SOVEREIGN BANKRUPTCY HYDRAULICS

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I. INTRODUCTION

Investors seem to buy sovereign debt for reasons best explained with reference to the not-unrelated question of why people read murder mysteries. In short, "they like to do so."[1]

Any other explanation runs up against the basic difficulty that sovereign debt does not look like debt at all, at least when viewed from any other part of the debt market.[2] After all, the "promise to pay" on sovereign debt is somewhat hazy, despite its centrality to any definition of "debt."[3] As Alexander Hamilton explained:

> The contracts between a nation and individuals are only binding on the conscience of the sovereign, and have no pretensions to a compulsive force. They confer no right of action, independent of the sovereign will.[4]

And if the promise to pay is not real, at least in the traditional contractual or Holmesian "bad man" sense,[5] the frequent suggestion that the world needs a sovereign bankruptcy mechanism is somewhat puzzling.[6] What precisely is gained?

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1. EDMUND PEARSON, QUEER BOOKS 247–48 (1928) ("Writers of book reviews, sixty to eighty times a year, begin their articles with the grave inquiry: Why do people like to read about murder? After a discussion, in language that at least seems to be the result of profound thought, they come to the conclusion that people like to read such books because they like to do so.").

2. Susan Block-Lieb, *Austerity, Debt Overhang, and the Design of International Standards on Sovereign, Corporate, and Consumer Debt Restructuring*, 22 IND. J. GLOBAL LEGAL STUD. 487, 527 (2015).

3. Mark L. J. Wright, *Sovereign Debt Restructuring: Problems and Prospects*, 2 HARV. BUS. L. REV. 153, 158 (2012) ("The difficulty of enforcing sovereign debt contracts is the fundamental problem of sovereign debt."); *see* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1, 13–17 (2004).

4. THE FEDERALIST NO. 81 (Alexander Hamilton).

5. Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 459 (1897), *reprinted in* 78 B.U. L. REV. 699, 701 (1998).

6. Suggestions in favor of sovereign bankruptcy, of various sorts, include Patrick Bolton & David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?*, 53 EMORY L.J. 763 (2004); Ross P. Buckley, *The*

The core of any bankruptcy or insolvency system consists of a stay against creditor action, an ability to recover preferential payments—which both promotes equity and reduces the chances of runs on the debtor—and an ability to revamp the debtor's operations by rejecting burdensome contracts and selling assets. Even the proponents of a sovereign bankruptcy system admit that these features are largely irrelevant to sovereign debtors.[7]

Of course, sovereigns come in a variety of flavors, with differing forms of "sovereign immunity." Few sovereigns retain full old-fashioned, George III style sovereign immunity.[8]

In the event of insolvency—or, more simply an inability to pay, since solvency is a somewhat difficult concept with regard to governmental debtors[9]—sovereign debtors have four potential tools at their disposal. First, the sovereign might hide behind its immunity, in the narrow sense. That is, the sovereign will simply refuse to be sued in court. Second, the sovereign might change the law applicable to the debt. To take a simple example, the sovereign entity might say "all past promises to repay in shiny metal are now replaced with promises to pay with pieces of paper."[10] That might violate certain norms—call it due process or fair play—but the sovereign probably at the same time controls the remedy for violations of such norms. Third, the sovereign might manipulate the currency in which its debts are paid. If the sovereign "makes the money," it can make more to pay the debts. There are economic consequences to doing this to an extreme, but the sovereign might view those consequences as preferable to those of a formal default.

These first three tools comprise the modern concept of sovereignty, at least in discussions of sovereign debt. But it is almost impossible to

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Bankruptcy of Nations: An Idea Whose Time Has Come, 43 INT'L L. 1189 (2009); Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 Geo. J. Int'l L. 299 (2005); Molly Ryan, *Sovereign Bankruptcy: Why Now and Why Not in the IMF*, 82 FORDHAM L. REV. 2473 (2014).

7. *See e.g.*, Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 984, 997, 1000 (2000); *see also* Richard M. Hynes, *State Default and Synthetic Bankruptcy*, 87 WASH. L. REV. 657 (2012).

8. Even this may overstate the degree of sovereignty that George III actually had, at least according to some Whigs of the time. SIMON SCHAMA, A HISTORY OF BRITAIN: THE FATE OF EMPIRE, 1776–2000, at 40–42 (2009).

9. Inability to pay is often the result of cash flow problems that arise regardless of whether the debtor has sufficient assets that, in theory, might be liquidated to pay the debts. Moreover, the ability to liquidate such assets is often more theoretical than real, given that the assets in some sense belong to an indefinite body of people, rather than any particular debtor.

10. *Cf.* Perry v. United States, 294 U.S. 330, 355 (1935).

talk about sovereign debtors without bringing in a fourth, related issue: the ability to shield assets from collection. Even if the debtor has lost its sovereignty in the first sense once it is haled to court, the prevailing party lacks any meaningful way to collect on the judgment. The local embassy or the ambassador's armored car are not subject to levy. If a government issuer can employ some or all of these mechanisms and thereby avoid paying its debt, it has little need of a bankruptcy mechanism because it can refuse to pay its debts or it can negotiate with creditors to restructure the debt on its own. Any holdouts will simply remain unpaid until they either agree to the terms of the restructuring or impose more costs on the sovereign, typically by blocking the sovereign's access to financial markets, than the sovereign is willing to bear. For these reasons, kings and queens of old had no need for a bankruptcy mechanism to resolve their insolvency issues because they could avail themselves of all four of the tools listed above. They would pay or rework their debts only if larger political or economic considerations induced them to do so, such as the need for more funds from lenders.[11] A bankruptcy judge operating under a bankruptcy law would have little to add to such discussions.

By contrast, no American municipality nor any modern emerging market borrowers can avail themselves of these three tools; they cannot refuse to consent to suit, change the law applicable to debts, or manipulate the currency in which the debt is to be repaid. These entities' ability to avoid paying turns on the fourth tool, which they can deploy with varying ability. For example, a municipal power company is not readily liquidated or turned over to creditors to do as they see fit. The practical impact of such liquidation—turning off the power to any part of a nation—seems incredible.[12] Debtors like the municipal power company need a bankruptcy procedure to corral its creditors into an equitable solution, while keeping public assets out of private hands.

In short, sovereignty and sovereign immunity occur along a continuum. The kings and queens of old at one end; the North Hudson Sewerage Authority[13] and its ilk at the other. The need for a bankruptcy system to address financial distress varies inversely with a sovereign's place on the continuum.[14]

11. Anna Gelpern, *Building a Better Seating Chart for Sovereign Restructurings*, 53 EMORY L.J. 1115, 1148 (2004).

12. Stephen J. Lubben, *Puerto Rico and the Bankruptcy Clause*, 88 AM. BANKR. L.J. 553, 578 (2014).

13. Indeed, "sewerage." NORTH HUDSON SEWERAGE AUTHORITY, http://www.nhudsonsa.com [https://perma.cc/HAW2-HDE3]

14. Anna Gelpern, *Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt*, 121 YALE L.J. 888, 939 (2012).

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This paper posits that sovereignty and the need for sovereign bankruptcy exist in tension: an issuer with full sovereignty has no need for a formal bankruptcy mechanism. In light of this tension, this paper explores whether the extension of chapter 9 of the United States Bankruptcy Code to federal territories like Puerto Rico, or government-backed entities like Amtrak or the Post Office may be justified.[15] Such an extension with respect to Puerto Rico turns on unresolved questions of sovereignty.

The tension between sovereignty and the need for a sovereign bankruptcy mechanism is illustrated by the recent Argentine debt crisis. Following Argentina's default on its bonds, bondholders brought suit and the federal courts, reading a bond indenture in an unusual way,[16] used injunctions to turn Argentina into something of a financial pariah. A broad reading of the courts' reasoning in these cases puts sovereigns in a precarious position.[17] Accordingly, sovereign debtors, facing a lack of access to the global financial system, like Argentina and other emerging markets borrowers, present a compelling case for a sovereign bankruptcy mechanism.[18] But if the Argentine cases are instead viewed as a "one-off," the need seems much less urgent.

Sovereign debtors that borrow outside their own currency—which would include Eurozone members—and debtors that borrow under foreign law have something less than full sovereignty with regard to their obligations, but the case for a sovereign bankruptcy mechanism still seems doubtful. These debtors still have strong powers to avoid paying if they really want to.

And bankruptcy for American states seems unwarranted unless one believes that the states have been entirely subordinated to the federal government, or the nation has unwittingly adopted a posture toward the states like that advocated by Alexander Hamilton at the Constitutional Convention,[19] but either seem hard to square with the Supreme Court's current jurisprudence. The New Deal's reconceptualization of

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15. *Contra* Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351 (2010).

16. *See* NML Capital, Ltd. v. Republic of Argentina, 699 F.3d 246, 257–61 (2d Cir. 2012). For a good summary of the issue, see Ryan, supra note 6, at 2493.

17. *See infra* notes 104–10 and accompanying text.

18. Martin Guzman & Joseph E. Stiglitz, *How Hedge Funds Held Argentina Ransom,* N.Y. TIMES, (Apr. 1, 2016), http://www.nytimes.com/2016/04/01/opinion/how-hedge-funds-held-argentina-for-ransom.html [https://perma.cc/R5SW-C3HA].

19. Michael W. McConnell, *What Would Hamilton Do?*, 35 HARV. J.L. & PUB. POL'Y 259, 270 (2012) ("[A]t the Constitutional Convention, Hamilton advocated a plan that would have reduced the States to mere administrative units of a unitary state—a proposal that attracted almost no support from other delegates.").

Congressional power remains deeply imbedded in our conception of federal-state relations, but the States remain at least partially sovereign.

In short, bankruptcy rules and norms should not be transplanted without careful thought.[20] Sovereign debt is still quite different from normal debt, provided that the debtor is actually sovereign.

II. DEBT AND SOVEREIGNTY

In this Part of the paper, I flesh out the discussion of the four aspects of sovereignty that a governmental debtor can use to avoid paying its creditors. I begin with the core of any conception of sovereignty, the ability to avoid lawsuits altogether through sovereign immunity. Then I look at the ability to control the underlying law, the ability to control the payment currency, and the ability to avoid collection actions, even if a judgment is entered against the sovereign.

A. Sovereignty in the First Sense (Staying Out of Court)

Historically sovereigns enjoyed complete immunity from suit in their own courts. Justice Holmes provided a succinct explanation for this form of immunity in 1907:

> A sovereign is exempt from suit, not because of any formal conception or obsolete theory, but on the logical and practical ground that there can be no legal right as against the authority that makes the law on which the right depends. 'Car on peut bien recevoir loy d'autruy, mais il est impossible par nature de se donner loy.' Bodin, Republique, . . .[21]

In the case of borrowing for public purposes, the sovereign often had to return to the market, and thus could be forced to reach an agreement with regard to outstanding debts before obtaining new funds.[22] When the sovereign borrowed for personal consumption, lenders could be left unpaid when the sovereign died.[23]

20. Stephen J. Lubben, *Out of the Past: Railroads & Sovereign Debt Restructuring*, 35 GEO. J. INT'L L. 845 (2004).

21. Kawananakoa v. Polyblank, 205 U.S. 349, 353 (1907).

22. Mauricio Drelichman & Hans-Joachim Voth, *Serial Defaults, Serial Profits: Returns to Sovereign Lending in Habsburg Spain, 1566–1600*, 48 EXPLORATIONS ECON. HIST. 1 (2011).

23. Frederick Louis, Prince of Wales, provides an example. His creditors went unpaid when he died before taking the throne. A colorful (and somewhat antisemitic) exposition of the Prince's interaction with his creditors can be found in chapter fifteen, in the first volume of J. FITZGERALD MOLLOY, COURT LIFE BELOW STAIRS (1885).

As a matter of comity, the same basic rules applied to sovereigns sued in another country's courts.[24] As explained by Chief Justice Marshall:

> The world being composed of distinct sovereignties, possessing equal rights and equal independence, whose mutual benefit is promoted by intercourse with each other, and by an interchange of those good offices which humanity dictates and its wants require, all sovereigns have consented to a relaxation in practice, in cases under certain peculiar circumstances, of that absolute and complete jurisdiction within their respective territories which sovereignty confers.[25]

In a federal system, like the United States, sovereigns beneath the "top level" sovereign may also enjoy immunity from suit in both their own courts, and in the courts of the senior sovereign.[26] Thus, Alexander Hamilton assumed that the state governments would retain full sovereign immunity upon adoption of the Constitution.[27]

The Supreme Court seemingly forgot this in *Chisholm v. Georgia*, when it held that a state could be sued in federal court.[28] The specific holding of the case was quickly reversed by adoption of the Eleventh Amendment.[29] The Supreme Court got the message, and ever since has held that states enjoy broad sovereign immunity, even beyond what

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24. *Supreme Court Permits Counterclaim Against Sovereign Not Growing Out of the Same Transaction*, 103 U. PA. L. REV. 980, 981 (1955).

25. The Schooner Exch. v. McFaddon, 11 U.S. 116, 136 (1812).

26. Note, *Reconciling State Sovereign Immunity with the Fourteenth Amendment*, 129 HARV. L. REV. 1068, 1068–69 (2016) ("[T]he balance between state autonomy and federal rights turns in large part on a concept not designed with dual federalism in mind: state sovereign immunity.").

27. THE FEDERALIST NO. 81 (Alexander Hamilton).

28. Chisholm v. Georgia, 2 U.S. 419 (1793). To be sure, it is not clear that *Chisholm* was wrong; what the Founding Fathers intended to do with regard to state sovereignty was vague, perhaps intentionally so. *See generally* JOHN V. ORTH, THE JUDICIAL POWER OF THE UNITED STATES (1987) (presenting an argument that the interpretation of state sovereignty in *Hans v. Louisiana* and related cases is very much a product of the rejection of Reconstruction); John J. Gibbons, *The Eleventh Amendment and State Sovereign Immunity: A Reinterpretation*, 83 COLUM. L. REV. 1889, 1893 (1983); *cf.* Stephen J. Lubben, *A New Understanding of the Bankruptcy Clause*, 64 CASE W. RES. L. REV. 319, 341 (2013) (noting that conflicting understandings of the Bankruptcy Clause amongst the Founding Fathers could still have lead to support for the Constitution).

29. Akhil Reed Amar, *Of Sovereignty and Federalism*, 96 YALE L.J. 1425, 1473 (1987); William A. Fletcher, *A Historical Interpretation of the Eleventh Amendment: A Narrow Construction of an Affirmative Grant of Jurisdiction Rather Than a Prohibition Against Jurisdiction*, 35 STAN. L. REV. 1033, 1058 (1983).

might be covered by the text of the Amendment.[30] As stated by the majority in *Alden*, "sovereign immunity derives not from the Eleventh Amendment but from the structure of the original Constitution itself."[31]

The only exceptions to this immunity come from specific instances where the Constitution changes the federal-state relationship, and allows for the imposition of federal authority over a state. So far, the Court has identified two instances where this occurs: under the Fourteenth Amendment and under the Bankruptcy Clause.[32]

This interpretation of the Bankruptcy Clause is perhaps puzzling, given that no other Article I power, even the seemingly more vigorous Commerce Clause, has been found to overcome a state's sovereignty.[33] But the argument appears to be that "inherent" in a *uniform* federal bankruptcy system is the notion that all—or at least, all save the federal sovereign[34]—must be bound by that system.[35] Interestingly, under the Bankruptcy Clause as interpreted by the Court, there is no requirement that Congress act to abrogate a state's immunity, rather the immunity was simply gone with the adoption of the Constitution.[36]

Following the Second World War, sovereign immunity began to change at the top level, even while it stayed largely unchanged with regard to sub-sovereigns.[37] In particular, most jurisdictions have carved out "commercial activity" from the sovereign immunity granted to foreign sovereigns.[38] Allegedly, this was the result of the broader range of economic activity that nations within the Soviet Bloc might undertake as compared with traditional states. As a general rule, issuing debt in the bond markets counts as commercial activity.[39]

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30. Hans v. Louisiana, 134 U.S. 1, 16 (1890). States also continue to enjoy sovereign immunity within their own courts. *See e.g.*, Mo. Ann. Stat. § 537.600.

31. Alden v. Maine, 527 U.S. 706, 707 (1999).

32. James E. Pfander & Jessica Dwinell, *A Declaratory Theory of State Accountability*, 102 VA. L. REV. 153, 166–67 (2016).

33. Cent. Va. Cmty. Coll. v. Katz, 546 U.S. 356, 373 (2006).

34. Congress has partially waived federal sovereign immunity under the Bankruptcy Code. 11 U.S.C. § 106 (2012).

35. Cent. Va. Cmty. Coll., 546 U.S. at 363–64; *see also* Lubben, *supra* note 28, at 408.

36. Section 106 of the present Bankruptcy Code, 11 U.S.C. § 106, thus became surplus as applied to the states.

37. W. Mark C. Weidemaier & Mitu Gulati, *Differing Perceptions? Market Practice and the Evolution of Foreign Sovereign Immunity,* J. OF L. & SOC. INQUIRY (2017).

38. 28 U.S.C. § 1605(a)(2) (2012) (permitting suit against foreign governments for their commercial acts); *see* Drexel Burnham Lambert Grp. v. Comm. of Receivers for Galadari, 12 F.3d 317, 330 (2d Cir. 1993).

39. State Immunity Act 1978, c. 33, § 3 (UK) (defining non-immune commercial transactions to include "any loan or other transaction for the provision of finance");

But this postwar change has only resulted in the foreign sovereign being susceptible to entry of a judgment. The traditional rule that diplomatic and sovereign property—like embassies and warships—are not susceptible to attachment remains in place.[40] That is, even under the new regime, actual collection against a sovereign remains problematic, as I discuss further below.

Because the rule never changed for the American states, they continue to enjoy an even more robust form of sovereign immunity, more like that enjoyed by nations before 1945.[41] Municipalities, on the other hand, have never enjoyed sovereign immunity within the United States.[42]

Non-state governmental entities like Puerto Rico need bankruptcy if they lack their own sovereignty and are outside the federal government's sovereignty.[43] If, however, they are entitled to either protection under the Eleventh Amendment, Congressionally delegated sovereignty, or common law equivalents, then the resolution of financial distress becomes a political concern not readily addressed by bankruptcy.[44] Nonetheless, Congress decided to give Puerto Rico a bankruptcy system through the enactment of PROMESA, and thus Puerto Rico has no need to test its sovereignty when it can avail itself of a bankruptcy discharge.[45] As a result, Puerto Rico's sovereignty will remain uncertain and vague for the foreseeable future.

B. The Second Line of Defense (Changing the Law)

There are two steps to obtaining a judgment on an unpaid debt: bringing the debtor to court, and demonstrating a legal entitlement to the

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Republic of Argentina v. Weltover, 504 U.S. 607 (1992) (holding that issuance of bonds was a commercial activity for which a foreign state might be sued in U.S. courts).

40. 28 U.S.C. §§ 1609–1611 (1976).

41. *See* Vicki C. Jackson, *The Supreme Court, the Eleventh Amendment, and State Sovereign Immunity*, 98 YALE L.J. 1, 79 (1988); *see also* Vincent S.J. Buccola, *An Ex Ante Approach to Excessive State Debt*, 64 DUKE L.J. 235, 247–48 (2014); Philip M. Thoennes, *Eo Nomine: The Divergence of State and Foreign Sovereign Immunity*, 19 LEWIS & CLARK L. REV. 543, 568 (2015).

42. Mt. Healthy City Bd. of Educ. v. Doyle, 429 U.S. 274, 280 (1977); Alex E. Rogers, *Clothing State Governmental Entities with Sovereign Immunity: Disarray in the Eleventh Amendment Arm-of-the-State Doctrine*, 92 COLUM. L. REV. 1243, 1246 (1992).

43. Contrast Central Va. Comty. Coll. v. Katz, 546 U.S. 356 (2006), where the community college is treated as an "arm" of Virginia.

44. Metcalf & Eddy, Inc. v. Puerto Rico Aqueduct & Sewer Auth., 991 F.2d 935, 939 n.3 (1st Cir. 1993) ("We have consistently treated Puerto Rico as if it were a state for Eleventh Amendment purposes.").

45. Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), 48 U.S.C. § 2101 et seq. (2016).

money claimed.[46] As noted in the prior section, many sovereigns have an ability to avoid the first and most fundamental part of the process—being haled to court. Some sovereigns also have an ability to dodge liability: if a party to a contract also has the ability to change the background contract law, they can create a system in which they never breach. That is, if France is facing a debt maturity that it will not have the funds to pay, it can change French law to provide that "the debt that was due tomorrow is now due next month." In modern democracies, such a move would be objectionable, and might trigger claims against the government.[47] But also note the government typically creates the system for presenting claims against the government.

Greece, an obviously distressed borrower, benefited from its sovereignty when it was able to change the law applicable to its outstanding debt.[48] As a condition to the original €130 billion bailout coordinated by the IMF and the Eurozone countries, Greece was required to significantly reduce its outstanding bond commitments through an exchange offer.[49] Accordingly, in 2012, Greece set out to restructure its sovereign bonds. Approximately, 86 percent (or €177.3 billion) of the bonds which Greece was trying to restructure were governed by Greek law.[50] By enacting the Greek Bondholder Act of 2012, which allowed the terms of the nation's bonds to be changed by majority rule, Greece amended the prior rule to abolish the unanimity requirement in the bonds. Ultimately more than 80 percent of Greek-law bondholders accepted the exchange offer, but all were bound by it.[51]

On the other hand, Ukraine, borrowing under the law of a different nation, found itself at least partially at the mercy of its creditors. Among these creditors was the creditor-nation, Russia, which recently arrogated Ukraine's sovereignty by direct military operation.[52]

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46. On the second point, see 11 U.S.C. § 502(b)(1) (2017).

47. W. Mark C. Weidemaier & Mitu Gulati, *A People's History of Collective Action Clauses*, 54 VA. J. INT'L L. 51, 81 (2013).

48. Anna Gelpern, *A Skeptic's Case for Sovereign Bankruptcy*, 50 HOUS. L. REV. 1095, 1118 (2013).

49. Jeromin Zettelmeyer, Christoph Trebecsh & Mitu Gulati, *The Greek Debt Restructuring: An Autopsy*, 28 ECON. POL'Y 513, 515–16 (2013).

50. Stephen Kim Park & Tim R Samples, *Towards Sovereign Equity*, 21 STAN. J.L. BUS. & FIN. 240, 270 (2016).

51. Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, *The Greek Debt Exchange: An Autopsy*, ECONOMIC POLICY FIFTY-SEVENTH PANEL MEETING 21 (Mar. 27, 2013), http://www.economic-policy.org/wp-content/uploads/2013/04/zettelmeyer.pdf [https://perma.cc/H8WU-GUK2].

52. *See infra* notes 120–22 and accompanying text; *see also* Cynthia Barmore & Chris Miller, *Dumping Debt and Seizing Assets: Ukrainian Countermeasures for Russian Aggression*, 67 STAN. L. REV. ONLINE 67, 72 (2014).

In the United States, state governments control contract law, but their ability to make changes to that law is limited by the Contracts Clause in the U.S. Constitution.[53] While modern thinking is that prospective changes are largely permissible under the Clause, retroactive changes, which are prohibited, are the sort that are most likely to be useful regarding outstanding debts.[54] Thus, American states have limited sovereignty along this dimension.[55]

Municipal governments have no control whatsoever on the background contract law that applies to their debts. The same is true for sovereign borrowers who agree to use the law of some other sovereign entity to govern their debts.[56] Both types of governmental borrowers lack this second element of sovereignty.

C. Another Aspect of Sovereignty (Printing the Money)

In a world of fiat currency, the governmental borrower controls the medium of debt repayment.[57]

The sovereign issuers that have something close to this extreme are the fortunate nations that only borrow in their own currency, under their own law. The United States, Canada, the United Kingdom, and Japan are representative examples.[58] Indeed, all indications are that these sorts of debtors are the most prolific issuers of sovereign debt.[59]

Most sovereigns, however, do not have the ability to borrow in their own currency and under their own law. While these sovereigns issue a comparatively small amount of debt, they get most of the attention when discussions of sovereign financial distress commence. This includes not only emerging market debtors and American governmental units below

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53. See *infra* note 99 and accompanying text.

54. *Rediscovering the Contract Clause*, 97 HARV. L. REV. 1414, 1427 (1984); *cf.* CFCU Cmty. Credit Union v. Hayward, 552 F.3d 253, 268 (2d Cir. 2009).

55. In addition, many (probably most) state constitutions also contain clauses like the federal Contracts Clause, layering on yet another limitation on action by the states. U.S. CONST. art. I, § 10, cl. 1. This limitation, however, is self-imposed, and could arguably be changed.

56. Keegan S. Drake, *The Fall and Rise of the Exit Consent*, 63 DUKE L.J. 1589, 1593 (2014).

57. Anna Gelpern, *Domestic Bonds, Credit Derivatives, and the Next Transformation of Sovereign Debt*, 83 CHI.-KENT L. REV. 147, 159 (2008).

58. *See* Michael Simkovic & Benjamin S. Kaminetzky, *Leveraged Buyout Bankruptcies, the Problem of Hindsight Bias, and the Credit Default Swap Solution*, 2011 COLUM. BUS. L. REV. 118, 189 (2011).

59. Anna Gelpern & Mitu Gulati, *The Wonder-Clause*, 41 J. COMP. ECON. 367, 369 (2013).

the federal government, but also members of the Eurozone who (at least in theory) are unable to print more euros.[60]

D. The Last Line of Defense (Not Paying Judgments)

Emerging market debtors formally have more sovereignty than American states, but they frequently borrow in dollars, euros, or pounds and submit to suit in American or English courts.[61] Nevertheless, at least until the recent Argentine cases,[62] it seemed these sovereigns still enjoyed a broad form of immunity given their lack of "attachable" assets within the United States.[63]

American municipalities—which include not only cities and towns, but also smaller units like municipal power companies, hospitals and sewer districts—enjoy no formal sovereign immunity, despite being "governments." Their primary protection against creditor conquest is the ultimate possibility that they might cease to exist. A senior sovereign looms with the ability to change the terms of the municipal sovereign's very existence.[64] In fact, a key piece of state sovereignty is the power of the states to govern their municipalities.[65] Furthermore, collection against a municipality is challenging because money judgments will not be enforced against property that is "devoted to public use."[66] Finally, courts can order city officials to collect taxes to pay off debts,[67] but this power is constrained by state law and the possibility that the official in question will simply resign their office rather than comply.[68] In this way

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60. David A. Skeel, Jr., *When Should Bankruptcy Be an Option (for People, Places, or Things)?*, 55 WM. & MARY L. REV. 2217, 2250 (2014).

61. Robert B. Ahdieh, *Between Mandate and Market: Contract Transition in the Shadow of the International Order*, 53 EMORY L.J. 691, 726 (2004); Daniel K. Tarullo, *Neither Order nor Chaos: The Legal Structure of Sovereign Debt Workouts*, 53 EMORY L.J. 657, 668 (2004).

62. *See infra* notes 104–10 and accompanying text.

63. W. Mark C. Weidemaier, *Disputing Boilerplate*, 82 TEMP. L. REV. 1, 5 (2009).

64. The physical or geographic area might remain liable for old debts, under a kind of Contracts Clause inspired successor liability theory. But what if nobody lives there? *See* Michelle Wilde Anderson, *Dissolving Cities*, 121 YALE L.J. 1364 (2012).

65. Frederick Tung, *After Orange County: Reforming California Municipal Bankruptcy Law*, 53 HASTINGS L.J. 885, 890 (2002); *see also* 11 U.S.C. § 903 (2016).

66. Preliminary Official Statement, The City of New York (Feb. 16, 2016); *see also* Comment, *II Rights of Creditors After Default*, 43 Yale L.J. 962, 963 (1934).

67. City of Galena v. Amy, 72 U.S. 705, 708–09 (1866); Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B.U. L. REV. 633, 649–50 (2008).

68. George H. Dession, *Municipal Debt Adjustment and the Supreme Court*, 46 YALE L.J. 199 (1936); D. Bruce La Pierre, *Enforcement of Judgments Against States and Local Governments: Judicial Control over the Power to Tax*, 61 GEO. WASH. L. REV. 299, 364 (1993).

municipalities, although they have no formal sovereign immunity, can protect their assets through an exemption from collection of which individual or corporate debtors could only dream.[69]

Bondholders know all of this when they buy sovereign debt of any sort. The disclosure documents routinely note the difficulty of exercising formal collection mechanisms. Investors thus purchase sovereign debt instruments with an understanding that "sovereign debt," or its domestic equivalent "municipal debt," is unlike traditional corporate debt.

III. THE BANKRUPTCY-SOVEREIGNTY DYNAMIC

This Part examines the interaction of sovereignty with a bankruptcy or insolvency system. In the first Section, I explain why a sovereign debtor will not benefit from bankruptcy's key features. To a sovereign who has retained sovereignty, the bankruptcy system has nothing to offer except to serve as a form of enhanced mediation, a task to which it is not ideally suited. But for a sovereign that lacks the elements of sovereignty, either by design or because it gave it up by contract, such a system retains some appeal. In the second Section of this Part, I consider how an insolvency mechanism works at cross purposes with the very *raison d'être* of a governmental entity.

A. The Usefulness of Bankruptcy

Insolvency systems are designed for debtors who risk having their value destroyed by individualistic creditor behavior.[70] Creditors acting in their individually rational self-interests can promote results that are socially inefficient.[71] The individual thrown into debtor's prison or the railroad corporation that is dismembered piecemeal by sheriff's sales

69. *See* Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 526 (1993).

70. *E.g.*, Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 984 (2004); Frederick Tung, *Confirmation and Claims Trading*, 90 NW. U. L. REV. 1684, 1689 (1996); Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 821 (2004).

71. G. Eric Brunstad, Jr. & Mike Sigal, *Competitive Choice Theory and the Broader Implications of the Supreme Court's Analysis in* Bank of America v. 203 North Lasalle Street Partnership, 54 BUS. LAW. 1475, 1532 (1999); Matthew L. Iwicki, Note, *Accounting for Relational Financing in the Creditors' Ex Ante Bargain: Beyond the General Average Model*, 76 VA. L. REV. 815, 817 (1990); Paul B. Lewis, *Bankruptcy Thermodynamics*, 50 FLA. L. REV. 329, 365 (1998); Robert K. Rasmussen, *Behavioral Economics, the Economic Analysis of Bankruptcy Law and the Pricing of Credit*, 51 VAND. L. REV. 1679, 1684 (1998).

provide representative examples.[72] Thus, virtually any insolvency system, in any jurisdiction, will be based around the idea of limiting individual creditor action in favor of collective recovery.[73]

But sovereigns are different; they face no risk of individual creditor suits demolishing their value.[74] Creditors can impose real costs on sovereigns—as the recent Argentine litigation demonstrates[75] —but only if the creditors are willing to incur costs themselves.[76] Even for all of their success in court, the holdout bondholders did not actually collect anything on their bonds until they finally settled with Argentina.[77] Because of their sovereignty, sovereign debtors go through life with a kind of "automatic stay" always in place.[78] As such, they would gain little from most of the features common to insolvency laws throughout the world. Rejecting contracts under legal process—as allowed by section 365 of the Bankruptcy Code— means little if the debtor already had an ability to breach with relative impunity. An ability to recover preferences[79] makes little sense if the debtor should have an ability to resist pressure to make preferential payments in the first instance.

More broadly, given that a governmental debtor is never subject to liquidation, the value of its assets are largely irrelevant to any debt restructuring discussion.[80] Instead, the question is the amount of revenues that the debtor might generate; or, more directly, the taxes the debtor might collect.[81] But the determination of the extent or present availability of the debtor's taxing power as a source for distribution to creditors is essentially a legislative function involving matters of public policy. A bankruptcy judge brings little to this discussion. As Anna

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72. *See* Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420, 1441–42 (2004).

73. Oscar Couwenberg & Stephen J. Lubben, *Essential Corporate Bankruptcy*, 16 EUR. BUS. ORG. L. REV. 39 (2015).

74. Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1050 (2004).

75. W. Mark C. Weidemaier & Anna Gelpern, *Injunctions in Sovereign Debt Litigation*, 31 YALE J. ON REG. 189, 215–16 (2014).

76. *See* Robert Auray, Note, *In Bonds We Trustee: A New Contractual Mechanism to Improve Sovereign Bond Restructurings*, 82 FORDHAM L. REV. 899, 927 (2013).

77. *See infra* notes 106–11 and accompanying text; Weidemaier, *supra* note 75, at 218; *see also* Julie Wernau, *Not So Fast: Argentina Still Has Some Bond Holdouts*, WALL ST. J. (Mar. 16, 2016), https://www.wsj.com/articles/not-so-fast-argentina-still-has-some-bond-holdouts-1458148654 [https://perma.cc/9AME-YUCN].

78. *See* discussion *supra* Part 1.

79. *See* 11 U.S.C. § 547.

80. Hal S. Scott, *A Bankruptcy Procedure for Sovereign Debtors*?, 37 INT'L L. 103, 130 (2003).

81. *See* Anne O. Krueger & Sean Hagan, *Sovereign Workouts: An IMF Perspective*, 6 CHI. J. INT'L L. 203, 206 (2005).

Gelpern has noted, "[b]ankruptcy is at best unproven, and at worst unsuited to overtly political tasks . . . ."[82]

A review of all of the proposals[83] for sovereign bankruptcy systems leads to the conclusion that the primary benefit conferred by such a system is the introduction of a discharge.[84] In the abstract, a governmental debtor should not need a discharge because it is sovereign. But the Argentine situation has highlighted the usefulness of a discharge with regard to holdout creditors.[85] Holdouts like the bondholders in that case could have been bound to a deal if Argentina's old bond obligations could have been discharged. And such a discharge could potentially remove the long tail of litigation that threatens any sovereign debt restructuring. The question is whether adopting such a system will simply move the pressure to an earlier stage, making the negotiations of a workout more fraught. In such circumstances, what does the bankruptcy process actually add? The decision to pay bondholders is ultimately one for policymakers, considering the need for market access as balanced against the cost to other constituencies, such as those who are hurt when funds for social services are redirected to creditors.[86]

At best, bankruptcy for sovereign debtors offers a system of mediation cleverly disguised in the ancient language of bankruptcy. The judge can gather the parties in a single forum, and urge them along the path toward a workout. The allocation of losses and the calibration of recoveries can be cloaked in the judicial language of a process that even within domestic law maintains a kind of technocratic distance from "normal" law. But at heart, the resolution of sovereign financial distress ultimately requires the sovereign to decide that it wants to pay.

Where a sovereign state gets into financial difficulties, the usual reorganization practice is relatively straightforward, not nearly as complex as a workout involving a large transnational firm.[87] The government makes an offer to its bondholders to exchange their existing

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82. Gelpern, *supra* note 14, at 895 (2012).

83. For an overview of the proposals, see Julian G. Ku, *Don't Cry for Sovereign Debtors: Why Argentina's Defeat in U.S. Courts Does Not Justify a Sovereign Debt Treaty*, 36 U. PA. J. INT'L L. 433, 439–42 (2014).

84. *See* Robert A. Hillman, *Contract Excuse and Bankruptcy*, 43 STAN. L. REV. 99, 120 (1990); *see generally* John C. McCoid, II, *Discharge: The Most Important Development in Bankruptcy History*, 70 AM. BANKR. L.J. 163 (1996).

85. D. Theodore Rave, *Governing the Anticommons in Aggregate Litigation*, 66 VAND. L. REV. 1183, 1223 (2013).

86. Stephen J. Lubben, *The Coming Mess in Venezuelan Debt*, N.Y. TIMES (Jan. 28, 2016), http://www.nytimes.com/2016/01/29/business/dealbook/the-coming-mess-in-venezuelan-debt.html [https://perma.cc/2P5J-YF3A].

87. Tim R. Samples, *Rogue Trends in Sovereign Debt: Argentina, Vulture Funds, and* Pari Passu *Under New York Law*, 35 NW. J. INT'L L. & BUS. 49, 62–63 (2014).

bonds for new bonds issued at a discount to the existing bonds; the bondholders take a "haircut." If the government and the bondholders are unable to reach an agreement, the government hides behind its sovereignty as long as it can and the bondholders hope that the state's need for market access ripens before the bondholders' collective will breaks down.

In short, sovereigns in the classic sense have very little need for a sovereign bankruptcy system. But as noted in the prior section of this paper, sovereigns exist along a continuum.

B. The Role of Government; The Role of an Insolvency System

Despite their varying degrees of immunity, all governments perform similar functions at a broad level. Namely, they provide presumably vital services to a collection of individuals by extracting funds from those individuals in some more-or-less uniform way. So long as an individual is present within the geographic boundaries of the sovereign, membership in that sovereign community is involuntary. At the same time, the governmental entity is compelled to provide services to all members. In this way, membership within the sovereign is involuntary in both directions, from both the entity's and individual's perspectives.

This distinguishes sovereigns from other collective entities, like corporations and other associations, where both membership and the scope of membership are open to individualistic contracting. And as such, the sovereign debtor-creditor relationship must necessarily bend to accommodate the unique qualities of the sovereign borrower.

In particular, creditor collection under the traditional debtor-creditor system has the potential to undermine the basic functions of the governmental borrower. The government's assets in some sense do not belong to the government, but instead exist only to facilitate the provision of governmental services. Redirecting them to individual creditors is inconsistent with that mandate. Seen in this light, the existence of sovereign immunity, while it often works a serious injustice in individual cases, makes a good deal of sense.[88] The stability of the government entity's asset pool, maintained for the benefit of the citizens within the scope of that particular governmental entity, is enhanced by limiting the normal powers of individual creditors.[89]

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88. *See* Richard H. Fallon, Jr. & Daniel J. Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 HARV. L. REV. 1731, 1784–85 (1991); Ernest A. Young, *The Rehnquist Court's Two Federalisms*, 83 TEX. L. REV. 1, 28 (2004).

89. *See* David A. Skeel, Jr., *"Sovereignty" Issues and the Church Bankruptcy Cases*, 29 SETON HALL LEGIS. J. 345, 348 (2005).

These considerations support the extension of traditional bankruptcy concepts, and a bankruptcy system more generally, as the governmental entity's sovereignty recedes. That is, protection of the sovereign asset pool justifies extension of the bankruptcy system when traditional sovereignty no longer serves this function. The next Part examines this dynamic in more detail.

IV. HYDRAULIC IMPLICATIONS

The thesis of this article is unassuming: the need for a sovereign bankruptcy mechanism varies inversely with the sovereignty of the debtor. In particular, the more robust the debtor's sovereignty, the less beneficial a respite from creditors through formal bankruptcy.

A. Hydraulics in General

The core of this argument rests on the premise that a sovereign debtor, enjoying full sovereign immunity, gains relatively little from the existence of a bankruptcy process. As developed in the prior Part, for this type of debtor a sovereign debt restructuring mechanism is often little more than glorified mediation.[90] Perhaps slightly more than mediation if we account for the ability to bind potential holdout creditors to a plan.[91] But even this additional power is of questionable utility: after all, holdouts still have slight ability to actually collect on their "unrestructured" debts. Essentially the resolution of holdout problems folds back on the question of mediation: the sovereign debtor and the holdout might reach an acceptable agreement.[92]

The need for a gilded mediation system is doubtful. Indeed, it would seem to do little more than obscure the true, political nature of sovereign debt restructurings. Sovereign debt and corporate debt are both called debt, but while the latter is a fundamentally contractual creation, sovereign debt is much more about political leverage than the specific terms of any bond indenture.[93] Importing the language of

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90. *Cf.* Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 261 (1987).

91. *See* Victor Brudney, *Corporate Bondholders and Debtor Opportunism: In Bad Times and Good*, 105 HARV. L. REV. 1821, 1860–63 (1992); Claire Finkelstein, *Financial Distress As a Noncooperative Game: A Proposal for Overcoming Obstacles to Private Workouts*, 102 YALE L.J. 2205, 2222 (1993).

92. Moreover, the growth of collective action clauses, particularly in broad form, would seem to offer a targeted solution to the specific issue of a small stub of immovable holdouts. *See* Jesse Kaplan, *Collective Action and the Competence of Courts: The Lessons of* NML v. Argentina, 20 STAN. J.L. BUS. & FIN. 1, 28 (2014).

93. Something that Learned Hand understood long ago. *See* Elizabeth G. Atkins, *Collateral Damage: An American Judge's Innovative but Misguided Attempt to Resolve*

chapter 11, or any other corporate or municipal bankruptcy regime, would only tend to obscure that reality.

David Skeel has argued for the extension of bankruptcy to American states, notwithstanding their strong form sovereign immunity, arguing that such an extension would allow for a more comprehensive restructuring that included non-bondholders in the workout.[94] The recent Puerto Rican bankruptcy legislation was allegedly codified within title 48, rather than title 11 where the rest of the Bankruptcy Code resides, to avoid any argument that the law provides a basis for a future enactment along the lines of what Skeel proposes.[95] It is true that many state and even national governments have promised much more than they can most likely pay to current and future retirees, often without revealing the problem to investors who bought government bonds. Other jurisdictions have issued loads of debt to support the public school system, only to later encourage students and parents to abandon the public school system in favor of charter schools or private schools funded with vouchers. But bankruptcy provides no solution for this necessarily political issue. At best, bankruptcy offers political actors, who are ultimately responsible for this situation, an ability to disclaim accountability for the hard choices that must be made. Facilitating this cowardice is hardly a reason to extend the bankruptcy system.

The need for a bankruptcy system to deal with distressed governmental borrowers grows only we when move off the case of "highly immune" debtors, like nations that borrow in their own currency, under their own laws, or U.S. states, which enjoy an old-fashioned kind of sovereign immunity. Governments with partial immunity face a real risk that individual creditor action might thwart governmental functions.

But even here, the need for bankruptcy lies along a continuum. Germany lacks the full sovereignty of the United Kingdom in that it borrows under a currency that it does not have absolute control over.[96] Nevertheless, because it borrows under its own law, it maintains a degree of control over its debt stock that renders the introduction of a

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the Enforcement Problem of Sovereign Debt, 28 GEO. J. LEGAL ETHICS 371, 371 (2015) (quoting Judge Hand, in a 1935 letter to Harlan Fiske Stone, saying "Everyone dealing with a sovereign knows he is dealing with a creature who can welch if he wants to welch. To trick up a lot of international stuff as if it were law frankly makes me puke, as dear old Holmes used to say.").

94. David A. Skeel, Jr., *States of Bankruptcy,* 79 U. CHI. L. REV. 677, 702–03 (2012); *see also* Skeel, *supra* note 60, at 2245.

95. 48 U.S.C. § 2105 (2016) ("The Law Revision Counsel is directed to place this Act as chapter 20 of Title 48.").

96. *How Germany Can Make or Break the Euro,* KNOWLEDGE@WHARTON (Mar. 17, 2015), http://knowledge.wharton.upenn.edu/article/how-germany-can-make-or-break-the-euro [https://perma.cc/3NHE-VYFT]

bankruptcy system of little value. The same is true for most members of the European Union, save for those, like Greece, that are compelled to borrow under some other nation's laws.[97]

In sum, the justification for bankruptcy only begins to develop when (1) a government's access to the debt markets comes under a currency controlled by another sovereign, (2) another sovereign's law governs the debt, (3) the sovereign does not enjoy sovereign immunity, and (4) substantial assets of the sovereign are subject to collection. If a bond is in local currency, the central bank can inflate that currency. If the bond is governed by local law, the issuer can change that law within the broad limits imposed by general norms of "due process."[98] But when the issuer government has control over neither law nor currency, the need for sovereign bankruptcy develops. For the national sovereign, it is here that post-war tradition of waiving immunity for commercial activities—namely, bond issuance—begins to have real bite.

B. Some Examples of Hydraulics in the Real World

Although American states control their own contract law, the ability to enact retroactive changes in that law is limited by the Contracts Clause[99] and the Fourteenth Amendment's Due Process Clause.[100] And of course only the federal government has the ability to control the national currency.[101] The state governments benefit from the strong sovereign immunity provided by the Eleventh Amendment, and common law sovereignty recognized by the Supreme Court since the late Nineteenth Century, combined with an independent power of taxation. As such, any given state is in much the same position as a nation who borrows under foreign law, in foreign currency.

Most national borrowers do not hold their external assets in their own name abroad, excepting for diplomatic assets, which are immune

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97. And even Greece only began to borrow under English law after it had encountered financial distress. Gregory H. Shill, *Boilerplate Shock: Sovereign Debt Contracts As Incubators of Systemic Risk*, 89 TUL. L. REV. 751, 770 n.75 (2015).

98. Gelpern, *supra* note 48, at 1118.

99. The Contracts Clause appears in the United States Constitution, Article I, section 10, clause 1, and provides:

> No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; *pass any* Bill of Attainder, ex post facto Law, *or Law impairing the Obligation of Contracts*, or grant any Title of Nobility. U.S. CONST. art. I, § 10, cl. 1 (emphasis added).

100. U. S. CONST. amend. XIV, § 1.

101. *See supra* note 99 ("No State shall . . . coin Money; emit Bills of Credit . . .").

from attachment.[102] And creditors do not have any ability to interfere with the administration of a foreign nation. Thus, these borrowers have little need of a bankruptcy mechanism.

In contrast, the sub-state governmental entities have no such sovereign immunity protection. Indeed, the typical American municipal debtor is in a much rougher situation than national debtors because they do not enjoy sovereign immunity, and face the possibility of creditor mandamus actions.[103] While, as noted earlier, there are various uses that can be used to avoid creditor collection,[104] all impose a significant indirect cost on the governmental entity and its provision of services.

Thus, while American municipal debtors clearly face a real risk of creditors interrupting their functioning, which thus justifies the existence of chapter 9 of the current Bankruptcy Code, the need for a bankruptcy system encompassing national debtors, even those who borrow under foreign law and in foreign currency, or state debtors is doubtful. Indeed, the analysis put forth herein suggests that but for the Second Circuit's puzzling analysis in connection with Argentina,[105] a sovereign debt restructuring mechanism for national borrowers is unwarranted.[106] The question is whether the Second Circuit's decision changes that conclusion.[107] That is not easily answered in the abstract, but it seems likely that, at the margin, the decision will incentivize holdout and litigation strategies.

The Second Circuit upheld the New York district court's ruling that the so-called *pari passu* clause, which provided that debt at issue in the litigation would rank equally with all other debt issued by Argentina, prohibited payments on any debt without paying all debts.[108] That is, the court transformed the clause from a rule of rank to a rule against

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102. G. Mitu Gulati & Kenneth N. Klee, *Sovereign Piracy*, 56 BUS. LAW. 635, 635–36 (2001).

103. A.M. HILLHOUSE, MUNICIPAL BONDS: A CENTURY OF EXPERIENCE 274–85, 297–99 (1936).

104. *See supra* discussion and text accompanying note 74.

105. John A. E. Pottow, *Mitigating the Problem of Vulture Holdout: International Certification Boards for Sovereign-Debt Restructurings*, 49 TEX. INT'L L.J. 219, 228–29 (2014).

106. *See* Alexandria L. Todd, *Defaulting the Purpose: The Future of Foreign Sovereign Debt Restructuring in the Wake of Argentina's Debt Crisis*, 81 BROOK. L. REV. 269, 277 (2015).

107. Laura Alfaro, *Sovereign Debt Restructuring: Evaluating the Impact of the Argentina Ruling*, 5 HARV. BUS. L. REV. 47, 67 (2015); Alison Wirtz, *Bilateral Investment Treaties, Holdout Investors, and Their Impact on Grenada's Sovereign Debt Crisis*, 16 CHI. J. INT'L L. 249, 269 (2015).

108. David Newfield, Pari Passu *As a Weapon and the Changes to Sovereign Debt Boilerplate After* Argentina v. NML, 24 U. MIAMI BUS. L. REV. 175, 187 (2016).

preferring one creditor over another.[109] The courts then proceeded to enjoin every conceivable financial institution from transacting with Argentina, so long as the country continued to ignore the courts' ruling on the interpretation of the *pari passu* clause.[110]

But litigation strategies are expensive, and it can be expected that future workouts will adapt to the lessons learned in the Argentine case.[111] For example, in the future it will make sense to use an indenture trustee that is not subject to jurisdiction in New York, as challenging as it may be to find such a trustee.

Ukraine is a similar borderline case, and perhaps an even more compelling case for a sovereign debt restructuring mechanism, given the extreme nature of the holdout creditor it faces. Russia lent Ukraine $3 billion, in the form of bonds, at a point when a pro-Russian president was in power in Ukraine.[112] That president was subsequently ousted, and Russia took over the Crimean peninsula. The multi-year-old conflict with pro-Russian separatists in Ukraine's eastern regions escalated, weighing on Ukraine's growth and economy generally.[113]

Ukraine is understandably reluctant to pay back a creditor who is largely responsible for the country's financial difficulties. In 2015, Russia refused to cooperate with Ukraine's other creditors who were prepared to restructure Ukraine's debt on favorable terms. The Russian bonds, interestingly, are governed by English law, and Russia has commenced proceedings in the High Court.[114] On the other hand, it is not at all clear that any *legal* mechanism will affect the relationship with such a creditor. And that brings us back to where we began: sovereign

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109. Stephen J. Lubben, *Possible Ripples from the Argentine Bond Litigation*, N.Y. TIMES: DEALBOOK (Dec. 13, 2012), https://dealbook.nytimes.com/2012/12/13/possible-ripple-effects-from-the-argentina-hedge-fund-court-fight [https://perma.cc/4AJ7-ZHM2].

110. Samples, *supra* note 87, at 49, 52–53; *see* Natalie A. Turchi, *Restructuring A Sovereign Bond* Pari Passu *Work-Around: Can Holdout Creditors Ever Have Equal Treatment?*, 83 FORDHAM L. REV. 2171, 2200 (2015).

111. *See* Ronald J. Silverman & Mark W. Deveno, *Distressed Sovereign Debt: A Creditor's Perspective*, 11 AM. BANKR. INST. L. REV. 179, 190 (2003).

112. Mark C. Weidemaier, *Adventures in Sovereign Debt: Enforcing Russia's Loan to Ukraine*, THE CLS BLUE SKY BLOG (Dec. 15, 2016), http://clsbluesky.law.columbia.edu/2016/12/15/adventures-in-sovereign-debt-enforcing-russias-loan-to-ukraine [https://perma.cc/T9YB-JUHA].

113. *The Other War,* ECONOMIST (Jan. 21, 2017), http://www.economist.com/news/business-and-finance/21714931-russia-may-extract-3bn-ukraine-ukraines-conflict-russia-also [https://perma.cc/WF5F-BMD9].

114. Karin Strohecker, *Moscow and Kiev Head for $3 Billion Debt Showdown in English Court*, REUTERS (Jan. 13, 2017) http://uk.reuters.com/article/uk-ukraine-russia-eurobonds/moscow-and-kiev-head-for-3-billion-debt-showdown-in-english-court-idUKKBN14X23J [https://perma.cc/MFN9-FAQ8].

debt, at least in its purest forms, is as much about politics as it is about contracts and law.[115]

Bankruptcy or restructuring mechanisms can be justified in the case of governmental entities who face a real possibility of creditor disruption. But for the typical sovereign, bankruptcy is essentially mediation, and nothing more. For these sorts of debtors, it is not clear that the effort of establishing a restructuring mechanism is justified when mediation of workouts is already available.[116]

V. CONCLUSION

Along the continuum of sovereign or governmental debtors, there is a narrow range of borrowers that might justify the creation and maintenance of a sovereign debt restructuring mechanism. These are the debtors who provide important governmental services, while lacking anything like traditional governmental immunity from suit. The sovereignty-bankruptcy hydraulics here push sovereignty so low that a bankruptcy mechanism is indeed justified.

Even though sovereign immunity—in the broad sense that I describe in this paper—has steadily declined in the past seven decades, it remains robust, especially when considered in conjunction with diplomatic immunity and other practical limitations on creditor collection.[117] Seen in this context, it is not clear what, if anything, a bankruptcy system brings to the table.

The one issue that might still justify a sovereign debt restructuring mechanism is cost, both financial and human.[118] The direct costs of chapter 11 have been extensively studied, although much remains to be learned, particularly with regard to indirect costs.[119] The present sovereign debt workout process is alleged to be inefficient, and thus costly.[120] But data on this point remain elusive.

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115. Jonathan Sedlak, *Sovereign Debt Restructuring: Statutory Reform or Contractual Solution?*, 152 U. PA. L. REV. 1483, 1514 (2004).

116. *See* Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. REV. 59, 83 (2000).

117. Ye Xie, Katia Porzecanski & Pietro D. Pitts, *Who Gets Citgo's Assets if Venezuela Defaults?*, BLOOMBERG (Dec. 15, 2014), http://www.bloomberg.com/news/articles/2014-12-15/who-gets-citgo-s-assets-if-venezuela-defaults- [https://perma.cc/Y2KG-2KXZ].

118. Lee C. Buchheit & G. Mitu Gulati, *Responsible Sovereign Lending and Borrowing*, LAW & CONTEMP. Probs., Fall 2010, at 63, 64.

119. Stephen J. Lubben, *What We "Know" About Chapter 11 Cost is Wrong*, 17 FORDHAM J. CORP. & FIN. L. 141 (2012).

120. Sean Hagan, *Designing A Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. Int'l L. 299, 338 (2005).