2012

United States Sovereign Debt: A Thought Experiment On Default And Restructuring

Charles W. Mooney Jr.
University of Pennsylvania Carey Law School

13
United States Sovereign Debt: A Thought Experiment On Default And Restructuring

Charles W. Mooney, Jr.*

I. Introduction

I have quite self-consciously styled this essay a "thought experiment" on the default and restructuring of United States (U.S.) sovereign debt. The U.S. debt addressed here is the obligation of the U.S. on its Treasury Securities. I make no claim that a default by the U.S on its Treasuries is likely or imminent. Nor do I argue that a restructuring, whether based on bilateral or multilateral negotiations or on unilateral imposition, would be in the interest of the U.S. if a default were likely or imminent or in any other circumstances. Instead, this essay assumes, without demonstrating, that at some time in the future conditions might be such that restructuring of U.S. obligations

* Charles A. Heimbold, Jr. Professor of Law, University of Pennsylvania Law School. I wish to thank Haley Wojdowski, J.D. 2012, University of Pennsylvania Law School, for excellent research assistance. This paper was prepared in connection with "Is U.S. Government Debt Different?", a conference sponsored by the Wharton Financial Institutions Center of the University of Pennsylvania and the University of Pennsylvania Law School which was held on May 5, 2012 (the "Conference"). I also wish to thank Donald S. Bernstein, William W. Bratton, Steven L. Schwarcz, David A. Skeel, the other participants at the Conference, and the participants at the University of Pennsylvania Law School 2012 annual faculty retreat for helpful comments on a draft of this paper.

on Treasuries *might* be in the interest of the U.S. I also do not claim that the hypothetical approaches to a restructuring discussed here are optimal. These exemplary approaches are adopted and analyzed solely for the purpose of exploring the feasibility of *any* restructuring.

By "restructuring," I mean a process resulting in an adjustment (*i.e.*, reduction) of the principal amount of the U.S. Treasury obligations. As I use the term, it includes both a reduction of debt as a legal matter, such as by consensual agreement, or a selective intentional default by the U.S. on a portion of its Treasury obligations with the stated intention not to pay the relevant debt. Given the difficulties attendant to the actual enforcement of the obligations on Treasuries, the latter approach may be considered a de facto reduction of principal.

The central assumption that a restructuring conceivably might be in the U.S. interest at some time in the future necessarily raises important questions. First, what are the economic and political circumstances that could give rise to a need for a beneficial restructuring of U.S. debt? It seems obvious that such a restructuring would make sense only in extremely dire economic circumstances. Part II of the essay sketches a scenario in which such circumstances might exist and how such a situation might come about. Nevertheless, no attempt is made here to analyze in detail the circumstances or possible events that might give rise to the need for a restructuring. One working assumption is that, in the face of an economic emergency, Congress would be highly motivated to find a solution. Another is that either Congress could eliminate the possibility that a domestic U.S. court could determine the legality of a restructuring or that the Court of Federal Claims[1] as well as the Supreme Court[2] would be amenable to approving a Congressional solution if at all possible.[3]

---

1 *See* note 134, *infra* (discussing jurisdiction of Court of Federal Claims).

2 It is possible that the legal issues implicated by a restructuring could never properly be presented before a court sitting in the U.S. However, much of the analysis assumes that, in some fashion, these issues could be before the Court.

3 It might make good sense for the U.S. to explore a restructuring before, and in anticipation of, a financial crisis. But I suspect that approach would not be feasible, given political realities.

Second, would any type of material restructuring of U.S. debt involving a material haircut of principal be feasible? This essay directly addresses this question. Part III examines the informational, logistical, and legal impediments to effecting any restructuring of the type considered here. To my knowledge, this specific topic of the feasibility of a restructuring of U.S. Treasury obligations and the issues that it raises largely have been unexplored in the literature. Of course, I must concede that it is possible that behind closed doors at the Department of Treasury and within the Federal Reserve System (Fed) the relevant issues have been pondered and analyzed in depth. For obvious reasons, such investigations, even if purely theoretical, would not be made public as they might trigger a crisis of confidence in the dollar and U.S. Treasuries. It is one thing for pointy-headed academics to offer thoughts on the subject and quite another for the U.S. and its central bankers to indicate that they may see default and restructuring as a real possibility. But I suspect that no such investigations have taken place. The statements and behavior of Treasury and the Fed during the period of 2007 to 2009 appear to reflect a classic case of denial. Exploring a U.S. default or restructuring would be much out of their institutional character. For that reason, I offer this essay as a modest initial step toward the needed investigation and analysis.

II. Imagining the (Im)Possible: A Journey Forward in Time and a Doomsday Scenario.

The following scenario taking place in the year 2018 is fiction.[4] Whether it is possible, I leave to others. It is inspired by the very real notion that if we are worrying only about what we believe is possible, we are almost surely missing something important. Almost two decades ago, I offered similar musings about attempting to anticipate and predict future developments in information technology. Consider the following (necessarily dated) passage:

> [T]he Frequent Change and Unpredictability attributes[5] also are apt descriptions of the financial markets generally in recent

4 It is not yet 2018.

5 These attributes are a part of a taxonomy of attributes of information technology which I explored.

years, where most of the significant events were thought to have been impossible shortly before they occurred. The following come to mind: a prime rate of 21 percent; the *de facto* failure of Continental Bank brought on by purchasing participations in loans generated by an Oklahoma City shopping center bank; a more than 500-point fall in the Dow Jones Industrial Average in one day; a $24 billion leveraged buyout (RJR Nabisco); allowing hundreds of insolvent S & Ls to continue operations; Texaco's Chapter 11 filing brought on by a single tort judgment; and the failure of Drexel, Burnham, Lambert, the high-flying securities firm darling of the 1980s. As the realization emerges that the "impossible" is the "normal" in the financial markets, perhaps the same realization will increasingly be seen as applicable to information technology.[6]

On to the story—

It is now March 2018. President Palin has announced that she will not run for reelection for a second term in 2020 in order to devote her complete attention to the worsening global economic crisis—especially to the U.S. economy and the U.S. monetary and fiscal policies (shades of LBJ). Vice President Ryan, Palin's go-to person on all things economic, has made a similar pledge and vow. Congress, Treasury, and the Fed, however, seem paralyzed and helpless.

As was the case a bit more than a decade ago, the usual suspects (Treasury and the Fed) failed to see that in 2012 the real financial bubble (much bigger than the housing bubble of 2007 to 2008) was just about to burst. It is now typical to blame the first Obama administration for the huge increases in U.S. debt and deficits from 2008 to 2012 because it failed to see the impending crisis. But it is likely that had McCain's "No we can't" approach prevailed in 2008, the result would have been essentially the same. Given Congress, Treasury, and the Fed as it was (and is), the U.S. government was trapped in an imagination-challenged debt spiral. Others, of course, outside of government and the conventional financial market par-

6 Charles W. Mooney, Jr., *Property, Credit, and Regulation Meet Information Technology: Clearance and Settlement in the Securities Markets*, 55 L. & Contemp. Probs. 131, 158 (1992).

ticipants, did see what was on the immediate horizon. They issued appropriate warnings, but they were not heeded.
As the economy entered (or reentered) a recession by the first or second quarter of 2013 (which quarter is not very important, looking back about five years), the U.S. deficit continued to grow apace. U.S. Treasuries continued to roll at every auction but at ever increasing interest yields. The largest holders of U.S. Treasuries (such as the Chinese and Japanese governments) began to question more openly the ability of the U.S. to continue to finance its growing debt burden. Eventually, it appeared that the time was approaching when the U.S. would not be able to continue to roll the increases in debt necessary for the debt service.

The U.S. government's response was to "monetize" its debt (an oversimplification, but sufficient for this sketch). Conventionally, the Fed continued to provide more and more funds to banks which, conventionally, increased the money supply through increased lending. But Congress, surprisingly, took a bolder step of directly creating more money by firing up the printing presses. Not surprisingly, Congress took the less bold approach of continuing to spend the increasing money supply beyond its available revenues and to refuse meaningful tax increases. While this spending did provide benefits, such as increased employment and enhanced infrastructure, the net result of the U.S. strategy was negative. Cutting to the chase, the result has been hyperinflation which now approaches 60% per year in the U.S. (shades of Germany and Austria almost a century ago). The U.S. has good company in 2018, as many other states face similar situations. The dollar remains a reserve currency, although a distant second to the Euro, only because of the relative size of the U.S. economy, the large volume of U.S. dollars, and the dollar's liquidity. Nonetheless, since 2012, the dollar's value against a typical basket of other currencies has fallen by about 70%.

So far, the principal benefit of the U.S. strategy has been to avoid a technical (i.e., actual) default on its debt. Even now, in this precarious situation in 2018, the conventional wisdom (in the U.S. and elsewhere) remains that a U.S. default is unthinkable. As it turns out, "unthinking" may be a better characterization for the conven-

tional wisdom. Nevertheless, it has become clear to many, including a majority of members of Congress, that continuing to print money to pay U.S. obligations is not sound monetary policy.

Today at a cabinet meeting in the White House, the prospect for a bold new approach surfaced. Following a briefing on the economy and the U.S. fiscal situation by the Treasury Secretary, the Attorney General asked a simple question: "Secretary Cain, I understand that the U.S. now is a distressed debtor. Could you tell us about your contingency plans for restructuring our debt?" The AG, clearly, was now the proverbial "skunk at the picnic." But the Treasury Secretary was at first speechless. There were no plans, of course. Speaking of default and restructuring of U.S. debt had always been taboo. But the AG, a former Circuit Judge, District Judge, and bankruptcy lawyer, was undeterred. The AG pressed her case, but the Treasury Secretary's only response was the unsurprising: "Seems to me that you are asking me a legal question." Following this exchange, the President asked the AG to come up with a plan.

The remainder of this paper focuses primarily on default and restructuring from the standpoint of the AG.

Of course, the benefits of reducing the U.S. obligations on Treasuries would be offset against the resulting costs. A default and restructuring could result in increases in the cost of borrowing by the U.S. in the future or even fundamental damage to the Treasuries market. Perhaps the most significant specter posed by a default would be the loss of continued access to the capital markets. Moreover, the significance of the Treasuries market both nationally and globally and the role of the dollar as a reserve currency (or not) at the time also would be significant. For example, a default and restructuring of U.S. Treasury obligations could trigger economic crises in Europe and Asia and could result in systemic defaults on the sovereign debt of multiple states and financial institutions. The bottom line is that the U.S. would have to consider whether its default and restructuring would cause more harm to its economy (and other states' economies) than the benefits of reducing its debt on a (presumably) one-time basis.

The extent and nature of the impact of a U.S. default and restructuring also would be an important aspect of designing the exemptions from default contemplated by alternative approaches discussed in Part III.B. Determining which classes of beneficial holders would qualify for the exemption would require much care in analyzing ex ante the likely effects of the scheme if implemented. Exempting domestic holders might be politically essential in order to garner Congressional support. That would mean that foreign holders would bear the first-line brunt of a default and restructuring, which would pose political as well as diplomatic risks and also might impair the achievement of a successful restructuring.[7] Moreover, exempting too much of the U.S. debt would undermine the whole purpose of restructuring.

For the most part, this paper proceeds on the basis that the chief (and obvious) benefit of a restructuring for the U.S. would be the actual or de facto reduction in principal of U.S. Treasury obligations (whether in legal effect or by virtue of selective default).[8] As a general matter, it is better to owe less debt than more debt, especially if debt is reduced other than by way of payment of principal. But the central object of this essay is to explore how the U.S. might restructure its Treasury debt.

7 To reiterate, I make no claim here as to the likely benefits or costs of a restructuring that would discriminate against either foreign holders or domestic holders or that would instead adopt an approach of intercreditor equality. The goal here is to explore *whether* such discrimination would be possible and *how* it might be achieved. For a recent study on intercreditor equity in ten recent sovereign debt restructurings, see Aitor Erce & Javier Diaz-Cassou, *Selective Sovereign Defaults* (May 4, 2011), *available* at http://www.webmeets.com/files/papers/SAEe/2011/299/Erce_intercreditor_equity.pdf. Erce and Diaz-Cassou identify Belize, the Dominican Republic, Ecuador, and Pakistan as examples of restructurings that discriminated against external (foreign) creditors. Id. at 17-18. As examples of discrimination against domestic creditors, they identify Argentina, Russia, and ("to a lesser extent") Ukraine. *Id*. at 20-21. They identify Uruguay, Granada, and Dominica as examples of a neutral approach. *Id.* at 19-20. The United States has it own history of discrimination against foreign creditors. *See, e.g.,* Wythe Holt, *The Origins of Alienage Jurisdiction*, 14 Okla. City U. L. Rev. 547, 553-62 (1989) (discussing discrimination by state legislatures against British creditors during the years following the Revolutionary War).

8 As explained below, under the Alternative 2 approach, the Treasuries obligations would not be reduced as a legal matter, but the U.S. would declare itself unwilling to pay X% of the principal obligations. Under Alternative 3, obligations would actually be reduced but only on a consensual basis.

An analysis of the likely impact of a U.S. default and restructuring as contemplated here is beyond the scope of this essay (and my expertise). Reducing the U.S. debt burden promises obvious benefits. But that is only one piece of the puzzle.

III. Outline of a Restructuring: Informational, Logistical, and Legal (Including Constitutional) Impediments

This part assumes that the U.S. might wish to restructure its debt in the future. It explores how the U.S. might go about this task and identifies various problems and impediments that would lie in the path of a restructuring. The restructuring of sovereign debt is necessarily complicated and difficult. This would be especially so in the case of U.S. debt.

A. Dynamics and Strategy.

Restructuring of U.S. obligations on Treasuries would face a significant and obvious complication. In general, the U.S. does not know the identity of the holders of its Treasuries that are held in the commercial book-entry system. (By "holders" of Treasuries, I mean the ultimate beneficial owners on the books of a Federal Reserve Bank or on the books of another intermediary with which the holder maintains a securities account, as discussed below.) It is true that we read about the large foreign holders of U.S. debt, including the Chinese and Japanese governments. But these data on holders of U.S. debt come from *surveys*.[9] With the exception of Treasuries held in the

9 See Major Foreign Holders of Treasury Securities (Jan. 2011 – Jan. 2012) available at http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt (March 15, 2012) [hereinafter, Major Holders].

> Estimated foreign holdings of U.S. Treasury marketable and non-marketable bills, bonds, and notes reported under the Treasury International Capital (TIC) reporting system are based on annual Surveys of Foreign Holdings of U.S. Securities and on monthly data. These data help provide a window into foreign ownership of U.S. Treasury securities, but they cannot attribute holdings of U.S. Treasury securities with complete accuracy. For example, if a U.S. Treasury security purchased by a foreign resident is held in a custodial account in a third country, the true ownership of the security will not be reflected in the data. The custodial data will also not properly attribute U.S. Treasury securities managed by foreign private portfolio managers who invest on behalf of residents of other countries. In addition, foreign countries may hold dollars and other U.S. assets that are not captured in the TIC data. For these reasons, it is difficult to draw precise conclusions about changes in

"Treasury Direct" or "Legacy Treasury Direct" systems, all Treasuries must be held in an account with a Federal Reserve Bank.[10] In general, only depository institutions (banks) that are members of the Federal Reserve System and certain other depository institutions, including U.S. branches of foreign banks and foreign central banks, are eligible to have such accounts.[11] Other holders must hold through an intermediary that holds through a Federal Reserve Bank or through another intermediary. While the U.S. would have ready access to the books of Federal Reserve Banks, it would not have access to the underlying books of the depository institutions that hold through their accounts with the Federal Reserve Banks or to the books of other intermediaries down the chain.[12]

Consider a hypothetical example. Assume that Bank of America (BoA) holds Treasuries of a given issue in its account with the Federal Reserve Bank of New York. BoA, in turn, has credited some of its holdings of that issue to the securities accounts of its customers. BoA's customers include Banque Delen, a Belgian bank, and Societe Generale, a French bank. Banque Delen has credited some of its holdings of that issue to its customers, who include the National Bank of Pakistan. National Bank of Pakistan, likewise, has credited some of its holdings of that issue to its customers, who include the

the foreign holdings of U.S. financial assets by individual countries from TIC data. *Id.* at n.1.

10 Treasuries held in the Treasury/Reserve Automated Debt Entry System (or "TRADES") are governed by the TRADES Regulations, 31 C.F.R. Part 357. Treasuries also may be held in the Legacy Treasury Direct and the Treasury Direct Systems, in which case the U.S. would know the identity of the owners. But the Treasuries held in those systems outside of TRADES consist of less than 3% of the outstanding Treasuries and major holders are unlikely to use them. *See* note 136, *infra* (discussing Treasury Direct and Legacy Treasury Direct Systems).

11 *See* Federal Reserve Banks Operating Circular No. 7, Book-Entry Securities Account Maintenance and Transfer Services (August 19, 2005), ¶ 3.12 (defining "Participant" and listing institutions that are eligible to maintain securities accounts with a Federal Reserve Bank) *available at* www.frbservices.org/files/regulations/pdf/operating_circular_7.pdf. National banks are required to become members of the Federal Reserve System. 12 U.S.C. § 222. State-chartered depository institutions may apply for membership, which requires approval by the Board of Governors of the Federal Reserve System. 12 U.S.C. §§ 321, 322.

12 *Cf.* Steven L. Schwarcz, *Intermediary Risk in a Global Economy*, 50 Duke L.J. 1541, 1547-48 (2001) (explaining why it is difficult to ascertain the identity of investors holding securities through these intermediaries).

governments of Cuba, Iran, and North Korea. Societe Generale also has made credits to its customers, who include both individual holders and other banks—and so on. The example reflects the "tiered," "intermediated" securities holding systems.

The significance of the U.S. not knowing the identity of its Treasuries holders would depend on its approach to a possible restructuring. For example, were the U.S. to pursue bilateral negotiations with China and Japan, any resulting restructuring agreement would necessarily involve identification of the particular Treasuries held by the non-U.S. party. Such an approach would have several drawbacks, however. For example, it is plausible that neither China nor Japan would agree to treatment that is different from that afforded by the U.S. to other, similarly situated Treasuries holders. Moreover, and significantly, obtaining sufficient leverage in the negotiations might require the U.S. to be prepared to make a credible threat of default and restructuring absent an agreed solution. On any maturity date of an issue of Treasuries, because the U.S. could not determine which (if any) portion of the Treasuries were held by China or Japan, China and Japan would assume that the U.S. would be forced to default on the entire issue. Because the majority of the outstanding U.S. debt is held domestically, including by individuals and pension funds in the U.S., any threat of a general default might not be credible. In contrast, the U.S. would prefer a credible threat of a *selective* default to only certain Treasuries holders. Subpart B outlines a novel approach that could allow the U.S. to pose such a credible threat.

Even if the U.S. could present a credible threat of selective default, there are other difficulties with pursuing bilateral negotiations with only selected large Treasuries holders. Once a holder is made aware of a possible default, they could move quickly to exit the market (i.e., sell the Treasuries) based on the nonpublic information. Because huge holdings such as those of China and Japan could not be liquidated quickly, the U.S. would desire to avoid extended and lengthy negotiations. It probably would be necessary to present to selected holders finalized restructuring arrangements on a take-it-or-leave-it basis. The proposal probably would be enhanced by a plan to impose an across-the-board restructuring along the lines described in subpart B if the consensual bilateral or trilateral restructuring arrangements were declined.

Bilateral negotiations would present yet another set of problems. As a general matter it makes some sense for a distressed debtor to sit down with major creditors to discuss the debtor's situation, alternatives, and proposed solutions. But in the case of sovereign debt held by other sovereigns, political issues and concerns may flow from and dominate the purely economic considerations. For example, the second and third largest government holders of U.S. debt, Japan and the United Kingdom, [13] are states with which the U.S. has close ties and very friendly relations. The largest such holder, China,[14] is a powerful rival with which the U.S. aspires to have a stable and friendly relationship.[15] Would these governments view a restructuring plan that targets their holdings as a repudiation of these relationships or even as a hostile act akin to a blockade or boycott? Of course, the identities of the holders of U.S. Treasuries could change dramatically following a period such as that described in the fictional scenario in Part II or under any scenario that would give rise to the need for the U.S. to restructure its debt. But the concerns as to the political effects would be relevant regardless of the identities of the largest governmental holders of U.S. debt.

Difficulties notwithstanding, bilateral restructuring negotiations may be the only feasible alternative. The two most attractive restructuring approaches discussed in subpart B depend on the legal discharge and satisfaction of a portion of non-exempted Treasury obligations or on

13 *See* Major Holders, *supra* note 9.

14 *See id.*

15 One op-ed author proposed that the U.S. should abandon its alliance with Taiwan in exchange for China forgiving the U.S. debt that it holds. Paul V. Kane, *To Save our Economy, Ditch Taiwan*, N.Y. Times, Nov. 10, 2011 at A35. The suggestion was met with a flurry of on-line opposition. *See, e.g., On Paul V. Kane and His Stupid Op-Ed*, The China Hotline (Nov. 12, 2011), *available at* http://thechinahotline.wordpress.com/2011/11/12/on-paul-v-kane-and-his-stupid-op-ed/; *Ditching Taiwan to save U.S. Economy will be Myopic, Naïve,* Asian Conservatives (Nov. 11, 2011), *available at* http://asianconservatives.com/economy/ditching-taiwan-to-save-u-s-economy-will-be-myopic-naive/; Joshua Keating, *Decline Watch: Can we save America by ditching Taiwan?*, Passport (Nov. 11, 2011), available at http://blog.foreignpolicy.com/posts/2011/11/11/decline_watch_can_we_save_america_by_ditching_taiwan.

a selective default on such obligations and the ability of the U.S. to substantially shelter its offshore assets from execution by future judgment debtors. If neither of those situations could be established, by virtue of legal or practical constraints, then bilateral negotiations might be the only route forward. However, for this purpose, the restructuring proposals discussed in subpart B need not be airtight as a legal matter. They need only be adequate to present a credible threat of a selective default and restructuring so as to push major holders of Treasuries to the negotiating table.[16]

B. Anatomy of a U.S. Debt Restructuring.

This subpart outlines three alternative approaches. One is a selective default initiated by the U.S. in lieu of a bilateral or multilateral negotiated restructuring process. It is combined with unilaterally imposed restructuring terms that would replace and discharge a portion of the Treasury obligations with new non-debt securities (Prosperity Shares). A second is a selective default combined with the issuance of reduced-value Prosperity Shares on account of a portion of the Treasury obligations, but without discharging or otherwise affecting the legal status of the U.S. Treasury obligations. The third is an offer to swap Prosperity Shares for Treasuries on a consensual basis. None of the alternatives contemplates a selective default based solely on the nationality of Treasuries holders. The Treasuries on which a selective default would occur would be determined based instead on broader objective classifications. But the structure and logistics could be employed to effect a selective default on any objective basis.

1. Alternative 1: New Prosperity Shares in Satisfaction and Discharge of Debt.

The U.S. would issue to *all* holders of record of Treasuries in the commercial book-entry system on the books of the Federal Reserve Banks units of new Prosperity Shares. One unit of Prosperity Shares would be issued for each $10,000 of Treasuries. The Federal Reserve Banks would credit the Prosperity Shares on their books to the ac-

16 One participant at the Conference suggested that an actual default on the maturity date of one issue of Treasuries should be sufficient to bring the major holders to the table. Others thought the result of that approach would be market chaos.

count holders on the date of issue (Record Date) which should not be a date on which any Treasuries are maturing. The issuance and announcement of the issuance would be made on the Record Date with no previous information being released to the public. To avoid manipulation, the announcement would be made on a Saturday and the record date would be 12:01AM on the following Monday, in the time zone immediately west of the international date line. At the opening of business on Monday in the U.S., the Federal Reserve Banks would enter the credits of the Prosperity Shares on the book-entry accounts they maintain (or the credits entered over the weekend would become final). No corresponding debits of Treasuries would be made to the accounts of the holders of record.

The Federal Reserve Bank account holders would, to the extent they hold as intermediaries for their own account holders, credit the Prosperity Shares to the accounts of their account holders. Those account holders, if holding as intermediaries, would in turn credit the Prosperity Shares to the accounts of their account holders and so on down the chain. Because the Treasuries are book-entry, they must be held in some form of intermediated securities holding system somewhere in the world.

The terms of the Prosperity Shares would provide that the Prosperity Shares would discharge and satisfy a specified percentage (X%) of the aggregate Treasuries beneficially held by each account holder.[17] The terms of the remaining percentage (Y%) of the aggregate amount of Treasuries would remain unaffected. On the maturity date of each issue of Treasuries, the U.S. would pay Y% of the principal (and interest if applicable) of the maturing Treasuries and those funds would find their way to the accounts of the beneficial holders in the usual fashion.

17 In order to ensure the effectiveness of a selective default, Congress also should withdraw its consent to be sued in the Court of Federal Claims on account of the non-exempted Treasuries. See text at notes 141-44, *infra*. An alternative but less effective approach would be to eliminate the permanent indefinite appropriation, in effect since 1977, for payment of all judgments of the Court of Federal Claims. *See* 31 U.S.C. § 1304 (2000) ("permanent, indefinite appropriation" for payment of judgments as certified by the Secretary of the Treasury); 28 U.S.C. § 2517(a) (final judgments of the Court of Federal Claims to be paid by Secretary of the Treasury based on presentation of a certification of the judgment).

The discharge and satisfaction of X% of the Treasuries would be conditional. The Prosperity Shares would specify the types of beneficial holders whose Treasuries would be exempt from that discharge. It is the exemption which would accommodate the selective default aspect of the restructuring. The exemption would be conditioned on the submission of certifications (in a standard form provided by the U.S. and available online) demonstrating the exempt status of a beneficial holder *at and as of the Record Date*. The certifications would require specified evidence of the qualifications for exemption and would be subject to penalty of perjury under U.S. law. The exemption qualifications could be stated positively or negatively. For example, they could exempt specified holders (*e.g.*, U.S. domestic holders of all types and foreign holders that are individuals or pension-related funds or entities).[18] Or they could specify the non-exempted holders (*e.g.*, foreign governments and political subdivisions, foreign for-profit entities, and foreign mutual funds or similar investment vehicles). The exemption also might extend to Treasuries to the extent held by a foreign financial firm as required minimum capital or reserves or to meet liquidity requirements.[19]

The discharge and satisfaction would apply in practice as to the X% of Treasuries until holders of the securities on the books of the Fed submitted appropriate certifications of exemption. Upon acceptance of appropriate certification, the Prosperity Shares would be debited on the books of the Federal Reserve Banks (and down the line) and the X% of the Treasuries would be reinstated (if the Treasuries remained on the books) or additional Treasuries would be credited (and down the line through the tiers of intermediaries).

The U.S. would not pay the non-exempted Treasuries at their maturities and would selectively default on the non-exempted debt. If, on a maturity date, an exemption certification had been received and accepted, the Treasuries would be paid. Otherwise, the U.S. would

18 If the exemption structure were to discriminate against foreign holders, the U.S. should ensure that it would not run afoul of any of its most favored nation obligations that might exist under GATT or any applicable bilateral investment treaties. *See* Steven L. Schwarcz, xr, Ch. xr (this volume).

19 Such an exemption would impose at least some risk that financial firms could manipulate the system and even cover for non-financial firm clients.

default. If an exemption certificate were received after the maturity date, the U.S. then would pay the principal with additional interest to the Treasuries holder.[20]

The terms of the Prosperity Shares would be structured to provide periodic payments to the holders that reflect in some fashion the growth of the U.S. economy and positive increases in the fiscal health of the U.S. (taking into account the aggregate debt and annual budget deficits or surpluses).[21] Clearly, the Prosperity Shares would have a value of considerably less than the X% of debt they would replace, so in that sense this structure would be a restructuring under which the non-exempted holders would take a haircut on their outstanding holdings of Treasuries. That is the whole point of a scheme to clean up the balance sheet by discharging or defaulting on a material portion of outstanding Treasuries. But the design and economic structure of the Prosperity Shares would present a challenge. They should offer a feasible, if not probable, opportunity for meaningful future value while not obligating the U.S. to such an extent that it would obtain insufficient relief and benefit from the haircut or default. They should be structured so that the U.S. has incentives to improve its economy. Were too much of the upside benefits allocated to the Prosperity Shares, disincentives to improving the U.S. economy might arise.

---

20 In order to allow more flexibility, the legislation might delegate to the President (perhaps with the consent of the Secretary of the Treasury and a majority of the Federal Reserve Board) the decision to default and, perhaps, even the decision as to the percentage of non-exempted debt to be defaulted and the extent and nature of the exemptions.

21 While nothing as radical as Prosperity Shares has been proposed, the U.S. has shown increasing flexibility in the terms of Treasuries. Treasury inflation-protected securities (TIPS) bear a stated rate of interest and the principal is adjusted for inflation on semiannual interest payment dates. They are redeemed at maturity at the higher of par or the inflation-adjusted principal amount. See 31 C.F.R. §365.5(b)(2) (notes), (c)(2) (bonds). It now appears that beginning in the second half of 2012 the U.S. will begin issuing floating-rate notes for the first time. Susanne Walker, *Treasury Is to Sell Floating Rate Notes in Second Half, Bond Dealers Say,* Bloomberg (Feb. 9, 2012) *available at* http://www.bloomberg.com/news/2012-02-09/treasury-to-sell-floaters-in-second-half-of-year-dealers-say.html. Another proposal would be to tie the interest rate on certain Treasuries to the United States' gross domestic product. Mark J. Kamstra & Robert J. Shiller, Trills *Instead of T-Bills: It's Time to Replace Part of Government Debt with Shares in GDP,* The Economists' Voice (Sept. 2010) *available at* http://econpapers.repec.org/article/bpjevoice/v_3a7_3ay_3a2010_3ai_3a3_3an_3a5.htm.

2. Alternative 2: Selective Default and New Prosperity Shares as Additional Compensation.

Alternative 2 would operate essentially in the same manner as Alternative 1, with certain important exceptions. First, Alternative 2 would not discharge and satisfy any Treasury obligations. The legislation and the terms of the Prosperity Shares would clearly state that nothing in the law affects the validity of the public debt and that all existing public debt would remain valid, binding, and enforceable in accordance with its terms. Second, Congress would authorize the Executive Branch to selectively default on the same portion of Treasury obligations that would be satisfied under Alternative 1. For example, it could require Presidential finding of an emergency and the issuance of an executive order to implement the program. Assuming Congress adopted Alternative 1 as its first choice, Alternative 2 would differ in a third respect. The tenor of the Prosperity Shares under Alternative 2 would be structured to have a value of approximately one-half of the Alternative 1 Prosperity Shares. The enabling legislation also would provide that all payments received by the holders of Prosperity Shares would reduce the Treasury obligations dollar for dollar.

3. Alternative 3: Selective Default and Prosperity Shares Exchange Offering.

Instead of issuing the Prosperity Shares to compensate holders for a U.S. default on a percentage of the non-exempted Treasuries as under Alternatives 1 and 2, under Alternative 3, the U.S. would offer the Prosperity Shares to all non-exempted Treasuries holders. Acceptance of the offer would have the consequence of discharging and satisfying X% of the non-exempted Treasuries as under Alternative 1. But Alternative 3 would modify Treasury obligations only with consent of the relevant holders.

C. Selected Legal Issues.

Subpart B focused primarily on *how* the U.S. might go about restructuring of its debt. In particular, it explained how a selective default could be achieved through certification of exemptions, thereby overcoming the anonymous intermediated holding structure for Treasuries. It also explained how Treasuries could be partially replaced or supplemented by Prosperity Shares, either on a unilateral or voluntary exchange basis. This subpart focuses on examples of legal issues and impediments that would attend a restructuring along the lines presented in subpart B.

1. Legal and Constitutional Authority and Power to Default and Restructure U.S. Debt.

A default and restructuring of Treasuries as contemplated here would require the Department of Treasury and the Fed to work in tandem to achieve the restructuring. But none of Treasury, the Fed, or the President would have the inherent power to default on U.S. debt on a discretionary basis. Treasuries are issued pursuant to statutory authority and statutorily authorized regulations. Only Congress would have the power to authorize the Executive Branch to default on (*i.e.*, to refuse to pay) Treasuries.[22] This would likely be the chief legal (much less, political) impediment to a restructuring of Treasuries. Even if the requisite majorities in Congress could be persuaded on the merits to approve such a default, the process of debate and negotiation would be messy. Moreover, the public nature of the process

22 Section 365.33 of the Department of Treasury's Uniform Offering Circular for Treasuries is captioned "Does the Treasury have any discretion in the auction process?". 31 C.F.R. § 356.33. Section 365.33(c) provides, "We reserve the right to modify the terms and conditions of new securities and to depart from the customary pattern of securities offerings at any time." It was suggested at the Conference that under this provision, Treasury could change the terms and conditions of issued and outstanding Treasuries. However, I believe the correct reading is that the provision refers to the terms of the new securities being auctioned. For purposes of the legal analysis presented here I disregard the possibility that the President has the unilateral power under current law to order a default, even in the face of the posited economic crisis. By way of analogy, I note that during the public debates about raising the debt ceiling in 2011 some argued that the President had the power to borrow in excess of the debt ceiling even without the approval of Congress. See, e.g., Eric A. Posner & Adrian Vermeule, *Obama Should Raise the Debt Ceiling on His Own*, The Opinion Pages (July 22, 2011), *available at* http://www.nytimes.com/2011/07/22/opinion/22posner.html. Also, I recognize that in such a crisis the President might order a default and that such an action might not present a justiciable issue. Nonetheless, the analysis proceeds on the more cautions assumption that Congressional approval would be necessary to effect a default and debt restructuring.

would present a serious, if not fatal, problem. The U.S. would lose the advantage of stealth and surprise, which would disrupt the market even before a completed restructuring were achieved (or worse, would block the possibility of a successful restructuring).

Consider some possible ways around this conundrum. The President, Treasury, and the Fed could implement the restructuring contingent upon post-hoc approval by Congress. Or, the President and Congressional Leaders could approach every member of Congress individually and confidentially. While unanimous agreement and support would be unlikely, the members' sense of patriotism and loyalty might be the basis for a pledge of strict confidentiality even by those who were not persuaded to approve the plan. At the appropriate time, a secret meeting of Congress could be called to approve the plan. Or, these approaches could be combined, with the first approach (an implementation contingent on subsequent Congressional approval) followed by an immediate Congressional approval based on earlier one-on-one confidential meetings.

The alternative approaches presented here are intended to illustrate examples of coherent restructurings that would proceed under the rule of law. If the President and Congress decide to default on the non-exempted Treasuries, Congress could simply fail to appropriate sufficient funds and payment of Treasuries in full would be impossible. That would be simple enough. The *unintentional* version of that scenario was the prospect that was the subject of so much discussion and debate during the 2011 debt ceiling impasse. In a restructuring mode, however, it would be wise for the U.S. to avoid the possibility of legal challenges in any U.S. courts that would have jurisdiction over the U.S. But it would also be desirable for the U.S. to take an approach that would not violate its own Constitution—whether or not the actions could be challenged in a court of law.

Alternatives 1 and 2 each might attract constitutional challenges. Depending on the terms of the Prosperity Shares, Alternative 3 might not be a feasible method of restructuring. Congress could at best hazard guesses at how legal challenges or market acceptance of Prosperity Shares might play out. Consequently, Congress could consider adopting all three alternatives as a hedge against future developments. It could give first priority to Alternative 1, with a savings clause to the effect that Alternative 2 would apply if Alternative 1 is not upheld. Alternative 3, then, would apply if Alternative 2 were to fail. Alternatively, if only one of the alternatives seems likely to be successful, Congress could opt for that approach. Once again, I should emphasize that these alternatives are illustrative only in order to provide a concrete setting for consideration of the various legal and practical issues that a restructuring would present.

a. Implementing Alternative 1.

Implementation of the Alternative 1 restructuring plan might be an unconstitutional exercise of Congressional power because it modifies the terms and relieves the U.S. of liability on the portion of the Treasury obligations replaced by the Prosperity Shares.[23] Unlike Alternative 2, which does not contemplate any discharge and satisfaction of the Treasury obligations as to which Prosperity Shares would be issued, and Alternative 3, which contemplates the substitution of Prosperity Shares for a portion of Treasuries debt only upon Treasuries holders' consent, Alternative 1 would unilaterally replace a portion of the Treasury obligations even in the absence of consent.

Section Four of the Fourteenth Amendment, provides in part: "The validity of the public debt of the United States . . . shall not be questioned."[24] Adopted in 1868, Section Four was originally written with an eye towards preventing challenges to Civil War debts,[25] but by its terms and as construed by the Supreme Court it applies to all federal debt.[26] An examination of the clause's structure and history

23 If the present option value of the Prosperity Shares could be shown to approximate the value of the putatively satisfied and discharged debt, that *might* solve the problem. But the terms of Prosperity Shares that could be so valued likely would not provide the debt relief contemplated by the restructuring.

24 U.S. Const. amend. XIV, §4.

25 Perry v. U.S., 294 U.S. 330, 354 (1935) ("this provision was undoubtedly inspired by the desire to put beyond question the obligations of the government issued during the Civil War.").

26 Id. (Perry held that the language of Section Four "indicates a broader connotation" than just covering Civil War debts, but "applies as well to the government bonds in question, and to others duly authorized by the Congress.") During the 2011 controversy over increasing the U.S. government debt ceiling, the scope of Section Four was the subject of sharp disagreement. *Compare* Laurence Tribe, *Guest*

has led one scholar to observe that "the intention was to lay down a constitutional canon for all time in order to protect and maintain the national honor and to strengthen the national credit."[27] A Congressional act that provides that the U.S. is not bound to pay a portion of its Treasuries debt as contemplated by Alternative 1 would, at least on its face, appear to "question[]" "[t]he validity of the public debt." The legislation would relieve the U.S. of its obligation to pay the portion of the Treasury obligations that would be replaced by the Prosperity Shares.

The only time the Supreme Court has construed Section Four was *Perry v. United States*, one of the *Gold Clause Cases*.[28] These cases concerned private corporate bonds, a U.S. gold certificate, and a U.S. government bond. The obligations each included a "gold clause" which stipulated that the relevant obligation was payable in gold

Post on the Debt Ceiling by Laurence Tribe, Dorf on Law (July 16, 2011) [hereinafter, Tribe, *Guest Post*], http://www.dorfonlaw.org/2011/07/guest-post-on-debt-ceiling-by-laurence.html. (arguing that the reference to "the public debt" in Section Four is limited to indebtedness such as bonds) with Neil H. Buchanan, *Borrowing, Spending, and Taxation: Further Thoughts on Professor Tribe's Reply,* Dorf on Law (July 19, 2011) [hereinafter, Buchanan, Borrowing], http://www.dorfonlaw.org/2011/07/borrowing-spending-and-taxation-further_19.html (arguing that it extends to all U.S. government obligations). For present purposes, it is clear enough that the public debt includes Treasuries that are the subject of this discussion. For a thorough analysis of the 2011 debt ceiling crisis and debates over legal issues, see Jeremy Kreisberg & Kelley O'Mara (under the supervision of Howell Jackson), [Ch. xr (this volume)] [*available at* http://finance.wharton.upenn.edu/conferences/debtconf/].

27 Phanor J. Eder, *A Forgotten Section of the Fourteenth Amendment*, 19 Cornell L.Q. 1, 15 (1933); see also Michael Abramowicz, *Beyond Balanced Budgets*, Fourteenth Amendment Style, 33 Tulsa L.J. 561, 585 (1997) ("A constitutional guarantee provided meaningful assurance to those who might purchase future government debt."); John McGuire, *The Public Debt Clause and the Social Security Trust Funds: Enforcement Mechanism or Historical Peculiarity?*, 7 Loy. J. Pub. Int. L. 203, 213-15 (2006) (explaining that the clause was designed to have a lasting influence and cover more than just Civil War debts). Donald Bernstein explained at the conference that the inflexibility that Section Four affords the U.S. in circumstances of financial distress has a very positive value. It forces "debtor discipline" which would be essential for a recovery. Donald S. Bernstein, xr, Ch. xr (this volume).

28 The cases are: *Perry v. U.S.*, 294 U.S. 330 (1935); *Nortz v. U.S.*, 294 U.S. 317 (1935); *Norman v. Baltimore & Ohio R.R. Co.*, 294 U.S. 240 (1935) (consolidated for review with *U.S. v. Bankers Trust Co.*). *See generally* Kenneth W. Dam, *From the Gold Clause Cases to the Gold Commission: A Half Century of American Monetary Law*, 50 U. Chi. L. Rev. 504, 514-18 (1983) (discussing the four major gold clause cases).

or gold coin. In 1933, early in the Roosevelt administration, Congress passed a Joint Resolution providing that a contractual requirement that payments be made in gold or specific coin or currency was against public policy, effectively nullifying such gold clauses.[29] The resolution further provided that any such obligations could be satisfied by the payment of any currency that was legal tender, dollar for dollar.[30]

Perry's plurality opinion on behalf of four Justices,[31] confirmed the unconstitutionality of a law that would relieve the U.S. from its obligation to pay federal debt according to its terms.[32] Mr. Perry was the holder of a U.S. government bond that made principal and interest "payable in United States gold coin of the present standard of value." [33] Perry sued to recover the amount in dollars equivalent to gold at earlier exchange rates under the gold clause term of the bond. The plurality opinion recognized that the Constitution empowers Congress to borrow money, which includes the right "to fix the amount to be borrowed and the terms of payment."[34] However, the plurality held the Joint Resolution to be unconstitutional insofar as it applied to gold clauses in federal obligations. The Court relied in part on Section Four. As it explained:

> We regard [Section Four] . . . as confirmatory of a fundamental principle, which applies as well to the government bonds in question, and to others duly authorized by the Congress, as to those issued before the Amendment was adopted. Nor can we perceive any reason for not considering the expression "the *validity* of the public debt" as embracing whatever concerns the integrity of the public obligations.[35]

The Court also relied directly on the fundamental principle confirmed by Section Four. It reasoned that "[h]aving this power to au-

29 H.R.J. Res. 192, 73d Cong., 48 Stat. 112-13 (1933) (enacted).
30 Id.
31 Mr. Justice Stone wrote a concurring opinion, discussed *infra,* thereby providing a 5-4 majority.
32 *Perry*, 294 U.S. at 353-54.
33 *See, e.g., Perry*, 294 U.S. at 347 (quoting bond terms).
34 *Perry,* 294 U.S. at 351.
35 *Id*. at 354.

thorize the issue of definite obligations for the payment of money borrowed, the Congress has not been vested with authority to alter or destroy those obligations."[36] The following discussion refers to this principle as the "non-abrogation principle." The Court further observed that "Congress was without power to reduce expenditures by abrogating contractual obligations" even in the face of a "great need of economy" and "widespread distress."[37]

While the use of language in *Perry's* plurality opinion as to the unconstitutionality of the Joint Resolution is quite clear, the actual holding of the case is quite astonishing. With reasoning that has been described as "baffling"[38] and "convoluted and suspect,"[39] the Court held that Perry was entitled to receive only the face amount of the bond *in dollars and not in gold coin*. The Court's holding left Perry in *exactly* the same position as would have been the case had the Court held the abrogation of gold clauses in U.S. bonds to be constitutional. Kenneth Dam explained the reasoning of the plurality opinion: [40]

> [T]he Court nonetheless relegated the holder of the government bond to receiving merely the face amount of $ 10,000 in legal tender currency. The Court reasoned that unlike the post-Civil War period, when coin and paper money floated in the marketplace at prices determined by supply and demand, the period of the Gold Clause Cases had a "single monetary system with an established parity of all currency and coins."[[41]] Even under the

36 *Id.* at 353; see also Id. at 352-53 (Congress "was without power to reduce expenditures by abrogating contractual obligations of the United States. To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an act of repudiation.") (*quoting Lynch v. U.S.,* 292 U.S. 571, 580 (1934)).

37 *Id.* at 352. While the Court held the government's modification of its obligations to be unconstitutional, it is noteworthy that "the *Perry* Court appeared determined not to upset governmental policy and ultimately did not award Perry damages." Abramowicz, supra note 27, at 603.

38 Henry Hart, *The Gold Clause in United States Bonds*, 48 Harv. L. Rev. 1057 (1935).

39 Dam, *supra* note 28, at 517. Dam virtually destroys the factual underpinnings of the plurality opinion that the gold clauses interfered with the federal government's power over money and that enforcing the clauses would cause a dislocation of the economy. *Id.* at 518-525.

40 *Id.* at 517 (footnotes omitted).

41 Quoting from *Perry*, 294 U.S. at 357.

> pre-1933 legislation, a gold coin could have been legal tender only for its face amount, not for the value of its gold content. Thus even if the bond had been paid in gold coin and even assuming that gold coin did not have to be surrendered to the government at the $ 20.67 price under the 1933 regulations, the bondholder could not have exchanged his gold coin at the thirty-five dollar price because no recipient would have been required to treat it as legal tender for more than its face amount. Moreover, he could not have exported the gold coin or sold it for its gold content. As a result, the holder had no legally cognizable loss of purchasing power. Since there was no "actual loss," recovery of money at the gold value—$ 1.69 per $ 1.00 face amount of the bonds—would "constitute not a recoupment of loss in any proper sense but an unjustified enrichment."[42]

The *Perry* plurality was clear that Congress has the power to deal with gold coin as a medium of exchange and that the requirement that gold be redeemed and the prohibition against export and sale of gold on the international market were lawful.[43] Thus, the Court held that the lawful acts of Congress permitted it to take an unlawful act—modification of the terms of its obligations—with impunity. The U.S. had modified its obligations *de facto*.[44] Mr. Justice Stone's concurring opinion made clear what the plurality opinion obfuscated (but clearly provided in result):

> While the Government's refusal to make the stipulated payment is a measure taken in the exercise of that power [to coin and regulate money], this does not disguise the fact that its action is to that extent a repudiation of its undertaking. As much as I deplore this refusal to fulfill the solemn promise of bonds of the United States, I cannot escape the conclusion, announced for the Court, that in the situation now presented, the Government, through the exercise of its sovereign power to regulate the

42 Quoting from *id.* at 358 (footnotes omitted).

43 *Perry*, 294 U.S. at 355-56.

44 Dam, *supra* note 28, at 518 ("The reasoning of the *Perry* plurality on the constitutional issue was, however, less important to the future of gold than was the result, which rendered gold clauses just as ineffective in government obligations as in private obligations.")

> value of money, has rendered itself immune from liability for its action. To that extent it has relieved itself of the obligation of its domestic bonds, precisely as it has relieved the obligors of private bonds in Norman v. Baltimore & Ohio R. Co., decided this day . . .[45]

Taking into account as well the four Justices who joined in the dissenting opinion, five of the nine Justices explicitly acknowledged that the government had effectively modified its obligations.[46]

With the result in *Perry* in mind, could Congress find a way to effectively implement Alternative 1 without running afoul of Section Four and the non-abrogation principle? Following is a sketch of one possible approach. It does not purport to be a definitive analysis but a point of departure for exploring this question.

It was quite convenient for the plurality and concurrence in *Perry* that the gold clause that Congress sought to override (albeit unconstitutionally, according to the plurality) was intimately related to the power over money that was lawfully exercised. Arguably, in the context of restructuring under Alternative 1, there is a Congressional power that might play a role somewhat analogous to that of Congressional power over money in *Perry*. It is the power conferred on Congress by the Bankruptcy Clause of the U.S. Constitution.[47] The Bankruptcy Clause provides that Congress has the power "To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."[48] Discussions of the Bankruptcy Clause often

---

45 *Perry*, 294 U.S. at 359. Stone's view was that it was sufficient to decide the case on the basis that there were no damages. He saw no need to go further. Unlike the plurality, he would not have reached the constitutional issue.

46 *Id.* at 377 (McReynolds, J., dissenting):

> The majority seem to hold that the Resolution of June 5th did not affect the gold clauses in bonds of the United States. Nevertheless we are told that no damage resulted to the holder now before us through the refusal to pay one of them in gold coin of the kind designated or its equivalent. This amounts to a declaration that the Government may give with one hand and take away with the other. Default is thus made both easy and safe!

47 U.S. Const. art. I, § 8, cl. 4.

48 *Id.* As understood at the time of the Framing of the Constitution, "insolvency laws under English law and the law of some colonies and states freed the debtor [from imprisonment] and distributed his assets among his creditors but did not re-

begin by noting the dearth of evidence concerning its origins and underlying purposes.[49] There is a good case to be made that its origins derive in substantial part from the federalism concerns that underlie diversity jurisdiction of the federal courts.[50] "[U]niform Laws on the subject of Bankruptcies throughout the United States,"[51] then, like federal courts in the diversity jurisdiction context, could provide a more neutral system that would be less biased in favor of local parties. While this federalism-related explanation carries significant weight, scholars continue to ponder the purposes and scope of the Bankruptcy Clause.[52]

I am aware of no evidence that the Framers considered the possibility that the Bankruptcy Clause might empower Congress to enact a law that would allow the U.S. government to discharge its debts. But surely that does not resolve the issue. I also am unaware of any sign that they considered municipal bankruptcies, but provisions for municipal bankruptcies have been on the books for more than

---

lieve him of his obligations to pay the underlying debts." Bruce H. Mann, Republic of Debtors: Bankruptcy in the Age of American Independence 80 (2002). On the other hand, "bankruptcy laws accomplished the same end [as insolvency laws] but also discharged the debtor from liability for unpaid debts. " *Id.* Within a few years, however, the Bankruptcy Clause was understood to empower Congress to enact either type of law. Jonathan C. Lipson, Debt and Democracy: Towards a Constitutional Theory of Bankruptcy, 83 Notre Dame L. Rev. 605, 633 (2008) [hereinafter, Lipson, Democracy]. Accordingly, I use the terms bankruptcy,bankruptcy law, and bankruptcy proceedingsin this broad sense.

49 *See generally*, e.g., David A. Skeel, Jr., *Debt's Dominion: A History of Bankruptcy Law in America* 3, 23-47 (2001) [hereinafter Skeel, *Debt's Dominion*], *citing* The Federalist No. 42 (James Madison) (Clinton Rossiter ed., 1961):

> Almost the only contemporary evidence of the meaning or importance of uniform bankruptcy comes in the Federalist No. 42. Written by James Madison, Federalist No. 42 describes federal bankruptcy legislation as intimately connected with the regulation of commerce, and necessary to prevent debtors from fleeing to another state to evade local enforcement of their obligations.

50 *See* Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure,* 61 Wash. & Lee L. Rev. 931, 982-90 (2004) [hereinafter, Mooney, *Normative Theory*].

51 U.S. Const. art. I, § 8, cl. 4.

52 *See, e.g.*, Skeel, Debt's Dominion at 23 (quoted *supra* note 49); Lipson, *Democracy, supra* note 48; Thomas Plank, *Bankruptcy and Federalism*, 71 Fordham L. Rev. 1063, 1090 n.106 (2002).; Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States,* 3 Am. Bankr. Inst. L. Rev. 5, 7-11 (1995).

seventy-five years.[53] The current version is found in Chapter 9 of the Bankruptcy Code.[54] And recently a debate has emerged over whether federal bankruptcy law should be amended to permit states of the U.S. to become debtors.[55] Certainly nothing in the text of the Bankruptcy Clause itself would appear to limit the power of Congress to enact a bankruptcy law providing for discharge of the obligations of a government, including the federal government. Bankruptcy law is a branch of civil procedure law, the purpose of which is to protect and vindicate the rights of those with legal entitlements (*e.g.*, creditors) vis-a vis a debtor in financial distress.[56] As such, expanding bankruptcy law to embrace the U.S. federal government would be a coherent and logical extension of existing federal jurisdiction over claims against the U.S.[57]

The Bankruptcy Clause does not dictate to Congress the metes and bounds of a bankruptcy law; such a law need only deal with the "uniform Laws on the subject of Bankruptcies throughout the United States."[58] A bankruptcy law need not be situated in a stand-alone act denominated as a bankruptcy law,[59] although that has been the approach in the U.S.[60] Could a bankruptcy law that applied only to the U.S. government as debtor be a "uniform Law[] . . . throughout the United States"? The Supreme Court addressed "the nature of the uni-

53 The first municipal bankruptcy act was enacted in 1934. Pub. L. No. 251, 73d Cong., 2d Sess., 48 Stat. 798 (1934).

54 11 U.S.C. §§ 901-946.

55 *See, e.g.,* David Skeel, *Give States a Way to Go Bankrupt*, 16 The Weekly Standard No. 11 (Nov. 29, 2010), *available at* http://www.weeklystandard.com/articles/give-states-way-go-bankrupt_518378.html?page=1; David A. Skeel, Jr., *States of Bankruptcy,* 79 U. Chi. L. Rev. 677 (2012) (arguing in favor of a bankruptcy law for states); Joe Weisenthal, *More on Why the "State Bankruptcy" Idea Is Dangerous Nonsense,* Business Insider (Jan. 24, 2011), *available at* http://articles.businessinsider.com/2011-01-24/markets/30021798_1_state-bankruptcy-tax-hikes-spending-cuts.

56 *See* Mooney, Normative Theory, supra note 50, at 951-54.

57 As discussed *infra,* claims against the U.S. government currently are subject to the jurisdiction of the Court of Federal Claims. See note 134, *infra.*

58 U.S. Const. art. I, § 8, cl. 4.

59 *See* Steven L. Schwarcz, A Minimalist Approach to State "Bankruptcy," 59 UCLA L. Rev. 322, 336 (2011).

60 *See* Act of April 4, 1800, chap. 19, 2 Stat. 19 (repealed 1803); Act of August 19, 1841, chap 9, 5 Stat. 440 (repealed 1843); Act of March 2, 1867, chap. 176, 14 Stat. 517 (repealed 1878); Bankruptcy Act of 1898, chap. 541, 30 Stat. 544 (repealed 1978); Bankruptcy Code, 11 U.S.C. §§ 101 *et seq*.

formity required by the Bankruptcy Clause" in *Railway Labor Executives' Association v. Gibbons*.[61] *Gibbons* held that an act enacted pursuant to the Bankruptcy Clause power was unconstitutional because it applied to only one named debtor and that debtor's creditors.[62] The act failed the uniformity requirement. As the Court explained:

> Our holding today does not impair Congress' ability under the Bankruptcy Clause to define classes of debtors and to structure relief accordingly. We have upheld bankruptcy laws that apply to a particular industry in a particular region. See 3R Act Cases, 419 U.S. 102 (1974). The uniformity requirement, however, prohibits Congress from enacting a bankruptcy law that, by definition, applies only to one regional debtor [the Chicago, Rock Island and Pacific Railroad Co.]. To survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors. A bankruptcy law . . . confined as it is to the affairs of one named debtor can hardly be considered uniform. To hold otherwise would allow Congress to repeal the uniformity requirement from Art. I, § 8, cl. 4, of the Constitution.[63]

Of course, Congress did not write an entirely new bankruptcy law solely for the Rock Island Railroad, it only added a few special provisions. It follows that any provisions of a bankruptcy law that would apply only to the U.S. government as debtor would be suspect under *Gibbons.*

One way around the problem would be for the legislation to provide for bankruptcy relief for a "defined class of debtors," which could be the sovereigns consisting of the U.S. government or the government of any state of the U.S. Or the class could include any sovereign (although the likelihood of a foreign sovereign state's use of such a law seems fanciful). Even so, it is likely that some provisions of the law necessarily would apply only to the U.S. government. In that case, the fact that the U.S. government is so unlike any other debtor might be sufficient to overcome a uniformity objection. Congress could enact a new, special law for sovereign bankruptcy or amend

61 455 U.S. 457, 469.
62 *Gibbons,* 455 U.S. at 473.
63 *Id*.

the Bankruptcy Code[64] to allow the U.S. to propose a restructuring plan. Because the restructuring should be accomplished immediately on the record date, it would be necessary to propose the restructuring as contemplated by Alternative 1 at the commencement of the bankruptcy case.[65] The legislation might plausibly confer jurisdiction to handle a sovereign debtor case on any federal District Court in the case of the U.S. government and on any District Court sitting in a debtor state in the case of a state of the U.S.[66]

As to substance, Chapter 9 on Adjustment of Debts of a Municipality might provide a template or checklist of sorts inasmuch as it sets out markers on which provisions of the Bankruptcy Code are appropriate for a government debtor and which are not.[67] At least two of Chapter 9's requirements for confirmation of a plan of adjustment of a debtor's debts might be troublesome if applicable to a plan along the lines of Alternative 1. First, Plan confirmation requires acceptance by at least one class of impaired claims, not taking into account the claims of "insiders."[68] It is doubtful that the holders of impaired claims based on non-exempted Treasuries would accept a plan that offered the Prosperity Shares in lieu of more substantial payments or other value. Perhaps another class of claims could be impaired with a better chance of acceptance, such as claims held by Federal Reserve Banks. On the other hand, those claims might be considered insider claims.

Second, assuming that the classes of claims that include the holders of non-exempted Treasuries would not accept the plan, in order to invoke the cramdown provisions of Chapter 9 for confirmation notwithstanding such nonacceptance, the plan must "not discriminate unfairly" with respect to nonaccepting classes of claims.[69] Discrimi-

64 11 U.S.C. §§ 101-1530.

65 To reiterate, the alternatives presented here are illustrative so as to facilitate a concrete discussion.

66 I make no attempt here in these few pages to address the myriad details of such a bankruptcy law.

67 *See* 6 Collier on Bankruptcy (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. 2011) ¶ 900.01[2][c] (discussing differences between Chapter 9 and Chapter 11 as to court involvement with operations of debtor).

68 11 U.S.C. §§ 901(a), 1129(a)(10).

69 11 U.S.C. §§ 901(a), 1129(b)(1).

nation based on the citizenship, residence, or principal place of business of Treasuries holders, as contemplated by Alternative 1, might constitute such unfair discrimination.[70] That is not to say that all unsecured creditors must be treated in the same fashion. Although Chapter 9 incorporates the priority for administrative expenses it does not incorporate the other priorities that apply in other chapters of the Bankruptcy Code.[71] It also does not adopt a baseline pro rata sharing distributional scheme as the Bankruptcy Code provides for liquidations under Chapter 7.[72] This leaves a debtor free to establish additional priorities pursuant to a plan. Presumably priorities with a rational, coherent basis, not unlike those established in Section 507 of the Bankruptcy Code, would not constitute unfair discrimination. Examples would include exempting from the Prosperity Share exchange (*i.e.*, affording priority to) claims below a specified dollar amount, claims of holders on behalf of pension funds, and claims necessary for a financial institution to maintain required minimum capital or reserves or to meet liquidity requirements.[73]

Notwithstanding the foregoing, in establishing a bankruptcy law that applied to the U.S. government, Congress would not be obliged to follow the Chapter 9 template.[74] For example, it could abandon

70 An analysis of unfair discrimination in the cramdown process is beyond the scope of this paper. Suffice it to say that the substantial disparity in treatment under Alternative 1 between the non-exempted and exempt Treasury obligations, which have identical priority outside bankruptcy, strongly suggests unfair discrimination.
71 11 U.S.C. § 901(a) (incorporating 11 U.S.C. § 507(a)(2) on administrative expenses but not the other priorities established in section 507).
72 *See* 11 U.S.C. § 726(a) (distributions in liquidation under Chapter 7).
73 Lest I draw criticism for inconsistency or bias in favor of a U.S. federal government bankruptcy, I should emphasize that awarding such priorities under bankruptcy law is wrong. *See* Mooney, *Normative Theory*, *supra* note 50, at 1053-58. It would be (and in some respects is, under Bankruptcy Code section 507(a)) inconsistent with my position that, in general, bankruptcy law should not adopt rules on basic rights and obligations that differ from those applicable outside of bankruptcy. *Id.* at 957-1010. Exceptions are appropriate when based on a rational need for special rules in bankruptcy in order to achieve its goals. Id. at 1011-60. In the present discussion, I do not advocate such priorities. My goal instead is to explore the options that would be available to the U.S. government in order to implement Alternative 1 in bankruptcy.
74 *See* Schwarcz, *supra* note 59, at 326. Indeed, following the Chapter 9 template arguably “can bring in a lot of excess baggage” because a sovereign debtor, such as the U.S. Government, is very different from municipalities. *Id*.

the concept of unfair discrimination in the new law. While that approach might be desirable for the U.S. government as debtor, it might be a very bad idea for state debtors. And treating the U.S. differently would again implicate the uniformity issue.

In addition to addressing the scope of the Bankruptcy Clause, it also is necessary to consider whether there would exist any conflict between implementation of Alternative 1 through the Bankruptcy Clause powers and any other Constitutional limitations. Under Section Four, for example, would such implementation “question[]” “the validity of the public debt”? Under any normal, accepted meaning of “validity” of debt the answer must be that it does not. “Valid” means “legal sufficiency”[75] and “binding” in the context of an obligation.[76] Bankruptcy provides remedies for and accommodates only valid obligations of the debtor, not invalid ones. Alternative 1 as implemented through a bankruptcy law would first determine the validity of a claim based on non-exempted Treasuries—an easy task for U.S. public debt, of course. Then the debt would be discharged and a distribution of Prosperity Shares would be made on account of the claim. In effect, there would be a novation that replaces a portion of

75 *See* Black’s Law Dictionary (9th ed. 2009) (defining the adjective “valid” as “[l] egally sufficient; binding,” indicating the related noun to be “validity,” and giving as an example “a valid contract.” Correspondingly, “invalid” means “not of binding force or legal efficacy” or “lacking in authority or obligation.” *Id*.

76 As must be apparent, I am not a Constitutional law expert. But I have given hundreds of written legal opinions to the effect that an agreement is “a legal, valid and binding obligation of [an obligor] and enforceable against [the obligor] in accordance with its terms” or a similar variation. As Arthur Field has explained: “The language ‘in accordance with its terms’ as well as the word ‘legal’ are often omitted in current usage. They add nothing to the opinion. The word ‘valid’ is also sometimes omitted as adding nothing.” Arthur Norman Field, Legal Opinions in Business Transactions § 6.15 (Practising Law Institute 2003). I think I understand “validity.” However, Michael Abramowicz takes the position that, in Section Four ,“validity” does not mean “legal” validity. Michael Abramowicz, *Train Wrecks, Budget Deficits, and the Entitlements Explosion: Exploring the Implications of the Fourteenth Amendment’s Public Debt Clause,* GW Legal Studies Research Paper no. 575 [hereinafter, Abramowicz, Train Wrecks], *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1874746. Perhaps his view of validity would make some sense if used in the instructions to a board game, for example. But to think “validity” as used in the United States Constitution does not mean “legal” validity seems more than far fetched. As noted, Field has explained that the “legal’ modifier adds nothing. I take up Abramowicz’s views on Section Four again in the discussion of Alternative 2. *See* pp. 44-46, infra.

the Treasury debt with the Prosperity Shares.[77] It is a truism that after discharge of the valid debt it would be transformed into Prosperity Shares and in that respect it would no longer be a valid debt for the former face amount. But that is the essence of a bankruptcy law. If Congress has the power under the Bankruptcy Clause to adopt a bankruptcy law that would apply to the U.S. government, then it necessarily has the power to provide for a discharge. Otherwise the Bankruptcy Clause power would be meaningless in this context.

From the foregoing, it appears that whether Congressional power to permit the implementation of Alternative 1under the Bankruptcy Clause conflicts with Section Four depends on whether a bankruptcy law applicable to the U.S. government as a debtor would be within the scope of the Bankruptcy Clause. As explained, if such a law is within the scope of the Bankruptcy Clause, it would prevail over any claim that it violates Section Four. In recent years, the Supreme Court has considered analogous potential conflicts between bankruptcy law and the Constitution apart from the Bankruptcy Clause, in particular sovereign immunity of the states of the U.S. under the Eleventh Amendment.[78]

In *Tennessee Student Assistance Corp. v. Hood*,[79] the Court held that a bankruptcy discharge of a student loan owed to a state "does not implicate a State's Eleventh Amendment immunity."[80] In effect, the majority opinion held that there is no Eleventh Amendment immunity from a discharge and, consequently, there was no conflict between that amendment and the discharge imposed by bankruptcy law. Two years later, in *Central Virginia Community College v. Katz*,[81] the Court held that a state's Eleventh Amendment sovereign immunity did not protect it against a suit to recover a pre-bankruptcy preferential payment made by the debtor to a state creditor. The principal

77 The statement in the text assumes that a bankruptcy law for the U.S. government would follow the pattern of discharge in Chapter 11. *See* 11 U.S.C. § 1141(d)(1).

78 U.S. Const. amend. XI. The Eleventh Amendment provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

79 541 U.S. 440 (2004).

80 *Id*. at 445.

81 546 U.S. 356 (2006).

rationale of the *Katz* majority opinion relied on the "*in rem*" nature of bankruptcy[82] and the "consent" of the states to suits in federal bankruptcy courts resulting from ratification of the Constitution.[83] The court further qualified its holding as applying only when the law under which Congress has permitted suit against the states is actually a bankruptcy law, i.e., a law "on the subject of Bankruptcies."[84] So, under *Katz*, there is a two-step model. First, examine the relevant nonbankruptcy legal entitlement—the Eleventh Amendment in *Katz*—to ascertain whether it is inconsistent with or would be contravened by the bankruptcy law involved. Second, determine whether the relevant bankruptcy law is actually one within the scope of the Bankruptcy Clause.

Applying this analysis to the present context, the discharge does affect the continued existence of the Treasury obligations, but only in the sense that the distribution in bankruptcy determines that valid debt is satisfied, not that it is invalidated. Moreover, it is clear enough that a law providing for a debtor's discharge is within the scope of the Bankruptcy Clause. As already noted, bankruptcy is part of civil procedure designed to provide remedies to holders of legal entitlements such as creditors. As to procedure, the Perry plurality opinion acknowledged:

> The fact that the United States may not be sued without its consent is a matter of procedure which does not affect the legal and binding character of its contracts. While the Congress is under no duty to provide remedies through the courts, the contractual obligation still exists and, despite infirmities of procedure, remains binding upon the conscience of the sovereign.[85]

If, as a *procedural* matter, Congress can lawfully fail to provide any remedy whatsoever for a breach of a U.S. contractual obligation, *a fortiori* it should have the power to provide a *procedural* remedy under the Bankruptcy Clause. This remedy posited here is the distribution of Prosperity Shares in satisfaction of the discharged portion of the Treasury obligations.

82 *Id*. at 362, 369-71.
83 *Id*. at 377-78.
84 *Id*. at 378-79.
85 *Perry*, 294 U.S. at 354.

Under any coherent distributional scheme of a bankruptcy law, the distributions to creditors must be grounded in a debtor's ability to pay. For purposes of confirming a plan under Chapter 11 of the Bankruptcy Code, for example, each holder of a claim of an impaired class must either accept the plan or receive property of a value not less than such holder would receive in a liquidation of the debtor—the "best interests" test. [86] But such a test is not feasible for a debtor that is a government. As explained in relation to a municipality debtor under Chapter 9:

> A municipality cannot be liquidated, its assets sold, and the proceeds used to pay its creditors. Nevertheless, the [best interests] concept is not without meaning in a municipal debt adjustment case. The concept should be interpreted to mean that the plan must be better than the alternative that creditors have. In the chapter 9 context, the alternative is dismissal of the case, permitting every creditor to fend for itself in the race to obtain the mandamus remedy and to collect the proceeds.[87]

In the present context, the alternative would likely be Alternative 2—a selective default and a race among holders to collect. As explained in Part III.C.3., the result probably would be uncollectible judgments (or no judgments at all, at least in the U.S., if non-exempted debt were removed from the jurisdiction of the Court of Federal Claims).[88] Presumably, the Prosperity Shares provided under Alternative 1 would offer a better result than uncollectible judgments and the less valuable Prosperity Shares provided under Alternative 2.

Although a discharge is a common feature of a bankruptcy regime, that does not end the inquiry as to the scope of the Bankruptcy Clause. One can easily imagine an unbiased, objective majority of the Supreme Court holding that a putative bankruptcy law that applies to the U.S. government as debtor is not within the scope of the Bankruptcy Clause. Such a holding likely would not be on the basis that the pattern and structure of the law is outside the common

---

86 11 U.S.C. § 1129(a)(7).

87 6 Collier on Bankruptcy (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. 2011) ¶ 943.03[7][a].

88 *See* text at notes 141-44, *infra*.

understanding of the attributes of a bankruptcy law. Instead, it likely would be grounded on the proposition that the Framers never contemplated that the federal government itself would be an eligible and appropriate debtor to which a bankruptcy law could apply. Moreover, because the result of a bankruptcy discharge would frustrate the substance of Section Four, the later adopted Fourteenth Amendment could be construed to have revoked any power to discharge U.S. debt even if that power resided in the Bankruptcy Clause as originally adopted. But this is where the working assumption set out above would come into play.[89] It is assumed that the Court would be highly motivated to uphold the legislation in the face of an extreme financial crisis. There being no textual bar in the language of the Bankruptcy Clause itself, it provides a convenient opening for a willing Court.

Even if the Bankruptcy Clause could accommodate a bankruptcy law for the federal government, arguably implementation of Alternative 1 would face another constitutional hurdle. Would a discharge of the non-exempted Treasury obligations and the distribution of the Prosperity Shares constitute an unconstitutional taking "for public use without just compensation" under the Fifth Amendment?[90] Many bankruptcy scholars are of the view that the powers of Congress conferred by the Bankruptcy Clause are governed by that clause and not the Takings Clause of the Fifth Amendment, so long as such laws enacted under the Bankruptcy Clause are applied only prospectively.[91] Others have argued, however, that even powers that are within the scope of the Bankruptcy Clause must be tested under the Takings Clause. For example, Julia Forrester's careful study of takings in the

89 *See* text at notes 1-3, *supra*.

90 U.S. Const. amend. V ("nor shall property be taken for public use, without just compensation"); Julia Forrester, *Bankruptcy Takings*, 51 Fla. L. Rev. 851, *passim*; Thomas Plank, *Bankruptcy and Federalism*, 71 Fordham L. Rev. 1063, 1090 n.106 (2002).

91 James Steven Rogers, *The Impairment of Secured Creditors= Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause,* 96 Harv. L. Rev. 973, 986-89, 1031 (1983) (arguing that prospective legislation under the Bankruptcy Clause could not constitute an unconstitutional taking under the Fifth Amendment and that the Bankruptcy Clause, and not the Fifth Amendment, controls limits on the power of Congress with respect to prospective legislation). As Julia Forrester has observed, "[p]rominent scholars have accepted his [Rogers'] conclusions without challenge." Forrester, supra note 90, at 855 & n.15 (collecting citations to articles relying on Rogers' conclusions) (1999).

context of bankruptcy provides a strong rebuttal of arguments that the exercise by Congress of its powers under the Bankruptcy Clause, even if prospective, is immune from attack as an unconstitutional taking.[92] Thomas Plank has reached the same conclusion.[93]
There would seem to be little question that the powers of Congress under the Bankruptcy Clause must yield to the Takings Clause. It is a fundamental constitutional principal that the general powers granted to Congress in the Constitution, including the Bankruptcy Clause, are subject to the Bill of Rights.[94] Surprisingly, however, scholars who have debated the issue have failed to take note of this general, overarching principle. In his thoughtful and thorough article, for example, James Rogers acknowledged and proceeded to rebut the prevailing view at the time that legislation under the Bankruptcy Clause is subject to the Takings Clause.[95] But neither Rogers nor Forrester explicitly took note of this general principle which appears to be dispositive of the question. Even so, it is doubtful that Alternative 1 would present an unconstitutional taking. If the Prosperity Shares distribution would pass muster under a Chapter 9-like best interests test, discussed above, that should constitute "just compensation" as it would under Chapter 9 itself.

The downside of implementing Alternative 1 through a sovereign bankruptcy regime is the involvement of a court. Even if handled by nonjudicial administrators, a system of appeals no doubt would be a necessary element of the system. That necessarily provides a forum for non-exempted Treasuries holders to attack the constitutionality of the scheme through a challenge to the scope of the Bankruptcy Clause or otherwise.

---

92 Forrester, *supra* note 90, at 854, 871-72, 885, 905, 911-12.
93 Plank, *supra,* note 90, at 1090 n.106.
94 *See*, e.g., John E. Nowak & Ronald D. Rotunda, Constitutional Law 208 (7th ed. 2004) ("The commerce power, like all other federal powers, is subject to the restrictions of the Bill of Rights and other fundamental constitutional guarantees."); 1 Tribe, American Constitutional Law 851 (3d ed. 2000) ("There are, however, other limits on those [congressional] powers . . . One obvious example is the Bill of Rights, which forbids measures that might otherwise be thought to fall within Congress' Article I powers (*e.g.*, prohibiting those engaged in commerce from speaking on political subjects).").
95 Rogers, *supra* note 91.

b. Implementing Alternative 2.

Under one possible statutory framework, Alternative 2 would become effective were Alternative 1 to be struck down. Alternatively, Congress might choose the Alternative 2 approach as the exclusive approach. Under Alternative 2, the validity of the public debt would be expressly preserved. However, the Executive Branch would be given discretion to selectively default on the non-exempted Treasuries, perhaps based upon specified Presidential findings and the declaration of an emergency. Congress also would approve the issuance of the (reduced value) Alternative 2 Prosperity Shares. The obvious question presented here is whether the selective default with Congressional authorization would pass muster as constitutional under Section Four and the non-abrogation principle.[96]

Under a purely textual analysis, Alternative 2 would not appear to "question[]" "[t]he validity of the public debt." Nor would it "alter or destroy those obligations" in contravention of the non-abrogation principle.[97] As already mentioned, as a legal term and concept, "validity" means "binding" and "enforceable.[98] Alternative 2, unlike Alternative 1, leaves the non-exempted Treasury obligations untouched. It would not affect their binding nature or enforceability. Holders would be free to pursue judgments and to seek enforcement against U.S. commercial assets around the world, subject to local laws on sovereign immunity. That is not to say that such enforcement efforts would not face substantial procedural hurdles. They certainly would, as discussed below in Part III.C.3. But the validity of the obligations would present no obstacles to enforcement. And Congress would not have altered or destroyed the obligations. Under Alternative 2, the U.S. would have no defense whatsoever as to its payment obligations.

The legislative history and historical context of Section Four offer support for this textual analysis.[99] Following the Civil War, Republi-

96 *Perry,* 294 U.S. at 354.
97 *Id*. at 353.
98 *See* text at note 76, *supra.*
99 For a concise exposition of this legislative history, see Jack Balkin, *The Legislative History of Section Four of the Fourteenth Amendment* (June 30, 2011) [hereinafter,

cans in Congress were concerned that a Democratic majority down the road might "repudiate" the debt incurred by the Union during the war.[100] While not free of doubt, it appears that the "repudiation" to be feared was the possibility that Congress might determine the wartime debt was not lawfully incurred—i.e., was invalid.[101] Michael Abramowicz, while explaining the phrase "authorized by law" in Section Four, observed that, without the phrase, Section Four "would have left open the possibility that a Democratic Congress could have repudiated the Union's Civil War bonds *as illegal and not part of the public debt.*"[102]

Senator Benjamin Wade of Ohio offered the initial proposal of what became the basis for Section Four. The proposal provided in pertinent part that "[t]he public debt . . . shall be inviolable."[103] Subsequently, Senator Howard introduced another proposal on the subject which provided: "The obligations of the United States, incurred in suppressing insurrection, or in defense of the Union, or for payment of bounties or pensions incident thereto, shall remain inviolate."[104] Howard's version was approved by the Senate.[105] Both versions differ substantially from Section Four as ultimately adopted—"[t]he va-

---

Balkin, *Legislative History*], http://balkin.blogspot.com/2011/06/legislative-history-of-section-four-of.html.

100 *Id.*

101 This is a somewhat unusual use of "repudiate" and "repudiation," which in the contract context are understood to mean merely a clear and unequivacal statement by a party that it will not perform. See, e.g., 23 *WILLISTON ON CONTRACTS* § 63:29 (Richard A. Lord, 4th ed.) ("A 'repudiation' is a statement by the obligor to the obligee indicating that the obligor will commit a breach that would itself give the obligee a claim for damages for total breach."). Of course, invalidity (or asserted invalidity) is one of many reasons why a party might choose to repudiate an obligation.

102 Abramowicz, *supra* note 27, at 588 (emphasis added).

103 Cong. Globe, 39th Cong., 1st Sess. 2768 (1866). Senator Wade revealed some concern about a future default in fact. For example, he asked if "open and hostile rebels" were to be seated in Congress "who can guaranty that the debts of the Government will be paid, or that your soldiers and the widows of your soldiers will not lose their pensions?" *Id.* at 2769. He argued that his proposal would "put the debt incurred in the civil war on our part under the guardianship of the Constitution." *Id.*

104 Cong. Globe, 39th Cong., 1st Sess. 2938 (1866).

105 *Id.* at 2941.

lidity of the public debt . . . shall not be questioned."[106] What does it mean for the "validity" of the public debt to be "questioned"? Is "validity . . . questioned" by a threat of default on the public debt? I believe not. Is it questioned by an actual default? Again, I believe not (or, at least, not *necessarily*).

Perry provides support for a strict textual analysis that explains what it means to "question" the public debt and that gives ordinary meaning to "validity." The plurality in *Perry* held that Congress lacks the authority to "alter or destroy" the U.S. government's obligations to repay borrowed funds. It also held that Section Four was "confirmatory" of this principle. This strongly suggests that to "question" the public debt would be an alteration or destruction of the terms of the debt. And, of course, that is exactly what the unconstitutional Congressional joint resolution had done by providing that the gold clauses in U.S. government bonds were against public policy and that the obligations could be satisfied with legal tender. The *Perry* Court also observed that "the validity of the public debt" embraces "whatever concerns the integrity of the public obligations." Equating "validity" with "integrity" also strongly suggests that the Court attributed the usual meaning to "validity"—binding and enforceable.[107] Under this analysis, Alternative 2, which leaves the non-exempted Treasuries valid and binding and enforceable under the original terms, would not "question[]" the "public debt."

Abramowicz has advanced an odd conception of "validity" which confounds the concept with that of "default." "The word 'validity' indicates that not merely the existence of the public debt, but also its binding force on the government 'shall not be questioned.'"[108] This statement seems at best incoherent. How can a debt or any obligation exist if it is not binding? It cannot. Abromowicz then argues:

106 U.S. Const. amend. XIV, §4.

107 Moreover, this understanding of validity is consistent with the last clause of the second sentence of Section Four, which *invalidates* debt incurred in aid of insurrection or for loss of slaves. The second sentence reads: "But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void. U.S. Const. amend. XIV, §4.

108 Abramowicz, *supra* note 27, at 594.

> The government thus may not acknowledge that the public debt exists but refuse to pay it. If the government fails to make a debt payment, the debt instrument is at least temporarily invalid for legal purposes. Moreover, there is no such thing as a valid debt that will nonetheless not be honored; a debt cannot be called 'valid' if existing laws will cause default on it. So as soon as Congress passes a statute that will lead to default in the absence of a change of course, the debt is invalid (or at least of questionable validity) and Congress has violated the original meaning of [Section Four].[109]

By conflating default with invalidity, the argument misses the point that a default can occur *only* with respect to valid debt. If putative debt is invalid it is not debt of a putative debtor and no default can occur. Under Alternative 2, the legal entitlements of holders of non-exempted Treasuries are unaffected. But Abramowicz's vision of default as invalidity clearly would consider Alternative 2 (and Alternative 1, of course) to be a violation of Section Four. Michael Stern also has taken strong exception to Abramowicz's suggestion that the threat of default would question the validity of the public debt.[110]

Abramowicz's more recent piece provides more detail on his views on validity. According to Abramowicz, Section Four:

> does not distinguish debts that are invalid for all practical purposes from debts that the law explicitly brands as invalid. The

109 *Id.* (footnotes omitted).

110 Michael Stern, "*Arrest Me: I Question the Validity of the Public Debt*," Point of Order (June 2, 2011), http://www.pointoforder.com/2011/06/02/arrest-me-i-question-the-validity-of-the-public-debt/:

> I think Abramowicz's argument here is weak. If the framers of the Fourteenth Amendment wanted to say that the government should take no action that would jeopardize the repayment of debt, surely there were more straightforward ways of saying so. . . . . If I conduct my financial affairs in such a way as to make it unlikely or impossible that I can repay all my creditors, I am acting irresponsibly, but I am not questioning the validity of my debts. Even a failure to pay a debt, if caused by inability rather than refusal to pay, cannot be said to question the debt's validity."

Stern does not explain his claim that refusal to pay a debt does question the debt's validity. In that sense, he joins Abramowicz in conflating validity with default.

> word "validity" does not implicitly contain such a distinction, and it is not modified by the word "legal." Reading the distinction into [Section Four] . . . would allow the government to pass one statute providing that debts shall be legally valid, but another providing that the Treasury must not make payment on them. This perverse definition of validity would allow an end-run around . . . [Section Four] and would defy the Framers' intent to reassure debt-holders that their debts will be honored.[111]

Whether Section Four should be construed to permit Congress to take the approach that Abramowicz describes in his hypothetical is a fair question. But it hardly seems perverse to read the word "validity" as used in the Constitution to mean "legally valid." Indeed, it is reading "validity" to have a meaning *other* than legally valid which would be perverse.

The point made by Abramowicz can be reframed. It is true that a law that instructs the Executive Branch or gives it discretion to decline to pay obligations on Treasuries largely achieves the same result as invalidation.[112] (That is the point, of course, of Alternative 2.) But the analysis need not hinge on a misunderstanding of the meaning of "validity" as something other than legal validity. Giving "validity" its usual meaning, the argument would be that even if a law provides in so many words that debt is valid, but the same or another law also permits nonpayment of the debt, it is not legally valid construing the relevant law as a whole. This is a more plausible analysis than distorting the meaning of "validity" beyond recognition. In a proper case, this reasoning could plausibly justify equating default (or even a threat of default) with invalidity.

Jack Balkin also views a legislative threat of default as a questioning of the validity of the public debt. He considers Senator Wade's proposal and supporting speech to support this view.

---

111 Abramowicz, *Train Wrecks, supra* note 76, at 26 n.109.

112 This would be especially so if the consent of the U.S. to be sued were withdrawn, though the possibility of foreign judgments and process on foreign assets would remain. *See* text at notes 141-44, *infra.*

> If Wade's speech offers the central rationale for Section Four, the goal was to remove threats of default on federal debts from partisan struggle. . . . . The threat of defaulting on government obligations is a powerful weapon, especially in a complex, interconnected world economy. . . . Section Four was placed in the Constitution to remove this weapon from ordinary politics.[113]

Balkin has pointed out that the Republican supporters of Section Four feared a default or threat of default by the Democrats were they to return to power following the Civil War. He argues that if only a formal repudiation of public debt would violate Section Four, then "the section is practically meaningless."[114] In Balkin's view, individual members of Congress who would threaten a U.S. default on public debt to gain political advantage are themselves violating Section Four.[115] He argues that the proper interpretation of Section Four must take into account the assurances that the Republicans needed. But, it is interesting that Balkin's putative Section Four violation would not be susceptible to any sort of plausible judicial remedy. Indeed, it is Balkin's interpretation that renders Section Four impotent because it envisions a violation without a remedy. How could that provide assurances to anyone? Moreover, it is plausible that when Section Four was debated and adopted, an actual, intentional default on *valid* public debt was not in the consciousness of the legislators.[116] Certainly that rings true in what Senator Hendricks had to say in op-

113 Balkin, *Legislative History, supra* note 99. For a critique of Balkin's description, see Michael Stern, "*Threatening Default*"*: A Response to Professor Balkin*, Point of Order (July 1, 2011), http://www.pointoforder.com/2011/07/01/threatening-default-a-response-to-professor-balkin/. Stern takes issue in particular with Balkin's reliance on Wade's proposal and speech while arguing that a threat of default does not amount to a prohibited repudiation. Balkin offered a detailed response defending his original analysis, pointing out that the final wording of Section Four was more similar to Wade's original proposal than to Howard's. Jack Balkin, *More on the Original Meaning of Section Four of the Fourteenth Amendment*, Balkinization (July 2, 2011) [hereinafter, Balkin, *More*], http://balkin.blogspot.com/2011/07/more-on-original-meaning-of-section.html.

114 Balkin, *More, supra* note 113.

115 *Id*. (post-Civil War setting); Jack Balkin, *Secretary Geithner understands the Constitution: The Republicans are violating the Fourteenth Amendment*, Balkinization (July 8, 2011), http://balkin.blogspot.com/2011/07/secretary-geithner-understands.html (2011 debt-ceiling crisis context).

116 This issue is worthy of further investigation.

position to Section Four.[117] On that view, protecting the public debt from invalidity would offer an effective method of protecting against actual default.

A lively debate about Section Four arose during the 2011 Congressional impasse over raising the debt limit. Almost fifteen years earlier, Abramowicz had argued that the federal debt-limit statute was unconstitutional as a violation of Section Four because it would lead to repudiation of the public debt absent Congressional action.[118] During the impasse, Neil Buchanan also took the position that the debt-ceiling statute is unconstitutional under Section Four.[119] However, Buchanan's position is that "[t]he debt limit is not unconstitutional because it increases the *risk* of default, but because it would actually require one."[120] Laurence Tribe was of the view that the debt-limit statute is not unconstitutional.[121] However, he conceded that what "makes more sense" is "a more modest interpretation of [Section Four] . . . under which only actual default (as opposed to any action that merely increases the risk of default) is impermissible."[122] Buchanan pointed out that in this respect Tribe agrees with him.[123]

A willing court could find additional substantial support and inspiration in Perry for adopting a strict textual analysis of Section Four that embraces "validity" in the normal sense and that supports the constitutionality of Alternative 2. *Perry* protected the validity and integrity of the U.S. government's promise to deliver gold coin by holding the attempt to eliminate the obligation unconstitutional. Like the hold-

117 Cong. Globe, 39th Cong., 1st Sess. 2940 (1866).

118 Abramowicz, *supra* note 27, at 578-80. For a more recent effort, see Abramowicz, *Train Wrecks, supra* note 76.

119 Neil H. Buchanan, *The Debt-Limit Crisis: A Problem That Will Keep Coming Back Unless President Obama Takes a Constitutional Stand Now*, Verdict (July 7, 2011), http://verdict.justia.com/2011/07/07/the-debt-limit-crisis; Neil H. Buchanan, *The Debt Ceiling Law is Unconstitutional: A Reply to Professor Tribe,* Verdict (July 11, 2011) [hereinafter, Buchanan, Reply], http://verdict.justia.com/2011/07/11/the-debt-ceiling-law-is-unconstitutional; Buchanan, *Borrowing,* supra note 26.

120 Buchanan, *Reply, supra* note 119.

121 Laurence Tribe, Op-Ed, *A Ceiling We Can't Wish Away*, N.Y. Times, July 7, 2011 [hereinafter, Tribe, *OpEd*, www.nytimes.com/2011/07/08/opinion/08tribe.html?_r=1&pagewanted=print; Tribe, *Guest Post*, *supra* note 26.

122 Tribe, Op-Ed, *supra* note 121.

123 Buchanan, *Reply, supra* note 119.

ing in *Perry*, Alternative 2 would leave the non-exempted Treasury obligations unaffected and would even reaffirm their validity and enforceability. As to remedies, in *Perry* the Court permitted the government to substitute the face amount of currency for its obligation to deliver gold coin. By a proper exercise of the government's powers over monetary policy, it had made it impossible for the holder of the gold clause bond to recover the original value of the gold. Under Alternative 2, the Prosperity Shares would be substituted for the actual payment of the non-exempted debt as called for under the terms of the Treasury obligations. As in *Perry*, Congress would have passed legislation authorizing the issuance of Prosperity Shares as a step toward rescuing the U.S. economy from an economic crisis. As in *Perry*, the value provided (the Prosperity Shares) to the non-exempted Treasuries holders would be less than the value originally promised (payment in full). But in *Perry*, the bond was paid and discharged by payment of the lesser value; Alternative 2 would leave the validity of the Treasury obligations intact and provide Prosperity Shares. In *Perry*, moreover, the offending joint resolution provided that gold clauses were "against public policy" and overtly changed the terms of U.S. obligations by providing that obligations could be satisfied not in gold but with legal tender.[124] Alternative 2 would not purport to change the terms of Treasuries, however. So long as the validity of the public debt remains pristine, arguably neither Section Four nor the non-abrogation principle (that Congress cannot alter or destroy U.S. obligations) would prohibit the U.S. from deciding not to pay the Treasury obligations voluntarily.

The power to decline to pay in the face of a national financial threat should not be confounded with the impairment of the validity or alteration of obligations. The exercise of monetary power relating to gold that was involved in *Perry* was, of course, closely related to the substance of the gold clause obligations. The relationship between the adoption of Alternative 2 as a general measure to ameliorate a financial crisis and the power of Congress over monetary policy is somewhat more attenuated. But there is a substantial connection nonetheless. Alternative 2 embraces a Congressional decision that continuing to print more money to pay U.S. obligations is bad mon-

124 *See* text at note 29, *supra*.

etary policy. A decision not to print money is as much an exercise over monetary policy as a contrary decision. As in *Perry*, under Alternative 2, the exercise by Congress of its power over monetary policy would leave non-exempt Treasury holders with less than the full benefit of their bargains. As in *Perry*, however, this result would prevent Section Four and the non-abrogation principle from overriding the power over monetary policy.

The discussion of Alternative 2 to this point has focused on the validity of the U.S. obligations, which Alternative 2 would not purport to affect. But the constitutionality of Alternative 2 also must be tested from another perspective that arises out of the sovereign nature of Treasuries. Certainly, holders of Treasuries have civil contractual claims based on the U.S. obligations to pay. But arguably they may have more than a contractual claim to the extent that U.S. law *requires* (other than by virtue of contractual obligation) the U.S. to pay. Current law provides with respect to Treasuries:

> (a) The faith of the United States Government is pledged to pay, in legal tender, principal and interest on the obligations of the Government issued under this chapter.
>
> (b) The Secretary of the Treasury shall pay interest due or accrued on the public debt. As the Secretary considers expedient, the Secretary may pay in advance interest on the public debt by a period of not more than one year, with or without a rebate of interest on the coupons.[125]

Subsection (a) does not directly require payment of principal, but that requirement might be implicit in "pledged to pay." Certainly, subsection (a) would authorize payment. Subsection (b) does directly require payment. Should these provisions, which are directed at the U.S. government, also be considered a part of the U.S. obligations to Treasury holders? Stated otherwise, are Treasury holders legal beneficiaries of these provisions? If so, then if Alternative 2 were implemented by a law that partially abrogated these provisions, that might well question the public debt and violate the non-abrogation principal.

125 31 U.S.C. § 3123(a), (b).

There would be no reason to modify the "faith of the United States Government" aspect of subsection (a) in order to implement Alternative 2. The faith of the U.S. would be unaffected inasmuch as the obligations would remain unaffected. Alternative 2 would, however, necessarily be at odds with an implicit directive to pay in subsection (a) and with subsection (b) in respect of interest payments on non-exempted Treasuries. But as directives to pay, these provisions provide no additional content to the U.S. obligations to holders of Treasuries. The terms of the Treasuries bind the U.S. to its payment obligations according to those terms. Nothing contained in section 3123 makes the U.S. any *more* obligated. Consequently, these provisions appear to be directives to the government and the Secretary rather than provisions intended to provide any additional substantive rights to holders.[126] Under this analysis, Alternative 2 would leave the U.S. obligations to holders of Treasuries intact, notwithstanding the decision of the executive branch to decline to pay obligations on the non-exempted Treasuries. It recognizes the difference between authorizing the Executive Branch to decline to pay, which would occur, and the elimination of the obligation of the U.S. to pay, which would not occur. On the other hand, it is clear enough that the Executive's

126 Section 365.30(a) of the Department of Treasury's Uniform Offering Circular for Treasuries provides:

> We will pay principal on bills, notes, and bonds on the maturity date as specified in the auction announcement. Interest on bills consists of the difference between the discounted amount paid by the investor at original issue and the par value we pay to the investor at maturity. Interest on notes and bonds accrues from the dated date. Interest is payable on a semiannual basis on the interest payment dates specified in the auction announcement through the maturity date. If any principal or interest payment date is a Saturday, Sunday, or other day on which the Federal Reserve System is not open for business, we will make the payment (without additional interest) on the next business day. If a bond is callable, we will pay the principal prior to maturity if we call it under its terms, which include providing appropriate public notice.

31 C.F.R. § 356.30(a). Like section 3123(a) and (b) discussed in the text, subsection (a) would not appear to establish an independent entitlement for the holders of Treasuries. Instead it is better seen as simply a term of the Treasuries inasmuch as the purpose of the Offering Circular is to establish the terms and conditions of Treasuries. See 31 C.F.R. §§ 356.0 ("Chapter 31 of Title 31 of the United States Code authorizes the Secretary of the Treasury to issue United States obligations, and to offer them for sale with the terms and conditions that the Secretary prescribes."); 356.1 ("The provisions in this part, including the appendices, and each individual auction announcement govern the sale and issuance of marketable Treasury securities issued on or after March 1, 1993.").

decision to default would in fact and law contravene the directives to pay in section 3123, so Alternative 2 would require Congress to provide an exception.

Notwithstanding the forgoing textual analysis distinguishing validity from default and the analysis of Section 3123(a) and (b) just advanced, defenders of Alternative 2's constitutionality would face an arguable flaw in these arguments. Although Alternative 2 would leave holders of non-exempted Treasuries with precisely the same legal entitlements vis-à-vis the U.S. as would have existed prior to its implementation, the actual judicial enforcement of Treasuries against the U.S. has never been a realistic expectation. Instead, confidence in the payment—and value—of Treasuries has been based on the "faith of the United States Government"[127] and the "contractual obligation . . . [that], despite infirmities of procedure, remains binding upon the conscience of the sovereign."[128] This seems to be the kernel of the argument advanced by Abramowicz and Balkin that legal validity with the prospect of nonpayment in fact violates Section Four.[129] But a contrary conclusion is also plausible, as discussed above. Neither Section Four nor the non-abrogation principle provides a positive command that the U.S. pay its obligations or a prohibition against nonpayment. The framers of Section Four might have chosen that approach but they did not. Section Four also does not condition the power of the government upon making a payment or giving other value as does the Fifth Amendment.[130] The non-exempted Treasuries would be valid obligations of the U.S. both before and after implementation of Alternative 2. Every day, obligors on valid obligations default and no one has ever thought such obligations are thereby invalidated. Finally, recall once again the holding in *Perry*. Notwithstanding the unconstitutionality of the attempt by Congress to abrogate the U.S. obligations under gold clauses, the Court allowed the *de facto* invalidation to stand.[131]

Given the working assumption of cooperative U.S. courts in a financial crisis, the ultimate constitutionality of Alternative 2 is plausible.

127 31 U.S.C. § 3123(a).
128 *Perry*, 294 U.S. at 354.
129 *See* text at notes 108-115, *supra*.
130 U.S. Const. amend. V (quoted in part supra note 90).
131 *See* text at notes 39-42, *supra*.

But that conclusion is far from clear. This underscores the importance of implementing Alternative 2 with steps to ensure that no U.S. court (i.e., no court with jurisdiction over the U.S.) would ever have the opportunity to examine the constitutionality of Alternative 2.[132]

c. Implementing Alternative 3.

The implementation of Alternative 3 would be straightforward. The U.S. would notify Treasuries holders of the exchange offer of Prosperity Shares in satisfaction of the specified percentage of Treasury obligations essentially on the same terms as under Alternative 1. However, unlike Alternative 1, the Prosperity Shares for Treasury obligations exchange would be strictly voluntary. Holders could choose to accept the offer or not to accept. This approach would avoid the legal difficulties and substantially reduce the political ramifications of the first two alternatives. It also would be more conducive for bilateral negotiations with major Treasuries holders, although the U.S. might not have sufficient leverage to succeed.

2. Credible Commitment Against Future Defaults.

Alternatives 1 and 2 would raise questions as to whether the U.S. might attempt serial restructurings. Such concerns would exacerbate the likely market fallout from either of these alternatives and might threaten future access of the U.S. to capital markets. How might the U.S. usefully assuage investors' concerns that the U.S. might repeat the process in the future? While a perfectly bulletproof prophylactic might not be possible, the issue is worth exploring. One approach would be to incorporate into the restructuring arrangement, possibly as a term of the Prosperity Shares, a poison pill-like feature. Such a feature might provide that any default on the non-defaulted portion of the Treasuries, or any future attempt to further restructure Treasuries, would *ipso facto* reinstate the status *quo ante*, impose a retroactive default interest rate, and provide for immediate payment of a penalty. Although such a provision could not prevent a future default, it might send a strong signal to the market that the restruc-

132 *See* text at notes 141-44, infra (discussing withdrawal of consent by the U.S. to jurisdiction).

turing is truly a one-time event.

3. Post-Default Enforcement of Treasuries.

Consider next the legal rights of holders of Treasuries upon a U.S. default. Recall that references to "holders" are to the underlying beneficial owners of Treasuries in the commercial book-entry system. But some holders are more equal than others.

a. The Race to Judgment.

The offering circular for Treasuries provides with respect to the commercial book-entry system:

> [W]e do not have any obligations to any person or entity that does not have an account with a Federal Reserve Bank. We also will not recognize the claims of any person or entity:
>
> (i) That does not have an account at a Federal Reserve Bank, or
>
> (ii) with respect to any accounts not maintained at a Federal Reserve Bank.[133]

It follows that the *only* persons entitled to enforce Treasuries held in the commercial book-entry system are the depository institutions with securities accounts at a Federal Reserve Bank to which Treasuries have been credited. We can refer to these holders as "recognized holders." Absent default, this circumstance is innocuous enough. The U.S. satisfies its obligations by crediting accounts at a Federal Reserve Bank. A Federal Reserve Bank then credits the accounts of its account holders. If those account holders are acting as intermediaries, they credit their own account holders in turn with the payment and so on down the chain of intermediated holdings. The issue of enforcement against the issuer never arises.

Now consider the default scenario. Under the assumption that Congress would not withdraw its consent to suits against the U.S., upon

133 31 C.F.R. § 356.30(c)(1). "We" is defined as "the Secretary of the Treasury and his or her delegates, including the Department of the Treasury, Bureau of the Public Debt, and their representatives. The term also includes Federal Reserve Banks acting as fiscal agents of the United States." 31 C.F.R. § 356.2.

a default, a recognized holder of Treasuries could sue the U.S. in the Court of Federal Claims to recover a money judgment. That court has exclusive jurisdiction over claims against the U.S. based on contract.[134] But it is not clear what role the recognized holders would play after default in respect of the other holders (*i.e.*, the recognized holders' account holders to which they had credited Treasuries). In the intermediated holding system in the U.S., an intermediary has no duty to its account holders to pursue a defaulting issuer of debt securities. This is so whether the intermediary holds through a Federal Reserve Bank or through another intermediary (such as a central securities depository), or whether the intermediary is itself a central securities depository that is the registered owner of the securities on the books of the issuer. In the world of corporate and municipal debt securities, however, there normally is an indenture trustee charged with enforcement on behalf of the holders; it is not a holder's intermediary that is charged with that responsibility.

Recognized holders would have little motivation to take enforcement action following a U.S. default on Treasuries except to the extent that they hold Treasuries on their own behalf (*i.e.*, proprietary holdings) as opposed to holding for their account holders. Moreover, if U.S. domestic holders' Treasuries were exempted from default, domestic recognized holders would have no motivation to enforce, other than as a courtesy or for relationship reasons, on behalf of their account holders who hold nonexempt Treasuries. On the other hand, a holder of non-exempted Treasuries would be free to move the securities to an account with a recognized holder that would be willing to enforce on the holder's behalf. In particular, foreign recognized hold-

134 28 U.S.C. § 1491(a)(1) (2011) ("The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort."). *See also Gross v. Griffin*, 800 F. Supp. 2d 293, 299 (D. Me. 2011) ("This grant of jurisdiction to the Court of Federal Claims is exclusive, but 'only to the extent that Congress has not granted any other court authority to hear the claims that may be decided by the [Court of Federal Claims].'") (quoting *Bowen v. Mass.*, 487 U.S. 879, 910 n.48 (1988)); *Wagner v. U.S., Dep't of Hous. & Urban Dev.*, 835 F. Supp. 953, 958 (E.D. Ky. 1993), aff'd, 43 F.3d 1473 (6th Cir. 1994) (holding that the Court of Federal Claims has exclusive jurisdiction over breach of contract claims against the United States).

ers might be willing to act on behalf of their non-exempted foreign account holders.

Unlike the situation of a trustee's enforcement under the terms of a bond indenture, currently there is no extant body of law or contractual arrangement that addresses enforcement by a recognized holder on behalf of its account holders (or account holders' account holders, etc.). It would be necessary to make such arrangements post-default. If a recognized holder wished to enforce its proprietary defaulted Treasuries, would it also be willing to enforce on behalf of its account holders? Inasmuch as the enforcement exercise would be a race to judgment and a subsequent race to locate and execute on assets not protected by sovereign immunity, such a recognized holder probably would not want to share recoveries with other holders. And holders probably would not be willing to subordinate their rights as a condition for their recognized holder to pursue their claims. It would be better to find another recognized holder without a proprietary claim that might be willing to enforce on behalf of other holders, subject to appropriate remuneration, indemnification, and the like. Presumably, counsel would be available to handle an enforcement action on a contingency basis.

As to Treasuries held in the commercial book-entry system, it is actually not surprising that the statutory and regulatory structure for actual enforcement is utterly unsuitable. No doubt it was created and has been operated on the unquestioned assumption that no default would ever occur. Action based on reasonable assumptions that turn out to be wrong is unfortunate. But action based on assumptions that are never questioned or examined may be considered careless. Even if it were absolutely clear that it would not be in the interest of the U.S. to default and attempt a restructuring of its Treasury obligations, having a clear and plausible means of enforcing the obligations should be a concern of holders of Treasuries. The occurrence of an "unintentional" default (*e.g.*, arising out of a Congressional impasse on raising the debt ceiling) or a default based on an inability to pay cannot be discounted entirely.

Some holders in the commercial book-entry system would have another alternative for enforcement. They could move their Treasuries from the commercial book-entry system to the Treasury Direct system.[135] This would provide a direct relationship with the U.S. and direct evidence of ownership of the Treasuries so held. But there are some limitations. Only recently have entities, as opposed to natural persons, been permitted to open Treasury Direct entity accounts.[136] Domestic U.S. governments are not eligible to open entity accounts.[137] One single named individual, the account manager, must be able to act alone with respect to the account. Most organizations must have a U.S. Employer Identification Number in order to open an account, which might be difficult or impossible for some foreign holders.[138] Moreover, because the holder would be identified to the U.S., it is unlikely that states such as Iran or Cuba would be willing to hold Treasuries through Treasury Direct.

Although the system is not enforcement friendly, one way or another the holder of defaulted Treasuries would find a way to pursue a claim

135 31 C.F.R. § 363.206(b) (2012) (explaining how to transfer Treasury securities to the TreasuryDirect system).

136 31 C.F.R. § 363.11 (2012) ("Only an individual or an entity is eligible to open a TreasuryDirect account."). The amendment to this regulation noted that: "To date, only individuals have been permitted to open a TreasuryDirect account. This final rule will permit certain specified entities to open accounts in TreasuryDirect and conduct transactions in eligible Treasury securities." Regulations Governing Securities Held in TreasuryDirect, 74 Fed. Reg. 19416-01 (final rule April 24, 2009) (codified at 31 C.F.R. pt. 363.11). An earlier direct registration system, now known as Legacy Treasury Direct, permits trusts, organizations, legal representatives of a decedent's estate, corporations, sole proprietorships, and partnerships to hold Treasuries. *See* Comparison of Legacy Treasury Direct with Treasury Direct, http://www.treasurydirect.gov/indiv/myaccount/comparisonltdandtd.htm. Legacy Treasury Direct is being phased out and new accounts cannot be opened. *Id.*

137 Regulations specify that registration of entities is limited to "sole proprietorship; partnership; corporation; limited liability company or professional limited liability company (LLC or PLLC); trust; decedent's estate; and estate of a living person such as an incompetent or a minor." 31 C.F.R. § 363.20(c) (2012). Moreover, the regulations specify that in the case of a trust, decedent's estate, or estate of a living person, registration is not available if the trust or legal representative of the estate "is acting on behalf of a federal, state, or local government." 31 C.F.R. § 363.20(c)(5)-(7) (2012). The regulation is silent as to registration if such an entity is acting on behalf of a foreign government.

138 31 C.F.R. § 363.11 (2012) ("In order to open a TreasuryDirect account, an . . . entity must have a valid SSN or employer identification number. The account owner must have a United States address of record and have an account at a United States depository financial institution that will accept debits and credits using the Automated Clearing House method of payment.").

in the Court of Federal Claims under current law. But as a part of implementing Alternatives 1 and 2, Congress might also withdraw its waiver of sovereign immunity and the jurisdiction of the Court of Federal Claims in respect of the non-exempted Treasury obligations. That would leave holders of defaulted non-exempted Treasury obligations without a U.S. forum in which to pursue a money judgment. If that approach is pursued, it also would be prudent to withdraw its waiver in connection with suits against U.S. government officials, as well.[139] That would deprive debt holders of a U.S. forum in which to challenge the constitutionality of Alternative 2.[140]

Arguably, Section Four itself could be construed as a waiver of sovereign immunity inasmuch as it protects the rights of the holders of public debt. But dictum in the plurality opinion Perry indicates otherwise, stating clearly that Congress is not obliged to provide remedies for creditors of the U.S.[141] Justice Stone's concurring opinion is in accord.

> There is no occasion now to resolve doubts, which I entertain, with respect to these questions. At present they are academic. Concededly they may be transferred wholly to the realm of speculation by the exercise of the undoubted power of the Government to withdraw the privilege of suit upon its gold clause obligations.[142]

Months after *Perry* was decided, Congress did withdraw its consent to suit against the U.S. based on gold clause obligations.[143] The only case to consider that withdrawal of consent upheld its validity and held that a claim under a gold clause bond was "barred by the doctrine of sovereign immunity."[144]

139 *See, e.g.*, 5 U.S.C. § 702 (permitting suits against officials and the U.S. for relief other than money damages).

140 As already explained, a bankruptcy law almost certainly would be subject to judicial scrutiny at some point, providing a means of challenging Alternative 1. *See* Part III.C.1.a., *supra* (discussing bankruptcy).

141 *Perry,* 294 U.S. at 354 (quoted *supra* text at note 85).

142 *Perry,* 294 U.S. at 360.

143 H. J. Res. 348, 74th Cong., 49 Stat. 938 § 2 (1935), *codified* at 31 U.S.C. 5118(c)(1)(B) & (C).

144 *Gold Bondholders Protective Council, Inc. v. United States*, 676 F.2d 643, 646

b. The Race to Recover.

Continuing the assumption that Congress would not withdraw its consent to suits against the U.S., now consider the means of enforcing a judgment against the U.S. obtained in the Court of Federal Claims.[145] The U.S. no doubt would assert an absolute sovereign immunity from execution in order to prevent enforcement of such a judgment against its assets located within U.S. territory. Whether such immunity from execution would be absolute under current U.S. law apparently has not been the subject of any reported decision. As with timely payment of Treasuries discussed above, it apparently has been assumed that judgments against the U.S. would be paid in due course and that Congress would always make necessary appropriations to do so.[146] In the absence of any controlling federal authority, it is virtually certain that a U.S. court would adopt absolute immunity from execution for domestic assets of the U.S. That would be consistent with laws enacted in other states with respect to domestic assets.[147] Inasmuch as the baseline for international law was

(Ct. Cl. 1982) ("In an unbroken line of decisions, it has been held that Congress may withdraw its consent to sue the Government at any time.").

145 Of course, a recognized holder or a holder through Treasury Direct also might choose to sue in another jurisdiction outside the U.S. What follows concerning sovereign immunity (or not) from execution would also apply to judgments obtained outside the U.S.

146 Consistent with an absolute immunity from execution, the Rules of Procedure of the Court of Federal Claims, which are patterned after and numbered consistently with the Federal Rules of Civil Procedure, provide in part: "Rule 69. Execution [Not used]." Any exceptions to absolute immunity from execution would be those applicable under United States federal common law (including international law).

147 *See* Código de Procedimientos Civiles [CPC] [Civil Procedure Code] Article 4, Diario Oficial de la Federación [DO], 16 de Enero de 2012 (Mex.) (stating that Mexican courts may not attach property of Mexico in aid of execution); *Société X v. U.S.*, (Court of Cassation 1993) *cited in* August Reinisch, *European Court Practice Concerning State Immunity from Enforcement Measures,* 17 Eur. J. Int'l L. 803, 813 (2006) (explaining that under Turkish legislation, only assets of the Turkish state are immune from execution). Bond prospectuses of certain countries also reflect that property of the State that is within the State will be immune from execution. *See* $1,000,000,000 State Treasury of Republic of Poland 5¼% Notes due 2014 (Prospectus dated Aug. 20, 2003) (Prospectus Supplement dated Oct. 22, 2003), at 60, http://www.sec.gov/Archives/edgar/data/79312/000119312503066700/d424b5.htm (last visited Apr. 10, 2012) ("Under the laws of Poland, subject to certain exceptions, assets of Poland are immune from attachment or other forms of execution whether before or after judgment."); U.S.$600,000,000 Republic of Chile Floating

absolute immunity, it would appear that by virtue of the absence of any statutory waiver of immunity from execution and any case law relating to U.S. domestic assets, no relaxation of absolute immunity has occurred.

Glidden v. Zdanok[148] reflects the conventional wisdom that absolute immunity from execution for the recovery of money judgments applies under U. S. law. In Glidden, the issue presented was whether judges of the Court of Claims (now, Court of Federal Claims) were Article III constitutional judges.[149] The Court held that they were Article III judges. Writing for the plurality, Justice Harlan accepted the proposition that the Court of Claims lacked the power to enforce money judgments against the U.S.

> The problem was recognized in the Congress that created the Court of Claims, where it was pointed out that if ability to enforce judgments were made a criterion of judicial power, no tribunal created under Article III would be able to assume jurisdiction of money claims against the United States. Cong. Globe, 33d Cong., 2d Sess. 113 (1854) (remarks of Senator Stuart). The subsequent vesting of such jurisdiction in the District Courts . . . of course bears witness that at least the Congress has not thought such a criterion imperative.[150]

The issue here is not precisely one of immunity from execution, but rather one of the exclusive power of Congress over appropriations.[151]

Rate Notes due 2008 (Prospectus dated Jan. 16, 2004), at 1, http://www.sec.gov/Archives/edgar/data/19957/000119312504009460/d424b5.htm (last visited Apr. 10, 2012) ("Chile will not waive immunity from attachment prior to judgment and attachment in aid of execution under Chilean law with respect to property of Chile located in Chile and with respect to its movable and immovable property which is destined to diplomatic and consular missions and to the residence of the head of such missions or to military purposes . . . since such waiver is not permitted under the laws of Chile."). *See* also Philip R. Wood, Project Finance, Subordinated Debt and State Loans 154 (1995) ("A state can pass legislation, binding on its courts, immunising domestic assets from execution, and many have done so.").

148 370 U.S. 530 (1962).

149 The status of judges of the Court of Customs and Patent Appeals also was at issue.

150 *Glidden*, 370 U.S. at 570.

151 U.S. Const. art. I, § 9, cl. 7 ("No Money shall be drawn from the Treasury,

But, of course, absent immunity from execution, a court could reach assets without infringing on that exclusive power over the purse. This compels the conclusion that absolute sovereign immunity from execution is U.S. law with respect to assets of the U.S. government.

The U.S. codified restricted immunity in the federal Foreign Sovereign Immunities Act (FSIA) in 1976, and since that time issues of immunity of foreign sovereign states from execution, as well as adjudication, has been governed by that act.[152] Even prior to enactment of the FSIA, U.S. policy and case law had embraced restricted immunity for foreign states.[153] The principal relevant exception from

but in Consequence of Appropriations made by Law . . ."). Recall the "permanent, indefinite appropriation" currently in effect. *See* note 17, *supra*. On Glidden and related issues, see Vicki Jackson, Suing the Federal Government: Sovereignty, Immunity, and Judicial Independence, 35 Geo. Wash. Int'l L. Rev. 521, 594-605 (2003).

152 See 28 U.S.C. §§ 1330, 1332, 1391(f), 1441(d), 1602-11 (2012) (encompassing the various sections of the Act). Although the title of the act refers to "Foreign Sovereign Immunity," it is common to refer to "sovereign" immunity as immunity of a government from suit (or execution) in its own courts. Immunity of foreign states in another state's forum is usually referred to as "state" immunity. For convenience, this discussion refers to "sovereign" immunity in both contexts.

153 In 1952, the Acting Legal Adviser to the U.S. Department of State, Jack B. Tate, notified the Department of Justice of a shift in U.S. policy from support for absolute sovereign immunity to the restrictive theory of sovereign immunity, which would recognize immunity of foreign States for their public and governmental, but not their commercial, activities. Letter from Jack B. Tate, Acting Legal Adviser of the U.S. Dep't of State, to Acting Attorney General Phillip B. Perlman (May 19, 1952), *reprinted in*, 26 Dep't St. Bull. 984 (1952). This letter is commonly referred to as the Tate Letter. For a brief discussion of the historical importance of the Tate Letter, *see* Ruth Donner, *The Tate Letter Revisited*, 9 Willamette J. Int'l L. & Disp. Resol. 27, 27-30 (2001).

After its release, courts frequently referenced the Tate Letter in cases concerning sovereign immunity. *See Nat'l City Bank of N.Y. v. Republic of China*, 348 U.S. 356, 360 (1955) (citing the Tate Letter, the Supreme Court noted that "[a]s the responsible agency for the conduct of foreign affairs, the State Department is the normal means of suggesting to the courts that a sovereign be granted immunity from a particular suit. . . . Recently the State Department has pronounced broadly against recognizing sovereign immunity for the commercial operations of a foreign government . . ."). *See also Alfred Dunhill of London, Inc. v. Republic of Cuba,* 425 U.S. 682, 706 (1976) (referencing the Tate Letter, "We decline to extend the act of state doctrine to acts committed by foreign sovereigns in the course of their purely commercial operations."); *N.E. Shipping Corp. v. Gov't of Pak.,* 1975 A.M.C. 2005, 2007 (S.D.N.Y. 1975) (dismissing the issue of sovereign immunity in cases involving commercial actions of a State by recognizing the Department of State's application of the restricimmunity from execution under the FSIA would be "property in the United States of a foreign state . . . used for a commercial activity in the United States . . . if— . . . the property is or was used for the commercial activity upon which the claim is based."[154] It is now well accepted that the issuance of debt securities by a sovereign state is "commercial activity."[155] But the FSIA applies only to foreign states, not to the immunity (or not) of the U.S.

Assets of the U.S. that are used for commercial activity and located outside the U.S could be reached by judgment creditors to the extent permitted by the sovereign immunity rules applicable in a relevant foreign court.[156] In much of Europe, legislatures and courts

tive theory of sovereign immunity as announced in the Tate Letter); *Amkor Corp. v. Bank of Korea*, 298 F. Supp. 143, 144 (S.D.N.Y. 1969) (holding that the Department of State's decision to not extend sovereign immunity to Korea was binding under the restrictive theory of sovereign immunity and, moreover, the court agreed with this decision because entering into a contract for the purchase of machinery and equipment to be used in the construction of a soda plant was "private and commercial in nature rather than public or political acts . . . ."); *Victory Transp. Inc. v. Comisaria General de Abastecimientos y Transportes,* 232 F. Supp. 294, 296 (S.D.N.Y. 1963) (holding that sovereign immunity did not prohibit a private corporation from filing suit against a branch of the Spanish Ministry of Commerce because the agreement to charter petitioner's vessel was a "commercial operation of the Spanish government" and, in recognition of the Tate Letter, "the defense of sovereign immunity [was] not available.") *aff'd* 336 F.2d 354 (2d Cir. 1964).

154 28 U.S.C. § 1610(a)(2).

155 In *Republic of Argentina v. Weltover,* the Supreme Court held that a State's debt securities are commercial activities. 504 U.S. 607, 620 (1992). The Court noted that the FSIA "provides that the commercial character of an act is to be determined by reference to its 'nature'" and "that when a foreign government acts, not as regulator of a market, but in the manner of a private player within it, the foreign sovereign's actions are 'commercial' within the meaning of the FSIA." *Id.* at 614. *See also Mortimer Off Shore Servs., Ltd.* v. F.R.G., 615 F.3d 97, 107-08 (2d Cir. 2010) (holding that the commercial activity exception of the FSIA applied because agricultural bonds are commercial in nature and Germany had affirmatively assumed liability for these bonds); *Turkmani v. Republic of Bol.*, 193 F. Supp. 2d 165, 174-75 (D.D.C. 2002) (relying on *Weltover,* the court held that bonds issued by Bolivia constituted commercial activity under the FSIA).

156 England's foreign sovereign immunity legislation is typical of the law applicable to attachment of property of foreign states. State Immunity Act, 1978, c. 33, § 13(4) (U.K.). For discussion on immunity from execution see Hazel Fox, The Law of State Immunity 599-662 (2d ed. 2008); Dhisadee Chamlongrasdr, Foreign State Immunity and Arbitration 259-333 (2007); State Practice Regarding State Immunities 151-248 (Gerhard Hafner et al. eds., 2006); Ernest K. Bankas, The State Im-

have adopted restricted immunity from execution for assets used for commercial activity.[157] Most of these jurisdictions do not confine the commercial exception to immunity to assets that have a connection with the claim asserted against the state.[158] Some others, like the

munity Controversy in International Law: Private Suits Against Sovereign States in Domestic Courts 182-84, 317-59 (2005).

157 *Banca Carige S.p.A Cassa Di Risparmio di Genova E Imperia v. Banco Nacional De Cuba*, [2001] Lloyd's Rep. 147, [153] (Eng.) ("The English common law adopted the 'restrictive' theory of sovereign immunity [regarding issues of attachment of a foreign State's property]."); *Société Sonotrach v. Migeon*, 77 I.L.R. 525, 527 (Fr. Court of Cassation 1985) ("The assets of a foreign State are, in principle, not subject to seizure, subject to exceptions in particular where they have been allocated for an economic or commercial activity . . . ."); *Condor & Filvem v. Nat'l Shipping Co. of Nigeria,* 33 I.L.M. 593 (It. Constitutional Court 1992), *sub nom Condor & Filvem v. Minister of Justice,* Case No. 329, 101 I.L.R. 394, 401-02 (It. Constitutional Court 1992) (holding that restrictive immunity for execution applied as long the property "is not destined to accomplish public functions," and allowing pre-judgment attachment on a vessel of the State-owned Nigerian shipping company for unpaid price of goods guaranteed by the Nigeria Central Bank and the State of Nigeria); *Abbott v. Republic of S. Afr.*, 113 I.L.R. 412, 425-26 (Spain Constitutional Court (Second Chamber) 1992) (holding that there was no longer a general rule of international law requiring foreign States to be granted absolute immunity from execution and allowing for execution of a State bank account for an unsatisfied judgment for salary arrears due to a foreign State employee, provided the funds were clearly and exclusively allocated for commercial or economic activities).

Restrictive immunity from execution is also generally observed outside of Europe. *See* Act on the Civil Jurisdiction of Japan with respect to a Foreign State, Act. No. 24 of 2009, art. 18(1) ("A Foreign State, etc. shall not be immune from jurisdiction with respect to proceedings of a civil execution procedures [sic] against the property held by said Foreign State, etc. that is in use or intended for use by said Foreign State, etc. exclusively for other than government non-commercial purposes."); *Cresh Co. v. Nauru Fin. Corp.*, Tokyo Chiho Saibansho [Tokyo Dist. Ct.] Nov. 30, 2000, 1740 HANREI JIHO [HANJI] 54, *translated in* 44 Japanese Ann. Int'l L. 204 (2001) (holding that the restricted theory had been adopted). *See also* State Immunity Act, R.S.C. 1985, c. S-18, §12(1)(b) (Can.) ("property of a foreign state that is located in Canada is immune from attachment and execution . . . except where . . . (b) the property is used or is intended for a commercial activity"); State Immunity Act 1979, §15(4) (Cap 313 1979) (Sing.) (stating that the Act "does not prevent the issue of any process in respect of property [of a State] which is for the time being in use or intended for use for commercial purposes."); Foreign States Immunities Act Act 87 of 1981 §14(3) (S. Afr.) (stating that the Act "does not prevent the issue of any process in respect of property [of a State] which is for the time being in use or intended for use for commercial purposes.").

158 Many sovereign immunity acts do not have a connection requirement. *See* State Immunity Act, 1978, c. 33, § 13(4) (U.K.) (State immunity "does not prevent the issue of any process in respect of property which is for the time being in use or intended for use for commercial purposes."); The State Immunity Ordinance, No.

U.S., do have a form of connection requirement for the applicability of an exception from immunity from execution.[159] The United Na-

VI of 1981, § 14(2)(b) Pak. Code (1981) (Pak.) ("the property of a State, not being property which is for the time being in use or intended for use for commercial purposes, shall not be subject to any process for the enforcement of a judgment or arbitration award or, in an action in rem, for its arrest detention or sale."); State Immunity Act 1979, §15(4) (Cap 313 1979) (Sing.) ("Paragraph (b) of subsection (2) does not prevent the issue of any process in respect of property which is for the time being in use or intended for use for commercial purposes."); State Immunity Act, R.S.C. 1985, c. S-18, §12(1)(b) (Can.) ("property of a foreign state that is located in Canada is immune from attachment and execution . . . except where . . . (b) the property is used or is intended for a commercial activity;"); Foreign States Immunities Act, Act 87 of 1981 §14(3) (S. Afr.) ("Subsection (1)(b) shall not prevent the issue of any process in respect of property which is for the time being in use or intended for use for commercial purposes.").

See also Nat'l Iranian Oil Co. Revenues from Oil Sales, 65 I.L.R. 215, 242 (F.R.G. Federal Constitutional Court 1983) (rejecting the requirement of a connection between the claim and the property sought to be attached, noting that "[a] principle of international customary law forbidding a State where proceedings have been brought from taking measures of enforcement and safeguarding measures against assets of a foreign State which have no connection with the substantive claim being brought, cannot be established at present."); *Condor & Filvem v. Nat'l Shipping Co. of Nigeria*, 33 I.L.M. 593 (It. Constitutional Court 1992), *sub nom Condor & Filvem v. Minister of Justice,* 101 I.L.R. 394, 402 (It. Constitutional Court 1992) ("a further restriction is not generally recognized . . . that there be a specific link with the subject matter of the request . . . ."); *Abbott v. Republic of S. Afr.*, 113 I.L.R. 413, 426 (Spain Constitutional Court, Second Chamber 1992) ("it is not necessary that the property in respect of which execution is sought should be intended for the selfsame activity jure gestionis as that which provoked the dispute. To hold otherwise would be to render illusory the right to enforcement of judgments in cases like the present one, involving the dismissal of an embassy employee.").

159 The French Court of Cassation held that the property in question had to be the subject matter of the claim in order to be attached, noting "immunity can be set aside in exceptional cases such as where the assets attached have been allocated for an economic or commercial activity of a private law nature, which has given rise to the claim at issue." *Islamic Republic of Iran v. Eurodif,* 77 I.L.R. 513, 515-16 (Court of Cassation, First Civil Chamber 1984) (noting that in this case "the debt originated in the very funds which had been allocated for the implementation of the Franco-Iranian programme for the production of nuclear energy, whose repudiation by the Iranian party gives rise to the application."). However, this holding may have been undermined by a more recent case. In 2001, a French Court of Appeal allowed for attachment of property of a foreign State relying on the ground that property was used or intended for use for commercial activity, but the court made no mention of the connection between the property sought to be attached and the underlying claim. *Creighton Ltd. v. Minister of Qatar*, Cour d'appel [CA] [regional court of appeal] Paris, 1st ch. G, Dec. 12, 2001, *reprinted* in Revue de l'Arbitrage

tions Convention on Jurisdictional Immunities of States and their Property (U.N. Convention) contains a somewhat curious connection requirement.[160] The U.N. Convention excepts from immunity from execution:

> property [that] is specifically in use or intended for use by the State for other than government non-commercial purposes and is in the territory of the State of the forum, provided that post-judgment measures of constraint may only be taken against property that has a connection with the entity against which the proceeding was directed.[161]

Under the U.N. Convention, a judgment creditor normally would not be permitted to execute against the property of one agency or instrumentality of a state to enforce a judgment against another, separate agency or instrumentality for want of a connection of the first entity's property with the second entity. That is consistent with the general rule that the assets of agencies and instrumentalities of

---

417, 418 (2003).

A required connection between the property sought for attachment and the underlying claim also appears in international conventions. *See* European Convention on State Immunity art 26, June 11, 1976, E.T.S. No. 74 ("a judgment rendered against a Contracting State . . . may be enforced in the State of the forum against property of the State against which judgment has been given, used exclusively in connection with such an activity . . . ."); International Law Association: Draft Convention on State Immunity art. 8(A)(2), March 1983, 22 I.L.M. 287 ("The property is in use for the purposes of commercial activity or was in use for the commercial activity upon which the claim is based"); International Law Commission Report on the Draft Articles Adopted at its Forty-Third Session art 18(1)(c), Sept. 11, 1991, 30 I.L.M. 1554 [*hereinafter Draft Articles on Jurisdictional Immunities of States and Their Property]* ("the property is specifically in use or intended for use by the State for other than government non-commercial purposes and is in the territory of the State of the forum and has a connection with the claim").

160 United Nations Convention on the Jurisdictional Immunities of States and Their Property, G.A. Res. 59/38, Annex, U.N. Doc. A/RES/59/38 (Dec. 2, 2004) (adopted without a vote) [hereinafter, U.N. Convention]. Resolutions of the General Assembly are *available at* http://www.un.org/documents/resga.htm. The U.N. Convention has 28 signatories and 13 parties, but 30 parties are required for it to enter into force. *Id.* Art. 30(1); http://treaties.un.org/Pages/ViewDetails.aspx?src=IND&mtdsg_no=III-13&chapter=3&lang=en.

161 U.N. Convention, Art. 19(c).

a foreign state are immune from execution based on claims against the state itself, assuming the necessary separateness of the agency or instrumentality exists.[162]

162 The U.S. Supreme Court recognized this general rule by holding that "government instrumentalities established as juridical entities distinct and independent from their sovereign should normally be treated as such." *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 626-27 (1983). *See also De Letelier v. Republic of Chile*, 748 F.2d 790, 793-94 (2d Cir. 1984) (noting the presumption of separateness of juridical bodies from its State-parent government). *But see Weinstein v. Republic of Iran*, 609 F.3d 43, 51 (2d Cir. 2010) (noting that the Terrorism Risk Insurance Act (TRIA) overrode the presumption of independent status). The relevant provision of TRIA applies in the case of "a judgment against a terrorist party based on a claim based upon an act of terrorism." Terrorism Risk Insurance Act of 2002, § 201(a), Pub. L. No. 107-297, 116 Stat. 2337 (codified at 28 U.S.C. § 1610, Historical and Statutory Notes, Treatment of Terrorist Assets).
British courts have also noted that "[t]he distinction between [state-controlled enterprises], and their governing state, may appear artificial: but it is an accepted distinction in the law of English and other states." *I Congreso del Partido*, [1983] 1 A.C. 244, 258 (H.L). Moreover, that court also held that commercial transactions entered into by state-owned organizations could not be attributed to the State, noting that "[t]he status of these organizations is familiar in our courts, and it has never been held that the relevant state is in law answerable for their actions." *Id*. at 271.
On the other hand, when a separate entity of the State is found liable, the property of the entity is generally not immune unless the act by the entity is in exercise of sovereign authority. *See* State Immunity Act, 1978, c. 33, § 14 (U.K.) (English law distinguishes between the State sovereign and its organs and separate entities of the State; these separate entities are not immune and their property is subject to ordinary measures of execution unless the separate entity is performing an act in exercise of sovereign authority); The State Immunity Ordinance, No. VI of 1981, § 15(2) Pak. Code (1981) (Pak.) ("A separate entity is immune from the jurisdiction of the courts of Pakistan if, and only if: (a) the proceedings relate to anything done by it in the exercise of sovereign authority; and (b) the circumstances are such that a State would have been so immune."); State Immunity Act 1979, §16(2) (Cap 313 1979) (Sing.) ("A separate entity is immune from the jurisdiction of the courts in Singapore if, and only if: (a) the proceedings relate to anything done by it in the exercise of sovereign authority; and (b) the circumstances are such that a State would have been so immune."); *Société Sonotrach v. Migeon*, 77 I.L.R. 525, 527 (Fr. Court of Cassation, First Civil Chamber 1985) ("The assets of a foreign State are, in principle, not subject to seizure, subject to exceptions in particular where they have been allocated for an economic or commercial activity. . . . On the other hand, the assets of public entities, whether personalized or not, which are distinct from the foreign State, may be subjected to attachment by all debtors of that entity, of whatever type, where the assets form part of a body of funds which that entity has allocated for a principal activity governed by private law.").

While restricted immunity from execution is the clear trend, many states continue to apply an absolute immunity from execution.[163] On the other hand, at least one state does not recognize any immunity from execution.[164] Efforts to harmonize the law in this field over the years have been largely unsuccessful.[165] There is a fair amount of case

163 Ernest K. Bankas, The State Immunity Controversy in International Law 321 (Springer 2005) ("And it is quite clear China, Brazil, Chile and Syria also follow the absolute sovereign immunity rule."). Other countries require authorization from the foreign State or their own government before any enforcement measures can be taken against a State. *See* Execution Act, art. 18, *translated in* Official Gazette of the Republic of Croatia, No. 88/2005, available at http://www.vsrh.hr/CustomPages/Static/HRV/Files/Legislation__Execution-Act.pdf ("Property of a foreign state in the Republic of Croatia may not be subject to execution or security without a prior approval by the Ministry of Justice of the Republic of Croatia, unless the foreign state consents to such execution or security."); Code of Arbitrazh Procedure of the Russian Federation art. 401 *translated* in 4 Russia & the Republics Legal Materials (William E. Butler ed., 2012) ("The filing of a suit in a court of the Russian Federation against a foreign state, involvement of a foreign State to participate in a case as a defendant or third person, imposition of arrest on property belonging to a foreign State and situated on the territory of the Russian Federation, and the adoption with respect to this property of other measures to secure a suit or levy execution against this property by way of enforcement of decisions of a court shall be permitted only with the consent of competent agencies of the respective State unless provided otherwise by an international treaty of the Russian Federation or a federal law."); Areios Pagos [A.P.] (Supreme Court, Plenary) 37/2002 (Greece) (reaffirming that article 923 of the Code of Civil Procedure requires the prior consent of the Minister of Justice to initiate enforcement proceedings against a foreign state); *Mirza Ali Akbar Kashani v. United Arab Republic,* 64 I.L.R. 489, 502 (India Supreme Court 1965) (holding that the effect of Section 86 of the Indian Code of Civil Procedure was "to modify" the doctrine of immunity whereby foreign States could not be sued without the consent of the Central Government).

164 Turkish courts generally deny any immunity from execution for foreign States. *See Société X v. U.S.,* (Court of Cassation 1993) *cited in* August Reinisch, *European Court Practice Concerning State Immunity from Enforcement Measures*, 17 Eur. J. Int'l L. 803, 813 (2006) (holding "that foreign states did not enjoy immunity from execution and that their property in Turkey could be seized because the applicable Turkish legislation exempted only assets of the Turkish state."). *See also Company X v. Embassy of Turkm*. (Tribunal de Grande Instance 2002) *cited in* Susan C. Breau, *Summary of State Practice Regarding State Immunities in the Council of Europe*, *in* State Practice Regarding State Immunities 240 (Gerhard Hafner et al. eds., 2006) (reaffirming that there is no immunity from execution in Turkish law); *Société v. La République Azerbaïdjan*, (Tribunal d'exécution 2001) cited in August Reinisch, *European Court Practice Concerning State Immunity from Enforcement Measures,* 17 Eur. J. Int'l L. 803, 813 (2006) (holding "that movable and immovable property of a foreign state could be seized.").

165 As mentioned, the U.N. Convention is not yet in force. The European Con-

law that addresses immunity from execution, but it reflects many conflicting holdings on the substance. For example, courts have taken various approaches to bank accounts that are in part used for sovereign, public activities and in part for commercial activities.[166]

---

vention on State Immunity is in force, however, with eight states parties. European Convention on State Immunity, May 16, 1972, T.S. No. 74 (Signed in Basle on May 16, 1972, and entered into force June 11, 1976). The Convention has an optional (by a state's declaration) exception from immunity from execution for commercial and industrial property. *Id*. at art. 26.

166 In the landmark *Philippine Embassy Bank Account* case, the plaintiff sought to attach a mixed bank account of a diplomatic mission. 65 I.L.R. 146 (F.R.G. Federal Constitutional Court 1977). Even though some of the account's transactions would have been considered commercial acts, the Court held that the account was immune from attachment because it was used to finance a diplomatic mission and prohibited courts from analyzing the specific uses of the funds. *Id*. at 185-89. The Court noted, however, that "international law does not prohibit asking the sending State to substantiate the fact that a given account is one that is used for the continued performance of the functions of its diplomatic mission." *Id*. at 189.

Similarly, the Italian Court of Cassation upheld prevailing case law that "[i]n the presence of mixed uses [of foreign State embassy bank accounts], the magistrate cannot be obliged to try and identify that portion of assets not used for sovereign purposes. Such intervention would be inadmissible as it would intrude into the exercise of sovereignty. Unless a non-sovereign use emerges clearly from the investigation and the evidence, the concept of immunity must prevail and be maintained." *Banamar-Capizzi v. Embassy of the Popular Democratic Republic of Algeria,* 87 I.L.R. 56, 61 (Italy Court of Cassation 1989). The House of Lords also followed suit by holding that a mixed bank account of an Embassy could not be dissected into commercial and sovereign purposes. *Alcom Ltd. v. Republic of Colom.*, 74 I.L.R. 170, 187 (Eng. House of Lords 1984). The court noted that the account is "one and indivisible; it is not susceptible of anticipatory dissection into the various uses to which moneys drawn upon it might have been put in the future if it had not been subjected to attachment by garnishee proceedings." *Id*. Because the foreign state certified its non-commercial use and the private party could not prove otherwise, the account was therefore immune from enforcement. *Id*. 187-88. The embassy bank account would, however, enjoy no immunity from execution if the account had been set aside "solely" to satisfy liabilities incurred in commercial transactions. *Id.* at 187.

Case law in France suggests that, with the exception of embassy bank accounts, mixed property may be attached. In 1969, the Court of Cassation held that, where a foreign State bank used the same account to settle commercial debts and to pay the expenses of its diplomatic services, the lower court erred in refusing execution on the chance of "risk originating in the impossibility of discriminating between the funds, a part of which only, as the court found, belongs to the State." *Englander v. Statni Banka Ceskoslovenska*, 52 I.L.R. 335, 336 (Fr. Court of Cassation 1969). However, in 1971, the Court created a sort of presumption that where the origin and destination of the funds of a foreign State could not be determined, then they would be immune from execution. *Clerget v. Banque Commerciale pour l'Europe du Nord*, 65

If the U.S. conceivably might undertake a default and restructuring process, it would do well also to undertake well in advance some planning for asset protection and judgment proofing. It could maximize protection by utilizing separate, independent agencies and instrumentalities for as much of its commercial activity as is possible. Asset transfers to such entities on the eve of a default might invite courts to disregard their separateness.[167] The U.S. also should not

I.L.R. 54, 56 (Fr. Court of Cassation, First Civil Chamber 1971). In 2000, the Paris Court of Appeal held that diplomatic bank accounts could not be attached without an explicit waiver, suggesting that execution in other instances would be permissible against property of a foreign State used for both commercial and sovereign purposes. *Russian Fed'n v. Noga,* 127 I.L.R. 156, 160-61 (Fr. Paris Court of Appeal 2000). The United States itself has flip-flopped on mixed bank accounts. In 1980, the D.C. District Court held that an analysis of the purposes of an embassy bank account was feasible and that the account was not immune from attachment. *Birch Shipping Corp. v. Embassy of the United Arab Republic of Tanz.*, 507 F.Supp. 311, 313 (D.D.C. 1980). The court also noted that if immunity were to be granted to a mixed account, it "would create a loophole, for any property could be made immune by using it, at one time or another, for some minor public purpose." *Id*. However, in 1987, the court refused to attach a mixed embassy bank account because the account was used for the functioning of a foreign State embassy and execution would undermine the Vienna Convention on Diplomatic Relations. *Liberian Eastern Timber Co. v. Gov't of the Republic of Liberia*, 659 F.Supp. 606, 610-11 (D.D.C. 1987) ("The Court, however, declines to order that if any portion of a bank account is used for a commercial activity then the entire account loses its immunity.").

167 In general, courts have noted multiple situations in which the presumption of separateness for juridical entities could be overcome. For instance, the U.S. Supreme Court held that the presumption of independent, separate juridical status had been overcome on "internationally recognized equitable principles." *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 621 (1983). In an action brought by a foreign state-owned bank against a private party, the court noted that Cuba was the real beneficiary because, without the bank, Cuba would be unable to obtain relief in the U.S. courts without waiving its sovereign immunity and answering for its liabilities from expropriation. *Id*. at 632. The court held that, under both international and national law, "Cuba cannot escape liability for acts in violation of international law simply by retransferring the assets to separate juridical entities" and the court "decline[d] to adhere blindly to the corporate form where doing so would cause such an injustice." *Id*. While not applied in the case, the Court also noted other areas in which the separateness of juridical bodies may be quashed, such as instances in which the relationship is that of principal and agent, or if equitable principles required it to prevent fraud and injustice. *Id.* at 629. *See also De Letelier v. Republic of Chile*, 748 F.2d 790, 794 (2d Cir. 1984) (While ultimately upholding the presumption of independent status, the court noted: "The broader message is that foreign states cannot avoid their obligations by engaging in abuses of corporate form. The *Bancec* Court held that a foreign state instrumentality is answerable

take too much comfort from the jurisdictions that adhere to absolute immunity from execution. Facing a U.S. default on obligations owed to a foreign state and its citizens, the state's courts might be induced to embrace the trend toward restricted immunity. The U.S also should consider strategic relocations of assets well in advance of implementing any default and restructuring plan.[168] It also should

just as its sovereign parent would be if the foreign state has abused the corporate form, or where recognizing the instrumentality's separate status works a fraud or an injustice."); *Kalamazoo Spice Extraction Co. v. Provisional Military Gov't of Socialist Eth.*, 616 F.Supp. 660, (W.D. Mich. 1985) (refused to uphold the presumption of separate juridical existence because the State exerted direct control over an entity in which the State became a majority shareholder through expropriation, and recognized that "the separate legal status of [the entity] under these circumstances would insulate the [State] from liability for its expropriation . . . while permitting the [State], through [the company], to profit from its commercial activities in the United States and to even assert a claim against KAL-SPICE to recover payment for assets of [the company] sold in this country."); *Walter Fuller Aircraft Sales Inc. v. Republic of the Philippines*, 965 F.3d 1375, 1380 (5th Cir. 1992) (enumerating factors to determine when the presumption of independent status should be overcome to allow for execution).

Whether entities should be viewed as separate from, or a part of the State, has also been illustrated in English law. *See Trendtex Trading Corp. v. Cent. Bank of Nig.,* 64 I.L.R. 111, 134 (Court of Appeal 1977) (holding that the Central Bank of Nigeria, separate legal entity with no clear expression of intent that it should have governmental status, was not an emanation, arm, alter ego or department of the State of Nigeria after looking to the functions and control of the organization and the evidence as a whole); *Baccus S.R.L. v. Servico Nacional Del Trigo*, 23 I.L.R. 160, 162-63 (Eng. Court of Appeal 1956) (whether a foreign department of State should lose its immunity because it conducts some of its activities by means of a separate legal entity depends on the nature of the activities and the foreign State's interest).

168 In general, military and diplomatic-related assets, Federal Reserve Bank assets, and other non-commercial assets should be protected by sovereign immunity from execution under most national laws and international law. U.N. Convention, art. 21 (listing property of a military character, for the performance of functions of the diplomatic mission of the State, central bank or other monetary authority of the State as property that should not be considered as property in use or intended for use by the State other than government non-commercial purposes).

The assets of diplomatic missions are generally immune from execution. *See, e.g.,* Vienna Convention on Diplomatic Relations, art. 22(3), April 18, 1961, 500 U.N.T.S. 95 ("The premises of the mission, their furnishings and other property thereon and the means of transport of the mission shall be immune from search requisition, attachment or execution."); Act on the Civil Jurisdiction of Japan with respect to a Foreign State, Act. No. 24 of 2009, art. 18(2)(i) (listing property that is exempted from execution as "Property which is used or intended for use in the performance of the functions of the diplomatic mission . . . ."); United States Foreign Sovereign Immunities Act, 28 U.S.C. § 1610(a)(4)(B) (2012) (stating that pursue massive securitizations of its receivables on a regular basis, continually converting them into cash that can be more easily sheltered domestically. Debts owing to the Export-Import Bank of the United States, whose activities in supporting U.S. exports by private firms is singularly commercial in character, are a prime example. While these debts are held by an agency or instrumentality that has a separate existence, prudence would dictate securitizations nonetheless.[169]

foreign State property shall not be immune, "*Provided*, That such property is not used for purposes of maintaining a diplomatic or consular mission or the residence of the Chief of such mission."). In the *Philippine Embassy Bank Account* case, the plaintiff sought to attach a mixed bank account of a diplomatic mission; however the German Constitutional Court held that "[c]laims against a general current bank account of the embassy of a foreign State which exists in the State of the forum and the purpose of which is to cover the embassy's costs and expenses are not subject to forced execution by the State of the forum." 65 I.L.R. 146, 164 (F.R.G. Federal Constitutional Court 1977).

Property of a Central Bank or other monetary authority of a foreign State. See State Immunity Act, R.S.C. 1985, c. S-18, § 12(4) (Can.) ("property of a foreign central bank or monetary authority that is held for its own account and is not used or intended for a commercial activity is immune from attachment and execution."); State Immunity Act, 1978, c. 33, § 14(4) (U.K.) ("Property of a State's central bank or other monetary authority shall not be regarded . . . as in use or intended for use for commercial purposes."); State Immunity Act 1979, § 16(4) (Cap 313 1979) (Sing.) ("Property of a State's central bank or other monetary authority shall not be regarded . . . as in use or intended for use for commercial purposes;"); The Law of the People's Republic of China on Judicial Immunity from Compulsory Measures Concerning the Property of Foreign Central Banks (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 25, 2005), arts. 1 & 2, *translated* in The National People's Congress of the People's Republic of China, http://www.npc.gov.cn/englishnpc/Law/2007-12/13/content_1384123.htm (last visited Feb. 17, 2012) (Article 1 states "The People's Republic of China grants to foreign central banks' property the judicial immunity from the compulsory measures of property preservation and execution . . . ."; however, Article 3 notes that "[w]here a foreign country grants no immunity to the property of the central bank of the People's Republic of China or to the property of the financial administration institutions of the special administrative regions of the People's Republic of China, or the immunity granted covers less items than what are provided for in this Law, the People's Republic of China shall apply the principle of reciprocity."); Foreign States Immunities Act, Act 87 of 1981 § 15(3) (S. Afr.) ("Property of the central bank or other monetary authority of a foreign state shall not be regarded . . . as in use or intended for use for commercial purposes . . . .").

Some assets, such as real property, would be impossible to relocate.

169 Moreover, any of the bank's loans made to Turkish borrowers likely would not be exempt from execution in Turkey. *See* note 164, *supra.*

Finally, it would be prudent for the U.S. to undertake in advance a thorough legal audit of its asset exposure under local laws on immunity from execution on a state-by-state basis around the world. Notwithstanding broad immunity from execution, experiences with recent efforts to enforce judgments against other sovereigns, such as Argentina and Iran, suggest that the U.S. could expect to battle many attempts to execute on commercial assets found outside the U.S. Moreover, given the likely dollar amounts of defaulted U.S. Treasuries, these battles could be massive in scale when compared to earlier experiences with other sovereign judgment debtors.

V. Conclusion

One goal of this paper has been to evaluate the feasibility of *any* type of restructuring of U.S. sovereign debt that would involve a material haircut (legal or *de facto*) of U.S. obligations. This essay has shown that a selective default and restructuring is feasible from logistical and informational perspectives and problematic but possibly feasible from a legal perspective. But this evaluation is only a first step in a discussion and analysis that should continue.

Further study of the circumstances—if any—under which a U.S. default and restructuring would be beneficial is important. When the national and global impact of such an approach is considered, it may be that default and restructuring is not, on balance, a realistic alternative. If that turns out to be so, it is nonetheless useful to know that and to know why it is so. The concern that sparked this essay derives from the apparent absence of evidence that anyone has explored the question in any depth. That failure, no doubt, was influenced by the failure to recognize that the new possible is the impossible. In the new normal, everything is thinkable.

Finally, there may be a kernel of a lesson in this paper for states other than the U.S. which may need to restructure sovereign debt in the future. The idea of a sovereign debt restructuring in an insolvency proceeding under the domestic laws of the sovereign debtor appears to be a novel concept. While there may be insurmountable constitutional impediments to such a proceeding under U.S. law, that may not be the case under the law of other states. An era of unprecedented judicial and administrative cooperation in the insolvencies of multinational debtors is emerging. This holds promise that future sovereign debt restructurings might be undertaken under the rule of law—that is, new regimes of insolvency designed for sovereign and other governmental debtors. But there is an important caveat to this suggestion. In order to inspire confidence, any such insolvency regime should be seen as fair to all concerned. It should be a real and recognizable insolvency regime with many of the traditional (in the relevant state) elements of such a regime. Ideally, moreover, it would be enacted in better times and not on the eve of a default.