

Lee Buchheit
What Happens Next – 03.27.2022

Lee Buchheit:

Thanks, Larry. You're asking what is the ultimate fate of the Russian Federation assets that the United States and the European Union have frozen? In particular, whether President Biden could, if he wished, confiscate those assets and make them available to the Ukraine government to help them with reconstruction. Estimates are 300 billion dollars of Russian Federation assets have been frozen. I expect most of it is in Europe.

There's no question about the president's legal authority to freeze those assets. It's been done many times before Iran, North Korea and most recently Venezuela. There is some question about his ability to confiscate the assets.

I believe he has that legal authority. President Biden thinks he has that legal authority. He has indicated that he intends to take seven billion dollars of Afghan Central Bank assets that have been frozen and allocate half of them towards humanitarian work in Afghanistan but the other half he intends to give to the victims of 9/11 that have obtained court judgements against the Taliban.

There are a couple of crucial timing issues here. I expect the Biden team would resist earmarking the frozen Russian Federation assets for another purpose. If there were to be a settlement Putin will surely ask that the sanctions be lifted and his money returned. And were Mr. Biden to commit that money for another purpose that would take 300 billion dollars off of the negotiating table, and he might be reluctant to do that.

The problem is that the longer this goes on the greater the risk that private parties will sue the Russian Federation. If Russian bonds go into default, one could expect that there will be lawsuits by bondholders, and by investors who've had their property confiscated in Russia. And once those lawsuits begin and the frozen assets become subject to attachments by private litigants that vastly complicates the president's ability to dispose of them. The best historical example here was President Reagan's decision in 1981 with respect to frozen Iranian assets after the hostage taking in Tehran in 1979. 400 lawsuits had been commenced against Iran in this country and a proportionate number of attachments of Iranian assets.

The deal that Reagan cut with the Iranians was that all of those lawsuits were to be voided, all of the claimants sent to The Hague to present their cases before the US/Iran claims tribunal and all of the assets to be made available to the claim's tribunal. Reagan was sued for having done that. He went to the US Supreme Court and prevailed but it was a very narrow decision. The concern that the US Government would have is that if you void those attachments, does that constitute a taking of private property without just compensation in violation of the fifth amendment?

We have this situation right now in Venezuela. President Trump froze Venezuelan assets. Private litigants have attached those frozen assets. The freezing order prevails but at such time as it is lifted those attachments would bite. That's the timing issue. President Biden would be

wise not to wait too long before deciding whether he is going to allocate frozen Russian Federation assets to some other purpose such as reconstruction activities in Ukraine.

Larry Bernstein:

Normally, if Russia were to default on its debt, its bondholders could not get an attachment on the Russian central bank's US Treasury portfolio. To clarify what you are saying, if Biden gave Russia's assets to Ukraine, the US government would not be at risk from any attachments by creditors, but if the Russian frozen assets are held by the US government, then a US court could require that the Russian assets be given to Russia's private creditors.

Lee Buchheit:

Correct. If President Biden were to outright confiscate, would those assets remain property of the Russian Federation and therefore be subject to attachment by third party creditors of the Russian Federation? I would think not and let's say tomorrow, all frozen assets subject to US jurisdiction are transferred to the Ukraine government to be used for reconstruction. At that point I think, they would no longer belong to the Russian Federation and no longer be subject to attachment.

Larry Bernstein:

Surely, the Russia Central Bank assets must be part of any negotiated settlement.

Lee Buchheit:

If Mr. Putin were prepared to sit at a settlement table he would surely insist. "Give me my money back and lift the sanctions." But the timing issue, Larry, is important. The President has that discretion now but at the point that private litigants begin to file attachment orders on those assets while they remain assets of the Russian Federation at that point voiding the attachments raises the question of whether the US government has taken property from those private litigants. That was the issue that Mr. Reagan confronted. The Supreme Court dodged it. The Supreme Court said, any litigant in that position who wishes to file a claim before the court of claims where you sue the US government, you're free to go and do it.

Larry Bernstein:

Biden has some time. If Russia misses an interest payment, there would be a grace period before the default is official, then it takes time for the bondholders to start a lawsuit and get a judgment.

Lee Buchheit:

You're right. There's a 30 day grace period on these bonds. Then 25% of the bond holders would have to accelerate. Then someone would have to sue. Russia would have 60 days to answer that lawsuit in a court. It would take another nine months to get a judgment. Once they got a judgment they would then have the ability to attach.

Larry Bernstein:

In litigation against a sovereign state, the US State Department often goes to court and requests that the judge not take an action that is averse to the president's foreign policy objectives. Biden will have a very legitimate argument here if the attachment undermines peace negotiations with Putin.

Lee Buchheit:

Federal courts take that very seriously. It's a constitutional issue. Foreign affairs is principally the responsibility of the executive branch and the judiciary is very leery of taking actions that could interfere with the executive's conduct of foreign affairs. Were the president to come into a federal court and say, "This is a matter of acute interest to the foreign affairs of this country." The court is not bound to accept that but would certainly give it a great deal of deference.

Larry Bernstein:

Biden's decision to confiscate 100s of Billions of dollars of Treasuries is a big deal. Individual investors and governments have purchased billions of dollars of supposedly riskless Treasury bonds and now we are saying that if a nation engages in policies that the President finds objectionable, then the President can confiscate the central bank's bonds and bonds held by foreign nationals.

The US government has benefitted enormously from being the world's reserve currency and having foreigners and especially foreign central banks finance our debt. Why are we going to risk ending that practice?

Lee Buchheit:

Yeah. Yeah. It's a fair point, that's what made the decision of the US Treasury to go after the Russian Central Bank's assets so significant. It sends a message to any country that is not a fast friend of the United States that were they to find themselves on the wrong end of a political dispute with Uncle Sam, they may find that their international reserves are effectively frozen and potentially subject to outright confiscation.

That is a pretty significant step for the United States to have taken, because there are a number of countries, and China surely at the top of the list, that have enormous holdings of US government securities that I'm sure they felt were safe from this risk. How many basis points might the US Treasury have to pay in additional interest rates, if these large foreign government buyers become leery of holding US Treasury securities? The decision to go after the Russian Central Bank was very significant.

Larry Bernstein:

How broad is the President's power to confiscate US corporate stocks and bonds held by foreign governments or foreign citizens?

Lee Buchheit:

His authority extends to any property subject to US jurisdiction in which the foreign state has an interest. So if they owned Exxon Mobil bonds, gold at Citibank, all of those assets are potentially subject to being frozen.

Foreign national's assets could also be frozen. I think a different legal issue, if a foreign national comes in and says, you've frozen my assets, what is the foreign policy basis for that? Because all of these actions are taken under a statute that gives the president the authority to do these things because they relate to foreign affairs of this country. An individual might have a better case to say, I'm scarcely a threat to the foreign policy of the United States.

Larry Bernstein:

Lee, you've participated in countless sovereign debt disputes, how do you think this situation will be resolved?

Lee Buchheit:

(laughs) It will eventually be settled sooner or later. Putin is so far committed, he has got to be able to show that he has won something with sufficient face saving. For example, I want Crimea to be recognized, I want the Donbas, I want a land corridor between Russia and Crimea, and I'll withdraw my troops. Maybe he could do that.

But there is a significant chance that Putin decides he's going to stay in Ukraine, the Ukrainian government does not acquiesce, and these sanctions remaining in place for a long time. The consequences on the Russian economy will be devastating. Look, (laughs) Cuba has been sitting there in isolation since 1960. It is possible for a country to become such a pariah that they are cut off diplomatically, economically, financially, even socially from the rest of the world. But you would not have thought a country as significant as Russia would wish that or could endure it for long.

Larry Bernstein:

I want to change the conversation to Russian individuals. Both the US and EU governments have been confiscating boats and homes in Belgravia owned by Russian nationals. I would have thought that personal property would be protected. And if this sort of action will become commonplace when a citizen's government is in conflict with the West, then the foreigner cannot hold personal property in the US or Europe? Would you recommend that Chinese nationals consider sale/lease backs, using non-recourse debt on property, or holding assets in complex offshore companies and trusts to disguise ownership?

Lee Buchheit:

Russian nationals rarely hold those assets in their own name (laughs). There will be a layer, upon layer, upon layer of holding companies often in jurisdictions that are not receptive to disclosure of beneficial owners. Could someone prove that the Russian national owns it? Even if they could, then the question would be become are those assets ostensibly in the name of an individual to be regarded as constructively Russian Federation assets and therefore subject to attachment by, let's say, Russian bondholders or the Ukraine government for damages to the Ukraine? That too is a big, big step. I would see that as a much more complicated process.

What are you gonna do with your money? How many New Zealand dollars can you buy? You've gotta put it someplace. And what this affair has shown is that in a situation where your home country does something that is regarded as truly outrageous by the Western world, those jurisdictions have the ability to freeze assets. Oligarchs would have to look hard to find places where they could put their money with absolute security.

Larry Bernstein:

If you were advising, the Central Bank of China that has trillions of dollars of US dollar and Euro denominated assets to reallocate its resources to prevent confiscation, what would you recommend?

Lee Buchheit:

It's a staggering amount of money. China, if they foresaw a situation in which there could be a rupture with the Western countries, they would draw down those positions. The Russians bought \$130 billion of their reserves in gold, and Biden just attempted to restrict even that. Maduro has been for the last few years attempting to sell his gold. He puts it on a private plane to Iran or Africa and tries to sell it. That's what Biden is trying to shut down with his latest round of sanctions.

Larry Bernstein:

This isn't the first time that the West has dealt with a rogue regime. What financial actions did we take against the Kaiser and Hitler's Germany?

Lee Buchheit:

We passed in 1917, the Trading with the Enemies Act. That statute gives this power to freeze foreign assets in the hands of the president. So we froze them. My recollection is that the Bayer pharmaceutical company, we may have actually (laughing) sold off their patents.

Larry Bernstein:

So far we've discussed state actions by our enemies, but sometimes we get into conflicts with our friends. For example, in 1956 the UK, France and Israel attacked Egypt over the nationalization of the Suez Canal. Eisenhower was blindsided and angry, and he limited the UK's ability to borrow money during a run-on Sterling forcing the UK to backdown. Do you think that the President could apply these powers over our friends and their citizens to force allies go get in line?

Lee Buchheit:

I think the provocation for the United States to take an action like this against a friend and ally has got to be pretty great. President Eisenhower expressed his severe disapproval of what was done in the Suez incident and that got those countries to back off it. But theoretically, if the president declares a situation to be of acute concern to the foreign policy of this country, it is not limited. In a practical sense, I think they would think hard about doing it without severe provocation.

Larry Bernstein:

This is a lot of power delegated to the President, what are the checks and balances from the Congress?

Lee Buchheit:

It is in the hands of the president. Congress authorized it by legislation, the Trading with the Enemy Act and then the international Emergency Economic Powers Act.

It is always up to Congress to pass legislation that would restrict what the president can do. But it's pretty much a discretion of the executive branch. It goes back to our constitutional allocation of foreign affairs principally in the hands of the executive branch.

Larry Bernstein:

Are there treaty protections for Russian individuals and their property?

Lee Buchheit:

I don't know whether the Russian Federation is a party to so-called bilateral investment treaties. These are treaties between two countries that give investors in each other's economy, the ability to pursue arbitration remedies in the event that their investments are confiscated.

If such treaties exist and I would expect they do exist, then that's probably the principle recourse. There are provisions in U.S. law permitting a cause of action where property has been taken in violation of international law. International law requires that if you expropriate property, you are obliged to pay prompt just and effective compensation. Over the last 25 years has been mostly private investors resorting to these arbitration remedies. Maduro's Venezuela has 30 some of these arbitration cases pending.

Larry Bernstein:

Russia successfully made an interest payment on its external debt a few days ago, but there was a lot of discussion about how the cash made its way through the financial system given the EU and US restrictions on Russia's money. What happened?

Lee Buchheit:

The payment went to JP Morgan and from there to Citibank acting as paying agent. JP Morgan, as you might expect, went back to OFAC and said, "We wanna be sure we can pass this through." The mystery here though, Larry, is where did that money come from? From a policy standpoint, OFAC logically should have said if that money is being sourced from unblocked accounts let it flow through because that just further drains Russia's FX reserves and amplifies the effects of the sanctions. But if they said the money could be debited from a blocked account, that strikes me as illogical. That allows Russia to use blocked money to service its debt. That's the mystery, where the money was sourced from.

Larry Bernstein:

I know the West is outraged by Putin's behavior, but does it make public policy sense to weaponize US Treasury bonds? This decision could have long-term implications on how we finance our debt and our role in the world, was this properly thought through?

Lee Buchheit:

I think they thought in through, Larry. They have previously refrained from acting as aggressively as they did in this case. They made the decision that the provocation was so outrageous that they would take that step.

But the three trillion-dollar question, what are you going to do with the money if you can't invest it in the world's most liquid and theoretically safe financial asset?

Larry Bernstein:

Lee, I end each episode on a note of optimism, what are you optimistic about?

Lee Buchheit:

I am optimistic that contrary to many people's expectations the Western nations have rallied together in the face of this that is some basis for optimism.