Bypassing Congress on Federal Debt: Executive Branch Options to Avoid Default

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In a prior article, I examined how a U.S. debt default might occur and analyzed its potential consequences. Even a mere “technical” default, such as temporarily missing an interest or principal payment, “almost certainly [would] have large systemic effects with long-term adverse consequences for Treasury finances and the U.S. economy.” The most plausible U.S. debt default would in fact be a technical default—a temporary default due to Congress’s failure to raise the federal debt ceiling. The U.S. Department of the Treasury recently cautioned that such a default, which became a near-reality in October 2013, could be disastrous: “In the event that a debt limit impasse were to lead to a default, it could have a catastrophic effect on not just financial markets but also on job creation, consumer spending and economic growth.”

This Feature focuses on that potential cause of a U.S. debt default—a technical default resulting from Congress’s failure to raise the federal debt ceiling—and analyzes how the executive branch of the federal government might be able to prevent such a default regardless of the Congress’s inclinations. My analysis assumes that Congress fails to raise the debt ceiling due to political paralysis, political gamesmanship, procedural voting impediments, or any reason other than a clear desire to force the nation to default on its debt; that more U.S. debt is coming due than can be refinanced.

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2. Terry Belton et al., The Domino Effect of a U.S. Treasury Technical Default, J.P. MORGAN 1, 4 (Apr. 19, 2011), http://perma.cc/0ZNnoaut2AB (explaining the possible effects of a technical default on U.S. debt caused by the failure to raise the debt ceiling). The report also concludes that a technical default would “likely” cause the United States to suffer a one-percent reduction in gross domestic product (GDP) due to higher interest rates and a likely equity selloff, and that such a default also “could leave lasting damage in its wake due to a permanent decline in foreign demand” for Treasury securities, which would “likely lead to higher borrowing costs and larger deficits.” Id.
under the applicable debt limit; and that the executive branch is searching for ways to avoid a debt default.

To that end, the Introduction provides historical context, explaining the debt ceiling as a means of delegating certain congressional borrowing authority to the executive and discussing the ongoing potential for debt-ceiling showdowns. Part I examines the publicly discussed options for avoiding a U.S. debt default, including the argument that the President has implicit borrowing authority under the Fourteenth Amendment and that the executive branch could prioritize its payment obligations. Part II also explains why these options are not generally considered viable.

Part II of the Feature proposes alternative options for avoiding default, applying structured finance modeling to federal debt. In the first of these options, a special-purpose entity (SPE) would issue debt that is not full faith and credit to the U.S. government per se and would use the proceeds to make a back-to-back loan to an executive-branch agency or entity on a nonrecourse but secured basis. In the second of these options, the special-purpose entity would use the proceeds to purchase income-generating financial assets, such as rights to the future payment of specified tax revenues. Part III also provides a detailed legal analysis of these alternative options.

Finally, Part III explains how credit rating agencies and investors would likely view these alternative options. Part III also discusses how these options should be constrained to prevent their potential abuse.

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5. See infra Part I. This list of options takes into account, among other sources, Nelson D. Schwartz & Charlie Savage, Wall St. Fears Go Beyond Shutdown, N.Y. TIMES, Oct. 2, 2013, http://www.nytimes.com/2013/10/03/business/wall-st-fears-go-beyond-shutdown.html (discussing that "economists and investors have quietly begun to explore the options the White House might have in the event Congress fails to act" on raising the federal debt limit).
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Introduction

Under the Constitution, Congress has exclusive authority to issue debt “on the credit of the United States.”6 Congress has long delegated some of that power to the Treasury Department.7 To avoid having to micromanage the Treasury Department’s debt issuances, Congress created the public debt limit8—colloquially known as the “debt ceiling”—within which the Treasury Department has virtually unfettered debt-issuance authority.9

As government costs increase, the debt ceiling may need to be raised to finance those costs.10 A substantial component of annual U.S. government expenditures is the payment of debt service—principal and interest—on maturing Treasury securities.11 Congress thus can threaten a default by refusing to raise the debt ceiling, creating the potential for a debt ceiling showdown between Congress and the executive branch. Such a showdown will loom large, for example, if Congress and the President are at loggerheads on spending and Congress uses the debt ceiling as leverage to try to extract spending cuts—a

6. U.S. CONST. art. 1, § 8, cl. 2 (providing that “The Congress shall have Power . . . To borrow Money on the credit of the United States”).
9. See Schwarcz, supra note 1, at 8.
10. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, THE BUDGET FOR FISCAL YEAR 2014 tbl.1.1 (2014) (indicating that the U.S. government is projected to operate at a deficit, albeit shrinking, through fiscal year 2018; if the government collects less in total than it spends, it must increase its level of debt overall).
11. Cf. id. at tbl.3.1 (observing that “Net Interest” as a percentage of total “U.S. Government Outlays,” or spending, has historically been 9% on average from 1940-2012, and is expected to fall to around 6% in fiscal years 2013 and 2014 before gradually rising to over 10% in fiscal year 2018). For an explanation of Treasury securities, see infra note 103 and accompanying text.

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scenario that has occurred many times, including during both the Clinton and Obama Administrations. This type of showdown can occur frequently because the federal government, like most governments worldwide, routinely depends on borrowing new money—often above the debt limit—to repay (i.e., refinance) its maturing debt. One might ask why governments routinely depend on borrowings to repay maturing debt. The answer is cost: using short-term debt to fund long-term projects is attractive because, if managed to avoid a default, such financing tends to lower the cost of borrowing. The interest rate on short-term debt is usually lower than that on long-term debt because, other things being equal, it is easier to assess a borrower’s ability to repay in the short term than in the long term, and long-term debt carries greater interest-rate risk.

In October 2013, for example, the Obama Administration warned that if the debt limit were not raised, the United States would shortly default on its debt. Congress agreed to a temporary increase until February 2014, at which time it postponed the problem by suspending the debt limit for another year. The problem, though, is not limited to these dates. As mentioned, the risk that a debt-ceiling showdown could trigger a debt default has been historically significant. Moreover, it will continue to be significant, because the rising federal government debt load will inevitably make future debt-ceiling increases necessary.

I. Extant Options for Avoiding Default

Principally, two options have been reported for avoiding a U.S. debt default: (A) that the President has implicit authority under the Fourteenth Amendment to the Constitution to borrow to avoid such a default; and (B) that

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12. See infra note 22 and accompanying text. See also Schwarcz, supra note 1, at 8 (discussing other debt-ceiling showdowns).
13. See infra notes 16-17 and accompanying text.
14. See Schwarcz, supra note 1, at 5.
15. Id.
16. The Treasury Department estimated that if the debt ceiling were not raised by October 17, 2013, it would have only $30 billion in cash, which would be used up in days. See Annie Lowrey, Treasury Puts a Date on When Cash May Run Out: Oct. 17, N.Y. TIMES, Sept. 25, 2013, http://www.nytimes.com/2013/09/26/business/treasury-warns-of-potential-default-by-mid-october.html.
the executive branch could prioritize payments, paying its maturing debt first, to avoid default. This Part considers these options in turn, along with other less-discussed methods.

A. The Fourteenth Amendment Option

According to this option, the President may “invoke authority under the [Fourteenth] Amendment” to the U.S. Constitution and order the “government to keep borrowing.” The rationale for this implicit authority is that the Fourteenth Amendment prohibits the government from questioning the “validity” of its public debt. This option is reported to have been “endorsed by former President Bill Clinton during an earlier debt standoff in 2011.” Two legal scholars have argued that it is one of the “least unconstitutional” options.

The problem, however, is that this option may not be constitutional at all, and even if it is, the resulting uncertainty will be costly. The Fourteenth Amendment does not explicitly authorize the executive branch to borrow to avoid default. Nor does it appear to provide any implicit authorization: its provision prohibiting the government from questioning the “validity” of its public debt was historically included solely to prevent a southern Democratic majority from repudiating Civil War debts. Although that provision has been held to apply generally, not just to Civil War debts, it is doubtful that “question[ing]” the “validity” of U.S. debt includes defaulting on such debt. Michael McConnell has lucidly explained the distinction: “Default is not the same as repudiation. If Congress repudiated the debt, it would be declaring that the debt is not owed. If Congress defaulted on the debt, the [debt] would still be owed; it would simply go (in part) unpaid.” The Obama Administration itself has announced that it does “not

20. Schwartz & Savage, supra note 5.
22. Schwartz & Savage, supra note 5.
24. See Michael W. McConnell, Origins of the Fiscal Constitution, in Is U.S. GOVERNMENT DEBT DIFFERENT? 45, 49-50 (Franklin Allen et al. eds., 2012), http://finance.wharton.upenn.edu/FIC/FICPress/usdebt.pdf; Stuart McCommas, Note, Forgotten but Not Lost: The Original Public Meaning of Section 4 of the Fourteenth Amendment, 99 VA. L. REV. 1291, 1325 (2013) (“Under the original public meaning of [Section 4 of the Fourteenth Amendment], only legal action directly repudiating the federal debt is unconstitutional.”).
26. I discuss this at length in Schwarzc, supra note 1, at 19-22.
27. McConnell, supra note 24, at 50.
believe that the Fourteenth Amendment gives the President the power to ignore the debt ceiling—period.”

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Debt borrowed by the federal government in violation of the debt ceiling would therefore be, at best, of uncertain constitutional validity. Any such borrowing could therefore have adverse consequences. For example, it could lead to a threat of impeachment from members of Congress opposed to such borrowing.29 Almost certainly, any such borrowing would be litigated up to the Supreme Court.30 Furthermore, and of greater practical importance, investors in debt securities evidencing the borrowing would likely demand a significant discount to compensate for the risk that the securities would be unenforceable.31

B. The Prioritization-of-Payments Option

Under an alternative approach, the executive branch would try to prioritize its payments, paying the maturing debt first in order to avoid default.32 It is uncertain, though, whether the executive branch has legal authority to pick and choose which creditors to pay.33 The authority to pay all debts of the United States is constitutionally vested in Congress.34 Congress has delegated the execution of that authority to the Secretary of the Treasury, who is required by law to make all payments on government obligations as they come due.35 An


29. Schwartz & Savage, supra note 5 (noting congressional Republicans’ opposition to this method).

30. There is a chance, however, that the Court would refuse to hear the case, deeming any dispute between the executive branch and Congress over unauthorized borrowing a nonjusticiable political question. See generally Baker v. Carr, 369 U.S. 186, 217 (1962) (enumerating the factors relevant to the question whether a particular suit should be dismissed as a political question); Tara L. Branum, President or King? The Use and Abuse of Executive Orders in Modern-Day America, 28 J. LEGIS. 1, 78 (2002) (“Courts will resolve separation of powers issues; however, they will not mediate ‘political questions’ or disputes that are strictly between the executive and legislative branches.” (citations omitted)). But see Zivotofsky v. Clinton, 132 S. Ct. 1421, 1428 (2012) (“The Judicial Branch appropriately exercises [its substantive] authority, including in a case such as this, where the question is whether Congress or the Executive is ‘aggrandizing its power at the expense of another branch.’”) (citations omitted); Curtis A. Bradley & Trevor W. Morrison, Presidential Power, Historical Practice, and Legal Constraint, 113 COLUM. L. REV. 1097, 1131 n.122 (2013) (citing Zivotofsky, 132 S. Ct. at 1427) (“The Supreme Court also recently signaled a narrow view of the political question doctrine, even in the area of foreign affairs.”).

31. Schwartz & Savage, supra note 5 (reporting that “specialists on Wall Street said questions about the legality of [such debt securities] might cause potential buyers to eschew them”).

32. Id. This option, called the paid prioritization effort, was included in the House of Representatives’ Fall 2013 Continuing Resolution. See Pub. L. No. 113-46, 127 Stat. 558 (2013).

33. Nocera, supra note 19 (reporting that “the Treasury Department says it does not have the authority to pick and choose which creditors to pay”); see Schwartz, supra note 1, at 32.

34. U.S. CONST. art. I, § 8, cl. 1 (“The Congress shall have Power . . . to pay the Debts . . . ”).

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... attempt by the House of Representatives to enable the Treasury Secretary to prioritize which obligations to pay failed in the Senate.36

Even if the executive does have the authority to choose which creditors to pay first, prioritizing payments would be “logistically forbidding” because the government uses “an ancient [payment] system that wasn’t designed for debt-ceiling damage control.”37 The Treasury Department would have to choose which among “approximately 80 million separate payments per month” to pay.38 Moreover, it is doubtful that prioritizing payments, if otherwise feasible, would be sufficient. In the October 2013 debt-ceiling showdown, for example, analysts estimate that prioritizing payments would have been unlikely to buy more than two weeks of time.39

C. Other Extant Options

Other options discussed for avoiding a U.S. debt default have been more fanciful. The most plausible, perhaps, is the $1 trillion platinum coin proposal. Congress has authorized the Secretary of the Treasury to mint platinum coins in any size, shape, and most importantly, denomination.40 The Treasury Secretary therefore could mint $1 trillion platinum coins, deposit them into the Treasury Department’s account at the Federal Reserve Bank, and possibly issue warrants and checks on the newly available funds without violating the debt limit.41

Though outlandish on its face, this idea has drawn support from Paul Krugman, among others.42 Some legal scholars have observed, however, that the $1 trillion platinum coin proposal fails as a pragmatically viable solution because it is so “cartoonish and desperate that it could undermine faith in the

36. The Full Faith and Credit Act, H.R. 807, 113th Cong. (2013), was passed by the House of Representatives but died in the Senate.
39. Cf. Schwartz & Savage, supra note 5 (reporting that on November 1, 2013, “nearly $70 billion has to be paid for Social Security, Medicare, military paychecks and other obligations”).
40. 31 U.S.C. § 5112(k) (2012) (“The Secretary may mint and issue platinum bullion coins and proof platinum coins in accordance with such specifications, designs, varieties, quantities, denominations, and inscriptions as the Secretary, in the Secretary’s discretion, may prescribe from time to time.”).
government's ability to repay its obligations" and would create market uncertainty. Commentators are also worried about the proposal’s political consequences.

II. Alternative Options for Avoiding Default

Because of the legal and practical impediments of the foregoing options, I next propose and analyze possible alternative options for avoiding default. These options attempt to bypass traditional borrowing limitations by applying structured finance modeling to federal debt. Structured finance is an essential basis of corporate finance, and an increasingly important basis of state and municipal finance. Its use in federal public finance has heretofore been minimal, however, probably because Treasury securities already bear extremely low interest rates.

Each of the structured finance options proposed would use an existing or newly created special-purpose entity (SPE) to issue debt that is not full faith and credit to the U.S. government per se. By analogy, many states raise the majority of their funding through SPEs, as opposed to directly issuing general obligation bonds. One of the reasons they do so is to borrow without violating archaic state-constitution-mandated debt ceilings. This Feature’s structured finance options have a similar goal: to enable the federal government to borrow without violating the archaic—or, at least, politically dysfunctional—borrowing constraints under the U.S. Constitution.

The analysis below begins by examining two structured finance options—a back-to-back borrowing option and an asset-sale option—that the executive branch could use, absent congressional authorization, to raise funding to repay maturing federal debt (thereby avoiding default). It also provides a detailed legal analysis of these options. The following Part examines how rating agencies and investors would likely view the SPE debt issued to raise that funding. Finally, I examine how the options could potentially be abused, and how to protect against such abuse.

43. Buchanan & Dorf, supra note 23, at 1231.
47. Id. at 370.
48. Id. at 375-76.
49. See infra Section III.A.
50. See infra Section III.B.
A. The Back-to-Back Borrowing Option

Under this option, an SPE would issue debt securities in amounts needed to repay maturing federal debt. The SPE would then lend the proceeds to an executive branch agency or entity on a back-to-back maturity basis. As a somewhat parallel precedent to this structure, the Federal Reserve very successfully created and used SPEs and back-to-back lending on an emergency basis, in 2008, to surmount statutory lender-of-last-resort restrictions under the Federal Reserve Act. 51

Back-to-Back Borrowing Structure

This structure is roughly analogous to a synthetic collateralized loan obligation (CLO) structure, in which an SPE issues securities to investors and then uses the proceeds to generate or acquire income-producing loans that serve to support ultimate repayment to the investors. 52 The CLO market is increasingly important and robust. 53

I next examine this structure from a legal standpoint, focusing first on creating an SPE to issue debt securities and thereafter on the SPE’s back-to-back on-lending of the proceeds of the debt issuance. I later examine this structure from the standpoint of rating agencies and investors.

51. See Schwarcz, supra note 46, at 373 n.17.
52. See, e.g., 1 JASON H.P. KRAVITT ET AL., SECURITIZATION OF FINANCIAL ASSETS § 4.05 (2007).
1. Creating an SPE to Issue Debt Securities

A threshold question for this structure—and also for the asset-sale structure—is whether the executive branch has the power and authority, absent explicit congressional delegation, to create an SPE that could issue debt securities. Although the standalone power of the executive branch to create corporate entities has never been directly tested in the courts, history (and logic) suggests that it has discretion to create such entities for the purpose of executing legislation passed by Congress. The executive branch’s authority, acting through the Treasury Department, to finance federal government operations and to pay the government’s financial obligations should provide sufficient power to create a debt-issuing SPE that is not itself, and that does not act as, an agency of the federal government. The mere failure of Congress to raise the debt ceiling should not undermine that authority.

Thus, through the issuance of a presidential executive order, the executive should have the power and authority to create a nongovernmental SPE that could issue debt securities. Such power and authority are implicitly delegated by Congress to the Secretary of the Treasury, who is responsible to pay principal and interest on federal debt. As a result, the creation of such a debt-issuing SPE would not violate Congress’s restrictions on executive branch creation of corporations under the Government Corporation Control Act (GCCA).

i. The Power to Create a Debt-Issuing SPE is Implicit in Congress’s Delegation of Responsibility to Pay Federal Debt

The Secretary of the Treasury is statutorily tasked with paying Treasury securities. U.S. presidents have the power to issue presidential executive orders to help members of the executive branch fulfill their responsibilities.

54. See infra Subsection II.B.1.
55. Congress itself clearly has the power to create SPEs in furtherance of legitimate governmental goals. See, e.g., McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819) (upholding the constitutionality of the Second Bank of the United States, under the authority of the Constitution’s Necessary and Proper Clause).
56. In the early 1940s, an executive branch agency, the Farm Security Administration, created several corporations to circumvent its own lack of statutory authority to purchase land. The inquiry into the legality of that agency’s actions was split along political lines with the Attorney General approving, and the Comptroller General disapproving. 3 U.S. GOV’T ACCOUNTABILITY OFFICE, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, pt. B, § 3 (2008), 2008 WL 6969355, at *4.
57. See infra notes 74-79 and accompanying text.
58. 31 U.S.C. § 3123(b) (2012) (providing in part that “[t]he Secretary of the Treasury shall pay interest due or accrued on the public debt”).
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The President therefore could issue an executive order directing the Secretary of the Treasury to create an SPE to issue debt and to use the proceeds to help pay maturing Treasury securities. The executive order would represent a resolution of ostensibly inconsistent congressional directives—on the one hand, to pay outstanding federal debt and, on the other hand, not to raise the debt ceiling—and would have the force of law, at least until Congress specifically says otherwise. The executive branch generally has substantial discretion in interpreting its obligations as defined by Congress, and its interpretation of legislation is usually afforded substantial deference.60

Congress theoretically could repeal an executive order creating a debt-issuing SPE for the purpose of avoiding default, but that would require a veto-bypassing supermajority, which is unlikely to occur.61 Executive orders are also subject to legal challenges, but those challenges are almost never successful. Of the thousands of executive orders,62 only two appear to have been successfully challenged in court.

The first successful challenge occurred in Youngstown Sheet & Tube Co. v. Sawyer,63 in which the steel industry persuaded the Supreme Court to overturn President Truman’s seizure through executive order of the entire U.S. steel industry. Justice Jackson’s concurrence in Youngstown established the principles for analyzing the validity of executive orders, articulating three

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60. See, e.g., Bowsher v. Synar, 478 U.S. 714, 733 (1986) (“Interpreting a law enacted by Congress to implement the legislative mandate is the very essence of ‘execution’ of the law.”); Chevron U.S.A. v. Natural Resources Defense Council, 467 U.S. 837, 844 (1984) (“We have long recognized that considerable weight should be accorded to an executive department’s construction of a statutory scheme it is entrusted to administer.”); see also Eric Posner, The President Has the Power to Raise the Debt Ceiling on His Own, SLATE (Jan. 4, 2013, 5:23 PM), http://www.slate.com/articles/news_and_politics/view_from_chicago/2013/01/debt_ceiling_president_obama_has_the_power_to_raise_the_debt_limit_without.html (arguing that in raising the debt ceiling the President could rely on his “emergency powers” or his administrative power to resolve conflicting congressional directives).

61. See, e.g., Branum, supra note 30, at 71 (observing that “overturning a presidential directive requires more than enactment of legislation according to the normal legislative processes. It is not enough for Congress to have enough votes to simply pass a statute overturning the presidential order. It must also have enough votes to overcome the probable presidential veto”). In other words, repealing a law—and an executive order is treated as law—requires the same process as enacting a law, so if the repeal is vetoed by the President it would require a supermajority vote to override. U.S. CONST. art. I, § 7, cl. 2. Cf. Noyes, supra note 59, at 846 & 846 n.38 (indicating that when “Congress . . . has acted[] to invalidate or repeal ‘incorrect’ executive branch interpretations of its statutes,” it has done so by passing legislation).


63. 343 U.S. 579 (1952). The other was Chamber of Commerce v. Reich, 74 F.3d 1322 (D.C. Cir. 1996) (invalidating an executive order because it was preempted by the National Labor Relations Act).
classifications of presidential power. The Supreme Court has since adopted Justice Jackson's opinion, and his tripartite analytical framework, as controlling precedent.

Under Justice Jackson's analysis in Youngstown, the scope of presidential authority varies directly with the degree of congressional authorization for the action in question. The closer the President is to the will of Congress, the stronger the presumption that the presidential action is constitutionally valid. As it becomes less clear whether the President is acting consistent with congressional will, the more likely it is that the President lacks the constitutional authority to act. Justice Jackson identified three zones of presidential power, ranging from the least vulnerable to judicial challenge to the most vulnerable to judicial challenge.

In the first category, "[w]hen the President acts pursuant to an express or implied authorization of Congress, his authority is at its maximum, for it includes all that he possesses in his own right plus all that Congress can delegate." An action "executed by the President pursuant to an Act of Congress would be supported by the strongest of presumptions . . . and the burden of persuasion would rest heavily upon any who might attack it." In other words, an executive order supported by an express or implied congressional directive is presumed to be constitutionally valid. In the second category,

When the President acts in absence of either a congressional grant or denial of authority, he can only rely upon his own independent powers, but there is a zone of twilight in which he and Congress may have concurrent authority, or in which its distribution is uncertain. Therefore, congressional inertia, indifference or quiescence may sometimes, at least as a practical matter, enable, if not invite, measures on independent presidential responsibility. In this area, any actual test of power is likely to depend on the imperatives of events and contemporary imponderables rather than on abstract theories of law.

Most executive orders appear to fall within this category of the Youngstown framework, which embraces all the circumstances where it is unclear whether the President is acting consistent with congressional will.


66. Youngstown, 343 U.S. at 635 (Jackson, J., concurring).

67. Id. at 637.

68. Id.
In the third category, "When the President takes measures incompatible with the expressed or implied will of Congress, his power is at its lowest ebb, for then he can rely only upon his own constitutional powers minus any constitutional powers of Congress over the matter." An executive order will fall within this category only when it is clear that the order is flatly inconsistent with congressional will and relates to matters over which Congress has at least some constitutional authority.

An executive order will fall within this category only when it is clear that the order is flatly inconsistent with congressional will and relates to matters over which Congress has at least some constitutional authority. In Youngstown, Justice Jackson deemed President Truman's seizure of the steel industry to be in the third category and ultimately voted with the majority in striking down the executive order.

An executive order directing the Treasury Department to create an SPE for purposes of avoiding a debt default—provided, as discussed below, that the SPE does not violate the GCCA—might arguably fall within the first zone of the Youngstown framework. Because Congress has delegated debt payment responsibility to the Secretary of the Treasury, the President would be acting pursuant to an implied authorization of Congress, so his authority should be at its maximum. Moreover, by helping avoid the serious adverse economic consequences (probably including a severe recession) of a default, that executive order should also be consistent with the "general tenor" of the statutory regime under which the executive branch manages the economy. That consistency provides an independent basis for concluding that the executive order might fall within the first zone of the Youngstown framework.

An executive order directing the Treasury Department to create an SPE for purposes of avoiding a debt default at least should fall within the second zone of the Youngstown framework, where the President acts upon his own independent powers in the absence of either a congressional grant or denial of authority. As explained below in more detail, Congress's failure to raise the debt ceiling represents "congressional inertia, indifference or quiescence" that, "as a practical matter, enable[s] . . . measures on independent presidential responsibility"—i.e., preventing a government default and its disastrous consequences. Congressional refusal to act is generally insufficient to put the President and Congress directly at odds with one another under Youngstown.

69. Id. at 637-38.
70. Id. at 639.
71. See id. at 640 ("This leaves the [steel] seizure to be justified only by the severe tests under the third grouping, where . . . we can sustain the President only by holding that [the seizure] is within his domain and beyond control by Congress.").
72. Id. at 655.
73. See infra notes 84-95 and accompanying text.
74. See Dames & Moore v. Regan, 453 U.S. 654, 678 (1981) (finding a presidential executive agreement to fall within zone one of the Youngstown framework despite evidence that Congress informally opposed the agreement because the executive agreement was consistent with the "general tenor" of the statutory regime allowing unilateral presidential action in times of national emergency to respond to hostile acts of foreign states).
75. Youngstown, 343 U.S. at 637.
76. See, e.g., Patricia L. Bellia, Executive Power in Youngstown's Shadows, 19 CONST. COMMENT. 87, 93 (2002) ([C]ourts tend to avoid exploring the President's constitutional foreign affairs
The argument that Congress’s failure to raise the debt ceiling represents “congressional inertia, indifference or quiescence” presumes that such failure does not express a clear desire to force the nation to default on its debt (in which case the President’s power would fall within the third zone of the Youngstown framework, creating a strong presumption of unconstitutionality). That presumption is supported by the facts. For example, the Majority Leader, Majority Whip, and two additional senior senators have demanded, in a private letter to the President, that he “take any lawful steps” to avoid default, including “without Congressional approval, if necessary.” The Full Faith and Credit Act, which was passed by the House of Representatives but died in the Senate, provided that “[i]n carrying out the statutory responsibilities to ‘support of the public credit’ and ‘managing the public debt’ the [Treasury] Secretary shall take all necessary actions to ensure all obligations of the United States Government with regard to debt held by the public are fully discharged when due.” Even members of Congress who have opposed raising the debt ceiling in the past have argued that the executive branch would still be able to take certain steps to avoid a default. Most parties agree, for example, that failure to raise the debt ceiling would not restrict the Treasury Department’s authority to attempt to prioritize payments to avoid a default. Congress’s failure to raise the debt ceiling, in other words, does not limit all possible methods of paying existing debt, nor does it require a default.

Even if an executive order directing the Treasury Department to create an SPE for purposes of avoiding a debt default fell within the third zone of the Youngstown framework, Congress might be unable to persuade the judiciary to declare the order unconstitutional—in which case, as a practical matter, the executive order would stand. As discussed above, this issue of executive power may be deemed a nonjusticiable political question. In addition, Congress (or members of Congress suing individually) may lack Article III standing to

powers—express or implied—instead finding congressional authorization in questionable circumstances or simply assuming that presidential action should stand as long as Congress is silent.”); id. at 144 (“The Dames & Moore Court interpreted Congress’s silence not as its understanding of the scope of the Executive’s constitutional powers, but rather as a legislative authorization or approval of the Executive’s conduct.”).

80. See id. (quoting Republican members of Congress arguing that the debt ceiling does not affect the executive branch’s power to prioritize some financial obligations over others).
81. See supra note 30.
challenge unilateral executive branch action taken to avoid a default, at least until it takes an affirmative stance against the President. Only when political remedies have been exhausted, or congressional votes effectively nullified by executive branch action, will courts recognize legislative standing.

ii. The Power to Create a Debt-Issuing SPE Would Not Violate Congress’s Restrictions on Executive Branch Creation of Corporations

Under the GCCA, Congress has restricted executive branch power to create corporations. The GCCA provides in relevant part that “[a]n agency may establish . . . a corporation to act as an agency only by or under a law of the United States specifically authorizing the action.” If the executive order creating the debt-issuing SPE violates the GCCA, that order—and hence the SPE created thereunder—would be presumed unconstitutional under the Youngstown framework.

It should be feasible, however, to craft the executive order in a way that does not violate the GCCA. At the outset, the debt-issuing SPE should be organized as an entity that is not a “corporation.” Additionally, it should not be allowed to “act as an agency.”

In the financial world, debt-issuing SPEs are routinely organized as entities that are not corporations to avoid an entity-level corporate tax. Typical debt-issuing SPEs are thus organized as limited liability companies (LLCs), partnerships, and even commercial trusts. If the executive order were to specify that the debt-issuing SPE should be organized in one of those forms, that alone might be sufficient to avoid the GCCA’s application.

82. See, e.g., Raines v. Byrd, 521 U.S. 811, 829 (1997) (holding that a group of congressmen lacked standing where political remedies, such as passing new legislation, were available); Chenoweth v. Clinton, 181 F.3d 112, 114 (D.C. Cir. 1999) (holding that a group of congressmen lacked standing to challenge an executive order, and noting “that courts should refrain from interfering in disputes arising out of the legislative process when a political remedy is available from within that process”).

83. See Anthony Clark Arend & Catherine B. Lotrionte, Congress Goes to Court: The Past,Present, and Future of Legislator Standing, 25 HARV. J.L. & PUB. POL’Y 209, 268 (2001) (“For a legislator to have standing, the [D.C. Circuit] in Campbell [v. Clinton] explained, there must be . . . no other legislative remedies available to rectify the action by the [President]. This means that whatever had been done by the [President] cannot be undone by legislative action.”).


85. See supra notes 69-70 and accompanying text.

86. Depending on politics, Congress could also retroactively approve the creation of the debt-issuing SPE. That could allow Congress to have its cake (by not raising the debt limit) and eat it too (by sanctioning the measures taken to avoid default). Of course, some members of Congress might later regret that approval if they want to again create a debt-ceiling showdown.

87. See STEVEN L. SCHWARCZ ET AL., SECURITIZATION, STRUCTURED FINANCE AND CAPITAL MARKETS § 5.02, at 112-17 (4th ed. 2004).

88. Id. § 5.02, at 117-27.
A party attempting to challenge that exemption might argue, however, that the GCCA's use of the term "corporation" should be broadly construed to mean any generic "corporate" (i.e., separately existing) entity. Even given that broader interpretation, however, the debt-issuing SPE would still not be subject to the GCCA unless it "act[s] as an agency." The SPE should not be acting "as an agency" if it is either a private entity that acts pursuant to specific contractual directions or a government-owned or controlled entity that does not engage in the implementation of government policy. The debt-issuing SPEs proposed in Part III should be able to be structured to fall into at least one of those exempted categories.

It is arguable, though I believe unlikely, that the GCCA itself might even more explicitly delegate power to the executive branch to create a debt-issuing SPE. Recall that the GCCA provides that "[a]n agency may establish . . . a corporation to act as an agency only by or under a law of the United States specifically authorizing the action." An executive order itself, however, is "law." The President's executive order, when necessary to enforce a federal statute, effectively becomes federal law and a part of the laws to which the statute relates. Under this reasoning, an executive order creating a debt-paying SPE would be within the first zone of the Youngstown framework because the President would be acting pursuant to an express authorization of Congress. The problem with this argument, however, is that it would be inconsistent with the House Report accompanying the legislation that became the GCCA, which indicates that the phrase "a law of the United States specifically authorizing the action" refers to further specific congressional authorization. Therefore, an "express authorization" argument under the GCCA is unlikely to be successful.

89. 31 U.S.C. § 9102.
90. See, e.g., Varicon Int’l v. Office of Pers. Mgmt., 934 F. Supp. 440, 446–47 (D.D.C. 1996) (concluding that the U.S. Investigations Service was not established to "act as an agency" under section 9102 of the GCCA because it "appear[ed] to be a private corporation which was awarded a government contract").
91. Cf. Lebron v. Nat’l R.R. Passenger Corp., 513 U.S. 374, 396 (1995) (stating that the GCCA phrase "acting as an agency" of the United States "was evidently intended to restrict the creation of all Government-controlled policy-implementing corporations, and not just some of them").
93. That argument could be further reinforced if the Secretary of the Treasury determines all material aspects of the debt securities issued by the SPE, including "(1) the form, denomination, maturity, interest rate, and conditions to which the obligations [under those debt securities] will be subject; (2) the way and time the obligations are issued; and (3) the price for which the obligations will be sold." 31 U.S.C. § 9108(a) (2012). That determination would follow the GCCA’s prescription that the Secretary of the Treasury make that determination "[b]efore a Government corporation issues obligations and offers obligations to the public." Id.
94. That House Report states in relevant part as follows:
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In summary, by issuing an executive order, the President should have at least implicit power and authority under Youngstown to create an SPE that could issue debt securities. If organized skillfully, that SPE would not violate Congress’s restrictions on executive branch establishment of corporations under the GCCA.

2. Lending the Proceeds on a Back-to-Back Basis

The second step of the back-to-back borrowing structure would be for the SPE to on-lend the proceeds of its issued debt to an executive branch agency or entity on a back-to-back maturity basis. For discussion purposes, this Feature will refer to that as the “on-lending.” The on-lending must be structured in a way that does not itself create debt that violates the federal debt limit. This creates a conundrum: how can the on-lending constitutionally avoid the need for congressional authorization, yet make investors in the SPE’s debt securities comfortable that there will be a reliable and adequate basis of repayment?

The structured finance concept of nonrecourse debt can help to resolve this conundrum. The term nonrecourse debt is a misnomer; it means debt that has recourse to collateral consisting of specific assets, not debt that lacks all recourse. As explained below, nonrecourse on-lending should be both constitutionally valid and acceptable to investors.

Nonrecourse on-lending should be constitutionally valid because it would create neither general recourse debt nor debt backed by the full faith and credit of the U.S. government—and thus the debt created by the on-lending should not be “on the credit of the United States.” The distinction between general

The committee does not consider the practices of chartering wholly owned Government corporations without prior authorization by the Congress . . . to be desirable. It believes that all such corporations should be authorized and chartered under Federal statute. The bill provides that in the future all corporations which are to be established for the purpose of acting as agencies or instrumentalities of the United States must be established by act of Congress or pursuant to an act of Congress specifically authorizing such action.


95. Another possible argument is that the President is not an “agency” within the meaning of the GCCA. See 31 U.S.C. § 9102 (2012) (“An agency may establish or acquire a corporation to act as an agency only by or under a law of the United States specifically authorizing the action.”). The GCCA defines “agency” as “a department, agency, or instrumentality of the United States Government,” and therefore does not explicitly include the President. 31 U.S.C. § 101 (2012). In a different but somewhat analogous context, the Supreme Court has held that the definition of the term “agency” under the Administrative Procedure Act does not include the President. Dalton v. Specter, 511 U.S. 462, 470 (1994). Under this argument, an executive order by the President creating a debt-issuing SPE would not violate the GCCA.

96. This related question would be irrelevant to the asset-sale structure because the SPE in that structure uses the proceeds to purchase financial assets, not to make a loan.

97. See, e.g., BLACK’S LAW DICTIONARY 1157 (9th ed. 2009) (defining “nonrecourse” debt as “an obligation that can be satisfied only out of the collateral securing the obligation and not out of the debtor’s other assets”).

recourse debt of the U.S. government and full-faith-and-credit debt of the U.S. government is unclear, and the terms might be synonymous. The phrase “full-faith-and-credit” is not explicitly statutorily defined in the context of U.S. government debt. Nonetheless, it appears to mean that holders of that debt have recourse generally to the United States government, and not merely to a particular government agency, for payment. That interpretation follows from the fact that federal statutes sometime state that the debt of specific governmental bodies is guaranteed by the full faith and credit of the United States and sometime state that such debt is not so guaranteed. Furthermore, general-obligation debt instruments issued by the Treasury Department, including long-term bonds and short-term notes and bills (collectively, “Treasury securities” or colloquially, “Treasuries”), are generally understood to be backed by the “full faith and credit of the United States.”

Nonrecourse on-lending would not create general recourse debt, and thus would not create full-faith-and-credit debt, if the SPE has recourse only to collateral consisting of specific assets for repayment. Arguably, that should avoid the need for congressional authorization of the debt created by the on-lending. Though there is no explicit precedent finding that nonrecourse debt is not “on the credit of the United States,” that finding would follow from the characteristics of the debt. Because nonrecourse debt is payable solely from a finite source—the specified collateral—it exposes creditors to a real risk of loss. Those creditors are therefore not making their credit decision based on the ability of the U.S. government to repay them, nor would the U.S. government be liable to repay them.

That raises the question, why would investors be prepared to purchase the SPE’s debt securities if they are payable solely from specified collateral? In answer, the collateral must provide a sufficiently reliable and adequate basis of repayment to make the investors comfortable. The customary way to

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99. When used to describe Treasury securities and other U.S. government debt, the phrase “full faith and credit” should not be confused with the “Full Faith and Credit Clause” of Article IV, Section 1 of the U.S. Constitution. The latter addresses the duties of U.S. states to respect the “public acts, records, and judicial proceedings of every other state.” U.S. CONST. art. IV, § 1.

100. See, e.g., 12 U.S.C. § 1721(g) (2012) (in the context of the Government National Mortgage Association (Ginnie Mae), providing that “[t]he full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guaranty [of Ginnie Mae debt] under this subsection”).

101. See, e.g., 16 U.S.C. § 5808(a) (2012) (in the context of the National Natural Resources Conservation Foundation, providing that “[t]he full faith and credit of the United States shall not extend to the Foundation”). The phrase “full faith and credit” might have originated in part from the statutory language of 31 U.S.C. § 3123(a) (2012), which states, “[t]he faith of the United States Government is pledged to pay . . . principal and interest on the obligations . . . issued under this chapter.”


accomplish that is for the collateral to consist of specific high-quality financial assets—i.e., assets that are expected to convert to cash.\textsuperscript{104}

The most plentiful high-quality financial assets that the federal government could pledge as collateral would be rights to the future payment of specified tax revenues.\textsuperscript{105} Thus, the SPE could on-lend the proceeds of its debt issuance to the Treasury Department on a nonrecourse basis. The Treasury Department would secure repayment of that loan with collateral consisting of rights to the future payment of specified tax revenues. (The Treasury Department has statutory authority to receive tax revenues, pursuant to which it created and oversees the Internal Revenue Service.\textsuperscript{106}) The SPE would only have recourse to those specified revenues,\textsuperscript{107} if and when they are collected; it would not have recourse to other tax revenues, nor would it have general recourse to the Treasury Department or any other part of the U.S. government.

If the federal government can constitutionally borrow solely through executive branch power in a way that makes investors in the SPE’s debt comfortable that there will be a reliable and adequate basis of repayment, one might ask what the SPE adds, and whether it would be simpler to omit the SPE step and have the federal government directly issue nonrecourse debt to investors. At least part of the answer is that the market is more likely to understand that SPE-issued debt, as opposed to Treasury Department-issued debt, is not full recourse to the government. That would reduce the chance of the debt being viewed as “potentially illegitimate,” which “could reduce investor confidence in the federal government’s commitment to meet its obligations.”\textsuperscript{108}

\textbf{B. The Asset-Sale Option}

Under this option, an SPE would, as before, issue debt securities in amounts needed to repay maturing federal debt. The SPE would then pay the proceeds to an executive branch agency or entity, most likely the Treasury

\textsuperscript{104} See infra Section III.A.

\textsuperscript{105} The power of the executive branch to give a security interest in assets, such as rights to the future payment of tax revenues, may well be subject to Congress’s broader power to “dispose of” assets. \textit{Cf.} Sioux Tribe of Indians v. United States, 316 U.S. 317, 326 (1942) (“Since the Constitution places the authority to dispose of public lands exclusively in Congress, the executive’s power to convey \textit{any} interest in these lands must be traced to Congressional delegation of its authority.”) (emphasis added). The analysis of that executive branch power would therefore be subsumed in this Feature’s analysis of the executive branch’s power to sell those assets. See infra notes 112-124 and accompanying text.


\textsuperscript{107} The options I propose do not involve a first call on all tax revenues or a call on tax revenues for an indefinite period. The tax revenues serving as collateral in the first option, or being purchased in the second option, are in each case a finite set whose value would not so greatly exceed the amount of the financing that someone could call into question whether the first option is truly nonrecourse or the second option is truly a sale.

\textsuperscript{108} Buchanan & Dorf, \textit{supra} note 23, at 1209 n.135.
Department, to purchase income-generating financial assets such as rights to the future payment of specified tax revenues. The SPE’s securities would be repayable from collections on the purchased financial assets. Because only the SPE, and not the federal government, is borrowing or legally liable for repayment, this structure would not create debt that could violate the federal debt limit.

This structure is analogous to a standard securitization structure, in which an SPE issues securities to investors and then uses the proceeds to purchase income-producing financial assets that serve to support ultimate repayment to the investors. Securitization is a major source of financing both domestically and worldwide.

I next examine this structure from a legal standpoint, focusing first on creating an SPE to issue debt securities and thereafter on the SPE using the proceeds of the debt issuance to purchase financial assets. I later examine this structure from the standpoint of rating agencies and investors.

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109. See supra notes 105-106 (discussing the Treasury Department’s right to receive future tax revenues).

110. SCHWARCZ ET AL., supra note 87, § 1.03, at 6-8.

111. Cf. Huw Jones, Bank of England to Take Fresh Look at Securitization Market, REUTERS, Nov. 28, 2013, http://www.reuters.com/article/2013/11/28/us-hoc-regulation-idUSBRE9AR0LD20131128 (reporting that the Bank of England “may step in to kickstart the securitisation market, which was discredited by the U.S. subprime crisis but is now seen as a valuable option for financing business growth”).
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1. Creating an SPE to Issue Debt Securities

A threshold question for this structure—as it was for the back-to-back borrowing structure—is whether the executive branch has the power and authority to create an SPE that could issue debt securities. The same analysis and conclusions would apply: that through the issuance of an executive order, the executive branch should have that power and authority, and that the creation of such a debt-issuing SPE would not violate Congress’s restrictions on executive branch creation of corporations under the GCCA.

2. Using the Proceeds to Purchase Financial Assets

In the second step of the asset-sale structure, the SPE would use the proceeds of its issued debt to purchase income-generating financial assets from an executive branch agency or entity. As before, the most significant type of executive branch financial assets would appear to be rights to payment of future tax revenues.

That raises the question of whether the executive branch has the power to sell financial assets. Regarding power to sell assets generally, the Constitution provides that “Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States.” The term “other property” is not limited to real property (i.e., land); it also has been interpreted to include personally, which would include financial assets. Nonetheless, as explained below, Congress already appears to have delegated sufficient power to the executive branch to sell financial assets to avoid default by paying maturing Treasury securities.

The Secretary of the Treasury has statutory authority to administer and enforce the Internal Revenue Code. Thus, the Secretary of the Treasury has statutory authority to collect taxes. The Secretary of the Treasury also has the statutory authority and duty to pay Treasury securities. Implicit in those authorities and duties, the Secretary of the Treasury should have the power to

112. U.S. CONST. art. IV, § 3, cl. 2.
116. See supra note 58 and accompanying text; see also 31 U.S.C. § 3327 (2012) (providing that the “Secretary of the Treasury may issue a check or other draft on public money in the Treasury to pay an obligation of the United States Government”). Because the power to tax is constitutionally given to Congress, U.S. CONST. art. I, § 8, cl. 1 (providing that “The Congress shall have Power To lay and collect Taxes”), Congress at least theoretically would have the power to change the tax delegation to the IRS, thereby undermining this structure to the extent it is based on tax revenues as the financial assets. The IRS is just a bureau of the Treasury Department, so Congress could abolish the Treasury Department and establish a new agency, but the new agency would once again be under the control of the executive branch. The separation of powers doctrine prevents Congress from enforcing the law; that power is vested in the executive branch.
monetize (i.e., effectively accelerate the timing of collection of) future taxes and avoid default, by selling rights to the payment of future tax revenues.\textsuperscript{117}

This interpretation is supported by United States v. Midwest Oil Co.,\textsuperscript{118} in which the Supreme Court explained that the President has considerable freedom to act when Congress has not explicitly forbidden the precise action in question. Specifically, the Court held that the President could unilaterally withdraw certain lands from the public market even though Congress had clearly provided that such lands should be free and open to all. In other words, a statute that easily could have been read to imply that Congress had taken a stance against the President was read narrowly to allow plenty of room for the President to act in the public’s best interest. The Court emphasized that the President’s implied authority “all the more readily operated . . . in view of the fact that its exercise was not only useful to the public, but did not interfere with any vested right of the citizen.”\textsuperscript{119} This is all the more compelling when “[e]mergencies . . . occur, or conditions . . . change as to require that the agent in charge should [act] in the public interest.”\textsuperscript{120}

In our case, if the President issues an executive order directing the Secretary of the Treasury to avoid default by selling rights to the payment of future tax revenues, he would (as before\textsuperscript{121}) be acting pursuant to an implied authorization of Congress\textsuperscript{122} so his authority should be at its maximum.\textsuperscript{123}

\textsuperscript{117} The Secretary of the Treasury, through the IRS, has even more explicit authority to settle and otherwise work with rights to payment of delinquent tax revenues and to collect those revenues by any means, including compromises for a reduced tax liability. See 14A MERTENS LAW OF FEDERAL INCOME TAXATION \S\ 54:141; see also 26 U.S.C. \S\ 7122 (2012) (outlining a compromise regime of civil or criminal cases arising under the internal revenue laws prior to referral to the Department of Justice for prosecution or deference). The Secretary of the Treasury should therefore have even clearer authority to securitize rights to delinquent tax revenues. That, in turn, could also help to shift risk from the government to the SPE’s investors on those revenues.

\textsuperscript{118} 236 U.S. 459 (1915).

\textsuperscript{119} Id. at 475. Although the facts of the case indicated a separate basis for the implied authority—that the President’s action represented a “long-continued practice, known to and acquiesced in by Congress,” id. at 474—the Court did not limit its opinion to that rationale.

\textsuperscript{120} Id. at 474.

\textsuperscript{121} See supra Subsection II.A.1.

\textsuperscript{122} One reviewer of this Feature suggested that the Anti-Deficiency Act (of which the most relevant provision is 31 U.S.C. \S\ 1341 (2012)) might restrict the authority of the Secretary of the Treasury to sell or otherwise transfer (e.g., grant as collateral) rights to the payment of future tax revenues. I do not believe it does. In relevant part, that Act prohibits executive branch officials from committing the federal government to contracts or other obligations for the payment of money before Congress has made an appropriation for that money (or otherwise authorized the contract or obligation). A contract to sell or grant a security interest in rights to the payment of future tax revenues is not a contract that obligates the federal government to pay money. To the contrary, it is merely a contract to sell or pledge an asset. (Even if it were a contract that obligates the federal government to pay money, there is some precedent that the contract would be exempt from the Anti-Deficiency Act because the contract effectuates the Secretary of the Treasury’s congressional mandate to pay government debts. 6 Op. Att’y Gen. 26 (1853).) Furthermore, in the case of collateral, subsection (a)(2) of the Antideficiency Act provides that it “does not apply to a corporation getting amounts to make loans . . . without legal liability of the United States Government,” and a nonrecourse loan by definition is a loan that is made without legal liability for repayment.
Furthermore, under the reasoning of Midwest Oil, that sale would be made in emergency conditions (to avoid a government debt default), thereby "requir[ing] that the [President and Secretary of the Treasury] should [act] in the public interest" regarding disposition of federal government property. Also consistent with that case, the sale would be "useful to the public" by avoiding the disastrous economic consequences of a debt default.

C. Comparing the Alternative Options

For both alternative options, the structures begin the same: creating an SPE to issue debt securities in amounts needed to repay maturing federal debt. To that extent, they are identical. The differences between the structures are in their second step.

In the second step of the back-to-back borrowing structure, the SPE on-lends the proceeds of its issued debt to an executive branch agency or entity on a back-to-back maturity basis. To avoid the need for congressional authorization yet make investors in the SPE's debt securities comfortable that there will be a reliable and adequate basis of repayment, the on-lending is made on a nonrecourse-debt basis secured by collateral consisting of specific high-quality financial assets. The most plentiful high-quality financial assets that could be pledged as collateral would be rights to the future payment of specified tax revenues. The executive branch borrower of the on-lent proceeds should therefore be the Treasury Department, which has the right to receive tax revenues (through its Internal Revenue Service) and also the right to use the on-lent proceeds to pay maturing Treasury securities, thereby also satisfying its obligation to pay those securities.

In the second step of the asset-sale structure, the SPE uses the proceeds of its issued debt to purchase income-generating financial assets from an executive branch agency or entity. As in the back-to-back borrowing structure, the most plentiful high-quality financial assets that could be purchased would be rights to the future payment of specified tax revenues. Congress has already delegated sufficient power to the executive branch to sell financial assets to pay maturing Treasury securities. The executive branch seller of the tax revenues should therefore be the Treasury Department (which has the right to receive

123. It is also worth noting that the Ashwander Court seemed to interpret Article IV, Section 3, Clause 2 of the U.S. Constitution as a federalism provision, not a separation of powers provision. See Ashwander v. Tenn. Valley Auth., 297 U.S. 288, 331 (1936) (noting that the power of the United States to sell assets was "a matter of grave concern because of the fear that 'the sale and disposal' might become 'a source of such immense revenue to the national government as to make it independent of and formidable to the people'" (quoting 2 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION §§ 1325-1326 (1833)). To that extent, one might argue that the Constitution does not much care which branch of the federal government is doing the selling so long as it respects the structural limitations placed on the federal government as a whole—for example, that the Treasury Department shouldn't securitize assets simply to make a profit but may securitize assets in an emergency situation to pay maturing debts.

124. See supra note 118 and accompanying text.
those revenues). The Treasury Department also has the right to use the proceeds of the sale to pay maturing Treasury securities, thereby (again) also satisfying its obligation to pay those securities.

As explained above, both of these structures should be legally valid and constitutional. However, the asset-sale structure may be cleaner for several reasons. It is closer to traditional securitization transactions, which are widely used not only in domestic financing but also in financing worldwide. That would not only be easier to explain in the United States but also should be more accessible and understandable to foreign investors, who—as explained below—may well dominate the purchase of the SPE’s securities. Additionally, rating agencies and investors will probably better understand the default risk of the asset-sale structure. Finally, the asset-sale structure has less legal “baggage” because it does not involve any federal government borrowing.

III. Extralegal Considerations

In the discussion below, I first examine how rating agencies and investors would likely view these alternative options as a business matter. Thereafter, I discuss how these options should be constrained to prevent their potential abuse.

A. Rating Agency and Investor Perspectives

Investors in the SPE’s debt securities will have a single goal: to be repaid principal and interest on those securities on a timely basis. In assessing the likelihood of timely repayment of any debt securities (including Treasury securities and other sovereign debt securities), investors customarily rely in part on ratings assigned to those securities by rating agencies, such as Standard and Poor’s (S&P) and Moody’s.

1. Ratings

The highest rating on long-term debt securities is AAA, with ratings descending to AA, then to A, and then to BBB and below. The higher the rating, the lower the credit risk associated with the securities in question as determined by the rating agency. The rating agencies follow explicit
methodologies in deriving their ratings. For example, S&P’s framework for rating structured finance securities considers five key factors: the credit quality of the underlying financial assets, legal and regulatory risks, payment structure and cash flow mechanics, operational and administrative risks, and counterparty risk.129

Consider how those factors would apply to the SPE’s debt securities. If (as this Feature proposes) the underlying financial assets are rights to the future payment of specified tax revenues, their credit quality should be good because taxpayers who fail to pay their taxes are subject to interest charges130 and civil and potentially criminal government penalties.131 Those rights, however, should be quantified as legally enforceable rights before they serve as the underlying financial assets.

2. Overcollateralization

Even if those rights are so quantified and legally enforceable, some taxpayers may fail to pay their taxes. Individuals, for example, may die and their estates may be insufficient to pay the taxes. Companies may liquidate. Even though the Internal Revenue Service’s claim for payment of taxes has priority over most other claims,132 some taxpayers may ultimately default on paying their taxes. To the extent the financial assets underlying payment of the SPE’s debt securities include tax claims that ultimately default, the SPE’s debt securities may similarly default.

To reduce the chance of that (similar) default on an SPE’s debt securities, investors in those securities normally expect, and rating agencies rating those securities customarily require, the anticipated collections on the underlying financial assets to exceed by some margin (e.g., 10%) the amounts needed to pay the SPE’s debt securities in full. This is referred to as “overcollateralization,” and it is typically achieved by adjusting downward the purchase price (in the case of an asset-sale structure) or collateral value (in the case of a back-to-back borrowing structure) of the financial assets for anticipated defaults and delayed collections.133 Overcollateralization also can

130. Interest accrues on all taxes not paid when due as well as on all civil and criminal penalties imposed. See 26 U.S.C. §§ 6601, 6611, 6621-6622 (2012); 2 WEST’S FEDERAL ADMINISTRATIVE PRACTICE § 1639 (2014).
131. Failure to pay taxes is subject to an initial 5% or 15% civil penalty, followed by another 5% or 15% penalty for each month that passes, up to a maximum of 25% or 75% depending on whether the failure was as a result of negligence or fraud, respectively. See 26 U.S.C. §§ 6651-6665 (2012); 2 WEST’S FEDERAL ADMINISTRATIVE PRACTICE, supra note 130, § 1640. Willful tax evasion is a felony, subjecting tax evaders to up to $100,000 in fines ($500,000 if the tax evader is a corporation) and five years' imprisonment. See 26 U.S.C. § 7201; 2 WEST’S FEDERAL ADMINISTRATIVE PRACTICE, supra note 130, § 1641.
133. 2 SECURITIZATION OF FINANCIAL ASSETS, supra note 52, § 8.02(B).
be—and often is—effectively achieved by owners of the SPE or other parties contributing some capital at the outset to the SPE,\(^1\) that gives the SPE additional value to pay its debt securities if collections on the underlying financial assets turn out to be insufficient.\(^2\)

Because the party transferring the financial assets is governmental (i.e., the Treasury Department) and governmental entities are not subject to bankruptcy, there should also be considerably more flexibility than in a private structured finance transaction for the transferor of the financial assets to make warranties as to their quality. In private transactions, investors and rating agencies are concerned that strong warranties might undermine the validity in bankruptcy of the transfer of the financial assets.\(^3\) In our transaction, however, the transferor of the financial assets—whether the transfer is structured as a secured loan or a sale—will be the Treasury Department. Therefore, the warranties on the quality of the transferred assets can be made as strong as the parties are willing to negotiate.\(^4\)

Thus, with sufficient overcollateralization and warranties, and assuming the underlying financial assets are legally enforceable rights to the future payment of specified tax revenues, the credit quality of those financial assets should be sufficient to support a highly rated debt issuance by the SPE.

Another factor that rating agencies regard as key is legal and regulatory risk.\(^5\) This Feature has focused extensively on that risk. Because part of that risk turns on the nature of the SPE itself, it is useful to make several observations regarding the SPE. Before doing that, however, it should be cautioned that most of this Feature's legal analysis turns on relatively thin precedent and issues of first impression. It therefore would be invaluable to investors, and rating agencies, to find a legal safe harbor.

3. "Reasonableness" Safe Harbor

In a commercial context, the concept of "apparent authority" creates a partial safe harbor, enabling parties to rely conclusively on the due authorization and execution of contracts that appear to be executed by properly authorized officers.\(^6\) In contrast, however, investors in the debt securities of an SPE created pursuant to an executive order that appears to be properly

\(^1\) Id. § 3.05(A)(3).

\(^2\) Id. § 4.05. Owners who contribute capital customarily expect any unused capital to be returned to them after the SPE's debt securities are paid in full. Id.

\(^3\) See SCHWARCZ ET AL., supra note 87, § 3.03, at 69-86.

\(^4\) Any such warranties on the quality of the transferred assets should be within the range of reasonableness, of course. A warranty stating that the Treasury Department would pay if a transferred asset did not collect on a timely basis would not be a reasonable warranty of quality but a full guarantee, effectively making the loan full recourse. Furthermore, warranties exposing the Treasury Department to indefinite damages for breach might violate the Anti-Deficiency Act. See supra note 122.

\(^5\) See supra note 129 and accompanying text.

\(^6\) See 2A C.J.S. AGENCY § 418.
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authorized cannot conclusively rely on the validity of that executive order (and thus cannot conclusively rely on the validity of the SPE thereby created). Nonetheless, as discussed below, foreign investors in those debt securities may well be able to conclusively rely on that validity.

If it is reasonable for foreign investors to rely upon the assertions of the executive branch that the executive order validly created the SPE on behalf of the U.S. government, such investors should be able, under the international law requirements for attribution of liability to a sovereign state, to enforce the SPE's debt. In particular, if the SPE's debt purported to be authorized by the executive branch and foreign investors could show, under usual principles of agency law, that they reasonably relied on that authorization, that debt would be deemed to be enforceable even if U.S. courts eventually concluded that the executive branch lacked that authority. International law explicitly recognizes that apparent authority binds state action. This is important because the "foreign investor community [already] holds nearly half of all [U.S.] Treasury securities." Therefore, foreign investor demand should be sufficient to purchase enough SPE debt to enable the U.S. government to repay its then-maturing Treasury securities.

To enable foreign investors to enforce their claims, the SPE debt (and in the case of the back-to-back borrowing structure, the debt created by the on-lending) should ideally include waivers of sovereign immunity from suit. Even absent such waivers, however, the United States has, under certain international treaties, waived sovereign immunity defenses and agreed to arbitration stemming from debt disputes with foreign creditors. To the extent the United

140. See, e.g., Office of Pers. Mgmt. v. Richmond, 496 U.S. 414, 420–27 (1990) (explaining that estoppel will apply rarely, if ever, against the federal government); Thomas v. INS, 35 F.3d 1332, 1338 (9th Cir. 1994) ("Estoppel and apparent authority normally will not substitute for actual authority to bind the United States government.") (citations omitted)).

141. See generally UNITED NATIONS INT'L LAW COMMISSION, RESPONSIBILITY OF STATES FOR INTERNATIONALLY WRONGFUL ACTS (2001) (defining the situations in which states violate their international law responsibilities).

142. Comment 8 to Article 7 of RESPONSIBILITY OF STATES FOR INTERNATIONALLY WRONGFUL ACTS, supra note 141, clarifies that "the question is whether [the relevant persons or entities] were acting with apparent authority." Comment 4 to that Article adds that this "modern rule is now firmly established . . . by international jurisprudence, State practice and the writings of jurists" (citations omitted).

143. Belton, supra note 2, at 1.

144. Whether foreign investor demand is in fact sufficient to purchase enough SPE debt to enable the U.S. government to repay its then-maturing Treasury securities will depend, of course, on market conditions at the time. Compare U.S. Treasury Issuance and Outstanding, SEC. INDUSTRY & FIN. MARKETS ASS'N, http://sifma.org/research/statistics.aspx (last visited Feb. 3, 2014) (indicating that between January 2011 and December 2013, the Treasury Department redeemed, on a monthly basis, an average of $565 billion of Treasury securities and issued $646.9 billion of Treasury securities, resulting in a net issuance of $81.9 billion), with Major Foreign Holders of U.S. Treasury Securities, U.S. DEPT OF THE TREASURY, http://www.treasury.gov/ticdata/Publish/mfh.txt (last visited Feb. 3, 2014) (stating that major foreign holders of Treasury securities increased their aggregate position by $18.4 billion each month, on average, accounting for nearly half of the net issuance).

States has assets outside its jurisdictional boundaries, foreign creditors might even be able to legally seize those assets to pay certain international arbitration awards.\textsuperscript{146} Foreign investors therefore should have greater incentives than domestic investors to purchase the debt securities contemplated by this Feature.

4. The SPE

As discussed, the debt-issuing SPE should be organized as an entity that is not a corporation. Additionally, it should not act as an agency. Within these parameters, there is considerable flexibility. First consider organizational choice.

Because organizational choice may be politically influenced, this Feature does not purport to dictate the outcome. It should be observed, however, that if the SPE is organized as an LLC, it can be managed like a corporation.\textsuperscript{147} Furthermore, a commercial trust other than a business trust, is not generally legally recognized as separately existing.\textsuperscript{148} Thus, it is least likely to be viewed as a “corporation” under the GCCA.

It is also critical to ensure that the SPE does not act “as an agency.” There appear to be two ways to accomplish this: by creating the SPE as a private entity that acts pursuant to specific contractual directions, or creating the SPE as a government-owned or controlled entity that does not implement government policy. The former option is especially feasible. There is ample precedent for finding and motivating private owners of SPEs.\textsuperscript{149} Furthermore,
the functions of the SPE contemplated by this Feature, and thus the tasks of its managers (who should be hired from the private sector), should be ministerial: to issue debt securities and, depending on the structure chosen, to either on-lend the proceeds on a nonrecourse basis, secured by specific financial assets, or use the proceeds to purchase financial assets.

Even though an SPE that acts ministerially does not make government policy, it must avoid "implementing" government policy to comply with the GCCA. Some might argue that a government-controlled SPE used to avoid a federal debt default could be seen as implementing government policy. Making the SPE both privately owned and privately controlled, however—in which case, the GCCA's restriction on implementing policy would not apply—should preclude such an argument. A private entity that acts pursuant to specific contractual directions is simply not subject to the GCCA.

However the debt-issuing SPE is organized, it should be created and staffed—and its operating structure, including the back-to-back borrowing or asset-sale structure, should be finalized—well in advance of a debt-ceiling dispute. That is critical to enable the SPE to be prepared to issue debt securities as and when needed to avert default. The most time-consuming process, for example, might involve obtaining rating-agency ratings of those securities. Because of the relatively high interest rate likely for those securities, I am not advocating that the SPE actually issue debt securities unless such issuance would be needed, merely that all lead-time dependent steps requisite to such issuance be completed in advance.

Other factors that rating agencies regard as key are payment structure and cash flow mechanics, and operational and administrative risks. Those factors should not be at issue in the context of the debt-issuing SPE contemplated by this article. The final factor that rating agencies regard as key is counterparty

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100% of CAFCO’s common stock”). Corporate Asset Funding Co., or CAFCO, is an SPE with capacity to issue $7 billion of debt securities. Id. at 1. Stone Street Contract Partners is a partnership formed by members of Goldman Sachs and compensated, in the author’s experience, by a percentage of each deal entered into by CAFCO. Another way to compensate private owners of SPEs is to allow them to share in any surplus overcollateralization.


152. This Feature does not purport to address strategic political considerations, such as whether the President might want the threat of a default to be real—and thus might prefer not to implement any means to avert default—to exert maximum pressure on Congress. Nor does this Feature address how Congress might react to an attempt by the President to implement the Feature’s recommendations. In general, though, any attempt by Congress to pass legislation restricting the President’s power to implement these recommendations would be subject to presidential veto.
risk. I see no need for counterparties, however, in the context of this Feature’s contemplated SPE.  

5. Implicit De Facto Government Guarantee

Another factor that rating agencies and investors might view as relevant in the context of this Feature’s contemplated SPE is the possibility of an implicit de facto government guarantee of the SPE’s debt. In public finance, a state will often have strong economic motivations to backstop the debt of its SPEs. A default on such debt could signal uncertainty as to whether the state will pay its debts generally, thereby jeopardizing the state’s credit rating. For example, in 1984, Ohio stood behind its water development authority’s revenue debt to reduce rating-agency scrutiny of a technical default on that debt. Markets and investors likewise believe that the economic compulsion to avoid increased borrowing costs resulting from a default on state-SPE debt provides an incentive for the state to pay that debt to avoid an SPE default.

Additionally, a state may support payment of an SPE’s debt merely to protect the state’s reputation more generally. In a corporate context, for example, at the outset of the 2008 financial crisis many banks backstopped their affiliated structured investment vehicles (SIVs) solely to protect their own reputations. In the case of Citigroup, this occurred notwithstanding that it reduced the capital ratio that regulators monitor to gauge that bank’s ability to withstand losses on bad loans and caused Moody’s to lower the bank’s long-term credit rating. The reputational harm of not supporting payment of an SPE’s debt may be even greater in a state than a corporate context because “investor perception of an implicit . . . government guarantee is hard to

153. In many commercial transactions, the SPE debt is dependent on payments from one or more counterparties, such as providers of currency swaps. Rating agencies then evaluate the counterparties’ financial stability, because they could constitute a “weak link”: If, for example, they fail to perform their swap obligations, the SPE may have insufficient funds in the relevant currency to pay its debt securities. 2 SECURITIZATION OF FINANCIAL ASSETS, supra note 52, § 7.03(F).

154. Schwarcz, supra note 46, at 381-83 (observing that, in the state context, rating agencies give top investment-grade ratings to SPE-issued public debt, partly based on the SPE’s expected cash flows and partly based on the reality that the state will not allow its SPE-debt to default because that would jeopardize the state’s own credit rating).

155. Cf. STANDARD & POOR’S, MORAL OBLIGATION BONDS 3 (2006) (observing that if “a properly structured moral obligation defaulted, despite clear original legislative support, the state’s willingness to pay on its other debt would need to be examined”).


157. See, e.g., Schwarcz, supra note 46, at 376-77 (discussing the use of state SPEs).

158. Shannon D. Harrington & Elizabeth Hester, Citigroup to Consolidate Seven SIVs on Balance Sheet (Update3), BLOOMBERG NEWS (Dec. 13, 2007, 9:07 PM), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aT01x2iDnZxk (reporting that Citigroup Inc. did this in the amount of $49 billion, following similar decisions by HSBC Holdings Plc and WestLB AG to backstop their SIVs).

159. Id.

160. Id. (reporting a lowering from Aa2 to Aa3).
break,”161 even by "statutory disclaimers and [prospectus] disclosures" that the SPE debt is not backed by the government.162

Thus, for these reasons—to avoid jeopardizing its credit rating and to generally protect its reputation—a state may well backstop the debt of its SPEs notwithstanding the absence of a legal obligation to do so.163 These reasons would appear to be less compelling, however, in the context of a privately owned and controlled debt-issuing SPE, even if the SPE was originally created by the Treasury Department. A default by that SPE on its debt securities would be unlikely to jeopardize credit ratings on full-faith-and-credit-backed Treasury securities. Nor should such a default impair the U.S. government’s reputation if investors receive proper disclosure about the risks inherent in the SPE’s debt securities. That disclosure should prominently warn of the risk that collections on the underlying financial assets might be insufficient, notwithstanding any applicable overcollateralization, to pay those debt securities in full and on a timely basis.

Rating agencies and investors should understand that risk, especially if the SPE utilizes the asset-sale structure. Recall that that structure is similar to the structure of a traditional securitization transaction, and investors in those types of transactions have experience taking the risk of the underlying financial assets.164 It might be less certain, however, that rating agencies and investors will understand the default risk if the SPE utilizes the back-to-back borrowing structure. That is because investors do not always fully understand the significance of nonrecourse debt. Indeed, arguably partly as a result of that lack of understanding, Congress included a provision in the Bankruptcy Code that sometimes gives creditors full recourse against nonrecourse borrowers.165 Because the obligor on the nonrecourse debt is the Treasury Department, some investors might mistakenly think that the credit of the Treasury Department stands behind the SPE’s debt securities. If the SPE ever defaults on its debt securities and investors claim they were misled—and especially if the media, including the foreign media given the likely dominance of foreign investors, 161. Cheryl D. Block, Congress and the Accounting Scandals: Is the Pot Calling the Kettle Black?, 82 Neb. L. Rev. 365, 437 (2003) (referencing investor perception of an implicit U.S. government backing of Fannie Mae’s debt).

162. Id. (referencing statutory disclaimers and prospectus disclosures that Fannie Mae’s debt is not backed by the U.S. government). In 1963, for example, the city of Chicago paid eighty percent of the back interest on bonds issued by the Calumet Skyway Authority due to a “feeling that a bond default by the Authority might damage the city’s overall bond rating.” JERRY MITCHELL, THE AMERICAN EXPERIMENT WITH GOVERNMENT CORPORATIONS 97 (1999) (citations omitted).

163. A state may also decide to support payment of SPE debt, even though the state is not legally obligated to do so, if the SPE operates as an integral part of government—essentially a “too important to fail” variant of the corporate notion of too big to fail. In a federal context, for example, this is exemplified by the U.S. government’s support of Fannie Mae and Freddie Mac’s debt in order to promote stability and liquidity in the housing markets. Schwarez, supra note 46, at 382.


165. See 11 U.S.C. § 1111(b)(1)(A) (2012). That provision would not apply, of course, against the Treasury Department, which is not subject to the Bankruptcy Code.
makes a big enough outcry—it is not inconceivable that the Treasury Department might decide to backstop the SPE’s debt securities.166

B. Curbing Potential Abuses

The alternative options for avoiding default should be distinguished from the current widespread abuse of SPE borrowing by states. As mentioned, one of the reasons states engage in SPE borrowing is to avoid violating archaic state-constitution-mandated debt ceilings. That use, which would be similar to the federal government’s use of SPE borrowing to avoid default, is arguably legitimate because those debt limits make it difficult for many states to function.167 Admittedly there may be more democratic ways of addressing the debt limit,168 such as amending state constitutions169 or, in the case of the federal government, for Congress to vote to increase the federal debt limit. But faced with the reality and consequences of default, SPE borrowing is a practical necessity.

Nonetheless, SPE borrowing has increasingly become subject to abuse in state public finance. The most prevalent reason that states currently engage in SPE borrowing is to reduce financial transparency and avoid public scrutiny. Even though states de facto guarantee their SPE debt,170 such debt “is rarely shown as debt on state balance sheets and, even when shown . . . may not be easily discernible.”171 This “lack of transparency can undermine public finance and also make it even more likely that states will continue to manage their financial affairs with insufficient regard to their ability to repay their debts.”172 Sadly, the monitoring insufficiency of states, absent appropriate media attention (which has been lacking173), makes states even more likely than corporations to use SPEs to hide their debt.174

Any federal use of SPE borrowing to avoid default should pay great care to counteract this potential illegitimacy, including through clear and transparent

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166. Indeed, the reality is that sponsors have often stood behind their defaulting SPEs, creating the perception of a de facto guarantee. See supra notes 158-160 and accompanying text. The fact that the U.S. government supported Fannie Mae’s and Freddie Mac’s debt, even though that was done because these entities operated as an integral part of government, see supra note 163, adds to that perception.

167. Schwarcz, supra note 46, at 378 (quoting from a telephone interview with a leading public finance lawyer).

168. Id.

169. Id.

170. See supra notes 158-160 and accompanying text.

171. Schwarcz, supra note 46, at 380. That article gives the example of New York showing $48.5 billion of debt in its 2006 financial statements but failing to show another $80 billion of New York state SPE debt. Id.

172. Id. at 383.

173. In April 2012, the New York Times accepted for publication an op-ed I wrote on this topic. To date they have failed to publish it, although they maintain their intention to do so.

174. Schwarcz, supra note 46, at 388.
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disclosure—not only to investors, but also to the public generally—of that debt and the federal government’s de facto obligations, if any, as well as any legal obligations with respect to that debt.175

Conclusions

Even a “technical” default by the United States on its debt, such as a delay in paying principal or interest due to Congress’s failure to raise the federal debt ceiling, could have serious systemic consequences, destroying financial markets and undermining job creation, consumer spending, and economic growth. The ongoing political gamesmanship between Congress and the executive branch has been threatening—and even if temporarily resolved, almost certainly will continue to threaten—such a default. The various options discussed in the media for averting a default have not been legally and pragmatically viable.

This Feature proposes new options for avoiding default, arguing that although the executive branch lacks authority to directly issue Treasury securities above the debt ceiling, it should have the power to raise financing by monetizing future tax revenues. In each of the proposed options, a non-governmental SPE would issue securities in amounts needed to repay maturing federal debt. Depending on the option, the SPE would either on-lend the proceeds of its issued securities to the Treasury Department on a nonrecourse basis, secured by specified future tax revenues; or the SPE would use the proceeds of its issued securities to purchase rights to future tax revenues from the Treasury Department. In each case, therefore, a finite set of specified future tax revenues176 would form the basis of repayment to investors.

These options should be legally valid and constitutional, notwithstanding the debt ceiling: neither involves the issuance of general-obligation or full-faith-and-credit government debt, and the second option does not involve the issuance of any government debt. Furthermore, based on the similarities of these options to successful financing transactions that are widely used in the United States and abroad, the securities issued thereunder should receive high credit ratings and also be attractive to investors. Because of provisions in foreign treaties, those securities should be especially attractive to foreign investors—who already purchase half of all Treasury securities.

These options are not intended to be standard financing structures. Being riskier than full-faith-and-credit Treasury securities, the securities issued under these options would almost certainly have to pay a higher interest rate than Treasury securities. The options should therefore be viewed, and this Feature

175. The only legal obligations should be on warranties as to the quality of transferred financial assets. See supra notes 135-137 and accompanying text.

176. In finance, a finite set of future revenues is typically referred to as a finite “pool” of those revenues.
presents them, as viable emergency measures, if needed, to avoid a U.S. debt default.