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Materials Packet 2

THE INTERNATIONAL FINANCIAL SYSTEM: SOVEREIGN BORROWERS

SOVEREIGN BORROWERS AND ISSUERS: RISKS AND RISK ASSESSMENT

Sovereigns participate in the financial markets in different ways. They issue debt securities in their domestic markets,[1] but foreign investors may also buy government securities. US Treasury securities are particularly attractive to foreign investors. The US has benefited significantly from the fact that the US dollar is the reserve currency, so US securities are attractive to foreign investors:

The long-term increase in intermediation, by facilitating the financing of ever-wider current account deficits and surpluses, has created an ever-larger class of investors who might be willing to hold cross-border claims. To create liabilities, of course, implies a willingness of some private investors and governments to hold the equivalent increase in claims at market-determined asset prices. Indeed, were it otherwise, the funding of liabilities would not be possible.
With the seeming willingness of foreigners to hold progressively greater amounts of cross-border claims against U.S. residents, at what point do net claims (that is, gross claims less gross liabilities) against the

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

United States become unsustainable and deficits decline? Presumably, a U.S. current account deficit of 5 percent or more of GDP would not have been readily fundable a half-century ago or perhaps even a couple of decades ago.. The ability to move that much of world saving to the United States in response to relative rates of return would have been hindered by a far lower degree of international financial intermediation. Endeavoring to transfer the equivalent of 5 percent of U.S. GDP from foreign financial institutions and persons to the United States would presumably have induced changes in the prices of assets that would have proved inhibiting.....

How much further can international financial intermediation stretch the capacity of world finance to move national savings across borders?

A major inhibitor appears to be what economists call "home bias." Virtually all our trading partners share our inclination to invest a disproportionate percentage of domestic savings in domestic capital assets, irrespective of the differential rates of return. People seem to prefer to invest in familiar local businesses even where currency and country risks do not exist. For the United States, studies have shown that individual investors and even professional money managers have a slight preference for investments in their own communities and states. Trust, so crucial an aspect of investing, is most likely to be fostered by the familiarity of local communities. As a consequence, home bias will likely continue to constrain the movement of world savings into its optimum use as capital investment, thus limiting the internationalization of financial intermediation and hence the growth of external assets and liabilities”.[2]

By the end of 2005 foreign investors were still willing to fund the US current account deficit. Alan Greenspan again commented on this phenomenon:

“The rise of the U.S. current account deficit over the past decade appears to have coincided with a pronounced new phase of globalization that is characterized by a major acceleration in U.S. productivity growth and the decline in what economists call home bias. In brief, home bias is the parochial tendency of persons, though faced with comparable or superior foreign opportunities, to invest domestic savings in the home country. The decline in home bias is reflected in savers increasingly reaching across national borders to invest in foreign assets. The rise in U.S. productivity growth attracted much of those savings toward investments in the United States. The greater rates of productivity growth in the United States, compared with still-subdued rates abroad, have apparently engendered corresponding differences in risk-adjusted expected rates of return and hence in the demand for U.S.-based assets.

Home bias implies that lower risk compensation is required for geographically proximate investment opportunities; when investors are familiar with the environment, they perceive less risk than they do for objectively comparable investment opportunities in far distant, less familiar environments...

...starting in the 1990s, home bias began to decline discernibly, the consequence of a dismantling of restrictions on capital flows and the advance of information and communication technologies that has effectively shrunk the time and distance that separate markets around the world. The vast improvements in these technologies have broadened investors' vision to the point that foreign investment appears less

[2] *See*, *e.g.*, Alan Greenspan, Remarks on Globalization, Berlin, Jan 13, 2004, at http://www.federalreserve.gov/BoardDocs/Speeches/2004/20040113/default.htm (Footnotes omitted)

risky than it did in earlier times....

Home bias, of course, is only one of several factors that determine how much a nation actually saves and what part of that saving, or of foreign saving, is attracted to fund domestic investment. Aside from the ex ante average inclination of global investors toward home bias, the difference between domestic saving and domestic investment--that is, the current account balance--is determined by the anticipated rate of return on foreign investments relative to domestic investments as well as the underlying propensity to save of one nation relative to that of other nations...

...What is special about the past decade is that the decline in home bias, along with the rise in U.S. productivity growth and the rise in the dollar, has engendered a large increase by U.S. residents in purchases of goods and services from foreign producers. The increased purchases have been willingly financed by foreign investors with implications that are not as yet clear.

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

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

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

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

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

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

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

...Regrettably, we do not as yet have a firm grasp of the implications of cross-border financial imbalances. If we did, our forecasting record on the international adjustment process would have been better in recent years. I presume that with time we will learn."[3]

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

"The domestic government bond market has expanded rapidly in Mexico since the mid-1990s. In part, this has reflected a conscious effort by the authorities to develop domestic sources of financing as a means of reducing the country's dependence on external capital flows. The abrupt withdrawal of external capital in late 1994, in what became widely known as the "tequila crisis", resulted in a deep economic and financial crisis in Mexico. This made policymakers acutely aware of the vulnerabilities associated with a heavy reliance on external financing....

...The tequila crisis of late 1994 was a good example of the risks of relying heavily on dollar-indexed securities. The early 1990s had been characterised not only by a substantial appreciation of the Mexican peso but also by a significant deterioration of the country's current account in spite of steadily improving public sector finances ... The rapid growth in Mexico's external liabilities created rising fears among investors that the country would have to devalue and/or default on its obligations. During the course of 1994, investors became increasingly reluctant to roll over their short term peso-denominated cetes and instead shifted their funds to short-term dollar-indexed tesobonos. This provided a temporary respite for the government, but the short-term nature of outstanding securities also meant that the transformation in the structure of debt towards tesobonos was extremely rapid. Whereas tesobonos had accounted for about 4% of domestic debt at the beginning of 1994, they accounted for most of that debt at the end of that year. The sudden withdrawal of foreign investment from the domestic market at the end of 1994 and the ensuing sharp drop in the Mexican peso resulted in an explosive growth in the peso value of dollar-indexed government liabilities, thereby adding a fiscal dimension to the external crisis. The

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[3] Alan Greenspan, International Imbalances, Remarks before the Advancing Enterprise Conference, London, England (December 2, 2005) *available at* http://www.federalreserve.gov/boarddocs/speeches/2005/200512022/default.htm

withdrawal of foreign investment led to severe financial instability, followed by a protracted recession."[4]

Despite these risks countries often want to make their securities attractive to foreign investors. Countries other than the US can make their own debt securities more attractive to foreign investors than they would otherwise be by issuing them denominated in US$ rather than in their own domestic currencies.[5] Issuing foreign currency denominated securities also allows countries to build their foreign exchange reserves.[6] Here is a description of Canada Notes (one type of foreign currency denominated security issued by Canada):

Canada Notes are promissory notes usually denominated in US dollars and available in book-entry form. They are issued in denominations of US$1,000 and integral multiples thereof. At present the aggregate principal amount outstanding issued under the program is limited to US$10.0 billion. Notes can be issued for terms of nine months or longer, and can be issued at a fixed or a floating rate.
The interest rate or interest rate formula, issue price, stated maturity, redemption or repayment provisions, and any other terms are established by the Government of Canada at the time of issuance of the notes and will be indicated in the Pricing Supplement. Delivery and payment for Canada Notes occur through the Bank of New York.
The notes are offered by the Government through five dealers: Credit Suisse First Boston Corporation, Goldman, Sachs & Co., Lehman Brothers Inc., Nesbitt Burns Securities Inc. and Scotia Capital Markets (USA) Inc. The Government may also sell notes to other dealers or directly to investors.
Canada Notes are issued for foreign exchange reserve funding purposes only.[7]

The currency in which a debt security is denominated is only one factor investors need to consider. Some sovereign issuers are economically sounder than others. The pricing of the

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

[5] International organisations may also issue US$ denominated securities, see, e.g., http://treasury.worldbank.org/web/pdf/GDIFprospectus.pdf as may foreign corporates. Sovereigns outside the euro area such as Venezuela and China have issued euro denominated debt. *See, e.g.*, European Central Bank, Review of the International Role of the Euro, 15-16 (December 2005) *available at* http://www.ecb.int/pub/pdf/other/euro-international-role200512en.pdf

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

[7] http://www.fin.gc.ca/invest/instru-e.html

debt securities should reflect their risk as an investment: economically sound issuers do not need to offer as high an interest rate to attract investors as issuers in a weaker financial position. But there may be a risk that a sovereign issuer will not in fact make the payments of interest or principal it has committed to make. This risk is called "**country risk**".[8] Investors in foreign government securities need to understand the level of risk they will be exposed to in investing. The FDIC, looking at country risk from the perspective of the banks it is involved in regulating,[9] has described country risk as: "the risk that economic, social and political conditions in a foreign country might adversely affect a bank's financial interests."[10] Country risk "includes the possibility of deteriorating economic conditions, political and social upheaval, nationalization and expropriation of assets, government repudiation of external indebtedness, exchange controls, and currency depreciation or devaluation."[11]

Ratings agencies such as Moodys, Standard & Poors[12] and Fitch Ratings assign ratings to sovereigns as they do to bonds issued by corporates. These ratings may affect the amount of capital banks need when lending to sovereigns,[13] and the investment decisions of investors and the pricing of sovereign debt:

"Sovereign credit ratings reflect a country's willingness and ability to repay its sovereign debts. More broadly, a country's sovereign credit rating is a key indicator of its financial system development and openness. Indeed, sovereign credit ratings are strong predictors of a country's equity market returns and valuations .... And... sovereign credit ratings are (not surprisingly) also strongly related to the cost of government borrowing...
We find strong support for our views that macroeconomic, development, and legal environment variables

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[8] http://www.investopedia.com/terms/c/countryrisk.asp : "The risk that a country will not be able to honor its financial commitments."

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

[10] http://www.fdic.gov/news/news/financial/2002/fil0223.html

[11] Guide to the Interagency Country Exposure Review Committee Process, 1 (Nov.1999) *available at* http://www.fdic.gov/regulations/safety/guide/Icerc.pdf

[12] *See, e.g.*, Standard & Poors, Sovereign Credit Ratings: A Primer (November 2004).

[13] The new Basle approach to bank capital adequacy (which we will look at later) takes account of sovereign ratings by credit rating agencies. *See, e.g.*, Gregory D Sutton, Potentially Endogenous Borrowing and Developing Country Sovereign Credit Ratings, 1, Financial Stability Institute Occasional Paper No. 5 (July 2005) *available at* http://www.bis.org/fsi/fsipapers05.pdf#search='sovereign%20ratings'

affect country credit ratings, but little support for a “legal origin” effect. We find that, ceteris paribus, GDP per capita, inflation, foreign debt, our underdevelopment index, and each legal environment variable all have a strongly significant statistical relationship with sovereign credit ratings. Higher GDP per capita, lower inflation, lower foreign debt per GDP, better development, and higher scores for voice of the people, political stability, government effectiveness, regulatory quality, rule of law, and corruption control all relate to better credit ratings. After controlling for other factors, legal origin indicators do not have a significant impact on credit ratings.”[14]

Standard and Poors has described its approach to rating sovereigns in a **Sovereign Credit Ratings Primer** [15]as follows:

Political risk.
The first of the 10 analytical categories in the sovereign ratings methodology profile (see "Sovereign Ratings Methodology Profile," above) is political risk. The stability, predictability, and transparency of a country's political institutions are important considerations in analyzing the parameters for economic policymaking, including how quickly policy errors are identified and corrected. The separation of powers, particularly judicial, is an important factor, as is the development of civil institutions, particularly an independent press. Standard & Poor's examines the degree to which politics is adversarial and the frequency of changes in government, as well as any public security concerns. Relations with neighboring countries are studied with an eye toward potential external security risk. National security is a concern when military threats place a significant burden on fiscal policy, reduce the flow of potential investment, and put the balance of payments under stress.
A political risk ranking of "1" for most EU sovereigns reflects the broad public backing for their open political frameworks, in which popular participation is high, the process of succession is clear, and the conduct of government is transparent and responsive to changing situations. Well-established institutions provide transparency and predictability, particularly with regard to property rights, in a relatively efficient manner. At the weaker end of the scale, political institutions may have a short track record and/or be considerably less open and effective. Political decision-making processes may be highly concentrated, or a significant portion of the population may be marginalized. There may be internal divisions along racial or economic lines, some geopolitical risk, or public security concerns. Political and external shocks are more likely to disrupt economic policy than at higher rankings. For example, the Republic of Indonesia's short track record with democracy, its problems with secessionist movements and terrorist-related bombings, its sometimes strained relationship with its donor group over economic policy and military reform, and the divisions between the indigenous and Chinese populations result in a weak political-risk ranking.

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[14] Alexander W. Butler & Larry Fauver, Legal and Economic Determinants of Sovereign Credit Ratings (Jan. 3, 2005) *available at* http://www.fma.org/Chicago/Papers/SovCreditRating.pdf#search='sovereign%20ratings'

[15] Standard & Poors, Sovereign Credit Ratings: A Primer (Mar. 15, 2004) available at http://info.worldbank.org/etools/docs/library/139503/S&P_Primer.pdf .

Income and economic structure.

The second of the 10 sovereign criteria categories is economic structure. Due to its decentralized decision making processes, a market economy with legally enforceable property rights is less prone to policy error and more respectful of the interests of creditors than one where the public sector dominates. Market reform in the transition economies of Central and Eastern Europe has brought the economic structure scores of the Republics of Slovenia and Hungary and the Czech Republic (among others) to, or close to, those of Western European sovereigns, whose market economies are well entrenched. Rankings in this category are highly correlated with per capita GDP, with a negative adjustment made for narrow economies, weak or less-developed financial systems, and wide income disparities. Weaker rankings may also reflect highly leveraged or undeveloped private sectors, structural impediments to growth, and large and somewhat inefficient public sectors.

For countries undertaking substantial economic reform, the sequencing of the various measures may be key to their effectiveness. While there have been successful variations, the most common starting point is the reduction of fiscal imbalances with the aim of macroeconomic stability; measures to improve labor market flexibility, to strengthen the domestic financial sector, and to open trade and services globally generally follow. Past economic crises, particularly in Asia in the late 1990s, suggest capital account liberalization should take place in conjunction with current account liberalization, but at an orderly pace that meshes with transparent progress in the other areas.

Economic growth prospects.

Standard & Poor's third analytical category for sovereign ratings is economic growth prospects. A government in a country with a growing standard of living and income distribution regarded as broadly equitable can support high public sector debt levels and withstand unexpected economic and political shocks more readily than a government in a country with a poor or stagnant economy. Trend growth exceeding 4.5% per year in the Republic of Estonia and a handful of other countries provides considerably more policy flexibility and a superior economic prospects ranking than Standard & Poor's ascribes to Japan, where economic growth prospects will remain comparatively weak until private sector restructuring is more entrenched... At top rating levels, the advanced level of development usually precludes high trend rates of growth. In what is commonly referred to as the speculative rating categories ('BB' and lower), growth is more likely to be erratic and suffer from structural impediments.... In its analysis of growth prospects, Standard & Poor's examines historical economic trends and projects into the future, based upon scrutiny of how fundamentals affecting investment and competitiveness have evolved.

Fiscal flexibility.

The fourth category in Standard & Poor's sovereign ratings methodology profile is fiscal flexibility, as measured by an examination of general government revenue, expenditure, and balance performance. Fiscal trends, along with methods of deficit financing and their inflationary impact, are important indicators of sovereign credit quality. Scores in this category are a function not only of surpluses and deficits, but also of revenue and expenditure flexibility and the effectiveness of expenditure programs. General government is the aggregate of the national, regional, and local government sectors, including social security and excluding intergovernmental transactions. Noncommercial off-budget and quasi-fiscal activities are included to the extent possible, with significant omissions noted.

Typically, the least-distortionary and most-growth-friendly tax system that also addresses equity concerns has a broad tax base and low tax rates. Sovereigns with strong scores in this category can adjust tax bases and rates without serious constitutional, political, or administrative difficulties. Effective expenditure programs provide the public services demanded by the population and the infrastructure and education levels needed to underpin sustainable economic growth, all within the confines of tax and fee resources and affordable financing. Procurement and tendering procedures are transparent. Arrears are quantified and deficits can be reconciled to trends in debt.

The Republic of Singapore receives a top score of "1" in the fiscal flexibility category, despite significant financing needs in its history, because astute investment in public infrastructure and an educated workforce have, over the past 40 years, transformed the country into a prosperous manufacturing- and service-based center. Lower scores are given where government money is not spent as effectively because of constitutional rigidities, political pressures, or corruption, and where revenue flexibility is constrained by already-high taxes or tax-collection difficulties. The environment is less conducive to sustainable economic growth and more suggestive of debt-servicing difficulties. The Republic of India's sizable deficits and limited revenue and expenditure flexibility give it a weak score in this category. As Chart 4 illustrates, deficits tend to be highest in the speculative-grade categories. Deficits may not be as high at the lowest rating levels ('B' and below), with the fiscal flexibility score affected more by quasi-fiscal activities, lack of transparency, and limited revenue and expenditure flexibility.

Pension obligations represent a fiscal pressure of growing significance for countries with rapidly aging populations. Standard & Poor's believes that the sovereign credit ratings of some highly rated EU members could begin to come under downward pressure over the medium term if there is no further fiscal consolidation and structural reform to counter the financial problems of aging societies ...

General government debt burden.

The fifth sovereign criteria category is the general government debt burden. Typically, governments borrow to finance combinations of consumption and investment that increase general government debt. Analysis of public finance is complicated by the fact that the taxation and monetary powers unique to sovereigns can permit them to manage widely varying debt levels over time. A sovereign such as Canada (with a substantial, albeit declining, debt burden but an unblemished track record of honoring debt obligations and a strong domestic capital market providing fairly low-cost financing) receives a better score in this category than some sovereigns in Latin America, which may have lower debt to GDP ratios but have higher and more variable debt-servicing burdens. Japan, the Kingdom of Belgium, and the Republic of Italy, all in the 'AA' range and among the most indebted of the rated sovereigns, bring the 'AA' median for general government debt above what one might expect... however, these countries have the wealth, level of development, and revenue-raising ability that allow their governments to support such high debt levels.

Off-budget and contingent liabilities.

Off-budget and contingent liabilities, the sixth sovereign criteria category, can be important rating considerations, with attention focused on the size and health of nonfinancial public sector enterprises (NFPEs) and the robustness of the financial sector. NFPEs pose a risk to the sovereign because they generally have been formed to further public policies and often suffer from weak profitability and low (or virtually nonexistent) equity bases, which leave them highly vulnerable to adverse economic circumstances. To varying degrees, NFPEs may collect and expend funds that further public policies outside of the budgetary process. If such quasi-fiscal activities are sizeable, the usefulness of general government statistics as an indicator of fiscal performance and position and the role of the government in the economy is diminished. Quasi-fiscal activities generate implicit contingent liabilities. The indebtedness of non self supporting NFPEs is a useful measure of the contingent liability, but account is also taken of profitable enterprises that price their products to further budgetary objectives, provide noncommercial services, and/or pay higher-than-commercial prices to suppliers.

The financial sector is a contingent liability because problems can impair a sovereign's credit standing when they lead to an official rescue of failing banks. The impetus to assist banks is strong when there is a systemic crisis, since banking-system soundness is essential to macroeconomic stability, effective demand management, and sustained economic growth. The sovereign foreign and local currency ratings of the Republic of Korea were sharply downgraded in 1997-1998, in part because of the escalating costs of supporting the country's banking sector. Standard & Poor's financial sector analysts regularly examine global financial sector risk ... and their assessments of the potential for a systemic crisis are a crucial input in this category of sovereign analysis. Public sector banks may weigh heavily in this category when they engage in various quasi-fiscal activities such as subsidized lending, bank rescue operations, or exchange-rate guarantees that are not provided for in the government's budget.

Modest off-budget and contingent liabilities provide the Kingdom of Denmark with a "1" ranking in this category. In contrast, the government of the People's Republic of China's heavy involvement in troubled state-owned enterprises and poor lending standards in its banking sector (albeit with some recent reform) justify a low ranking in this category.

Monetary flexibility.

Monetary flexibility, the seventh risk category in the sovereign ratings methodology profile, can be an important leading indicator of sovereign credit trends. Significant monetization of budget deficits often fuels price inflation, which can undermine popular support for a government and cause serious economic damage...a combination of rising commodity prices and higher deficits and debt burdens suggest potentially greater inflation going forward than the very low levels of the recent past.

In evaluating monetary flexibility, Standard & Poor's considers:

.. Price behavior in economic cycles and relative to trading partners;

.. The market orientation of monetary policy tools and the degree to which their effectiveness is facilitated by a transparent, well-developed, and well-regulated financial sector and debt market;

.. Institutional factors, such as the operational independence of the central bank; and

.. The compatibility of the exchange-rate regime with monetary policy goals.

The top ranking of "1" is assigned to the European Central Bank and the U.S., among others. Low inflation is supported by independent central banks pursuing sustainable monetary and exchange-rate policies, and monetary flexibility is bolstered by transparent and well-developed capital markets. On the other hand, the Central Bank of Russia's conduct of monetary policy is constrained by a weak financial sector and less sophisticated capital markets, and the country continues to be plagued by double-digit, albeit declining, inflation—resulting in a much-weaker monetary stability score.

In conjunction with enhancing monetary flexibility and the effectiveness of monetary tools, the depth and breadth of a country's capital markets can also act as an important discipline. A sovereign has fewer incentives to default on local currency obligations when they are held by a broad cross section of domestic investors, rather than concentrated in the hands of local banks. For this reason, the establishment of mandatory, privately funded pension funds in a number of countries (such as the Republic of Chile) helps bolster the sovereign's credit standing by creating an influential new class of bondholders. The experience of many Organization for Economic Cooperation and Development (OECD) countries suggests that, even when public debt is high, creditworthiness can be sustained over long periods when policymakers are responsive to constituencies with vested interests in safeguarding the internal value of money and financial contracts.

External liquidity.

The eighth risk category in the sovereign ratings methodology profile is external liquidity. Standard & Poor's balance-of-payments analysis focuses on the impact of economic policy upon the external sector, and on the external sector's structural characteristics. In the short run, the ability of policymakers to manage financial pressure from abroad depends partly upon the structure of the current and capital accounts. Yet, balance-of-payments pressures neither appear spontaneously nor reach large magnitudes for structural reasons alone. In most cases, they can be traced back to flawed economic policies. Standard & Poor's approach reflects the premise that the macroeconomic and microeconomic policies discussed earlier affect balance-of-payments behavior.

For this reason, the size of a country's current account deficit, which reflects the excess of investment over savings, may not by itself be an important rating consideration. The tendency for some countries to run current account surpluses and others to run current account deficits is well documented. It is the product of many factors, not all of them negative and not all related to government policies. Some of countries in Central and Eastern Europe that are slated for EU membership on May 1, 2004, run large current account deficits that are financed with little difficulty because they are not the byproduct of fiscal mismanagement. However, the Kingdom of Thailand's 1997 foreign exchange crisis is a sharp reminder that large current account deficits can also be a symptom of serious underlying weaknesses—in this case, a financial sector whose asset quality had weakened dramatically after years of rapid domestic credit growth. And, as the United Mexican States' 1995 debt servicing crisis illustrated, current account deficits are a concern when government policies result in a public sector external debt structure that is vulnerable to sudden changes in investor sentiment.

A key quantitative measure in this criteria category is the gross external financing gap (the current account deficit plus short-term liabilities to nonresidents, including deposits and principal due on medium- and longterm public and private sector debt) as a percent of usable foreign exchange reserves, ... The ratio tends to be below 100% for investment-grade sovereigns and above that for speculative-grade sovereigns. Factors that may mitigate the risk of a high financing gap include substantial foreign direct investment (FDI), particularly green-field, and expectations of stronger export growth, presumably the result of the investment that is contributing to the gap.

Usable foreign exchange reserves, which include only those reserves available for foreign exchange operations and repayment of external debt, usually act as a financial buffer for the government during periods of balance-of-payments stress. Whether a given level of reserves is, or is not, adequate is judged not only in relation to the gross external financing gap, but also to the government's financial and exchange rate policies and, consequently, the vulnerability of reserves to changes in current and capital

account flows. Reserves deposited with national banks, pledged as security, or sold forward in the exchange markets are not included in usable reserves. In addition, for sovereigns that have adopted a currency board or have a long-standing fixed peg with another currency, some adjustment is made for the fact that a portion of reserves may be needed to underpin confidence in the exchange-rate link. The U.S. maintains very low reserves. It can do so because the U.S. dollar generally has floated against other currencies since 1971. The dollar's unique status as the key currency financing global trade and investment also reduces the need for gold and foreign exchange. Most other high-investment-grade sovereigns with floating currencies and little foreign currency debt also require relatively modest reserves.
...international liquidity is more critical at lower rating levels when, as is often the case, government debt is denominated in foreign currencies or significant amounts of local currency debt are held by cross border investors. Fiscal setbacks and other economic or political shocks can, consequently, impair financial market access. Most Latin American sovereigns fall into this category and, as a result, generally maintain above-average reserves.
Public and private sector external debt burdens.
The ninth and tenth sovereign criteria categories are the external debt burdens of the public and private sectors. Standard & Poor's examines each sovereign's external balance sheet, which shows residents' assets and liabilities vis-à-vis the rest of the world alongside an analysis of its balance-of-payments flows. The main focus is on trends in the public sector external debt position, the magnitude of the government's contingent liabilities, and the adequacy of foreign-exchange reserves to service both public and (particularly in a crisis) private sector foreign currency debt. To complete the picture, Standard & Poor's calculates an international investment position. This is the broadest measure of a country's external financial position. It adds the value of private sector debt and equity liabilities to public sector external indebtedness denominated in local and foreign currencies.
Public sector external debt includes the direct and guaranteed debt of the central government, obligations of regional and local governments, and the nonguaranteed debt of other public sector entities. Net public sector external debt equals total public sector external debt minus public sector external financial assets, including usable reserves. To measure the magnitude of the public sector external debt burden, Standard & Poor's compares it to current account receipts (CAR) (proceeds from exports of goods and services along with investment income and transfers received from nonresidents).... The presence in the 'A' category of a few sovereigns with public sectors in strong net external creditor positions (in particular, the Republic of Botswana, the Czech Republic, the Hong Kong Special Administrative Region, the State of Kuwait, and the Kingdom of Saudi Arabia) keep the 'A' debt burden below what one might otherwise expect. However, the ratings of these sovereigns are constrained by a combination of geopolitical risk, economic concentration, and other factors.

Sovereigns do default, and foreign investors in their debt suffer losses as a result. This how **Donald Powell** (at the time Chairman of the FDIC and now the Federal Gulf Coast Recovery Coordinator)[16] described Argentina's recent crisis:

[16] http://www.whitehouse.gov/news/releases/2005/11/20051101-6.html

Argentina's problems originated with overspending. After three years of rising fiscal deficits and unemployment, in 1999 foreign investors began to seriously question Argentina's ability to rein in its spending and repay its obligations under the peso-dollar peg. Argentina's country risk premium began to rise, leading domestic and foreign investors to pull money out of the country in massive country-wide bank runs. After IMF loan packages and debt swaps proved ineffective in stemming the exodus... the Argentine government resorted to restrictions on bank withdrawals and the largest sovereign default in history. Finally, in January 2002, Argentina suspended the peso-dollar peg. [17]

Where sovereign debtors find difficulty in meeting their commitments on existing debt obligations they may reschedule or restructure their debt, negotiating for changes in the terms of the debt. After Argentina declared a moratorium which affected bond issues, bondholders[18] sued Argentina in federal district court in the US and moved to certify a class action. Argentina argued that "the only really effective way to resolve a sovereign debt crisis ... is through voluntary debt restructuring." and that " to the extent bond litigation is expanded from suits by individual bondholders ... into one or more class actions, this will serve as a disincentive to participating in the debt restructuring effort and will interfere with that effort."[19] Despite this argument the court certified the class.

In 2004 Argentina announced proposed terms of a restructuring of its debt[20] and the debt restructuring plan was carried out in early 2005.[21] Many bondholders were unhappy about

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[17] Powell speech, note 9 above. See also the chronology at http://www.standardandpoors.com/europe/francais/Fr_news/The-Argentine-Crisis-Chronology2_07-06-02.html . The bank freeze was relaxed in December 2002. See, e.g., http://news.bbc.co.uk/1/hi/business/2535539.stm

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

[19] *H.W. Urban GmbH* v *Republic of Argentina* 2003 U.S. Dist. LEXIS 23363 at p 4 (SDNY 2003). The SDNY granted partial summary judgment in this case in 2006. *H.W. Urban GmbH* v. *Republic of Argentina*, 2006 U.S. Dist. LEXIS 9668 (SDNY 2006). See also http://www.argentinaclassaction.com/ . Contrast *Allan Applestein Ttee Grantor Trust* v *Republic of Argentina* 2003 U.S. Dist. LEXIS 7837.

[20] http://www.argentinedebtinfo.gov.ar/documentos/amendment_10-6-04_finalisimo.pdf

[21] *See, e.g.*, Argentina's Debt Restructuring: a Victory by Default?, The Economist (Mar 3rd 2005) *available at* http://www.economist.com/business/displayStory.cfm?story_id=3715779&no_na_tran=1

Argentina's offer.[22] A number of lawsuits involving bondholders have persisted since the restructuring.[23] During 2006 the SDNY has granted summary judgment in a number of cases.[24] One creditor is attempting to attach Argentine assets.[25]

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

"Argentina reserves the right, in its absolute discretion, to purchase, exchange, offer to purchase or exchange, or enter into a settlement in respect of any Eligible Securities that are not exchanged pursuant to the Offer (in accordance with their respective terms) and, to the extent permitted by applicable law, purchase or offer to purchase Eligible Securities in the open market, in privately negotiated transactions or otherwise. Any such purchase, exchange, offer to purchase or exchange or settlement will be made in accordance with applicable law. The terms of any such purchases, exchanges, offers or settlements could differ from the terms of the Offer. Holders of New Securities will be entitled to participate in any voluntary purchase, exchange, offer to purchase or exchange extended to or agreed with holders of Eligible Securities not exchanged pursuant to the Offer as described below..."[26]

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

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

[22] See, for example, the website of the Global Committee of Argentina Bondholders at http://www.gcab.org/pages/1/index.htm .

[23] As of April 2005 there were about 50 Argentina bondholder cases, involving over 285 plaintiffs, pending in the Southern District of New York. *See Lopez Fontana* v. *Republic of Argentina*, 415 F.3d 238 (2d. Cir 2005). *See also e.g.*, *Million Air Corp*. v. *Republic of Argentina*, 2005 U.S. Dist. LEXIS 23904 (SDNY 2005)

[24] *See, e.g.*, *Martinez* v *Argentina*, note 18 above.

[25] *Capital Ventures Int'l* v. *Republic of Argentina*, 443 F.3d 214 (2d. Cir 2006).

[26] See http://www.gcab.org/images/GCAB_Position_Paper_-_MFC_Clause_-_1-31-05.pdf

privately negotiated exchange or purchase on more favorable terms that is labeled a "settlement" would not trigger the MFC Clause.

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

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

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

Even if holders of the New Securities believe that the MFC Clause has been triggered, enforceability of the MFC Clause will be very difficult and onerous. According to the Prospectus Supplement, if Argentina breaches the MFC Clause and does not cure the breach within 90 days after it receives written notice thereof, the holders of New Securities can declare an event of default. To declare an event of default, holders of at least 25% of the aggregate principal amount of the debt securities of that series may, by written notice, declare the debt securities of that series to be immediately due and payable and such amounts will become immediately due and payable provided that the event of default is materially prejudicial to the interests of the holders of the debt securities of that series. Even if holders of the New Securities organize the requisite 25% threshold, actually stating a claim may be extremely difficult because of the ambiguity of the MFC Clause. In addition, due to the difficulties in organizing holders representing at least 25% of the aggregate principal amount of the debt securities, declaring an event of default under the New Securities will be a challenging process. Furthermore, even if an event of default is declared and the New Securities are accelerated, there is no guarantee that Argentina will actually pay. Finally, even if holders of New Securities organize and can prove a violation of the MFC Clause, Argentina has already shown its willingness to render itself immune from the enforcement of judgments in all major financial jurisdictions. As a result, if Argentina refuses to pay, then the holders that participate in the Offer will end up in the same position as they are today."[27]

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

[27] *Id.*

At the end of 2005 Argentina announced that it would repay its debt to the IMF in full.[28] In mid-2006 the World Bank announced a new programme of financial assistance to Argentina (adding to existing outstanding loans to Argentina). The World Bank said:

Notwithstanding the debt restructuring of June 2005 and the overall improvement in Argentina's debt profile, debt sustainability will remain a concern and an important source of risk. Even after the debt restructuring and repayment to the IMF, Argentina's total public debt remains high and the public debt service burden in the medium term significant, in the US$13 billion range per year. The US$24 billion in holdouts, US$3 billion in Paris club arrears, and contingent liabilities arising from the cases before ICSID all represent sources of potential increases in the debt service burden in the future, although the timetable for their resolution remains unclear. The 35 percent reduction in international reserves resulting from the early repayment of the IMF reduced the country's external liquidity, but reserves remain adequate to cover 100 percent of the money base and are again accumulating with continued Central Bank purchases of foreign exchange. Under the Government's medium-term macroeconomic framework, the public debt to GDP ratio is projected to decline steadily over the medium-term. [29]

Some commentators have written about "catalytic finance" suggesting that "the provision of official assistance to a country undergoing a financial crisis spurs other interested parties to take actions that mitigate the crisis. In particular, it rests on the premise that, under the right conditions, official assistance and private sector funding are strategic complements. That is, the provision of official assistance galvanizes the private sector creditors into rolling over short term loans, and thereby alleviating the funding crisis faced by the debtor country."[30] Others argue that the intervention of the IMF can increase moral hazard.[31] The picture of Argentina paying off the

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

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

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

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

IMF in full when private sector creditors were offered only a portion of what was owed to them raises some questions. It is worth noting that Argentina has issued dollar denominated debt securities since the restructuring:

On July 18, the Government issued US$1 billion of dollar-denominated bonds of eight years maturity. The cut-off price of the auction was 91 cents per dollar issued, which resulted in an annualized implicit return of 8 percent on average. The total demand was 54 percent higher than the amount issued....In March 2006 the Government issued US$500 million of Bonar V bonds in a market-priced auction. The Bonar V is a bullet bond denominated in US dollars of five years of maturity. The auction resulted in an implicit annual interest yield of 8.4 percent. About 80 percent of the new bonds were acquired by foreign banks. The total amount of bonds issued in 2006 as of end of March is US$2 billion. This includes the Bonar V and an additional US$1.5 billion of Boden 2012 issued to the Venezuelan Government. [32]

Corporates may also reschedule their debt if they have financial problems, but corporates do so in the shadow of domestic insolvency and administration regimes which do not exist for sovereigns. The IMF proposed an insolvency regime for sovereigns,[33] but the proposal was controversial and is not currently being pursued in any active way.[34] A section of these materials describes the proposal and the market-based solution which many commentators argued for, and which a G10 working group has endorsed[35] as an alternative. Another privately developed mechanism which may encourage investment in sovereign debt (including the debt of emerging market economies) is the credit default swap market.[36]

(debtor moral hazard). Also investors do not have the right incentives to diversify their risk and avoid investments in riskier countries when IMF support is readily available (creditor moral hazard)."

32 *Id*. at 84-5.

33 This proposal is considered below at page 58 ff.

34 *See*, *e.g.*, Communique of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, April 12, 2003, at http://www.imf.org/external/np/sec/pr/2003/pr0350.htm

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

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

In addition to using procedures for negotiating changes in the rights and obligations of sovereign borrowers and their creditors, some firms will invest (or speculate) in the distressed debt of sovereigns (or corporates). These firms may be described as "vulture funds"

VULTURE FUND CASES:
Elliott Associates, L.P.* v *The Republic of Panama (see page 19)
Elliott Associates, L.P.* v *Banco De La Nacion (see page 26)

The following two cases arose out of purchases of sovereign debt by a vulture fund. The cases are included partly because they contain descriptive material on international financial activity. The Brady Plan, described in both cases was a plan to facilitate restructuring of sovereign debt.[37] The cases are also included because they illustrate behaviour of holdout creditors and the debtors' attempt to block the holdout's attempt to receive payment. Notice how Elliott Associates acts in the context of this plan. Do you approve of Elliott Associates' actions? The first case (Panama) raises a number of different legal issues; the second case (Peru) is more focused. Identify the legal issues. Both cases illustrate how international financial transactions take place in a context where the relevant applicable legal rules are rules of domestic legal systems, rather than international rules. Consider the analysis of the application of the New York statute in both cases. Do you agree with the courts' interpretation of the statute? Do you agree with the Second Circuit's description of the policy reasons for allowing Elliott to enforce the debt in the Peru case? Are there any policy reasons that might point in the opposite direction?

Some of the issues raised by international financial transactions will be issues of interpretation of the contract(s) (see the Panama case), but other issues will be non-contractual (both cases). Parties to a transaction can negotiate the terms of their relationship, but their contracts exist within a legal environment which includes other rules. Parties to the transaction can negotiate which law is to be the proper law of the contract, and, if the court upholds this choice of law, that law will govern questions such as how to interpret the contract.[38] However rules of another legal system may apply to decide other questions (e.g. tort liability, liability for breach of fiduciary duties, statutes which disable a person from enforcing a contract under

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[37] *See*, *e.g.*, http://www.emta.org/emarkets/brady.html ("The basic tenets of the Brady Plan were relatively simple and were derived from common practices in domestic U.S. corporate work-out transactions: (1) bank creditors would grant debt relief in exchange for greater assurance of collectability in the form of principal and interest collateral; (2) debt relief needed to be linked to some assurance of economic reform and (3) the resulting debt should be more highly tradable, to allow creditors to diversify risk more widely throughout the financial and investment community. ")

[38] We will think about choice of law briefly later.

certain circumstances). So, if a firm such as Elliott Associates sued to enforce a debt in another jurisdiction (because the debtor had assets there) that other jurisdiction might have rules about champerty which were different from those in New York.

Elliott Associates, L.P. v *The Republic of Panama* [39]

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

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

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

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

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

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

Although I conclude that the doctrine of collateral estoppel does not bar Panama from asserting

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[39] 975 F. Supp. 332 (SDNY 1997)

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

BACKGROUND

A. The Agreements

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

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

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

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

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

B. Procedural History

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

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

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

DISCUSSION

A. Collateral Estoppel

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

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

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

B. Elliott's Breach of Contract Claim

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

1. The Timing of the Assignments

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

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

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

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

Panama's contention that the assignments to Elliott at issue in this case were not made until after October 20, 1995 is based solely on the two "Assignment Notices" submitted to Panama and the Agent from the Banks and Elliott... Both of these Assignment Notices are dated after October 20, 1995 and state that the assignments to Elliott take effect on dates after the Final Trading Date... The assignment from Swiss Bank is dated October 31, 1995 and states that the assignment "is effective October 31, 1995." The assignment from Citibank is dated November 6, 1995 and states that it "is effective from November 6, 1995." Panama argues that these documents show that Elliott and the Banks acknowledge that "they had assigned an interest in the 1982 Agreement after October 20, 1995." ...

The two assignment notices are insufficient to raise a genuine issue of fact, for the record shows clearly that the dates of the assignment notices are the dates the assignments were "settled." The dates of both notices, of course, precede the November 10, 1995 "settlement" date. A reasonable factfinder could only conclude that the assignment notices merely consummated -- or made effective -- trades that were made before the Final Trading Date.

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

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

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

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

2. Financial Institution

Under section 14.07 of the 1982 Agreement,

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

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

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

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

3. Champerty

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

Under section 489 of the New York Judiciary Law,

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

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

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

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

Panama argues that the assignments are champertous because, as it contends additional discovery would show, Elliott bought the loans with the sole or primary intent to sue. Panama has submitted no evidence to support that claim, however, other than its counsel's affidavit alleging that Newman and one of Elliott's attorneys have been engaging in a "pattern and practice" of buying defaulted debt on the secondary market and bringing suit on such debt... According to Panama, Elliott first purchased the debt at issue shortly after Paul Singer, Elliott's general partner, was solicited by Newman, and Newman has an oral agreement with Elliott by which he will obtain an undisclosed percentage of any profits Elliott wins in this suit... Even if all of these allegations are true, as Justice Gammerman held, they do not require an inference or determination that Elliott's actions were champertous...

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

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

It may be, as Panama alleges, that when Elliott purchased the loans, it had no intention of participating in the restructuring under the 1995 Financing Plan and that it hoped to gain an advantage thereby in negotiating with Panama for payment. Although one could reasonably quarrel with the seemliness of this investment strategy or the propriety in general of such "vulture fund" tactics as investing in distressed companies or loans, criminal statutes must be narrowly construed, and the purchase of a loan in the circumstances of this case surely does not rise to the level of criminal conduct.

Even assuming Elliott had no intention of participating in the 1995 Financing Plan, no reasonable factfinder could conclude that it spent $ 8 million just to enjoy the pleasures of litigation. To the contrary, clearly there were possibilities other than litigation when Elliott purchased the loans: (i) Elliott could have re-traded the loans on the market; (ii) Panama could have re-paid the loans in full; and (iii) Elliott and Panama could have agreed on a discount that would still have permitted Elliott to turn a profit. The fact that Elliott was prepared to file suit if none of these possibilities materialized did not render the assignments champertous....

Because no genuine issue of material fact exists to be tried with respect to any of Panama's defenses, Elliott's motion for summary judgment on its breach of contract claim is granted.

C. Panama's Counterclaim
The final issue is the viability of Panama's counterclaim for tortious interference with contract. Under New York law, to establish a claim of tortious interference with contract, a plaintiff must prove: (1) the existence of a contract; (2) defendant's knowledge thereof; (3) defendant's intentional inducement of a breach of that contract; and (4) damages...

Elliott argues that Panama's claim for tortious interference must be dismissed because Panama has failed, among other things, to demonstrate the existence of a genuine issue of fact with respect to the intent aspect of the third element. I agree. Hence, Elliott's motion for summary judgment is granted.

The intent required to sustain a claim for tortious interference with contract is "exclusive malicious motivation." ...The action must have been taken by the defendant "without justification, for the sole purpose of harming the plaintiffs."...

Here, a reasonable factfinder could only conclude that Elliott was not acting with "exclusive malicious motivation" or for the "sole purpose" of harming Panama. To the contrary, Elliott spent some $ 8 million. It did that not because it wanted to hurt Panama or interfere with Panama's contracts, but because of the most basic of motivations -- it wanted to make money. Elliott invested in the foreign debt because it was hoping to turn a profit.

Hence, no genuine issue of material fact exists as to the third element of tortious interference with contract and the counterclaim must be dismissed.

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

Elliott Associates, L.P. v *Banco De La Nacion* [40]

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

BACKGROUND

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[40] 194 F.3d 363 (2d. Cir, 1999).

Elliott is an investment fund with its principal offices located in New York City. Elliott was founded by Paul Singer in 1977 and he remains its sole general partner. One of the primary types of instruments that Elliott invests in is the securities of "distressed" debtors, that is, debtors that have defaulted on their payments to creditors. Singer testified that he invests in debt when he believes that the true or "fundamental" value of the debt is greater than the value accorded by the market. Elliott characterizes its approach to its investments as "activist." Thus, despite sometimes accepting the terms offered to other creditors, Elliott explains that it frequently engages in direct negotiations with the debtor and argues that, as a result, it has occasionally received a greater return than other creditors.

In August or September of 1995, Singer was approached by Jay Newman to discuss investing in distressed foreign sovereign debt. Newman, an independent consultant, had worked in the emerging market debt field at major brokerage houses Lehman Brothers, Dillon Read, and Morgan Stanley, as well as managing his own offshore fund, the Percheron Fund. The secondary market for such debt first developed in the early 1980s when the original lender banks began selling the non-performing debt of countries that had ceased servicing their external debt to other investors, including brokerage firms, in order to reduce the banks' exposure and to permit them to lend additional funds to developing countries. The Debtors submitted evidence at trial that, from 1993 onwards, Newman had acted with attorney Michael Straus to solicit investors and provide advice to offshore fund Water Street Bank & Trust Company, Ltd. ("Water Street"). The Debtors alleged that, at Water Street, Newman and Straus purchased the sovereign debt of Poland, Ecuador, Ivory Coast, Panama, and Congo, and filed lawsuits seeking full payment of the debt with Straus acting as the trial counsel. The Debtors' contention at trial in the instant case was that Newman and Straus moved to Elliott from Water Street because it was a good "substitute plaintiff" in that it specialized in the purchase of distressed assets, had funds available to invest, and, unlike Water Street, which had refused in discovery to disclose the names of its individual investors, was unconcerned about exposing the identity of its principals.

I.

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

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

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

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

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

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

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

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

II.

On October 18, 1996, ten days before the Exchange Agreement was scheduled to be executed, Elliott filed suit against the Debtors in New York Supreme Court and sought an ex parte order of prejudgment attachment. The Debtors subsequently alleged at trial that the reason for Elliott filing suit at that time was that the collateral for the Brady bonds was United States Treasury bonds, which were held at the Federal Reserve Bank of New York, and thus made suitable assets for attachment. The Exchange Agreement was finally executed on November 8, 1996.

Elliott's suit was subsequently removed to federal district court pursuant to the Foreign Sovereign Immunities Act, 28 U.S.C. § 1441(d) (1994), where the district court denied Elliott's motion for prejudgment attachment on December 27, 1996, and its motion for summary judgment on April 29, 1997. After discovery, the case was tried in a bench trial from March 17 to March 25, 1998, and final argument was heard on May 26, 1998.

On August 6, 1998, the district court issued its opinion dismissing Elliott's complaint on the ground that Elliott's purchase of the Peruvian debt violated Section 489 of the New York Judiciary Law. The district court found as a fact that "Elliott purchased the Peruvian debt with the intent and purpose to sue." ... The district court noted that Elliott had no familiarity with purchasing sovereign debt until it met

Newman, who together with Straus, had "a long history" in purchasing sovereign debt and suing on it... The district court further found that Elliott intentionally "delayed closing its purchases of Peruvian debt until the Second Circuit had clarified the litigation risks."... Moreover, the district court found that "Elliott did not seriously consider alternatives to bringing an action," including holding and reselling the debt, participating in Peru's privatization program, participating in the Brady Plan, or negotiating separately with the Debtors to obtain terms more favorable than the Brady terms... The district court found that "none of these alternatives was realistically considered by Elliott when it purchased Peruvian debt" and that "from the start, Elliott intended to sue and the testimony to the contrary was not credible." .. With respect to the letters sent by Elliott to the Debtors after purchasing the debt, the court found that these letters and the other accompanying steps to negotiate "were pretextual and never demonstrated a good faith negotiating position." ...

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

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

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

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

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

DISCUSSION

I. A.

As an initial matter, while in agreement that the district court's findings of fact are reviewed for clear error... the parties dispute the appropriate level of deference to be given to the district court's interpretation of Section 489 of the New York Judiciary Law. The Debtors urge that we follow this court's statement in Ewing v. Ruml, 892 F.2d 168 (2d Cir. 1989), that "[where] the interpretation of state law is made by a district judge sitting in that state, it is entitled to great weight and should not be reversed unless it is clearly wrong.".... Both Ewing and the other case relied upon by the Debtors for this proposition, Lomartira v. American Auto. Ins. Co., 371 F.2d 550 (2d Cir. 1967), were decided before the Supreme Court's decision in Salve Regina College v. Russell, 499 U.S. 225, 113 L. Ed. 2d 190, 111 S. Ct. 1217 (1991), which resolved a split among the Circuits on this very issue. In Salve Regina College, the Supreme Court expressly held that "a court of appeals should review de novo a district court's determination of state law." ... Subsequent appeals decided by this Circuit have thus accorded no deference to district court interpretations of state law, nor will we...

In determining the law of the State of New York, "we will consider not only state statutes but also state decisional law." ... "Where the law of the state is uncertain or ambiguous, we will carefully predict how the highest court of the state would resolve the uncertainty or ambiguity." ... Indeed, "a federal court is free to consider all of the resources to which the highest court of the state could look, including decisions in other jurisdictions on the same or analogous issues."...

B.

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

II. A.

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

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

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

B.

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

C.

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

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

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

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

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

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

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

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

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

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

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

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

The Court of Appeals reversed, explaining that:

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

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

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

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

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

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

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

D.

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

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

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

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

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

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

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

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

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

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

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

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

THE PARI PASSU CLAUSE IN BOND DOCUMENTATION

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

> The Notes rank, and will rank, pari passu in right of payment with all other present and future unsecured and unsubordinated External Indebtedness of the Issuer.[41]

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

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[41] Lee C. Buchheit, Jeremiah S. Pam, The *Pari Passu* Clause in Sovereign Debt Instruments, 1 (Working Paper 2003) available at http://www.law.georgetown.edu/international/documents/Pam.pdf#search='pari%20passu%20clause'

“Once cross-border lenders became aware that some legal systems permitted actions that had the effect of legally subordinating existing debt to other obligations of the borrower, in or out of bankruptcy, they needed contractual provisions that would (i) bring to light, at the time a new loan was being considered, whether such senior claims already existed in the borrower’s debt stock, and (ii) prevent the borrower from subsequently subordinating the new loan. Adapting the traditional pari passu clause was the answer...

Following its introduction into cross-border syndicated loans in the 1970s to deal with the risk of involuntary subordination, this new version of the pari passu clause prospered. For the last thirty years, it has been a standard feature of cross-border credit agreements for both corporate and sovereign borrowers.”[42]

They identify other purposes of the clause:

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

Our research suggests that had they been asked at the time (the 1970s onward) to justify the presence of a pari passu clause in an unsecured cross-border credit instrument with a sovereign borrower, contract drafters would have given three reasons: a lingering concern about the earmarking of assets, the danger that a foreign sovereign decree altering the legal ranking of existing debts might be given effect by a court outside of the debtor country and the risk of involuntary subordination through action by another lender. The opacity of the clause is explained by the fact that in the minds of the early Euromarket drafters, it was intended to protect lenders against all three, very different, risks. They thus saw a positive virtue in the vagueness of the phrase “pari passu in priority of payment.” As the decades moved on, one of these concerns (earmarking) was addressed through an expanded negative pledge clause in most cross-border credit instruments. A second risk (the effect of sovereign decrees) was addressed by judicial decisions. But the third (involuntary subordination through action by another lender) remains a serious concern for the cross-border lender, and the pari passu clause persists as the contractual mitigant for that risk.”[43]

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

“...how could a fallacious interpretation of a boilerplate clause -- without a basis in law, or practice or commentary -- have taken even a shallow root in the minds of some market participants? It is true that the text of the pari passu clause itself is remarkably unconfiding about what the drafters were seeking to achieve with the provision, but that only explains why it presented such an attractive target for creative

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[42] Id. at 26-7

[43] Id. at 31

explanations by litigants in search of an effective remedy against a sovereign debtor.
We believe that the ratable payment interpretation of the pari passu clause had an intuitive, almost an emotional, appeal to some people because it only seems fair that debtors not discriminate among similarly-situated creditors when faced with financial difficulties. And if a practice of differential payments just feels wrong, these people reasoned, then surely there must be something in the underlying instruments that forbids it? When a thorough search of the underlying instruments turned up no express prohibition against the making of differential payments, the last resort was to read such a prohibition into ...the pari passu clause.
The truth is that creditors do sometimes worry about cash-strapped borrowers discriminating among similarly-situated creditors in terms of payments and, when they do, there are a variety of documentary techniques for dealing with the problem. For example
• Sharing clauses are a nearly invariable feature of syndicated commercial bank loan agreements. The clauses were motivated by a concern that participating banks without an on-going business relationship with the borrower might be the first to feel a payment default, while the borrower's "house" banks continued to be paid. The sharing clause constitutes an intercreditor agreement among the banks in the syndicate to share any disproportionate payments or recoveries among themselves on a ratable basis.
• In many bond issues (including all publicly-issued corporate bond issues in the United States), the securities are issued pursuant to a trust indenture (in English practice, a trust deed). The trustee is obliged to distribute all payments or recoveries among bondholders on a strictly ratable basis. Indeed, in U.S. trust indenture practice most, and in English practice all enforcement actions against the borrower are centralized in the trustee so that the goal of ratable sharing of recoveries is preserved.
• Many project finance transactions, where several different types of lenders participate, call for an intercreditor agreement among the lenders to ensure ratable sharing of payments and losses.
• Intercreditor agreements are also frequently used in corporate debt workouts where the parties wish to keep the borrower out of a formal bankruptcy proceeding. Equal treatment of similar-situated creditors is, of course, a fundamental premise of most bankruptcy systems. Creditors desiring to replicate this feature in an out-of-court debt workout can do so by means of an intercreditor agreement that provides for ratable sharing of payments or recoveries.
• Subordination agreements are the instruments of choice when lenders to the same borrower want to establish legally-enforceable priorities that will take effect in, and sometimes out of, bankruptcy. These agreements come in many different varieties, but they all have one thing in common: they establish contractual payment priorities among creditors that would otherwise have equally-ranking claims against the borrower.
In short, lenders are indeed sometimes concerned about borrowers making differential payments to similarly-situated creditors. To this extent, the proponents of the ratable payment theory of the pari passu clause have accurately analyzed a sentiment in the creditor community. But when lenders wish to address this issue, they do so explicitly (and very often elaborately) in contracts or clauses that establish their right to receive ratable payments, as well as their remedies -- against the Borrower and against each other -- if they do not. Such intercreditor duties are not inferred merely by virtue of being a lender to the same borrower (under the "it's only fair" theory of intercreditor relationships), nor are they implied by a lender's equal legal ranking with other creditors or by a contractual promise by the borrower to

preserve that equal ranking."[44]

An argument that a pari passu clause could operate as a constraint on creditors requiring them, to ensure that other creditors were receiving payment when they did was rejected in the Southern District of New York in 2003 in *Nacional Financiera, S.N.C.* v. *Chase Manhattan Bank*:[45]

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

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

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

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

Note that it is possible to specify by contract that creditors who are parties to a particular contract will not seek to put themselves in a better position than other creditors or that they will share any benefit they obtain with other creditors.

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

[45] 2003 U.S. Dist. LEXIS 6160

SOVEREIGN IMMUNITY

Sovereign states benefit from immunity in courts of other states in relation to acts of sovereign authority.[46] In the US, the **Foreign Sovereign Immunities Act** (FSIA) governs foreign sovereign immunity. The statute contains a number of exceptions to the immunity which are relevant to international financial transactions.

28 USCS § 1602

Findings and declaration of purpose

The Congress finds that the determination by United States courts of the claims of foreign states to immunity from the jurisdiction of such courts would serve the interests of justice and would protect the rights of both foreign states and litigants in United States courts. Under international law, states are not immune from the jurisdiction of foreign courts insofar as their commercial activities are concerned, and their commercial property may be levied upon for the satisfaction of judgments rendered against them in connection with their commercial activities. Claims of foreign states to immunity should henceforth be decided by courts of the United States and of the States in conformity with the principles set forth in this chapter

§ 1603 Definitions

For purposes of this chapter -

(a) A "foreign state", except as used in section 1608 of this title, includes a political subdivision of a foreign state or an agency or instrumentality of a foreign state as defined in subsection (b).

(b) An "agency or instrumentality of a foreign state" means any entity -

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

(2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and

(3) which is neither a citizen of a State of the United States as defined in section 1332 (c) and (d) of this title, nor created under the laws of any third country.

(c) The "United States" includes all territory and waters, continental or insular, subject to the jurisdiction of the United States.

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

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

(e) A "commercial activity carried on in the United States by a foreign state" means commercial activity carried on by such state and having substantial contact with the United States

§ 1604 Immunity of a foreign state from jurisdiction

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

§ 1605. General exceptions to the jurisdictional immunity of a foreign state

(a) A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case--

(1) in which the foreign state has waived its immunity either explicitly or by implication, notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver;

(2) in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States;

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

(4) in which rights in property in the United States acquired by succession or gift or rights in immovable property situated in the United States are in issue;

(5) not otherwise encompassed in paragraph (2) above, in which money damages are sought against a foreign state for personal injury or death, or damage to or loss of property, occurring in the United States and caused by the tortious act or omission of that foreign state or of any official or employee of that foreign state while acting within the scope of his office or employment; except this paragraph shall not apply to--

(A) any claim based upon the exercise or performance or the failure to exercise or perform a discretionary function regardless of whether the discretion be abused, or

(B) any claim arising out of malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract rights;

(6) in which the action is brought, either to enforce an agreement made by the foreign state with or for the benefit of a private party to submit to arbitration all or any differences which have arisen or which may arise between the parties with respect to a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration under the laws of the United States, or to confirm an award made pursuant to such an agreement to arbitrate, if (A) the arbitration takes place or is intended to take place in the United States, (B) the agreement or award is or may be governed by a

treaty or other international agreement in force for the United States calling for the recognition and enforcement of arbitral awards, (C) the underlying claim, save for the agreement to arbitrate, could have been brought in a United States court under this section or section 1607, or (D) paragraph (1) of this subsection is otherwise applicable; or

(7) not otherwise covered by paragraph (2), in which money damages are sought against a foreign state for personal injury or death that was caused by an act of torture, extrajudicial killing, aircraft sabotage, hostage taking, or the provision of material support or resources (as defined in section 2339A of title 18) for such an act if such act or provision of material support is engaged in by an official, employee, or agent of such foreign state while acting within the scope of his or her office, employment, or agency, except that the court shall decline to hear a claim under this paragraph--

(A) if the foreign state was not designated as a state sponsor of terrorism under section 6(j) of the Export Administration Act of 1979 (50 U.S.C. App. 2405(j)) or section 620A of the Foreign Assistance Act of 1961 (22 U.S.C. 2371) at the time the act occurred, unless later so designated as a result of such act or the act is related to Case Number 1:00CV03110(EGS) in the United States District Court for the District of Columbia; and

(B) even if the foreign state is or was so designated, if--

(i) the act occurred in the foreign state against which the claim has been brought and the claimant has not afforded the foreign state a reasonable opportunity to arbitrate the claim in accordance with accepted international rules of arbitration; or

(ii) neither the claimant nor the victim was a national of the United States (as that term is defined in section 101(a)(22) of the Immigration and Nationality Act [8 USCS § 1101(a)(22)]) when the act upon which the claim is based occurred.

§ 1609 Immunity from attachment and execution of property of a foreign state[47]

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

§ 1610. Exceptions to the immunity from attachment or execution

(a) The property in the United States of a foreign state, as defined in section 1603(a) of this chapter, used for a commercial activity in the United States, shall not be immune from attachment in aid of execution, or from execution, upon a judgment entered by a court of the United States or of a State after the effective date of this Act, if--

(1) the foreign state has waived its immunity from attachment in aid of execution or from execution either explicitly or by implication, notwithstanding any withdrawal of the waiver the foreign state may purport to effect except in accordance with the terms of the waiver, or

(2) the property is or was used for the commercial activity upon which the claim is based, or

(3) the execution relates to a judgment establishing rights in property which has been taken in violation

[47] In December 2005 the Northern District of Illinois held that it was for the foreign sovereign to invoke this immunity and that others who held the foreign sovereign's property (a museum and a university) could not do so. *Rubin* v. *Islamic Republic of Iran*, 2005 U.S. Dist. LEXIS 33675 (N.D.Ill. 2005)

of international law or which has been exchanged for property taken in violation of international law, or
...
(5) the property consists of any contractual obligation or any proceeds from such a contractual obligation to indemnify or hold harmless the foreign state or its employees under a policy of automobile or other liability or casualty insurance covering the claim which merged into the judgment, or
(6) the judgment is based on an order confirming an arbitral award rendered against the foreign state, provided that attachment in aid of execution, or execution, would not be inconsistent with any provision in the arbitral agreement, or
(7) the judgment relates to a claim for which the foreign state is not immune under section 1605(a)(7), regardless of whether the property is or was involved with the act upon which the claim is based.
(b) In addition to subsection (a), any property in the United States of an agency or instrumentality of a foreign state engaged in commercial activity in the United States shall not be immune from attachment in aid of execution, or from execution, upon a judgment entered by a court of the United States or of a State after the effective date of this Act if--
(1) the agency or instrumentality has waived its immunity from attachment in aid of execution or from execution either explicitly or implicitly, notwithstanding any withdrawal of the waiver the agency or instrumentality may purport to effect except in accordance with the terms of the waiver, or
(2) the judgment relates to a claim for which the agency or instrumentality is not immune by virtue of section 1605(a)(2), (3), (5), or (7), or 1605(b) of this chapter, regardless of whether the property is or was involved in the act upon which the claim is based.
(c) No attachment or execution referred to in subsections (a) and (b) of this section shall be permitted until the court has ordered such attachment and execution after having determined that a reasonable period of time has elapsed following the entry of judgment and the giving of any notice required under section 1608(e) of this chapter.
(d) The property of a foreign state, as defined in section 1603(a) of this chapter, used for a commercial activity in the United States, shall not be immune from attachment prior to the entry of judgment in any action brought in a court of the United States or of a State, or prior to the elapse of the period of time provided in subsection (c) of this section, if--
(1) the foreign state has explicitly waived its immunity from attachment prior to judgment, notwithstanding any withdrawal of the waiver the foreign state may purport to effect except in accordance with the terms of the waiver, and
(2) the purpose of the attachment is to secure satisfaction of a judgment that has been or may ultimately be entered against the foreign state, and not to obtain jurisdiction.
...
(f) (1) (A) Notwithstanding any other provision of law, including but not limited to section 208(f) of the Foreign Missions Act (22 U.S.C. 4308(f)), and except as provided in subparagraph (B), any property with respect to which financial transactions are prohibited or regulated pursuant to section 5(b) of the Trading with the Enemy Act (50 U.S.C. App. 5(b)), section 620(a) of the Foreign Assistance Act of 1961 (22 U.S.C. 2370(a)), sections 202 and 203 of the International Emergency Economic Powers Act (50 U.S.C. 1701-1702), or any other proclamation, order, regulation, or license issued pursuant thereto, shall be subject to execution or attachment in aid of execution of any judgment relating to a claim for which a foreign state (including any agency or instrumentality or such state) claiming such property is not

immune under section 1605(a)(7).
(B) Subparagraph (A) shall not apply if, at the time the property is expropriated or seized by the foreign state, the property has been held in title by a natural person or, if held in trust, has been held for the benefit of a natural person or persons.
(2) (A) At the request of any party in whose favor a judgment has been issued with respect to a claim for which the foreign state is not immune under section 1605(a)(7), the Secretary of the Treasury and the Secretary of State should make every effort to fully, promptly, and effectively assist any judgment creditor or any court that has issued any such judgment in identifying, locating, and executing against the property of that foreign state or any agency or instrumentality of such state.
(B) In providing such assistance, the Secretaries--
(i) may provide such information to the court under seal; and
(ii) should make every effort to provide the information in a manner sufficient to allow the court to direct the United States Marshall's office to promptly and effectively execute against that property.
(3) Waiver. The President may waive any provision of paragraph (1) in the interest of national security.

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

Although financial transactions are considered to be commercial, contracts with sovereigns should contain waivers of sovereign immunity, reducing the likelihood of disputes.[48] The following materials suggest why this is so.

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[48] See the example on page 68 below. A waiver of immunity in a conditional document has been held to be ineffective where the condition was not fulfilled. *Can-Am Int'l, LLC* v. *Republic of Trinidad & Tobago*, 169 Fed. Appx. 396 (5th Cir 2006).

In ***Republic of Argentina*** **v** ***Weltover*** [49] the US Supreme Court held:

> ...when a foreign government acts, not as regulator of a market, but in the manner of a private player within it, the foreign sovereign's actions are "commercial" within the meaning of the FSIA. Moreover, because the Act provides that the commercial character of an act is to be determined by reference to its "nature" rather than its "purpose," 28 U. S. C. § 1603(d), the question is not whether the foreign government is acting with a profit motive or instead with the aim of fulfilling uniquely sovereign objectives. Rather, the issue is whether the particular actions that the foreign state performs (whatever the motive behind them) are the type of actions by which a private party engages in "trade and traffic or commerce," .... Thus, a foreign government's issuance of regulations limiting foreign currency exchange is a sovereign activity, because such authoritative control of commerce cannot be exercised by a private party; whereas a contract to buy army boots or even bullets is a "commercial" activity, because private companies can similarly use sales contracts to acquire goods...

The court went on to state:

> The commercial character of the Bonods is confirmed by the fact that they are in almost all respects garden-variety debt instruments: They may be held by private parties; they are negotiable and may be traded on the international market (except in Argentina); and they promise a future stream of cash income. We recognize that, prior to the enactment of the FSIA, there was authority suggesting that the issuance of public debt instruments did not constitute a commercial activity. Victory Transport, 336 F.2d at 360 (dicta). There is, however, nothing distinctive about the state's assumption of debt (other than perhaps its purpose) that would cause it always to be classified as jure imperii, and in this regard it is significant that Victory Transport expressed confusion as to whether the "nature" or the "purpose" of a transaction was controlling in determining commerciality,... Because the FSIA has now clearly established that the "nature" governs, we perceive no basis for concluding that the issuance of debt should be treated as categorically different from other activities of foreign states.
>
> Argentina contends that, although the FSIA bars consideration of "purpose," a court must nonetheless fully consider the context of a transaction in order to determine whether it is "commercial." Accordingly, Argentina claims that the Court of Appeals erred by defining the relevant conduct in what Argentina considers an overly generalized, acontextual manner and by essentially adopting a per se rule that all "issuance of debt instruments" is "commercial." .... We have no occasion to consider such a per se rule, because it seems to us that even in full context, there is nothing about the issuance of these Bonods (except perhaps its purpose) that is not analogous to a private commercial transaction.
>
> Argentina points to the fact that the transactions in which the Bonods were issued did not have the ordinary commercial consequence of raising capital or financing acquisitions. Assuming for the sake

[49] 504 US 607 (1992). In the case two holders of Argentinian bonds (called Bonods) sued Argentina for breach of contract for failure to pay on the bonds. The Court held that the US federal courts did have jurisdiction over the case because foreign states could be subject to suits in US courts for acts in connection with a commercial activity under the FSIA..

of argument that this is not an example of judging the commerciality of a transaction by its purpose, the ready answer is that private parties regularly issue bonds, not just to raise capital or to finance purchases, but also to refinance debt. That is what Argentina did here: By virtue of the earlier FEIC contracts, Argentina was already obligated to supply the United States dollars needed to retire the FEIC-insured debts; the Bonods simply allowed Argentina to restructure its existing obligations. Argentina further asserts (without proof or even elaboration) that it "received consideration [for the Bonods] in no way commensurate with [their] value,"... Assuming that to be true, it makes no difference. Engaging in a commercial act does not require the receipt of fair value, or even compliance with the common-law requirements of consideration.

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

In a recent decision, in *Lavaggi* v *Republic of Argentina*,[50] the Southern District of New York dismissed investors' claims against Argentina where there were no allegations that bonds or notes had been sold in the US:

Plaintiff argues that the commercial activity exception is satisfied by the "very act of raising capital by introducing negotiable promissory notes in the United States - indeed, the very presence of highly-transferable notes in the United States." As to the first part of plaintiff's argument, it is true that the sale of such notes by a foreign state directly to investors in the United States would fall within the commercial activity exception. However, there is no allegation or evidence that the Republic or its agents sold even a single Euro Bond or Swiss Bond in the United States. Indeed, the language of the Prospectus of the Swiss Bond strictly prohibits such sales. As for plaintiff's second claim, that the "very presence of highly-transferable notes in the United States" is sufficient to invoke the commercial activity

[50] 2005 U.S. Dist. LEXIS 18548 (SDNY 2005)

exception, the court need only note the presence of a secondary market for "highly-transferable" notes. Although trading on a secondary market is likely to result in the transfer of such bonds to investors in the United States, such secondary transfers between investors are clearly not "commercial activity" of the Republic. Therefore, the Court finds that it does not have subject matter jurisdiction over the claims regarding the Euro Bond and the Swiss Bond.

Expropriation is a governmental rather than a commercial act. In *Yang Rong* v. *Liaoning Province Government*[51] the DC Circuit affirmed the District Court's dismissal of a complaint under the FSIA on the basis that the defendant Chinese province's expropriation of the plaintiff finance company's equity interest in a holding company was a sovereign act. The facts of this case provide an illustration of country risk:

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

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

In September 1992, Broadsino transferred its Brilliance Holdings stock to the Foundation. Eventually, Rong and Ming agreed "that the Foundation would hold the shares in trust for Broadsino, in effect acting as the nominee for Broadsino," and that Rong was to have sole authority to manage, control and

[51] 452 F.3d 883 (DC Cir. 2006) at http://pacer.cadc.uscourts.gov/docs/common/opinions/200607/05-7030a.pdf .

administer the Foundation's equity interest in Brilliance Holdings...The transferred Brilliance Holdings shares were held in the Foundation's name. As a result of this arrangement, as well as the sale of 28.75 per cent of Brilliance Holdings shares in October 2002, the Foundation held 55.88 per cent of the Brilliance Holdings shares and Jin Bei Shareholding held 15.37 per cent... At Rong's direction, Broadsino paid the costs to register and list the Brilliance Holdings stock and paid various administrative fees to the Foundation. He also managed and directed Brilliance Holdings' primary holding, Shen Yang Automotive, arranging with Toyota and General Motors to manufacture automobiles for those companies. All of Shen Yang Automotive's manufacturing facilities were located in Liaoning Province.

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

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

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

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

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

A Working Group of the ABA proposed amending the FSIA because of uncertainties about some of the terms contained in the statute.[52] For example, the Group noted uncertainty about the extent to which the statute applies to subsidiaries of corporations owned by a foreign state:

"we examine the "tiering" and "pooling" issues, that is, the question of entities indirectly owned by a foreign state and entities owned by more than one foreign state. We propose statutory language to apply the Act to an entity majority owned by more than one foreign state and to all levels of subsidiaries as long as they are ultimately majority owned by a foreign state. We combine our recommendation on tiering with a proposal to include a rebuttable presumption that an instrumentality owned by another instrumentality rather than the state itself is engaged in commercial activity."[53]

On waivers, the Group said:

First, although questions have been raised about the absence of a requirement connecting an explicit waiver to the territory of the United States, the Working Group does not recommend any amendment to the current statutory language as long as courts satisfy themselves, using traditional methods of contract interpretation, that a foreign state or instrumentality's waiver was a consent to be sued in the United States. Second, because of the costs and uncertainties associated with implied waivers, the Working Group proposes to amend the FSIA to limit implied waivers to those situations in which a foreign state or instrumentality participates as a defendant in litigation without properly raising or preserving a defense of sovereign immunity. Third, the Working Group recommends that the statute be amended to include language specifying the governing law for determining a person's actual or apparent authority to waive sovereign immunity."[54]

On the commercial exception, the Group said:
"The only significant change the Working Group recommends for the commercial activity exception is to require a "substantial" and direct effect in the United States when applying the third clause dealing with commercial activity and acts occurring outside of the United States. In Part V, we explain that the Supreme Court's construction of the current direct effect language has caused confusion and

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[52] Report on the U.S. Foreign Sovereign Immunities Act by a Working Group of the International Litigation Committee of the Section of International Law and Practice of the American Bar Association, April 2001, *available at* http://www.abanet.org/intlaw/divisions/business/report.pdf See also American Bar Association Section of International Law and Practice Report to the House of Delegates Recommending Amendments to the FSIA, (2002) *available at* http://www.abanet.org/leadership/2002/113d.pdf

[53] Id. at p. 9.

[54] Id. at pp 10-11.

disagreements in the lower courts and permits U.S. courts to resolve commercial cases having only the most distant relationship with the United States."[55]

In relation to torts, the Group:
"recommends two clarifying amendments to the tort exception. First, the U.S. connection language should be amended to specify that the Act applies only when a substantial portion of the tortious act or omission occurs in the United States and that the place of injury or damage is not relevant. Second, the Act should be amended to make clear that the types of claims that may not be brought under the tort exception, such as defamation, deceit, and malicious prosecution, may be brought under the commercial activity exception. The Working Group also examined the part of the tort exception preserving immunity from tort claims for discretionary functions and determined that courts should continue to apply the current statutory language to deal with the issues that arise."[56]

The Group also recommended removing restrictions on property which could be subject to execution in the US.[57]

EMTA, the "principal trade group for the Emerging Markets trading and investment community"[58] opposed these proposed amendments to the FSIA, in part because it argued that the proposed changes to the FSIA "would have a decidedly negative impact on the ability of emerging market creditors to obtain enforcement of significant categories of the external debt of sovereign borrowers following sovereign defaults." [59] In particular, the EMTA argued against the ABA Working Group's proposal that there should be a substantial and direct effect in the US in relation to the commercial activity:

From the perspective of emerging market participants, the Working Group's recommendation would, if adopted, displace the bright-line clarity of Weltover, and introduce its own, far more damaging, "confusion and disarray" into the enforcement of financial contracts denominated in United States dollars and payable in the United States which did not contain express submissions to jurisdiction and waivers of immunity. In addition, it goes virtually without saying that introducing the word "substantial" into the jurisdictional test would make it significantly more difficult for United States contracting parties in a broad range of non-financial contracts to obtain jurisdiction in the United States over a defaulting sovereign

[55] Id. at p. 11.

[56] Id.

[57] Id. at p. 12.

[58] http://www.emta.org/about/ .

[59] EMTA, Opposition of EMTA to Proposed Amendments to the U.S. Foreign Sovereign Immunities Act of 1976, (Aug. 7, 2002) *available at* http://www.emta.org/ndevelop/fsia.pdf

counterparty. While the Working Group nowhere illuminates the extent to which the proposed amendment would constrict the subject matter jurisdiction of the U.S. courts, it is clear that, under the Working Group's proposal, subject matter jurisdiction would no longer extend to the full reach allowed by due process under International Shoe v. Washington, 326 U.S. 310 (1945), as intended by the Congress in enacting the FSIA in the first place... The "minimum contacts" test articulated in International Shoe can in no way be squared with the "direct and substantial effects" the Working Group would require.[60]

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

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

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

We nonetheless have little difficulty concluding that Argentina's unilateral rescheduling of the maturity dates on the Bonods had a "direct effect" in the United States. Respondents had designated their accounts in New York as the place of payment, and Argentina made some interest payments into those accounts before announcing that it was rescheduling the payments. Because New York was thus the place of performance for Argentina's ultimate contractual obligations, the rescheduling of those

[60] Id.

obligations necessarily had a "direct effect" in the United States: Money that was supposed to have been delivered to a New York bank for deposit was not forthcoming. We reject Argentina's suggestion that the "direct effect" requirement cannot be satisfied where the plaintiffs are all foreign corporations with no other connections to the United States. We expressly stated in Verlinden that the FSIA permits "a foreign plaintiff to sue a foreign sovereign in the courts of the United States, provided the substantive requirements of the Act are satisfied,"...

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

The ABA's Working Group has this to say:

The *Weltover* Court's discussion of "direct effect" has caused two problems. First, the Court defined direct effect too broadly, made it too easily satisfied, and therefore made U.S. courts available to resolve disputes that have only the most distant relationship with the United States. That means that cases could arise in which foreign states question or object to the application of U.S. law on foreign sovereign immunity. Second, by referring to New York as the place of performance for Argentina's contractual obligations, the Court created confusion and disarray over whether, in a case dependent on the third clause, a contract must require some performance in the United States (a situation already addressed by the first clause) or whether some other "legally significant act" must occur in the United States.[61]

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

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

The Court make take judicial notice of the fact that the Congo is a oil-rich nation with more than sufficient assets to pay its debts but one of the world's most notorious debtors...Congo has repeatedly refused to honor court judgments, not only the judgments entered in London, but judgments entered in New York courts as well.[62]

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[61] Note 52 above, at 83.

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

RESTRUCTURING OR AN INTERNATIONAL BANKRUPTCY PROCEDURE FOR SOVEREIGNS?

Sovereign defaults have often led to restructuring transactions. Two proposals for how to deal with problems associated with sovereign defaults have surfaced.[63] One set of proposals focuses on developing formal procedures for states' financial problems which are analogous to domestic insolvency regimes; the other focuses on developing contractual provisions which financial institutions can include in contracts with sovereigns.[64] This situation illustrates a more general phenomenon: some people prefer regulatory solutions to problems, others prefer negotiated solutions. Read the descriptions of both sets of proposals and decide whether you think that formal solutions or market solutions are likely to be more effective. Are there other reasons than effectiveness for preferring one type of solution over another?

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

A significant proportion of sovereign bond issues now includes collective action clauses. Last year Rodrigo de Rato, the Managing Director of the IMF stated: "As of end-February 2005, over 45 percent of sovereign bond issues in international markets contained CAC's. This increasing use of CAC's is contributing to fill an important gap in the international financial architecture."[65] The UK has adjusted the collective action clauses it uses to reflect the G10 Working Group's recommendations (see below):

"The inclusion of collective action clauses (CACs) in international bond issues can help strengthen the

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

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

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

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

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

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

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

The Institute for International Finance has developed a set of Principles For Stable Capital Flows And Fair Debt Restructuring in Emerging Markets.[67]

The Proposed Sovereign Debt Restructuring Mechanism

The following speech by Anne Krueger of the IMF describes this proposal (as well as collective action clauses):

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

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

[67] http://www.iif.com/data/public/principles-final_0305.pdf

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

To conclude, brief mention should be made of the current status of the CAC and SDRM proposals. The IMF is encouraging individual countries to put CAC clauses in their new bond issues, and, as already mentioned, in some countries they are now the established practice. For the SDRM, the International Monetary and Finance Committee has asked the IMF to bring a concrete proposal to its spring meetings...At that time, the international community will decide on what steps forward should be taken.[68]

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

Critics came from many quarters--from banks and funds, from economists and legal experts, from emerging nations and finally from the US Treasury. There was one common denominator in the protests: this is an expanded role for the IMF, whether by the institution itself or by the courts and committees it might control behind the scenes. And it is one that will increase--not decrease as claimed--the uncertainty that leads to volatility in markets and will result in less lending at higher costs for emerging economies.

There is fear that the policy objectives of dominant IMF members will influence decisions. There is

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

anticipation of conflict of interest since the IMF and other multilateral agencies are large creditors that may not be forever immune to sharing in losses when debt is restructured. There is hostility to a rigid and static bureaucracy whose decisions are imposed by fiat and are difficult to predict. In sum, we are seeing another episode in the classic confrontation between regulation and free markets.

As the debate continues, the IMF is weakening its rhetoric but not its grip. Much is being made of the free will of debtors and creditors to determine outcomes. Little is being said about the expanded reach that the plan would invest in the IMF or in the allegedly independent courts and committees it would create. The IMF is counting on money, on its ability to grant or withhold massive amounts of desirable subsidized funding, to force debtors and creditors to comply with Fund wishes at every stage of the restructuring process.

Whether directly or indirectly, the IMF would be empowered to:

• Decide how long creditors can be prevented from suing a defaulted borrower.
• Rule on whether a nation's economic policies are sound and whether it is negotiating in good faith.
• Control access to interim financing while existing debt payments are suspended.
• Hold a veto over restructuring agreements reached by the debtor and its creditors. [69]

Collective Action Clauses
Report of the G10 Working Group on Contractual Clauses (attached)[70]
EMCA Model Covenants for New Sovereign Debt Issues [71]

Amendments

"Amendments." No amendment or waiver of any provision of the Bonds or the Fiscal Agency Agreement, nor consent to any departure by the Issuer therefrom, shall in any event be effective unless in writing and consented to (including by electronic mail) by Bondholders holding at least 75% in principal amount of the Bonds then outstanding, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given; provided that no amendment, waiver or consent shall, unless in writing and consented to by Bondholders holding at least 95% in principal amount of the Bonds then outstanding, do any of the following: (a) subject the Bondholders to any additional obligations, (b) reduce the principal of, or interest on any of the Bonds, (c) change the currency of payment of the principal or interest on any Bond; (d) change any date fixed for any payment in respect of principal of, or interest on, any of the Bonds, or (e) waive, modify or otherwise affect [insert cross-references to any Sections containing provisions relating to: pari passu protection, negative

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[69] See, e.g., Adam Lerrick and Allan H. Meltzer, Sovereign Default the Private Sector Can Resolve Bankruptcy Without a Formal Court, Carnegie Mellon Quarterly International Economics Report, April 2002, *available at* http://www.house.gov/jec/imf/bank.pdf

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

[71] The document is dated May 3, 2002, and is available at http://www.emta.org/ndevelop/model.pdf . The EMCA is the Emerging Markets Creditors Association.

pledge covenant, cross-default and cross-acceleration, requirement that Issuer cancel any exchanged indebtedness, eligibility for debt conversion programs, restrictions on incurrence of additional indebtedness, requirement of listing on stock exchange, waiver of immunities, choice of law, consent to jurisdiction and service of process],; provided further that no amendment, waiver or consent shall, unless in writing and consented to by all of the Bondholders, change this Section; provided further that no amendment, waiver or consent shall, unless in writing and consented to by the Fiscal Agent in addition to the Bondholders required hereinabove to take such action, affect the rights or duties of the Fiscal Agent under the Fiscal Agency Agreement.

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

Assets

"Assets" means assets, property and rights in property of any kind whatsoever. For the avoidance of doubt, the term "Assets" as used in this Agreement means property and property rights in their broadest senses, including all forms of tangible property (including without limitation both personal and real property, regardless of its use or intended use) and all forms of intangible property (including without limitation claims, causes of action and rights to receive any form of payments, whether described as revenues, cash or in-kind royalties, concession fees, taxes, income, or the proceeds of sales of natural resources). Further, the term "Assets" as used in this Agreement includes any International Monetary Assets as defined herein; and further includes any assets, property and rights in property of any kind whatsoever held in the name of or otherwise under the control of any agency or instrumentality of the Issuer, including without limitation any such assets, property or rights in property held in the name, or on behalf, of the Issuer or the Central Bank of Issuer.

Event of Default; Acceleration

Each of the following constitutes an event of default:

1. Non-Payment: the Issuer does not pay principal or interest in respect of the Bonds when due and such failure continues for 30 calendar days.
2. Breach of Other Obligations : the Issuer fails to perform any other material obligation contained in the Bonds or Fiscal Agency Agreement (including but not limited to [crossreference section of Fiscal Agency Agreement regarding Bondholder representatives' fees and expenses]) and that failure continues for 30 calendar days after any holder gives written notice to the Issuer to remedy the failure and gives a copy of that notice to the Fiscal Agent.
3. Cross Acceleration: any External Public Indebtedness of the Issuer in principal amount equal to or greater than $25,000,000 or its equivalent in other currencies is accelerated, other than by optional or mandatory prepayment or redemption.
4. Moratorium: the Issuer declares a general moratorium on the payment of its External Public Indebtedness.
5. Validity: the Issuer contests the validity of any Bonds in a formal administrative, legislative or judicial proceeding.

6. Failure of Authorization: any legislative, executive or constitutional authorization necessary for the Issuer to perform its material obligations under any Bond ceases to be in full force and effect or is modified in a manner which adversely affects the rights and claims of any of the holders.
7. Material Adverse Change : any event or condition (including, but not limited to, any material adverse change in the economic or financial condition of the Issuer or its Central Bank) that gives reasonable grounds to apprehend, in the reasonable judgment of the holders of at least [25%] of the principal amount of Bonds then outstanding, that the Issuer will not, or will be unable to, perform or observe in the normal course its obligations under the Bonds and the Fiscal Agency Agreement.
If any of the above events of default occurs and is continuing, holders of Bonds representing at least 25 % in principal amount of the Bonds then outstanding may declare the principal amount of the Bond to be due and payable immediately by giving written notice to the Issuer and to the Fiscal Agent. Upon such declaration, the Fiscal Agent shall promptly give notice thereof to the holders of Bonds. Such an acceleration may only be rescinded with the consent of holders of Bonds representing at least 75 % in principal amount of the Bonds then outstanding.

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

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

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

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

or such other meanings as shall be formally adopted by the IMF from time to time.

Jurisdiction, Waiver, etc.

“Consent to Jurisdiction; Service of Process; Waiver of Immunities.”

(a) The Issuer hereby irrevocably submits itself and its Assets to the non-exclusive jurisdiction of the High Court of Justice in London and any New York State or United States Federal court sitting in New York State and any appellate court in any action or other proceeding arising out of or relating to the Bonds or the Fiscal Agency Agreement. The Issuer hereby irrevocably agrees that all claims in respect of any such action or proceeding may be heard and determined in the High Court of Justice in London or such New York State or United States Federal court or any such appellate court. The Issuer hereby irrevocably appoints (i) The Law Debenture Corporation, Limited (the “London Process Agent”), at its offices in London, England, as its agent to receive on behalf of itself and its Assets service of copies of the summons and complaint and any other process which may be served in any such action or proceeding before the High Court of Justice in London and (ii) CT Corporation System (the “New York Process Agent”, and together with the London Process Agent being collectively the “Process Agents” and each a “Process Agent”), at its offices in New York, New York, United States, as its agent to receive on behalf of itself and its Assets service of copies of the summons and complaint and any other process which may be served in any such action or proceeding before any such New York State or United States Federal Court. Further, in the event of any proceeding brought in any court in the United Kingdom or in any State or Federal Court in the United States to enforce any judgment rendered in any such action, service of any process, pleadings, discovery requests or any other materials shall be validly made by delivery to the London or New York Process Agents respectively, regardless whether the proceeding is lodged in London or New York. Service of process in accordance with this Section may be made by delivering a copy of such process to the Issuer in care of the appropriate Process Agent at such Process Agent’s then-current address, and the Issuer expressly and irrevocably authorizes and directs each Process Agent to accept such service on its behalf. Service upon such Process Agents shall be valid service on the Issuer or with respect to its Assets regardless whether the Issuer shall have ceased to pay any fees of such Process Agent and regardless whether the Issuer shall have purported unilaterally to withdraw its consent to such service.

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

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

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

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

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

Lien

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

Negative Pledge

"Negative Pledge." So long as any Bond shall remain outstanding, the Issuer will not create or permit to

be created and continue, nor permit the Central Bank of Issuer, or any other agency or instrumentality of the Issuer, to create or permit to be created and continue, (a) any Lien for any purpose upon or with respect to any International Monetary Assets;
(b) any Lien upon or with respect to any Asset of the Issuer, the Central Bank of Issuer, or any agency or instrumentality of the Issuer, to secure or provide for the payment of External Indebtedness of any person; or
(c) any Lien upon or with respect to any Assets of any person to secure or provide for the payment of External Indebtedness incurred or guaranteed by the Issuer, the Central Bank of Issuer, or any agency or instrumentality of the Issuer, other than Permitted Liens [to be separately defined and itemized on a Schedule].
(i) Enter into any credit agreement or other contract for External Indebtedness, nor permit the Central Bank of Issuer or any agency or instrumentality of Issuer, to enter into any credit agreement or other contract for External Indebtedness, which grants by contract to any other person any right of set off, banker's lien, counter-claim or similar contractual right, or otherwise has the practical effect of granting such person preferential access over the creditors hereunder to the Assets of Issuer, the Central Bank of Issuer, or any agency or instrumentality of Issuer, or granting such person payment rights in derogation of the pari passu treatment set forth in Section ___ of the Bonds or the Fiscal Agency Agreement.
(ii) Restructure, redenominate or recharacterize any existing credit agreement or other contract for External Indebtedness as a loan or other contract for Local Indebtedness, with the legal or practical effect of granting local creditors preferential or other payment rights senior to the creditors hereunder or in derogation of the pari passu treatment set forth in Section ___ of the Bonds or the Fiscal Agency Agreement.

Pari Passu and other Affirmative Covenants
"Affirmative Covenants." So long as any Bond shall remain outstanding, the Issuer will: (a) Undertake to include in its budget for each of its fiscal years amounts sufficient to repay principal of and interest on the Bonds and all other amounts payable by the Issuer hereunder in accordance with the terms hereof.
(b) Duly obtain and maintain in full force and effect all governmental approvals (including any exchange control approvals) which may be necessary under the laws of Issuer for the execution, delivery and performance of the Bonds and the Fiscal Agency Agreement by the Issuer or for the validity or enforceability hereof and duly take all necessary and appropriate governmental and administrative action in Issuer in order to make all payments to be made hereunder as required by the Bonds and the Fiscal Agency Agreement.
(c) Ensure that at all times its payment obligations hereunder constitute unconditional general obligations of the Issuer ranking at least pari passu in priority of payment with all other External Indebtedness of the Issuer or any of its agencies or instrumentalities now or hereafter outstanding, and will be paid as such. For the avoidance of doubt, the Issuer's covenant to maintain the pari passu status of the Bonds and its payment obligations hereunder means that the Issuer will service the Bonds on a pari passu basis. Accordingly, if an event of default under the Bonds or any other External Indebtedness of the Issuer or of any of its agencies or instrumentalities has occurred and is continuing, the Issuer shall not make (or authorize) any payment of principal or interest in respect of any other such External

Indebtedness (whether regularly scheduled or otherwise) without simultaneously making a proportionate payment of principal and/or interest in respect of the Bonds.
(d) Furnish to the Fiscal Agent in sufficient copies for distribution to each Bondholder:
i. Semiannually, a reasonably detailed report and analysis of the financial condition of the Issuer as of the end of each prior calendar year or halfyear, as the case may be;
ii. Within 30 days after delivery to the Issuer, each annual report prepared by the IMF staff after the date hereof on the economy and international balance of payments of the Issuer or any report prepared by the IMF staff in lieu of such an annual report;
iii. Promptly after it is entered into, each agreement, undertaking and understanding reached by the Issuer, the Central Bank of Issuer, or any agency or instrumentality of Issuer after the date hereof with the IMF or any international development banks;
iv. Within 30 days after the transmittal to the IMF or any international development banks, copies of all economic or financial reports on the performance of the economy or financial condition of the Issuer;
v. Such other financial, statistical and general information as may be requested by the Fiscal Agent on behalf of the Bondholders or by Bondholders holding at least 5% in principal amount of the Bonds then outstanding.
(e) To assure performance of the foregoing subparagraphs, Issuer shall at the closing execute (and whether or not so executed this Agreement shall constitute) an irrevocable instruction to the IMF and any multinational development banks directing them to provide to the Fiscal Agent and the Bondholders any information required hereunder to the extent not provided by Issuer.

Purchase and Cancellation
The Issuer, the Central Bank of Issuer, and any agencies or instrumentalities of Issuer may, if an event of default has not occurred, purchase any Bonds in the open market or otherwise and at any price. Any Bonds so purchased may be cancelled or held and resold. Any Bond so purchased, while held by or on behalf of the Issuer, Central Bank of Issuer, and any agencies or instrumentalities of Issuer, shall be deemed not to be outstanding. The Issuer must inform the Fiscal Agent of any Bond that is held by itself, Central Bank of Issuer, and any agencies or instrumentalities of Issuer. Any Bonds so cancelled will not be reissued.

[In the Form of Bond]
Meetings of Bondholders.
(a) The Issuer at any time may, and (i) upon a request in writing to the Fiscal Agent made at any time by Bondholders holding not less than 10% of the aggregate outstanding principal amount of the Bonds or (ii) following receipt of notice from Bondholders holding not less than [5%] of the aggregate outstanding principal amount of the Bonds that an even of default has occurred and is continuing, the Fiscal Agent shall promptly, convene a meeting of Bondholders.
(b) At a meeting of the holders of the Bonds called for any of the above purposes, persons entitled to vote 75% in aggregate principal amount of the Bonds at the time outstanding shall constitute a quorum.
(c) Further provisions concerning meetings of Bondholders are set forth in the Fiscal Agency Agreement.

Notices.
(a) All notices to Bondholders will be given by publication in The Wall Street Journal, The Financial Times and, so long as the Bonds are listed on the Luxembourg Stock Exchange and it is so required for continued listing thereon, in the Luxemburger Wort.
(b) In addition, all notices to Bondholders will be given to EMTA for publication on its website (www.emta.org) and to EMCA for publication on its website (www.emcreditors.com) and for other distribution to their members.

[In the Fiscal Agency Agreement]
Meetings of Bondholders.
(a) The Issuer may at any time call a meeting of the Bondholders, such meeting to be held at such time and at such place in [New York City] as the Issuer shall determine, for any purpose referred to in the Bonds. (i) Upon a request in writing to the Fiscal Agent made at any time by holders of not less than 10% of the aggregate outstanding principal amount of the Bonds, or (ii) following receipt of notice from Bondholders holding not less than [5%] of the aggregate outstanding principal amount of the Bonds that an event of default under the Bonds has occurred and is continuing, the Fiscal Agent shall convene a meeting of Bondholders and such meeting shall be held at such time and at such place in [New York City] as the Fiscal Agent shall determine. Prior to any such meeting, the Fiscal Agent shall distribute to the Bondholders such written materials or proposals as may be delivered to it by holders of not less than 10% of the aggregate outstanding principal amount of the Bonds. Notice of any meeting of Bondholders, setting forth the time and place of such meeting and in general terms the action proposed to be taken at such meeting, shall be given by the Fiscal Agent to the Bondholders at least twice by publication in accordance with the notice provisions contained in the Bonds, the first notice to be given not less than 15 nor more than 45 days before the date fixed for the meeting. [To be entitled to vote at any meeting of Bondholders, a person must be (x) a holder of one or more Bonds or (y) a person appointed by an instrument in writing as proxy by the holder of one or more Bonds. The only persons who shall be entitled to be present or to speak at any meeting of Bondholders shall be the persons entitled to vote at such meeting and their counsel and any representatives of the Fiscal Agent and their counsel and, in the case of any such meeting called by (or to which the Issuer is otherwise invited), representatives of the Issuer and its counsel.]
(b) The quorum requirements at any meeting of Bondholders are set forth in the Bonds.
No business shall be transacted in the absence of a quorum, unless a quorum is present when the meeting is called to order. In the absence of a quorum within 30 minutes of the time appointed for any such meeting, the meeting may be adjourned for a period of not less than ten days as determined by the temporary chairman of the meeting appointed pursuant to paragraph (d) below. Notice of the reconvening of any adjourned meeting shall be given as provided above except that such notice need be given only once but must be given not less than five days before the date on which the meeting is scheduled to be reconvened.
(c) Any Bondholder who has executed an instrument in writing appointing a person as proxy shall be deemed to be present for the purposes of determining a quorum and be deemed to have voted in accordance with the vote of the person appointed as such proxy; provided that such Bondholder shall be considered as present or voting only with respect to the matters voted on by such person in accordance

with such instrument in writing. Any resolution passed or decision taken at any meeting of Bondholders duly held in accordance with this Section shall be binding on all the Bondholders whether or not present or represented at the meeting.
(d) The Fiscal Agent shall appoint a temporary chairman of the meeting. A permanent chairman and a permanent secretary of the meeting shall be elected by vote of the holders of a majority in principal amount of the Bonds represented at the meeting. At any meeting of Bondholders, each Bondholder or proxy shall be entitled to one vote for each U.S. $1,000 in principal amount of Bonds held or represented by him; provided that no vote shall be cast or counted at any meeting in respect of any Bond challenged as not outstanding and ruled by the chairman of the meeting to be not outstanding. The chairman of the meeting shall have no right to vote except as a Bondholder or proxy. Any meeting of Bondholders duly called at which a quorum is present may be adjourned from time to time, and the meeting may be held as so adjourned without further notice.
(e) At any Bondholder meeting after an event of default held pursuant to paragraph (a) (ii) above, the Bondholders may appoint a representative and/or Bondholder committee, which in turn may engage independent legal counsel and/or financial advisors to represent the collective interests of the Bondholders. Any such Bondholder committee shall meet at such times and places, adopt such internal rules to govern its meetings, engage in such discussions with the Issuer, and coordinate with such other creditor groups, as it deems appropriate. The Issuer shall pay the fees of any such representative and the expenses of any such representative and/or Bondholder committee (including the fees and expenses of any such legal counsel or financial advisors within 30 calendar days after delivery to the Issuer of an invoice (with appropriate supporting documentation) itemizing such fees and expenses).
(f) The holding of Bonds shall be proved by the registry books maintained in accordance with [Section hereof] or by a certificate or certificates of the Registrar. The Issuer may, at its option, fix a record date (not less than 15 nor more than 45 days before the date fixed for such meeting) for the determination of holders entitled to vote at any meeting, but shall have no obligation to do so.

[Incurrence of Indebtedness Covenants]
Without proposing specific language at this time, it is EMCA's position that Issuers should agree to so-called "incurrence" covenants modeled on those common in high yield debt instruments, whereby the Issuer is permitted to engage in future borrowings and privatizations or other sales of assets, but only when it is in compliance with certain financial ratios, or the action is otherwise permitted by certain well-defined criteria to be negotiated on a country-by-country basis.

Here is one argument from Federico Weinschelbaum and Jose Wynne that a SDRM-type procedure might be preferable to CACs:

CACs introduce flexibility in situations of financial distress by facilitating renegotiation. In their absence, bondholders have no incentives to enter into the renegotiation process since, individually, they are unable to affect the probability of repayment (as long as the debt is not held by a large lender). CACs solve the problem of free riding among creditors within a legal jurisdiction because a supermajority of bondholders can make the outcome of the renegotiation mandatory for all. But the existence of CACs does not always imply a friendly restructuring process. Sovereigns tend to issue debt in different jurisdictions, and while CACs coordinate creditors within each one, the free riding problem between jurisdictions remains. This is a feature of the 1990s not present in the 1980s, when few banks concentrated most of the sovereign bonds. To attend to this problem, the idea of an international bankruptcy procedure (or an SDRM), to coordinate creditors in different jurisdictions, has been put forward.

It has been argued that facilitating renegotiation can have both positive and negative consequences. Because renegotiation relieves countries from debt overhang, governments might run reckless fiscal policies that increase the likelihood of financial crisis. Since lenders anticipate this behavior, the cost of the lack of commitment to run responsible fiscal policies is borne by the country itself. In the end, the severity of the moral hazard problem determines whether facilitating renegotiation, by creating an SDRM, make countries worse or better off. The debate about the value of an SDRM lies precisely on this trade off.[72]

[72] Federico Weinschelbaum & Jose Wynne, *Renegotiation, Collective Action Clauses and Sovereign Debt Markets,* 67 J. OF INT'L ECON. 47-72 (2005) *available at* http://faculty.fuqua.duke.edu/~josew/Jose_archivos/Collective_Action.pdf