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# THE CONCEPT OF ODIOS DEBT IN PUBLIC INTERNATIONAL LAW

*Prof. Robert Howse*

## Abstract

*The concept of “odious debt” regroups a particular set of equitable considerations that have often been raised to adjust or sever debt obligations in the context of political transitions, based on the purported odiousness of the previous regime and the notion that the debt it incurred did not benefit, or was used to repress, the people. This paper begins with an exploration of the grounds of the “odious debt” concept in basic international law structures and principles. The international law obligation to repay debt has never been accepted as absolute, and has been frequently limited or qualified by a range of equitable considerations, some of which may be regrouped under the concept of “odiousness.” This is consistent with the accepted view that equity constitutes part of the content of “the general principles of law of civilized nations”, one of the fundamental sources of international law stipulated in the Statute of the International Court of Justice. At the same time, most debt contracts between States and private creditors are governed by the domestic private law specified in the contract. The legal systems of these jurisdictions may well have concepts such as “clean hands” or the notion that contracts related to illegal purposes are invalid. These concepts overlap with elements of the notion of “odiousness” as a basis for invalidating debt obligations. Investor/state arbitration tribunals, for example, have been comfortable taking into account such considerations in determining whether repudiation of contractual obligations to an investor by the host State is consistent with international law. This suggests that such concepts may indeed form part of the content of equity as “a general principle of law of civilized nations”, especially if widely shared among different legal systems.*

*The paper surveys a range of actual transitional situations in order to articulate the various ways in which “odiousness” has been invoked by a successor regime as a ground for limiting its obligations to repay debt incurred by the previous regime. The paper also looks at some situations where other States’ tribunals have rejected or questioned claims of a transitional regime to adjust or sever debt obligations based on considerations of “odiousness”. Examination of these situations does not lead to skepticism concerning the legal grounds for a notion of “odious debt.” Usually, in the cases examined, there were doubts concerning the facts as to whether the debt in question was “odious” or actually conferred some benefits on the population or the new regime, or whether the transitional regime’s claim was based on an overly broad notion of “odiousness.” In none of these situations was a claim of odious debt rejected on grounds that international law simply does not countenance alteration in state-to-state debt obligations based on any equitable considerations whatsoever. The paper concludes that, due to the complexity and variety of transitional contexts, there is no single obvious legal forum for the adjudication or settlement of claims of odiousness. Depending on context, such claims might appropriately be raised in bilateral or multilateral negotiations on debt relief, or they could be adjudicated in the context of arbitration or domestic litigation. State-to-state debt contracts may specify a forum for the settlement of disputes. However, invocation of the concept of odious debt in multiple forums in respect of diverse debt contracts involving the same debtor State risks inconsistent decisions. Here, the examination of considerations of odiousness by a single special transitional tribunal seized with all the claims related to the political transition in question may be an attractive solution.*

## INTRODUCTION AND BRIEF OVERVIEW

The concept of “odious debts” has taken on a growing legal and political significance in the early 21st century. Since the post-colonial era, and continuing in recent years, a large number of political regime changes have occurred, whether due to war, revolution, secession, or the peaceful evolution of societies from one form of Government to another. Such transitions pervasively raise issues of the continuity of legal obligations from the old regime to the new, including the disposition of debt obligations acquired by the previous regime.

The odious debt concept seeks to provide a moral and legal foundation for severing, in whole or in part, the continuity of legal obligations where the debt in question was contracted by a prior “odious” regime and was used in ways that were not beneficial or were harmful to the interests of the population. Usually, it also has been pertinent to the concept to establish whether or not the creditor knew or should have known of these circumstances at the time the debt was contracted.

The relevance of the odious debt concept to political transitions is both distinct from and related to the debate on whether, as a matter of law or policy, international financial institutions or other potential creditors should *ex ante* be prevented or deterred from lending to *existing* regimes that are declared “odious”. This is a point associated with the issue of lending conditionality. This discussion paper examines the odious debt doctrine largely in the context of selected, relevant past or ongoing political transitions; the possibility of *ex ante* declaration of debt as “odious” is however discussed briefly in chapter V in relation to private and governmental creditors.

### I. DEFINITION OF THE ODIUS DEBT CONCEPT

The modern concept of odious debts was first articulated in the post-World War I context, by the jurist Alexander Nahum Sack, in his 1927 book *The Effects of State Transformations on their Public Debts and Other Financial Obligations*. For Sack, odious debts were debts contracted and spent against the interests of the population of a State, without its consent, and with full awareness of the creditor. Sack (1929) wrote as follows:

“...if a despotic power incurs a debt not for the needs or in the interest of the State, but to strengthen its despotic regime, to repress its population that fights against it, etc., this debt is odious for the population of the State.

“The debt is not an obligation for the nation; it is a regime’s debt, a personal debt of the power that has incurred it, consequently it falls within this power....The reason these ‘odious’ debts cannot be considered to encumber the territory of the State, is that such debts do not fulfill one of the conditions that determines the legality of the debts of the State, that is: the debts of the State must be incurred and the funds from it employed for the needs and in the interest of the State. ‘Odious’ debts, incurred and used for ends which, to the knowledge of the creditors, are contrary to the interests of the nation, do not compromise the latter – in the case that the nation succeeds in getting rid of the Government which incurs them – except to the extent that real advantages were obtained from these debts.”

Sack divided odious debts into several categories: war debts, subjugated or imposed debts, and regime debts. Other jurists have used slightly different taxonomies. O’Connell (1967) referred to



“hostile debts” in addition to war debt; others have referred to “profligate debts”. Still others refer to a new category of “developing world debts not spent in the interests of the population” framing the concept in terms of irresponsible or odious lending (Khalfan et al., 2003).<sup>1</sup>

The most common classical types of odious debts are hostile debts and war debts. “Hostile debts” can be defined as debts incurred to suppress secessionist movements, to conquer peoples and so forth. “War debts” are debts contracted by the State for the purpose of funding a war which the State eventually loses and whereby the victor is not obliged to repay the debt.

In the context of the negotiation of the Vienna Convention on the Succession of States in Respect of Matters other than Treaties (still not ratified) Mohammed Bedjaoui<sup>2</sup>, Special Rapporteur of the International Law Commission, concluded that “odious debt” is an umbrella term covering a range of specific debts – war debts and subjugated or imposed debts being but two examples. He clarified the situation as follows:

- (a) From the standpoint of the successor State, an odious debt can be taken to mean a state debt contracted by the predecessor State to serve purposes contrary to the major interests of either the successor State or the territory that is transferred to it;
- (b) From the standpoint of the international community, an odious debt could be taken to mean any debt contracted for purposes that are not in conformity with contemporary international law and, in particular, the principles of international law embodied in the Charter of the United Nations.<sup>3</sup>

Sack believed that state practice was such that the doctrine of odious debts could be said to be part of positive international law – a generally accepted rule of law. However, to avoid opportunistic use of the doctrine in inappropriate situations, Sack (1929: 163) proposed a process for the practical application of the doctrine that would be fair to all parties:

“(1) The new Government would have to prove and an international tribunal would have to ascertain the following:

- “(a) That the needs which the former Government claimed in order to contract the debt in question, were odious and clearly in contradiction to the interests of the people of the entirety of the former State or a part thereof, and
- “(b) That the creditors, at the moment of paying out the loan, were aware of its odious purpose.

“(2) Upon establishment of these two points, the creditors must then prove that the funds for this loan were not utilized for odious purposes – harming the people of the entire State or part of it – but for general or specific purposes of the State which do not have the character of being odious.”

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<sup>1</sup> See also the discussion of illegitimate debt in New Economics Foundation, *Odious Lending: Debt Relief As If Morals Mattered*, (2005): illegal debt, onerous debt, odious debt, unsustainable debt, moral debt, environmental debt, historical debt.

<sup>2</sup> Currently a member of the International Court of Justice.

<sup>3</sup> *Ninth Report on the Succession of States in Respect of Matters other than Treaties*, 1977 Yearbook of the International Law Commission, Vol. 2 (Part 1): 68 and 70.

The above formulation does not appear to require that the creditors be aware of how in fact the funds were actually spent. Nevertheless, subsequent jurists, notably O'Connell (1967: 459), treat this aspect as implicit in Sack's formulation.

## II. NORMATIVE SOURCES OF THE ODIIOUS DEBT CONCEPT

Like many concepts in international law, the concept of odious debt has been shaped by multiple normative sources: formal concepts of sovereignty and statehood have been influential and so have notions of political justice and accountability, as well as ideas of fair dealing and equity in contractual relations. In recent and contemporary treatments of odious debt, human rights elements have attained importance – as they have more generally in thinking about problems of transitional justice (Teitel, 2003).

However, to understand properly the normative foundations of the concept of odious debt, it is necessary to bear in mind that it constitutes a *limitation* on the international legal obligation to repay state-to-state debts. This obligation has generally been articulated as based on the notion of *pacta sunt servanda*, the requirement that States honour their agreements with one another. However, the concept of *pacta sunt servanda* concerns treaties, that is to say, state-to-state agreements that evidence the intent of the States in question to be bound in *international* law. When States enter into loan contracts with other States, do they intend that the obligations in question be international law obligations, private law obligations or both? The limitation of the *pacta sunt servanda* concept for settling the issue of continuity of debt obligations became clear early on when both theorists and state practitioners grappled with the problem of state succession.

Generally speaking, when state succession occurs, whether through dismemberment (the case of the Soviet Union), succession or some other change that alters the nature of the sovereign itself, international legal obligations are not thought to be automatically transferred to the new State or States. As a formal matter, the identity of the sovereign itself has changed and the new sovereign has not expressed its will to be bound. Applying these formal conceptions of the limits of international legal obligation where sovereignty changes to the case of state-to-state debts was quickly understood to be problematic. Firstly, as a practical matter, it could lead to financial instability and uncertainty in the case of this kind of transition. Secondly, it could entail unjust enrichment, to the extent that the new State would benefit from the loans or their effects (such as public infrastructure) without providing compensation for those benefits. Thus, the notion of “maintenance” of debt obligations in the case of succession arose as a sort of *exception* to the notion that change of “statehood” itself does not entail an automatic transfer of the legal obligations of the former sovereign to the new State(s).

There have been attempts to eliminate “maintenance” as a general rule in the case of newly independent States; however, these attempts have never gained the support of most developed States. The 1978 Vienna Convention on Succession of States in Respect of Treaties and the 1983 Vienna Convention on Succession of States in Respect of State Property, Archives and Debts include a provision referred to as the “clean slate rule” (Abrahams, 2000). Article 16 of the 1978 Convention provides that “a newly independent State is not bound to maintain in force or to become party to, any treaty by reason only of the fact that at the date of the succession of States the treaty was in force in respect of the territory to which the succession of States relates.” More pertinently, Article 38 of the 1983 Convention provides as follows:

“(1) When the successor State is a newly independent State, no state debt of the predecessor State shall pass to the newly independent State, unless an agreement between them provides otherwise in view of the link between the state debt of the predecessor State connected with its activity in the territory to which the succession of States relates and the property, rights and interests which pass to the newly independent State.

“(2) The agreement referred to in paragraph 1 shall not infringe on the principle of the permanent sovereignty of every people over its wealth and natural resources, nor shall its implementation endanger the fundamental economic *equilibria* of the newly independent State.”<sup>4</sup>

One commentator argues that by establishing a presumption that newly independent States do not inherit any debt, the Convention gives little incentive to enter into an agreement to take on any of the debt of their predecessors. Perhaps this helps to explain why so few developed States have adhered to the Property Convention (Khalfan et al., 2003: 34).

Abrahams (2000) argues that there exists an important link between these two “clean slate” articles and “odious debts”. The International Law Commission, in dealing with the question of “odious debts”, adopted the approach that it would first “examine each particular type of succession of States, because the rule to be formulated might well settle the issue and dispose of the need to draft general provisions on the matter” (Bedjaoui: 67). Abrahams believes that it was clearly intended that the question of odious debt be addressed in the context of the rules relating to the succession of newly independent States. “Thus, inherent in the ‘clean slate rule’ is the rationale that debts of a predecessor State might be ‘odious’ and for that reason States should be able to invoke the said rule within the contexts of Articles 16 and 38 of the two Conventions respectively” (Abrahams, 2000).

The notion of “maintenance” has, in any case, underpinned for centuries the practice of negotiated transfer of state debts in the case of succession. At the same time, other political, economic and legal considerations also have shaped such negotiations, leading to settlements that in a range of cases resulted in partial cancellation or (rarely) complete cancellation of some debts. The legal considerations have included considerations of justice or equity. One example is that apportionment of debt between several new States that are the successor of a single now-defunct State has to take into consideration the relative benefit from the lending that flows to each of these successor States, not just considerations of relative gross domestic product, population or territory. Consideration of the “odiousness” of a particular debt is another example.

Equity and justice have been brought into the disposition of debt in the case of succession because, both within the main private law systems of the world and in public international law, they have been long recognized as limits or qualifications to legal obligation – albeit limits that typically are not expressed as “rules”, but rather as modifications or adjustments to rules in individual cases.

Thus, Grotius (1625) held that contracts made by the sovereign that are of no advantage and harmful to the State should not be honoured, and in particular where public money has been pledged for purposes that are not for the public good. Similarly, Grotius held that contracts made

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<sup>4</sup> Note that Article 38 has been critiqued for not dealing with situations in which the creditors of the successor State may be private creditors of another State. See M. Bedjaoui, *13<sup>th</sup> Report on Succession of States in Respect of Matters Other than Treaties*, para. 127.

by a usurper regime that has overthrown a legitimate regime should not be honoured when the usurper has been removed.

Among the sources of international law recognized in Article 38 of the Statute of the International Court of Justice are “the general principles of law of civilized nations”. These are principles common to a wide range of the world’s legal systems. Equitable limits to contractual obligations in such systems have included illegality, fraud, fundamentally changed circumstances, knowledge that an agent is not properly acting on behalf of the contracting principal and duress. Equitable considerations have frequently been explicitly applied by international tribunals in determining the reasonable and fair contours or limits of international legal obligations (Lowe, 1992 and Friedmann, 1964).

As will be shown, the concept of odious debt is really a regrouping of a range of such equitable considerations as applied to particular transitional contexts. Not all of these contexts pertain to state succession: in fact, the challenges of political transition are often the same whether state succession in the formal sense of an alteration of abstract sovereignty is involved or not.

While general principles to be discerned from the limits of contractual obligation in domestic legal systems are one source of equity or justice, it would be odd if the evolving normative content of international law itself were not also to be such a source. In the case of those international agreements that are treaties,<sup>5</sup> the Vienna Convention on the Law of Treaties requires that the obligations in any one agreement be read in light of other binding agreements as well “as any relevant rules of international law applicable between the parties.” This certainly includes elements of human rights law that have become custom (or even preemptory norms). Domestic and international practice since the Second World War increasingly evokes accountability for human rights abuses – especially crimes against humanity – as a high priority for the international system. In the current era of international law, such accountability extends beyond the state actors most directly involved in the context of the abuses to private actors and even corporations, including various decrees of complicity or facilitation of such wrongful acts.

In the context of state indebtedness to private creditors, debt contracts are typically based on a chosen domestic system of law, specified in a choice of law clause in the contract. Here, also, the relevance of the notion of odious debt has not been explicitly elaborated on in the literature. Does an odious debt doctrine impose, as a matter of state responsibility in international law, an obligation on States to ensure that odious debts are not enforced in their domestic legal systems? Or does it simply add to the considerations that courts in most domestic legal systems would weigh in determining the limits of freedom of contract (illegality, fraud, changed circumstances, ostensible authority of the agent to contract, public policy, etc.)?

In the case of state contracts with private creditors, Sornarajah (2004: 419–427) has pointed out that, despite frequent incantations to that effect by commentators and creditors, there is no evidence of general international law establishing the sanctity of such contracts. Certainly, in some circumstances, repudiation of a contract with a foreign investor might violate the customary international law of state responsibility for treatment of aliens (the fair and equitable treatment standard, which is also incorporated into many bilateral investment treaties and trade agreements). But such a standard itself depends on notions of justice and equity, and therefore would imply the relevance of considerations such as the odiousness of the debt.

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<sup>5</sup> Treaties are binding as a matter of international law and the doctrine of “maintenance” in effect turns State-to-State debt agreements into treaties.

A skeptical view of the doctrine of odious debt may hold that there is inadequate state practice and certainly lack of *opinio juris* to establish an obligation to make odious debt obligations unenforceable in domestic legal systems. But the concept of odious debt obligations can nevertheless make a distinctive contribution to the application of domestic law doctrines limiting contractual obligation by incorporating sensitivity to the contemporary demands of transitional justice as well as global justice in the broadest sense. More critical views of the odious debt concept show concern that it does not yield *ex ante* certainty concerning the situations in which debt will be considered odious, depending instead on case-by-case application of quite general legal standards to controversial matters. Yet the common law of contracts has functioned effectively as a default for transactions in financial markets for hundreds of years. This is despite having evolved case by case through judicial application of general norms and concepts in widely varying circumstances. There is a rich case law in the common law world concerning the limits of contractual freedom, whereby contractual obligations have been found unenforceable or partly enforceable. Generally speaking, these limits have not prevented the growth of sophisticated and well-functioning financial markets.

### III. THE CONCEPT OF ODIUS DEBT AS A BRANCH OF THE JURISPRUDENCE OF TRANSITIONAL JUSTICE

The idea of odious debt is often discussed in the abstract from the political and institutional context. The notion of “repudiation” of debt is in itself inadequate to capture the complex possibilities of how and where a “doctrine” of odious debt might be invoked, especially given the critical importance of the transitional context concerned.

First of all, in the case of state-to-state debt, the notion of odious debt might be invoked against a claim that there is an international law obligation to repay the debt. Such a claim might in theory be invoked in state-to-state arbitration or even in the International Court of Justice, but in practice it is much more likely to be voiced in political or diplomatic discussions and negotiations in the context of political transition in the debtor country. Or alternatively, odious debt could be a concept applied by a specialized tribunal seized with addressing legal issues of transition. From this perspective, the concept of odious debt, rather than a self-standing legal doctrine, might be regarded as a *lex specialis* of transitional justice, a form of justice that is inherently and pervasively political and legal as well as highly contextualized in its specific content. Cheng (2007), for example, rejects the odious debt doctrine based on the notion that outcomes in international relations must either be fully determined by legal rules or decided by political bargaining in the absence of legal rules; he rightly sees the importance of pragmatic considerations of economic and financial stability in transitional situations but sees a legal approach as at odds with the taking account of those considerations.<sup>6</sup> However, critiques of the “doctrine” of odious debt concerned with the inherent indeterminacy of concepts such as the odiousness of a regime, or with the need to balance considerations of odiousness with political and economic concerns such as future access to capital markets and the need for economic and financial market stability in a transitional situation, may miss the point.<sup>7</sup>

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<sup>6</sup> See the work of Teitel, who identified this phenomenon, coining the expression and developing the concept of “transitional justice” (Teitel, 2000).

<sup>7</sup> This bifurcation of law and politics seems to ignore one of the central insights of modern legal scholarship, derived from the work of economist Ronald Coase: at least in a world where transaction costs are greater than zero, bargains are always struck in the shadow of the law, and conversely, actual outcomes

The odious debt concept does not create an *obligation* in all circumstances to repudiate the debt in question. Instead, when the creditor *chooses* to invoke the doctrine, it can provide one kind of normative and legal foundation for a transitional solution that includes debt reduction. For example, it is not inconsistent with the concept of odious debt that this transitional solution includes partial repayment of such debt. In some transitional situations, the best option for reasons of economic and financial stability could be to continue to pay all debt, even if it is odious.

Cheng suggests that the odious debt concept somehow would require that a debtor assert the non-enforcement of all the debt in question.<sup>8</sup> However, in reality, rather than repudiating debt, a debtor State might invoke concerns of odious debt in negotiations with its creditors in order to reach compromise that promotes financial stability and future access to credit. Parties often hold back from the exercise of their full legal rights and obligations for pragmatic reasons, including reputation effects and an interest in maintaining relationships. This does not mean that the rights and obligations are lesser or that their existence does not have an important bearing on the negotiated outcome. It would be mistaken to invoke cases where the debt was arguably odious but the outcome was adjustment not elimination of obligations to show that state practice does not support the existence of an odious debt concept as customary international law. Transitional (or successor) regimes may, in some contexts, give amnesties and pardons to human rights violators in the previous regime where this is desirable for purposes of reconciliation and building a successful democracy (Teitel, 2003). Similarly, transitional regimes may also decide to continue relationships with financial institutions that had odious dealings with the previous regime when the economic and financial stability of the transition suggests such a course of action.

Moreover, in terms of accountability for past injustices and abuses, a transitional State may decide to examine the actions of the international financial community in the context of a truth commission, such as the South African Truth and Reconciliation Commission. A transitional State may decide that repudiation of debt is not the only way of addressing its connection to a legacy of oppression. Willingness to admit complicity in “odiousness” and to make amends through new lending or even apologies may in some cases satisfy a transitional regime’s concern for accountability about the past.

At the same time, it is not fatal to the concept of odious debt that, in state practice, one rarely sees *all* the considerations or aspects of transitional justice in debt obligation that have been regrouped under the notion of odious debt operating in the same situation. Cheng, rather like Gelpern, seeks to explain away state practice supporting the relevance of odiousness to the obligation to repay by suggesting that practice with respect to war debts and decolonization is irrelevant to odiousness. The normative considerations, according to Cheng, are entirely different (Cheng, 2007). However, one of the central considerations with respect to war debts is that the debt cannot be considered as beneficial to the postwar successor State and its population, which is clearly *one* consideration that is involved in the determination of odiousness. Similarly, it is certainly the case

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are not simply determined by the rules but by the bargains that parties negotiate in the shadow of the law (Cheng, 2007).

<sup>8</sup> Cheng sometimes assumes that the odiousness of the regime was the decisive and sufficient consideration for non-enforcement of debt under the odious debt doctrine; but, as we have seen, the doctrine involves not only considering the odiousness of the regime but that of the debt itself, including whether the debt has conferred in whole or in part some benefit on the population who must now bear it. The balancing of these various considerations may well entail a legal answer under the odious debt doctrine that involves the enforceability of some debts but not others.

that the oppressive nature of the prewar or colonial regime has been a factor in justifying a refusal to pay war debts or debts incurred in colonial situations, and this of course also highlights another aspect of odiousness.

Therefore, a review of a large number of such instances might well conclude that in different transitional situations, certain normative considerations may be more important than others.

state actors are not typically seeking to articulate a doctrine in the abstract, but rather are seeking to solve a particular problem or dispute using a conception of the *equitable limits* of sanctity of contract in transitional situations and to articulate *the contours of those limits for that particular situation*. Therefore, they may well only refer to the facet of odiousness that is most salient to the situation in question. Some scholars supporting the odious debt concept (such as Sack) may have attempted to articulate the doctrine as a set of strict conditions that must be present in every instance in order to justify the non-enforcement of debt. However, state practice is more supportive of the notion that one or more of the normative considerations usually described as odiousness have been present in decisions concerning enforceability of debt in a wide variety of historical eras and across a wide range of transitional situations.

The fact that a wide range of legal and political considerations is relevant in determining the continuity of debt obligations in contexts of transition may explain in part the failure of States to agree on the expression of the notion of “odious debt” as a general rule that would determine the fate of state debt obligations regardless of the transitional context. One effort to establish such a general rule is represented by a proposal in respect of the 1983 Vienna Convention on Succession of States in Respect of State Property, Archives and Debts, the only international convention that relates to the subject of debt repayment. The International Law Commission Draft defined odious debts as: “(a) all debts contracted by the predecessor State with a view to attaining objectives contrary to the major interests of the successor State or of the transferred territory; (b) all debts contracted by the predecessor State with an aim and for a purpose not in conformity with international law embodied in Charter of the United Nations” (Wood, 1980). This definition was ultimately not included in the final text of the Convention, which has not yet come into force, not having achieved the requisite number of ratifications.

According to King, the decision to exclude a reference in the convention to odious debts “has dual significance. On the one hand, it indicates some juristic acceptance of the importance of the doctrine, while on the other hand, it illustrates the reluctance of both States and perhaps the Commission itself to include the doctrine explicitly” (Khalfan et al., 2003: 33).

Meanwhile, the 1969 Vienna Convention on the Law of Treaties reassessed the strict international law principle of *pacta sunt servanda* (Frankenberg and Knieper, 1984). Article 62 provides that a termination or suspension of provisions in a treaty could arise from a substantive change in circumstances – an appeal on the basis of *clausula rebus sic stantibus*. The change in circumstances must present a substantial basis for the consent of the parties and the change in circumstances must radically alter the extent of contractual obligations yet to be fulfilled. In addition, Articles 49 and 50 reflect an emerging body of international law in respect of fraud and corruption of a representative of a State. This is not tailored to the situation of debtors but it does challenge the sanctity of treaties (Khalfan et al., 2003: note 1). According to King, had the Conventions been codified today, a greater *opinio juris* may have emerged with respect to the issue of odious debt (Khalfan et al., 2003: note 1: 33). Global affairs have evolved in the intervening years, placing much more emphasis on the advancement of human rights and the importance of humanitarian considerations in international financial practice.

#### **IV. KEY TRANSITIONAL CONTEXTS WHERE THE CONCEPT OF ODIOS DEBT HAS BEEN INVOKED**

##### **Annexation of the Republic of Texas**

In 1844, the United States annexed the Republic of Texas. Despite provisions to the contrary in the treaty of union which the Senate failed to ratify, the United States initially refused to pay all pre-annexation debts, but paid the majority of the debt on a *pro rata* basis in 1855. Hoeflich (1982) suggests that the federal Government's approach was confused, in the end placing more emphasis on equitable arguments to do what was "right" and "just" in the circumstances.

##### **The Fourteenth Amendment of the United States Constitution**

The Fourteenth Amendment of the Constitution of the United States of America was ratified on 9 July 1868. The Fourth Section of the Fourteenth Amendment reads as follows:

"The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebelling, shall not be questioned. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void."

The main purpose of the Fourteenth Amendment was of course was to ensure the repudiation of secession and to abolish slavery, and the other sections of the Amendment are much more historically significant.

The Fourth Section considers that debts of the Confederacy not collected before the end of the Civil War were null and void. This was to punish those who had helped the Confederacy. The federal Government did, however, pay all the insurance debts – those debts attributable to the destruction of homes and crops by Union soldiers – even though those debts were the responsibility of the State to the people of that State. This meant that the insurrectionist States were indebted to the United States Government, making it easier to rebuild their States from the devastation caused by the war. In order to be readmitted to the Union, Southern States were required to ratify the amendment.

##### **United States refusal to assume Cuban debt – 1898 Paris Conference**

In 1898, after the Spanish–American War, Spain ceded the United States sovereignty over Cuba, the Philippines, Puerto Rico and certain territories. The Americans refused to assume certain debt owed by Spain, secured by revenues of Cuba. The American Commissioners argued as follows (Moore, 1906):

- (a) The loan was not contracted for the benefit of Cubans, indeed some of the funds had been used to suppress popular uprisings in Cuba and to reincorporate Santo Domingo into the Spanish Dominions. The loans were hostile to the people required to pay them.
- (b) Cuba had not consented to the debts.
- (c) The creditors knew that the pledge of Cuban revenues to secure the loans had been given in the context of efforts to suppress a struggle for freedom from the Spanish rule.



Therefore the creditors “took their obvious chances of their investment on so precarious a security.”

Spain made the classic arguments based on a narrow legal interpretation of the international law governing succession that the United States was bound notwithstanding the circumstances surrounding the use of the loan. According to the Spanish Commissioners: “It is perfectly self-evident that if, during the period intervening between the assumption by a sovereign of an obligation and the fulfillment of the same, he shall cease to be bound thereby through relinquishment or any other lawful conveyance, the outstanding obligation passes as an integral part of the sovereignty itself to him who succeeds him” (Moore, 1906). In the end, neither Cuba nor the United States assumed these debts in the Treaty of Paris, although Spain never abandoned its position in the matter.

Insofar as the United States Commissioners explicitly referred to the Cuban debt as “odious”, this is arguably the first direct application of the doctrine of odious debt. It is of course mentioned by Sack, whereas O’Connell classifies the Cuban debt controversy as a hostile debt situation. However, Bedjaoui refers to “subjugation debts” or “debts contracted by a State with a view to attempting to repress an insurrectionary movement or war of liberation in a territory that it dominates or seeks to dominate, or to strengthen its economic colonization of that territory” (Bedjaoui: 72).

### **Soviet repudiation of Tsarist debts**

After the Revolution of 1917, the Provisional Soviet Government initially agreed to repay the outstanding debt of the Tsarist Government. However, by 1918, the Soviet Government had repudiated the debt. Sack, who himself was a former minister in the Tsarist regime, notes a particular Soviet doctrine that regards acts of previous Governments as incurring personal obligations only, and not ones that bind the State (Sack, 1929: 68). Nevertheless even for Sack, it could be argued that the repudiated debts were “odious” and therefore were unenforceable against the successor regime, given the evidence that Tsarist Russia did not rule in the interests of its population (Sack, 1929: 157).

### **Treaty of Versailles of 1919 and Polish debts**

Article 254 of the Treaty of Versailles exempted Poland from the apportionments of those debts which “in the opinion of the Reparation Commission are attributable to the measures taken by the German and Prussian Governments for the German colonization of Poland” (O’Connell, 1967: 189). Article 254 then set out the manner in which German public debts contracted prior to 1 August 1 1914 were assumed by successor States. O’Connell and others agreed that the Treaty of Versailles effectively applied the odious debt test used by the American Commissioners in the Cuban debt controversy.

### **Tinoco arbitration – 1923 (*Great Britain and Costa Rica 1923*)**

In 1922, Costa Rica refused to honour loans made by the Royal Bank of Canada to the former dictator Federico Tinoco. This is an example of state practice with respect to a change of Government and not state succession. It is also an example of an instance where the issue of odiousness of the debt became salient in a claim espoused on behalf of a private creditor.

In 1917, Federico Tinoco overthrew the Government of Costa Rica and later held an election to ratify the “revolution”. During the summer of 1919, the Banco Internacional de Costa Rica issued several “bills” of credit to the Royal Bank of Canada, in respect of which the Royal Bank paid several cheques drawn by the Tinoco Government. The money was used personally by Tinoco and his brother and for no public purpose. By August 1919, Tinoco and his brother had left the country and the Government fell in September. The restored Government of Costa Rica enacted a law which invalidated all transactions between the State and the holders of the “bills” issued by the Banco Internacional.

Chief Justice William Howard Taft was the sole arbitrator for the dispute. Taft agreed that the Tinoco Government was a *de facto* Government capable of binding the State to international obligations. Despite this, Taft emphasized the fact that the debt in question did not create a valid public debt, nor was it in the public interest. The evidence established that the funds were used for the personal enrichment of the Tinoco brothers and that the bank was aware of this, since the transactions “were made at a time when the popularity of the Tinoco Government had disappeared, and when the political and military movement aiming at the overthrow of that Government was gaining strength” (*Great Britain and Costa Rica 1923*: 176). Taft required the Royal Bank to discharge the burden of proving that the Costa Rican Governments had used the money for legitimate purposes, something which it could not do. Accordingly, Taft found that the legislation invalidating the transactions in question did not constitute an international wrong.

Meron (1957) has a different take on the arbitration. He argues that Taft dismissed the claim of Great Britain on behalf of the Royal Bank of Canada because the contract was *ultra vires* the Constitution in force at the time. The contract contained provisions regarding taxes, and therefore to be valid required the approval of both Houses of Congress, not the Chamber of Deputies alone.

It can be argued that the Tinoco arbitration establishes some authority for the existence of *opinio juris* with respect to the doctrine of odious debt. Taft’s judgment adopts a consistent approach confirming the rule on the non-transferability of “odious debts”.

Buchheit et al. (2006) disagree, arguing that Tinoco should be narrowly interpreted as depending on the particular facts that the Tinocos appropriated the whole of the debt. The result might have been different had the debt only been partially odious (Buchheit et al., 2006). But this does not reduce the value of the Tinoco arbitration as a source of law on odious debt. The concept of odiousness of debt is sufficiently flexible to address situations where debt is only partly odious – for example, where part of the funds may have been used for legitimate purposes to benefit the population. In such a circumstance, and depending on the exact factual matrix, it might be appropriate to maintain that there is a continuing obligation, at least with respect to that part of the total amount that is non-odious.

### **German repudiation of Austrian debts – 1938**

The Government Austria was heavily indebted to foreign creditors at the time of the German annexation of Austria in 1938, when loans from creditors had been expressly designed to prevent union with Germany. Germany repudiated the debt, citing prior American and British practice and arguing that it was contracted against the interests of the Austrian people (Hoeflich, 1982: 63–64). To no avail, the Americans tried to argue that much of the debt had been used for the purchase of food.

### **1947 Treaty of Peace with Italy**

The 1947 Treaty of Peace with Italy incorporated the principle underlying Article 254 of the 1919 Treaty of Versailles, whereby the Reparations Commission exempted Poland from those debts attributable to the measures taken by the Governments of Germany and Prussia from the German occupation of Poland. Under this treaty, the Franco–Italian Conciliation Commission ruled that “debts contracted by the ceding State for war purposes, or for the purpose of expanding a territory which was first annexed and subsequently liberated, cannot bind the successor or restored State. The ruling drew a parallel with the Italian occupation of Ethiopia, considering it inconceivable that Ethiopia should have to assume the burden of expenses incurred by Italy in order to ensure its domination over Ethiopian territory” (Bedjaoui: 71).

### **Apartheid debt**

Advocates of repudiation of debt incurred by the apartheid South African regime argue that apartheid was the equivalent of a racial dictatorship, condemned as such by the international community for many years. South Africa was forced to leave the Commonwealth in 1961. In 1973, the United Nations called apartheid a crime against humanity. The struggle of the South African people was recognized as a struggle for national liberation. In 1977, the United Nations imposed a mandatory arms embargo and in 1985 the United Nations Security Council imposed trade sanctions on the apartheid regime. Despite this, the regime continued to borrow from private banks throughout the 1980s. In July 1985, the Government declared a state of emergency and on 1 September South Africa defaulted and stopped paying its creditors. In order to accelerate the end of the regime, Archbishop Desmond Tutu, among others, called on the banks not to reschedule South Africa’s debts and advocated the confiscation of South African assets abroad instead. Nevertheless, a settlement was reached in 1987 with 14 major banks from Germany, Switzerland, the United Kingdom, the United States and France.

After being elected president of South Africa, Nelson Mandela and the African National Congress came under heavy pressure not to renounce apartheid debt (Hanlon, 2002). The new Government distanced itself from calls to nullify its apartheid-era debts. It was considered important not to default on debts in order to attract critical foreign investment. However, Hanlon (2002: 28) is typical of observers who argue that the promise of foreign investment has not been kept.

“Foreign direct investment has been tiny – only two thirds of the profits repatriated by companies on investments they made in the apartheid State. And new lending has not kept up with repayments – over six years South Africa paid out \$3.7 billion more than it received. Thus, promises have not been kept and policy advice was wrong. If South Africa had frozen profits on apartheid-era investments and simply repudiated the odious apartheid debt – or even if it had demanded a ten year moratorium – it would have been \$10 billion better off. Foreign aid during this period was only \$1.1 billion, so even if aid had been cut off, South Africa would have profited by \$8.9 billion.”

Meanwhile, on 12 November 2002, a suit was filed in the New York Eastern District Court for apartheid reparations against eight banks and 12 oil, transport, communications technology and armaments companies from Germany, Switzerland, Britain, the United States, the Netherlands and France. The suit was filed on behalf of the Khulumani Support Group, representing 32,000 individual “victims of state-sanctioned torture, murder, rape, arbitrary detention and inhumane

treatment”, by the Apartheid Debt and Reparations Campaign of Jubilee South Africa.<sup>9</sup> The suit was brought pursuant to the Alien Torts Claims Act (ATCA) which allows any non-United States citizen to bring a claim for damages against any other person who has violated customary international law.

The Government of South Africa continues to distance itself from the popular movement to cancel the apartheid debt. For example, its top ministers denounced the lawsuit seeking reparations from banks that loaned to the apartheid regime because “we are talking to those very companies named on the lawsuits about investing in post-apartheid South Africa.”<sup>10</sup>

Others argue that the United Nations Security Council should have gone farther in 1985 and declared that “it would not consider debt incurred by the apartheid Government as a legitimate obligation of any successor Government” (Jayachandran and Kremer, 2005). The private banks would not have been willing to make the loans that effectively kept South Africa afloat for a few more years. Similar action could have been taken after major shareholders forced the International Monetary Fund to cut all lending to the former President of Croatia, Franjo Tudjman, in 1997, after he was accused of resorting to political violence and appropriating public funds. However, in the absence of international action at the level of the United Nations Security Council, private commercial banks continued to lend Croatia a further \$2 billion until Tudjman’s death in 1999.

### **Arbitrations concerning Iranian debts owed to the United States**

These claims dated back to 1982, whereby the United States claimed to be owed a substantial amount of money pursuant to a contract dated 1948 relating to the purchase by Iran of certain World War II surplus military property. Among other things, the Islamic Republic of Iran denied any liability, claiming that the debts were odious debts. According to the Islamic Republic of Iran, the contracts were imposed by the United States and were “subjugation debts” of the prior regime. As such, they are “not transferable to the Islamic Republic of Iran”.<sup>11</sup> In concluding that the Government of the Islamic Republic of Iran could not invoke the “rule of odious debts”, the Iran–United States Claims Tribunal held that the original contract was not imposed on Iran. The Tribunal stated as follows:

“50. In particular, it is not possible to establish any connection between the Contract and the crisis in Iran that led to the Islamic Republic of Iran in 1979. The Contract did not and in fact could not, in any respect detract from or undermine the new Constitution, the social order and the form of government of Iran as created in and after 1979. Also, the time gap is too considerable to allow for any such hypothesis.

“51. The Tribunal is of the opinion that the debt under the 1948 Contract cannot be classified under the notion of ‘odious debts’ as understood in international law. They were not contracted with a view to attaining objectives contrary to the

<sup>9</sup> <http://www.cmht.com/casewatch/humanrights/aprtheid/html>. See also *About Africa Action*, Africa Policy E-Journal, November 12, 2002 and other issues.

<sup>10</sup> “South Africa Shuns Apartheid Lawsuits”, *Guardian*, November 27, 2002.

<sup>11</sup> *The United States of America v. The Islamic Republic of Iran* (Case No. B36), Award No. 574-B36-2, 3 December 1996), 32 Iran-United States C.T.R. 162 (1996):175–176.

legitimate interests of Iran nor were they contracted with an aim and for a purpose not in conformity with international law”<sup>12</sup>.

The Tribunal was careful, however, to state that it was not taking any position on the status of the doctrinal debate over the concept of “odious debts” in international law:

“In any event, the Tribunal will limit itself to stating that the said concept belongs to the realm of law of state succession. That law does not find application to the events in Iran. The revolutionary changes in Iran fall under the heading of state continuity, not state succession. This statement does not exclude a realist approach that recognizes that in practice the border between the concepts of continuity and succession is not always rigid.<sup>13</sup> In spite of the change in head of State and the system of government in 1979, Iran remained the same subject of international law as before the Islamic Revolution. For when a Government is removed through a revolution, the State, as an international person, remains unchanged and the new Government generally assumes all the previous international rights and obligations of the State”.<sup>14</sup>

### **Iraqi debt**

Prior to the overthrow of the Government of Saddam Hussein, Iraq accumulated over \$125 billion of unpaid debts. Several commentators have argued that since the debts were generated as a result of financing a dictatorship and military aggression (Adams 2004), they should be classified as odious and held to be unenforceable. Furthermore, a United States congressional initiative was introduced, following the overthrow of the Iraqi regime in 2003 to eliminate Iraqi odious debt. The bill was based on the notion that such debt not only impedes a successful rebuilding of post-authoritarian States, but that the debts were never legitimate inheritances of the new Government due to the doctrine of odious debts (Jayachandran and Kremer, 2005). Senior officials of the United States Government have, on some occasions, evoked considerations of “odiousness” in arguing for the cancellation of Iraqi debt. Then Treasury Secretary John Snow referred to the notion that “the people of Iraq should not be saddled with those debts incurred through the regime of a dictator who has now gone.”<sup>15</sup> Undersecretary of Defense Paul Wolfowitz emphasized in testimony before the Senate Armed Services Committee that much of the money borrowed by the Iraqi regime had been used “to buy weapons and to build palaces and to build instruments of oppression.”<sup>16</sup> Eventually, Iraqi debt relief was granted not with references to its legitimacy but instead for reasons of “debt sustainability”.

Buchheit et al. (2006) criticize what they term an overly enthusiastic and indiscriminate application of the odious debt doctrine post-Iraq, and argue that commentators have gone far beyond Sack’s original loan-by-loan analysis, and are now simplistically content to label a regime

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<sup>12</sup> *Ibid.* The tribunal cited the definition of “odious debts” by Mohammed Bedjaoui, *Ninth Report on Succession of States in respect of matters other than treaties*, United Nations Doc. A/CN.4/301 and Add. 1, paras. pp. 117–140, (1977) I.L.C. Yearbook, Vol. II, Part One, 45, pp. 67–70.

<sup>13</sup> *Ibid.*, citing Ian Brownlie, *Principles of Public International Law*, pp. 82–85, (4<sup>th</sup> ed., 1990).

<sup>14</sup> *Ibid.*, p. 176, para. 54.

<sup>15</sup> Quoted in Joshua Craze, “Jubilee Iraq,” the LIP Magazine, available online at <http://www.thelip.org/?p=93>.

<sup>16</sup> Quoted in Nile Gardiner and Mark Miles, “Forgive the Iraqi Debt,” Executive Memorandum #871, Heritage Foundation, April 30 2003, available at <http://www.heritage.org/Research/TradeandForeignAid/em871.cfm>.

“odious” and thereafter qualify all debt regardless of its provenance or use as “odious debt” (Buchheit et al., 2006: 22). These experts argue that successor global regimes should rely only on municipal courts of law to invalidate infamous debts of their predecessors on a case-by-case basis. Indeed, the Iraqi case could be seen as an example of a transitional situation (which continues to transition four years after the change of regime), in which invoking considerations of odiousness might make the task of obtaining relief more difficult or slower than the use of more evident and easily applicable criteria of economic sustainability.

### **Norway’s ship export debt**

After an evaluation, the Government of Norway in 2006 determined that obligations arising out of lending to certain developing countries as part of the Ship Export Campaign of 1976–1980, and guaranteed through the Norwegian Institute for Export Credits, should be cancelled on grounds that Norway ought to share responsibility with the debtor countries for the failure of the programme as a development policy, given what were determined to be inadequate needs analyses and risk assessments. This is not an example of “odious debt” and indeed the Government stressed that the debt was not “illegitimate”. But the notion of co-responsibility exemplified by the unilateral and unconditional cancellation of these debts on 2 March 2007 does reflect the idea that repayment may be subject to broader considerations of the equities of the debtor–creditor relationship.

## **V. SELECTED ISSUES IN THE APPLICATION OF THE ODIUS DEBT CONCEPT**

### **State succession versus government succession**

The original context in which the issue of odiousness of debt became salient was that of state succession, i.e. where the international legal personality of the State that contracted the debt has been eliminated or transformed.<sup>17</sup> It is fairly obvious that in cases of state succession, the issue of the future of debt obligations *must* be addressed, since the debtor as a legal person has ceased to exist. The fact that this has been the predominant traditional context in which the odiousness of debt has arisen as an issue has been interpreted in some instances as suggesting that the doctrine of odious debt applies *only* in cases of state succession and not other kinds of political transition, such as regime change. This was the assumption of the Iran Claims Tribunal, as noted above. However, strictly speaking, the Iran Claims Tribunal’s remark may be viewed as *dicta* since the Tribunal explicitly stated that it was not going to pronounce on the odious debt doctrine as a matter of law. Both O’Connell and Brownlie challenge the assumption that the odious debt doctrine is limited to state succession (Khalfan et al., 2003: 47). King points to the Tinoco arbitration as clearly establishing that the distinction between state succession and government succession should not be fatal to the odious debt doctrine, while Frankenberg et al. also note that the distinction is incongruous (Frankenberg and Knieper: 432).

Although state succession and regime change raise different issues from the perspective of international legal personality, these differences nevertheless do not lessen the extent to which there are common normative challenges of transitional justice (Teitel *Transitional Justice, supra*). As discussed above, part of the confusion concerning the application of the odious debt doctrine to government succession arises from the way that some Governments have disclaimed debt they

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<sup>17</sup> An example of State succession would be the dissolution of the former Yugoslavia or Soviet Union and the establishment of several new States on the same territory.

considered odious on the purported legal ground that government succession eliminates the obligation to repay. This is contrary to the default rule of continuity of legal obligations in government succession. But it does not follow that the rejection of such claims by the international community is a rejection of odiousness of debt as a basis for non-enforcement. It is instead a rejection of government succession *per se* or *in itself* as a basis for discharge of the obligation to repay. For example, the notion that a political revolution necessarily discharges the obligation to repay debt incurred by the previous regime has sometimes been advanced after regime change. Such a notion is certainly far too broad and in tension with the current *default* rule in international law that government succession does not alter or eliminate a State's international obligations, i.e. government change does not change international legal personality.

However, as a *default* rule, this doctrine is entirely consistent with the notion that considerations of odiousness of debt may affect the obligation to repay after a political transition that does not entail state succession. According to one expert, "When Chief Justice William Taft sat as arbitrator in *Great Britain v. Costa Rica* ...he could not rely on the doctrine of odious debt because Costa Rica did not undergo state succession. Instead, Taft confirmed the international rule in existence at that time that government succession does not terminate preexisting state debts because the identity of the State is unchanged" (Cheng, 2007: 20–21).<sup>18</sup> On the other hand, Taft's opinion could be interpreted differently: it was precisely *because* the default rule was that government succession does not terminate preexisting state debts that Taft went on to consider whether, despite that default rule, odiousness might nevertheless be a basis for non-enforcement; and Taft's answer was yes.

### **Creditor knowledge of odiousness**

In recent articulations of the concept of odious debt, one of the conditions for the characterization of debt as odious and eligible for repudiation is that the creditor at the time at which the loan contract was made knew, or should have known, that the debt was odious, i.e. that the funds were intended for a purpose contrary to the interests of the population. Proving subjective knowledge of this kind is in many instances a difficult proposition, although in some cases the likelihood of such knowledge is virtually obvious (Tinoco). Short of actual subjective knowledge, the notion that the lender ought to have known the intent of the debtor raises the issue of the nature and extent of the burden imposed on creditors to take positive steps to inform themselves of the purposes of the loan, and to assess the credibility of assertions of borrower state officials in that respect.

There are no obvious international legal rules that establish an appropriate standard for creditor behaviour in this respect: however, as noted in chapter III of this study, the general principles of law of "civilized nations" are a valid source of international law, and are drawn from the common repository of the world's main legal systems. Along these lines, notions of responsibility in contractual negotiations from domestic legal contexts may acquire the status of general principles and fill the gap in international legal material.

For example, in some domestic legal systems and in some circumstances, agency law places a duty of diligence on a third party or creditor in ascertaining whether an agent (the debtor State) is exceeding its authority. This agent only has authority to act for the benefit of his principal (the population) to which it owes a fiduciary duty.<sup>19</sup> The very power of making binding commitments

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<sup>18</sup> This case (the Tinoco arbitration) is discussed above in some detail.

<sup>19</sup> Buchheit et al. (2006) citing ReStatement (Second) of Agency para 312, and (Third) Draft No.4 (2003) 215.

on behalf of another is considered to carry with it special responsibility for acting in the interests of that person.

Based on the agency concept, a regime's reputation for exploiting and oppressing its own people may place on the lender a higher burden to satisfy itself that the proceeds of the borrowing are benefiting the principal (the country) and not just the agent. The legal analysis allowing for the piercing of the corporate veil on situations of abuse by a controlling shareholder, can also be adapted to the legal analysis of sovereign States. A court may be able to fashion a remedy to allow a creditor to recover from an abusing shareholder in the corporate context, or a State to avoid debts contracted by a collusive lender and corrupt government officials in the sovereign context.

Even if a loan is assigned to a third party who had no knowledge of, for example, corruption or bribery contrary to the United States Foreign Corrupt Practices Act 1977, the law relating to the assignment of contractual rights provides that the borrower can raise the same defences against the assignee. The assignee never gets a better right than the assignor had.

In general, the domestic law of contract may provide ample room for a judge or adjudicator to balance the equities in a case involving illegal behavior of one or more of the parties to the transaction. Examples include applying the principle of unjust enrichment (one cannot receive a benefit at another's expense without conferring a reciprocal benefit), abuse of rights<sup>20</sup> (one cannot exercise one's rights in an excessive or abusive manner, such that it harms the rights of others), restitution, etc.

Note that the domestic law principle of *in pari delicto* will also be applied to a plaintiff complaining of illegal conduct who does not have clean hands. In *Adler v. Federal Republic of Nigeria*,<sup>21</sup> the plaintiff was barred from recovering any of the money lost in a financial scam, even though the court acknowledged the fraud and that the criminals would receive a windfall. The Ninth Circuit stated that: "[P]ublic policy favors discouraging frauds such as the one perpetrated on Adler, but it also favors discouraging individuals such as Adler from voluntarily participating in such schemes and paying bribes to bring them to fruition".<sup>22</sup> Domestic private law systems may also be a source of principles where there is subjective awareness of creditors (Khalfan et al., 2003). The standard can be actual guiding knowledge, willfully ignoring the obvious, and willfully and recklessly failing to make such inquiries as an honest and reasonable person would make.

### **The fungibility of debt**

The concept of odious debt, where applied on a case-by-case or loan-by-loan basis, depends on the notion that a particular loan was used for a purpose contrary to the interests of the people of the sovereign in question. However, it is clearly arguable that loans that are used for a non-odious purpose may indirectly contribute to odious purposes, in that the sovereign is enabled to free other funds that would otherwise be needed for non-odious purposes and put them to odious purposes. There is thus a conceptual argument for declaring "odious" a proportion of *all* loans to an oppressive regime that was spending money on odious purposes, whether or not a connection can be established between any particular loan and an odious purpose. Such an approach almost necessarily implies a political action, either unilateral or negotiated, rather than a case-by-case

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<sup>20</sup> There is some authority for the notion that abuse of rights is a general principle of law.

<sup>21</sup> 219 F.3d 869 (9<sup>th</sup> Cir. 2000).

<sup>22</sup> *Ibid.*, p.877.



litigation of individual loan contracts. Moreover, whether, in the absence of the loan(s) in question, an oppressive regime would have chosen to spend other available funds on non-odious rather than odious purposes is, of course, a counterfactual that is very difficult to prove as a fact in a litigation context. Oppressive regimes often will avoid what would appear to be even the most essential spending on legitimate public purposes in order to deploy funds to oppressive goals or purposes contrary to international law.

### **State-to-state debt vs. state debt to private creditors**

The odious debt concept has emerged primarily as a limitation on the international law obligation of maintenance of debt obligations in the case of State, arguably also, government succession. As noted in chapter III above, there is no comparable general international law obligation to maintain debt obligations to private creditors in the case of such political transitions, simply because performance of contracts with aliens who are private parties is not an international law obligation as such (Reinisch, 1995). Nevertheless, there are some situations where the repudiation of contractual obligations to private creditors may constitute a violation of international law. These could include situations where the repudiation of obligations under a loan contract is analogous to expropriation of property, or where the repudiation is discriminatory or arbitrary (*ibid.*: 93). It has also been argued that, where the repudiating State gains a genuine benefit from the funds in question, an internationally wrongful unjust enrichment may be present. This is based on the notion that restitution for unjust enrichment has become a general principle of law (Meron, 1957: 277).

As the Tinoco arbitration illustrates, the equitable considerations underlying the concept of odious debt can constitute a powerful defense against claims that failure to honour the contractual rights of an alien violates the minimum standard of treatment in the customary international law of state responsibility for protection of aliens (which includes the notion that treatment of aliens not be a “denial of justice”). Also, the equitable considerations underpinning the concept of odious debt are an obvious answer to a claim of unjust enrichment, i.e. one of the essential elements of the odious debt concept is that the successor regime is *not* enriched unjustly by the funds in question, since they have been dissipated on purposes actually harmful to the interests of the people, or the successor regime itself. As the Iran Claims Tribunal noted in *Flexi-Van Leasing Inc. v. Iran*,<sup>23</sup> “It is inherent in the principle of unjust enrichment that there must have been an enrichment of one party to the detriment of the other. Where there is no ‘beneficial gain’ to the party allegedly enriched, the remedy of unjust enrichment is not available.”

While considerations of odiousness may affect claims that non-repayment of debt to private creditors constitute a violation of *international law*, it is a separate question whether considerations of odiousness might affect the obligations of debtor States to private creditors under domestic private law. This is usually specified as the law of the contract in the case of state contracts with private creditors. In this respect, it is worth noting the widespread concept of contract law that invalidates a contract for an illegal purpose, even where such invalidity would leave the party proposing the illegal purpose personally enriched.

Of significance here is the United States case of *Adler v. Federal Republic of Nigeria*, discussed above in connection with the issue of determining creditor knowledge of odiousness. In *Adler*, the United States Court of Appeals for the Third Circuit dismissed the action of a United States citizen seeking to recover monies spent (purportedly) to advance an undertaking with the purpose of fraudulently extracting public funds in Nigeria through the collusion of corrupt officials. The

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<sup>23</sup> 12 Iran-U.S. C.T.R., 335, 352.

appeals court held that the contractual claim must be dismissed on the grounds of “unclean hands” on the part of the plaintiffs. It found that it was not necessary for the plaintiffs to have actively devised or proposed the illegal purpose, but only that they voluntarily participated in it. Moreover, it was irrelevant that the defendants were more at fault than the plaintiffs. In this particular case, the court pointed to the illegality of the contract in the United States where the plaintiff was seeking relief, citing United States anti-corruption laws. However, the contract was also illegal in its purpose under the laws of Nigeria. There is obviously considerable overlap between some of the elements of “odiousness” and the closely related notions of “clean hands” and the defense of illegality in contract law. Many odious purposes might even be illegal under the law prevailing at the time in the oppressive regime in question. For example, South African human rights abuses were conducted through deviation from the formal law existing in the regime. Moreover, they may be illegal and contrary to public in the forum State where the creditor is seeking to enforce the contract.

### ***Ex ante* designation of debt as odious**

As noted, one of the major policy concerns that has deterred some transitional regimes from repudiating “odious” debt from the previous regime is that of reputation in the capital markets; a transitional regime may be concerned that creditors will not in the future provide access to funds, because they are unable to distinguish the exceptional political decision to repudiate debt due to its odiousness from the general creditworthiness of the regime. Whether this is empirically true or not, it does appear to influence decision-making of transitional regimes (e.g. South Africa). Kremer and Jayachandran have argued that one way of addressing this problem would be to have some international institution declare *ex ante* that a regime is odious; in order to lend to such a regime, a creditor would then have to exercise due diligence to ensure that the funds were applied to legitimate, non-odious purposes, in order to avoid the possibility of a successor regime repudiating the debt as odious (Kremer and Jayachandran, 2002; Jayachandran et al., 2005). This approach would have the advantage of deterring lending to odious regimes in the first place as well as giving a transitional regime a kind of “cover” for repudiating the debt, since the creditor would have known *ex ante* that it could not be expected to be repaid by that new regime. Kremer and Jayachandran consider different possible types of institution, including a council of independent jurists, the United Nations Security Council and even a major non-governmental organization such as Transparency International.

As a matter of political feasibility, it is to be doubted whether consensus in the international community could easily be achieved to transfer to any new body the power to make such sensitive judgments concerning the nature of a particular *existing* regime and its capacity to participate in international economic relations. But within certain limits, the Security Council could now under the Charter of the United Nations arguably make such judgments, provided that the odiousness of the regime had effects on international peace and security, which is the key area of competence of the Security Council.<sup>24</sup> Within the Security Council, it is difficult to believe, based on past and indeed current experience, that the members’ strategic and economic interests in the relation to the regime in question would not affect their willingness to declare it “odious.”

One criterion that Kremer and Jayachandran suggest for “odiousness” is whether a regime is democratic. The most clear-cut case would be a military coup that replaces a democracy with an authoritarian regime: debt incurred by the new regime that is not used to benefit the people would be declared odious. In many other situations, however, the democracy criterion could lead to

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<sup>24</sup> Thus, the action of the Security Council in relation to apartheid was linked to the threat to regional security that was created by the pursuit of this policy within South Africa.

uncertainty and opportunistic behavior when applied *ex ante*: for instance, in situations where an incumbent elected Government planned to rig elections or suspend democracy, it would simply have incentives to hide such an intent, borrowing as much as possible before the “odiousness” of the regime became apparent and was declared. Moreover, as a general matter, a regime in power has many means available to it to conceal information about its repressive activities and the way in which particular sources of funding are allocated to those activities: this may make the “due diligence” standard rather ineffective or difficult to apply. The possibility of an *ex ante* declaration of odiousness would further increase the regime’s incentives to hide its repressiveness. There are relatively few States today where there is no attempt at all at the appearance of democracy, i.e. no elections whatsoever. On the other hand, in the context of the new global environment, largely determined by overriding security concerns, it is not clear whether due diligence criteria would remain objective and not dictated by donor–creditor interests. Thus, *ex ante* judgments about odiousness, if based on a democracy criterion, would either have to be limited to only a small subset of all situations that are blatantly oppressive or more subtle judgments about the fairness of elections and related practices would need to be made. This is not to argue that such judgments could not be principled and objective, but only that building consensus in international institutions may be very difficult.

## **VI. CONCLUSION: POLICY AND LEGAL IMPLICATIONS OF THE INVOCATION OF THE ODIUS DEBT CONCEPT IN TRANSITIONAL CONTEXTS**

It is well established in international law that a political transition, even from an oppressive regime to a popularly legitimized one, does not *in itself* break the continuity of state-to-state debt obligations, even where the transition involves state succession.

At the same time, state practice, the rulings of international tribunals and the writings of most academic authorities reflect acceptance of some equitable limits to the sanctity of state-to-state debt agreements. The international law obligation to repay debt has never been accepted as absolute, and has frequently been limited or qualified by a range of equitable considerations, some of which may be regrouped under the concept of “odiousness”. This is consistent with the accepted view that equity constitutes part of the content of “the general principles of law of civilized nations,” one of the fundamental sources of international law stipulated in the Statute of the International Court of Justice.

The concept of “odious debt” regroups a particular set of equitable considerations that have often been raised to adjust or sever debt obligations in the context of political transitions. A survey of such transitional situations in the past or present indicates that the way in which the “odiousness” is argued as a ground for limiting obligations, which varies from one transitional context to another, and may differ depending on whether the transition involved, is for instance a secession, whether it arises from war or decolonization or simply a political revolution.

In a number of the situations in question, tribunals or other States have rejected or questioned claims to adjust or sever debt obligations based on considerations of “odiousness.” However, this has usually been because of doubts on the facts as to whether the debt in question was “odious” or actually conferred some benefits on the population or the new regime. In none of these situations was a claim of odious debt rejected on grounds that international law simply does not countenance alteration in state-to-state debt obligations based on any equitable considerations whatever. In some situations, the debtor State made overly broad claims to repudiation of debt obligations (the case of attempted Soviet repudiation of Tsarist debts and more recently the

Islamic Republic of Iran's attempted repudiation of pre-revolutionary debts before the Iran Claims Tribunal).

Political transitions pose complex, multi-faceted challenges for the transitional regime, from accountability for wrongs of the past, to establishing a framework of legal stability and economic reconstruction. Dealing with odious debt from the prior regime usually involves political as well as legal considerations. Even where a strong legal argument exists for repudiation of some or all debt based on considerations of odiousness, a transitional regime may well prefer to negotiate a voluntary adjustment in obligations with its creditors or even to continue to repay the debt. South Africa is a case in point. Such decisions do not detract from the availability of considerations of odiousness as a legal basis for alteration of debt obligations, but rather simply testify that transitional justice is political, and not just legal.

The complexity and variety of transitional contexts further suggests that there is no single obvious legal forum for the adjudication or settlement of claims of odiousness. Depending on context, such claims might appropriately be raised in bilateral or multilateral negotiations on debt relief, or they could be adjudicated in the context of arbitration or domestic litigation. State-to-state debt contracts may specify a forum for the settlement of disputes. However, invocation of the concept of odious debt in multiple forums in respect of diverse debt contracts involving the same debtor State risks inconsistent decisions. Here, the examination of considerations of odiousness by a single special transitional tribunal seized with all the claims related to the political transition in question may be an attractive solution. The interests of consistency and predictability would argue in favor of the debtor State and its creditor States agreeing on the jurisdiction of such a single tribunal and perhaps also the range of equitable considerations, including "odiousness", that it is to apply.

With respect to obligations of debtor States to private, i.e. non-state, creditors, there is no established rule of international law that requires that these be continued in the case of political transition. Only where changes in contractual rights amount to a denial of justice or otherwise fall short of the minimum standard of treatment of aliens in customary international law, or where these changes can be characterized as an expropriation of property rights or unjust enrichment, can any claim be established against the debtor State in international law. Where odiousness can be established, it would be very difficult for a private creditor or a State espousing its claim to argue successfully that the alteration of contractual rights is a denial of justice. Nor could the alteration of contractual rights be considered fundamentally unfair or discriminatory and thereby a violation the customary international law standard of treatment for aliens.<sup>25</sup> At the same time, most debt contracts between States and private creditors are governed by the domestic private law specified in the contract. The legal systems of these jurisdictions may well have concepts such as "clean hands" or the notion that contracts related to illegal purposes are invalid. These concepts overlap with elements of the notion of "odiousness" as a basis for invalidating debt obligations. Investor/state arbitration tribunals, for example, have been comfortable taking into account such considerations in determining whether repudiation of contractual obligations to an investor by the host State is consistent with international law. This suggests that such concepts may indeed form part of the content of equity as "a general principle of law of civilized nations", especially if widely shared among different legal systems.

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<sup>25</sup> Nor could it be claimed that an unjust enrichment occurred, since a key aspect of odiousness is the notion that the population of the debtor State did *not* benefit from the loan.

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