

## Can Debts Be Odious and, thus, Be Void?

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### I. Introduction

Consider the following: there is a 'bad guy' head of a state who borrows money in the name of the state he is representing from another state or a bank. Is the debt resulting from this credit void? Or: is it legal to have a state pay back loans which had been taken by such a bad guy and been used by him to buy, *inter alia*, weapons with which he had killed, *inter alia*, members of the families the survivors of which are now bound to repay those loans through their taxes? Very emotional questions, indeed. But they are not fictitious or hypothetical – they are posed in fact, and claim legal validity under the term 'odious debts'. What might appear to many lawyers almost as a parody of 'law and economics' or 'law and literature' – namely 'law and emotions' – is referred to by many NGOs as binding law, and not without some serious argument. The implications, to be sure, are enormous. If there exists a legal doctrine called 'odious debts' states like Iraq<sup>1</sup> are likely to be debt-free – not because the lender states should display grace after liberation from Saddam Hussein, but because of legal consequences! 'Odious debts' are understood as a legal institution which, by force of law, makes certain debts automatically null and void.<sup>2</sup>

The doctrine of 'odious debts' dates back little more than a hundred years. Because it has been topical only sporadically over this period, it is unclear whether or not it already has the precision or 'marginal sharpness' that would be necessary if it were to be used as a legal

instrument. This uncertainty, in turn, makes the term 'odious debts' appear very versatile in the way it can be used and instrumentalised. In particular, the value statement already inherent in the terminology tends to mislead one into exploiting this doctrine to attempt to render morally repugnant facts legally null and void. In view of these facts, it is the (thankless) task of the legal scholar to call for caution to be exercised in drawing conclusions of this sort (however understandable they may be in human terms), and to point out the distinction between law and morality,<sup>3</sup> which is a hard-won victory in legal history, and which requires recognition by the legal community.

This exhortation naturally does not negate the option of developing legally practicable contours, with the help of which certain debts can be termed 'odious', and can be dealt with accordingly on a legal level. It is only an attempt to clarify the fact that moral indignation, however justified, cannot automatically produce the desired legal consequences by using a purportedly legal concept. For this, the term must be defined more precisely in legal terms. This paper will look at the extent to which this appears feasible at the present time.

### II. History of the 'odious debt' concept

The phenomenal efforts being made to seek a way to end debt repayment at the state level has a long history.<sup>4</sup> The first recorded use of the juridification of

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- \* A slightly different version of this article has been published under the title "'Odious Debts' vs. Debt Trap: A Realistic Help?" in 31 *Brooklyn Journal of Int'l Law* 83 ff. (2005.)
- 1 For the complicated, multi-levelled debt structure of present day Iraq see Caron, 'The Reconstruction of Iraq: Dealing with Debt', 11 *UC Davis J. Of Int'l Law & Policy* 123 ff. (2004).
  - 2 Debt forgiveness is, thus, seen as an improper act of voluntary grace. If there is instead a legal automatism, there is no room for grace and reciprocal gratitude. For the 'traditional' treatment of state debts and the possibility of their restructuring, see, for example, Fabio Marcelli, *Il Debito Estero dei Paesi in via di Sviluppo nel Diritto Internazionale* (2004); August Reinisch & Gerhard Hafner, *Staatensukzession und Schuldenübernahme beim 'Zerfall' der Sowjetunion* (1995).
  - 3 See Immanuel Kant, *Metaphysische Anfangsgründe der Rechtslehre* § E at 47.
  - 4 See, e.g., Max Huber, *Die Staatensukzession* 84 (1898); M.H. Hoeflich, 'Through a Glass Darkly: Reflections Upon the History of the International Law of Public Debt in Connection with State Succession', *U. Ill. L. Rev.* 39 (1982). For other precedents (although not expressly based on the principle of odious debts) see Theo Kneifel, Kirchliche Arbeitsstelle Südliches Afrika (KASA), "'Odious Debts' – Ein Sonderfall von Illegitimen Schulden am Beispiel der Apartheidschulden Südafrikas' (Feb. 2002), <[www.odiousdebts.org/odiousdebts/publications/odiousdebts\\_KASA.pdf](http://www.odiousdebts.org/odiousdebts/publications/odiousdebts_KASA.pdf)>; Andreas Fischer-Lescano, 'Odious Debts und das Weltrecht', 36 *Kritische Justiz* 223 (2003), available at <[www.odiousdebts.org/odiousdebts/publications/Fischer-Lescano.pdf](http://www.odiousdebts.org/odiousdebts/publications/Fischer-Lescano.pdf)>; Lee C. Buchheit, G. Mitu Gulati, Robert B. Thompson, 'The Dilemma of Odious Debts' (forthcoming in *Duke Law Review*: on file with the present author).

the term 'odious debt' in this respect, however, dates back to 1898 where it was cited by the United States of America.<sup>5</sup> In the wake of the Spanish-American War, from which the United States emerged victorious, 'odious debt' was taken as a justification for not repaying Cuba's debts to Spain, which the United States, as the protective power over Cuba, would normally have honoured.<sup>6</sup> The United States claimed that these debts were 'odious' because the money lent to Cuba by Spain, which then had to be repaid, would have served to petrify the oppression of the Cuban people with the private law instrument of obligations.<sup>7</sup>

The term resurfaced about a quarter of a century later in Costa Rica, triggered by an act of parliament and the subsequent arbitration proceedings.<sup>8</sup> In 1919, Costa Rica managed to end the dictatorship of Frederico Tinoco, and passed a law (the Law of Nullities) repudiating the debts granted by the Royal Bank of Canada to the dictator in the name of Costa Rica, on the grounds that they were 'odious'.<sup>9</sup> The subsequent arbitration proceedings ended in 1923, when the arbitrator, Chief Justice Taft of the US Supreme Court, in his ruling, upheld the right of Costa Rica to act in this way.<sup>10</sup>

A few years later, the legal scholar Alexander Nahum Sack produced an in-depth study in which he examined attempts to define the doctrine of 'odious debts' precisely in legal terms, such that it could be operationalised.<sup>11</sup> According to Sack, a successor state is only bound to repay the debts of its predecessor if the funds thus obtained were used to meet the needs of the state and were obtained in the best interests of the state.<sup>12</sup> If however, (1) the funds were not used to meet the needs of the state and were not obtained in the best interests of the state, and (2) the creditors were aware of this fact, then the granting of the loan represents a hostile act against the people of the debtor state, which renders the debt 'odious' and thus invalid.

Sack is often held to be the academic who has dealt in most depth with the issue of what happens to national

debts after a change of regime.<sup>13</sup> He is still in some ways the 'crown prince' of advocates of this legal principle. Recently however, his proposal has been taken one step further in a Canadian study.<sup>14</sup> The authors propose that the 'odiousness' of a national debt should be determined not only on the basis of the two criteria advanced by Sack. They argue that a third, objective criterion should be added – that the debts must have been taken out with the consent of the population.

Previously, in the early 1980s, the International Law Commission had already tried to find a definition in the context of developing the Vienna Convention on Succession of States in respect of State Property, Archives and Debts from 4 April 1983.<sup>15</sup> The proposal was as follows:

'Article C. Definition of odious debts

For the purposes of the present articles, 'odious debts' means:

- (a) all debts contracted by the predecessor State with a view to attaining objectives contrary to the major interests of the successor State or of the transferred territory;
- (b) all debts contracted by the predecessor State with an aim and for a purpose not in conformity with international law and, in particular, the principles of international law embodied in the Charter of the United Nations.'

However, not only was this article not inserted into the Convention, the Convention itself has not yet come into force.<sup>16</sup>

To wind up this brief historical outline, it can be said that these lines of thought and argumentation leave too great a vacuum in theory and in practice for us to accept the principle of 'odious debts' as a legal institution recognised under customary law.<sup>17</sup> For this to happen, the principle would have to have been applied

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5 Hoeflich, *supra* note 4, at 53-54.

6 See generally 'Sovereignty: Its Acquisition and Loss, The Cuban Debt', 1 Moore, *Digest of International Law*, 1906 § 97, at 351-385 (summarizing the peace negotiations process between the United States and Spain); Ernst H. Feilchenfeld, *Public Debts and State Succession* 329 (1931).

7 Moore, *supra* note 6, at 367.

8 Gr. Brit. v. Costa Rica, 1 R. *Int'l Arb. Awards* 375 (1923).

9 *Id.* at 376.

10 *Id.* at 399.

11 See generally Alexander Nahum Sack, *Les Effets des Transformations des Etats sur leurs Dettes Publiques et Autres Obligations Financières: Traité Juridique et Financier* (1927) [hereinafter Sack, *Les Effets des Transformations*]; Alexander Nahum Sack, *La Succession aux Dettes Publiques D'État* 70 (1929).

12 Sack, *Les Effets des Transformations*, *supra* note 11, at 157 with 25 seqq.

13 Feilchenfeld, *supra* note 6, at 16.

14 Ashfaq Khalfan, Jeff King & Bryan Thomas, 'Advancing the Odious Debt Doctrine' (11 March 2003) (unpublished manuscript, available at <[www.odiousdebts.org/odiousdebts/publications/Advancing\\_the\\_Odious\\_Debt\\_Doctrine.pdf](http://www.odiousdebts.org/odiousdebts/publications/Advancing_the_Odious_Debt_Doctrine.pdf)>).

15 Documents of the Thirty-Third Session, [1981] II Y.B. *Int'l L. Comm'n* 79, U.N. Doc. A/CN.4/SER.A/1981/Add.1 (82.V.4).

16 See <[untreaty.un.org/ilc/texts/instruments/english/conventions/3\\_3\\_1983.pdf](http://untreaty.un.org/ilc/texts/instruments/english/conventions/3_3_1983.pdf)>.

17 See also Fischer-Lescano *supra* note 4. On customary law from the stance of international law as a whole, see Christian Tomuschat, 'International Law: Ensuring the Survival of Mankind in the Eve of a New Century', in Académie de Droit International, *Recueil des Cours: Collected Courses of The Hague Academy of International Law* 1999 No. 281, at 324 (2001).

over a longer period, and it would have to be recognised as a legally binding obligation.<sup>18</sup>

### III. Purpose of ‘odious debts’

Before we go on to look at the question of whether and how the doctrine of ‘odious debts’ can be or could be used legally, at least in the future, in the proposed manner, it would be helpful to clarify the purpose of this new legal principle.

#### A. The original purpose

The two practical examples given above in Part II were retrospective. The outcome thus could not have been foreseen by the two parties to the loan agreement when the loan was originally granted. Thus (from a European legal stance), an essential prerequisite of law is not met – i.e. the tenet that the law should act as an instrument to steer the behaviour of actors.

It is true that this alone is not enough to call into question the legal validity of the measures, for customary law in particular. This generally accepted source of law, *cf.* article 38 para. 1(b) ICJ Statute, is characterised precisely by the fact that somewhere at some point in time, a new legal understanding emerges which, in the course of time, becomes so convincing that it eventually becomes an integral part of the general sense of justice.<sup>19</sup> We have not yet reached this point, however, with respect to the doctrine of ‘odious debts’. Even if one hundred percent agreement is not needed to achieve this level of acceptance, neither is it enough for a few small groups to be convinced of the legal validity of a concept for it to become accepted as customary law.

#### B. Today’s purpose

The direct *purpose* of the doctrine of ‘odious debts’ seems to be to create an impact which would steer the behaviour of relevant actors. Like a signal, it should remind the parties involved in future loan agreements to respect the limits of private autonomy (*‘Privatautonomie’*) set by the new legal principle.

This doctrine would thus take its place among a number of existing legal regulations – in particular those under private and constitutional law – which act as protective mechanisms against any irresponsible commitment on the part of a state.<sup>20</sup> Under both constitutional and civil law, usually it is clearly stated what formalities a country must comply with before entering into a commitment of this sort. If these formalities are ignored, which according to reports appears to be the case more often than not, the commitments regularly have no legally binding impact, even under private law.<sup>21</sup> A doctrine of ‘odious debts’ could not add any more serious or further-reaching form of invalidity – with the exception perhaps of the demonstratively expressed stronger moralistic condemnation.

Any legally recognised doctrine of ‘odious debts’ would thus only come into play over and above the (long-standing) legal instruments already in use. Since the doctrine would be used to enforce certain moral values, an attempt would have to be made to reach a global agreement on these moral values because the very simple fact of the matter is that here, as in any other instances, the values praised by one party appear to be unacceptable by another. Considerations pertaining to a discussion (let alone a clarification) of this sort have no place in a legal study, however, so we will simply state that the *goals* of having the ‘odious debts’ doctrine accepted as a legal principle must surely be to leave a dictatorial regime high and dry in material terms, and thus to foster democratic forms of government. For, in line with the variations of the doctrine of ‘odious debts’ proposed thus far, the potential lender can only then be sure at the planning stage that the sum borrowed will be repaid in the latter case.

### IV. Pros and cons of ‘odious debts’

Whatever the finer details of these objectives, we must examine in legal terms the pros and cons of introducing (or establishing) the doctrine of ‘odious debts’.

#### A. Cons

The crucial and most obvious argument against establishing the doctrine of ‘odious debts’ is the basic legal

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18 See Ignaz Seidl-Hohenveldern & Tortsten Stein, *Völkerrecht* § 28 para. 467, at 99 (10th edn 2000).

19 See Bernhardt, ‘Customary International Law’ in: *id.* (ed.), *Encyclopedia of Public International Law* (1984).

20 The question as to whether or not a legal regulation of this sort is an instrument of international, public or civil law is of more technical interest, and the issue will not be analyzed in any more depth here. See generally August Reinisch, *State Responsibility for Debts: International Law Aspects of External Debt and Debt Restructuring* (1995).

21 There are of course *de facto* problems in obtaining legally binding confirmation that contracts of this sort are null and void, and even greater difficulties involved in stipulating the legal consequences of a decision of this sort.

principle *pacta sunt servanda* (pacts must be respected).<sup>22</sup> This ancient principle is not based on inflexible and stubborn legal thinking, but on the recognition of the value of having a firm basis for planning, not only for the economy but in interpersonal dealings in general. Even if the ‘invention’ of the contract *per se* is not necessarily the result of this sort of need for future security or security in some other form, the binding nature of a contract once entered into is a matter of personal and economic interest. We should not lose sight of the fact that any incursions into this security will trigger a response on the part of the party affected, which ought to be taken into account before any pertinent new legal principle is introduced.

In the case in hand, the response might well be that the willingness of potential lenders to grant loans drops dramatically. We can, of course, counter that this is precisely the desired effect (see III.B) of the doctrine – that certain states or certain governments are unable to borrow money. However plausible this argument might appear at first sight, if we disregard for the moment the fate of the population (i.e. each individual citizen) affected, the consequences are far-reaching. However, as morally repugnant as it might seem to lend money to a generally abhorred dictator, what about the loans accorded to his in-no-way-disreputable predecessor,<sup>23</sup> which are due for repayment under the regime of the dictator? Who is to set the yardstick for what is to be deemed ‘generally abhorred’? What will happen if a head of government with a hitherto unblemished reputation suddenly turns bad during his period in office? Should a sort of black list be drawn up of endangered countries?<sup>24</sup>

The list of questions of this sort could easily be continued. However, the examples already given indicate the trend that a doctrine of ‘odious debts’ would imply a politicisation and moralisation of legal considerations,<sup>25</sup> which would doubtless make it more difficult to borrow money in many cases, and would entirely preclude it in others. This cannot be the overall desired effect; for it is the populations of the countries affected

who would then bear the brunt of the changes. If the aim is not to introduce any across-the-board bans on lending, but to deem on a one-off basis those loans or parts of loans legally untenable that fall into the category of ‘odious’, this will at the very least involve considerably higher costs on the part of lenders, since they will have to monitor the actions of their borrowers much more closely. Lenders will not be able to wriggle out of their responsibility to refuse to be part of ‘odious debts’ by incorporating a simple provision in their lending agreements to the effect that the funds lent are to be used for a generally accepted purpose. Consequently, if the costs of monitoring borrowers rises, the costs of borrowing will rise, which will in turn make borrowing prohibitively expensive for some countries, and severely restrict the borrowing capacities of others.

### B. Pros

On the other hand, we must realise that there is a current worldwide trend to erode the principle of *pacta sunt servanda* which has been held in such esteem for thousands of years. In the field of civil law, we can point to consumer protection law, which has been developing over the last forty years or so.<sup>26</sup> One of its main achievements has been to make it significantly easier to rescind a contract, thus making serious inroads into the binding nature of contracts.

While it is true that this comparison is not entirely apt, given that consumers play no part in the borrowing sector involved here, and that consumer protection law regularly excludes ‘non-consumers’ from its field of application, it should be mentioned, since calls for the recognition of the doctrine of ‘odious debts’ practically all appear to be based on a *de facto* power gap between the lender and the borrower (or at least the population of the borrowing state). Given the fact that globalisation is shrinking our world to the ‘global village’ in which international law is increasingly moving

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- 22 See Manfred Lachs, ‘*Pacta sunt servanda*’, in Bernhardt (ed.), *Encyclopedia of Public International Law* (1984); Restatement (Third) of the Foreign Relations Law of the United States § 321 cmt. a (1987) (*pacta sunt servanda* ‘lies at the core of the law of international agreements and is perhaps the most important principle of international law’.); see also Vienna Convention on the Law of Treaties art. 26, 27 January 1980, 1155 U.N.T.S. 331.
- 23 It is more than just a historical footnote that the term ‘dictator’ stems from the ancient Roman republic where this office was seen as a salvation in a desperate situation. See Wolfgang Kunkel & Martin Schermaier, *Römische Rechtsgeschichte* 22 (13th edn 2001).
- 24 A proposal of this sort is made by Seema Jayachandran & Michael Kremer, ‘Odious Debt’ (Apr. 2005) (unpublished manuscript), <post.economics.harvard.edu/faculty/kremer/webpapers/Odious\_Debt05.pdf> (proposing to impose loan sanctions in lieu of trade sanctions against dictatorial regimes). An (unofficial) list of this sort already exists in conjunction with the infamous Alien Tort Claims Act, 28 U.S.C. § 1350 (1994), in the United States. See AmnestyUSA.org, *Annual Report: The State of Human Rights*, <www.amnestyusa.org/annualreport/annualreport.html. Anyone transacting with the governments of these countries (currently roughly 150) runs the risk of being taken to court in the United States today by the populations of these countries.
- 25 Paradoxically Anupam Chander, ‘Odious Securitization’, 53 *Emory Law Journal* 923 (2005).
- 26 See, e.g., Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, art. 3, para. 5, 1999 O.J. (L 171) 12, 15.

into areas that were hitherto the prerogative of civil law,<sup>27</sup> the parallel drawn between consumer protection under civil law and international law no longer appears quite so unthinkable.

Equally, the 'erosion' of the basic principle of *pacta sunt servanda* is slowly being seen in international law. It is no coincidence that here too (although still in very few isolated cases) the principle of democracy, which is enshrined in international public law, is being taken as grounds to justify the cancelling of long-standing contracts, although no reason exists to terminate the contract under either the agreed terms of the contract or under other valid legal provisions.<sup>28</sup>

In view of these findings, we must conclude that the introduction of a legally binding doctrine of 'odious debts' is not automatically condemned to failure on the grounds that contracts, once concluded, must be honoured. Another qualification of this basic principle does not by any means imply a fundamental rejection of the traditional principle – particularly in view of the erosion of the binding nature of this principle that can be observed in many areas of law, worldwide. On the other hand, it must be said that the introduction of any doctrine of this sort will make it more difficult to borrow money in the future, thus potentially at least worsening the living conditions of entire populations.

## V. Approaches to resolving the problem

If we sum up the findings so far, we can state the following: the doctrine of 'odious debts' has not yet achieved the status of customary law. The desired introduction serves the goal (*inter alia*) of undermining the material basis of dictatorships and fostering democratisation worldwide. The introduction of the doctrine would doubtless make it more difficult to borrow money, but would not entail any fundamental break with existing law.

If these are the starting conditions for any doctrine of 'odious debts' in whatever form, we must then look at the finer points. What form should the doctrine take,

or how should it be formulated in legal terms, in order to achieve the intended objectives? The answer to this entails two steps. First, we must look at the approaches proposed to date, and secondly, we must devise our own proposal.

### A. Response (ad hoc)

The cases to date in which the doctrine of 'odious debts' has been invoked (Cuba, Costa Rica) are, from a legal point of view, particularly unfortunate cases of the application of 'law'. By deciding retrospectively on the legal nullity of the debts, they preclude the steering impact of law already discussed in section III.A. If it is uncertain *ex ante* whether or not the sword of Damocles of legal unenforceability is merely hanging over the sum lent, or whether it might actually fall, the foundation for the costing of loans begins to wobble. If the sword falls, the lender must bear the risk that the borrower might not conform to the norms of acceptable and accepted behaviour. At best, this appears to be a perhaps morally justified preferential treatment for the population thus freed from the yoke of debts, but in legal terms it is difficult to reconcile this with a basic sense of justice.

At this juncture we should, however, add a qualification. The idea of the law as a steering instrument can be put into practice in various ways. In Germany, for instance, it takes a different form from that adopted in the United States. Whereas in Germany, the legislator is held to be responsible for ensuring security in planning, which means that the feasible path to be taken must be laid down *ex ante* in great detail,<sup>29</sup> the prevalent philosophy in the United States is that individuals are free to wheel and deal as they please, but that in so doing they accept the risk that some court might at some point in time brand this (past) wheeling and dealing illegal.<sup>30</sup> So what would appear untenable in Germany is the expression of a fundamental understanding of liberty in the United States.

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- 27 It is enough to mention the discussion on the introduction of a state insolvency law. See Christoph G. Paulus, 'A Statutory Procedure for Restructuring Debts of Sovereign States', in Thomas Wegerich *et al.* (eds), *Recht der Internationalen Wirtschaft* No. 49, at 401-406 (2003); see also Detlev F. Vagts, 'Sovereign Bankruptcy: In re Germany (1953), In re Iraq (2004)', 98 *Am. J. Int'l. L.* 302 (2004); or Steven T. Kargman, 'Addressing Financial Distress in Emerging Markets: An Overview of Key Concepts in Corporate and Sovereign Restructurings', XXXI *Course of International Law*, 2004 – publication of the OAS 2005, 453 ff.
- 28 See Christian B. Fulda, 'Demokratie und *pacta sunt servanda*' (10 October 2002) (unpublished dissertation), <edoc.hu-berlin.de/> (follow 'dissertationen' hyperlink; then follow 'F' hyperlink; then follow 'Fulda, Christian B'. hyperlink). The article mentioned *supra* at note 25 by Anupam Chander points into the same direction. Additionally, an argument *e contrario* can be drawn from Theodor Meron, *The Humanization of International Law*, 2006, 208 f. where the author argues for the non-terminability of human rights-related treaties.
- 29 See Eckart Klein & Thomas Giegerich, 'The Parliamentary Democracy', in Ulrich Karpen (ed.), *The Constitution of the Federal Republic of Germany* 150-151 (1988).
- 30 See, e.g., Paul Carrington, 'The American Tradition of Private Law Enforcement', 5 *German L.J.* 1413 (2004), available at <www.germanlawjournal.com/pdf/Vol05No12/PDF\_Vol\_05\_No\_12\_1413-1429\_SI\_Carrington.pdf> (arguing that business conduct in the United States is regulated *ex post* by private plaintiffs 'in the form of civil money judgments rather than *ex ante* in the form of official approval or disapproval').

## B. Prevention (ex ante)

Having looked at these premises, it would thus appear preferable from a German point of view to develop preventive criteria for a doctrine of 'odious debts' that is to be applied in the future.

### I. The new proposal

a) This approach is in line with the Canadian proposal mentioned above.<sup>31</sup> It extends Sack's criteria, stating three conditions – lack of consent on the part of the people, the loan not being in the interests of the people, and the lender's knowledge of the other two facts. If all three conditions are met, this would render the debt null and void, and thus effectively free the borrower from the obligation to repay the debt.

b) Two positive facets of this proposal should be mentioned. First, by pinpointing 'creditor awareness', it stands out from many other proposals and ideas advanced by various NGOs, which simply ignore (intentionally or unintentionally) this condition.<sup>32</sup> It is quite clear that this cannot be, and one would assume that there is no need to labour the point. However, in order to make things as clear as possible, we should stress the fact that it would be extremely unjust, in line with all precepts of justice that exist in the civilised world, to foist on a lender, merely because he is a lender, the risk that the funds lent by him might be used to some improper purpose. This risk can only be attributed to the lender if he can subjectively be held responsible for the odious use to which the borrowed sum is put.

The second positive aspect is that the proposal does not concentrate on a change of government or regime, as was the case in both Cuba and Costa Rica, and was more or less explicitly taken as a major contributory ground or appeared to play a major role in Sack's proposals. A result of this sort might *de facto* play an important part in honouring existing commitments. For instance, what dictator, however rough, would plead that his debts were null and void on the basis of the doctrine of 'odious debts', when in the future he would be dependent on borrowing more funds at regular intervals. However, in legal terms, we must always see the 'odiousness', however we chose to define it, independently of and separate from any such government or regime changes. The fact that such a change takes place does not make the funds previously lent and used in any way more odious. The change *per se* is nothing that could increase the burden of guilt of an odious dictator. We can thus conclude that a legally binding doctrine of 'odious debts' is independent of any such

change in government or regime. The debt *per se* is odious; it does not merely become odious because of any change in the actors involved.

c) At the same time, however, the criteria contained in the Canadian proposal must be criticised, because they are too vague and therefore incalculable.

If the consent of the population is needed, the application of the doctrine must (surely) be excluded if a democratically elected government is in power. Whether this, or the opposite case, genuinely limits the desired target group sufficiently, appears questionable. For first, we must ask how we should proceed in the case of a mock democracy, in which the government claims to be legitimated by the votes of the people, as is the case in 'true' democracies. Secondly, monarchies or spiritual heads of a religious state are thus, by virtue of the structure of the state, branded potentially odious, which will automatically make it more difficult for them to borrow money, and will thus make borrowing more expensive for them.

This leads us to the underlying and truly fundamental question – namely, who should define who is a dictator under the terms of the doctrine of 'odious debts'? This is an extremely delicate question, and cannot be answered using the yardstick of existing law, or indeed existing philosophy. The answer that 'any government that is not legitimated by the people' can in no way be accepted as being sufficiently precise.

The other objective criterion of the Canadian proposal – absence of benefit – suffers the same shortcomings. Who is to provide the yardstick against which 'benefit' is to be measured? This is important in both factual and temporal terms: in factual terms, because it must be possible to define *ex ante* what serves the interests of the population and what does not. There are no blanket answers to this question, however. Weapons purchases, for instance (to take a particularly controversial example), are only discreditable because of the individual circumstances that accompany them – i.e. if they are to be used for an unjustified war of aggression or for other criminal purposes, but not if they are to be used for the country's own defence. Or, to take another example, funds might be used to install a system of repression in the form of prisons, but what number of prisons can be said to be in the interests of the population, and what number can be considered excessive and hence no longer in their interests? Nobody would seriously suggest that a country should not be allowed to build prisons at all.

Doubts are justified in the other direction too, however. The construction of schools and hospitals is

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31 See *supra* Part II.

32 Surprisingly, the same is true for the abovementioned definition by the International Law Commission.

generally considered to be in the interests of the population. But what is to happen if these schools and hospitals remain the sole prerogative of the rich, or of the family of the ruler? The question is, to put it succinctly, who are the 'people', and who should represent them?

This brings us to the temporal aspect. At which point should we ask about the 'benefit' – the time of lending or the time at which a decision is made as to whether or not the debt is odious? From a legal stance, it can only make sense to look at the time of lending. Otherwise, lenders would be expected to perform monitoring functions, which they would either be unable to perform, or which would make the loan prohibitively expensive.

Finally, we must also criticise the subjective criterion of 'creditor awareness'. While it is, as already mentioned, essential, the focus cannot be exclusively on the positive knowledge on the part of the lender. This would make it all too easy to circumvent the doctrine. If it is to be, to any real degree, applicable in practice, the subjective yardstick must be worded more precisely, such, for instance, that positive knowledge can be considered to be on an equal basis with ignorance resulting from gross negligence.

## 2. *Lex mercatoria*

While we must concede that the criticism above appears to imply that it is possible to achieve greater precision, it must be said that, at present at least, this will be difficult since we have not gotten much further than considering the structure of a statutory definition. Having said this, though, we can attempt to come closer to an appropriate solution – and do so without departing too far from what we have dealt with so far. It is particularly helpful to base our work on existing models, the legal character of which is unquestionable.

This stance allows us to look at a complex of regulations, which can best claim to be accepted worldwide, or at least to be the *lex mercatoria*<sup>33</sup> complied with – the UNIDROIT Principles of International Commercial Contracts.<sup>34</sup> Courts in many countries are increasingly relying on these Principles when they are called on to judge international contracts and when it is not entirely clear which legal system should be applied.<sup>35</sup> Since the lending agreements we are dealing with here are generally of a commercial nature, it is natural that we should take as our guidelines the UNIDROIT Principles.

Article 3.1(b) restricts the field of application of the Principles in that they do not deal with invalidity arising from immorality. Thus, this *lex mercatoria* expressly makes no statement on this generally accepted legal principle, which comes closest to the doctrine of 'odious debts'. This is a reflection, first, of the unwillingness to incorporate moral aspects in the legal sphere, and secondly, of the realisation that standards of morality vary so widely the world over that it would be impossible to find a common denominator.

Nevertheless, Article 3.10 does provide for basic rules when there is a 'excessive advantage' between the duties of the parties, as a result of which the pertinent contract can be contested. This right exists 'if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage'. The text goes on to list the factors that should be taken into consideration: 'the fact that the other party has taken unfair advantage of the first party's dependence, economic distress or urgent needs, or of its improvidence, ignorance, inexperience or lack of bargaining skill', as well as 'the nature and purpose of the contract'.

It is not entirely certain, however, whether or not this approach can be developed to produce an operational doctrine of 'odious debts'. Even if there is indeed a gross disparity between the lender's duty and the duty of the people of the borrowing state, in many cases that are of interest here, it is unlikely that there is a great disparity between the lender and the – in legal terms which are the only relevant party here – representative of the borrowing state.

## 3. Case groups

Nevertheless, the above '*lex mercatoria* approach' can be used in other ways. We can apply the methods prescribed in article 3.10 of combining various elements to the question of whether or not debts are 'odious'. This is not unusual in terms of legislation, and is often encountered in the national standardisation of offences such as the immorality of legal transactions. At first glance, this procedure might seem even less precise than the three conditions laid down in the Canadian proposal, but the advantage of the method proposed here over the criticised lack of precision in the attempts hitherto to concretise the doctrine of 'odious debts' is as follows.

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33 On the *lex mercatoria* in general, see Jan Dalhuisen, *Dalhuisen on International Commercial, Financial and Trade Law* 191-198 (2d ed. 2004); *id.*, 'Legal Orders And Their Manifestation: The Operation of the International Commercial And Legal Order And Its Lex Mercatoria', 24 *Berkeley J. of Int'l Law* 129 ff. (2006).

34 Int'l Institute for the Unification of Private Law, *UNIDROIT Principles of International Commercial Contracts* (2004), available at >[www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf](http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf)> [hereinafter UNIDROIT Principles].

35 See Michael Joachim Bonell, 'UNIDROIT Principles and the Lex Mercatoria', in *Lex Mercatoria and Arbitration* 249, 249 (Thomas E. Carbonneau ed., 2004); Michael Joachim Bonell, 'UNIDROIT Principles as a Means of Interpreting and Supplementing International Uniform Law', 13 *Int'l Ct. Arb. Bull.* 29-31 (Special Supp. 2002).

The odiousness of a debt is not automatic, provided the said factual elements are met. Instead, a number of diverse facts must be seen in context before a decision is made in each individual case. This procedure, which will initially have to commence by force of circumstances, can be defined increasingly precisely as more experience is gained, by establishing so-called case groups. Once established, these case groups will represent the experience gained in several cases such that when this level of experience is gained, an individual case can be accorded to an already recognised case group of 'odious debts', and the legal consequences will then become sort of axiomatic. Thus, while the rulings in the beginning will have the flair of being some kind of decisionism – since they are made without any pre-existing experience and without directly comparative material – they will gain predictability and certainty in the long run and will eventually line up to a coherent chain of decisions.

The advantage of this procedure is that the large number of possible case constellations is not forced from the outset into a straight-jacket of predefined characteristics, but the necessary openness that allows us to take into account the wide range of possible options is ensured. With every case dealt with, however, the acquired experience will grow, with the result that the initial openness can gradually be replaced with increasingly precise formulations culminating in the establishment of case groups.

In terms of the foreseeability and calculability for potential lenders, which we have considered at several junctures to be extremely important, national experience with standards of this sort (in Germany we need only quote section 138 of the German Civil Code)<sup>36</sup> indicates that this form of standard-setting is acceptable. Also, if the criteria for the assessment of each individual case are sufficiently clear, lenders can more easily anticipate the outcome than would be the case with the definitions of factual elements, which in many ways are too narrow and/or too broad.

Apart from the above-mentioned need to be able to impute the 'odiousness' to both sides always and with no exceptions by means of subjective prerequisites such as knowledge of the purpose for which the funds would be used, or the fact that the lender should have had such knowledge – the following could be the main criteria:

#### a) Borrower's representative

For reasons of legal precision, the term 'borrower's representative' must first be explained. While we often speak of the 'borrower', in the cases relevant here, this term is inappropriate. The 'borrower' is always the country in question and not the natural person who is targeted by the doctrine of 'odious debts', i.e. the dictator or despotic ruler. Thus, the focus should not be on the borrower, but on the person who uses the borrower in order to take out a loan. In somewhat simplified terms, we shall use the term 'borrower's representative' to designate this person hereinafter.

It is generally accepted in the discussion of the case of Costa Rica discussed above, or of Iraq at present, that the odiousness of a debt can arise as a result of the person or the behaviour of this borrower's representative. The question as to how a necessary degree of censure can be identified, however, is extremely difficult to answer, and can only be touched on here. It is by no means sufficient to define the circle of individuals affected in terms of their lack of democratic legitimation (see above), unless we wish to consider it odious *per se* that there is no (genuine?) democracy in that country. We can define more usable criteria if we measure the legitimation of the borrower's representative taking generally accepted requirements as a yardstick. International law can help us here<sup>37</sup> – for instance, fundamental principles such as the *jus cogens* (peremptory norm of general international law).<sup>38</sup> We could, perhaps, also use the conventions on human rights to which the state in question is signatory.

It is true, all the same, that the consequence of gearing action to these yardsticks of values is that one category of odiousness, which has often been advanced and which was specifically mentioned in the arbitration in the Costa Rica case, namely the use of the loan for the personal purposes of the borrower's representative, cannot be identified. It is thus up to the borrowing state, rather than to the lender, to demand repayment from the ruler who has thereby benefited personally.

#### b) Creditors

Another advantage of the concrete definitions of a doctrine of 'odious debts' proposed here is that it opens our eyes to the fact that the odiousness need not be caused by the state representative alone. It is only rarely noted

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36 Bürgerliches Gesetzbuch [BGB] [Civil Code] 1896, § 138(1) (E.R.G.). For the United States approach, see Joseph M. Perillo (ed.), 15 *Grace McLane Giesel, Corbin on Contracts: Contracts Contrary to Public Policy* (2003). For an international law perspective, see Alfred von Verdross, 'Der Grundsatz "pacta sunt servanda" und die Grenze der "guten Sitten" im Völkerrecht', 16 *Zeitschrift für öffentliches Recht* 79 (1936).

37 The present proposal coincides with the idea expressed by the International Law Commission in their above-mentioned definition.

38 Under the terms of the Vienna Convention on the Law of Treaties, a treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. Vienna Convention on the Law of Treaties art. 64, 23 May 1969, 1155 U.N.T.S. 347; see Meron, *supra* note 28, 201 ff.

that the very first instance of the doctrine of 'odious debts' being applied, in Cuba, is a case in which the creditor (in this case Spain) was responsible for giving the debt its negative character.<sup>39</sup> Again, the aim here is not to make moral issues or values the sole criteria for assessment, and so in this context too, the fundamental principles of international law already cited in the above section, perhaps accompanied by human rights conventions to which the lender's state is a signatory, will have to be used. If, for instance, debts arise as a result of an unjustified war of aggression, at least one criterion of odiousness would be met.<sup>40</sup>

#### c) Purpose of the loan

Another criterion used to identify 'odious debts' might be the purpose of the loan. Great caution is called for here though. The truism that there are two sides to every story applies here, too. We have already pointed out above that weapons purchases or the construction of prisons are not odious *per se*, just as the construction of schools and hospitals need not necessarily be an automatic blessing for the population. However, the purpose of a given loan will have to be assessed against the provisions of international law in order to produce generally binding values-based yardsticks.

#### d) General circumstances

Another criterion that will have to be defined more precisely, and surely will be defined more precisely in the future, is the general circumstances under which the loan is granted. The high standards of international law norms need not necessarily be applied exclusively here. To fine-tune the identification of odiousness, other circumstances could also play a part, such as money laundering, cooperation with internationally wanted criminals (drug dealers, money launderers, etc.) or comparable factors.

### 4. Result

In conclusion, a doctrine of 'odious debts' appears to be legally practicable if it is based on more precisely defined standard conditions than has been the case to date. This can be achieved by taking a step back from the factual elements which are not detailed enough and by replacing them with an open factual element

of 'odious debts', which would then be limited by assessment factors that are as concrete as possible so as to establish case groups. If these are to gain general acceptance, the values-based yardsticks used must be stringent – they cannot be allowed to reflect only the ethical beliefs of one small group. If these factors are set in relation to one another, and if a certain debt is judged odious on this basis, we must still demonstrate that both parties involved are accountable, with the help of subjective criteria. If this is the case, the legal consequences will follow.

## VI. Legal consequences

This final, apparently banal statement conceals a problem. What should the legal consequences be? If the goal of the doctrine of 'odious debts' is to liberate a state by law from its obligation to honour its debts, provided they meet the terms of this doctrine, it is not really appropriate to declare the automatic nullity of the loan agreement or to bestow the right to repudiate the contract. For, if only the legal basis, i.e. the loan agreement *per se*, were declared null and void, the lender could demand the repayment of at least the sum granted as a loan on the grounds of unjust enrichment. Whether or not this would apply to the agreed interest is uncertain. We should also point out once again that a large number of loan agreements are likely to be null and void anyway because they contravene inter-state formalities.

If we are to achieve the declared goal of the doctrine of 'odious debts', then we must not only have the loan agreement declared null and void, but also preclude demands for repayment on the grounds of unjust enrichment. There is a parallel to this in civil law in almost all legal systems based on Roman law in the form of a provision corresponding to the German Civil Code (BGB) section 817.<sup>41</sup> According to these provisions, the lender is not entitled to demand repayment on the grounds of unjust enrichment, if both the borrower and the lender can be accused of unethical behaviour under certain circumstances.<sup>42</sup>

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39 This peculiarity is noted by Jürgen Kaiser & Antje Queck, *Odious Debts – Odious Creditors? International Claims on Iraq*, at 7 (Friedrich Ebert Stiftung, Dialogue on Globalization, Occasional Papers No. 12, 2004), <[www.fes-geneva.org/publications/OccasionalPapers/FES%20OccPapers%2012.pdf](http://www.fes-geneva.org/publications/OccasionalPapers/FES%20OccPapers%2012.pdf)>.

40 See U.N. GAOR, Int'l L. Comm'n, *Fourth Report on State Responsibility*, at 17, U.N. Doc. A/CN.4/517 (2 April 2001) (prepared by James Crawford) (arguing that violations of international law, such as genocide and wars of aggression 'are such an affront to the international community as a whole that they need to be distinguished from other violations, [as in] the laws of war ...').

41 In the United States, this legal consequence is applied in cases when a contract is illegal. See Peter Hay, *U.S.-Amerikanisches Recht* 56 (2000).

42 See, e.g., Code civil [C. Civ] art. 1370 (Fr.); Código Civil Federal [C.C.F.] [Federal Civil Code] art. 1882 (Mex.); see also Civil Law on Restitution, <[www.ucc.ie/law/restitution/civi.htm](http://www.ucc.ie/law/restitution/civi.htm)>.

## VII. Institutional aspects

One final, extremely important question pertains to the institution that is to be responsible for enforcing this new legal principle. Because of well-known reservations, this responsibility should not be accorded to the IMF/World Bank<sup>43</sup> or to the International Court in The Hague.<sup>44</sup> *Ad hoc* arbitration, like the Iran–US tribunal, is unlikely to be acceptable because the specific power relations in that case are unlikely to be replicated. However, using a different arbitration court in each instance would prejudice the establishment of case groups proposed in this study. A fairly consistent court or panel would be needed for this.

Under these circumstances, we find ourselves faced with only two options: either we use existing court institutions or we create a new body. As for the first option, one possibility would be the Dispute Settlement Body of the WTO pursuant to article III(3) of the Convention of 15 April 1994.<sup>45</sup> This would be the preferred solution because this body has already gathered a wealth of expertise in global legal disputes.

As for the second option, creating a new body would be the responsibility of the UN<sup>46</sup> – perhaps to be transferred to UNCTAD because of the subject matter involved. Procedures could be based on those proposed by the IMF for a Sovereign Debt Restructuring Mechanism (SDRM) and the pertinent Dispute Resolution Forum (DRF).<sup>47</sup>

Such a panel of judges would have the exclusive power to decide on the relevant cases. The rules containing the details of the procedure could be established by that very panel itself. However, it should be clear from the outset that any suit brought to the panel can be initiated only by a petition. A general duty to initiate suit would instead require a worldwide control system which is bound (according to national experience) to be selective and thereby inefficient. The consequential question – namely who should be given the right to file a petition is, as a matter of course, a political one.

The answer depends on what one tries to achieve with the new legal principle. If only the parties to the loan contract in question were permitted to file a petition, it would seem more than likely that a procedure

would be initiated only after a change of government or political system, since it might be assumed that hardly any party would have an interest in learning that a debt is odious unless it goes through such a political change. If, in contrast, the circle of potential candidates for initiating such law suits is drawn too broadly (including, e.g., NGOs) this will foster a certain control mentality which, in turn, will result in a whole set of further problems. Thus, it is necessary to find an appropriate process which guarantees access to the panel in cases of odious debts without imposing an unbearable control mechanism on the parties involved.

## VIII. Results

The above deliberations can be summed up in the following points:

- The doctrine of ‘odious debts’ has not yet acquired the status of a legal rule. The only conceivable source of law would be customary law, but the necessary prerequisites have not yet been met.
- The existing proposals for defining an ‘odious debt’ doctrine make very clear the direction in which the doctrine is headed. However, the proposed definitions are still not precise enough to be acceptable as a general rule. What is needed is a higher degree of flexibility.
- Such degree of flexibility could be achieved by establishing open factual elements with sufficiently precise assessment factors, in order to establish case groups in the course of time.
- The legal consequence of this ‘odious debt’ doctrine would not only be the nullity of the underlying loan agreement, but also the denial of the right of the lender to demand repayment on the grounds of unjust enrichment.
- The court responsible for judging whether or not a debt is odious could either be the Dispute Settlement Body of the WTO/GATT or a new court set up by the UN, along the lines of the DRF.

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43 See, e.g., Joseph Stiglitz, ‘Odious Rulers, Odious Debts’, *Atlantic Monthly*, Nov. 2003, at 42, available at <[www.globalpolicy.org/soecon/develop/debt/2003/11odiousdebts.htm](http://www.globalpolicy.org/soecon/develop/debt/2003/11odiousdebts.htm)> (arguing that the IMF playing a central role in the bankruptcy process would be problematic because it is one of the international community’s major creditors). The same would hold true more or less with respect to the World Bank’s ICSID tribunal.

44 This court, of course, could be involved under the present conditions only if both parties to the loan agreement are states.

45 About this panel and how it works, see Matthias Herdegen, ‘Internationales Wirtschaftsrecht’, in *Juristische Kurz-Lehrbücher* No. 4, § 7 at 151 (2003); Ignaz Seidl-Hohenveldern & Gerhard Loibl, *Das Recht der Internationalen Organisationen einschließlich der Supranationalen Gemeinschaften* 182, para. 1312 (7th edn 2000); John Jackson, *The Jurisprudence of GATT and the WTO* 133 (2000).

46 See Stiglitz, *supra* note 43, at 42.

47 See Christoph G. Paulus, ‘Die Rolle des Richters in einem künftigen SDRM’, in Hans-Peter Kirchhof, *Insolvenzrecht im Wandel der Zeit: Festschrift für Hans-Peter Kirchhof zum 65. Geburtstag* 421 (2003).