct the lower courts' intrusive injunctions and to safeguard the ability of sovereign states to restructure debt in an orderly fashion.

INTRODUCTION AND SUMMARY OF ARGUMENT

In 2001, Argentina defaulted on roughly $80 billion in foreign public debt. *NML Capital, Ltd. v. Banco Central de la Republica Argentina* ("*NML Capital I*"), 652 F.3d 172, 175 (2d Cir. 2011). This default was "one of the most catastrophic events in recent economic history" and marked a two-week period that saw four interim Argentine presidents. S. Takagi, *Argentina's Default of 2001*, in *The Evidence and Impact of Financial Globalization* 709, 717 (Gerard Caprio ed., 2012). Since defaulting, Argentina has not made payments on the defaulted bonds. *NML Capital I*, 652 F.3d at 175.

Sovereign defaults are devastating for the economic, social, and political life of a state. But unfortunately, these events "have been an almost universal rite of passage for every country as it has matured from an emerging market economy to an advanced developed economy." Carmen M. Reinhart & Kenneth S. Rogoff, *This Time Is Different* xxx (2009).

Default by a sovereign state is qualitatively, and often quantitatively, different from default by a private company. When a private company defaults, domestic bankruptcy procedures typically provide for an orderly resolution between creditors and the defaulting debtor. By contrast, no formal bankruptcy system exists for sovereign states.

There is, however, an *informal* system for the orderly resolution of debt when sovereign states default. Since the 1980s, that system has developed to merge principles of law with financial, economic, political, and foreign relations considerations. In short, states restructure their debt with creditors, integrating debt relief with new funding and appropriate economic policy adjustment. *See* Int'l Monetary Fund ("IMF"), *Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework* 11 (Apr. 26, 2013), https://www.imf.org/external/np/pp/eng/2013/042613.pdf. This informal system has worked reasonably well, as numerous nations have restructured their debt in accordance with its principles.

Argentina, in restructuring its debt in 2005 and 2010, offered to exchange its defaulted bonds for new exchange bonds with modified terms and a substantial reduction in value. Creditors holding nearly 92% of the face value of the defaulted bonds voluntarily accepted Argentina's exchange offer. *NML Capital I*, 652 F.3d at 176 n.4. But respondents declined to participate in the voluntary exchange. Instead, they filed a series of lawsuits in federal court in New York.

In one set of actions on some of the defaulted bonds, respondents sought and obtained money judgments against Argentina—the typical, adequate remedy at law for nonpayment of a security or other debt instrument. But respondents have been unable to execute fully on these money judgments, because the Foreign Sovereign Immunities Act (FSIA), 28 U.S.C. § 1603 *et seq.*, confers broader immunity from attachment and execution than it does from lawsuits.[3] In other words, while the United States as a matter of policy does not endorse foreign states' non-payment of U.S. judgments,[4] U.S. federal law indisputably establishes some *rights* (to sue foreign states) for which the *remedy* (by way of execution and attachment) is limited because the universe of assets not covered by sovereign immunity is itself limited.

Respondents, however, do not accept that, as a consequence of the FSIA, there may be only a limited remedy in U.S. courts for the right they exercised to sue Argentina on its defaulted bonds, rather than participate in Argentina's voluntary exchange. Accordingly, in the cases below, based on their novel interpretation of the pari passu clause in Argentina's bonds, respondents sought an alternative remedy:

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[3] In a separate case already before this Court, lower courts permitted respondents to take worldwide discovery of Argentina's assets, including assets that are immune from attachment or execution under the FSIA. The Court will hear argument in that case on April 21, 2014. *Republic of Argentina v. NML Capital, Ltd.*, No. 12-842.

[4] *See, e.g.*, Brief for the United States of America as Amicus Curiae in Support of Reversal ("United States Amicus Brief of April 4, 2012") at 3, *NML Capital, Ltd. v. Republic of Argentina*, No. 12-105-CV(L) (2d Cir. Apr. 4, 2012), 2012 WL 1150791, at *3.

equitable relief in the form of specific performance enforced by injunctions.

Although participants in sovereign bond markets, including Brazil, have long understood pari passu clauses to protect bondholders solely from legal subordination, respondents argued that the protection instead requires "ratable payments" to all foreign creditors. According to respondents, a "ratable payments" obligation would mean that Argentina violates the clause by paying holders of other foreign public debt while not paying respondents. Respondents claimed that Argentina, by making payments on exchange bonds, but not on defaulted bonds of holdout creditors, was violating the pari passu clause.

Despite confirmation from the United States that this construction of the pari passu clause "deviates from decades of settled market expectations," United States Amicus Brief of April 4, 2012 at 5, 2012 WL 1150791, at *5, the courts below accepted respondents' argument. Worse still, the courts enforced their misinterpretation of the pari passu clause not through the traditional legal remedy of a money judgment, but via intrusive injunctions barring Argentina from paying exchange bondholders unless it makes ratable payments to holdouts as well. Of course, none of these payments would be from funds subject to attachment and execution under the FSIA; if they were, respondents would not need to jump through such hoops. The injunctions, rather, effectively prohibit Argentina from using some immune assets for one purpose (to pay exchange bondholders) unless it also uses other immune assets for another purpose (to pay holdouts). The injunctions also purport to bind financial institutions and clearinghouses worldwide that facilitate Argentina's payments to exchange bondholders.

Brazil agrees with Argentina that this Court should grant certiorari both to certify the interpretation of the pari passu clause to the New York Court of Appeals, and to review and reverse the lower courts' misuse of equity to effectuate a blatant end run around the broad immunity from attachment and execution accorded to foreign states by the FSIA.

Brazil submits this brief to highlight three reasons why this case is of the utmost import to the international order. First, injunctions like those issued in this case are an affront to the sovereignty and dignity of foreign nations, including Brazil. Second, if allowed to stand, the injunctions will undermine the well-established informal system that has developed for sovereigns to restructure defaulted debt. That system may benefit from refinement, but it has been an important and necessary feature of the international financial architecture, and the Second Circuit's decision fundamentally altered it, far exceeding that court's remit. Third, contrary to the Second Circuit's assurances, collective action clauses in newer bonds decidedly do *not* exclude the possibility that the circumstances of this case will recur. The Second Circuit's decision, if left to stand, will cast a shadow over the global sovereign debt market in which U.S. markets play a key role. The consequences of this case simply cannot be overstated.

This Court should grant certiorari to rectify the serious and enormously consequential errors below, to preserve settled expectations—of foreign nations and markets alike—regarding the meaning of the pari passu clause, and to redeem the U.S. law of sovereign immunity for the benefit of all nations and the comity among them.

ARGUMENT

I. THE INJUNCTIONS ARE AN AFFRONT TO FOREIGN STATES, INCLUDING BRAZIL, AND JEOPARDIZE FOREIGN RELATIONS INTERESTS

The doctrine of foreign sovereign immunity, which "has been recognized since early in the history of [the United States]," is premised on "the common interest impelling [sovereign nations] to mutual intercourse." *Republic of Philippines v. Pimentel*, 553 U.S. 851, 865 (2008) (internal quotation marks omitted). In circumventing the principles of foreign sovereign immunity, the Second Circuit's decision imperils the "common interest[s]" of foreign nations and the United States alike.

The Second Circuit's decision is an affront to the dignity of Brazil and other nations that relied on the long-settled understanding, enshrined in the FSIA, that the assets of a sovereign nation enjoy broad immunity from attachment and execution to satisfy money judgments. The decision below also jeopardizes the interests of the United States abroad, which depend on the principle of reciprocity fostered by the FSIA. United States Amicus Brief of April 4, 2012 at 28-30, 2012 WL 1150791, at *28-30.

A. The Decision Below Offends the Sovereignty and Dignity of Brazil and Other Foreign States

"[F]oreign sovereign immunity derives from standards of . . . respect for the 'power and dignity' of the foreign sovereign." *Pimentel*, 553 U.S. at 866 (quoting *Nat'l City Bank of N.Y. v. Republic of China*, 348 U.S. 356, 362 (1955)). Indeed, as Chief Justice Marshall explained in this Court's seminal decision on the doctrine, foreign sovereign immunity is "essential to the dignity of [a] sovereign." *Schooner Exch. v. McFaddon*, 11 U.S. (7 Cranch) 116, 139 (1812).

This bedrock principle—respect for the dignity of a foreign sovereign—lies at the heart of the tradition, enshrined in the FSIA, that courts in the United States may not permit attachment or execution of a judgment on the immune assets of another sovereign nation. 28 U.S.C. §§ 1609-1611. For "the judicial seizure of the property of a friendly state" is nothing less than "an affront to [that nation's] dignity." *Republic of Mexico v. Hoffman*, 324 U.S. 30, 35-36 (1945); *see also Pimentel*, 553 U.S. at 866 (warning of the "specific affront that could result to [another nation] if property it claims is seized by the decree of a foreign court").

Indeed, in the related case involving discovery of Argentina's immune assets worldwide, the United States explained, as an *amicus curiae*, that "judicial seizure of a foreign state's property may be regarded as a serious affront to the state's sovereignty and affect our foreign relations with it." Brief for the United States as Amicus Curiae in Support of Petitioner ("United State Amicus Brief of March 3, 2014") at 9, *Republic of Argentina v. NML Capital, Ltd.*, No. 12-842 (Mar. 3, 2014), 2014 WL 827994, at *9. Accordingly, "that carefully constructed [FSIA immunity] framework preserves comity . . . and addresses concerns about reciprocity for the United States when sued abroad." *Id.*

As petitioner demonstrates, the Second Circuit's novel theory of specific performance is merely an end run around the FSIA's broad immunity from attachment and execution on foreign states' assets to satisfy a money judgment. Pet. at 26-29. For the Second Circuit to claim that it does no such thing, on the myopic notion that the injunctions do not technically "exercis[e] dominion over sovereign property," only adds insult to injury. *NML Capital, Ltd. v. Republic of Argentina* ("*NML Capital II*"), 699 F.3d 246, 262 (2d Cir. 2012). The Second Circuit's decision presents Argentina with an unacceptable Hobson's Choice: either use immune assets to pay the holdouts, or default on the more than $24 billion in exchange bonds that remain outstanding. Pet. at 3.[5]

The Second Circuit's dismissive approach to foreign sovereign immunity is not only "an affront to [the] dignity" of Argentina, *Pimentel*, 553 U.S. at 866 (internal quotation marks omitted), but to the dignity of all nations that have issued debt in the United States on the premise that the letter and purpose of the FSIA would be respected. Brazil is a prime example. It currently has over $36 billion in outstanding public bonds governed by New York law, with pari passu clauses akin to Argentina's. Brazil issued these bonds with certain understandings and expectations about the scope of FSIA immunity from attachment

[5] Based on a misguided view of the nature of central bank reserves, and ignoring the multi-billion dollar universe of potential claims by other holdouts, the Second Circuit concluded that Argentina could simply tap into its reserve assets—approximately $40 billion at the time, now less—and turn them over to respondents, who hold claims of roughly $1.33 billion. *See NML Capital II*, 699 F.3d at 251, 263. But sovereign debt restructuring is far from a matter of simple arithmetic. Indeed, during a typical restructuring process, IMF economists examine a multitude of "macroeconomic, policy, and financing variables" to determine "the envelope of financial resources that is available for debt service payments." *See* IMF, *Sovereign Debt Restructuring*, *supra*, at 14.

and execution. Whether or not those clauses will ever be triggered in Brazil's case is of no moment. By suddenly and unexpectedly abridging the protections on which Brazil relied, and jeopardizing the predictability of Brazil's substantial financial interests, the Second Circuit paid short shrift to the dignity and respect due Brazil and the countless other nations with sovereign debt outstanding in the United States.

Moreover, Brazil has no way of knowing whether the Second Circuit's decision is merely the tip of the iceberg. As the United States explained in the related discovery action, the decision "injects . . . unpredictability and disorder into the already complex problems posed by sovereign defaults." United States Amicus Brief of April 4, 2012 at 10, 2012 WL 1150791, at *10. Sovereign nations such as Brazil are left to consider the prospect of analogous measures in other scenarios, both foreseeable and unforeseeable. The end result is that the entire purpose of foreign sovereign immunity is undermined—foreign nations will view their assets as subject to the whims and creative legal theories of United States courts.

This Court has made clear that where "the dignity and rights of a friendly sovereign state" are at stake, "[a] case is one of such public importance and exceptional character" that this Court's intervention is compelled. *Ex parte Republic of Peru*, 318 U.S. 578, 586-87 (1943). This case possesses that exceptional character. Indeed, the affront that the injunctions present to the dignity of Brazil, Argentina, and other foreign nations is crystal clear when comparing the present action to the discovery action in which this Court has already granted certiorari. The compelled discovery of a foreign nation's immune assets certainly intrudes on its sovereignty, but it is not remotely as offensive as an injunction purporting to dictate how those assets can and cannot be used. If considerations of comity warranted this Court's review in the former circumstances, Petition for a Writ of Certiorari at 26-29, *Republic of Argentina v. NML Capital, Ltd.*, No. 12-842 (Jan. 7, 2013), 2013 WL 122883, at *26-29, they surely do in this context as well.

B. The Decision Below Jeopardizes Foreign Relations

The impact of the Second Circuit's decision will by no means be limited to Argentina; the decision presents serious consequences for all nations, including the United States, in conducting their affairs abroad. Indeed, the United States has left no room for doubt on this question in its participation in this and the parallel discovery litigation. It has emphasized that "[the] carefully constructed [FSIA] framework preserves comity . . . and addresses concerns about reciprocity for the United States when sued abroad." United State Amicus Brief of March 3, 2014 at 9, 2014 WL 827994, at *9. By circumventing this carefully crafted framework, the decision could have "adverse effects on [the United States'] foreign relations and pose reciprocal concerns with respect to U.S. government assets." United States Amicus Brief of April 4, 2012 at 22, 2012 WL 1150791, at *22.

The risk to U.S. interests, and the erroneous nature of the Second Circuit's reasoning, can be illustrated with a simple example. Suppose local employees at a U.S. Embassy claim that higher wages for American employees violate the host country's equal-pay labor laws. On the rationale applied below, rather than order the United States to pay more money to the local employees, that host country's courts could issue injunctions prohibiting the U.S. Embassy from paying its American employees at all, unless and until it made equivalent payments to its local employees. Even more intrusive, such injunctions might cover the U.S. Embassy's bank or any other financial institution in the host country that facilitates the Embassy's payments to employees and others. Of course, the United States would not stand for such injunctions, nor should it or any other sovereign nation. But there is no material difference between this situation and that presented by the injunctions.

Far from being a remote hypothesis, the Second Circuit's reasoning could in fact inspire judges in the Brazilian labor courts who currently preside over lawsuits in which the United States is the defendant. There are at least four pending labor cases against the United States, along with at least nine other cases in which the United States is asserting its immunities in Brazilian courts. In such cases, the Brazilian Attorney General has intervened on behalf of the United States—invoking the reciprocity principle—when courts have improperly attempted to attach funds belonging to the United States to enforce money judgments. If the Second Circuit's decision stands, however, Brazilian courts may be far less receptive to this position.

This is but one example of the myriad and unpredictable ways in which the Second Circuit's decision could impact the United States' interests. Brazil need not elaborate at length on this point; for the many reasons documented by the United States throughout this litigation, this case presents considerations of the utmost import to the functioning of the U.S. Government.

At a bare minimum, a decision that could significantly impact the vital interests of countless nations, including, as mentioned, the United States, should be made by this Court, not a lower court. This Court's review is therefore essential.

II. THE INJUNCTIONS UNDERMINE THE INFORMAL INTERNATIONAL SYSTEM FOR SOVEREIGN DEBT RESTRUCTURING

In addition to offending the sovereign prerogatives of sister nations, the injunctions in this case threaten to upend the international system that has developed, and on which numerous distressed nations have relied, to restructure debt voluntarily with creditors. That significant and unwarranted consequence is another reason this Court's review is so critically needed.

There is no formal bankruptcy procedure for sovereign states. States do nonetheless default on debt quite regularly. Since the 1980s, however, resolution of sovereign defaults has proceeded within a framework that, while informal, is firmly established. By design, the system merges principles of law with financial, economic, political, and foreign relations considerations. Recovery programs integrate debt relief with new funding and appropriate adjustment policies. *See* IMF, *Sovereign Debt Restructuring*, *supra*, at 11. Brazil supports and actively contributed to the development of this integrated framework, which the United States likewise has consistently encouraged. *See* United States Amicus Brief of April 4, 2012 at 5, 2012 WL 1150791, at *5 (mentioning the "decades of effort the United States has expended to encourage a system of cooperative resolution of sovereign debt crises").

In 2004, a leading financial industry association, the Institute for International Finance (IIF), collaborated with emerging market governments to develop an influential formulation of the framework for resolution of sovereign defaults, the "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets." Inst. of Int'l Fin., *Key Principles Agreed To Strengthen Emerging Markets Finance* (Nov. 22, 2004), http://www.iif.com/press/press+3.php. These principles set forth "voluntary market-based guidelines for cooperative action in which borrowers and creditors alike recognize their mutual interest in pursuing dialogue and cooperative actions." Inst. of Int'l Fin., *Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets* 4 (Mar. 31, 2005), file:///C:/Users/dj4198/Downloads/principles-final_0305.pdf. The G-20 Finance Ministers and Central Bank Governors officially commended those principles as a basis for strengthening crisis prevention and crisis management. *See* Communiqué, Meeting of Finance Ministers and Central Bank Governors (Nov. 21, 2004), https://www.g20.org/sites/default/files/g20_resources/library/Communique_of_Finance_Ministers_and_Central_Bank_Governors_Berlin_Germany_20_21_November_2004.pdf.[6]

The system has functioned reasonably well in practice. According to the IMF, from 2003 to 2013 at least 13 sovereign states restructured their public debt. IMF, *Sovereign Debt Restructuring*, *supra*, at 22.

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[6] The Principles Consultative Group has recently refined the principles and simply renamed them, the "Principles for Stable Capital Flows and Fair Debt Restructuring." Inst. of Int'l Fin., *Principles for Stable Capital Flows and Fair Debt Restructuring* (Oct. 12, 2013).

The key pillar of this informal system is the ability of the distressed sovereign to exchange its defaulted debt for new debt. This requires creditors to accept voluntarily the terms of the new debt, which include a reduction in amounts originally owed. Simply put, if creditors will not voluntarily exchange their defaulted debt, the system cannot function effectively.

One important incentive for creditors is the limited universe of assets available for execution of judgments resulting from the execution provisions of the FSIA, similar statutes in other countries, as well as the international law of immunity from execution applied in civil law jurisdictions. Yet, the lower courts' injunctions in this case attack this key pillar of the international system. They will undermine future restructuring efforts by discouraging creditors from voluntarily exchanging defaulted debt. Bondholders agree to accept exchange bonds that pay less because at least they pay something, whereas defaulted debt pays nothing. But if entities holding a minority of the defaulted bonds can obtain an injunction prohibiting the distressed state from paying even the exchange bonds unless it makes ratable payments to holdouts, bondholders have much less incentive, if any, to exchange voluntarily in the first place. The threat of injunctions like the ones here creates a material risk that exchange bondholders would agree to accept less than they are owed, only to receive nothing after a ratable payments injunction issues. After all, under the Second Circuit's theory, the country is free to pay no creditors.

Indeed, the IMF has already endeavored to address this risk. More than a decade ago, the IMF determined that the system would not be secure if uncooperative creditors held even much weaker means to frustrate an orderly restructuring. From 1989 to 1999, the IMF policy permitted disbursement of IMF funding only if (i) negotiations between the state and its private creditors *had begun*, and (ii) there were *firm indications* that a sovereign borrower and its private creditors will negotiate in good faith on a debt restructuring plan. IMF, *Policy on Lending into Arrears to Private Creditors* 1 (June 14, 1999), https://www.imf.org/external/pubs/ft/privcred/lending.pdf.

In 1999, the IMF Executive Board determined that even these two modest requirements "may be too restrictive and could lead to instances in which creditors (particularly bondholders) could exercise a de facto veto over Fund lending." *Id.* at vii. Accordingly, the IMF Executive Board changed the policy to require that the distressed state instead engage in "a 'good faith effort' to reach a collaborative agreement with its private creditors." *Id.* at vii-viii. Lamentably, the injunctions at issue here restore the situation the IMF was so careful to avoid—the prospect of private bondholders dictating the fate of a nation's debt restructuring and economic recovery.

Given the number and volume of restructurings under the informal system that has developed over the past several decades, the destabilizing impact of the decisions below amply justifies this Court's review.

III. THE SECOND CIRCUIT IS WRONG THAT COLLECTIVE ACTION CLAUSES WILL PREVENT FUTURE CASES LIKE THIS ONE

The Second Circuit erroneously discounted the prospect and gravity of disrupting the existing framework for resolution of sovereign defaults. It concluded that the recent emergence of collective action clauses ("CACs") in sovereign bonds will obviate the need for coercive judicial measures in the future. This assessment betrays a fundamentally flawed understanding of CACs. Properly understood, CACs do not ensure that "cases like this one are unlikely to occur in the future." *NML Capital, Ltd. v. Republic of Argentina* ("*NML Capital III*"), 727 F.3d 230, 247 (2d Cir. 2013). In fact, injunctions are a game-changer against which CACs provide no protection. If upheld in this case, the injunctions will cast a shadow over the entire global sovereign debt market.

A. The Second Circuit Incorrectly Theorized that Collective Action Clauses in Sovereign Bonds Would Preclude Future Implications for Sovereign Debt Restructurings

The Second Circuit rejected warnings from the United States that the injunctions would jeopardize future sovereign debt restructurings. The court determined that, in its view, coercing a sovereign state to make ratable payments on defaulted bonds would not "have the practical effect of enabling 'a single creditor to thwart the implementation of an internationally supported restructuring plan,' as the United States contends." *NML Capital II*, 699 F.3d at 263-64 (quoting United States Amicus Brief of April 4, 2012 at 5, 2012 WL 1150791, at *5).

Rather, according to the Second Circuit, "*cases like this one are unlikely to occur in the future* because Argentina has been a uniquely recalcitrant debtor and *because newer bonds almost universally include collective action clauses*." *NML Capital III*, 727 F.3d at 247 (emphases added). The Second Circuit reasoned, incorrectly, that "a restructuring failure on one series" of bonds with CACs "would still allow restructuring of the remainder of a sovereign's debt." *Id.*

The Second Circuit's assumption that CACs will prevent the holdout problem presented in this case reflects a fundamental misunderstanding of the nature of CACs.[7]

B. The United States Correctly Cautioned About the Serious and Foreseeable Risks that the Injunctions Pose for Future Sovereign Debt Restructurings

A typical CAC enables a qualified majority of bondholders of one series of bonds, typically 75% of holders (based on the total principal amount in the series), to restructure the terms of every bond within the same series. *See* IMF, *Sovereign Debt Restructuring*, *supra*, at 14, box 1. Brazil began including CACs in its bonds in 2003, and they have followed this mold.

States issue bonds in various series. Brazil, for example, currently has 23 series of outstanding bonds

[7] The Second Circuit's other justification for its unprecedented approach—that "Argentina has been a uniquely recalcitrant debtor"—is similarly misguided. *NML Capital III*, 727 F.3d at 247. The pari passu clause makes no distinction for "unique recalcitrance." Nor does the FSIA. *See* 28 U.S.C. § 1609. Brazil expresses no views on the specific tactics pursued by Argentina in its negotiations, but the key point is that there is no justification for departure from established law and policy reflected in the FSIA, which undergirds the current informal international system for sovereign debt restructuring by limiting the universe of assets available for execution thereby incentivizing participation in voluntary debt restructuring.

governed by New York law.[8] Since CACs operate only on one series of bonds, creditors can capture an individual issue. Once a sovereign default is imminent or already has occurred, creditors are able to acquire bonds at deep discounts, making capture relatively inexpensive compared to the potential reward. This is because under a typical CAC, the most a creditor would need to acquire to achieve veto power for a single issue is 25% of the total face value for the series, and would-be holdouts can target a series with low outstanding amounts. Taking Brazil as an example, an investor could obtain a blocking position in the Global Bond 2024 Series B, with an outstanding principal amount of $664 million, by purchases at a discount without spending an inordinate amount of capital.[9]

The Second Circuit declared that "a restructuring failure on one series would still allow restructuring of the remainder of a sovereign's debt." *NML Capital III*, 727 F.3d at 247. Prior to the introduction of the injunctions issued and upheld in the courts below, this might have been true: a state could restructure its bond series that were not captive to holdouts, and then decide, if it wished, the value of conceding different terms to holdout creditors.

The injunctions issued below, however, are a game-changer. Now, holdouts not only can "free ride" on the sacrifice of creditors who restructure bonds in default, but also can hold those same creditors as financial hostages, *after* the restructuring. Payments from the

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[8] Federative Republic of Brazil Ex-99. (D) to Form 18-K (Aug. 27, 2013), *available at* https://www.sec.gov/Archives/edgar/data/205317/000119312513347232/d589021dex99d.htm.

[9] *Id.*

sovereign state to holders of restructured bonds will face the risk of becoming contingent on "ratable payments" to holdout creditors. According to the courts below, "ratable payments" would require paying 100% of the amount nominally due, which typically would be the sum of principal and interest.

Creditors of sovereign states—especially creditors who are present during and shortly after a restructuring—are sophisticated investors. Those creditors may have learned from the holders of restructured Argentine bonds, many of whom participated in the proceedings below. In the future, creditors will not voluntarily subject themselves to the status of contingent creditors, while holdouts reap rewards for non-cooperation with a sovereign default recovery program. To the contrary, rational investors likely will prefer to wield a pari passu clause and a motion for injunctive relief, rather than participate in an orderly, consensual restructuring process, conducive to sustainable recovery.

Even the development of "aggregation clauses," which have become standard in Eurozone sovereign bonds, does not resolve this problem.[10] Aggregation clauses are CAC variants that allow bondholders, acting collectively across multiple series of bonds, the possibility to bind every series issued under the same

[10] As of January 1, 2013, all new Eurozone government securities of maturity greater than one year must include CACs. Treaty Establishing the European Stability Mechanism art. 12, Feb. 2, 2012, *available at* http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf. Under the standard terms of reference, those CACs include an aggregation clause. Europa Econ. & Fin. Comm., Subcomm. on EU Sovereign Debt Mkts., *Common Terms of Reference*, http://europa.eu/efc/sub_committee/pdf/cac_-_text_model_cac.pdf.

trust indenture or deed. These clauses typically carry a voting threshold of 75% for the aggregate vote (across all series), which, if achieved, is then subject to approval from 66.7% of each series, for a given series to become bound. *See* IMF, *Sovereign Debt Restructuring*, *supra*, at 14, box 1. In this scenario, a holdout would need 33.3% of face value, rather than 25%, to obtain a veto power, only a marginal difference.

In the new legal framework that the courts below have imposed, the obstacle to obtaining requisite approval levels for a sovereign debt restructuring will not be "transaction costs and other procedural inefficiencies," as the Second Circuit suggested. *NML Capital III*, 727 F.3d at 247 (internal quotation marks omitted). Rather, the obstacle to the orderly resolution of sovereign debt defaults will be the threat of coercive judicial measures addressed to sovereigns and extended to financial institutions and clearing organizations. This development promises to upend the cooperative sovereign default resolution process that developed across multiple decades, with the support of the IMF, the United States, and the international community, including Brazil.

CONCLUSION

The Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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