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Contract, Priority, and Odious Debt

Adam Feibelman

CONTRACT, PRIORITY, AND ODIOUS DEBT*

ADAM FEIBELMAN**

This Article proposes that sovereign nations and their creditors adopt a contractual approach to the seemingly intractable problem of odious debt. Odious debt is generally defined as an obligation incurred by a despotic or illegitimate leader that provides no value to the population of the sovereign. In recent years, spurred primarily by the financial problems of post-Hussein Iraq, many writers and commentators have proposed doctrinal and institutional mechanisms that would provide odious debt relief. These proposals all face practical challenges, and they would likely involve significant risk of destabilizing financial markets. Under a contractual approach, a majority or supermajority of a sovereign's creditors would have the power to identify odious obligations of the sovereign. The sovereign would then be obligated to repudiate these debts. Creditors should have good incentives to employ this arrangement discriminately. More than any other relevant actors, creditors will internalize the costs and benefits of odious debt relief. Even if the private benefits of contractual odious debt arrangements are modest, they might create significant positive externalities. If so, academics, official actors, and policy advocates should encourage sovereigns and their creditors to adopt such arrangements.

** Associate Professor of Law, University of North Carolina at Chapel Hill. Thanks to Douglas Baird, Scott Baker, Stephanie Bonilla, Lee Buchheit, Adrienne Davis, Anna Gelpern, Mitu Gulati, Barry Herman, Melissa Jacoby, Jeff King, Hiroshi Motomura, Richard Myers, Rafael Pardo, Eric Posner, Robert Rasmussen, Steven Schwarcz, David Skeel, Paul Stephan, Michael Waibel, Mark Weisburd, Deborah Weissman, Steven Willborn, Ingrid Wuerth, participants in Duke Law School's law & finance workshop, and participants in workshops at the University of North Carolina School of Law, the University of Cincinnati College of Law, and the 2006 annual meeting of the Southeastern Association of Law Schools. All errors are my own.

INTRODUCTION

This Article proposes that sovereign nations and their creditors adopt a contractual approach to the seemingly intractable problem of odious debt. Generally speaking, "odious debt" is an obligation incurred in the name of a sovereign nation by a despotic or illegitimate government, the proceeds of which only enrich the despot or fund the repression of his or her subjects. Most writers on the topic agree that such obligations violate principles of justice or reduce social welfare or both; citizens of a sovereign debtor should, ideally, not be bound to repay odious debt incurred by their leaders.[1] Despite

1. There is a sizeable and growing body of scholarship on the topic of odious debt, including Omri Ben-Shahar & Mitu Gulati, *Partially Odious Debts? A Framework for an Optimal Liability Regime*, LAW & CONTEMP. PROBS. (forthcoming 2007) (on file with the North Carolina Law Review); Patrick Bolton & David Skeel, *Odious Debts or Odious Regimes?*, LAW & CONTEMP. PROBS. (forthcoming 2007) (on file with the North Carolina Law Review); Lee C. Buchheit et al., *The Dilemma of Odious Debts*, 56 DUKE L.J. (forthcoming 2007) (on file with the North Carolina Law Review); Anupam Chander, *Odious Securitization*, 53 EMORY L.J. 923 (2004); Anna Gelpern, *Odious, Not Debt*, LAW & CONTEMP. PROBS. (forthcoming 2007) (on file with the North Carolina Law Review) [hereinafter Gelpern, *Odious, Not Debt*]; Anna Gelpern, *What Iraq and Argentina Might Learn from Each Other*, 6 CHI. J. INT'L L. 391 (2005) [hereinafter Gelpern, *Iraq and Argentina*]; Michael Kremer & Seema Jayachandran, *Odious Debt*, 96 AM. ECON. REV. 82 (2006); Christoph G. Paulus, *"Odious Debts" vs. Debt Trap: A Realistic Help?*, 31 BROOK. J. INT'L L. 83 (2005); Jedediah Purdy & Kimberly Fielding, *Sovereigns, Trustees, Guardians: Private-Law Concepts and the Limits of Legitimate State Power*, LAW & CONTEMP. PROBS. (forthcoming 2007) (on file with the North Carolina Law Review); Paul B. Stephan, *The Institutionalist Implications of an Odious Debt Doctrine*, LAW & CONTEMP. PROBS. (forthcoming 2007) (on file with the North Carolina Law Review); Raghuram Rajan, *Odious or Just Malodorous?*, FIN. & DEV., Dec. 2004, at 54; Joseph Stiglitz, *Odious Rulers, Odious Debts*, ATLANTIC MONTHLY, Nov. 2003, at 39; James Feinerman, *Odious Debts: Old and New* (Georgetown Univ. Law Ctr. Working Paper, 2004); Ashfaq Khalfan, Jeff King & Bryan Thomas, *Advancing the Odious Debt Doctrine*

this wide agreement, however, sovereigns generally do not repudiate obligations on the ground that the debt is odious or that it is otherwise inequitable.[2] This is true despite the fact that sovereigns have the ability to thwart enforcement of their obligations if they choose; creditors have no reliable way to reach a sovereign's assets without the sovereign's cooperation.[3] The conventional explanation for this behavior is that sovereigns are restrained from doing so by fear that they will suffer reputational harm or fear that they will be penalized by other countries and international institutions.[4]

The recent transition of regimes in Iraq has unleashed a wave of interest in the possibility of repudiating sovereign debt on equitable grounds. In the wake of the recent war, a variety of commentators, scholars, and policymakers proposed that the new Iraqi regime should repudiate as odious some or all of the debts it inherited from Saddam Hussein's regime.[5] As explained in Part I below, some of these individuals and organizations argued that international law recognizes a doctrine of odious debt.[6] Such a doctrine would provide a defense if a sovereign's creditors attempt to enforce debts that did not provide a benefit to the sovereign's citizens and that were incurred without the citizens' consent. It is not clear, however, whether such a doctrine is in fact part of international law. Furthermore, if it is a viable doctrine in any context, there is serious doubt as to whether it applies in cases of government succession. Given the frailty of this "traditional" odious debt doctrine,[7] various commentators have proposed doctrinal and institutional alternatives.[8] For example, some writers have suggested that sovereigns might challenge enforcement of their obligations in domestic courts pursuant to domestic legal doctrines drawn from private law and corporate law.

Yet another strand of recent commentary and scholarship has considered alternative institutional mechanisms that would enable

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(Ctr. for Int'l Sustainable Dev. Law, Working Paper No. COM/RES/ESJ, 2003), *available at* http://www.cisdl.org/pdf/debtentire.pdf; Patricia Adams, *Iraq's Odious Debts* (Cato Inst. Policy Analysis, No. 526, 2004), *available at* http://www.cato.org/pubs/pas/pa526.pdf.

2. *See infra* notes 22–23 and accompanying text.
3. *See infra* note 94 and accompanying text.
4. *See infra* notes 22–23 and accompanying text.
5. *See infra* note 21 and accompanying text.
6. *See infra* Part I.A. Claims that such a doctrine exists apparently originated in 1927 with the work of Alexander N. Sack. *See* Alexander N. Sack, *Les Effets des Transformations des Etat sur Leurs Dettes Publiques et Autres Obligations Financieres*, *translated in* PATRICIA ADAMS, ODIOUS DEBTS: LOOSE LENDING, CORRUPTION, AND THE THIRD WORLD'S ENVIRONMENTAL LEGACY 164 (1991).
7. *See infra* Part I.A.
8. *See infra* Part I.B.

sovereigns to repudiate odious obligations. For example, a vocal group of writers and advocates proposed creating a tribunal that would have resolved odious debt claims against Iraq's creditors.[9] They proposed that the tribunal be modeled on the U.S.-Iran tribunal and that it employ the doctrine of odious debt noted above.[10] This proposal may now be moot with respect to Iraq, but it provides a general model for a potential odious debt mechanism. Perhaps most ambitiously, Michael Kremer and Seema Jayachandran have proposed an odious debt tribunal or institution that would identify and designate odious regimes, as opposed to odious debts, and do so ex ante.[11] Initially, they proposed that the primary aim of such an institution would be to impose loan embargoes on regimes designated as odious; in a subsequent paper, they have proposed that the institution should aim instead to severely limit lending to these regimes.[12]

This Article represents the first effort to propose and defend a private, contractual approach to the odious debt problem. To adopt a contractual odious debt mechanism, a sovereign would promise its voluntary creditors at the contracting stage that it will not incur odious debt and that it will repudiate or subordinate[13] any of its obligations designated as odious ex post. Incurring odious debt would be an event of default by the sovereign. The sovereign would

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9. The group, Jubilee Iraq, described itself as "a network of groups and individuals (business people, lawyers, economists, politicians, aid workers and others) working to ensure that the Iraqi people—emerging from decades of war, oppression and sanctions—are not unjustly forced to pay Saddam's bills." *See* Jubilee Iraq, About Us, http://www.jubileeiraq.org/aboutus.htm (last visited Feb. 18, 2007). This proposal is discussed at length *infra* in notes 72–80 and accompanying text.

10. *See infra* note 74 and accompanying text.

11. *See* Kremer & Jayachandran, *supra* note 1, at 90. This proposal is discussed at length *infra* in notes 81–88 and accompanying text.

12. *See* Seema Jayachandran et al., Applying the Odious Debts Doctrine While Preserving Legitimate Lending 13 (June 2006) (unpublished manuscript, on file with the North Carolina Law Review).

13. This agreement could provide for repudiation of odious debt or subordination of such debt or both. Repudiation of odious debts would ensure that holders of these debts collect nothing regardless of how other creditors are treated. Subordinating the debt in the traditional sense would result in those creditors receiving nothing unless all non-odious debts were paid in full. To the extent of any conflict between odious and non-odious creditors over a claim to a debtor's assets, the non-odious creditors would prevail under either approach. Thus, for example, in any restructuring where non-odious debts would take a loss, and where this priority is respected, the practical effect on odious debts would be the same—their interests would effectively be eliminated. To make the arguments of this Article easier to state, unless otherwise clear in the text, the term "repudiation" is used hereafter to refer to any scheme that subordinates or discharges sovereign obligations.

also promise each creditor that it will inform subsequent creditors of the contractual arrangement and that it will make similar agreements with these creditors. The parties would give a majority or supermajority of the sovereign's creditors authority to designate obligations as odious pursuant to a contractual definition. The sovereign would then be obligated to repudiate debts designated as odious by the creditors. Ideally, the contractual definition of odiousness should be tied to the actual use of the funds obtained by the sovereign. It should also include safe harbors designed to promote effective monitoring by creditors.

Any strategy for discharging odious debt must be carefully circumscribed to assure future lenders that sovereign debtors will not arbitrarily repudiate their obligations. A successful mechanism must distinguish, as clearly and predictably as possible, between debt that the sovereign is expected to repay and odious debt subject to repudiation. If the standard for odiousness is relatively clear and enforcement is predictable, creditors will be able to anticipate the risk of repudiation or subordination on that ground. It will effectively segment the market for sovereign debt, creating a kind of priority scheme, giving priority to non-odious debt.[14] Sovereigns that want to raise funds for legitimate purposes should then be able to incur non-odious debt at lower rates compared to potentially odious debt. Increasing the cost of borrowing potentially odious debt should reduce the amount of odious debt incurred by sovereigns. If the markets for odious and non-odious debt can be segmented in this way, it may enable sovereigns to repudiate odious debt and avoid being punished by market actors or the official sector.

A contractual odious debt arrangement is more likely than other mechanisms to enable repudiation of odious debt while maintaining the stability of the market for sovereign debt.[15] As explained in Part III, there are good reasons to allocate to creditors at least part of the authority to define odious debt, identify particular debts that meet the definition, and enforce the repudiation of those debts. More than any other actors, creditors will internalize the costs and benefits of any odious debt mechanism. They benefit most clearly when their sovereign debtors avoid incurring or repudiate obligations that would

14. If odious debt is subordinated to non-odious debt, then there is priority between the two in the conventional sense. If odious debt can be repudiated or discharged, then non-odious debt still has priority, though in a less conventional sense. In the broadest terms, priority is created by any factor that systematically changes the likelihood of repayment relative to other obligations.

15. *See infra* Parts III.B–C.

reduce the value of their own claims. Yet, they will bear direct costs of the mechanism because of the chance that it will be employed against them. They will also bear costs of the mechanism if it destabilizes financial markets or causes other creditors to significantly reduce the credit available to sovereigns in general. If the benefits of the mechanism outweigh these costs, creditors should have an incentive to adopt the scheme.

Sovereign debtors should also have incentives to adopt such a contractual odious debt mechanism. They will benefit from the arrangement because it will make it easier for them to obtain ex post relief from some odious debt. More important, however, it may benefit sovereigns by reducing the cost to them of incurring debt that is clearly not odious. If it makes it easier for sovereigns to credibly commit to borrowing for legitimate purposes, this should reduce their overall cost of borrowing. It follows that the mechanism will probably be most useful for relatively responsible regimes. Bad regimes will almost certainly not contract into the scheme. Still, the availability of an effective contractual mechanism may help countries that overthrow these bad regimes by making it easier for them to repudiate debts incurred by the bad regime and avoid at least some of the negative results of doing so.

To be sure, such a contractual scheme would face significant practical obstacles, especially the logistical challenges of coordinating the mechanism itself.[16] Yet, as other writers have noted in other contexts, a single debtor can coordinate a broad contractual arrangement with its various creditors.[17] A private, contractual odious debt mechanism requires coordination around only one particular issue: whether certain debts incurred by a common sovereign debtor should be repudiated as odious. The fact that market actors may be hesitant to adopt the scheme in the first place presents another obstacle. But market participants, nudged by some official-sector institutions, have increasingly embraced creditor coordination as a potential means to restructure sovereign debt instruments.[18] This development may have helped make market participants more receptive to other contract-based developments.[19]

16. *See infra* notes 102–05, 116–18 and accompanying text.

17. *See infra* notes 129–30 and accompanying text.

18. *See infra* notes 119–26 and accompanying text.

19. *See generally* Anna Gelpern & Mitu Gulati, *The Political Economy of Altering Standard Form Contracts: A Case Study*, 84 WASH. U. L. REV. (forthcoming June 2007) (manuscript at 5, on file with the North Carolina Law Review) (noting that "the apparent

Furthermore, market participants may be increasingly motivated to contract with respect to odious debt as policymakers, advocates, and sovereigns continue to debate employing other, more disruptive approaches. It is worth noting that a contractual odious debt mechanism is not necessarily exclusive of alternative approaches. Finally, if market participants are hesitant to adopt this contractual innovation, the official sector may want to prod them to do so if the contractual scheme would create significant positive externalities.

I. THE PROBLEM AND RECENT PROPOSALS

Events in the wake of the Iraq war have drawn much attention to the question of whether and when sovereigns should be able to repudiate their debts. Saddam Hussein's regime left its successor with approximately $125 billion to $150 billion in external debt.[20] Hussein apparently used much of the proceeds of this debt for his personal benefit or to finance the repression of Iraqi citizens. After his regime fell, these citizens remained indebted for the obligations he incurred. Furthermore, the weight of these Hussein-era debts made it difficult for a new Iraqi regime to begin to fund the country's post-war recovery. Various commentators—people affiliated with the American administration, for example, and other debt relief advocates—proposed that the new Iraqi regime should simply disavow obligations incurred by Saddam Hussein.[21] They argued that debts incurred by Hussein's regime were odious debts and that the new regime should not be bound to repay them.

This was a dramatic proposal. As noted above, sovereigns generally do not repudiate their obligations.[22] While they have the ability to thwart enforcement of their obligations if they choose, they do not do so for fear of immediate market-based penalties or longer-

success of the CAC campaign may have created a new model where economic policy proposals are framed in terms of private contract reform").

20. *See* Buchheit et al., *supra* note 1 (manuscript at 19); Gelpern, *Iraq and Argentina*, *supra* note 1, at 391.

21. *See* Buchheit et al., *supra* note 1 (manuscript at 18–20) (discussing the spike in interest in repudiating Iraqi debt after the fall of Hussein); Gelpern, *Iraq and Argentina*, *supra* note 1, at 403 ("Some Iraqi politicians, international NGOs, and their allies (notably including Paul Wolfowitz and Richard Perle) have argued passionately that Iraq must repudiate its debt as illegitimate because it was incurred under Saddam Hussein."); Jayachandran et al., *supra* note 12, at 6–7.

22. *See* Kremer & Jayachandran, *supra* note 1, at 86 ("The status quo of the sovereign debt market indeed seems to be that successor governments, concerned about their reputation, typically accept responsibility for debt, independent of the nature of the preceding regime.")

term damage to their reputations.[23] To be sure, sovereigns have defaulted on their obligations, or threatened to do so, throughout history.[24] When a sovereign cannot make timely payments on its obligations or determines that it has an unsustainable level of debt,[25] it may default or threaten to do so in hopes of getting some measure

23. The question of why sovereigns repay their obligations is a major theme in scholarship on sovereign debt. *See, e.g.*, William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1, 11–17 (2004) (citing Charles Lipson, *The IMF, Commercial Banks, and Third World Debts*, *in* DEBT AND THE LESS DEVELOPED COUNTRIES 317, 322–23 (Joshua D. Aronson ed., 1979)); Mitu Gulati & George Triantis, *The Economics of Creditor Control: Sovereign Versus Corporate Contracts*, 75 U. CIN. L. REV. (forthcoming 2007) (manuscript at 13–14, on file with the North Carolina Law Review); Jeffrey Sachs, *Theoretical Issues in International Borrowing*, *in* PRINCETON STUDIES IN INTERNATIONAL FINANCE NO. 54, at 23 (1984); Jonathan Eaton & Raquel Fernandez, *Sovereign Debt* 2–21 (Nat'l Bureau of Econ. Research, Working Paper No. 5131, 1995). The conventional answer to the question is that sovereigns are restrained by the fear of penalties in the form of higher interest rates or reduced access to credit in the future. *See* NOURIEL ROUBINI & BRAD SETSER, BAILOUTS OR BAIL-INS? 81 (2004); Jonathan Eaton & Mark Gersovitz, *Debt with Potential Repudiation: Theoretical and Empirical Analysis*, 48 REV. ECON. STUD. 289, 289–90 (1981); Kremer & Jayachandran, *supra* note 1, at 90; Robert K. Rasmussen, *Integrating a Theory of the State into Sovereign Debt Restructuring*, 53 EMORY L.J. 1159, 1177 (2004). Other writers suggest that sovereigns are also restrained by the threat of more immediate penalties, such as sanctions by third parties. *See* ROUBINI & SETSER, *supra*, at 81; Jeremy Bulow & Kenneth Rogoff, *A Constant Recontracting Model of Sovereign Debt*, 97 J. POL. ECON. 155, 157–58 (1989) (finding that reputational costs alone are not sufficient to give sovereigns incentives to pay); Gulati & Triantis, *supra* (manuscript at 14); Michael P. Dooley & Sujata Verma, *Rescue Packages and Output Losses Following Crises* 6 (Nat'l Bureau of Econ. Research, Working Paper No. 8315, 2001).

24. Throughout the mid-nineteenth century and the early twentieth century, various sovereigns experienced financial crises, and a significant amount of this debt was forgiven. *See* Jonathan Sedlak, Comment, *Sovereign Debt Restructuring: Statutory Reform or Contractual Solution?*, 152 U. PA. L. REV. 1483, 1489–90 (2004) (citing Peter H. Lindert & Peter J. Morton, *How Sovereign Debt Has Worked*, *in* DEVELOPING COUNTRY DEBT AND THE WORLD ECONOMY 225–26 (Jeffrey D. Sachs ed., 1989)). A financial crisis in Argentina led to the emergence of the Paris Club of creditor nations in 1956. *See* Randall Dodd, *Sovereign Debt Restructuring*, 9 FINANCIER 46, 46 (2002). Since its creation, the Paris Club has made over 350 agreements concerning the debt of over seventy-five sovereigns. *See id.*

25. A sovereign's debt load is arguably unsustainable if it is more than the sovereign can repay without overtaxing its citizens or under-consuming public goods. Stated another way, a sovereign debt load is unsustainable if it is "[in]consistent with the country's overall capacity to make payments." ROUBINI & SETSER, *supra* note 23, at 172. For explanations of why reducing debt overhang may be appealing for creditors, see, for example, Bratton & Gulati, *supra* note 23, at 18; Paul R. Krugman, *Market-Based Debt-Reduction Schemes*, *in* ANALYTICAL ISSUES IN DEBT 263–66 (Jacob A. Frenkel et al. eds., 1989); Kenneth Rogoff, *Symposium on New Institutions for Developing Country Debt*, 4 J. ECON. PERSP. 3 (1990); Jeffrey D. Sachs, *The Debt Overhang of Developing Countries*, *in* DEBT, STABILIZATION, AND DEVELOPMENT 89 (Guillermo Calvo et al. eds., 1986); Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393, 393–94 (1981); ROUBINI & SETSER, *supra* note 23, at 172–73.

of debt relief. It may be able to obtain such relief from the official sector, from its creditors, or from both.[26] In recent decades, sovereign debt restructuring has become an increasingly common feature of financial markets.[27] In the last ten years, for example, Russia, Ukraine, Pakistan, Ecuador, Argentina, Uruguay, and Iraq have all had a significant amount of external debt restructured and forgiven.[28]

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26. Such relief may be in the form of a reduction in the amount of the obligation, a change in the terms and period of repayment, a change in the asset pool used to repay the obligation, a change in the tax treatment of proceeds of obligations, or a change in capital restrictions applicable to payments made against the obligation and so on.

27. The modern era of sovereign debt crises arguably began with a period of relatively heavy lending to developing countries in the 1970s and 1980s. *See* Feinerman, *supra* note 1, at 12; Sedlak, *supra* note 24, at 1489 n.27 (citing Enrique R. Carrasco & Randall Thomas, *Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539, 550–54 (1996)). Beginning in the late 1970s, a number of countries—such as Jamaica, Peru, South Africa, and Turkey—began experiencing financial crises. *See* Paolo Manasse & Nouriel Roubini, *"Rules of Thumb" for Sovereign Debt Crises* 9 (Int'l Monetary Fund Working Paper No. 05-42, 2005). In the 1980s, a broader crisis developed in Latin America involving Argentina, Bolivia, Brazil, Chile, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Jamaica, Mexico, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay, and Venezuela. *See id.*; Carrasco & Thomas, *supra*, at 550–54; Sedlak, *supra* note 24, at 1489. During this period, banks holding sovereign obligations were initially convinced to restructure their obligations and provide additional credit to help the sovereigns meet short-term payments. Eventually, in 1989, under the so-called "Brady Plan," many of these banks swapped their loans for long-term bonds. *See* ROUBINI & SETSER, *supra* note 23, at 12–13; WILLIAM CLINE, INTERNATIONAL DEBT REEXAMINED 215–22 (1995); JAMES BOUGHTON, SILENT REVOLUTION: THE INTERNATIONAL MONETARY FUND, 1979-1989, at 32 (2001); Jeffrey D. Sachs, *A Strategy for Efficient Debt Reduction*, 4 J. ECON. PERSP. 19 (1990) (discussing the role of the Brady Plan in attempting to alleviate the debt of sovereign nations). For a discussion of the debt crisis leading up to the enactment of the Brady Plan, see generally FOREIGN DEBT AND ECONOMIC PERFORMANCE (Jeffrey D. Sachs ed., 1989); NAT'L BUREAU OF ECON. RESEARCH, DEVELOPING COUNTRY DEBT AND ECONOMIC PERFORMANCE (Jeffrey D. Sachs ed., 1990). Mexico experienced a major financial crisis in 1994. *See* RUMU SARKAR, DEVELOPMENT LAW AND INTERNATIONAL FINANCE 158–61 (2002); Rory MacMillan, *The Next Sovereign Debt Crisis*, 31 STAN. J. INT'L L. 305, 308 (1995). The Mexican crisis was resolved through almost $40 billion in relief committed by the IMF and the United States. *See* ROUBINI & SETSER, *supra* note 23, at 183; SARKAR, *supra*, at 160; MacMillan, *supra*, at 306. A number of countries in Southeast Asia—including Indonesia, Pakistan, South Korea, and Thailand—experienced crises in the late 1990s. *See* Sedlak, *supra* note 24, at 1489; Duncan E. Williams, Note, *Policy Perspectives on the Use of Capital Controls in Emerging Market Nations: Lessons from the Asian Financial Crisis and a Look at the International Legal Regime*, 70 FORDHAM L. REV. 561, 564–70 (2001).

28. For a comprehensive study of recent sovereign debt restructuring and creditor "haircuts," see Federico Sturzenegger & Jeromin Zettelmeyer, *Haircuts: Estimating Investor Losses in Sovereign Restructurings, 1998-2005*, at 3–4 (Int'l Monetary Fund Working Paper No. 05-137, 2005) (describing recent debt restructuring by Russia, Ukraine, Pakistan, Ecuador, Argentina, and Uruguay). Broadly speaking, these most recent restructurings have been characterized by some combination of emergency financing, voluntary agreement by creditors to swap existing obligations for new ones, and

These restructurings have ultimately been conducted with the grudging consent of creditors and they have generally been sought by sovereigns on economic grounds. Where a sovereign's debt load is unsustainable, it may be in its creditors' interest for the sovereign to reduce its overall debt-load or adjust the nature of its obligations to improve sustainability.[29]

The experience of post-Hussein Iraq is instructive though somewhat unique. Iraq obtained debt relief from its creditors against the dramatic backdrop of efforts by the United Nations and the United States to institute what one writer has described as a "backdoor bankruptcy."[30] At the urging of the U.S. government and its allies, most of Iraq's bilateral creditors agreed to restructure their claims against Iraq in late 2004 and early 2005, reducing Iraqi obligations by tens of billions of dollars.[31] Aside from the claims of these bilateral creditors, Iraq inherited approximately $20 billion in Hussein-era obligations owed to private commercial creditors. In late December of 2005, Iraq negotiated a restructuring of most of its

efforts to pressure creditors who resist the voluntary swap. This general combination of factors has been described as a "bail-in" to distinguish it from the heavy official-sector rescues, or bailouts, of the recent past. For a comprehensive study of this shift in approaches, see ROUBINI & SETSER, *supra* note 23, at 119–80.

29. *See supra* notes 27–28 and accompanying text.

30. Gelpern, *Iraq and Argentina*, *supra* note 1, at 394–96. In 2003, the United Nations Security Council effectively stayed collection efforts against Iraq's oil and gas assets and other assets located in member nations. *Id.*

31. *Id.* at 402 ("Thanks to all out U.S. diplomacy, Iraq has secured a reduction of 80 percent in principal and past due interest from the Paris Club of government leaders, and promised the Paris Club to seek comparable relief from the rest of its creditors."). Creditor nations that are members of the Paris Club held $20 billion to $40 billion in Iraqi debt when the Hussein regime fell. They agreed to restructure those obligations, writing off over three-quarters of that amount. The arrangement entailed a phaseout of the restructured debt over a four-year period. *See Iraqi Debt Write-Off Wins Approval*, BBC NEWS, Nov. 21, 2004, http://news.bbc.co.uk/2/hi/business/4029905.stm. Other nations outside the Paris Club—especially Kuwait, Qatar, and Saudi Arabia—have apparently also restructured debts owed to them by Iraq on terms similar to the Paris Club deal. *See Saudis Offer To Slash Iraqi Debt*, BBC NEWS, Jan. 21, 2004, http://news.bbc.co.uk/2/hi/business/3418357.stm. As of December 2006, thirty-four non-Paris Club creditors had forgiven most or all of their claims against Iraq. *See Indonesia Cancels 80% of Iraqi Debt*, BALI TIMES, Dec. 1, 2006, http://www.thebalitimes.com/2006/12/01/indonesia-cancels-80-of-iraqi-debt. The debts owed to these non-Paris Club bilateral creditors had totaled $60 billion to $80 billion. *See* Jubilee Iraq, Saddam's Debts Today (Latest Estimates), http://www.jubileeiraq.org/debt_today.htm (last visited Jan. 22, 2007). These arrangements apparently do not address war reparations claimed by Kuwait stemming from Iraq's occupation of that country in the lead-up to the first Gulf War. *See id.*

commercial debts by offering an exchange of new debt for old commercial debt.[32]

When Iraq's creditors did ultimately agree to restructure and forgive Hussein-era obligations, they did not do so on equitable grounds.[33] And the Iraqi regime claimed at the time that it was not seeking debt relief based on such grounds.[34] Nonetheless, it appears that Iraqi officials may have used (or benefited implicitly from) the threat of repudiating Iraq's debts to help persuade creditors to restructure the sovereign's obligations.[35] More recently, it appears that Nigeria may have used a similar threat in attempting to secure debt restructuring.[36] Still, many countries across the globe are burdened by significant debts incurred by oppressive regimes that do not appear to have provided any value to their citizens.[37] While Iraq managed to secure debt relief with the consent of its creditors, discussion of the quality of Iraq's debt appears to have awakened a more general interest in the topic of odious debt. A number of

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32. *See* Andrew Balls & Joanna Chung, *Critical Phase in Debt Restructuring Completed*, FIN. TIMES (London), Dec. 24–25, 2005, at 5, *available at* 2005 WLNR 20898528; Joanna Chung, *Iraq's Debt Solution Ruffles Feathers*, FIN. TIMES (London), Dec. 21, 2005, at 37, *available at* 2005 WLNR 20626291. Apparently, this exchange represented sixty percent of Iraq's commercial debts. Balls & Chung, *supra*. Iraq had previously repurchased some of its other commercial debts before this exchange. *Id.*

33. It is worth noting that, even if Iraq had formally asserted before a court or tribunal that its inherited debts were odious, it is not at all clear that a decisionmaker would have found any of these debts to be odious. To the extent that the proceeds of debts incurred by Hussein were actually, or even arguably, used for the benefit of citizens of Iraq, they would presumably not have been deemed odious under the traditional definition. *But see* Adams, *supra* note 1, at 1 ("Most debts created by Saddam Hussein in the name of the Iraqi people would qualify as 'odious' according to the international Doctrine of Odious Debts."). Adams acknowledges that some Iraqi debt was incurred for "legitimate governmental purposes and in the interests of the public" but argues that most of the debt "went to a repressive state machinery, to arms, and to palaces." *Id.* at 9.

34. At least according to public statements by Iraqi officials, they were not inclined to unilaterally repudiate the Hussein-era obligations. *See* Gelpern, *Iraq and Argentina*, *supra* note 1, at 406; Buchheit et al., *supra* note 1 (manuscript at 19–21 n.64). The issue quickly became moot, however, as debt relief was forthcoming.

35. *See, e.g.*, Buchheit et al., *supra* note 1, (manuscript at 20–21 n.64) (quoting Ali Allawi, Iraq's Minister of Finance, as expressing sympathy for the view that Hussein's debts were illegitimate).

36. *See Nigeria To Get $18bn Debt Relief*, BBC NEWS, June 30, 2005, http://news.bbc.co.uk/2/hi/business/4637395.stm. As this Article goes to print, Ecuador is threatening to repudiate some of its external obligations as "illegitimate." *See, e.g.*, *Ecuador, Calling Debt 'Illegitimate,' May Repay 40%*, BLOOMBERG NEWS, Jan. 18, 2007, http://www.bloomberg.com/apps/news?pid=20601087&sid=aLG4apB1PUp0&refer=home.

37. According to various authors, the following are examples of countries that have significant obligations that could potentially be characterized as odious: Nicaragua, Philippines, Haiti, South Africa, Congo (formerly Zaire), Nigeria, and Croatia. *See* Buchheit et al., *supra* note 1 (manuscript at 4).

writers and advocates have continued to try to identify mechanisms that might provide a measure of odious debt relief to other countries. The remainder of this Part describes some of the proposed mechanisms and notes some of the threshold formal and institutional challenges facing these existing proposals.

A. *The Traditional Doctrine*

Some proponents of repudiating Iraq's Hussein-era debt and other debt relief advocates have argued that there is an international legal doctrine of odious debt. According to this account, Alexander Sack first identified the doctrine of odious debt as a component of customary international law.[38] Sack argued that under public international law, a sovereign obligation is odious if: (1) the proceeds of the obligation do not benefit the population of a sovereign; (2) the obligation is incurred without their consent; and (3) the creditor knows these facts.[39] According to Sack, odious debts do not become obligations of the state; a succeeding government, for example, is not obligated to repay such debts. These obligations are essentially personal debts of the regime that incurred them without the consent and against the interests of the population.[40] They are subject to repudiation if the borrower (or its agent) elects to object to enforcement. To borrow language from other legal domains, these debts are voidable.[41]

If viable, the doctrine that Sack articulated represents an important exception to the general principle of customary international law that governments inherit the rights and obligations of the regimes they succeed.[42] In elaborating this doctrine of odious

38. For discussions of the legal history of the odious debt doctrine, see, for example, Feinerman, *supra* note 1, at 1–12; Khalfan, King & Thomas, *supra* note 1, at 22–34; Buchheit et al., *supra* note 1 (manuscript at 12–21); Gelpern, *Iraq and Argentina*, *supra* note 1, at 403–06. For an early discussion of the legal doctrine, see ERNST H. FEILCHENFELD, PUBLIC DEBTS AND STATE SUCCESSION 862 (1931); DANIEL P. O'CONNELL, STATE SUCCESSION IN MUNICIPAL AND INTERNATIONAL LAW 458–62 (1967); James L. Foorman & Michael E. Jehle, *Effects of State and Government Succession on Commercial Bank Loans to Foreign Sovereign Borrowers*, 1982 U. ILL. L. REV. 9, 21–25 (1982); Gunter Frankenburg & Rolf Knieper, *Legal Problems of the Overindebtedness of Developing Countries: The Current Relevance of the Doctrine of Odious Debts*, 12 INT'L J. SOC. L. 415, 431 (1984).

39. *See* Buchheit et al., *supra* note 1 (manuscript at 16).

40. *See* Buchheit et al., *supra* note 1 (manuscript at 15); Khalfan, King & Thomas, *supra* note 1, at 15.

41. *See, e.g.*, Khalfan, King & Thomas, *supra* note 1, at 2 ("[O]ne should not claim that odious debts are illegal under international law.").

42. *See, e.g.*, Gelpern, *Iraq and Argentina*, *supra* note 1, at 404.

debt, Sack and subsequent commentators rely heavily on a few historical examples. One of the primary episodes that Sack offered as evidence of the doctrine was the repudiation of Cuban debt by the United States in the wake of the Spanish-American War.[43] The debt in question had been incurred by Spain, apparently to suppress independence movements in Cuba.[44] When Cuba achieved independence, Spain argued that Cuba was responsible for the debt. In postwar negotiations, the United States asserted that the debt was odious and thus not enforceable.[45] While Spain rejected the equitable claim, it eventually stopped asserting that Cuba had to honor the obligations.[46]

Upon reflection, however, the dispute over this Cuban debt seems to be tenuously connected to the broad definition of odious debt that Sack had set forth. As others have noted, this episode appears to have been an example of state succession, not government succession.[47] State succession occurs when a territory ceases to be part of one state and becomes part of another. Government succession, by contrast, occurs when a state retains its basic integrity but experiences a transition of governing regimes.[48] A number of other episodes that have historically been described as evidence of state practice of repudiating odious debt similarly appear to be instances of state succession. For example, England refused to honor debts incurred by the Boer Republics in the course of conflict between them;[49] the early Soviet government refused to pay much of the debt of Tsarist Russia;[50] the United States refused to pay claims of the Republic of Texas after Texas became an American state;[51] in 1883, Mexico repudiated debt incurred by the Hapsburg monarchy in the course of attempting to sustain colonial control over Mexico;[52]

43. *See* Buchheit et al., *supra* note 1 (manuscript at 11–13); Gelpern, *Iraq and Argentina*, *supra* note 1, at 403–05; Khalfan, King & Thomas, *supra* note 1, at 25–26 (citing FEILCHENFELD, *supra* note 38, at 328).

44. *See* Gelpern, *Iraq and Argentina*, *supra* note 1, at 404.

45. *See* Khalfan, King & Thomas, *supra* note 1, at 25.

46. *See* Gelpern, *Iraq and Argentina*, *supra* note 1, at 405.

47. *See* Khalfan, King & Thomas, *supra* note 1, at 21–29; Buchheit et al., *supra* note 1 (manuscript at 11–17); O'CONNELL, *supra* note 38, at 461–62.

48. Admittedly, it can be difficult to distinguish state and government succession, especially in the context of social revolutions. *See, e.g.*, Khalfan, King & Thomas, *supra* note 1, at 47 (citing O'CONNELL, *supra* note 38, at vi); IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 673–74 (1998) (criticizing the distinction).

49. *See* Khalfan, King & Thomas, *supra* note 1, at 26. Significantly, England did eventually pay a fraction of those debts. *Id.*

50. *See id.* at 27.

51. *See id.* at 22.

52. *See id.* at 24.

under the Treaty of Versailles, Poland was not obliged to honor certain debts that Germany (and Prussia before Germany) had incurred in Poland's name in the wake of annexing Polish regions;[53] in 1919 and 1920, the government of Costa Rica repudiated obligations incurred by the short-lived, revolutionary government of Federico Tinoco;[54] and finally, some countries—especially African countries such as Tanzania, Eritrea, Rwanda, and Burundi—have repudiated debts incurred by their colonial regimes.[55] These kinds of disputes over sovereign debt have occurred in more recent history as well. The International Conference on the Former Yugoslavia's working group on succession is currently working to determine apportionment of debts of the former Yugoslavia among its successor states.[56]

As these episodes suggest, there is some historical evidence that states sometimes repudiate obligations in the context of state succession, especially in the wake of war or hostilities or decolonization. There is arguably some evidence of repudiation in the context of government successions, including the examples of Tsarist Russia and Costa Rica described above. It is questionable, however, whether such cases reflect a doctrinal exception to the general rule of repayment in the case of government succession.[57] Furthermore, most countries that experience revolutionary or post-colonial transitions do not repudiate existing obligations.[58]

53. *See id.* at 27.

54. *See id.* at 41. A dispute arising from Costa Rica's action in this episode ended up in arbitration, with U.S. Supreme Court Chief Justice Taft acting as arbitrator. He found that the country's act was valid because the funds had not been used by Tinoco for a legitimate governmental purpose. *Id.*; Great Britain v. Costa Rica, 2 Ann. Dig. 34 (1923).

55. *See* Khalfan, King & Thomas, *supra* note 1, at 31.

56. *See id.* at 28.

57. *See* Gelpern, *Iraq and Argentina*, *supra* note 1, at 406 ("[N]o national or international tribunal has ever cited Odious Debt as grounds for invalidating a sovereign obligation."). It does appear that the concept or doctrine of odiousness was raised, unsuccessfully, in disputes over obligations owed by China and Iran. *See* Buchheit et al., *supra* note 1 (manuscript at 19–20) (citing Jackson v. People's Republic of China, 550 F. Supp. 869, 872 (N.D. Ala. 1982); Jackson v. People's Republic of China, 794 F.2d 1490, 1495 (11th Cir. 1986); United States v. Iran, 32 Iran-U.S. Cl. Trib. Rep. 162 (1996)).

58. *See* Khalfan, King & Thomas, *supra* note 1, at 31 (noting that "most African states did in fact assume colonial debts but never recognized that they were obliged by law to do so"); *id.* at 29 (noting that countries including France, Spain, Portugal, the Netherlands, Bavaria, Mexico, Ecuador, Brazil, Costa Rica, Turkey, and Germany did not repudiate debts incurred by pre-revolutionary regimes).

B. Other Proposals

1. Domestic Law

Due in part to uncertainty about the status of the traditional doctrine of odious debt noted above, some commentators have proposed addressing odious debt with alternative doctrines.[59] Lee Buchheit, Mitu Gulati, and Robert Thompson have proposed, for example, that sovereigns might raise arguments sounding in domestic commercial/corporate law to defend against enforcement of their obligations.[60] Their proposal is based in part on the likelihood that litigation over potentially odious debt will occur in domestic courts in the United States.[61] They propose that sovereign debts could be found unenforceable under contract law as against public policy;[62] under the equitable doctrine of unclean hands;[63] under agency doctrines; or pursuant to defenses analogous to corporate veil-piercing.[64] Under American law of agency, for example, a principal is

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59. *See, e.g.*, Buchheit et al., *supra* note 1 (manuscript at 29–47) (exploring the relevance of domestic private legal doctrines); Adam Feibelman, *Equitable Subordination and Sovereign Debt*, LAW & CONTEMP. PROBS. (forthcoming 2007) (manuscript at 4, on file with the North Carolina Law Review) (proposing that non-odious creditors could employ the doctrine of equitable subordination against odious creditors).

60. *See* Buchheit et al., *supra* note 1 (manuscript at 28–48); *see also* Gelpern, *Iraq and Argentina*, *supra* note 1, at 411–12 (noting that the *Tinoco* case can arguably be seen as a precedent for using domestic law concepts to effectively fashion a new odious debt doctrine).

61. This is a reasonable working assumption. There has been an increase in litigation over sovereign debt throughout the last decade, and much of the recent litigation has been in United States courts, mostly federal courts. *See, e.g.*, Urban v. Argentina, No. 02 Civ. 5699 (TPG), 2004 WL 307293 (S.D.N.Y. Feb. 17, 2004) (certifying a class of creditors suing the sovereign); Lightwater Corp., Ltd. v. Argentina, No. 02 Civ. 3804, 2003 WL 1878420 (S.D.N.Y. Apr. 14, 2003) (rejecting the sovereign's request for a stay of litigation to negotiate with creditors). Other recent cases include Af-Cap, Inc. v. Congo, 462 F.3d 417 (5th Cir. 2006) (defining tax revenue and royalties received by the sovereign as "commercial activity" and subject to attachment because they were transferred to another creditor); Turkmani v. Bolivia, 193 F. Supp. 2d 165 (D.D.C. 2002); Hirshon v. Bolivia, 979 F. Supp. 908 (D.D.C. 1997); Kensington Int'l, Ltd. v. BNP Paribas, S.A., No. 03602569 (N.Y. Sup. Ct. Jan. 24, 2005) (unpublished opinion on file with the North Carolina Law Review); *see also* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1045 (2004); Charles D. Schmerler, *Defaulted Sovereign Debt? Litigate It!*, N.Y. L.J., Feb. 22, 2005, http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1108992913591.

62. *See* Buchheit et al., *supra* note 1 (manuscript at 28–30).

63. *See id.* (manuscript at 30–32).

64. *See id.* (manuscript at 37–39). Under corporate law, the obligations of a corporation generally do not extend to its shareholders. Under some circumstances, however, a creditor can reach the assets of the corporation's shareholders. These writers propose that a sovereign is essentially a corporate entity, but that its corporate status

generally bound by the actions of its agent if the agent was acting with authority—actual or apparent—to bind the principal.[65] An agent may not have authority to bind the principal, however, if it is clear to a third party that the principal derives no benefit from the proposed transaction.[66] In such a case, the third party bears the risk that the agent is acting without authority.[67] This principle might provide that a creditor cannot enforce certain obligations incurred by a regime that did not benefit the sovereign.[68] The leader or government of a sovereign is arguably an agent for the present and future population of the sovereign nation.[69] A leader may lose authority to bind the sovereign principal in a transaction with a creditor if the creditor knows that the sovereign will derive no benefit from the transaction.

Domestic private law doctrines may have fewer practical threshold challenges than the traditional odious debt doctrine. First, unlike the odious debt doctrine, there will not be threshold questions about whether these familiar doctrines exist.[70] Second, a domestic court relying on domestic private legal doctrines to resolve a dispute over sovereign obligations may have fewer institutional concerns than it would if it were asked to apply international customary law or other international legal doctrines.[71] A domestic court hearing these claims

could be dissolved if its leaders collude with third parties to harm the entity and its shareholders. *Id.* (manuscript at 38–39).

65. *See* RESTATEMENT (SECOND) OF AGENCY §§ 7–8 (1958).

66. *See* Buchheit et al., *supra* note 1 (manuscript at 34–35); RESTATEMENT (SECOND) OF AGENCY § 262 cmt. a (1958).

67. *See* RESTATEMENT (SECOND) OF AGENCY § 262 cmt. a (1958).

68. *See* Buchheit et al., *supra* note 1 (manuscript at 35–37).

69. *See id.* (manuscript at 33).

70. The doctrine should be available pursuant to the laws of New York or England as specified by agreement. *See* Buchheit et al., *supra* note 1 (manuscript at 29). *See generally* Deborah A. DeMott, *Agency by Analogy: A Comment on Odious Debt*, LAW & CONTEMP. PROBS. (forthcoming 2007) (on file with the North Carolina Law Review) (evaluating the application of agency concepts to sovereign debt disputes).

71. Even if international law recognizes a doctrine of odious debt, it might be difficult to convince courts to apply the doctrine to discharge sovereign obligations. This is especially true of domestic courts, a likely venue for litigation over sovereign debt. *See supra* note 61 and accompanying text. As an initial matter, there is some debate about the formal status of customary international law in U.S. domestic courts. *See generally* Curtis A. Bradley & Jack L. Goldsmith, *Customary International Law as Federal Common Law: A Critique of the Modern Position*, 110 HARV. L. REV. 815 (1997) (criticizing the conventional view that customary international law generally has the status of federal common law); A.M. Weisburd, *State Courts, Federal Courts, and International Cases*, 20 YALE J. INT'L L. 1 (1995) (same); Curtis A. Bradley et al., *Sosa,* Customary International Law, and the Continuing Relevance of *Erie* (Aug. 2006) (unpublished manuscript, on file with the North Carolina Law Review) (same). *But see* Harold Hongju Koh, *The 2004 Term: The Supreme Court Meets International Law*, 12 TULSA J. COMP. & INT'L L. 1, 12 (2004) (arguing that the Supreme Court has recognized the conventional view). Domestic

would be working with a familiar doctrinal backdrop. Private law doctrines such as agency or corporate veil-piercing are relatively thick and well developed. Assuming that a domestic court is satisfied that it has jurisdiction over a particular dispute, it should have basic institutional confidence in applying domestic commercial law to the dispute.

2. Other Institutions

While Iraq was working to restructure its obligations, a group of nongovernmental organizations and individuals proposed that an independent tribunal should be created and given the responsibility to designate certain Iraqi debts as odious.[72] They argued that "[t]he debts which Saddam owes cannot be legitimately passed on to the Iraqi people without assessment by an arbitration tribunal employing the doctrine of odious debts to assess whether the Iraqi people benefited from these loans."[73] They proposed that the tribunal be patterned after the Iran-United States Claims Tribunal, which was established in 1981 to resolve claims that stemmed from the Iranian Revolution.[74] Such a tribunal would presumably be created through political negotiation between the new Iraqi regime and creditor states (or the home governments of Iraq's creditors). These advocates proposed that the tribunal adopt the arbitration framework of the United Nations Committee on International Trade Law.[75] They also proposed that the agreements creating the tribunal would stipulate that the Sackian doctrine of odious debt would have the force of law in the tribunal's deliberations.[76] Finally, they proposed that creditor

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courts might have institutional concerns or hesitation about applying customary international law in general and about finding sovereign obligations unenforceable in particular. Such courts may not have robust institutional self-confidence to apply customary international law in such a way as to effectively discharge sovereign obligations. *See generally* Stephan, *supra* note 1 (exploring institutional issues related to the odious debt doctrine and to customary international law in general). Some writers have considered whether odious debt claims might be raised before the International Court of Justice. *See* Khalfan, King & Thomas, *supra* note 1, at 58–65. Such an approach might give rise to fewer institutional concerns than asserting the doctrine in litigation before domestic courts.

72. *See* Jubilee Iraq, Preliminary Structural and Procedural Aspects of Iraq Debt Tribunal, http://www.jubileeiraq.org/tribunal.htm (last visited Feb. 1, 2007); *see also* Gelpern, *Iraq and Argentina*, *supra* note 1, at 403 (citing the proposal).

73. *See* Jubilee Iraq, *supra* note 9.

74. *See* Jubilee Iraq, *supra* note 72. The Iran-United States Claims Tribunal adopted the arbitration rules of the United Nations Committee on International Trade Law with some modifications. *Id.*

75. *See id.*

76. *See id.*

nations who agree to create the tribunal should also agree to halt or avoid litigation over Iraqi debt in their domestic courts.[77] While the need for an Iraqi debt tribunal is essentially moot after the country's debt restructuring, a debt-claims tribunal remains an interesting potential mechanism for addressing similar disputes in other contexts.

Such a tribunal would face some predictable practical threshold challenges of its own.[78] Most notably, there will be significant political challenges in creating such an entity in the first place. As proponents of the Iraqi debt tribunal acknowledge, the Iran-U.S. tribunal was adopted because there were strong political forces balanced on either side of a dispute between two powerful parties.[79] It is not at all clear whether or when this kind of ex post balance of interests will recur in any particular context. Such a tribunal would be feasible in some contexts but perhaps not others. Not only would this create uncertainty, it would give rise to significant costs; parties would need to invest time and/or resources in each separate context to promote creating a tribunal and then putting one in place.. Where it is possible to create a tribunal of this kind in the first place, it will be difficult to insulate the tribunal from ongoing political influences.[80]

Two economists, Michael Kremer and Seema Jayachandran, have proposed creating an ongoing international tribunal or some similar institution to evaluate the relative odiousness of existing regimes as opposed to the odiousness of particular debts.[81] They model the effect of a "hypothetical perfectly truthful institution" that would be charged with determining whether particular sovereign regimes are odious.[82] They propose that major powers could create an entirely new odious debt institution for this purpose or that designations under the scheme could be made by the United Nations Security Council.[83] Their model predicts that a regime succeeding one that the institution designated as odious could disavow the debts incurred by the odious regime without suffering damage to its

77. *See id.*

78. *See* Paulus, *supra* note 1, at 92–95 (critiquing the odious debt tribunal proposals).

79. *See* Jubilee Iraq, *supra* note 72.

80. *See infra* note 87 and accompanying text.

81. *See* Kremer & Jayachandran, *supra* note 1, at 90. They propose that major powers could create an entirely new odious debt institution or that designations under the scheme could be made by the United Nations Security Council. *See id.* at 91–92.

82. Michael Kremer & Seema Jayachandran, Odious Debt 2 (Apr. 2002) (unpublished manuscript, on file with the North Carolina Law Review).

83. *See* Kremer & Jayachandran, *supra* note 1, at 91; *see also* Bolton & Skeel, *supra* note 1 (manuscript at 3) (proposing an approach to odious debt in which the United Nations and/or the International Monetary Fund would designate regimes as odious).

reputation and its ability to borrow in the future.[84] More significantly, most non-odious creditors would presumably avoid lending to regimes designated as odious or would charge a much higher interest rate to do so. The few creditors who would willingly lend to such a regime designated as odious would do so at such a risk that they would have to charge high, if not prohibitive, rates.[85] As Anna Gelpern has noted, such a scheme would "remove some reputational damage to a country from repudiating odious debt, would shield the country from lawsuits, and would enable meaningful risk assessment by creditors. Most importantly, it may discourage lending to oppressive governments and free their people from responsibility for the debts."[86]

Despite these advantages, this proposal will face political obstacles similar to those noted above.[87] Here, however, the political pressures may be even greater because the international community will be asked to create an ongoing institution with a broad-ranging mandate. The consequences of designating a sovereign as odious will be very significant, and the international community will presumably be skeptical of creating an institution with this power over sovereigns.[88] Furthermore, unlike a sovereign-specific claims tribunal, no sovereign will be able to ensure that it will not become a target of the institution. Sovereigns might believe that they would be ceding too much of their own sovereignty by creating such an institution.

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84. *See* Bolton & Skeel, *supra* note 1 (manuscript at 3).

85. The cost of credit for sovereigns at risk of being designated as odious would presumably increase as well. *See, e.g.*, Rajan, *supra* note 1, at 54. Rajan notes that the value of debts incurred before an odious designation would likely be affected by the prospect of a potential subsequent designation. This is true even though the mechanism would purport to affect only future debts; sovereigns will be more likely to default on existing debts if future credit is not forthcoming.

86. *See* Gelpern, *Iraq and Argentina*, *supra* note 1, at 413.

87. *See supra* note 80 and accompanying text. Such a scheme would presumably be at least as difficult to create as the tribunal discussed above that would review sovereign debts for odiousness ex post. Given the broader effect of an ex ante designation, these difficulties might be much greater, although Kremer and Jayachandran claim the opposite. *See* Kremer & Jayachandran *supra* note 1, at 90–91. They argue that if such an institution were to judge only the potential odiousness of future debts, then it would be relatively unlikely to be affected by biases or political influences favoring either creditors or the populations of sovereign debtors. *Id.* Gelpern suggests that "the institutional design challenge is no greater than in the case of trade sanctions, and the overall framework is sensible and innovative." Gelpern, *Iraq and Argentina*, *supra* note 1, at 413.

88. The development of the International Criminal Court provides an example of the difficulty in creating an international tribunal with significant power over powerful sovereigns. *See, e.g.*, Paul B. Stephan, *U.S. Constitutionalism and International Law: What the Multilateralist Move Leaves Out*, 2 J. INT'L CRIM. JUST. 11, 12–13 (2004).

Finally, some commentators have noted that a formal sovereign bankruptcy regime might provide a useful mechanism for enabling sovereigns to discharge their odious obligations.[89] The procedural architecture of a bankruptcy system enables troubled debtors and their creditors to identify claims against the debtor, define the debtor's assets, and then determine how to apportion the assets to the various claimants. In general, a bankruptcy system can promote efficient restructuring of a debtor's capital structure to maximize creditors' collective recovery. Bankruptcy systems also provide a useful procedure for distinguishing different classes of obligations and for enforcing priority among them.[90] Most significantly, domestic bankruptcy law allows for subordination of some inequitable debt.[91] A sovereign bankruptcy scheme could serve these functions; it could provide efficient sovereign debt relief in general and include provisions for subordinating or discharging odious debt in particular.[92]

The practical obstacles to creating a sovereign bankruptcy scheme are not hypothetical. In fact, despite widespread interest in developing a bankruptcy regime for sovereigns, it has proven to be intractably difficult to do so. In recent years, officials at the International Monetary Fund ("IMF") proposed a Sovereign Debt

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89. *See* NOREENA HERTZ, THE DEBT THREAT 187–94 (2004) ("[D]omestic bankruptcy ... provides us with a good basis on which to design a mechanism for determining which sovereign debts are unpayable or illegitimate, and how debtors and creditors should be treated as a result."); Stiglitz, *supra* note 1, at 42 (arguing that a bankruptcy system for sovereigns could provide relief from obligations incurred by outlaw or odious regimes pursuant to rules established by the United Nations).

90. In the private bankruptcy context, bankruptcy law generally enforces priorities or seniority among and between creditors by respecting differences between secured and nonsecured creditors and other voluntary contractual arrangements. It often alters privately ordered priorities to create priorities for credit extended for administrative purposes in bankruptcy, to secure interim or emergency financing, or to reflect certain social policies. *See* 11 U.S.C. § 507 (2000) (setting forth priorities among unsecured claims in bankruptcy).

91. Bankruptcy law in the United States has codified the doctrine of equitable subordination. *See id.* § 510(c). Section 510(c) provides that a bankruptcy court may "under principles of equitable subordination subordinate for purposes of distribution all or part" of a claim or interest. *Id.* The test for subordination under this provision is that "(i) [t]he claimant must have engaged in some type of inequitable conduct [and] (ii) [t]he misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant." *In re* Mobile Steel Co., 563 F.2d 692, 700 (5th Cir. 1977) (citation omitted). Claims that are subordinated under this provision are often the product of fraud, misrepresentation, breach of fiduciary duties, illegality, or actions by insiders that hurt the financial positions of creditors to the corporation.

92. Significant for present purposes, a bankruptcy scheme could also enforce a contractual arrangement that provided for repudiation of odious debts.

Restructuring Mechanism ("SDRM").[93] The SDRM proposal was largely motivated by an interest in undermining the ability of creditors to effectively hold up sovereign debt restructuring arrangements by refusing to participate or by pursuing independent enforcement activities.[94] The IMF's SDRM proposal envisioned a "minimal bankruptcy" scheme, with features that would effectively stay collection efforts, provide priority for new credit, allow for a cramdown of dissenting creditors, and provide a formal structure for negotiating the restructuring of obligations.[95] Sovereign bond market participants in the United States and officials in the U.S. Treasury were apparently some of the main opponents of the IMF's SDRM scheme.[96] The proposal was apparently shelved in April 2003,[97] and it does not appear that its proponents are seeking to revive the proposal in the near future.[98]

At present, then, the issue of odious debt presents a vexing challenge. There seems to be broad agreement that sovereigns should not incur odious debt and that, ideally, successor regimes should not be required to repay such debt. But there are serious practical challenges to implementing any of the doctrines or institutions discussed above. Furthermore, as explained below in Part III, these solutions are not well suited to limiting the negative

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93. For a discussion of the proposal supported by the IMF, see, for example, Bratton & Gulati, *supra* note 23, at 26–43.

94. "[E]rosion of sovereign immunities since the 1950's" has led to an increase in lawsuits brought by sovereigns' creditors, Gelpern, *Iraq and Argentina*, *supra* note 1, at 396, even though sovereigns can still effectively thwart creditors' efforts to enforce judgments. *See id.* at 396–97; Gulati & Triantis, *supra* note 23 (manuscript at 13–14); Patrick Bolton & David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?*, 53 EMORY L.J. 763, 781 (2004). Significantly, commentators have been concerned that bondholders will become more active and more successful in both suing and trying to enforce judgments. *See, e.g.*, Gelpern, *Iraq and Argentina*, *supra* note 1, at 396–97.

95. *See* Bratton & Gulati, *supra* note 23, at 26; Gelpern, *Iraq and Argentina*, *supra* note 1, at 398–99; Anne Krueger, First Deputy Managing Dir., Int'l Monetary Fund, International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring, Address at the National Economists' Club Annual Members' Dinner (Nov. 26, 2001), http://www.imf.org/external/np/speeches/2001/112601.htm.

96. Bolton & Skeel, *supra* note 94, at 764–65. They were purportedly concerned that the scheme might encourage sovereign bankruptcies and that this would destabilize the market for sovereign debt. *Id.*; ROUBINI & SETSER, *supra* note 23, at 289–90.

97. Gelpern, *Iraq and Argentina*, *supra* note 1, at 399; Feinerman, *supra* note 1, at 22.

98. Some commentators have recently argued that a formal sovereign bankruptcy regime is either unnecessary or unappealing compared to ad hoc approaches to sovereign debt restructuring. *See, e.g.*, LEX RIEFFEL, RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD HOC MACHINERY 18 (2003). In any event, the remainder of this Article assumes that a sovereign bankruptcy is not likely to emerge in the near future.

economic consequences for sovereigns that repudiate their odious debts. Some commentators have suggested that no practicable mechanism for repudiating odious debt can be created; some of these writers have proposed that sovereign debtors with odious debts frame their efforts to get debt relief in terms of their inability to repay.[99] This Article is more sanguine; it does not argue that the proposals for an odious debt mechanism discussed above are fatally flawed or ultimately infeasible. It is possible that any one or some combination of them would represent an improvement over the status quo. Rather, Parts II and III argue that a contractual approach to odious debt may be more feasible and more appealing than these alternatives.

II. A CONTRACTUAL ODIOUS DEBT MECHANISM

This Part describes a contractual approach to the odious debt problem. It explains how parties could adopt such a mechanism; it then explains how they might define odious debt, provide for it to be designated, and enforce the repudiation of debts designated as odious.[100] This Part assumes that sovereigns and their creditors will have incentives to adopt such a mechanism; the following Part defends that assumption.[101]

A. *The Contractual Arrangement*

To avoid complicated transitional concerns for a moment, imagine the hypothetical case of a new sovereign with no existing creditors.[102] To adopt a contractual odious debt mechanism, the sovereign could expressly promise its initial creditors that it will not incur odious debt. The parties could expressly acknowledge that their credit arrangement does not create an odious obligation by designating the purpose of their transaction. They could further provide that if any debt owed by the sovereign is determined to be odious, then the sovereign agrees to repudiate that obligation. As discussed below, the parties would presumably include a contractual

99. *See, e.g.*, Gelpern, *Iraq and Argentina*, *supra* note 1, at 407. *See generally* Rajan, *supra* note 1 (expressing skepticism about proposals to address the odious debt problem).

100. As noted above, *supra* note 13, an odious debt relief mechanism might provide for repudiation or some form of subordination. For the sake of simplicity, this discussion uses the term repudiation; a contractual mechanism could just as easily provide for subordination of debt or some other form of altering seniority for debts designated as odious. Either approach creates a form of priority in the broadest sense of the term.

101. This assumption is examined *infra* in Part III.C.

102. Complicated transition problems are addressed *infra* in Part II.B.2.

definition of odious debt in their agreements.[103] The sovereign could also commit to require its subsequent creditors to agree to adopt the same contractual arrangement.[104] By promising its initial creditors that it will require subsequent creditors to opt into the arrangement, the sovereign not only sets the contractual mechanism in place, but it also further commits itself to avoid incurring odious debt.[105] A breach of any of the promises or commitments noted above would be an event of default by the sovereign borrower.

Given that the sovereign may subsequently try to cheat or shirk, creditors opting in to the arrangement will want to try to put other potential creditors on notice that they intend to honor and enforce the scheme. Bondholders may be in a relatively good position to do this; sovereigns already disclose at least some of the terms of their bonds pursuant to securities regulation.[106] Purchasers could insist that sovereigns disclose the arrangement. Private or bilateral creditors may have a harder time putting other creditors on notice; they might try to advertise the arrangement in other ways, perhaps through publication. It is also possible that creditors, sovereigns, or other entities could create a recording or disclosure mechanism specifically designed for such arrangements.[107] Furthermore, if such a scheme becomes conventional, creditors will increasingly be on constructive notice to inquire of sovereign debtors whether there are any odious debt agreements in force. As discussed below, such notice may or may not be given formal effect,[108] but it may help deter some creditors from extending odious debt in the first place.

If a sovereign and its creditors agree that the sovereign will repudiate any odious debt it incurs, the agreement will have to indicate how those debts will be identified. The parties could theoretically designate an independent decisionmaker for this purpose. They might agree, for example, to allow creditors to enforce the agreement in U.S. courts or before an international tribunal.

103. *See infra* Part II.D.

104. The sovereign itself will contract with all subsequent voluntary creditors and should be in a position to insist upon these subsequent agreements. *See infra* notes 129–30 and accompanying text.

105. *See infra* Part II.B.1.

106. *See, e.g.*, Stephen J. Choi & G. Mitu Gulati, *An Empirical Study of Securities Disclosure Practice*, 80 TUL. L. REV. 1023, 1027 (2006) (explaining that a sovereign bond issue prospectus and prospectus supplement will disclose certain information about the terms of the underlying bond contract).

107. It is possible, for example, that a public institution like the IMF could manage such a registry and help publicize the information. Rating agencies could presumably disseminate this information as well.

108. *See infra* notes 114–15 and accompanying text.

Such an arrangement would effectively mimic by contract one or more of the alternative mechanisms discussed above. The parties might also consider giving the responsibility to designate odious debts to the sovereign. As discussed below in more detail, however, creditors should have better incentives than sovereigns or other actors in determining whether particular debts are odious. Therefore, the responsibility for designating debts as odious ex post under a contractual arrangement would ideally be given to the sovereign's creditors. It is worth noting that the IMF's SDRM proposal envisioned a similar kind of voting mechanism among creditors.[109] Designing the procedural rules that would enable creditors to designate odious debt will be a significant practical challenge for such a contractual approach. This Article does not propose a detailed solution to this challenge. Generally speaking, a majority or supermajority of the sovereign's creditors could be given the power to designate any of the sovereign's obligations as odious. Alternatively, the parties could agree that creditors representing a dominant percentage of claims against the sovereign would have this power. In any event, the voting scheme should not require too great a degree of unanimity; if so, it will effectively give creditors an incentive to become uncooperative holdouts.

A contractual odious debt mechanism will face significant but surmountable enforcement challenges. The parties should agree at the lending stage that the sovereign will refuse to pay any obligations identified as odious by a majority of creditors (or any other decisionmaker chosen by the parties). Thus, creditors would designate debts as odious and then insist that the sovereign refuse to honor the odious debt. As noted above, sovereign regimes are generally hesitant to repudiate their sovereign's obligations.[110] This is especially true where the regime may have acute short-term interests.[111] The contractual odious debt arrangement should correct these incentives because the sovereign's refusal to repudiate will be an event of default on its existing credit arrangements. Thus, a sovereign should have a strong incentive to repudiate debt designated as odious under the arrangement to avoid immediate default on other obligations. Furthermore, where a responsible regime has succeeded a repressive one, the new regime should be very receptive to repudiating existing debt if it thinks it can do so without damaging its

109. *See* Krueger, *supra* note 95.
110. *See supra* notes 22–23 and accompanying text.
111. *See* Bolton & Skeel, *supra* note 94, at 770–71.

reputation or being punished by legitimate creditors and institutional actors.

Ideally, the contractual arrangement described above would operate without the need for any judicial intervention. Undoubtedly, however, some creditors whose obligations are repudiated under the arrangement will litigate to challenge the treatment of their obligations. As noted above, creditors have grown increasingly inclined to litigate claims against their sovereign borrowers.[112] Given the likelihood of such litigation, the parties might actually agree ex ante that any designation by creditors of a debt as odious could be reviewed in a domestic court.[113] This would presumably provide a measure of protection or encouragement for minority creditors, and it might help persuade hesitant creditors to opt into the arrangement.

There are good reasons to believe, however, that a contractual odious debt mechanism could minimize the role of judicial enforcement. The contractual arrangement itself will place a limit on the ability of creditors to successfully challenge repudiation of their obligations. A court would assess repudiation under the arrangement as a question of contract law—whether the creditor assented to the terms of the arrangement and whether the other creditors performed in accordance with the terms of the arrangement. If a creditor opts in to the odious debt scheme, it should not succeed in a lawsuit challenging the designation of its debts as odious unless there is some reason to believe that the designation was made arbitrarily. Unless the debt designated as odious bears no similarity to the contractual definition, this should be a relatively quick and easy contract dispute.

It will obviously be harder to employ the contractual arrangement against creditors who did not opt into the arrangement themselves. As noted above, a sovereign that adopts this contractual arrangement with some creditors might cheat by borrowing from a creditor without insisting that the creditor agree to opt into the arrangement. Such debts may likely turn out to be odious; the sovereign would presumably not need to cheat to borrow non-odious debt. In that case, if other creditors designated that obligation as odious, there are a number of reasons to believe that the arrangement might still enable the sovereign to repudiate this claim. If such a creditor sued to challenge the repudiation of its debt, the majority

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112. *See supra* note 61 and accompanying text (discussing the decline of sovereign immunity and increased litigation by sovereigns' creditors).

113. *See, e.g.*, Bratton & Gulati, *supra* note 23, at 61–76 (discussing the need to rely on judicial backstop enforcement of intercreditor duties).

creditors and the sovereign might be able to argue that the complaining creditor had notice of the arrangement.[114] If the sovereign and the majority creditors could show that the complaining creditor had notice of the contractual arrangement, they might be able to imply actual assent to the mechanism.[115]

If they cannot enforce the arrangement on grounds of actual implied assent, the sovereign or its creditors may attempt to employ one of the odious debt doctrines discussed above—the traditional odious debt doctrine, for example, or some variant based in domestic private law. This may seem like a move back to square one in the odious debt problem, but it is not. Relying on these doctrines on the back end of an otherwise comprehensive contractual arrangement is different from relying on them as a primary mechanism. In that circumstance, a majority of the sovereign's creditors will already have designated the debt in question as odious and will have insisted that the sovereign repudiate the debt. It may be easier to succeed under those doctrines when the sovereign and creditors are acting in good faith pursuant to a thoughtfully designed, contractual arrangement. Furthermore, some of the practical dangers of repudiating sovereign debt should be reduced when it is done against the contractual backdrop described above. As discussed below in more detail, the market for sovereign debt will almost surely be disturbed by any repudiation of debt by a sovereign. It should be less disturbed if the repudiated debt had first been designated as odious by a majority of the sovereign's creditors.

B. *Transitions*

1. Good Regime, Questionable Reputation

Imagine now an existing regime that wants to opt into a contractual odious debt scheme. This regime wants to incur obligations that are valuable to its population, but it has a questionable financial and political history. Due to its shaky reputation for responsible borrowing, this regime may have difficulty

114. As suggested above, the parties could create some form of recording or notice scheme for this very purpose. *See supra* note 107 and accompanying text.

115. For a restatement of the principles relating to contractual obligations implied in fact, see RESTATEMENT (SECOND) OF CONTRACTS § 4 cmt. a. Under these principles, a contractual term becomes effective if one contracting party knows that its counter-party intends to agree to that term and the first party does not object. *Id.* This doctrine would presumably not apply to situations where sovereigns actually express an intent not to agree to the term with their creditors.

convincing creditors of its intention to borrow for the benefit of its population. The contractual mechanism described above would give the sovereign an opportunity to commit to avoid incurring odious obligations. It would also create a contractual mechanism that would give the sovereign's non-odious creditors the ability to insist that any odious obligations incurred by the sovereign would be repudiated.

This sovereign presumably has a complicated array of existing creditors, none of which have made any agreements or representations regarding odious debt. To opt into a contractual odious debt arrangement, the sovereign might renegotiate its existing credit arrangements. Assuming that the odious debt arrangement is valuable to the creditors and the sovereign,[116] there should be real opportunities for efficient refinancing into the scheme.[117] Even if this sovereign cannot renegotiate with its existing creditors to adopt the arrangement, it may be able to transition into the scheme through agreements with future creditors. To do so, it might promise new creditors that it will attempt to encourage its existing creditors to opt into the arrangement. As the sovereign persuades any of its new or existing creditors to adopt the arrangement, then other creditors should be less and less resistant to the scheme. They will presumably have more confidence in the sovereign's commitment to borrow funds that provide value to its citizens. Significantly, by adopting the agreement, the existing regime will limit the ability of its successor governments to borrow odious debt. If a subsequent regime attempts to borrow odious debt, potential creditors will have to lend into the contractual arrangement.

2. Questionable or Bad Regime

The development of a contractual odious debt-relief mechanism should also have some impact on a regime that has questionable purposes for borrowing. Such a sovereign may not seek to adopt the arrangement itself. If the arrangement becomes common, creditors will presumably take note of this, taking it as a sign that the sovereign may intend to borrow odious debt. This may, in turn, cause the creditors to assign a lower value to the obligation and propose a higher rate (or require greater up-front payments). A questionable regime may agree to adopt the odious debt arrangement to avoid this.

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116. *See infra* Part III.C. (proposing that the contractual mechanism will be valuable to creditors and sovereign borrowers).

117. Some debt holders will likely not be the original creditors, however, and it may be hard to renegotiate with assignees and purchasers of these obligations. *See* Buchheit et al., *supra* note 1 (manuscript at 32–33).

If the regime adopts the arrangement, even as a pretense, it will have put in place a contractual mechanism for repudiating odious debt in the future.

A contractual odious debt relief mechanism could have beneficial effects even on those sovereigns whose leaders have unquestionably bad motives. Assume the worst-case scenario: a regime that does not make any attempt to borrow funds for the benefit of its citizens and does not make any pretense of doing so. It refuses to make any promises not to incur odious debt. At the very least, if the contractual mechanism becomes prevalent, that should make it somewhat harder or more expensive for this regime to get funds. It is entirely possible, however, that this regime will simply not care about incurring the higher cost of credit; it is willing to soak the last drop of value out of its nation before relinquishing power. It is fair to assume that such a regime will incur a significant amount of debt that could reasonably be defined as odious.

Once such a regime falls, however, the availability of a contractual odious debt mechanism will prove beneficial to a successor regime. The new regime will presumably want to borrow new funds necessary to recover from the problems left by the previous regime and it will may want to try to repudiate its existing odious obligations. A contractual mechanism might help with both of these goals even if none of the sovereign's existing creditors had opted into the arrangement. The new regime might be able to borrow new funds at a lower cost by committing not to incur odious debt in the future. In many respects, the new regime is in the same situation as the good regime with an uncertain reputation discussed above. It may not be able to convince existing creditors to renegotiate into the contractual scheme, but it could encourage subsequent creditors to do so. Through its responsible borrowing going forward, it can develop a good reputation and make its promise to avoid odious debt credible.

The development of a contractual odious debt relief scheme may also make it more feasible for this new regime to repudiate its inherited obligations unilaterally. As discussed above, successor regimes do not repudiate their obligations due to reputational concerns or fear of other penalties.[118] If the successor could effectively commit to future creditors that it will not incur odious debt, that regime might be able to mitigate some of the costs of repudiating its inherited debts. The new regime may, for example, be

118. *See supra* notes 22–23 and accompanying text.

able to borrow new funds under the contractual arrangement and then ask the new, non-odious creditors to designate the existing obligations as odious. It could then repudiate pre-existing obligations without suffering a penalty, though not formally pursuant to the arrangement itself. In this way, sovereigns that throw off truly odious regimes can transition into a private scheme by effectively leveraging new non-odious creditors against old odious ones.

3. Summary

To summarize, the contractual mechanism described in this section is designed to operate as follows. A sovereign and its creditors will agree at the lending stage that the obligation they create will be subject to repudiation if it is odious. The sovereign will also promise each creditor that it will make similar agreements with other creditors and that if it subsequently incurs odious debt, those obligations will be subject to repudiation. If the sovereign incurs odious debt in the future or if it borrows from a creditor who does not opt into the arrangement, it will breach its agreement with its existing creditors. These creditors would be given authority under their agreements with the sovereign to designate debts as odious ex post, and the sovereign will be committed to repudiate these debts. Actions taken pursuant to the agreement should withstand judicial review, which will reduce the chances of litigation. It may be possible to enforce the agreement against creditors who have notice of the general arrangement even if they do not formally adopt it. The availability of this contractual arrangement may embolden sovereigns with existing odious debts to repudiate those obligations; if those sovereigns can opt into the arrangement with subsequent creditors they may be able to avoid some of the costs of unilaterally repudiating their existing obligations.

C. Embracing Contract

The most significant practical challenge to a contractual odious debt mechanism will be coordinating the contracting process with the sovereign and its various debtors. Recent developments in the sovereign debt market suggest that market participants may be amenable to a contractual approach to odious debt. After a wave of sovereign debt restructurings in the last two decades, many market observers and participants became increasingly interested in promoting greater use of collective action provisions in sovereign

bonds.[119] These provisions, historically common in bonds issued under English law, allow a majority or supermajority of creditors to alter important terms of their bonds, including the amount of the obligation.[120] Sovereign bonds issued in the United States have, until recently, not included clauses that authorize a majority or supermajority of creditors to alter payment dates, amount of obligations under the bonds, or other significant terms.[121] Around 2002 or 2003, the U.S. Department of the Treasury began to advocate the use of collective action clauses in sovereign debt instruments issued in the United States.[122] Treasury and other proponents of such arrangements argued at the time that they promote efficient sovereign debt restructuring.[123] In 2003, Mexico issued bonds under New York law that included "majority modification" provisions; since then, nearly all issues under New York law have included these collective action clauses.[124] This episode reveals, first, that the market

119. *See* Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1333–34 (2002); Gelpern & Gulati, *supra* note 19 (manuscript at 3).

120. Since the late nineteenth century, corporate and sovereign bonds issued under English law have included these provisions. Buchheit & Gulati, *supra* note 119, at 1325 ("Majority action clauses are now a regular feature of both corporate and sovereign bonds governed by the laws of England."); Gelpern & Gulati, *supra* note 19 (manuscript at 3). They were adopted in large part to limit the ability of minority creditors to effectively hold up a debt restructuring process. Buchheit & Gulati, *supra* note 119, at 1324. The problem of hold-out creditors in the private context was addressed in the United States first by the development of equity receiverships and, eventually, by corporate reorganization law under Chapter 11. *See* DAVID A. SKEEL, JR., DEBT'S DOMINION 57 (2001).

121. *See* Buchheit & Gulati, *supra* note 119, at 1329. As Buchheit and Gulati explain in detail, the development of such clauses was stymied by concerns about the negotiability of the debt instruments and, eventually, by the availability of corporate restructuring laws. *Id.* at 1326–29. While Congress addressed the restructuring needs of domestic corporations, however, it did not address the similar needs of sovereign borrowers. *Id.* at 1330. "A sovereign bond issuer of the early twenty-first century [issued under U.S. law] is in much the same spot as the distressed corporate or railroad bond issuer of the early twentieth century." *Id.* at 1322. That said, bonds issued under United States law historically allowed some creditor coordination. For example, 75% of creditors have long had the power to agree to defer the timing of payments for a relatively short period of time. *See id.* at 1328. Furthermore, most sovereign bonds have also provided that 25% of creditors can trigger an acceleration of a sovereign's obligations upon default and that 75% of creditors can reverse such an acceleration. *See id.* at 1330–31 (noting the value of such a provision to a sovereign that wants to renegotiate its obligations to creditors).

122. *See* Bolton & Skeel, *supra* note 94, at 765; Gelpern & Gulati, *supra* note 19 (manuscript at 20).

123. Advocates of collective action clauses propose that domestic courts would likely police restructuring of bond obligations under majority action clauses and would impose intercreditor duties to protect minority bondholders. *See* Buchheit & Gulati, *supra* note 119, at 1337–41. They note that before the creation of Chapter 11, there was a "flowering" of intercreditor duties to try to address similar hold-out problems. *Id.* at 1337–38.

124. The exact reasons for this shift are complex and probably hidden from history. According to Gelpern and Gulati, who interviewed most of the market and official-sector

for sovereign debt is willing to adopt contractual innovations. Equally important, it shows that the official sector—in this case, the U.S. Treasury—can play an instrumental role in prodding market participants to embrace new contractual approaches. This is especially true where the benefits are not obvious to the private actors,[125] or where the innovation might create significant positive externalities that the parties themselves would not capture. Finally, this episode may show that market participants are willing to adopt innovative contractual approaches to forestall more dramatic reforms or solutions.[126]

Significant for present purposes, at least some commentators have proposed that sovereigns and creditors could employ collective action clauses more broadly. At the height of interest in the IMF's proposal, Lee Buchheit and Mitu Gulati proposed that sovereigns and creditors could employ available contractual arrangements to adopt and enforce a broad restructuring plan.[127] Buchheit and Gulati and other writers have further suggested that sovereigns and their creditors might be able to create an effective scheme of priorities by contract through subordination agreements.[128] It has gone largely underappreciated that important strands of contract theory, especially contract-based bankruptcy theory, provide theoretical support for this private, contractual approach to debt restructuring.[129] Contract

actors involved in this episode, the shift occurred in part as a result of pressure (often informal) from officials at the U.S. Treasury. *See* Gelpern & Gulati, *supra* note 19 (manuscript at 64); *see also id.* (manuscript at 12) (noting an earlier shift in this direction by issuers, including Bulgaria, Kazakhstan, Egypt, Lebanon, and Qatar, that "had no broader market impact").

125. There is still debate about whether collective action clauses are efficient or provide any real benefit. *See* Gelpern & Gulati, *supra* note 19 (manuscript at 29). In fact, in recent years, Pakistan, Ukraine, and Ecuador have flinched instead of relying on the collective action clauses in their bonds and cramming down agreements on minority creditors. *See* Buchheit & Gulati, *supra* note 119, at 1346.

126. *See, e.g.*, Gelpern & Gulati, *supra* note 19 (manuscript at 17–18) (noting that some commentators explained the adoption of collective action clauses in bonds issued under New York law as a product of "fear of SDRM").

127. *See* Buchheit & Gulati, *supra* note 119, at 1345–51. Buchheit and Gulati consider whether it would be necessary to employ some external procedural mechanism/umbrella like an equitable receivership or a class action through which to conduct this collective restructuring. *Id.* at 1352–57.

128. David Skeel, *Why Contracts Are Saving Sovereign Bankruptcy*, INT'L FIN. L. REV., Mar. 2006, at 3, 3; Anna Gelpern, *Building a Better Seating Chart for Sovereign Restructurings*, 53 EMORY L.J. 1115, 1119 (2004).

129. This body of scholarship argues that contractual arrangements between firms and lenders regarding insolvency-state actions should not be prohibited under existing domestic bankruptcy regimes. Early work in this tradition focused on innovative mechanisms for determining the value of firms for the purpose of deciding whether they

theories of bankruptcy question the conventional assumption that a formal bankruptcy scheme is necessary to solve creditors' collective action problems.[130] They provide some support for the proposition that a borrower and its voluntary creditors can coordinate with each other to adopt a comprehensive contractual arrangement regarding debt restructuring.

D. *Defining Odiousness*

As noted above, a contractual odious debt arrangement should presumably include a definition of odious debt that the parties agree will be subject to repudiation. Part of the appeal of a private contractual solution to odious debt is that it gives this definitional task to sovereigns and their creditors. This section suggests that sovereigns and their creditors should define debt as odious if it does not provide a benefit to the citizens of the sovereign borrower.

Determining when a sovereign and its citizens received value or benefit from any particular transaction would obviously present a challenge. This definition should exclude obligations that provide funds used to finance conventional public goods. Credit provided to fund projects like highways, dams, hospitals, and schools, etc., should presumptively not be considered odious. On the opposite end of the spectrum, credit that simply provides funds for a leader's personal bank account should presumptively fall within the definition. Undoubtedly, however, many projects will be difficult to classify

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should be reorganized or liquidated. *See, e.g.*, Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127 (1986); Douglas G. Baird, *A World Without Bankruptcy*, LAW & CONTEMP. PROBS., Spring 1987, at 173. This initial round of scholarship tended to assume, however, that a mandatory bankruptcy procedure was necessary because firms and their creditors were not able to agree ex ante about how to resolve claims to the firm's assets if it became insolvent. *See, e.g.*, Baird, *The Uneasy Case*, *supra*, at 130–32. Significantly, however, Baird was one of the first contemporary scholars to raise the serious question of whether a mandatory bankruptcy regime was likely to reflect the arrangement that investors and firms would actually choose if the law allowed them to do so. *See id.* at 135 & n.12 (arguing that investors cannot reach agreement themselves, but acknowledging that it is impossible to know this for sure). Interestingly, bankruptcy scholars who have considered contractual arrangements for sovereign debt restructuring are decidedly skeptical about the feasibility of doing so. *See* David A. Skeel, *Can Majority Voting Provisions Do It All?*, 52 EMORY L.J. 417, 422–25 (2003); Rasmussen, *supra* note 23, at 1162, 1185.

130. *See* Randal C. Picker, *Security Interests, Misbehavior, and Common Pools*, 59 U. CHI. L. REV. 645, 675–79 (1992); Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 313–15 (1993); Alan Schwartz, *Contracting About Bankruptcy*, 13 J.L. ECON. & ORG. 127, 128 (1997) ("Collective action problems . . . sometimes yield to contractual solutions.").

under this scheme.[131] Consider, for example, the construction of a vanity palace. On one hand, this enriches the dictator because it simply provides a personal benefit. But it might provide jobs, and it might serve the civic function of monuments more generally. The possibility of corruption also complicates this definitional scheme.[132] Given these difficulties in classification, the definition of "benefit" should be generously construed. Repudiation of debt as odious should be an exceptional event, and debts should be defined as odious only if they are clearly not valuable. Assuming that creditors will prefer a narrow, predictable definition,[133] they will tend to err on the side of defining odiousness narrowly.

Significantly, the definition should also include an explicit safe harbor provision based on creditors' efforts to determine the purpose of the sovereign's borrowing.[134] The definition might provide, for example, that debts are not odious if a creditor credibly insisted on accounting at the lending stage, engaged in monitoring thereafter, and/or structured credit facilities to try to ensure that the funds it

131. For an argument that it may be possible to determine whether and when a particular loan provided value or benefit to the citizens of a sovereign, see Ben-Shahar & Gulati, *supra* note 1 (manuscript at 20–23).

132. The fact that private individuals or government officials derive unauthorized or unwarranted benefits from a transfer should not in and of itself resolve whether the transfer is odious or not. Yet corruption might be evidence that there was, in fact, no benefit or value. Consider the example of a stupid public venture—the bridge to nowhere—that is rife with corruption and skimming of funds. The relevant question will be whether the funds borrowed to build the bridge created any benefit or value for the citizens of the sovereign. The fact that there was corruption associated with the project might help indicate that the bridge was not intended as a public good to begin with, but it will not be dispositive. It is possible that corruption and odiousness are only different in degree, but the difference should be important as a practical matter.

Some writers would largely define odiousness with reference to various proxies like fraud, corruption, or end-stage timing—factors that might indicate the likelihood that particular debts are odious. *See, e.g.*, Buchheit et al., *supra* note 1 (manuscript at 5). In the case of odious debt, using definitional proxies may result in significant costs of over- and under-inclusiveness. Procedural proxies such as fraud or corruption will be especially costly. This problem is likely to be exacerbated the more despotic a regime is; everything a corrupt country does is likely to seem corrupt. Using corruption as a proxy in this context will simply ensure that an odious debt mechanism will be unable to distinguish many odious obligations from non-odious ones. *See supra* note 131 and accompanying text. It is also entirely possible for a regime to incur obligations that provide no value through a noncorrupt process. If an odious debt mechanism cannot designate those loans as odious, it will be underinclusive.

133. *See infra* notes 146–51 and accompanying text.

134. Jayachandran, Kremer and Shafter's most recent article makes the same point, and they develop a due diligence model for resolving odious debt disputes. *See* Jayachandran et al., *supra* note 12, at 18–22.

extended did in fact benefit the sovereign.[135] Such a safe harbor provision would leverage creditors' ability to serve as effective monitors. It is generally understood that creditors are often effective monitors of their borrowers.[136] In the context of private borrowers, they serve important governance functions, and there is reason to believe that these governance functions increase the value of their borrowers. Currently, it appears that sovereigns' creditors do not engage in significant levels of this kind of governance or monitoring, largely delegating these functions to multilateral institutions.[137] Conditioning safe harbor protection on creditors' monitoring may motivate them to take advantage of their access to information and to employ their unique monitoring skills.

To illustrate the foregoing points, imagine the following scenario. Sovereign A borrows $15 million from three different creditors ($5 million each). The sovereign tells Creditor 1 and Creditor 2 that it will use the funds to build a state university, but it makes no representation to Creditor 3 about the use of the funds. Creditor 1 subsequently insists on seeing evidence that the proceeds of its loan were actually used for building the university, and the sovereign provides evidence that it spent $8 million on building the university. It turns out that $7 million subsequently ends up in the Swiss bank account of the president of the sovereign. Under the definition proposed above, the $7 million would presumably be designated as odious. Creditor 3 made no efforts to insist on accounting or monitoring; it extended $5 million without even inquiring about the purpose of the loans. It could therefore not show that it deserved safe

135. Defining odious debt in this way might lead to a shift to more project-based financing and less borrowing for "uncontractable" purposes.

136. For an extended discussion of creditor monitoring and creditor governance, see Adam Feibelman, *Commercial Lending and the Separation of Banking and Commerce*, 75 U. CIN. L. REV. (forthcoming 2007) (manuscript at 10, on file with the North Carolina Law Review).

137. *See generally* Gulati & Triantis, *supra* note 23 (noting that most sovereign bonds include a provision requiring the sovereign debtor to maintain its IMF eligibility or membership). It appears that, under the leadership of Paul Wolfowitz, the World Bank has begun to play a much more aggressive role in monitoring the financial activities of sovereign regimes. *See* Ben-Shahar & Gulati, *supra* note 1 (manuscript at 34) (suggesting that sovereign debt instruments could require sovereigns to remain in good standing with the World Bank); Jai Damle, *The Odious Debt Doctrine After Iraq*, 70 LAW & CONTEMP. PROBS (forthcoming 2007) (manuscript at 13–14, on file with the North Carolina Law Review) (discussing Wolfowitz's plan to make assistance from the World Bank dependant on anti-corruption policies). *But see* Gelpern, *Odious, Not Debt*, *supra* note 1 (manuscript at 9–10) (arguing that some bilateral creditors and especially major-power sovereigns use their lending relationships as a lever of governance or control over their bilateral borrowers).

harbor treatment. Creditor 1, on the other hand, might deserve safe harbor treatment because it required accounting ex ante and then monitored the use of the funds.

Creditor 2 would present a difficult issue. It extended credit pursuant to the sovereign's representation about legitimate use of funds, but it did not make any serious effort to confirm that the funds were actually used for this purpose. Depending on the nature of the safe harbor protection, there are three ways that this creditor's claim might be characterized. First, the creditor might not be able to benefit at all from safe harbor treatment because it made no effort to confirm that its loan was used for the purpose represented by the sovereign. In that case, its entire debt would be deemed odious. On the other hand, the creditor might be able to argue that $3 million of its loan should not be considered odious because it made some efforts at the lending stage to lend for non-odious purposes; in other words, it might be able to claim the balance of non-odious debt after the first creditor's $5 million is subtracted. Finally, the creditor might get the full benefit of safe harbor because it made at least some effort to lend for a legitimate use.

One obvious practical problem with defining odious debt in relation to the actual use of the funds is that money is fungible.[138] Sovereigns have many creditors and other sources of funds, so it will be hard to determine how the funds from each creditor are used. Reconsider the three creditors discussed above; from a bird's-eye view, each creditor arguably helped finance the university and each helped pad the personal accounts of the despot. This may present a fatal challenge to the safe harbor proposal, and it may be impossible to determine in any case whether the proceeds of a loan provided a benefit to the sovereign. In many circumstances, however, it will be possible to trace funds ex post.[139] Sophisticated forensic accounting

138. *See, e.g.*, Rajan, *supra* note 1, at 54.

139. In fact, creditors and courts routinely engage in ex post tracing of proceeds in the context of secured lending to private borrowers. Article 9 of the Uniform Commercial Code provides that "a security interest attaches to any identifiable proceeds of collateral." *See* U.C.C. § 9-315(a)(2) (2005). Often proceeds will be commingled with other fungible assets. To deal with this, Article 9 also provides that "proceeds that are commingled with other property are identifiable proceeds ... if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing ...." *See* U.C.C. § 9-315(b)(2). For discussion of tracing proceeds in this context, see, for example, Richard L. Barnes, *Tracing Commingled Proceeds: The Metamorphosis of Equity Principles into U.C.C. Doctrine*, 51 U. PITT. L. REV. 281, 285–306 (1990); Richard L. Barnes, *UCC Article Nine Revised: Priorities, Preferences, and Liens Effective Only in Bankruptcy*, 82 NEB. L. REV. 607, 619 (2004); Harris J. Dia, Note, *Tracing Cash Proceeds in Insolvency Proceedings Under Revised Article 9*, 9 AM. BANKR. INST. L. REV. 385, 389–91 (2001).

investigations can aid in determining whether funds from a loan or bond issue directly or indirectly helped fund odious or non-odious uses.[140] If enforceability depended on it, parties will have incentives to disclose or try to discover information that would aid in making these determinations.

Imagine a variation of the scenario discussed above; this time, only one creditor, Creditor A, lends $5 million. The sovereign borrower builds a university for $5 million, and the sovereign leader ends up with $5 million in his or her Swiss bank account. It may be possible to demonstrate that the sovereign's obligation to Creditor A is odious. The fact that the leader received a personal benefit after the loan may itself be evidence that the proceeds of the loan were used for this purpose. It may also be possible to establish that the sovereign's revenues or available assets before the loan would have been sufficient to fund the university project and that the sovereign did not experience other accompanying tax reductions or increases in consumption. These factors might help forensic accountants establish that the proceeds of the loan made possible the personal benefit of the leader.[141] If Creditor A made no effort to avoid this misuse of its

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Granted, this context is different than the use of proceeds of a loan, but the experience of secured creditors in tracing this financial information suggests that many creditors have sophisticated abilities to gather and evaluate this kind of accounting information.

140. Forensic accounting has become a significant area of expertise in recent decades. Experts in this field have become essential components of litigation strategy in areas such as divorce, antitrust, government corruption, and corporate fraud. For discussion of the growing importance and sophistication of forensic accounting, see Michael J. Bazyler, *WWW.SWISSBANKCLAIMS.COM: The Legality and Morality of the Holocaust-Era Settlement with the Swiss Banks*, 25 FORDHAM INT'L L.J. 64, 76 n.27 (2001); Lyman P.Q. Johnson, *The Audit Committee's Ethical and Legal Responsibilities: The State Law Perspective*, 47 S. TEX. L. REV. 27, 53 (2005); Steven V. Melnik, *The Inadequate Utilization of the Accounting Profession in the United States Government's Fight Against Money Laundering*, 4 N.Y.U. J. LEGIS. & PUB. POL'Y 143, 155–56 (2000); Philippa Webb, *The United Nations Convention Against Corruption: Global Achievement or Missed Opportunity?*, 8 J. INT'L ECON. L. 191, 210–11 (2005); Molly L. Zohn, *How Antitrust Damages Measure Up with Respect to the* Daubert *Factors*, 13 GEO. MASON L. REV. 697, 733 (2005).

141. It may often be easier to trace the use of trade credit. It would be fairly clear, for example, that a supplier of mustard gas on credit helped finance the gassing of dissident populations by the sovereign's military. Suppliers of chicken farm equipment on credit, by contrast, probably did not help finance similar abuses. Admittedly, some trade credit will be harder to categorize. For example, it may be harder to determine whether claims of suppliers of conventional military weapons should be subject to repudiation if the regime uses those types of weapons against its own citizens. In such cases, the mechanism might rely on the same type of tracing principles described above, and it might rely on the same type of safe harbor protections as well. If so, it would be necessary to determine what the creditor knew about the intended use of the supplies and whether it took other

funds, then it would not enjoy safe harbor, and its debt may be repudiated by a subsequent regime at the direction of the sovereign's non-odious creditors. A creditor could try to avoid this result by insisting that the funds it transfers to the sovereign be segregated from general funds and dedicated to particular uses.

III. ADVANTAGES OF A CONTRACTUAL APPROACH

The foregoing Part explained that a contractual approach to odious debt is practicable. This Part argues that it should also be desirable. A contractual approach is likely to serve the normative goals of odious debt relief better than the alternative proposals discussed above.

A. *Odious Debt Goals*

Any mechanism designed to enable sovereigns to repudiate odious debt would have two primary and interrelated goals. First, most obviously, it would expand the ability of sovereign governments to obtain debt relief ex post. A sovereign would gain the ability to improve its financial position by repudiating obligations incurred for unproductive or odious purposes. This is especially valuable for sovereigns that are carrying an unsustainable debt load. Reducing "debt overhang" helps sovereigns fund public goods and promote development.[142] The mechanism would presumably benefit a sovereign that owes potentially odious debt, even if its does not decide to employ the mechanism. As suggested above, if a sovereign can make a credible threat to repudiate its obligations, it should gain some advantage in attempting to negotiate for debt restructuring.[143]

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opportunities to monitor the use of the supplies and perhaps condition its own continuing performance thereupon.

142. *See supra* note 25 and accompanying text. An odious debt relief mechanism should also prove beneficial to sovereigns that have sustainable levels of debt. In theory, discharging any debt that did not add value to the sovereign should be efficient. Such debts simply add to the financial obligations of the current government. They inefficiently inflate the tax burden of its citizens by requiring tax increases to fund the same amount of public goods or by decreasing the sovereign's consumption and provision of public goods. Furthermore, because of the need to devote tax revenues or national resources to repay these obligations, the overall value of the sovereign's outstanding debt will presumably decline. The sovereign will have to pay a higher rate for any additional credit it needs, if it can obtain any. If a sovereign is able to repudiate such obligations, the value of the sovereign's other (presumably non-odious) outstanding debts should increase, and its cost of borrowing should decline.

143. *See supra* notes 35–36 and accompanying text (discussing the possibility that Iraq and Nigeria may have prodded creditors into voluntary restructuring by implicitly threatening to repudiate debts as odious).

This benefit of ex post debt relief is not costless. Sovereigns must make sure that they do not undermine the confidence of creditors. Thus, if sovereigns are going to entertain the possibility of repudiating their obligations, they will need to be able to assure creditors that they will not do so arbitrarily. The grounds of repudiation should be as clear and predictable as possible so that creditors can lend to sovereigns and avoid the conditions of repudiation. Otherwise, creditors may simply stop lending to sovereigns or they may charge sovereigns a very high rate, outweighing any benefit of the debt relief.

The second and perhaps more important goal of an odious debt mechanism is to affect the behavior of sovereign regimes (and their creditors) ex ante, at the lending stage.[144] If odious debt is subject to discharge, repudiation, or subordination, then the cost of borrowing potentially odious debt should increase. If so, it should become harder, or more expensive, for despotic regimes to incur such debts, creating a disciplining force against such regimes.[145] Ideally, this should promote improved governance and reduce the chances that a regime will engage in abuses against its own population.

B. *A Normative Critique of Existing Proposals*

Assuming that any of the proposed odious debt doctrines or institutions can overcome the various formal and political threshold challenges outlined above in Part I, these proposals are still probably not well designed to achieve the primary goals of odious debt relief. Most of these proposals are not likely to develop a consistent practical definition of odious debt. Consider the traditional doctrine itself, for example. The fact that the doctrine has not been unambiguously employed over the last century or so means that there are no clean precedents defining the scope of the doctrine in practice.[146] In proposing to apply the doctrine to the Iraq context, commentators have had to refer back to the broad definition of the doctrine as articulated by Sack nearly a century ago. If the odious

144. *See* Paulus, *supra* note 1, at 87–88; Kremer & Jayachandran, *supra* note 1, at 90–91.

145. Various factors may undermine this disciplinary effect. If sovereigns have relatively easy access to tax revenue or national resources, for example, their demand for credit may not respond to the cost of credit as directly as would be true of a borrower with more constraints.

146. As Anna Gelpern notes of the traditional doctrine, "in its current state [the doctrine] offers no meaningful guidance to shape decisions on lending to the emerging markets." *See* Gelpern, *Iraq and Argentina*, *supra* note 1, at 412; Paulus, *supra* note 1, at 83.

debt doctrine were to be applied today, a decisionmaker would essentially have to paint on a blank canvas.[147] Given the importance of clarity and predictability for any mechanism for repudiating sovereign debt, this uncertainty is troubling. Employing doctrines drawn from domestic private law would lead to similar problems. Because courts would not be painting on a blank canvas with such doctrines, however, they might be able to apply them somewhat less erratically and more predictably.

Any potential uncertainty and unpredictability associated with these doctrines are compounded by the fact that they represent an inherently ad hoc approach to odious debt questions.[148] It is doubtful whether courts will be able to apply any standard of odiousness consistently and predictably. Courts are inclined to focus heavily on the cases before them and to resolve legal issues in light of case-specific factors.[149] Under such circumstances, courts of general jurisdiction are unlikely to develop useful expertise or a coherent doctrine of odious debt over time. And significantly, these courts will probably not have to bear any significant costs of choosing a suboptimal definition of odiousness or of applying the definition unpredictably. Thus, there is no reason to believe that they will have good incentives to avoid unsettling financial markets.[150]

By comparison, an odious debt claims tribunal like the one described in Part I would probably be more likely to develop some expertise in sovereign debt claims because that would be its exclusive purpose. At least with respect to the particular set of claims within the tribunal's jurisdiction, the arbitrators of each tribunal will also have the ability to develop a relatively clear standard for odiousness and to apply the standard consistently. They may also have incentives do so. The success of such a tribunal would largely depend on its perceived legitimacy and usefulness. Arbitrators would presumably be invested in the success of the tribunal and would therefore have an incentive to reach decisions that were perceived as well-reasoned and consistent. A tribunal created by broad political agreement between official and private creditors and the Iraqi regime may also enjoy

147. *See supra* Part I.A.

148. *See* Paulus, *supra* note 1, at 91–92.

149. For a similar argument in a different context, see Adam Feibelman, *Federal Bankruptcy Law and State Sovereign Immunity*, 81 TEX. L. REV. 1381, 1405 (2003).

150. There are similar problems with an approach that would rely on bringing claims before the International Court of Justice. *See supra* note 71. Such a court is unlikely to develop any expertise in these types of disputes and is unlikely to have strong institutional incentives to efficiently discharge or subordinate sovereign obligations.

more institutional confidence than, say, domestic courts in designating particular debts for repudiation.

Nonetheless, an odious debt claim tribunal will likely face similar definitional problems as those discussed above. Such an approach is arguably more ad hoc than any of the doctrinal approaches. Decisions made by one tribunal might provide a useful guide as standards or rules regarding odious debt, but these decisions would have no formal precedential value for future disputes involving other sovereigns. Each tribunal might look to cases from previous tribunals or from elsewhere as persuasive authority, but none would have an incentive to carefully develop a coherent and predictable doctrine over time. Since each tribunal would have a life of one generation, there is no reason to believe that the concerns of a country-specific tribunal would extend beyond its particular domain. For these reasons, a tribunal might have weak incentives to try to be sensitive to the effects that its actions may have on financial markets generally or on other sovereign borrowers.

The odious debt institution proposed by Kremer and Jayachandran may generate a more predictable, uniform approach to odious debt. The consequences of a designation would be so great that the tribunal would be under significant pressure to be clear and consistent in its application. Because it would be an ongoing institution with responsibility to make odious debt determinations over time, it would also be in a relatively good position to act in a predictable and coherent manner. It should have more of an incentive to do so, as the legitimacy of such an institution would largely be a function of its consistency in making principled decisions about odiousness over time. A potentially significant problem with the scheme, however, is that it is necessarily an unforgiving binary scheme. If a regime is actually designated odious, it will likely face the equivalent of a loan or aid embargo.[151] Embargoes are not uncommon in international affairs, but the kind of embargo envisioned by Kremer and Jayachandran would likely be harsher than most. While such an embargo should have some beneficial effects on the incentives of odious regimes, it may be tougher medicine than the world community wants to employ, even against despots.[152] Given

151. *See* Kremer & Jayachandran, *supra* note 1, at 87–89.

152. *See* Gelpern, *Iraq and Argentina*, *supra* note 1, at 413 ("[T]he aid penalty seems excessive and impractical . . . ."); Buchheit et al., *supra* note 1 (manuscript at 26 n.85) (citing David A. Baldwin, *Reconciling Political Sanctions with Globalization and Free Trade: Prologamena to Thinking About Economic Sanctions and Free Trade*, 4 CHI. J. INT'L L. 271 (2003)); Justin D. Stalls, *Economic Sanctions*, 11 U. MIAMI INT'L. & COMP. L.

these stakes, such a tribunal would likely—as a practical matter—hesitate to designate a regime as odious until it had become egregiously bad. There is a significant risk that it would not be willing to do so at all. Perhaps for these reasons, these authors have proposed an alternative approach, one that would enable creditors to lend to regimes designated as odious so long as the creditors make efforts to confirm that the credit is used for non-odious purposes.[153] Such a change may mitigate the dramatic effects of being designated as odious, but it seems likely that the designation would still be extremely disruptive.

It is quite possible that a formal sovereign bankruptcy procedure would provide a better mechanism for addressing odious debt than the other options discussed above. A bankruptcy administrator or decisionmaker with experience in sovereign debt matters would have significant advantages over a general domestic court, the International Court of Justice, or an international tribunal in addressing odious debt claims. Such an actor would likely be more familiar with the substance and scope of sovereigns' credit relationships than other courts or tribunals. Like the IMF and other financial institutions in the international public sector, it would presumably develop a relatively sophisticated understanding of the ongoing financial concerns of sovereigns as well as their creditors. Perhaps more important, individuals associated with a formal sovereign bankruptcy institution should have good incentives to try to develop an efficient approach to odious debt. Like the tribunal proposed by Kremer and Jayachandran, an ongoing sovereign bankruptcy institution would internalize some of the costs of suboptimal repudiation of odious debt. Its ongoing legitimacy would presumably be directly related to its success in balancing the goal of odious debt relief with the concerns of financial markets.

Similarly, a sovereign bankruptcy-type court or tribunal would also be able to eliminate some of the tensions between odious debt claims and general debt restructuring. The other proposals discussed above are quite weak in this regard. An ad hoc odious debt mechanism is most unlikely to promote quick, comprehensive restructuring of a sovereign's various debts and may even delay a sovereign's ability to obtain emergency interim financing. A tribunal

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REV. 115, 157 (2003); Kremer & Jayachandran, *supra* note 1, at 87 (discussing how sanctions can have injurious effects on the population of the sovereign targeted by them); Michael Wines, *When Doing Good Also Aides the Devil*, N.Y. TIMES, Dec. 25, 2005, § 4, at 5.

153. *See* Jayachandran et al., *supra* note 12 (manuscript at 18–19).

or a court of general jurisdiction may have weak incentives to proceed as expeditiously as possible when a sovereign has immediate needs for restructuring.[154] By contrast, where a sovereign has potential odious debt claims and a general need for restructuring, a sovereign bankruptcy process could resolve both issues simultaneously and in a comprehensive manner. A bankruptcy decisionmaker might be able to convince creditors to agree to a restructuring of non-odious debts if odious debts are repudiated or subordinated. As noted above, however, it does not appear that a sovereign bankruptcy regime is likely to emerge as an available alternative in the near future.

C. Why Contract Is Better

A contractual odious debt arrangement may be preferable to the available alternative mechanisms discussed above. A crucial premise of the contractual approach is that both a sovereign and its creditors should have incentives to adopt such an arrangement in the first place. As suggested above, a sovereign will have two primary incentives to agree to a provision for repudiation of odious debt. First, and most obviously, doing so may improve the chances that the sovereign will derive a benefit ex post in the form of debt relief if it incurs odious debt. Second, to the extent that such an arrangement successfully segments the market for sovereign debt, it may lower the cost of non-odious debt to sovereigns that can credibly commit to avoid incurring odious debt.

Perhaps more significantly, bona fide creditors of a sovereign should also have incentives to opt in to the arrangement. Recall that odious debt does not benefit the sovereign debtor or the citizens of the sovereign. Presumably, a creditor who is lending non-odious debt to a sovereign does not want its debtor to incur other obligations that provide no value to the sovereign. Such obligations represent competing claims to the sovereign's assets without improving the financial strength of the sovereign. At least in theory they will decrease the value of the creditor's claim. Furthermore, such credit may enable the sovereign to engage in destructive or wasteful behavior that more directly reduces the value of a creditor's existing claim. It may also help entrench regimes that do not care much about the welfare of their citizens or the sustainability of the sovereign's

154. In fact, the Iran-U.S. Claims Tribunal "took decades to sift through each claim against Iran." *See* Gelpern, *Iraq and Argentina*, *supra* note 1, at 410; Jubilee Iraq, *supra* note 72.

debt load. These factors suggest that creditors will internalize many of the benefits of an odious debt relief mechanism if it reduces the amount of odious debt that sovereigns incur or repay.

There is some evidence that creditors do have such concerns about the behavior of their sovereign debtors. As noted above, sovereign bonds generally include provisions requiring sovereigns to maintain good standing with the IMF.[155] This practice may be a way for creditors to delegate monitoring functions to this institution.[156] Furthermore, there is evidence that legitimate creditors are increasingly motivated to challenge claims of competing creditors who have acted inequitably. Consider the recent case of *Kensington International, Ltd. v. BNP Paribas, S.A.*[157] In that case, Kensington, a creditor to the Republic of Congo, sued BNP Paribas, alleging that the French bank had helped the Congolese government hide assets from which BNP Paribas itself had apparently been repaid. The case suggests that bona fide creditors have incentives to help police other creditors who act inequitably.

Yet creditors will also internalize some of the costs of any mechanism that allows sovereigns to discharge odious debts. Perhaps most obviously, they will be subject to direct operation of the mechanism; they will run the risk that their sovereign debtors will repudiate debts owed to them pursuant to the mechanism. Non-odious creditors will also bear costs created by the application of the mechanism against other creditors. There is a danger under a contractual scheme, for example, that a majority of creditors might try to oppress minority creditors by arbitrarily or unfairly characterizing their debts as odious. If they do, however, they would likely end up damaging their own interests in lending to financially viable sovereigns in the future. As noted above, if an odious debt mechanism were overenforced, it would be more difficult or more costly for sovereigns to secure valuable financing in general.[158] This would not only hurt sovereigns who want to secure value-enhancing debts going forward; it would also hurt creditors of those sovereigns. Non-odious creditors will have a stake in enabling their sovereign debtor to establish other non-odious credit relationships (especially

155. *See* Gulati & Triantis, *supra* note 23 (manuscript at 27).

156. *See supra* note 137 and accompanying text.

157. Kensington Int'l, Ltd. v. BNP Paribas, S.A., No. 03602569 (N.Y. Sup. Ct. Jan. 24, 2005) (unpublished opinion, on file with the North Carolina Law Review). The case was dismissed on procedural grounds, and it is not clear if Kensington is still pursuing the litigation.

158. *See supra* Part III.A and accompanying text.

trade credit and/or transitional financing). Consider what would happen if trade creditors began to fear that their obligations will be arbitrarily repudiated. They would become more hesitant to extend credit to a sovereign, and the cost of trade credit would increase accordingly. If the sovereign has trouble securing trade credit or other valuable forms of credit going forward, or if it must pay considerably more for these facilities, then it may be more likely to experience some form of financial distress, compromising its existing obligations. Finally, some creditors will be repeat players and may be subject to reputational sanctions for aggressive, abusive behavior. Thus, for example, a sovereign may be reluctant to borrow from a creditor who develops a bad reputation for treating other creditors badly.

Thus, while non-odious creditors have an interest in ensuring that odious debts are identified and repudiated, they also have a strong interest in ensuring that any odious debt mechanism not be overly aggressive in discharging sovereign obligations. This suggests that the interests of these creditors are aligned in important respects with those of the citizens of their sovereign debtors. Both have a real interest in making sure the sovereign only incurs obligations that provide value to the nation itself. When a sovereign incurs odious debt, the burden is borne by citizens to the extent that they must ultimately help pay off the obligation, an obligation from which they derive no benefit. The burden is borne by non-odious creditors to the extent that they face a somewhat higher risk of actual default, suffer a more immediate loss in the value of their obligations, or share a smaller pie in the case of debt restructuring. Both would prefer that the sovereign repudiate any odious debts it incurs, and yet both have a significant, ongoing stake in wanting to protect the financial reputation of the sovereign. This is not to say that these interests are perfectly aligned. Creditors may prefer that their sovereign borrower not pursue costly or risky policies designed to benefit the welfare of their population. It is theoretically possible that a majority of a sovereign's creditors could vote under a contractual mechanism to designate as odious obligations incurred to promote these policies. They might be restrained from taking such action, however, by reputational or direct financial costs of doing so.[159] Furthermore, such actions might not withstand judicial review if the debts designated as odious did not conform to the contractual definition.[160]

159. *See supra* Part III.C.

160. *See supra* notes 113–14 and accompanying text.

A contractual odious debt relief arrangement also has advantages at the enforcement stage, when regimes may want to balk from repudiating or restructuring their sovereign's debt.[161] As noted above, under a contractual approach, the sovereign will have strong incentives to abide by the terms of its odious debt agreement. If a debt is designated as odious, it is because a majority or supermajority of the sovereign's creditors deemed it to be so. There is good reason to believe that the sovereign would be penalized for breaching the agreement by paying the debt, an event of default. These costs will provide at least some disciplining force on sovereign regimes. Furthermore, repudiating odious debts under the arrangement will give current and subsequent creditors more confidence that the sovereign will not incur odious debts in the future. This would likely improve the creditworthiness of the sovereign to some extent. Finally, if the sovereign is experiencing financial crisis and is seeking general debt restructuring, its creditors may have some significant leverage—they can condition debt relief on a commitment from the sovereign to repudiate the odious debts. In such a case, the creditors might agree to provide necessary emergency or interim financing and to condition this credit on enforcing the odious debt mechanism.[162]

CONCLUSION

The contractual mechanism proposed in this Article is designed to provide a measure of debt relief and to improve the ex ante incentives of sovereigns and their creditors. It is not designed to create strong prohibitions or to ensure that sovereigns will not incur odious debt. Some creditors and some sovereigns will almost certainly continue to create odious debt in the face of this or any other odious debt mechanism. A despot who is genuinely unconcerned about the welfare of his or her citizens will have little incentive to reduce the sovereign's cost of credit.[163] Creditors who are willing to lend to such a regime will continue to do so, and they may

161. Bolton & Skeel, *supra* note 94, at 770–71.

162. This also reflects that a contractual odious debt mechanism would be less disruptive for sovereigns needing general debt restructuring. The operation of the mechanism would basically involve the same parties that would need to negotiate a general debt restructuring. It would be entirely possible to make odious debt determinations in the course of those negotiations.

163. Furthermore, a despot who is determined to obtain private benefits can appropriate wealth in other ways than siphoning off borrowed funds. *See* Rajan, *supra* note 1, at 55.

devise ways to make these transactions profitable, requiring kickbacks or insisting on an immediate exchange of value.[164]

That said, a contractual odious debt mechanism should have some real force to restrain these kinds of transactions. By leveraging the interests and the monitoring skills of creditors, a contractual approach may be more effective than alternative mechanisms at reducing the amount of odious debt outstanding. The contractual mechanism should significantly increase the cost of odious transactions by increasing the chance that these obligations will actually be repudiated. Even reckless or ruthless creditors may be less willing to extend odious debts and more likely to demand higher return for potentially odious debts, thereby shrinking the credit available to regimes inclined to incur such debt. Furthermore, it will leverage the power of creditors to affect the behavior of sovereign governments, perhaps prompting more transparent accounting and monitoring. Even modest success at reducing the amount of odious debt outstanding should significantly improve the welfare of citizens of sovereign debtors across the globe.

If a contractual solution to the odious debt problem would promote the interests of creditors and sovereigns and is otherwise preferable to proposed alternatives, it is fair to ask why these parties do not already make such private arrangements. In truth, this is puzzling, and it might indicate that there are serious obstacles to contracting around odious debt that are not immediately obvious. On the other hand, it may be due in part to path dependency. As a general matter, contractual innovation comes slowly and uncertainly to sovereign debt markets.[165] Thus, it is not implausible to believe that sovereigns and their creditors have failed to adopt an efficient contractual arrangement. This is especially true if the overall efficiency of the arrangement is a product of positive externalities. It may be, for example, that the citizens of various sovereigns would benefit significantly from this contractual innovation (if it reduces the amount of odious debt they must repay, for example) while the parties themselves receive only modest benefits. If that is the case, the official sector could play an important role in encouraging parties to adopt a contractual approach to the odious debt problem.

164. *See, e.g.*, Feinerman, *supra* note 1 (manuscript at 13–14) (suggesting that making odious sovereign loans was good business for lenders in the 1970s).

165. *See generally* Gelpern & Gulati, *supra* note 19 (exploring the complex and somewhat mysterious factors leading to adoption of collective action clauses in sovereign bonds issued under New York law).