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Don't Cry for Me Argentine Bondholders: Second Circuit Briefing Concludes

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An update on the final round of appellate filings in the *NML v. Argentina* appeal. Next up: oral argument on February 27.

On January 25, briefs were filed with the Second Circuit on behalf of two groups of plaintiff-appellees in the appeal from District Court Judge Griesa's November 21 injunction, NML and Aurelius. And on February 1, four sets of reply briefs were filed, on behalf of appellants Argentina, Bank of New York Mellon (BNY Mellon), the Exchange Bondholders Group, and Fintech Advisory. Under the schedule set by the Second Circuit, briefing is now concluded, and the next major event will be oral argument before the Second Circuit on February 27.

Copies of all of these papers can be found on our Argentine Sovereign Debt webpage, at http://www.shearman.com/argentine-sovereign-debt/. Our summary of the prior briefing on this appeal can also be found there.

We summarize below the major points made in each of these six briefs, followed by our compilation of the major issues cutting across the virtual mountain of briefing confronting the three-judge panel that will decide this case.

Summary of Plaintiff-Appellee Briefs Filed on January 25

Brief for Plaintiff NML Capital, Ltd.

NML Capital's brief primarily addresses the arguments advanced by Argentina and by the Exchange Bondholders Group. A major theme of NML's brief (and, in our view, an argument of significance) is that the Second Circuit's initial October 26 decision definitively resolved many of the issues that the Appellants are now arguing, such as the arguments that breach of the *pari passu* clause does not justify a "Ratable Payment" to the plaintiffs, and that the Injunction violates the Foreign Sovereign Immunities Act (FSIA). Accordingly, in NML's view, there is really little left to be determined on this appeal – just a clarification as to exactly how the Ratable Payment formula is to work (as to which there is in fact little debate), and the resolution of questions concerning the application of the Injunction to "third parties" (in our view, really the primary open issue).

More specifically, NML argues:

- The Ratable Payment formula, as clarified by Judge Griesa on remand, is itself no longer open to debate, as Argentina has not even challenged it. NML says, "*As the district court properly understood, this Court did not ask that the court reconsider the requirement that Argentina make a Ratable Payment to Appellees if it makes a payment on the Exchange Bonds. It asked the district court to clarify the operation of that requirement. The district court did so. And neither Argentina nor its new allies are now arguing that the district court should have clarified its Injunction differently*."
- Arguments that the Injunction harms holders of Exchange Bonds are incorrect, and have already been rejected. "*The district court rejected the argument, and this Court affirmed, quoting the district court's conclusion that, '[a]s to the exchange bondholders, the Injunction[] do[es] not 'jeopardiz[e] [their] rights' because 'all that the Republic has to do' is 'honor its legal obligations'"— something which it has 'sufficient funds' to do.*" NML continues that it would be inappropriate for the Court to assume that Argentina will defy the Injunction and not make payment on the Exchange Bonds, and if Argentina adopts that approach, "*Any threat of harm to the exchange bondholders thus comes not from the Injunction, but from Argentina.*"
- As to Argentina's argument that the Injunction violates the FSIA, NML argues that the FSIA issue was clearly decided in the Second Circuit's October 26 decision, and is therefore unreviewable "*law of the case*."
- Finally, NML argues that the two Constitutional arguments advanced by the Exchange Bondholders – that the Injunction was issued in a manner that violated their Due Process rights and is also an unconstitutional "taking" – are without precedent and are simply not made out under the current facts.

Brief for Plaintiff Aurelius Capital

The brief filed on behalf of Aurelius Capital addresses primarily arguments advanced by participants in the payment stream, especially BNY Mellon. Most significantly (in our view), Aurelius deals with the issue of whether the Injunction can be extended to BNY Mellon consistent with Federal Rule of Civil Procedure 65.

- Rule 65 (which is entitled "*Injunctions and Restraining Orders*") provides that an injunction can "*bind*" "*persons who are in active concert or participation with*" a party to a litigation who has itself been enjoined. A major issue here is whether BNY Mellon, as indenture trustee on the Exchange Bonds, would be in "*active concert and participation with*" Argentina if it were to process payment on the Exchange Bonds when Argentina is itself enjoined. Aurelius argues yes: "*The 'essence' of that rule is that 'defendants may not nullify a decree by carrying out prohibited acts through aiders and abettors, although they were not parties to the original proceeding.'*" (Citations omitted.) "*If [participants in the payment stream] do not receive a certification that Argentina has made a ratable payment to Appellees, they would know that they are substantially assisting Argentina in accomplishing that objective if they process payments on the exchange bonds.*" As discussed below, this argument is deeply contested.
- Aurelius also responds to the arguments that BNY Mellon and the other payment stream participants have, without Due Process, been placed at risk of contempt. They argue that such a claim is premature, as contempt will only be imposed later, after contempt proceedings. (This argument would appear to require the payment stream participants to risk contempt and find out only later whether their conduct violates the Injunction.)

Summary of Appellants' Reply Briefs Filed on February 1

Appellant reply briefs were filed by Argentina, BNY Mellon, the Exchange Bondholders Group, and Fintech Advisory.

Reply Brief for The Republic of Argentina

Argentina's theme, running throughout its brief, continues to be that the Injunction unfairly favors the plaintiffs: "*Any actual claim to 'equal treatment' would be satisfied by treating all holdout creditors on the same terms as the participants in the Republic's 2010 Exchange Offer. … There is nothing equitable, in the name of 'equal treatment,' in depriving the exchange bondholders of the benefit of their own bargain, and thereby imperiling the restructuring of 92 percent of the Republic's external debt that was accomplished only because of the exchange bondholders' willingness to accept that bargain.*"

More specifically, Argentina argues:

- The Injunction violates the FSIA: the Injunction "*requires[s] a turnover of property not in the United States, and therefore outside the scope of the court's enforcement powers under the FSIA.*" Note, however, that the Second Circuit could well take the view that it has already decided this question adversely to Argentina. (*See* October 26 Decision at pages 24 to 26.)
- The Injunction improperly reaches non-parties, particularly BNY Mellon, in violation of Rule 65 and UCC 4A: "*[The Injunction] sweep[s] up … as purported aiders and abettors all parties with any role in the exchange bondholders' receipt of payment on their bonds, although those parties play no role in the Republic's decisions and are merely doing their jobs.*" Elsewhere Argentina argues, "*Any purported violation by the Republic of the Amended Injunctions would therefore be consummated before any non-party – including BNYM – takes any further action, and none of the enjoined third parties 'aids or abets' the Republic's payment to BNYM.*"

Reply Brief for Non-Party Appellant The Bank of New York Mellon

The heart of BNY Mellon's brief is a retort to Aurelius' view as to the meaning of "*active concert and participation*," as that term is used in Rule 65. Whereas Aurelius essentially argues that any non-party who takes any action on behalf of an enjoined defendant with knowledge that the defendant is acting in defiance of an injunction can be caught by that injunction, BNY Mellon argues that Rule 65 sets a much higher standard. "*BNY Mellon's receipt and distribution of funds–without a shred of evidence that it has joined with Argentina in any scheme to circumvent the Injunctions–is not 'active concert or participation with' Argentina's presumed violation of the Injunctions.*" Elsewhere BNY Mellon argues, "*a finding of 'active concert' requires more than a non-party's knowledge of the injunction, or even that the injunction's terms have been breached. The non-party must act 'with' the wrongdoer for the purpose of accomplishing the breach.*" And, "*passive conduct by a non-party cannot be transformed into 'active concert' with a wrongdoer simply because that non-party theoretically could take preemptive action–here, rejecting payment–to avoid engaging in the passive conduct.*"

Brief for Non-Party Appellant Exchange Bondholder Group

The major theme in the brief on behalf of the Exchange Bondholders is that they are "*pawns*" in a dispute between others and that the Injunction unreasonably burdens them: "*The [Exchange Bondholders] wish only to enjoy their contractual rights without being dragged into or used as a pawn in the dispute between Plaintiffs and the Republic.*" The Exchange Bondholders go on to argue that the Injunction deprives them of their property (as they assume as established that

Argentina will default on the Exchange Bonds rather than pay the plaintiffs). On the basis of that deprivation, the Exchange Bondholders argue that their Constitutional rights to substantive and procedural Due Process have been denied and that they have been subjected to an unconstitutional "taking."

Brief for Non-Party Appellant Fintech Advisory, Inc.

Fintech's brief focuses particularly on the inequities claimed to be visited on the Exchange Bondholders as the result of the Injunction: "*[T]he District Court imposed an injunction that is manifestly inequitable: it uses the non-party Exchange Bondholders' contractual right to be paid as a weapon against the Republic to coerce it to comply with another party's judgment, a judgment for which the Exchange Bondholders are in no way accountable.*" Fintech also presses the Constitutional "takings," Rule 65, and UCC 4A arguments.

Summary of Key Arguments

When the three judges of the Second Circuit sit down to decide this case, they will be confronted with a pile of more than two dozen briefs, advancing scores of arguments and points. We cannot summarize them all, but think that the major issues will break down into the four broad categories we set forth below.

Our view is that many of these arguments were substantially resolved in the Second Circuit's decision of October 26 or are simply not strong. However, we do think that one major argument that will occupy the Court is BNY Mellon's claim that it is not properly within the scope of the Injunction under Federal Rule of Civil Procedure 65(d)(2)(C). Accordingly, we think that there is a prospect of a split decision, with Argentina remaining subject to the Injunction, but restraint on BNY Mellon excised.

I. Does the Injunction violate the Foreign Sovereign Immunities Act?
    1. Argentina's first argument in both of its briefs.
    2. Major "*law of the case*" problem for Argentina, as the Second Circuit appears to have already decided this issue. (*See* October 26 decision at pages 24 to 26.)
    3. For Argentina to prevail would likely require extension of current law.

II. Is the Injunction unconstitutional?
    1. Is it an unconstitutional "taking" of the Exchange Bondholders' rights?
        a. Not established that a judicial order can be a "taking."
        b. Arguably hypothetical, as it assumes Argentina won't pay, even if enjoined.
    2. Were the Exchange Bondholders and the payment stream participants denied Due Process?
        a. Difficult to argue lack of notice in such a high profile case.
        b. Impact on the Exchange Bondholders would arguably be result of an independent decision by Argentina not to pay rather than the Injunction.

III. Does the Injunction abridge important public policies?
    1. Does the Injunction interfere with future sovereign restructurings?

2. Does the Injunction tarnish New York City as a financial center and New York law as a global standard?
    a. These types of arguments rarely determine the outcome of lawsuits.

IV. Are the terms of the Injunction inequitable?

1. Argentina says "yes": the Injunction doesn't provide for "*equal treatment*" of Plaintiffs, but more favorable treatment.
    a. "*Law of the case*" problem for Argentina: Second Circuit has already affirmed Judge Griesa's decision that a "Ratable Payment" is called for. (*See* October 26 decision at page 28.)
2. Exchange Bondholders say "yes": the injunction holds them hostage to a battle they are not involved in.
    a. Assumes Argentina, if enjoined, won't pay anybody.
    b. The "payment obligations" sentence of the *pari passu* clause arguably requires "all or nothing" payments.
3. BNY Mellon says "yes": application of Injunction to BNY Mellon violates Federal Rule of Civil Procedure 65(d)(2)(C) and UCC Article 4A.
    a. As to Rule 65, see discussion below.
    b. The potential application of the "anti-injunction" provisions of UCC Article 4A to the facts of this case is obscure at best and, in our view, the Court is likely to seek to avoid ruling on this point.

Special Focus: Rule 65(d)(2)(C) – What Does "*In Active Concert and Participation*" Mean?

Rule 65(d)(2) of the Federal Rules of Civil Procedure provides that an injunction is binding on both the parties to a proceeding and on "*other persons who are in active concert or participation*" with the parties. Judge Griesa, in his opinion of November 21, wrote that "*[i]t is probably true that these parties [participants in the payment process] are not all agents of Argentina, but they surely are 'in active concert or participation' with Argentina in processing the payments from Argentina to the exchange bondholders*." The outcome of the pending appeal could well turn on whether the Second Circuit accepts Judge Griesa's understanding of "*active concert and participation*." There is little helpful Second Circuit precedent as to the limits of Rule 65, as both sides have tacitly acknowledged in their reliance on decisions from other circuits. The Second Circuit panel that will hear this appeal accordingly retains considerable discretion in approaching this issue.

Many of the prior decisions that have addressed Rule 65 have treated the phrase "*active concert and participation*" as analogous to "*aiding and abetting*," language that Judge Griesa himself used in the Injunction. (*See* November 21 Injunction at paragraph 2(e). In briefest summary, "*aiding and abetting*" occurs when, despite actual knowledge of its unlawful nature, a party assists in the commission of an unlawful act.) However, the courts often require that such assistance be "*substantial*" – a qualification emphasized by BNY Mellon. BNY Mellon also emphasizes that the US Supreme Court has said that the scope of an injunction "*must be limited to confederates or associates of the defendant*," which, it says, it is not.

The plaintiffs have countered that the concept of "*active concert and participation*" is more expansive than that of aiding and abetting, noting that the Second Circuit "*has never held that the panoply of aiding-and-abetting standards applies to Rule 65*." (Aurelius Brief at 22.) Plaintiffs are correct that "*active concert and participation*" is not synonymous with aiding and abetting. Courts have also viewed this concept in terms of "*privity*," a term used to describe a tight alignment of interests; privity may exist between one corporation and its successor, for example, or between a franchisor and its

franchisees. In consequence, privity, like aiding and abetting, may suggest a closer relationship between two parties than one finds in the relationship between an issuer and an indenture trustee.

The plaintiffs' basic argument – that no one is free to willfully assist in the violation of a court order – is undeniably compelling, as is the unstated argument that their victory may be Pyrrhic if Argentina is enjoined but BNY Mellon is not. But so too are arguments for respecting limits on judicial power, particularly as to non-parties who are just "*doing their jobs*" (as Argentina puts it). In the absence of decisive precedent, the question of how best to reconcile these competing concerns will weigh heavily on the Second Circuit's reading of Rule 65(d)(2)(C). (For those interested in exploring this issue further, *see* Aurelius' brief at pages 15 to 21, Argentina's reply brief at 14 to 19, and BNY Mellon's reply brief at 8 to 24, all of which are available on our Argentine Sovereign Debt webpage.)

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We will issue a further update following oral argument, scheduled to be held on February 27.

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