

**PRESENTED AT**

**35<sup>th</sup> Annual Jay L. Westbrook Bankruptcy Conference**

November 17-18, 2016

Austin, Texas

## **Government Debt Restructure Principles**

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FINANCIAL RESTRUCTURE FOR BUSINESSES AND GOVERNMENTS

## GOVERNMENT DEBT RESTRUCTURE PRINCIPLES

Presented at the Duke University School of Law Symposium  
*“Modern Municipal Restructurings: Puerto Rico and Beyond”*

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NOVEMBER 10, 2015

## Preface

Many U.S. cities and states have built infrastructure and provided for the welfare of their citizens by borrowing massively from the capital markets and promising benefits to their employees that they have not funded out of their tax base. Now they cannot realistically afford to pay all of this debt.

Likewise, many democratic, capitalist nations around the world have accumulated massive debt to the capital markets while providing for the defense and welfare of their people that they now cannot realistically afford to repay.

Wise government leaders will find ways to solve these problems by obtaining fair contributions from labor, capital and taxpayers.

Here is a way to process government insolvency so that, after reasonable austerity and use of taxation, capital creditors are paid all they can reasonably expect under the circumstances, but more than they would receive by exercising their legal remedies against governments which have only partially waived sovereign immunity. To use terms of art, this would be a debt restructuring that is fair and equitable, and in the best interests of creditors.

While difficult to do, it is easy to outline how to approach such a debt restructure. Rigorously assess what governmental services need to be provided and what labor costs can be afforded, for both current and retired employees. Make a judgment about the appropriate level of taxation. Based on reasonable judgments about “austerity” and “tax levels,” make a preliminary judgment about how much bond debt is sustainable.

Armed with this understanding, initiate negotiations concerning austerity and bond debt levels. The possibility of a payment moratorium can provide substantial leverage. Since creditor remedies against governments are often weak, the possibility of a moratorium alone might be enough to encourage agreement to a reasonable debt restructure plan.

A moratorium will likely provoke collection actions by creditors which must be defended. However, if a government defendant can broaden the scope of the issues and join necessary parties, it can use the judicial proceeding to propose a reasonable plan to restructure debt.

When considering actions against an insolvent government, the ultimate question before the court is not simply whether sovereign immunity has been sufficiently waived to permit one bond creditor to collect its debt. Rather, the issue should be how much can the government debtor reasonably afford to pay to all of its bond creditors. The possibility of a trial about this issue will provide additional power to lead to a fair debt restructure.

Cities in the U.S. already have an available judicial forum where a determination can be made that their debt restructure plan is fair and equitable and in the best interests of creditors and, thus, can be forced on holdout creditors who refuse to negotiate a reasonable deal. If so authorized by

its state government, a municipality can have a trial about this in a plan confirmation hearing in a Chapter 9 case under the federal Bankruptcy Code.

Sovereign governments like Greece, Ukraine or Puerto Rico can improvise ways to have a similar trial, either by broadening the parties and issues in a collection lawsuit, or by agreeing with creditors to have an arbitration about what is a fair and equitable payment.

Democratic governments will not survive if, in an effort to repay debt obligations substantially in full, they impose unreasonable taxation and austerity measures that primarily burden middle and lower class citizens. Such a transfer of wealth away from middle and lower classes will put at risk the survival of many U.S. cities, states and territories, and many sovereign states. Ultimately it will put democracy at risk.

The better approach, described below and in **Leading a Government to Solvency**, provides a way to establish a sustainable balance between, labor, capital and taxpayers.

**A. Given the amount of debt accumulated by democracies around the world since WWII and the extent of government insolvency, it is important for elected officials to understand how to lead their governments to solvency.**

1. There are two models for leading to solvency: either (a) elected government officials lead to a debt restructure based on their judgment of a reasonable amount of austerity, taxation and debt discharge, or (b) the capital community dictates its views on those issues.
2. Failure of elected officials to identify insolvency and lead to resolving it results in significant problems.
  - a. Leaving unaffordable government debt in place stagnates the growth of the economy it governs through a drawn out deterioration of services and pressure to increase taxes that drive away economic vitality.
  - b. Delay by government officials in dealing with insolvency abdicates leadership to special interests.

**B. It is good public policy to use Core Restructure Principles to overcome government insolvency.**

1. Government insolvency has been around for a long time in human history, and a number of bad ways have been developed to try to deal with it.
2. One bad way is to ignore it, pretend it does not exist, and leave it to the next administration. Politicians call this kicking the can down the road to the next administration. Detroit, Puerto Rico, Greece, and many other countries in Europe are showing that this method is not viable.

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First appeared as part of the conference materials for the  
35<sup>th</sup> Annual Jay L. Westbrook Bankruptcy Conference session  
"Restructuring Public Finances—Chapter 9 and Alternatives"