COMMENTS

THE CONTRACTS CLAUSE AND THE CONSTITUTIONALITY OF A MODEL LAW APPROACH TO SOVEREIGN DEBT RESTRUCTURING

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INTRODUCTION

The recent controversy regarding Argentina's dragging debt litigation has revived the longstanding academic discussion about the need for plausible solutions for those countries attempting to address their unsustainable debt burdens.[1] The Argentinean crisis was exacerbated by a problem with a holdout creditor group, who effectively refused to accept the same debt write-down as other creditors in 2005 and 2010. Instead, the group sought full payment of their claim through litigation in the New York courts, leading to a fresh default in 2014.[2] While a multitude of issues came to light during the fifteen-year battle that included both in-court litigation and out-of-court negotiations, perhaps one of the most salient lessons from these proceedings is that financial crises are not a thing of the past, and their specter can usher in profound consequences regarding countries' economic and political stability.[3] Moreover, the contentious nature of the Argentinian proceedings demonstrates the need for an institutionalized mechanism for those instances in which a government cannot realistically pay its debts. A better, more standardized debt resolution system could exist to preserve the rights of creditors and debtor countries alike.[4]

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1 Bloomberg View, *Editorial: Argentina's Debt Deal Doesn't Solve the Real Problem*, NEW HAVEN REG. (Mar. 1, 2016) http://www.nhregister.com/opinion/20160301/editorial-argentinas-debt-deal-doesnt-solve-the-real-problem.

2 *Argentina's Debt: At Last*, THE ECONOMIST (Mar. 5, 2016), http://www.economist.com/news/americas/21693786-agreement-victory-countrys-new-president-argentina-reaches-deal-its.

3 *See* Alinna Arora & Rodrigo Olivares Caminal, *Rethinking the Sovereign Debt Restructuring Approach*, 9 LAW & BUS. REV. AM. 629, 629 (discussing how in developing economies like Turkey and Argentina, the predominance of government debt in international markets makes sovereign debt crises like Turkey and Argentina into economy-wide financial crises).

4 *Id.* at 631; *see also* The Associated Press, *Argentina and a Group of U.S. Holdout Creditors Announce a Deal in a Longstanding Debt Standoff, Potentially Breaking an Impasse that Has Kept the South American Country on*

Although in Argentina's case the parties were able to eventually reach a resolution, the implications of a large-scale sovereign debt default in today's interdependent international financial system pose a serious systemic threat. The mere prospect of these rippling consequences has already led to radical changes in how debt is issued worldwide.[5] Indeed, in 2016 the International Monetary Fund warned that if countries do not start acting in concert towards some kind of common goals, the global economy "could be derailed" and urged countries to move "urgently" and "collectively" to boost global growth prospects.[6] Despite the cooperation urged by such statements, widespread uncertainty and disagreements among countries persist, thus allowing uncertainty to loom over our increasingly globalized economy. As sovereign bonds become increasingly prevalent in the global capital markets, the potential for a single nation's debt default to trigger a larger systemic collapse grows—mainly because as issuance of these bonds proliferates, the economic dependency between countries likewise increases.[7]

The contemporary Argentinian example and earlier crises in Greece and Ecuador are all evidence of the serious costs that accompany the current inconsistent resolutions to sovereign debt processes.[8] Unresolved sovereign debt issues carry huge costs, and have at once caused financial and other damage to individual debtor nations, citizens, and creditors.[9] When countries' external debt exceeds sustainable levels and the borrower state is unable to service payments of principal and interest, there is no way for creditors to force repayment by these sovereign nations, since there is no legal framework under which to wind up a country, or seize and liquidate its domestically-held assets.[10] As a result, in addition to the IMF's statements, there is a growing recognition within the sovereign debt markets for a more dependable approach to the risks accompanying potential default, and more specifically, for a mechanism that allows for consistency in sover-

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the Margins of International Credit Markets, N.Y. TIMES, (Feb. 29, 2016) http://nyti.ms/1nbSph0; *Argentina's Debt: At Last*, *supra* note 2.

5 Bloomberg View, *supra* note 1.

6 Ngaire Woods, *The Global Economy's Stealth Resilience*, PROJECT SYNDICATE, (Mar. 3, 2016) https://www.project-syndicate.org/commentary/g-20-shanghai-meeting-distributed-governance-by-ngaire-woods-2016-03.

7 Steven L. Schwarcz, *Sovereign Debt Restructuring Options: An Analytical Comparison*, 2 HARV. BUS. L. REV. 95, 97 (2012) ("As global capital markets increasingly (and inevitably) embrace sovereign bonds, the potential for a nation's debt default to trigger a larger systemic collapse increases as these relationships become even more linked.")

8 *See* Jack Boorman, *Alternative Approaches to Sovereign Debt Restructuring*, 23 CATO J. 59, 59 (2003) (arguing the extended process of bringing defaulted sovereign debt to resolution caused intolerable economic losses in Ecuador); *see also* Steven L. Schwarcz, *Sovereign Debt Restructuring: A Model-Law Approach*, J. GLOBALIZATION & DEV., 2 (2016) (enumerating mechanisms by which extended and uncertain insolvent sovereign debt resolution harms all stakeholders).

9 Schwarcz, *supra* note 8, at 2–3.

10 Jonathan Sedlak, *Sovereign Debt Restructuring: Statutory Reform or Contractual Solution?*, 152 U. PA. L. REV. 1483, 1487 (2004).

eign debt restructuring across nations.[11] However, the international financial system currently offers no established framework for the predictable and orderly restructuring of sovereign debt, and the fact that debt is issued in different manners in different jurisdictions simply exacerbates the problem.[12] As Boorman notes, "[i]n the view of many, however, the costs incurred under the current international financial architecture are unnecessarily large and act to the detriment of both debtors and their creditors.[13]

There is clearly a need for change. As a result of the inefficiencies of the current system and the increasing media and academic focus on these debt-restructuring issues, Professor Steven A. Schwarcz, a leader in the study of sovereign debt and expert in the restructuring field, has recently crafted a forthcoming proposal for a statutory framework.[14] His innovative statutory solution consists of a cross-jurisdictional model law. This law, if adopted by at least two jurisdictions at a national or subnational level, would create what Schwarcz believes to be the most legally and practically feasible mechanism under which a sovereign debt restructuring could take place—and due to the distribution of bondholders and governing law, his proposal suggests that the law would be most successful if the United States enacted it on a subnational level, through adoption in New York state.[15]

Though his proposal exhibits many benefits, and would, if adopted, create a single comprehensive mechanism with which the international markets could cohesively approach sovereign debt, his proposal nonetheless raises some concerns with respect to its legal feasibility. In particular, the law's retroactive modification of creditors' debt contracts, particularly those being acted upon at a subnational level, is arguably in violation of the federal Contracts Clause,[16] a provision of the U.S. Constitution that prohibits states from enacting any legislation that impairs its citizens' existing contractual obligations.[17] In exploring the question of constitutionality, the refutations and challenges contained in this paper are not meant to be criti-

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11 *See, e.g.*, INTERNATIONAL MONETARY FUND, SOVEREIGN DEBT RESTRUCTURING—RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK (Apr. 26, 2013), *https://www.imf.org/external/np/pp/eng/2013/042613.pdf*. "Sovereign debt restructuring" is a term that refers to the processes that result in an adjustment of the principal amount of treasury obligations, and seek to make a country's debt sustainable. Sedlak, *supra* note 10 at 1491; *see generally* Charles W. Mooney, Jr., *United States Sovereign Debt: A Thought Experiment On Default And Restructuring* 2 (Univ. of Pa. Law Sch. Inst. for Law & Econ., Research Paper No. 14-40, 2012) (discussing the unpredictable consequences of a hypothetical U.S. sovereign default).

12 Shalendra D. Sharma, *Resolving Sovereign Debt: Collective Action Clauses or the Sovereign Debt Restructuring Mechanism*, 38 J. WORLD TRADE 627, 627 (2004).

13 Boorman, *supra* note 8, at 59.

14 *See generally* Schwarcz, *supra* note 7.

15 *Id.* at 11.

16 Alternatively, some literature refers to this clause as the "Contract Clause." This paper will, for convenience's sake, refer to it consistently as the "Contracts Clause."

17 U.S. CONST. art I, § 10.

cisms, as Schwarcz's model law is one of the most compelling examples of a realistic, adaptable mechanism that could effect sovereign debt restructuring. However, this analysis seeks to show, through a historical approach, that as Contracts Clause jurisprudence has evolved, it likewise follows that the legal feasibility of such a law is perhaps less clean, and more open to criticism, than Schwarcz's initial proposal contemplates.

Part I of this paper will describe the legal and academic landscape surrounding sovereign debt restructuring and the problems that currently limit the effectiveness of the contractual legal system. Part II will delve into solutions: specifically, it will explore Professor Schwarcz's statutory proposal and explain the benefits of his model law, which is arguably one of the few mechanisms under which a cross-jurisdictional restructuring mechanism could actually be effected. Part III will then address the constitutional issues that this model law approach creates, and explore Contracts Clause jurisprudence to ascertain the law's legal soundness. Using the lessons of Part III, Part IV will address and refute the primary counterarguments that the staunchest proponents of the model law could raise—namely, that there is no mechanism with which creditors can challenge the law, and that a court should uphold the model law on policy grounds. Part V, then, will propose alternative policy strands that could be incorporated into the law, and move towards a solution that could limit the unlimited universe of creditors with standing, which may make the law a more legally appealing, and constitutional, option.

I. SOVEREIGN DEBT RESTRUCTURING: CURRENT PROBLEMS AND PROPOSED SOLUTIONS

A sovereign debt restructuring differs from a typical corporate restructuring in several key ways. Perhaps most notably, institutionalized mechanisms exist for the distribution of assets in a private corporate scenario, in which creditors can force an insolvent corporation to liquidate and convey its assets through the procedures of a bankruptcy court or other tribunal.[18] And although some U.S. entities at the municipal level have special provisions for reorganization, a relatively tidy liquidation option, at the current time, is unavailable when the debtor is sovereign at either a national or subnational level.[19] Further, the goal of a sovereign debt restructuring is

18 Steven L. Schwarcz, *Sovereign Debt Restructuting: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 957–58 (2000).

19 With regard to a subnational bankruptcy, some politicians and academics, including Schwarcz and David Skeel, have suggested that Congress should extend federal bankruptcy regimes to the states, but even in such a case it would likely not bring about a liquidation under Chapter 7 (as practically speaking, this seems implausible), but would likely take more of the flavor of a reorganization under Chapter 11 of the Bankruptcy Code, or an extension of Chapter 9 (which covers municipal bankruptcies). *See* David A. Skeel Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677,

only reorganization of the debt, and the safety valve of liquidation is not an exit option for a debtor state, even those in the most inherently "bad" financial situations.[20] Beginning in the 1980s and continuing into the twenty first century, there has been a rise in the number of debtor countries seeking relief for debt burdens, and among these parties are some of the largest debtors worldwide—yet "[s]overeign debt restructuring is a problem that has been ignored for quite some time"[21] despite the earlier discussed integration of global markets and accompanying criticisms of bailouts.[22]

Practically speaking, if a sovereign debtor shows itself willing to meet its debts when it becomes possible, it is in the interests of all the creditors to maintain their relationship with the debtor-state and negotiate a workable solution. Like a bankruptcy-based reorganization, in which agreement on a plan is rewarded while failure to agree is penalized, the most efficient forms of sovereign debt restructuring are those that are consensual.[23] That said, reaching this consensus is a "haphazard affair."[24] Achievement of those consensual aspects of a plan is often undermined by the parties' interests: the debtor-state and its creditors necessarily are in conflict, which often makes it difficult, if not impossible, for these two parties to reach agreement on a single restructuring plan, let alone which legal framework to apply.[25] Beyond this, there are often intercreditor disagreements, which signal another problem that can arise at virtually any stage of a restructuring and derail the process.[26]

Although the advocacy and involvement of the International Monetary Fund is importantly symbolically, as it is a multilateral government entity attempting to aid in the process of sovereign debt restructuring, its involvement has only further complicated the situation. A bailout by the IMF is one mechanism with which a distressed company can find relief,[27] but this solution remains controversial because in bailouts the Fund is acting as "a lender of last resort" to financially troubled states.[28] The IMF's

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694 (2012); *see also* Steven L. Schwarcz, *A Minimalist Approach to State 'Bankruptcy'*, 59 UCLA L. REV. 322, 325–26 (2011).

20 Schwarcz, *supra* note 18, at 959, n.7 (noting that no conversion similar to that in a corporate bankruptcy is within the realm of consideration for a sovereign restructuring) (citing Sachs, *infra* note 31).

21 Sedlak, *supra* note 10, at 1514.

22 *See* Graeme F. Rea, *Restructuring Sovereign Debt—Will There be New International Law and Institutions?*, 77 AM. SOC'Y INT'L L. PROC. 312 (1983) (describing the ad hoc processes and complications of stabilizing insolvent governments).

23 *Id.* at 312.

24 Schwarcz, *supra* note 18, at 959

25 *Id.* at 959–60.

26 For instance, see the holdout problem that exists within the Collective Action Clause solution to restructuring, *supra* note 2 and accompanying text; *see also infra* note 46 and accompanying text.

27 Arora & Caminal, *supra* note 3, at 630.

28 Schwarcz, *supra* note 18, at 961.

lending practice has created what has been labeled a risk of "moral hazard," a scenario in which countries hoping for an IMF bailout will fail to undertake a prudent economic course, as they will be protected from default and thus can engage in unwarranted financial risk without any meaningful oversight.[29] Though the IMF has imposed conditions of fiscal responsibility through lending practices (mainly through an approach known as "conditionality") such attempts to alleviate moral hazard sometimes fail, and the problem persists.[30] In a criticism of the IMF's role in debt workouts, and in recommending an overhaul of its lending practices, Jeffrey Sachs states "[t]he IMF's own tactics—and failure to act like a bankruptcy manager—help to breed failures."[31]

Currently, uncertainty surrounds every aspect of the sovereign debt restructuring process.[32] As the above debates show, restructuring sovereign debt is a difficult subject, one that is open to criticism on multiple fronts and presents several layered political and social questions. Some such questions include: At what point does a country decide that its debt is unsustainable? Once it does reach this conclusion, why is any one particular mechanism the proper one to restructure that debt? What parties have a stake in the proceedings, and how involved should the official international community be in the eventual restructuring?[33] And while "[d]ebt can almost always be serviced in some abstract sense, through additional taxation and through the diversion of yet more domestic production to exports to generate the revenue and foreign exchange needed to service the debt," there is a threshold question regarding whether a large-scale debt restructuring is ever appropriate, as well as what parties should be able to force, or prevent, the restructuring's results.[34] Further, a debtor state's decision is even more complicated by the fact that it cannot restructure its debt completely unilaterally without suffering "reputational cost in the world financial community."[35] Resulting from these political uncertainties is the need for the debt servicing mechanism to be effective in not only restructuring the debt, but to also to garner the support and endorsement of the international community. This approval necessarily includes that of the International Monetary

29 *Id*. at 962.

30 *Id*. at 963.

31 Jeffrey D. Sachs, 1995, *Do We Need an International Lender of Last Resort?*, Princeton University Frank D. Graham Lecture (Apr. 20, 1995), http://hdl.handle.net/10022/AC:P:8279.

32 Arora & Caminal, *supra* note 3, at 630.

33 Boorman, *supra* note 8, at 60.

34 *Id.* at 61.

35 Steven L. Schwarcz, *"Idiot's Guide" to Sovereign Debt Restructuring,* 53 EMORY L.J. 1189, 1192 (2004); Sachs, *supra* note 31*; see also* Schwarcz, *supra* note 7, at 101 (recognizing unilateral debt reorganization as an alternative to bilateral debt restructuring, but noting that "[t]he nation may well suffer reputational consequences, and any national assets (such as ships or airplanes) outside the nation's jurisprudence might be able to be seized.")

Fund, who will likely still need to commit resources to continue to assist the debtor country, regardless of the Fund's own role in complicity allowing governments to remain in financial distress.[36]

Because the current system lacks consistency and cohesion, academics have debated what resolution framework is the best mechanism to institutionalize widely and consistently, and there is, remarkably, "widespread agreement for a revamped sovereign debt restructuring process."[37] Though some radical mechanisms and discussions exist, and have ranged from strict court-supervised international bankruptcy regimes,[38] to systems modeled on railroad receiverships,[39] to even more freewheeling, completely decentralized approaches,[40] the primary academic debate centers on either adopting a cross-border regime of either a contractual or a statutory nature. This divide is sometimes identified as a difference drawn between public law, which is embodied through a statutory approach that would require agreement across states, versus the private law solutions, which could be undertaken unilaterally, and take the form of individual collective action clauses.[41]

The private law solution to address sovereign debt restructuring is contractual, and treats each issuance of debt as its own distinct contract and, therefore, subject to its own terms. This approach provides a certain process to restructure debt, the lack of which currently prevents investors from adequately assessing the cost of default.[42] Often, issued debt instruments contain collective action clauses, or CACs. The CAC approach is described as "voluntary and market based" and is contingent on the inclusion of these various clauses in individual bond instruments, leaving jurisdiction to the courts in which the instrument was issued.[43] Proponents of this contractual approach often extol the virtues of market-based solutions, and policy proposals in this arena encourage creditors and debtors to actively en-

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36 Boorman *supra* note 8, at 61.

37 Arora & Caminal, *supra* note 3, at 631.

38 Jeffrey Sachs proposed an international bankruptcy regime modeled on Chapter 11 of the US Bankruptcy code to provide insolvent countries the same protection from creditors as private firm. *See* Sharma, *supra* note 12, at 628.

39 *See generally* Stephen J. Lubben, *Out of the Past: Railroads & Sovereign Debt Restructuring*, 35 GEO. J. INT'L L. 845, 845–46 (2004) (suggesting many analogies and parallels between the options for bankruptcy proceedings for railroads and sovereign nations, since both structures operate in the absence of a statutory framework and do not have a liquidation as an exit option, a railroad receivership proceeding could plausibly be adapted for a sovereign nation with certain limitations.)

40 *See* Arora & Caminal, *supra* note 3, at 649 (detailing a CAC-modifying proposal by the U.S. Undersecretary John B. Taylor).

41 Schwarcz, *supra* note 35, at 1190.

42 Sedlak, *supra* note 10, at 1499 ("With no process in place, investors are unable to adequately assess the cost of default. Without this information, not only are bonds priced inaccurately, but great uncertainty ensues when a country has debts that are unmanagemeable.")

43 Boorman, *supra* note 8, at 65.

gage in altering the terms under which countries borrow money.[44] Suggested mechanisms for improvement of this system would allow for the broadening of the use of these CACs in order to allow the holders of the debt to understand more clearly its relationship with the debtor for the restructuring of those claims.[45] Further, some proposals contain initiation and engagement clauses, which are designed to attack the minority holdout problem and uncertainties about procedure.[46] The traditional form of a CAC provides for majority enforcement and majority restructuring provisions, which have been in use for some time, and have received attention as being likely to deserve wider use.[47]

In this system, however, there is a collective action problem that has worsened significantly among creditors as debtor states have begun borrowing more money from bond investors.[48] This has led to the holdout problem discussed earlier with respect to Argentina: when facing a plan of reorganization, one or more creditor groups can prevent a consensual plan from being reached in the hope that the need to reach an agreement becomes so powerful that other parties will buy out the holdout claims or pay them a premium.[49] U.S. Courts have even recognized, in some instances, that such behavior is permissible in the sovereign debt context.[50] Therefore, at each stage of a contractual sovereign debt restructuring, problems plague the readjustment of debt claims to the detriment of the non-holdout creditors as well as the debtor.[51]

There is a current movement towards better formulated, more viable steps that address these problems, such as when contingency clauses are added, which could aggregate creditor claims for voting purposes, or authorize a trustee of a bondholder syndicate to act as a representative in a restructuring.[52] However, little progress has come out of these ambitious initiatives, and any continued efforts largely appear to mimic the effects and role of a statutory solution to the problem. Although the consistent inclusion of such clauses would be an improvement over the state of affairs, there is a question whether this approach even goes far enough in effecting an orderly restructuring, especially because of the lack of uniformity of lan-

44 Sedlak, *supra* note 10, at 1498.

45 Boorman, *supra* note 8, at 60.

46 Sedlak, *supra* note 10, at 1500.

47 Boorman, *supra* note 8, at 65.

48 Schwarcz, *supra* note 18, at 960.

49 Schwarcz, *supra* note 7, at 98.

50 *Id*. (citing the opinion in *Allied Bank International v. Banco Credito Agricola de Cartago*, 757 F.2d 516 (2d Cir. 1985), in which a member of a bank syndicate held out in an agreement with Costa Rican sovereign debtors and the court granted summary judgment on the theory that the loan was clearly due and payable).

51 Schwarcz, *supra* note 18, at 961.

52 *See* Boorman, *supra* note 8, at 65, 67 (describing the movement towards more ambitious contingency clauses).

guage across jurisdictions and bond instruments.[53] It should be noted that restructurings in Ecuador and the Ukraine demonstrated that a restructuring is possible under this voluntary contractual agreement system.[54]

II. ONE STATUTORY APPROACH: A MODEL LAW AS A MEANS TO RESTRUCTURE SOVEREIGN DEBT

As a result of these collective action problems presented by the contractual approach, numerous parties, including the IMF, have voiced support for some statutory creation that would function like a consistent, international bankruptcy regime.[55] Generally speaking, a well-designed statutory solution is largely preferable to a contractual one. A statutory solution would allow a sovereign the ability to bind its minority creditors under the power of law, thereby addressing the holdout problem and enabling the debtor-states to restructure debt free of this concern.[56] Thus, the desire to reduce the social costs of sovereign debt has led toward a movement pursuing a systematic legal resolution framework, one that takes the form of a cross-jurisdictional statute that can help debtor states restructure unsustainable sovereign debt.[57]

Once-IMF Director Anne Kreuger stated, in a proposal for a sovereign debt restructuring mechanism, that the most important element of any new restructuring framework would be a mechanism to allow a qualified majority of creditors to bind minority creditors.[58] The IMF proposed its own Sovereign Debt Restructuring Mechanism, one that was formally designed to move away from the messy contractual approach and instead organize creditors and countries in an effort to restructure their debt in an orderly and timely manner,[59] but the idea never gained traction and has been largely abandoned.[60] As a result, the contractual, market based approach has become the status quo, though calls for a formal restructuring mecha-

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53 Boorman, *supra* note 8, at 65–67.

54 Arora & Caminal, *supra* note 3, at 637.

55 Sedlak, *supra* note 10, at 1491; Bloomberg View, *supra* note 1; *see also* Charles W. Mooney, Jr., *A Framework for a Formal Sovereign Debt Restructuring Mechanism: The KISS Principle (Keep It Simple, Stupid) and Other Guiding Principles*, 37 MICH. J. INT'L L. 57, 60 (2015)(discussing the continued need for a formal restructuring mechanism notwithstanding the rejection of the IMF's SDRM proposal and widespread use and acceptance of CACs).

56 Sedlak, *supra* note 10, at 1493–94.

57 Richard Gitlin & Brett House, *A Blueprint for a Sovereign Debt Forum*, 27 CIGI PAPERS 5, 5 (2014).

58 Sedlak, *supra* note 10, at 1494 (quoting Anne O. Kreuger, *A New Approach to Sovereign Debt Restructuring*, Int'l Monetary Fund, at 14 (2002), http://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf at 2 (internal quotes omitted)).

59 See Arora, *supra* note 3, at 633.

60 Mooney, *supra* note 55, at 58 ("The proposal received support, but was eventually abandoned" citing its reasons for its abandonment as, *inter alia*, the opposition of the United States and the private sector).

nism have not ceased, and have, in light of the Eurozone crisis, actually resurged.[61]

In response to recent financial crises, a similar, contemporary proposal comes from Professor Steven L. Schwarcz: across borders, states would adopt a model law to achieve a voluntary resolution framework within their jurisdictions.[62] Such an approach, he argues, would reduce the need for sovereign debt bailouts by organizations like the IMF, which he calls "costly" and the main cause of the aforementioned "moral hazard" issue.[63] Further, Schwarcz claims that a model law approach would "reduce the risk of systemic contagion" from a debtor-state's default, an important goal in today's interdependent financial system.[64]

Schwarcz arrived at this statutory approach after observing the system of CACs, which he labels a "deeply dysfunctional" approach that "produces bad law,"[65] and noting that the more sustainable and consistent model laws are not unprecedented in cross-jurisdictional lawmaking.[66] His proposal points out how CACs are insufficient to solve the holdout problem, as many sovereign debt contracts lack them, and still require unanimity to effect a restructuring.[67] Further, even in those contracts that contain CACs, the requirements are so high that the holdouts come about in another fashion, and such contracts are only binding to the contract parties.[68] In sum, radically improved CACs, such as those proposed by the International Capital Market Association in August 2014, are insufficient to address the immediacy of the problem at hand.[69]

It is at this point in his proposal that Schwarcz asserts that a model law would be the preferable approach, since each participating government will adopt the law and take its own individual requisite steps to make it effective,

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61 Mooney, *supra* note 55, at 60.

62 Schwarcz, *supra* note 8, at 6.

63 *Id.* at 4–5.

64 *Id.* at 5.

65 *Id.* at 3.

66 *Id.* at 6. Schwarcz cites, as precedent, the UNCITRAL Model Law on International Commercial Arbitration as an example of an international insolvency law, while the Uniform Commercial Code is an example of a subnational model law that was uniformly enacted on a multi-state level. *See also* United Nations, UNCITRAL Model Law on International Commercial Arbitration (1985, with amendments as adopted in 2006), http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998_Ebook.pdf (establishing a model law regularizing arbitration as a method of settling disputes in the international commercial markets).

67 *Schwarcz*, *supra* note 8, at 3.

68 *Id.* ("Even in sovereign debt contracts that include CACs, the supermajority requirement may be so high (e.g. three-quarters) that vulture funds are able to purchase vote-blocking positions that enable them to act as holdouts").

69 *See id.* at 4 ("Even if all new sovereign debt contracts were to include aggregate-voting CACs, it will be many years before existing debt contracts, which do not include them, are paid off.")

while still adhering to the same, or close to the same legislative text.[70] As opposed to a convention, a model law permits the texts of the laws to vary, while also allowing any enacted laws to be amended by member states unilaterally if the need so arises.[71] For this reason, a model law approach is arguably preferable to adhering to a convention, which is a legal tool that is legally very similar to a cross-border treaty. Though a convention would similarly require each member state to adhere to its requirements, and in most cases are preferable to model laws because they are binding upon the nations, who cannot renege on their agreements,[72] such certainty is less preferable in the current instance. In most situations in which a country is experimenting with new proposals,[73] model laws can have broad acceptance and tweaks that a strict convention does not allow, and if a state wants to modify or denounce a model law, it can do so on a smaller state or subnational level, which would not violate international law.[74]

The structure of Schwarcz's model law is meant to provide effective mechanisms for a restructuring while reducing the social costs of a debt crisis, systemic risk, creditor uncertainty, and the need for bailouts.[75] He achieves this though applying the law retroactively and overriding any contractual provisions inconsistent with "any contractual provisions that are inconsistent with the provisions of this [l]aw."[76] The law is invoked by voluntary petition, and immediately notifies all creditors of the state's intention to negotiate a plan.[77] The law outlines a binding voting structure in its Chapter III, Article 7[78] as well as terms of Lending and a Priority Scheme in its Chapter IV, Articles 8 and 9.[79] All disputes under the law are resolved by binding arbitration through an international court.[80]

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70 *See* Schwarcz, *supra* note 18, (noting that Professor Schwarcz has alternatively argued for the adoption of an international convention in 1999–2000); *see also* Steven L. Schwarcz, *Idiot's Guide to Sovereign Debt Restructuring* 53 EMORY L.J. 1189, 1192 (2004) (concluding that a statutory approach is the most preferable and effective way of effecting a restructuring in); *see also* Schwarcz, *supra* note 7, at 97 (suggesting that the model approach is the next line of scholarship for Schwarcz).

71 Charles W. Mooney, Jr., "Extraterritorial Impact of Choice of Law Rules for Non-United States Debtors Under Revised Uniform Commercial Code Article 9 and a New Proposal for International Harmonization," in CROSS-BORDER SECURITY AND INSOLVENCY (Michael Bridge & Robert Stevens eds., Oxford University Press 2001).

72 Schwarcz, *supra* note 8, at 6–7.

73 *Id.*

74 *See* Mooney, *supra* note 71, at 202.

75 Schwarcz, *supra* note 7, at 13.

76 *Id*. at 24, 35.

77 *Id.* at 36.

78 *See id.* at 37 ("A class of claims has agreed to a Plan if creditors holding at least [two-thirds] in amount and more than [one-half] in number of the claims of such class [voting on such Plan] [entitled to vote of such Plan] agree to the Plan," noting how selecting those actually voting on the plan can more easily lead to Plan approval).

79 *Id.* at 38 ("Subject to Article 8(3), the State shall have the right to borrow money on such terms and conditions as it deems appropriate"; "The State shall repay loans approved under Article 8

Rather than advocating for large-scale, multi-member adoption of his model law, Schwarcz instead proposes the enactment to be limited to one or two jurisdictions.[81] More specifically, because either New York or English law governs most sovereign debt contracts, Schwarcz believes one or both of those jurisdictions should adopt his model law, with one state's adoption incentivizing the other to similarly adopt.[82]

III. THE LEGAL FEASIBILITY OF THIS MODEL LAW APPROACH

In his proposal, Schwarcz maintains that even despite the retroactive application of the model law, it is nonetheless within the scope of legal feasibility—because it rests its constitutionality on an exercise of New York's police powers, its retroactive features would be constitutionally justified.[83] Looking to precedent, the Model Law cleanly relies on the Supreme Court's 1934 decision *Home Building & Loan v. Blaisdell*, an opinion that does indeed speak of the legal standard that upholds otherwise unconstitutional acts in the name of the police power.[84] Schwarcz claims that the state of New York could effectively frame its law to meet the five factor test the Court first recognized in *Blaisdell,* which allowed the law in that instance to survive a Contracts Clause challenge.[85] As he states, any law enacted as an exercise of a state's police powers would have to (1) address a grave temporary economic emergency, (2) protect a basis societal interest, not a favored group, (3) provide relief—in the form of supermajority aggregate voting for debt relief and temporary funding—that is appropriately tailored to the emergency it is enacted to address, (4) impose reasonable conditions, and (5) be limited in its application to the duration of the economic emergency.[86] Schwarcz also says that "[m]ore recent jurisprudence suggests [that] even more leeway" could be granted to laws that normally would be subject to a Contracts Clause challenge,[87] and that such leeway granted may be even greater if the constitutional impairment is "not substantial."[88]

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prior to paying any other claims. . . . The claims of creditors of the State are subordinated to the extent needed to effectuate the priority payment under this Article 9.")

80 *See id.* ("All disputes under this Law shall be resolved by binding arbitration before a panel of three arbitrators.")

81 *Id.* at 5.

82 *Id.*

83 *Id.* at 5, 25–26 n.137–38 and accompanying text ("Such a statute would survive a Contracts Clause challenge if it . . . [he then lists the *Blaisdell* factors]").

84 Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934).

85 *Id.* at 444–47.

86 *Id.*

87 Schwarcz, *supra* note 8, at 26 n.133 (citing Healthnow N.Y. Inc. v. N.Y. State Ins. Dept., 110 A.D. 3d 1216, 1217 (N.Y. App. Div. 3d Dep't 2013) (noting that "this case, however, is a state court decision."))

88 Schwarcz, *supra* note 8, at 26 n.134 (citing Energy Reserves Grp. v. Kan. Power & Light Co., 459 U.S. 400, 411 (1983)).

On this foundation, Schwarcz states "New York . . . should be able to frame its enactment of the [m]odel [l]aw in such a way as to not violate the Contracts Clause" and it therefore should meet the U.S. Supreme Court's criteria to survive a Contracts Clause challenge.[89] The questions about the law's legal feasibility, however, do not end here. Although Schwarcz is correct in recognizing that the Supreme Court rejected a Contracts Clause challenge in *Blaisdell* in part on account of the economic emergency posed by the Depression, courts seem likely to treat invocations of emergency more skeptically when made in service to the state's own self-interest.[90] And although it is indeed possible his law may comport with the emergency powers doctrine presented in *Blaisdell,* the narrowness of the exception may yet undermine his law's feasibility. Further, a historical survey of Contracts Clause jurisprudence shows how challenges to the Clause, and exceptions found, rarely predictably align with precedent, and instead are highly subject to the social climate under which the challenge is raised. In addition, there is a question as to whether a state even has the ability to enact a subnational insolvency law, or whether the evolution of the Bankruptcy Clause would redistribute such power elsewhere.

A. Blaisdell *and Emergency Powers Exception*

The model law's clean reliance on the *Blaisdell* factor understates the complexity of the constitutional legal landscape that would allow a state law to be immune from a Contracts Clause challenge, and fails to mention the accompanying heightened judicial scrutiny that the state, in enacting a self-serving model law, would realistically receive. Further, the law's reliance on solely the *Blaisdell* case understates the illusive nature of the opinion and the uncertainties it contained, as "[m]any scholars consider [*Blaisdell*] an aberration in Contract[s] Clause jurisprudence and contend its emphasis upon flexible judicial interpretation and the wide latitude of state police powers undermined the security of vested contract rights."[91] Of particular concern is the Model Law's retroactivity, which Schwarcz himself notes that this could raise an enforceability concern under domestic subnational law,[92] noting how this particular feature of the law could render it as being a violation of the Contracts Clause.

At the time *Blaisdell* bubbled up to the courts, Franklin Delano Roosevelt was president, over four thousand banks had failed, the national in-

89 *Id.* at 25.

90 Emily D. Johnson & Ernest A. Young, *The Constitutional Law of State Debt*, 7 DUKE J. CONST. L. & PUB. POL. 117, 134 (2012).

91 Samuel R. Olken, *Charles Evans Hughes and the* Blaisdell *Decision: A Historical Study of contract Clause Jurisprudence*, 72 OR. L. REV. 513, 515 (1993).

92 Schwarcz, *supra* note 8, at 25.

come had been halved, over a quarter of the work force was idle, and all areas of the economy were close to failure.[93] In response to the wave of farm foreclosures that this economic state entailed, Minnesota passed a law under which mortgagers who were unable to make their payments were permitted to turn to state courts to alter their payment schedules.[94] The economic climate was highly uncertain, and the need for some kind of financial act was become all the more apparent.

Contextualism, then, is the basic premise underlying the *Blaisdell* decision. Justice Hughes' majority opinion reveals that that the constitutional provision in question should be interpreted not in the abstract, but both within "the context of the entire Constitution," as well as that of "the social situation confronting the Court"—in other words, the same constitutional provisions "may mandate different results in similar cases arising at different points in history."[95] As a result, the text of the *Blaisdell* opinion is highly suggestive that the case was decided wholly within the tumultuous economic and social climate under which it arose, with Hughes stating, "[e]mergency does not create power. Emergency does not increase granted power or remove or diminish the restrictions imposed upon power granted or reserved," and that an emergency may justify the *use*, even if not the *existence* of the police power.[96] The Great Depression (the "emergency" Hughes was alluding to) served as the grounds under which the opinion rests. Though Hughes also recognizes that the law in question is exactly the kind of law that the Contracts Clause, and framers sought to prevent,[97] his holding nonetheless expressed the belief that some degree of impairment was nonetheless constitutionally permissible. And indeed, the ability for the court to exercise any emergency power, "thus transcending the carefully crafted textual boundaries emplaced on government actors, is [likely] implicit within the structure of the Constitution."[98] Because precedent was not "directly applicable to the question" before the court "in view of the conditions with which the Minnesota statute seeks to safeguard the interests of the mortgagee-purchaser," the Court instead looked to cases under which the economic interests of the state "may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts."[99]

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93 Rebecca M. Kahan, *Constitutional Stretch, Snap-Back, & Sag: Why* Blaisdell *was a Harsher Blow to Liberty than* Korematsu, 99 NW. U. L. REV. 1279, 1302 (2005).

94 Charles A. Bieneman, Note, *Legal Interpretation and a Constitutional Case:* Home Building & Loan Association v. Blaisdell, 90 MICH. L. REV. 2534, 2537 (1992).

95 *Id.* at 2534.

96 Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 425–26 (1934).

97 *Id.* at 428–29.

98 Kahan, *supra* note 93, at 1286.

99 *Blaisdell*, 290 U.S. at 434, 437.

Some scholarship argues that *Blaisdell*'s interpretation of the Contracts Clause is legally baseless, and was instead applied only due to the "[s]trong social pressures to uphold the Minnesota Mortgage Moratorium [that] undeniably existed."[100] Minnesota's law was intended to give creditors what the mortgagors could pay, and did not wholly abrogate (even if it did impair) the mortgagors' obligation on the contract. However, the finely-worded Contracts Clause leaves no gap in interpretation to shoehorn this policy perspective in—"[w]ere the clause vague or ambiguous, a Court might find gaps allowing it interpretive leeway."[101] This reading of *Blaisdell* suggests that the Contracts Clause paid little to no attention to the positive law at the time, and was therefore exclusively appropriate for the mortgagors and creditors in the Great Depression, but likely should not be widely applicable in other contexts.

Clearly, the list of factors that the court set out is evidence of efforts to narrowly construe the *Blaisdell* opinion.[102] The state's action "must be limited by reasonable conditions appropriate to the emergency"[103] and the relief "must have reasonable relation to the legitimate end to which the State is entitled to direct its legislation,"[104] and such relief would be considered unconstitutional if it was "neither temporary nor conditional" and contained "no limitations as to time, amount, circumstances, or need."[105]

The Court has allowed for this emergency exception for regulations that are needed to preserve "what is best for the body politic in the long run" and such benefits can "prevail over the interests of particular individuals."[106] And though it is true that the Supreme Court has at times granted inalienable police powers an expansive interpretation, it is not certain that such leeway would be similarly given to those regulations simply meant to relieve a state from its own economic debt, especially if, as Justice Sutherland claims in his dissent to *Blaisdell*, the Contracts Clause serves the "studied purpose of preventing legislation designed to relieve debtors *especially* in time of distress"[107] *Blaisdell* did not address whether economic interests are included in the powers protecting the public welfare, though the Court did explicitly state that the state's reserved powers could not be construed to allow a state to repudiate its debts.[108] Moreover, there is some skepticism

100 Bieneman, *supra* note 94, at 2561.

101 *Id.* at 2563.

102 Olken, *supra* note 91, at 595. ("As a whole, these cases demonstrate the perception of the Chief Justice and other members of the *Blaisdell* majority about the limitations of their decision. Hughes, in particular, did not intend to eviscerate the constitutional protection of vested contract rights.")

103 W. B. Worthen Co. v. Thomas, 292 U.S. 426, 433 (1934).

104 *Id.* at 433.

105 *Id.* at 434.

106 Shepard v. Village of Skaneateles, 89 N.E.2d 619 (1949).

107 Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 453 (1934).

108 *Id.* at 439.

about this "'pure' economic state of emergency, [which,] though relatively unknown before the twentieth century, is now invoked as a justification by both left- and right-wing governments seeking to pursue widely disparate economic policies."[109]

For contrast, the court has recognized public health as being a legitimate concern, and other obvious emergencies, like remedying the immediate nuisance of flooding, as permissible exercises of states' police powers.[110] However,

> "[u]nlike legislation for the preservation of health and moral welfare, most of which fit within a traditional notion of governmental responsibility, laws that sought to alter the allocation of economic resources, or otherwise subject vested contract rights to the exigencies of economic change, raised critical questions about the permissible scope of state regulation under the Contract[s] Clause."[111]

Under this framework, in order to fall within the emergency powers exception articulated by *Blaisdell*, the model law faces a few hurdles. Although the holding in *Blaisdell* is an instance in which a law was seen as a valid exercise of states police powers and immune from a Contracts Clause challenge, it was based on the very tenuous, narrow, policy-driven exception to the rule. And although Schwarcz's model law has the general well being of the public at its core, the law is not necessarily serving those public safety and policy goals typically associated with the Contracts Clause. Further, though the economic climate is difficult and getting worse, the law, if broadly applied, does not appear to be enacted pursuant to any single particular emergency. Most importantly, the method of adoption here—a state-enacted law with procedures for restructuring—is not temporary. The fact that such questions even exist within this uncertain legal landscape suggests that perhaps Schwarcz's model law may be subject to constitutional challenges, even if under this *Blaisdell* standard alone.

B. Contracts Clause Jurisprudence in a Historical Context

The Court's later opinions further this idea that the Constitution may be less tolerant of these economically centered, state-enacted statutes, since, "[i]f a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract[s] Clause would provide no protection at all."[112] Coupled with this fact, and as the socially-focused, policy-based decision in *Blaisdell* is evidence of, "the value of precedent as a prediction of outcomes in contracts

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109 Kahan, *supra* note 93, at 1284.

110 *See* Manigault v. Springs, 199 U.S. 473, 484 (1905).

111 Olken, *supra* note 91, at 545.

112 U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 26 (1977).

clause cases is questionable."[113] Strengthening this uncertainty is Contracts Clause jurisprudence, which, both before and after *Blaisdell*, is characterized more by unpredictability than Schwarcz's proposal would lead his audience to believe. Indeed, "conflicts between law and politics have frequently dominated the Court's contracts clause jurisprudence, and as a result the treatment of precedent that masks the political choices of another time is misleading and confusing."[114] Court jurisprudence after *Blaisdell* suggests a less lenient approach to broadly applicable exceptions based on police powers, and especially economic exceptions, which paves a rocky path for the model law's success. A historical analysis of the Contracts Clause shows the fluctuating standards in the Court's interpretation of the scope of the emergency powers exception, but more importantly, that there is no uniform test to determine whether a Contracts Clause violation can be sustained. As long as this uncertainty remains in American law, it may undermine any scenario in which two jurisdictions will voluntarily enact the model law, thereby defeating it as a feasible mechanism to restructure sovereign debt.

At various points in its history, the Contracts Clause has been considered a dormant part of the Constitution, with some scholars noting, "few constitutional provisions have had such a profound impact on American law and have undergone such a dramatic decline as the Contract[s] Clause."[115] Historically, the Contracts Clause developed in response to debt-relief laws, which frustrated the enforcement of contracts and threatened the rights of many property owners—its "original task was to restore stability" and sanctity to these contracts.[116] Because state protection towards contracts was considered inadequate, the Clause was incorporated into the Constitution at the Convention. Though the circumstances surrounding its initial adoption and ratification were "shrouded in mystery,"[117] which "highlights [its] inherent ambiguity,"[118] it nonetheless served as "one of the only protections against state interference with contractual obligations."[119]

The Clause experienced a heyday in the Marshall Court, which treated it as a "muscular restraint on state authority," before being more narrowly applied by Justice Taney, who used it more as a means of affording states more policymaking power.[120] At first, the Contracts Clause was understood

113 J. Michael Veron, *The Contracts Clause and the Court: A View of Precedent and Practice in Constitutional Adjudication*, 54 TUL. L. REV. 117, 119–20 (1979).

114 *Id.*

115 James W. Ely, Jr., *Whatever Happened to the Contract Clause?*, 4 CHARLESTON L. REV. 371, 371 (2010).

116 Michael Cataldo, *Revival or Revolution: U.S. Trust's Role in the Contracts Clause Circuit Split*, 87 ST. JOHN'S L. REV. 1145, 1147 (2013).

117 Ely, *supra* note 115, at 373.

118 Olken, *supra* note 91, at 519.

119 Cataldo, *supra* note 116, at 1145.

120 *Id.* at 1148.

as "primarily as a constraint on legislative impairment of *private* contracts—that is, to prevent states from intervening on behalf of private debtors against their creditors. Beginning with *Fletcher v. Peck*, however, the Supreme Court has made it clear the Contracts Clause protects public contracts" as well.[121] As a result of this broadening, the Clause now protected agreements between states and individuals as well as private contracts, and courts felt free in applying the Clause's provisions to tax-exemption agreements, grants of corporate charters, land grants, agreements between states, and state insolvency laws.[122] The clause was narrowed, however, through the case of *Ogden v. Saunders*, in which the Supreme Court held that the Contracts Clause was directed at only laws that retroactively interfered with contracts,[123] suggesting that the Clause was in place to protect rights that already existed, rather than expand or circumscribe the right to contract.[124]

In the middle of the twentieth century, the Clause steadily declined, and the Court found no violations of the provision between 1941–1977, leading to the Court's necessary insistence, by 1978, that "the Contract[s] Clause remains part of the Constitution. It is not a dead letter."[125] Perhaps as a result of this, many litigants are "unsure of the scope of the scope of the Clause's power," yet its text presents a substantial barrier to any type of legislation that impairs existing contractual modification, particularly the contracts of those creditors that are modified without their consent.[126] As mentioned earlier in this paper, the limits of the clause run up against the state's inalienable police powers as first articulated in *Stone v. Mississippi*,[127] powers that prohibit a state from contracting away its ability to protect those within its borders or to promote or protect the public commonwealth and economic activity within its borders, even if an exercise of such power impairs existing contracts.[128] Later jurisprudence revealed that, although states have the ability to modify their own contracts, that power is not unlimited—state governments can impair their own contracts without violating the Clause if they institutionalize impairment is sufficiently justified by public policy goals.[129]

Since *U.S. Trust,* impairment, on its own, is not enough for a sustainable violation., or in the inverse, states can create constitutionally-sound im-

121 Johnson & Young, *supra* note 90, at 131.

122 Ely, *supra* note 115, at 374.

123 *Id.* at 377.

124 *See* Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 260–61 (1827) (sustaining the constitutionality of a New York insolvency statute, as all parties impliedly assented to the conditions of the impairment).

125 Ely, *supra* note 115, at 376.

126 Cataldo, *supra* note 116, at 1145.

127 Stone v. Mississippi, 101 U.S. 814, 817 (1879).

128 Olken, *supra* note 91, at 454 ("However, in *Stone v. Mississippi*, the Court unequivocally used inalienable police powers as the principal basis of its decision to sustain a state constitutional provision . . . in contravention of a previous state charter").

129 *See* U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 25 (1977).

pairments on its citizens' contracts.[130] As a result, Contracts Clause claims are analyzed under a two-pronged test[131] asking first whether a state's law creates a substantial impairment of existing constitutional relationships.[132] If the court finds a substantial impairment, then it will next consider whether the impairment of a public contract was "reasonable and necessary to serve an important public purpose."[133] Courts ratchet up or down levels of legislative deference based on a number of factors, including whether the state is a party to the contract.[134] For an example of this deference in practice, in *Chicago Board of Realtors, Inc. v. City of Chicago,*[135] the Seventh Circuit upheld an Illinois law that altered the relationship between landlords and tenants in Chicago. However, the court was heavily influenced by a few factors not at issue here—the new law was to be applied prospectively rather than retroactively, and the court utilized lowered level of scrutiny because of the already heavy regulation in landlord-tenant law and the state not being a party to the contracts.[136] As a result, for constitutional purposes, it was rational to believe the law would lead to improved public health and welfare. In instances in which the state is alleged to have impaired a contract to which it is a party, the court will give less deference to a legislative determination of reasonableness and necessity, "because the State's self-interest is at stake."[137] Coupled with this fact, an exercise of the police power that retroactively affects preexisting contracts is further "scrutinized with suspicion,"[138] leading to a compounding scrutiny that can make a state's laws subject to a very high threshold.

It is at this point in our analysis that the court's "reasonable and necessary" prong set out in *U.S. Trust* becomes important.[139] In its opinion, the

130 *Id.* at 21.

131 Parella v. Ret. Bd. R.I. Emp.'s Ret. Sys., 173 F.3d 46, 59 (1st Cir. 1999). Occasionally, courts state this test as a three part test, including the Wisconsin Court of Appeals in *Reserve Life Ins. Co. v. LaFollette* 323 N.W.2d 173, 176 (Wis. Ct. App. 1982), but the factors in each test are essentially the same. The third question simply further examines the effect of the law on appropriateness of the public purpose of the original law.

132 Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244 (1978).

133 *U.S. Trust Co.*, 431 U.S. at 21, 25; *see also* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 434–40 (1934) (explaining the limitation on a state's police power and the reserved power must be construed in harmony).

134 *US. Trust Co.*, 431 U.S. at 26 ("complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake.")

135 Chicago Bd. Realtors, Inc. v. City of Chicago, 819 F.2d 732 (7th Cir. 1987).

136 *Id.* at 736–37.

137 Parella v. Ret. Bd. R.I. Emp.'s Ret. Sys., 173 F.3d 46, 59 (1st Cir. 1999) (internal quotation omitted).

138 Veron, *supra* note 113, at 1979.

139 "As with laws impairing the obligations of private contracts, an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose. In applying this standard, however, complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake." *U.S. Trust Co.,* 431 U.S. at 25–26.

Court found that the state's "total" repeal of a covenant was a violation since a less drastic modification was feasible, and total repeal was therefore not necessary, especially since states will always have a reason to reduce their own financial obligations, even if the given reason is an "important public purpose."[140] Relying in part on its earlier *El Paso* holding, the Supreme Court used the expectations of the contracting parties as a basis for reasonability.[141] If the changes in perception of the state are of "degree and not of kind," then the impairments are unreasonable.[142] This "reasonable and necessary" prong has inspired circuit splits and conflicting opinions,[143] with the Fourth, Sixth, and Ninth Circuit Courts of Appeals employing their own variations of this prong, while the Second Circuit strictly applying the test from *U.S. Trust*.[144] Most dangerously for Schwarcz's model law, the Sixth and Ninth Circuits give very little deference to state legislatures, and construe their tests to further what they believe is the "spirit" of U.S. Trust—resulting in continued invalidation of state action in a Contracts Clause context.[145]

Some courts maintain that this dual standard, which places increased scrutiny on public contracts, is misguided, particularly the Seventh Circuit, who has held that "when a state repudiates a contract to which it is a party it is doing nothing different from what a private party does when the party repudiates a contract," and correctly adds that "it would be absurd to turn every breach of contract by a state or municipality into a violation of the federal Constitution."[146] As this is the case, the crucial question becomes whether or not the plaintiffs under Schwarcz's law retain the right to recover damages for the breach of contract. If the state's repudiation of its obligation extinguishes its duty to pay damages, then it will have impaired the obligation of contract. A plaintiff would have to contend that they are barred from recovering damages from the State as a result of the State's amendment of their bond contracts.[147]

At any rate, the lack of uniformity between federal circuits is a concern, and the fact that *U.S. Trust* has created such a lack of guidance that those five different circuits read its holding differently does not promote the legal feasibility of Schwarcz's law. Instead, it raises a question about whether a state—

140 *Id.* at 29–30.

141 City of El Paso v. Simmons, 379 U.S. 497, 515 (1965) (relying on *Blaisdell* but did not make a distinction between public and private contracts).

142 *U.S. Trust Co.*, 431 U.S. at 32.

143 Cataldo, *supra* note 116, at 1159.

144 *Id.* at 1161.

145 *Id*. at 1165; *see also* Southern California Gas Co. v. City of Santa Ana, 336 F.3d 885, 894 (9th Cir. 2003); Toledo Area AFL-CIO Council v. Pizza, 154 F.3d 307, 323 (6th Cir. 1998).

146 Horwitz-Matthrews, Inc. v. City of Chicago, 78 F.3d 1248, 1250 (7th Cir. 1996).

147 Paul M. Secunda, *Constitutional Contracts Clause Challenges in Public Pension Litigation*, 28 HOFSTRA LAB. & EMPL. L.J. 263, 286 (2011).

even New York, which has a great interest in the proceedings—would enact such a law before the circuit split is resolved by the Supreme Court.

C. State Authority to Enact a Subnational Insolvency Law

Putting Contracts Clause challenges aside, a second, almost equally important constitutional issue arises regarding the authority under which a state could enact a restructuring or insolvency law on a subnational level. Though Schwarcz only lightly addresses this topic ("New York's enactment of the model law should represent an exercise of New York's police powers, a quintessential state responsibility"),[148] he frames it in a Contracts Clause context. Perhaps a more logical move would be to justify the law's enactment under the Bankruptcy Clause of the federal constitution, which has long been considered a source of congressional power.[149] The Constitution overtly grants Congress the authority to regulate bankruptcy through this often-ignored provision.[150] This Clause is a particularly appealing basis for enactment since the only times the Supreme Court has found an already-enacted bankruptcy law to exceed Congress's power were in narrowly applicable cases, such as those that applied to only a single debtor, and therefore this constitutional provision should be read as one that expands power rather than limits it.[151]

However, a historical approach analyzing both existing and defunct American debtor laws in the United States shows how state innovation in the bankruptcy arena can experience disfavor and hostility by the courts, and the history of court decisions that led to the modern understanding of the bankruptcy clause serve are evidence of the constitutional questions that a subnational restructuring law would entail.[152] Subnational insolvency laws that apply only to one given state may not be constitutional generally speaking, especially under the modern understanding of the Bankruptcy Clause. To the extent that it is considered in modern constitutional scholarship, the Clause is viewed as part of a Hamiltonian effort, especially when paired with the Commerce Clause and the Contracts Clause to work, to operate federally and keep the states from piecemeal regulation.[153]

Early bankruptcy laws, which were on occasion enacted on state levels, were responses to financial crises. For instance, The Supreme Court's 1819 decision in *Sturges v. Crowninshield*[154] struck down a New York bankruptcy

148 Schwarcz, *supra* note 8, at 15 n.72.

149 Lubben, *A New Understanding of the Bankruptcy Clause*, 64 CASE WEST. RES. L. REV. 319, 353, 410, 411 (2013).

150 U.S. CONST.. art. I, § 8, cl. 4.

151 Lubben, *supra* note 149, at 411.

152 *Id.* at 410.

153 Lubben, *supra* note 149.

154 14 U.S. (4 Wheat.) 122 (1819).

law under the Contracts Clause, and serves a seminal case showing that states did not have full authority to enact bankruptcy laws applying solely to debtors within their jurisdictions. Instead, such power skews more federally, with the purpose of maintaining uniformity in insolvency proceedings for debtors across state lines.[155]

All said, Lubben's article and analysis lead to a conclusion that "[b]ased on current precedents, the [Bankruptcy] Clause allows for a strong federal power over all types of creditors . . . subject only to a weak internal requirement of uniformity."[156] In other words, an insolvency law that is not in violation of the Bankruptcy Clause may need be one that can apply interstate, and allow for uniform treatment for creditors. Though it seems easy enough, this would present issues for Schwarcz's model law, as its current inception applies solely to the bonds held within New York's own jurisdiction, and for those creditors contained within that state's jurisdiction. Enacting the model law across multiple state lines may offer a solution is still a possibility, but as the vast majority of the restructured bonds would be held in New York, it seems unlikely that another state would be compelled to consider passing the law at all.

D. *Continuing Difficulties with Liquidation Analysis and Unconstitutional Contract Impairment*

This is not to say that every subnational, state-enacted insolvency law is preempted or barred by the Bankruptcy Code, as those instances under which Congress does not exercise its constitutional bankruptcy power, states may enact laws addressing debtors' rights, so long as they "do not unconstitutionally impair contractual obligations."[157] This was firmly established in the Supreme Court case *Faitoute Iron & Steel Co. v. City of Asbury Park*, in which a state law restructuring of city debt was seen as constitutionally permissible. Taking place prior to the enactment of the federal adoption of the bankruptcy code, this state law restructurings was permissible.[158] Here, the court reasoned that the city's restructuring was commenced in New Jersey state court prior to there being a federal bankruptcy alternative in existence at the time.[159]

Obviously, since a federal restructuring law for municipalities now exists through Chapter 9 of the Code,[160] the above case, which addresses a city's

155 *See* Lubben, *supra* note 149, at 319 ("Congress's powers regarding insolvency were simply to impose uniformity").

156 *Id.* at 410.

157 Martin J. Bienenstock & Andrea G. Miller, *Analyzing the Contracts Clause's Impact on State Law Restructurings*, N.Y. L.J. (Online), Sept. 14, 2015.

158 *See Faitoute Iron & Steel Co. v. City of Asbury Park,* 316 U.S. 502 (1942).

159 *Id.* at 508.

160 *See* 11 U. S. C. § 9.

restructuring, would face a preemption argument today. However, because a similar federal mechanism does not exist for a sovereign state, then under this analysis a state's sovereign debt restructuring law would not be unconstitutional on its face. Instead, it would need to be analyzed in the same fashion as those restructuring laws that exist independently of federal insolvency laws—most notably, those for insurance companies and other banks.[161] In the United States, "[i]nsurance company insolvencies are not handled under the Bankruptcy Code but are governed by state insurance receivership laws and regulations."[162]

In an insurance and state banks legislation context, the Contracts Clause does not function as a strict bar for those states seeking to pass restructuring laws addressing these debt obligations, but serves mainly as a prohibition against those kinds of legislation that "materially reduc[e] the value of a contractual obligation" in the absence of a police power exception.[163] Under this reasoning, a state is permitted to enact some legislation that could restructure the debt of entities such as banks and insurance companies so long as the law preserves, for creditors, the values that they can obtain enforcing such entities' obligations.[164] "The recurring theme in these decisions is that the value of the contractual obligation is not unconstitutionally impaired if the creditors receive at least what they would receive if they enforced their claims."[165]

Similar to these insurance and state bank insolvency laws, sovereign debt restructuring mechanisms, even those enacted on a statewide level, would probably not be wholly prohibited by the Bankruptcy Clause, which is silent on the topic. However, the larger issue is a persisting Contracts Clause challenge that arises when attempting to prove that a creditor would receive just as much value for his/her claims in a restructuring as he/she would in liquidation. This cannot be shown for a sovereign, as it cannot have a typical liquidation in the way that a corporation could, through exhaustive asset sales.

This highlights a key constitutional distinction: one between permissible debt enforcement laws and those laws discharging debtors from maintaining their debts on their after-acquired property.[166] A constitutional state restructuring law that addresses only corporations or similar entities can allow those corporation-debtors to liquidate through selling assets and leaving

161 *See, e.g.*, David A. Skeel, Jr. *The Law and Finance of Bank and Insurance Insolvency Regulation*, 76 TEX. L. REV. 723, 727–32 (1998) (discussing the multitude and divergences of state and federal banking and insurance regulatory bodies).

162 Francine L. Semaya & William K. Broudy, *A Primer on Insurance Receiverships*, BRIEF, Fall 2010, at 22.

163 Bienenstock & Miler, *supra* note 157.

164 *Id.*

165 *Id.*

166 *Id.* at 3.

a shell after distributions to creditors, and such a law can exist with the sole purpose of organizing debt payment without permitting a discharge. For an individual seeking restructuring under a similar law, such sales processes does not exist, and any future acquired property would need to be discharged from existing debts.[167] As a result, creditors' rights are always impaired in the case of personal discharges from debt, as "in the absence of property the personal obligation to pay constitutes the only value of the debt."[168] In this respect, a sovereign is like an individual, as a restructuring would necessarily need to take the place of a discharge, rather than liquidation, and places debtor-states into the same murky constitutional territory.

IV. POSSIBLE COUNTERARGUMENTS TO CONSTITUTIONAL CHALLENGES

This section seeks to further engage with the legal feasibility of the model law in a hypothetical scenario, particularly if the model law is passed by New York. Proponents of the law would likely raise two arguments—first, that even if creditors sought recourse against the state, they would have no legal mechanism to do so, and second, that if a court ever heard such a claim, the dire economic situation that necessitated the law's enactment would overrule the interests of any creditors on policy grounds. Both of these claims are explored in detail, and ultimately refuted, below.

A. Creditors Lack a Legal Mechanism for Enforcing Their Rights

Even if repudiation of a bond is seen as entirely unconstitutional under the Contracts Clause, the question remains as to whether the bondholders have any prospect of a remedy—in particular, it seems unlikely that a state court would grant these unpopular bondholders any recovery against the very state the court sits in, and sovereign immunity for a state, coupled with the Eleventh Amendment's penumbra, usually bars federal question suits predicated on the Contracts Clause.[169] Despite this hurdle, there are certain avenues with which federal court suits could nonetheless continue.[170]

The burden of proof in a Contracts Clause context is a significant question, and in a typical case, it falls upon the party asserting the Contracts Clause violation, who will need to show that no reasonable interpretation of the facts would justify the exercise.[171] A claim that state alteration of a debt contract's payment terms violated the Contracts Clause is a federal claim

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167 *See id.* at 3.

168 *See* Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 187–88 (1902) (internal quotation omitted).

169 Johnson & Young, *supra* note 90, at 150.

170 *Id.* at 148–52 (suggesting two possible avenues including waiver of immunity, which already exists in may state law bond obligations or statutory abrogation of state immunity).

171 Shepard v. Skaneateles, 89 N.E.2d 619, 620 (N.Y. 1949).

under the Constitution, not a state contract claim. "Commentators and judges generally agree that the Eleventh Amendment's textual bar does not extend to federal question suits. . . . [and] federal courts may issue *prospective* relief—that is, injunctions and declaratory judgments—against state officers who are alleged to be acting in violation of the U.S. Constitution."[172] "This may permit certain challenges to IOU's: a creditor might sue, for instance, to enjoin the issuance of IOUs that arguably impair the obligation of the underlying debt instruments."[173]

Unlike other constitutional violations, there is some dispute over whether claims for Contracts Clause violations can permissibly function procedurally as civil rights claims under § 1983,[174] which allows for a procedural vehicle absent substantive law, including for federal Contracts Clause violations.[175] The Fourth Circuit Court of Appeals held that "Section 1983 provides no basis to complain of an alleged impairment" and can be utilized in a Contracts Clause only as a direct constitutional challenge—in other words, when a state has foreclosed the imposition of an adequate remedy for an established impairment, but not as a means of indirectly claiming that the government is merely contravening the Constitution, even if that contravention led to a deprivation of rights typically protected by § 1983.[176] In other words, the acts of the state would need to rise to the level of a constitutional impairment of obligation, rather than a mere breach of contract.[177]

Practically speaking, if there is a Contracts Clause violation, there are questions concerning the remedy that a state employee would be entitled to.[178] Even if the model law does amount to a Contracts Clause violation, it may not even matter, since the creditors will likely be left without a remedy, thus disincentivizing them to bring a lawsuit. Creditors and beneficiaries will then remain unable to force actual payment on the original debtor or obligation, as the general structure of state sovereign immunity law is designed to prevent courts from compelling payment on debts that threaten

172 Johnson & Young, *supra* note 90, at 135–36.

173 *Id.*

174 *See* Civil Rights Act of 1871, 42 U. S. C. § 1983 (2006) ("Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State . . . subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress").

175 James P. McMahon, *Section 1983 Causes of Action Under the Contracts Clause of the Constitution*, 21 GEO. MASON L. REV. 467, 468 (2014) ("When a government passes an ordinance that retroactively infringes on a private party's contractual rights, the private party often seeks redress under the Contracts Clause of the U.S. Constitution. Many times, these plaintiffs attempt to bring a claim pursuant to 42 U.S.C. § 1983. Section 1983 authorizes redress for the deprivation of 'any rights, privileges, or immunities secured by the Constitution' . . . [and] provides plaintiffs with powerful benefits not available when vindicating contractual rights though other methods.")

176 Secunda, *supra* note 147, at 286.

177 *Id.* at 286.

178 Johnson & Young, *supra* note 90, at 135.

the financial viability of the states.[179] Further, "[t]he Supreme Court has interpreted [the Constitution] to impose significant constraints on retroactive legislation affecting property rights" yet "paying some state obligations by short-term IOUs, however, may well be insufficiently serious to trigger those protections."[180]

That being said, "the law rarely cuts off all remedies,"[181] and this, coupled with the fact that creditors currently engage in holdout behavior at the detriment of their fellow creditors shows how tactics in a restructuring context may not be based entirely in logic or payoffs. If an arguable vehicle for a lawsuit exists, and creditors can arguably take advantage of it, then there is some member of a group of creditors who will likely attempt to utilize it. Especially since, as this paper has shown, there are, at the very least some questions about the constitutionality of this particular model law. As a result, these threats of unconstitutionality can call into serious question the willingness of governments outside of New York to enact such a law. Particularly in the United States, in the case of an actual insolvency, these constitutionality concerns would have the potential to undermine the practical benefits of the model law. If creditors would always raise an unconstitutionality argument, such a law would likely not be adopted on a national or subnational level before it has the opportunity to be tested, and approved, by the Supreme Court.

B. Courts Should Strike Down Creditor Claims on Policy Grounds

Though opponents may disagree, on policy grounds it is hard to maintain that the constitutional questions would weigh in favor of the state passage of the restructuring law. Instead, a questioning court should correctly recognize how the emergency powers exception is one of many examples of "extra-constitutional responses to economic crises" that "may ultimately degrade liberty interests more than extra-constitutional responses to violent crises."[182] Because those factors present during economic crisis—and in governmental solutions to economic crisis—tend to provoke judicial responses that gradually integrate into non-emergency constitutionalism, there is a greater danger that emergency-based encroachments on economic liberty will become entrenched in our legal system than those emergency-based encroachments on civil liberty.[183] Thus, it is important to consider these more subtle encroachments of federal power on economic liberty, and prevent them when they appear contested in a courtroom.

179 *Id.* at 136.

180 *Id.* at 134.

181 *Id.* at 162.

182 Kahan, *supra* note 93, at 1280.

183 *Id.*

Further, a competing policy argument weighing in favor of opponents to the law is an originalism one, which would ultimately lead to a strengthening of the Contracts Clause. If courts are able to have unlimited reign to judge the "necessity" of contracts, this may run afoul of the original intent of the Framers, who clearly intended the goal of the Clause to promote stability for both the state and private parties entering a contract.[184] The Contracts Clause was originally concerned with individualized credit laws, and sought to prevent inconsistent and unstable commercial transactions.[185] The Framers, as expressed through ratification of the Clause, believed that fairness was inherent only in the bargaining process, and allowing states to effectively abrogate this process would result in discord.[186] As the law is constantly in flux and subject to questions about whether it is a dead letter, when one of these cases arises in a courtroom it is in the judge's best interest to affirm its power, and the intent of the Framers, through his or her ruling.

V. TOWARDS A CONSTITUTIONAL ALTERNATIVE: A LAW OF RECOGNITION

Rather than having New York adopt the law wholesale, the state may be able to adopt a law of recognition, one that says that New York will recognize a foreign sovereign debt restructuring, but under certain criteria that would make it comport with the emergency powers exception. This will especially be true if England is able and willing to adopt the law on its own—although this would result in the fading of New York law in the international monetary arena. This law of recognition may also limit the standing of creditors to bring suit, including under a 1984 claim as expressed above, since the state would not be the one impairing their claims.

Of course, a problem with a law of recognition is one of plausibility—why would any state or subnational entity pass a law of recognition without any real interest in the restructuring of the debts of anther sovereign nation? This idea of support and recognition by U.S. subnational becomes all the more unlikely when considering how prevalent English law, at the expense of American law, would become internationally.

Further, there is a legal question that persists for Contracts Clause purposes about whether recognizing a foreign judgment can functionally serve as a constitutional workaround. Seeing as New York would be refusing to enforce New York law contracts based on recognition of the English law, creditors could make a plausible argument that even a recognition obligation in this context, though it is one step removed from state level courts, might nonetheless violate the clause. A law of recognition functions to di-

184 *See* Cataldo, *supra* note 116, at 1179.
185 *See* Ely, *supra* note 115, at 372.
186 *See* Veron, *supra* note 113, at 158.

rectly enforce foreign judgments as domestic ones,[187] and though "recognition" differs from "enforcement," the state is nonetheless seeking to domesticate this judgment in the eyes of the U.S. Courts and treat it the same as other state decisions that benefit from Full Faith & Credit.[188] Functionally speaking, the recognition is serving to produce the same effect and have the same authority as a case originally decided in the subnational jurisdiction.[189] This may undermine the state's ability to pass a law recognizing such English judgments, as an enforcing U.S. court can only accept a foreign judgment when there is no reason why comity of the United States should not be given to the foreign judgment,[190] and unconstitutionality of a restructuring under the Contracts Clause can certainly open a judgment up to the same challenges that it would receive if effected in a U.S. court. Though it creates a convoluted pathway and likely will exhaust certain creditors seeking enforcement, it is hard to see why, functionally, a subnational law of recognition would substantively differ from the initial plan for a state sanctioned model law.

CONCLUSION

As recent international fiscal crises have shown, the issues of sovereign debt are of increasing importance, especially because of the interconnectedness of the financial markets and the bailout-driven "moral hazard" incentives. Further, the contract-based approach results in inconsistencies and, even if radical changes and uniformity are brought about in CACs, the ultimate results are a long time away. In the meantime, creditor states would still face real collective action problems. In any event, the need for a consistent, predictable mechanism with which to restructure sovereign debt in the event of a default has become more of a necessity rather than the academic thought experiment that it once was. Of course, in the United States, the balance between constitutional rights and efficient, sustainable economic solutions will become a major factor, particularly when laws are implemented on a state level.

As the wealth of legal scholarship leading to Schwarcz's proposal has shown, the issue surrounding selecting the correct statutory mechanism is complicated, and designing the ultimate law even more so. Although this paper is meant to show the benefits of choosing a statutory approach to sov-

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187 Yuliya Zeynalova, *The Law on Recognition and Enforcement of Foreign Judgments: Is It Broken and How Do We Fix It?*, 31 BERKELEY J. INT'L L. 150, 155 (2013).

188 *Id.*

189 *Id*.

190 Hilton v. Guyot, 159 U.S. 113, 234 (1895). *See also* Donald Earl Childress III, *Comity as Conflict: Reinstating International Comity as Conflict of* Laws, 44 UNIV. OF CA. DAVIS L. REV. 12, 14 (noting how comity encourages a court's deference to a foreign sovereign and requires a balance of various public, private, and international factors when determining if comity is due).

ereign debt, it is also meant to provide a map of some of the constitutional legal issues that can arise with a subnational statutory solution. Hopefully, the issues and solutions that it offers are some that scholars and legislatures can incorporate into their future proposals, and therefore strengthen everyone in the quest to achieve more durable, reliable solutions.