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Felonious, Erroneous, It's All Odious: A Story of Debt Gone Wrong

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NOTES

FELONIOUS, ERRONEOUS, IT'S ALL ODIOUS: A STORY OF DEBT GONE WRONG

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Iraq is paying off debt from Saddam Hussein's rule. South Africa is paying off debt obligations incurred under apartheid rule. Argentina is renegotiating debts that can be traced back to a de facto military-civilian regime that was ousted in 1976. There are numerous examples in which sovereigns are paying off debts that previous governing regimes incurred while oppressing their citizens. Should sovereigns be obligated to pay these debts? Were the debts really incurred by the sovereign or were they incurred by the governing regime in question? What if the lender knew in advance what the proceeds would be used for?

The doctrine of odious debt seeks to resolve this dilemma. It proposes that sovereigns should not have to pay back debts that were incurred without the consent of the people and for purposes that do not benefit the people, provided that the lender was aware of each of these conditions. The doctrine itself is almost a century old, but sovereigns have yet to embrace it due to fear of the repercussions. Scholars have proposed ex ante and ex post mechanisms to apply the doctrine, but none have been accepted to date. This Note proposes a unique solution that seeks to identify odious expenditures before debt proceeds are entirely exhausted by a regime, providing a remedy that falls between the traditional ex ante and ex post solutions.

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INTRODUCTION

Sovereigns have questioned the legitimacy of odious debt[1] for more than a century, at least since William H. Taft arbitrated *Great Britain v. Costa Rica*[2] ("the Tinoco Arbitration") in 1923.[3] The topic has been debated in the scholarly community since Alexander Sack formalized the doctrine in 1927.[4] After a period of relatively little dialogue on the matter, the topic was revitalized in 2003 with the crumble of the Saddam Hussein regime.[5] The newly instated Iraqi government successfully renegotiated its debt with the Paris Club,[6] representing one-third of its total postregime external debts, down 80 percent.[7] It did so with the support of key U.S. and World Bank (or "the Bank") officials who advocated for the forgiveness of Iraqi bond debt that was used for odious purposes.[8] At its core, the doctrine of odious debt seeks to resolve the moral and economic dilemma[9] of what should happen to a sovereign's debts after a despotic regime incurs the debt for purposes that do not benefit its citizens and is subsequently overthrown.[10]

A whitepaper published by the Obama-Biden campaign in 2008 has since politicized the issue in the United States: "As president, Barack Obama will lead a multilateral effort to address the issue of 'odious debt' by investigating ways in which 'loan sanctions' might be employed to create disincentives for private creditors to lend money to repressive, authoritarian regimes."[11] No significant political progress has been made since Obama raised the issue during his initial election. However, the ongoing debt debate regarding Argentina's debt, as evidenced in *NML Capital, Ltd. v.*

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1. Odious debt was traditionally defined as "debts incurred by a despotic regime that do not benefit the people bound to repay the loans." Lee C. Buchheit, G. Mitu Gulati & Robert B. Thompson, *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201, 1203 (2007).

2. 1 R.I.A.A. 371 (1923).

3. Buchheit, Gulati & Thompson, *supra* note 1, at 1216–18.

4. *See id.* at 1218.

5. *See generally* Jai Damle, *The Odious Debt Doctrine After Iraq*, 70 LAW & CONTEMP. PROBS. 139, 150 (2007) ("Following the regime change in Iraq, there was an increase in conferences and articles on odious debt."); Anna Gelpern, *What Iraq and Argentina Might Learn from Each Other*, 6 CHI. J. INT'L L. 391, 393 (2005).

6. The Paris Club is an informal group of creditors that tries to develop sustainable debt payment solutions for debtor nations. PARIS CLUB, http://www.clubdeparis.org/en (last visited Oct. 21, 2015) [http://perma.cc/JSH8-TPNJ].

7. *See* MARTIN A. WEISS, CONG. RESEARCH SERV., IRAQ'S DEBT RELIEF: PROCEDURE AND POTENTIAL IMPLICATIONS FOR INTERNATIONAL DEBT RELIEF 9 (2006), http://fpc.state.gov/documents/organization/65761.pdf [http://perma.cc/D2MA-QNV2]; YVONNE WONG, SOVEREIGN FINANCE AND THE POVERTY OF NATIONS: ODIOUS DEBT IN INTERNATIONAL LAW 8 (2012); *see also* Associated Press, *Eighty Percent of Iraq Debt Cut by Paris Club*, USA TODAY (Nov. 21, 2004), http://usatoday30.usatoday.com/news/world/iraq/2004-11-21-iraq-debt-cut_x.htm ("The United States had been pressing for up to 95% of the Paris Club debt to be lifted.") [http://perma.cc/G2AN-EGFH].

8. *See* WEISS, *supra* note 7, at 9.

9. For a discussion of the moral and economic justifications that have been given for the doctrine, see *infra* Part II.C.1.

10. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1224.

11. OBAMA FOR AMERICA, STRENGTHENING OUR COMMON SECURITY BY INVESTING IN OUR COMMON HUMANITY, http://www.cgdev.org/doc/blog/obama_strengthen_security.pdf (last visited Oct. 21, 2015) [http://perma.cc/D4UT-Y9CM].

Republic of Argentina,[12] beckons a new tide of literature and discussion on this sovereign debt issue.

This Note begins in Part I by providing a broad overview of sovereign debt. It then looks at issues specific to odious debt, including a discussion of the basics of odious debt, the historical background, and the importance of addressing the issue today. Part II first reviews proposed ex post institutional remedies to the doctrine. It then steps back to look at the ex ante solutions developed by scholars. In Part III, this Note proposes a solution falling between ex ante and ex post solutions that expands the role of traditional actors in sovereign debt issuances.

I. FROM THE TOP: SOVEREIGN DEBT AND THE ODIOUS DEBT DOCTRINE

This part first provides a general overview on sovereign debt, including some distinguishing factors between sovereign and corporate debt and the specific challenges presented by sovereign debt. It then explores issues specific to odious debt. It concludes by stating why the issue needs to be addressed today.

A. An Overview of Sovereign Debt

Sovereigns, like corporations, are able to increase their available funds by incurring debt or raising capital. Corporations seek equity by issuing stock.[13] Sovereigns, instead, impose taxes on their constituents to fund their budgetary needs.[14] In lieu of diluting their ownership structure, businesses may incur debt to raise capital,[15] such as by taking out loans or issuing bonds.[16] Rather than taxing its people to raise funds, countries may also incur debt through the same channels.[17]

Despite their apparent similarities in fundraising, there are several distinctions between loans and bonds. Loans are traditionally issued by a single lender who engages in high level monitoring of the debtor.[18] Due to the steep costs associated with monitoring loans, they are traditionally highly illiquid and cannot be traded.[19] Bonds, on the other hand, are

12. 699 F.3d 246 (2d Cir. 2012); *see infra* note 139 (providing an overview of the NML Capital litigation).

13. *See* Yankov Amihud, Kenneth Garbade & Marcel Kahan, *A New Governance Structure for Corporate Bonds*, 51 STAN. L. REV. 447, 450 (1999).

14. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1211.

15. *See* Amihud, Garbade & Kahan, *supra* note 13, at 450.

16. *See* Elisabeth de Fontenay, *Do the Securities Laws Matter? The Rise of the Leveraged Loan Market*, 39 J. CORP. L. 725, 727 (2014) (describing the traditional differences between loans and bonds and arguing that in recent years "bonds and loans are now virtually interchangeable"). Fontenay describes changes in the structuring of loans that have led to an established market for trading on loans, lessening the traditional distinctions between the two forms of debt. *Id.*

17. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1211.

18. *See* de Fontenay, *supra* note 16, at 727.

19. *See id.*

traditionally held by a large variety of bondholders who do not engage in intense monitoring.[20] Bonds are usually highly transferrable.[21]

Securitization[22] of sovereign debt began in the 1990s and has permitted traditional investors to invest in sovereign debt.[23] Most sovereign bonds are issued under New York or English law.[24] Foreign sovereign bonds governed by New York law are typically issued through a fiscal agency agreement.[25] This agreement provides the terms of the bond and the relationship between the fiscal agent and the debtor issuing the bond (the issuer).[26] Under fiscal agency agreements, the agent represents the bond issuer, not the bondholders.[27] Each bondholder retains its enforcement rights against the issuer.[28]

The primary alternative arrangement for issuing bonds is through a trust indenture or trust deed.[29] Under English law, the standard practice is to structure a sovereign bond issuance pursuant to a trust deed.[30] In a departure from the fiscal agent approach, this method utilizes an indenture trustee who represents the bondholders.[31] The indenture provides the terms of the issuance, including the face value of the bond, payment terms, rights of the bondholders, and duties of the trustee.[32] U.S. trust indentures vary slightly from English trust deeds, but both allocate at least some enforcement capabilities to the trustee, such as the ability to accelerate bond payments in case of a default.[33] Default provisions, such as acceleration

20. *See id.* Bonds can be held by investment banks and regular retail investors. *See id.*; *see also* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards? The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1072 (2004).

21. *See* Amihud, Garbade & Kahan, *supra* note 13, at 450.

22. Securitization is the packaging of separate financial products into a single product, which then issues different tranches of the product to investors. *See* de Fontenay, *supra* note 16, at 741 n.84.

23. *See generally* Gelpern, *supra* note 5, at 397.

24. Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts* 41 (IMF, Working Paper No. WP/12/203, 2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf [http://perma.cc/4B33-DTC9].

25. *See* Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1332 (2002); Fisch & Gentile, *supra* note 20, at 1103.

26. *See* Fisch & Gentile, *supra* note 20, at 1102.

27. *See* Buchheit & Gulati, *supra* note 25, at 1332; Fisch & Gentile, *supra* note 20, at 1102.

28. *See* Buchheit & Gulati, *supra* note 25, at 1332.

29. *See id.* at 1331–32; Fisch & Gentile, *supra* note 20, at 1102–03.

30. *See* Fisch & Gentile, *supra* note 20, at 1103.

31. *See* Buchheit & Gulati, *supra* note 25, at 1331; Morey W. McDaniel, *Bondholders and Corporate Governance*, 41 BUS. LAW. 413, 413 (1986).

32. *See generally* Ad Hoc Comm. for Revision of the 1983 Model Simplified Indenture, *Revised Model Simplified Indenture*, 55 BUS. LAW. 1115 (2000) [hereinafter *Revised Model Simplified Indenture*].

33. *See* Buchheit & Gulati, *supra* note 25, at 1330–31; Fisch & Gentile, *supra* note 20, at 1103. Unlike the bond trustee, the fiscal agent generally lacks the discretionary power to accelerate bond payments. *See* Buchheit & Gulati, *supra* note 25, at 1330.

clauses, permit the use of court proceedings by bondholders to protect their rights under the agreement against the debtor.[34]

Distinctions between sovereign and corporate debtors are apparent when reviewing the capabilities of the issuer to pay its debts. When a corporate debtor becomes insolvent, there are bankruptcy regimes established to settle its debts with creditors through debt restructuring.[35] In the absence of a successful reorganization, a corporation's debt ends with a liquidation of assets and the dissolution of the company.[36] Similar to a corporation, a sovereign could arguably liquidate some of its assets.[37] Unlike a corporation, however, a sovereign debtor can—at least in an abstract sense—always pay its debt.[38] The government may increase taxes or divert domestic production to generate foreign export revenue.[39] With these capabilities, it becomes more difficult to determine the extent of a country's insolvency.[40]

And further unlike corporate entities, no bankruptcy mechanism currently exists to liberate a country from its debts;[41] thus, sovereign entities do not have the ability to dissolve when they are unable to pay their debts.[42] Even when a new government regime takes over, the country's legal personality continues, requiring the state to assume the debt incurred by the country under the predecessor regime.[43]

Sovereigns, thus, face a unique problem in which they cannot cleanse themselves from previously incurred debt.[44] The lack of an institutional remedy does not preclude sovereigns from attempting to renegotiate their debts directly with the bondholders.[45] However, it has led some

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34. *See Revised Model Simplified Indenture*, *supra* note 32, at 1135–39 (providing the defaults and remedies provisions under Article 6 of the model indenture).

35. Thomas S. Wyler, *Wiping the Slate: Maintaining Capital Markets While Addressing the Odious Debt Dilemma*, 29 U. PA. J. INT'L L. 947, 955–56 (2008). *See generally* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 8–11 (1986) (discussing the fundamentals of bankruptcy law and creditor remedies outside of bankruptcy).

36. *See* Wyler, *supra* note 35, at 956.

37. *See* Stephen J. Choi, Mitu Gulati & Eric A. Posner, *The Evolution of Contractual Terms in Sovereign Bonds*, 4 J. LEGAL ANALYSIS 131, 133 (2012) ("Greece, for example, could theoretically sell the Parthenon or some of its sovereign territory.").

38. *See* Jonathan Sedlak, *Sovereign Debt Restructuring: Statutory Reform or Contractual Solution?*, 152 U. PA. L. REV. 1483, 1487 (2013) ("If a company fails to repay its debts, the business can be dismantled by the unpaid creditors. However, no parallel mechanism exists to force repayment by sovereign nations since no creditor has the ability to dismantle or liquidate a country.").

39. *See id.* at 1488.

40. *See id.*

41. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1207.

42. *See id.*

43. *See* Paul Williams & Jennifer Harris, *State Succession to Debts and Assets: The Modern Law and Policy*, 42 HARV. INT'L J.L. 355, 362 (2001).

44. *See* Anna Gelpern, *A Skeptic's Case for Sovereign Bankruptcy*, 50 HOUS. L. REV. 1095, 1119 (2013) (asserting "the idea of a truly fresh start is essentially inconceivable for a sovereign"). *But cf.* JACKSON, *supra* note 35, at 225–52 (discussing individuals' ability to obtain a fresh start under bankruptcy law).

45. *See* Fisch & Gentile, *supra* note 20, at 1044. The restructuring may result in a new payment schedule, lower debt obligation, or both. *See* Das, Papaioannou & Trebesch, *supra* note 24, at 7.

bondholders to take advantage of the institutional shortcoming by holding out from a sovereign's debt restructuring plan and seeking payment of the full contracted amount in the courtroom.[46]

These holdout creditors are commonly referred to as "vulture funds."[47] Vulture funds generally purchase sovereign debt at a deep discount after the country has been in financial distress for an extended period of time and the bond's value has significantly dropped.[48] While most bondholders agree to debt restructurings in these circumstances, vulture funds hold out for full repayment on their investments.[49] The average payout for a successful vulture fund is between three and twenty times the actual price the fund paid for the debt.[50]

NML Capital, Ltd. ("NML Capital") is one such vulture fund.[51] Argentina defaulted on its bond debt in 2001.[52] NML Capital, a holder of the Argentine bonds, has since refused to participate in the country's 2005 and 2010 debt restructurings.[53] Instead, the fund sought full payment in the Southern District of New York.[54] The court held that Argentina had violated the terms of its bond agreements and the fund was entitled to full payment.[55]

In addition to the traditional restructuring negotiations that develop privately between sovereigns and their bondholders, there have been some recent efforts to address the lack of a formal system to discharge sovereign debts. The International Monetary Fund (IMF) proposed a restructuring

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46. *See, e.g.*, Fisch & Gentile, *supra* note 20, at 1075–88 (discussing sovereign debt cases involving Argentina, Costa Rica, Jamaica, Brazil, Peru, and Bolivia); Gelpern, *supra* note 5, at 394 ("The erosion of sovereign immunities since the 1950s exposed governments to a real risk of creditor lawsuits in national courts. The result was a boon for the development of private law in an area previously dominated by foreign ministries."). See *infra* notes 122–25 and accompanying text for a discussion on why this switch occurred in the 1950s.

47. *See* Fisch & Gentile, *supra* note 20, at 1045 n.2; John Muse-Fisher, *Starving the Vultures:* NML Capital v. Republic of Argentina *and Solutions to the Problem of Distressed-Debt Funds*, 102 CALIF. L. REV. 1671, 1673 (2001). While the term has negative connotations, some scholars suggest that holdout creditors may actually be beneficial. *Compare* Das, Papaioannou & Trebesch, *supra* note 24, at 28 (noting that creditor holdouts and litigation is widely seen as the main reason for delayed and inefficient debt restructurings), *with* Fisch & Gentile, *supra* note 20, at 1098–99 (arguing that vulture funds may actually improve the restructuring process and steer sovereigns away from opportunistic defaults), *and* Gelpern, *supra* note 44, at 1102 (citing that "[r]ecent empirical studies confirm that . . . holdouts have not held up many sovereign bond restructurings").

48. *See* Fisch & Gentile, *supra* note 20, at 1045 n.2; Muse-Fisher, *supra* note 47, at 1673.

49. *See* Caroline M. Gentile, *The Market for Odious Debt*, 73 LAW & CONTEMP. PROBS. 151, 167 (2010) ("[Vulture funds purchase] the debt of troubled issuers for pennies on the dollar and then, once a violation of the terms of the bonds occurs, seek to enforce their rights (including, when applicable, the right to the repayment of the full value of the debt) through litigation.").

50. *See* Muse-Fisher, *supra* note 47, at 1673–74.

51. *See, e.g.*, *id.* at 1674.

52. *See* Gelpern, *supra* note 44, at 1117; Muse-Fisher, *supra* note 47, at 1689.

53. *See* Muse-Fisher, *supra* note 47, at 1689.

54. *See infra* note 139.

55. *See infra* note 139.

mechanism in 2001 to address this institutional shortcoming.[56] However, it failed to pick up traction due to institutional inadequacies and a lack of support from the United States.[57]

The Group of Seven ("G-7")[58] agreed to the Debt-Relief Initiative for Heavily Indebted Poor Countries ("HIPC Initiative") in 1996.[59] This initiative resolved to provide debt relief to a large number of the world's least developed countries.[60] While noble in its goal, the initiative faced criticism by traditional advocates of HIPC debt relief because, it was argued, the debts were incurred by regimes wrought with unaccountable corruption and wasteful spending.[61] Essentially, these advocates feared that sovereigns would not benefit from the debt relief because they would continue the same policies as before.[62] Should the sovereign be given debt relief if its policies will likely change? Should debt relief be permitted for a sovereign that was ruled by a corrupt regime when it incurred the debt, but has since been overthrown? These are questions for the doctrine of odious debt.[63]

B. A Dialogue on Odious Debt

Odious debt has been a controversial type of sovereign debt, and countries have historically avoided its application. Yet, it has sound public policy justifications that are supported by scholars and politicians alike. The international economy can benefit from limiting the funds available to despotic regimes that cause undue harm to people. This section begins with a basic overview of the odious debt doctrine. Next, it reviews different categories of debt that may be classified as odious. It then evaluates which type of shift in control merits use of the doctrine. The section concludes with a review of some of the doctrine's applications throughout history.

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56. *See* Anne Krueger, First Deputy Managing Dir., IMF, Address at the National Economists' Club Annual Members' Dinner: International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring (Nov. 26, 2001), https://www.imf.org/external/np/speeches/2001/112601.htm [http://perma.cc/KG45-6D6N]; *see also* Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299, 301–02 (2005).

57. *See infra* notes 250–59 and accompanying text.

58. The G-7 consists of major industrial countries (namely, Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) that periodically convene to discuss major economic and financial issues. *A Guide to Committees, Groups, and Clubs*, IMF (Sept. 17, 2015), http://www.imf.org/external/np/exr/facts/groups.htm#G7 [http://perma.cc/DFU7-SNAB].

59. *See* James V. Feinerman, *Odious Debt, Old and New: The Legal Intellectual History of an Idea*, 70 LAW & CONTEMP. PROBS. 193, 214 (2007).

60. *See id.* The initiative provided the specific level of relief that it felt was necessary "in a particular country to achieve 'debt sustainability.'" NANCY BIRDSALL & JOHN WILLIAMSON, DELIVERING ON DEBT RELIEF: FROM IMF GOLD TO A NEW AID ARCHITECTURE 25 (2002).

61. *See* BIRDSALL & WILLIAMSON, *supra* note 60, at 33; Feinerman, *supra* note 59, at 214–15.

62. *See* BIRDSALL & WILLIAMSON, *supra* note 60, at 32.

63. *See, e.g.*, Andrew Yianni & David Tinkler, *Is There a Recognized Legal Doctrine of Odious Debts?*, 32 N.C. J. INT'L. & COM. REG. 749, 751 (2007).

1. Breaking Down the Basics

Alexander Sack's formalization of the doctrine of odious debt called for three conditions to be met before absolving a state of its obligation to repay its debts: (1) the debts must be incurred by a despotic power; (2) the proceeds must result in an absence of benefit to the sovereign's constituents; and (3) the creditor must be aware of the first two conditions.[64]

The first element requires that a despotic regime incur the debt. This means that there must be an absence of consent by the people to the government in place.[65] This begs the question of whether a democratically appointed government is necessarily precluded from the odious debt analysis.[66]

The second element requires a determination that debt proceeds were not used for the benefit of a country's populace. This is not an exact science. What makes the use of debt odious under the doctrine? The use of debt proceeds by a tyrannical leader to suppress internal dissent of its people is clearly odious.[67] A despot using proceeds to fly Aerosmith in to the country to perform at his daughter's fifth birthday would also be odious.[68] But is hiring Nobel Prize-winning economists to count the grains of sand in a desert odious or simply a poor use of resources?[69]

The third prong of Sack's formulation is that the creditor is aware that the debts were incurred absent consent of the people and were used for purposes that lack benefit to the people. In essence, a culpable creditor accepts the risk of default, shifting the burden of debt payment away from innocent citizens.[70] Put differently, creditors should not have to suffer the consequences if they were deceived by the regime.[71] The subjective nature of this element has faced criticism.[72] Requiring positive knowledge of the

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64. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1218 (citing ALEXANDER N. SACK, LES EFFETS DES TRANSFORMATIONS DES ÉTATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIÉRES [THE EFFECTS OF STATE TRANSFORMATIONS ON THEIR PUBLIC DEBTS AND OTHER FINANCIAL OBLIGATIONS] 157–63 (1927)); Ashfaq Khalfan, Jeff King & Bryan Thomas, *Advancing the Odious Debt Doctrine* 1–2 (CISDL, Working Paper No. COM/RES/ESJ/, 2003), http://www.dette2000.org/data/File/odious_debt_CISDL.pdf [http://perma.cc/BR4W-L9GK].

65. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1218.

66. *Id.* at 1228–29. Buchheit, Gulati, and Thompson warn that odiousness is a subjective concept and can invite ethnocentrism. *See id.*

67. *See* Daniel K. Tarullo, *Odious Debt in Retrospect*, 70 LAW & CONTEMP. PROBS. 263, 267 (2007).

68. *See generally* Buchheit, Gulati & Thompson, *supra* note 1, at 1231 (describing loans made to a regime which are then stolen by its members).

69. *See id.* at 1231, 1245 (using the "grains of sand" example to show that pointlessly incurred debts may still bind a noncorrupt sovereign and its people).

70. *Id.* at 1251.

71. *See* Wyler, *supra* note 35, at 966–67.

72. *See* Christopher G. Paulus, *"Odious Debts" Vs. Debt Trap: A Realistic Help?*, 31 BROOK. J. INT'L L. 83, 94–95 (2005); *see also* Seema Jayachandran, Michael Kremer & Jonathan Shafter, Applying the Odious Debts Doctrine While Preserving Legitimate Lending 18 (June 2006), http://iis-db.stanford.edu/pubs/21472/ApplyingtheOdiousDebtsDoctrine.pdf

creditor may permit the creditor to circumvent the doctrine by not determining the use of debt proceeds.[73] A more objective "known or should have known" standard could have a more sound application.[74]

Under the doctrine, odious debts are considered debts of the government regime rather than the sovereign itself, because the debt proceeds are not used for the needs and interests of the sovereign.[75] Sack's argument is that these debts can only be collected from a particular odious regime if all three elements have been met.[76] As such, the successor government should be able to legally repudiate debt incurred by its despotic predecessor.[77] Sack's determination is made after the fact;[78] that is, a regime and its debts cannot be found odious until the debt proceeds are used and the regime has been overthrown.[79] As discussed below, some scholars have approached the doctrine from an ex ante method in an effort cut off potential lending to despotic regimes that are likely to generate odious debts.[80]

2. Defining Odious Debt

The question of what satisfies the second prong of Sack's test—that the country uses debt proceeds in a way that does not benefit its people—has been subject to different interpretations. There is insufficient application of the doctrine to establish any customary uses or limitations. As such, scholars have advanced their own categories to analyze types of odious debt.

Sack advanced two categories of odious debt: (1) debts used to "repress the population that fights against [the despotic regime]," and (2) debts incurred by members of government which are "manifestly personal" in use.[81] Recent commentators have expanded the number of classifications.

Andrew Yianni and David Tinkler have identified three types of odious debt: hostile debt, war debt, and debt of a developing country that does not benefit its people.[82] Hostile debt, they argue, is used "aggressively against the interests of a population," such as for war, conquest, and suppressing its own citizens.[83] They distinguish this from war debt, which is incurred by a

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(arguing that the subjective standard is too lenient on creditors) [http://perma.cc/MC28-69MS].

73. *See* Paulus, *supra* note 72, at 94–95; *see also* Jeff A. King, *Odious Debt: The Terms of the Debate*, 32 N.C. J. INT'L & COM. REG. 605, 632–33 (2007).

74. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1251.

75. *See* King, *supra* note 73, at 624.

76. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1218 (citing SACK, *supra* note 64, at 157).

77. *See* WONG, *supra* note 7, at 7; Buchheit, Gulati & Thompson, *supra* note 1, at 1218 (citing SACK, *supra* note 64, at 157).

78. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1218.

79. *See id.*

80. *See infra* Part II.B.

81. *See* Yianni & Tinkler, *supra* note 63, at 750 (citing PATRICIA ADAMS, ODIOUS DEBTS: LOOSE LENDING, CORRUPTION AND THE THIRD WORLD'S ENVIRONMENTAL LEGACY 165–66 (1991)).

82. *See id.* at 756–66.

83. *Id.* at 757.

state that subsequently loses during a war.[84] The conquering government may choose which war debt obligations of the predecessor government it would like to assume.[85] The third type of debt Yianni and Tinkler propose is debt of a developing country that is not in the interest of its people.[86] This would include using the proceeds for personal items, such as building lavish mansions and other corrupt purposes.[87]

Jeff King developed a very similar breakdown of odious debt that he separated into four categories: war debts, subjugation debts, illegal occupation debts, and fraudulent, illegal, or corruption debts.[88] King's "subjugation debts" and "fraudulent, illegal, or corruption debts" correspond with Yianni and Tinkler's first and third classifications discussed above, respectively.[89] Illegal occupation debt is based on the presumption that "foreign occupation can bring no benefits [to a sovereign's citizens] unless benefits are specifically proved."[90] He distinguishes odious war debts, which he describes as debts used by a predecessor state in war against the successor state, from non-odious war-related debts.[91]

Lee Buchheit, Mitu Gulati, and Robert Thompson distinguish war debts as being separate from odious debt.[92] Like odious debt, war debts are an arguable exception to the general rule of state succession.[93] The war debts exception asks whether debts incurred by a previous regime should be enforceable against a conquering state.[94] It asks what expectations a creditor should reasonably have when extending credit to a sovereign that is eventually overthrown by an attacking country.[95]

3. Applying the Doctrine

Sack's classic formulation only applies when there has been a government succession.[96] However, the legal community currently lacks a consensus on whether to apply the doctrine to government succession or

84. *See id.* at 760.

85. *See id.* at 761. See *infra* notes 106–13 for an example of war debts during the Spanish-American War.

86. *See* Yianni & Tinkler, *supra* note 63, at 761–62.

87. *See id.*

88. *See* King, *supra* note 73, at 650–59.

89. *See id.* at 650–52; *supra* notes 83–87 and accompanying text.

90. King, *supra* note 73, at 652.

91. *See id.* at 650. For example, the United States could not have regarded Iraq's 2003 debts as war debts because "the United States was neither the target of the armed attack such loans funded nor the successor state to Iraq." *Id.* at 629.

92. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1212–14. The authors define war debts as those incurred "to finance the conduct of hostilities against a force, foreign or domestic, that eventually succeeds in overthrowing the contracting government." *Id.* at 1212.

93. *See id.* at 1212–14.

94. *See id.* For example, after Great Britain took over the South African Republics at the end of the Boer War, it only offered to assume the Republics' debts that were incurred before the start of the war. *See id.* at 1212–13.

95. *See id.* at 1213.

96. *See* Adam Feibelman, *Contract, Priority, and Odious Debt*, 85 N.C. L. REV. 727, 739 (2007).

also to state succession.[97] A government succession occurs when the governing body changes but the sovereign itself remains intact.[98] Recent examples of government succession include the regime changes in Afghanistan and Iraq.[99] A state succession occurs "when a territory ceases to be part of one state and becomes part of another."[100] Under the doctrine of state succession, the incoming government automatically inherits debts of the predecessor government.[101]

The distinctions between state and government succession, however, are not always clear.[102] Professor D.P. O'Connell warns that the distinction between the two may be so minimal that the classification of a transition "is often quite arbitrary."[103] Even if the distinction were clear, a number of scholars advocate expanding the doctrine to cases of state succession.[104]

4. Contextualizing Odious Debt with a Historical Backdrop

While the doctrine of odious debt has been developed and refined by scholars over the last century, it has never been expressly cited as grounds for forgiving sovereign debt by a national or international tribunal.[105] This section first discusses the Spanish-American War and the Tinoco Arbitration, two of the most frequently cited pieces of history by advocates of the doctrine. Next, it describes the shift in the landscape provided by the U.S. Foreign Sovereign Immunities Act. Finally, it addresses the restructuring of Iraqi and Argentine debt over the last twenty years, which have helped renew the odious debt discussion.

a. The Spanish-American War

By the end of the Spanish-American War in 1898, Spain had contracted a large amount of debt that was secured by Cuban revenues.[106] The United States, having seized the Cuban territory, repudiated the debts under

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97. *See* King, *supra* note 73, at 648 (describing a lack of consensus in the scholarly community).

98. *See* Fiebelman, *supra* note 96, at 739.

99. Tai-Heng Cheng, *Renegotiating the Odious Debt Doctrine*, 70 LAW & CONTEMP. PROBS. 7, 11 (2007).

100. Fiebelman, *supra* note 96, at 739; *see also* Cheng, *supra* note 99, at 10. For an example of state succession after the Spanish-American War, see *infra* notes 106–13.

101. *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 208 note (AM. LAW INST. 1987) ("International law sharply distinguishes the succession of states, which may create a discontinuity in statehood, from a succession of governments, which leaves the statehood unaffected."). *But see* King, *supra* note 73, at 609 (arguing "it is still far from settled law that a successor state is liable for the debts of the predecessor state").

102. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1206; Khalfan, King & Thomas, *supra* note 64, at 47.

103. 1 D.P. O'CONNELL, STATE SUCCESSION IN MUNICIPAL AND INTERNATIONAL LAW vi (1967).

104. *See, e.g.*, King, *supra* note 73, at 648–50; Khalfan, King & Thomas, *supra* note 64, at 47.

105. *See* Gelpern, *supra* note 5, at 406.

106. *See id.* at 404.

multiple theories, including that the debts were not agreed to by and did not benefit the Cuban people.[107] Evidence supported this assertion and indicated that the debt proceeds, which were added to Spain's national budget, ultimately helped oppress the Cuban people.[108]

Initially, Spain argued that the United States should be responsible for the debts as they were contracted by Spain when it was the legitimate governing sovereign of Cuba.[109] The United States countered that Spain was in exclusive control of Cuba's finances and, therefore, Cuba itself had not actually contracted the debts.[110] During treaty negotiations, both the United States and Spain asserted several theories in support of their positions.[111] At one point, Spain offered to disclaim all debts not used to aid improvements in Cuba.[112] Ultimately, however, the United States succeeded in repudiating all of Cuba's outstanding debts.[113]

b. The Tinoco Arbitration

Dictator Frederico Tinoco ruled Costa Rica from 1917 to 1919.[114] Prior to being overthrown, Tinoco was able to secure financing from the Royal Bank of Canada that assisted in his escape but that never made its way to the Costa Rican people.[115] An arbitration ensued in 1923 when the bank tried to enforce the debts in Costa Rica.[116]

The sole arbitrator, William H. Taft, distinguished this government succession from the circumstances involved in a state succession (such as the one dealt with after the Spanish-American War).[117] Taft found that a change of government has no effect on the debt obligations of the state, but that the loan itself was fraudulent.[118] The bank could not "base its case for repayment on 'the mere form of the transaction' but must prove its good faith in lending the money 'for the real use of the Costa Rican Government under the Tinoco regime . . . for its legitimate use.'"[119] But here, the bank knew that the loan proceeds would be used for the personal benefit of Tinoco.[120]

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107. *See id.*; Gentile, *supra* note 49, at 154–55.

108. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1215; Sara Ludington, Mitu Gulati & Alfred L. Brophy, *Applied Legal History: Demystifying the Doctrine of Odious Debt*, 11 THEORETICAL INQUIRIES L. 247, 251–52 (2010).

109. *See* Ludington, Gulati & Brophy, *supra* note 108, at 253.

110. *See* Gentile, *supra* note 49, at 154–55; Ludington, Gulati & Brophy, *supra* note 108, at 253.

111. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1214–16; Ludington, Gulati & Brophy, *supra* note 108, at 250–58.

112. *See* Ludington, Gulati & Brophy, *supra* note 108, at 255.

113. *See id.* at 256.

114. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1216.

115. *See* Gelpern, *supra* note 5, at 411; Yianni & Tinkler, *supra* note 63, at 762.

116. *See generally* Great Britain v. Costa Rica, 1 R.I.A.A. 371 (1923).

117. *See id.* at 380; Cheng, *supra* note 99, at 16; Gelpern, *supra* note 5, at 411.

118. *See* Gelpern, *supra* note 5, at 411.

119. Ludington, Gulati & Brophy, *supra* note 108, at 258 (quoting *Great Britain*, 1 R.I.A.A. at 394).

120. *See* Gelpern, *supra* note 5, at 411.

Some scholars, however, do not agree that the arbitration supports the doctrine. Sarah Ludington, Mitu Gulati, and Alfred L. Brophy argue that "first, Tinoco was not clearly a despot; second, Taft was an archconservative and an unlikely champion of debt-burdened fledgling democracies; third, Taft applied a substance-over-form analysis" by stating, in essence, that the loans were actually made to Tinoco, not to Costa Rica.[121] Despite this criticism, the Tinoco Arbitration is still cited as a leading example of the odious debt doctrine in action.

c. The Foreign Sovereign Immunities Act

Sovereigns are generally protected from litigation in domestic courts under the theory of sovereign immunity.[122] This theory began to face scrutiny in 1952 after the United States adopted a principle that allowed sovereigns to be sued in connection with borrowing money abroad.[123] This was later codified in the U.S. Foreign Sovereign Immunities Act of 1976, the U.K. State Immunity Act of 1979, and numerous similar laws in other countries.[124] These laws showed a level of acceptance in giving up sovereign immunity, but did not provide significant help to creditors in enforcing judgments.[125]

d. The Iraq War and Argentina's Debt Restructuring

Since the Tinoco Arbitration, the odious debt doctrine has been implicated on several occasions.[126] Recent examples include debt restructurings conducted by Iraq and Argentina over the last two decades. Neither sovereign chose to utilize the doctrine.

The doctrine was implicated with the fall of the Iraqi regime in 2003. When Saddam Hussein was ousted in 2003, Iraq had approximately $125 billion in external debt, including a mixture of bilateral, commercial, and multilateral (e.g., IMF) creditors.[127] Average per capita income in Iraq had

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121. *See* Ludington, Gulati & Brophy, *supra* note 108, at 260.

122. *See* Patrick Bolton & David Skeel, *Odious Debts or Odious Regimes?*, 70 LAW & CONTEMP. PROBS. 83, 91 (2007); Choi, Gulati & Posner, *supra* note 37, at 135.

123. *See* Letter from Jack B. Tate, Acting Legal Adviser, Dep't of State, to Philip B. Perlman, Acting Attorney General (May 19, 1952), *in* 26 DEP'T ST. BULL. 984, 984–85 (1952), *and in* Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682, 714 (1976) ("[I]t will hereafter be the Department [of State's] policy to follow [a] restrictive theory of sovereign immunity in the consideration of requests of foreign governments for a grant of sovereign immunity."). Under the restrictive theory of sovereign immunity, immunity is extended to public acts of a state, but not to private acts. *See Alfred Dunhill of London*, 425 U.S. at 711–13.

124. *See* Gelpern, *supra* note 5, at 396 n.21.

125. *See id.* at 396. For example, Argentina has refused to pay out creditors despite a court holding that creditors are entitled to payment. *See id.* at 402.

126. Examples of this include Nazi Germany's refusal to assume Austrian debts after its annexation in 1938, postrevolution China's refusal to accept prerevolution debts in 1952, and France's refusal to assume debts in its administration of Algeria in 1962. *See* King, *supra* note 73, at 634–35.

127. *See* WEISS, *supra* note 7, at 1.

dropped from $3836 in 1980 to $715 in 2002.[128] Some members of Congress proposed the repudiation of these debts under the Iraq Freedom From Debt Act in 2003.[129] Iraqi officials did not wish to utilize the doctrine for debt repudiation, and Congress failed to gain sufficient support to pass the Act.[130] Ultimately, however, negotiations between Iraq and the Paris Club led to an 80 percent reduction of Paris Club and commercial debt.[131] Iraq is also supposed to receive an overall debt cancellation of 80 percent from all of its creditors.[132] By 2010, Iraq had reduced its external debt to $45 billion.[133]

Argentina can attribute a portion of its current debt back to debt incurred by the Junta, a de facto military-civilian regime that ousted the government in 1976 and increased the public debt eightfold in a period of a few years.[134] Still coping with a significant debt trap, former Argentine President Nestor Kirchner argued during his 2003 inaugural address, "We cannot go back to paying our debts at the expense of hunger and exclusion of Argentines generating more poverty and increasing social conflicts."[135] Creditors, Kirchner argued, cannot collect if Argentina does not do well.[136] In 2005, Anna Gelpern reasoned that "[i]f Argentina succeeds [in major debt restructurings], it will show in graphic terms that most countries considering [o]dious [d]ebt have ready alternatives for securing deep debt relief without proving state succession, illegitimacy, or specific knowledge by the creditors, and without costly and time-consuming claim-by-claim

128. *See* U.S. DEP'T OF STATE, REBUILDING IRAQ: U.S. ACHIEVEMENTS THROUGH THE IRAQ RELIEF AND RECONSTRUCTION FUND 1 (2006), http://2001-2009.state.gov/documents/organization/60952.pdf [http://perma.cc/BM42-3JVA].

129. *See* WEISS, *supra* note 7, at 15; *see also* Cheng, *supra* note 99, at 26 ("It is noteworthy that the United States' call for debt cancellation was not merely for the benefit of the Iraqis. It also benefitted the U.S. government.").

130. *See* WEISS, *supra* note 7, at 15; WONG, *supra* note 7, at 8 ("Although not using the actual terminology of odious debt, the underlying principles of Sack's doctrine were espoused by the USA in its rhetoric on Saddam, Iraq's debt, and Iraq's repayment obligations.").

131. *See* WEISS, *supra* note 7, at 1; Omri Ben-Shahar & Mitu Gulati, *Partially Odious Debts?*, 70 LAW & CONTEMP. PROBS. 47, 54 (2007) ("Iraq received one of the largest write-offs ever (eighty percent) in the Paris Club." (citing Andy Metzger, *A Mission Accomplished*, LEGAL TIMES, Apr. 10, 2006, at 1)).

132. *See* WEISS, *supra* note 7, at 10.

133. *See Government Debt*, CENTRAL BANK OF IRAQ, http://www.cbi.iq/index.php?pid=GovernmentSecurities (last visited Oct. 21, 2015) [http://perma.cc/5GB6-UVNA].

134. Ellen Brown, *Cry for Argentina: Odious Debt, Fiscal Mismanagement or Pillage? Financial Mechanisms Which Spearhead Nations into Bankruptcy*, CTR. FOR RESEARCH ON GLOBALIZATION (Aug. 12, 2014), http://www.globalresearch.ca/cry-for-argentina-odious-debt-fiscal-mismanagement-or-pillage-financial-mechanisms-which-spearhead-nations-into-bankruptcy/5395691 [http://perma.cc/M84Q-XWTC].

135. Doctor Nestor Kirchner, President of the Republic of Arg., Discurso del Señor Presidente de la Nación Ante la Honorable Asamblea Legislativa [Inaugural Address of President Kirchner] (May 25, 2003), http://www.presidencia.gob.ar/discursos-2007/24414, *English translation available in Argentina: Full Text of Kirchner's Inaugural Speech*, BBC MONITORING INTERNATIONAL REPORTS (May 26, 2003) [http://perma.cc/MN72-M8WN].

136. Gelpern, *supra* note 5, at 408 n.57 (citing Inaugural Address of President Kirchner, *supra* note 135).

adjudication."[137] By 2010, Argentina managed to reach an agreement with 92 percent of its bondholders to accept about one-third of their original investment.[138]

Today, Argentina is still faced with holdout creditors from the restructuring.[139] Bonds held by these creditors can be traced back to the 1970s.[140] While Argentina could still raise a defense of odious debt, pointing to the Junta's series of illegitimate policies, it has yet to do so.[141]

C. Revitalization of the Odious Debt Doctrine

For the handful of instances in which the doctrine of odious debt has been implicated, there is an overabundance of examples in which the indebted country has wished not to implicate the doctrine.[142] Countries that have accrued unwieldy debts and are undergoing administrative changes could gain tremendously from the doctrine. Yet, there is a fear of potential economic backlash—such as higher interest rates and limited access to capital—in invoking this doctrine to relieve the debts. This section discusses the need for an odious debt doctrine and the fear sovereigns have in using it.

1. A Need for the Doctrine

There is continuing debate among scholars on whether the forgiveness of odious debt is a question of economic or moral consequence.[143] Gelpern suggests that one lesson from Iraq's recent debt restructuring is that the international community is willing to provide assistance when a country's financial distress represents an "extraordinary political threat," but that the same sentiment is not availed to those dealing with periodic government wrongdoing.[144]

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137. *Id.* at 410.

138. *See Argentina's Fernandez de Kirchner Wants Creditor Talks*, BBC NEWS (June 20, 2014), http://www.bbc.com/news/business-27951439 [http://perma.cc/TZ67-P9PE].

139. *See supra* notes 52–55 and accompanying text. In October of 2012, the Second Circuit found that Argentina had breached its debt agreement; it affirmed the district court's orders to enjoin Argentina from making payments to its restructured bonds without making ratable payments to its other bondholders, and it remanded to the district court on the issue of clarifying the impact of its injunction on third parties. *See* NML Capital, Ltd. v. Republic of Argentina, 699 F.3d. 246, 262 (2d Cir. 2012) (holding that the Foreign Sovereign Immunities Act will not immunize Argentina's extraterritorial assets from postjudgment discovery). On remand, the district court amended its injunction orders against Argentina, and the Second Circuit affirmed. *See* NML Capital, Ltd. v. Republic of Argentina, 727 F.3d 230 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 2819 (2014).

140. *See* Brown, *supra* note 134.

141. *See id.*

142. *See infra* Part I.C.2.

143. *See* Bolton & Skeel, *supra* note 122, at 85–87 (discussing the moral and economic arguments for the doctrine); *see also* Wyler, *supra* note 35, at 948 (stating "the scholarly motivations behind [the doctrine] vary widely—some believe it's a moral question; others believe it is an economic one").

144. Gelpern, *supra* note 5, at 400.

Under the moral argument for the doctrine, some despotic regimes are so reprehensible that they should be condemned by discouraging third parties from lending to them.[145] Odious debt incurred by a predecessor regime should not be binding on the state's citizens and the regime that replaces it.[146] They should be deemed unenforceable as a matter of justice.[147] This justification, however, is complicated by the fact that odious regimes do not always use proceeds for odious purposes.[148]

The economic justification for the doctrine is that it can be used to increase the welfare of the sovereign after the despotic regime has been removed.[149] Sovereigns may benefit from a lower debt burden, a lower likelihood of the emergence of odious regimes that reduce welfare, and a lower likelihood of long-lasting odious regimes.[150] By forcing countries to pay off cumbersome debt burdens, cycles of economic failure can be ongoing.[151] In developing countries, it is less likely that their outstanding debt is from original debt obligations than from accrued interest and refinancing of those original obligations.[152] In addition, "[f]ailed states are increasingly recognized as posing significant threats to the security of the global community."[153] By forgiving the odious debt of a country, the doctrine facilitates rebuilding the sovereign's government and infrastructure in a timely manner.[154]

Scholars disagree on whether there is sufficient state practice and case law to support the doctrine.[155] As mentioned above, no tribunals have expressly used the doctrine as a ground for canceling a country's sovereign debt.[156] Moreover, some scholars argue that the doctrine "stands on rather

145. *See* Bolton & Skeel, *supra* note 122, at 85; *see also* Ludington, Gulati & Brophy, *supra* note 108, at 251–58 (discussing the moral justification for debt forgiveness in Cuba after the Spanish-American War).

146. *See* Bolton & Skeel, *supra* note 122, at 85.

147. *See id.*; Sabine Michalowski & Juan Pablo Bohoslavsky, *Ius Cogens, Transitional Justice and Other Trends of the Debate on Odious Debts: A Response to the World Bank Discussion Paper on Odious Debts*, 48 COLUM. J. TRANSNAT'L L. 59, 107 (2009) ("[I]t is argued that debt might be repudiated, whether or not the country would be able to repay it, where it would be so unjust as to be immoral to burden the people of the debtor state with repayment of that debt.").

148. *See* Bolton & Skeel, *supra* note 122, at 85 ("Some loans, or portions of some loans, may be used for beneficial projects such as building bridges or roads, or expanding access to clean water.").

149. *See id.* at 86; Tom Ginsburg & Thomas S. Ulen, *Odious Debt, Odious Credit, Economic Development, and Democratization*, 70 LAW & CONTEMP. PROBS. 115, 122 (2007) (arguing that "a sensible solution to the issue of odious debt should explicitly consider the extent to which forgiveness of odious debt can significantly further [economic development and democratization]").

150. *See* Bolton & Skeel, *supra* note 122, at 86; *see also* Wyler, *supra* note 35, at 950.

151. *See* Wyler, *supra* note 35, at 950.

152. *See* Feinerman, *supra* note 59, at 215.

153. Jayachandran, Kremer & Shafter, *supra* note 72, at 2.

154. *See id.*; Ben-Shahar & Gulati, *supra* note 131, at 49 (arguing that creditors are frequently in a better position than a sovereign "to protect against [the] harm of insolvency"); Jayachandran, Kremer & Shafter, *supra* note 72, at 2.

155. *See* Michalowski & Bohoslavsky, *supra* note 147, at 64.

156. *See supra* note 105 and accompanying text.

weak ground" as an international law principle.[157] Without an established law governing the issue, sovereigns pursuing debt relief must use the common law of courts and customary international law.[158] Moreover, courts must substitute different validations for permitting forgiveness of a country's debt. Unfortunately, no single jurisdiction governs the vast majority of external sovereign debt.[159] With different jurisdictions applying different substantive law, inconsistent precedents are established.[160]

2. The Fear of the Doctrine

Numerous opportunities to invoke the doctrine of odious debt have presented themselves in the past.[161] In some situations, only two of Sack's elements were present, but at other times all three elements were well evidenced.[162] Nevertheless, sovereigns continuously choose not to invoke the doctrine.[163] They are often afraid of raising the doctrine themselves.[164]

A country that is suitably positioned to invoke the doctrine is one that has just rid itself of a despotic leader that incurred large debts providing no benefit to the individuals under its rule. Likely, the country's people have just surmounted a great amount of strife to overthrow the despot. The country is in need of organizing its new government. It is in need of economic stability, which will require the support of the international community. The new government, lacking an established, credit worthy reputation, would be turning away from the debt obligations for which a promise to repay exists.[165] As such, raising the doctrine could tarnish the country's reputation with potential lenders in the international community.[166]

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157. Michalowski & Bohoslavsky, *supra* note 147, at 64. Scholars disagree on whether the doctrine should apply to state successions in addition to government successions. *See supra* note 97 and accompanying text. Scholars also disagree on whether the doctrine should be used ex post or whether an institutional remedy is needed to create an ex ante solution. *See generally infra* Part II.

158. *See* Ludington, Gulati & Brophy, *supra* note 108, at 248.

159. *See id.* at 248–49.

160. *See id.*; Paul B. Stephan, *The Institutionalist Implications of an Odious Debt Doctrine*, 70 LAW & CONTEMP. PROBS. 213, 229 (2007) ("[R]esting the odious debt doctrine on customary international law [risks] the possibility of divergent interpretations.").

161. *See* Yianni & Tinkler, *supra* note 63, at 767.

162. *Compare id.* at 763–66 (noting that an application of the doctrine to *World Duty Free Limited v. Republic of Kenya* would not meet Sack's second prong because "in the absence of [a bribe to Kenya's president], it would be difficult to argue that a contract to build substantial facilities at two major airports would be against the interests of Kenya"), *with* Damle, *supra* note 5, at 139–40 (discussing the Apartheid's debt in South Africa).

163. As noted above, Iraqi officials adamantly fought against invoking the doctrine, even though there was international support for its use. *See supra* note 130 and accompanying text.

164. *See, e.g.*, Damle, *supra* note 5, at 140; Jayachandran, Kremer & Shafter, *supra* note 72, at 2.

165. *See* Gelpern, *supra* note 5, at 407; Jayachandran, Kremer & Shafter, *supra* note 72, at 2 (arguing that "successor governments to illegitimate regimes do not invoke the odious debt doctrine out of fear that doing so would deprive them of necessary access to global credit markets").

166. *See* Gelpern, *supra* note 5, at 407.

South Africa's clean break from the apartheid regime in 1994 is frequently named as an ideal case for the doctrine's application.[167] South Africa feared that its ability to borrow in the future would be hurt if it did not continue its debt payments and so did not raise the doctrine.[168] In another example, Nigeria incurred a significant amount of debt under despotic regimes that were subsequently overthrown.[169] Since 1986, the country has been involved in five Paris Club restructurings without raising the odious debt doctrine.[170]

This fear may ultimately be misplaced. For example, after the Civil War, eight southern states were able to scale down or repudiate their Reconstruction-era debts by claiming that corrupt state governments incurred them.[171] There are multiple other examples in which U.S. states have been able to refuse payment on certain debts while maintaining a reputation of financial reliability to future creditors.[172]

II. FROM THE GROUND UP: CURRENT DOCTRINAL APPROACHES

The odious debt doctrine has gained significant traction in the scholarly community over the last decade as countries continue to struggle to pay off debts when there are moral and economic justifications for forgiving them. This part looks at possible ways to establish a formal odious debt doctrine in order to solve this dilemma. Scholars are often divided on the question of whether the solution is in an ex post judicial mechanism or an ex ante labeling scheme. The ex post methods first argued by Sack in the early twentieth century are reviewed in Part II.A. Part II.B. then analyzes the more recently developed ex ante approach.

A. The Ex Post Approach

This section first reviews tactics that can be used in the courtroom. Next, it looks at the use of the U.N. Security Council to decide when the doctrine should be implemented. It concludes with proposed solutions that involve the World Bank and the IMF.

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167. *See* Damle, *supra* note 5, at 139–40; Yianni & Tinkler, *supra* note 63, at 752.

168. *See* Damle, *supra* note 5, at 140; A. Mechele Dickerson, *Insolvency Principles and the Odious Debt Doctrine: The Missing Link in the Debate*, 70 LAW & CONTEMP. PROBS. 53, 64 (2007) ("The new South African leaders did not repudiate [their apartheid-era] debts, most likely because they were concerned that doing so would harm the country's ability to attract foreign investment.").

169. *See* Damle, *supra* note 5, at 152–54; Yianni & Tinkler, *supra* note 63, at 767 n.123.

170. *See* Yianni & Tinkler, *supra* note 63, at 767. Prior to its 2005 Paris Club deal, the Nigerian legislature had resolved to repudiate its foreign debts. *See* Damle, *supra* note 5, at 152. Between 1956 and 2007, there were more than four hundred Paris Club restructuring deals involving more than eighty indebted countries. *Id.* Iraq is one such example of a recent restructuring. *See supra* notes 127–31 and accompanying text.

171. *See* Ludington, Gulati & Brophy, *supra* note 108, at 275–79.

172. *See* Michalowski & Bohoslavsky, *supra* note 147, at 96.

1. Courtroom Solutions

This section first discusses traditional courtroom tactics, including public policy considerations, the doctrine of unclean hands, and agency law remedies. It then discusses the ability of courts to invoke the doctrine of odious debt under customary international law.

The third prong of Sack's formulation—requiring the creditor to have knowledge that the loan proceeds were obtained without the consent of the people for a purpose that does not benefit the people—raises public policy concerns.[173] Creditors may be enticed into funding a sovereign's odious plans through above-market interest rates or outright bribes.[174] The U.S. Foreign Corrupt Practices Act of 1977 may find such action to be criminal.[175] A similar remedy under the U.K. Bribery Act of 2010 would also be available.[176] In the case of government succession, most scholars find little authority for the doctrine beyond cases in which the lender was bribed or otherwise corrupt.[177]

A debtor sovereign may also defend itself through the doctrine of unclean hands. Buchheit, Gulati, and Thompson propose that a lender be denied recovery if the debtor sovereign successfully pleads the unclean hands defense.[178] The defense blocks debt recovery if the lender is "tainted with inequitableness or bad faith relative to the matter in which [one] seeks relief, however improper may have been the behavior of the [sovereign]."[179] When there are public policy concerns, the defense "assumes even wider and more significant proportions."[180] This defense is not new to the sovereign context. In *Adler v. Federal Republic of Nigeria*,[181] the defense was successfully used to bar recovery to the plaintiffs who participated in a criminal scheme with Nigerian government officials.[182]

An agency law remedy is possible by analogizing a sovereign's constituents and their government to a corporate principal and its agents.[183]

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173. *See supra* note 64 and accompanying text.

174. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1232.

175. *See* 15 U.S.C. § 78m (2012) (requiring issuers to maintain records that fairly and accurately reflect the issuer's transactions and maintain a system of internal accounting controls).

176. *See* Bribery Act 2010, c. 23 (UK).

177. *See, e.g.*, King, *supra* note 73, at 665.

178. Buchheit, Gulati & Thompson, *supra* note 1, at 1235–37.

179. Precision Instrument Mfg. Co. v. Auto. Maint. Mach. Co., 324 U.S. 806, 814 (1945). For an application in the U.K. context, see, for example, *Royal Bank of Scotland Plc v. Highland Financial Partners LP* [2012] EWHC (Comm) 1278, [para. 175] (Eng.), http://www.bailii.org/ew/cases/EWHC/Comm/2012/1278.html [http://perma.cc/3DP3-SANU].

180. *Precision Instrument Mfg. Co.*, 324 U.S. at 815.

181. 219 F.3d 869 (9th Cir. 2000).

182. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1236–38 (summarizing *Adler*).

183. *See id.* at 1237–38. There is an open question as to whether the sovereign's people or the sovereign itself should be the principal. *See* Deborah A. DeMott, *Agency by Analogy: A Comment on Odious Debt*, 70 LAW & CONTEMP. PROBS. 157, 161 (2007) ("The composition of [a country's] people will also shift over time, making the people, as opposed the . . . state, less tractable as a principal [than the sovereign itself].").

Under agency law, an agent is able to bind its principal if it acts with actual or apparent authority.[184] If the agent has no such authority when binding its principal, the principal can still act to ratify the agent's actions.[185] If the agent, however, colludes with a third party in a manner adverse to the principal, the principal should not have to assume the liability for that agent's wrongful acts.[186] A principal is therefore not liable to a lender when the lender is aware that the agent is acting for its personal benefit.[187]

In corporate law, a legal fiction separates the entity from its shareholders who enjoy limited liability.[188] However, this legal fiction can be abused and ultimately removed by a court or tribunal.[189] The United States argued at the end of the Spanish-American War that the bonds secured by Cuban revenues were actually attributable directly to Spain.[190] This argument is analogous to "veil piercing" in the corporate context.[191] Under this doctrine, an innocent lender can seek payment directly from a shareholder when the shareholder's wrongdoing warrants direct collection by the lender.

In the sovereign context, citizens are not protected by limited liability, and the government itself is not directly liable for the sovereign's debts.[192] As such, a country and its citizens have unlimited liability to repay the debts once the regime has been overthrown.[193] Veil piercing in the sovereign context would permit a lender to collect directly from a despot.[194] Moreover, once a court finds that a lender knowingly funded a regime for its odious purposes, the citizens would no longer be responsible for paying back the debt.[195]

Buchheit, Gulati, and Thompson do warn that these corporate defenses would only achieve some of the objectives of odious debt.[196] Lenders would have reason to be more cautious before lending to regimes.[197] However, elements of these defenses can be difficult to prove and may not permit a full debt cancellation.[198]

184. RESTATEMENT (THIRD) OF AGENCY §§ 2.01, 2.03 (AM. LAW INST. 2006).

185. *Id.* § 4.01.

186. *Id.* § 5.04 cmt. c.

187. *See id.*; Buchheit, Gulati & Thompson, *supra* note 1, at 1243.

188. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1246–47; McDaniel, *supra* note 31, at 420.

189. *See* Ludington, Gulati & Brophy, *supra* note 108, at 268.

190. *See supra* notes 106–13 and accompanying text.

191. *See* Ludington, Gulati & Brophy, *supra* note 108, at 268.

192. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1248–50.

193. *Id.* at 1249.

194. *See id.* at 1248; Ludington, Gulati & Brophy, *supra* note 108, at 254.

195. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1251; Ludington, Gulati & Brophy, *supra* note 108, at 254 (discussing the application of the veil-piercing argument by the United States against Spain after the Spanish-American War).

196. Buchheit, Gulati & Thompson, *supra* note 1, at 1261.

197. *See id.*

198. *See id.* at 1251–56, 1261; Stephan, *supra* note 160, at 224 ("What existing national law does not do, however, is rescind a contract when the loan contract was unwise . . . in the absence of a national law forbidding the borrowing authority from undertaking the transaction." (emphasis omitted)).

Parties generally select English or New York law in choice of law provisions in bond indentures.[199] Analyzing the doctrine under the laws and practices of the United States and United Kingdom may not, however, be enough. Courts may decide to integrate rules of customary international law into their domestic law.[200] However, the doctrine has not yet become customary international law.[201] Gelpern suggests that, if anything, it is "a doctrine of public-international law aspiring to the status of customary international law."[202]

The Statute of the International Court of Justice provides an authoritative list of sources of international law.[203] These include international conventions, international custom, general principles of law recognized by states, and, as a secondary source, judicial rulings and teachings of industry experts.[204] To become a rule of international law, it must be invoked "in accordance with a constant and uniform usage by the [sovereigns] in question."[205] However, the doctrine's limited uses in the past show insufficient practice for a finding of customary international law.[206]

Professor Paul Stephan builds off of this issue in a discussion of his "bottom-up" approach to recognizing odious debt under customary international law.[207] Under this approach, Stephan argues the doctrine could become a part of customary international law upon a finding made by an authoritative tribunal.[208] Such a finding would also pressure courts in the United Kingdom and New York to accept the doctrine of odious debts.[209] Unfortunately, courts in separate jurisdictions may ultimately

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199. *See supra* note 24 and accompanying text.

200. *See* Stephan, *supra* note 160, at 221. The Supreme Court in *Banco Nacional de Cuba v. Sabbatino* did not question New York State courts' ability to look toward customary international law for support, but held that federal common law would not look to it. 376 U.S. 398 (1964). "Absent application of the *Sabbatino* override, then, New York courts (and presumably British ones as well) have the power to invoke international custom and conceivably might do so with respect to the odious debt doctrine." Stephan, *supra* note 160, at 223.

201. *See* Emily F. Mancina, *Sinners in the Hands of an Angry God: Resurrecting the Odious Debt Doctrine in International Law*, 36 GEO. WASH. INT'L L. REV. 1239, 1252 (2004) ("[The odious debt doctrine] does not exist under any treaties, nor does it exist in state practice, as no state has explicitly invoked it and prevailed by raising the doctrine as a defense to a legal obligation to repay its debts."); Paulus, *supra* note 72, at 91.

202. Anna Gelpern, *Odious, Not Debt*, 70 LAW & CONTEMP. PROBS. 81, 85 (2007) (noting odious debt lacks sufficient state practice and *opinio juris*).

203. *See* Statute of International Court of Justice art. 38, June 26, 1945, http://www.icj-cij.org/documents/index.php?p1=4&p2=2&p3=0#CHAPTER_II [http://perma.cc/8J2M-54CT].

204. *Id.*

205. Asylum (Colom./Peru), 1950 I.C.J. 266, 276 (Nov. 20).

206. *See* Yianni & Tinkler, *supra* note 63, at 768.

207. *See* Stephan, *supra* note 160, at 229–31.

208. *Id.* at 229. It is unlikely, however, that a single holding by an international tribunal would be sufficient to establish a customary law. *See* Gelpern, *supra* note 202, at 85 ("To qualify as custom, a legal norm traditionally must 'harden' through general, consistent practice of states over time, which must be 'accepted as law'—that is, experienced as binding and legal, rather than habitual, discretionary, or accidental.").

209. *See* Stephan, *supra* note 160, at 229.

apply the doctrine in different circumstances, creating an inconsistency in its application.[210]

Because the last quasi application of the odious debt doctrine occurred during the Tinoco Arbitration nearly a century ago, its adoption would likely shock the sovereign debt market, increasing legal risks.[211] Further, there is no solid definition of odious debt in customary international law.[212] Courts could limit the doctrine's application to sovereigns subject to sanctions of the Security Council.[213] Alternatively, courts could create a presumption of odiousness when sufficient repression and instances of murder are seen.[214]

Another issue arises in waiting for customary international law to develop in tribunals: most sovereign debt restructurings do not involve any arbitration or litigation.[215] Sovereign debtors have generally used tools available in the official sector to resolve debt issues.[216] Negotiations between a sovereign and its bondholders may result in a partial debt cancellation, longer debt maturities, or lower interest rates.[217] Sovereigns participating in renegotiations of their debt will not, however, use the doctrine as an express reason for requesting relief.[218] Moreover, partial debt cancellation does not fulfill the moral or economic justifications for the doctrine. Despotic leaders may still obtain loans for odious uses, and sovereigns may nonetheless be faced with outstanding debt obligations that they are unable to pay.

2. The U.N. Security Council

After the fall of the Saddam Hussein regime, the U.N. Security Council froze all Iraqi assets held by U.N. member nations.[219] It also immunized all Iraqi wealth from oil and gas production, an industry representing more than 75 percent of Iraq's economy at the time, from creditors' grasps.[220]

As evidenced by this example, the U.N. Security Council already has a significant amount of authority.[221] Under the U.N. Charter, the Security

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210. *See id.*

211. *See id.* at 229. *See generally* Great Britain v. Costa Rica, 1 R.I.A.A. 371 (1923).

212. *See* Michalowski & Bohoslavsky, *supra* note 147, at 63; Stephan, *supra* note 160, at 230 ("A judge seeking to . . . determine what qualifies as odious would find a wealth of opinion but no clear and determinant core.").

213. *See* Stephan, *supra* note 160, at 230.

214. *See id.*

215. *See id.* at 218.

216. *See* Gelpern, *supra* note 5, at 400. For example, the U.N. Security Council required its member nations to transfer all Iraqi assets in their jurisdictions to a specially designated development fund. *See id.* at 395. Iraq was subsequently able to reduce its debt obligations through renegotiations with Paris Club bondholders. *See id.* at 402.

217. *See* Das, Papaioannou & Trebesch, *supra* note 24, at 7–8.

218. *See generally supra* Part I.C.2.

219. *See supra* note 216.

220. *See* S.C. Res. 1483, ¶ 22 (May 22, 2003), http://www.unesco.org/culture/laws/pdf/resolution1483_iraq_en.pdf [http://perma.cc/4EHV-RN82]; Gelpern, *supra* note 5, at 394–96.

221. *See* Stephan, *supra* note 160, at 227.

Council can impose economic sanctions on abusive regimes when that abuse threatens international order.[222] As such, it could order member states not to recognize the debts incurred by odious regimes.[223]

While states are obligated to carry out Security Council resolutions, the resolutions do not automatically translate into binding domestic law.[224] The Security Council also cannot act without consensus among all of its permanent members—China, France, Russia, the United Kingdom, and the United States.[225] As such, leaving decisions of odious debt to the Security Council may have "little practical significance."[226]

3. World Bank and IMF Solutions

Some experts believe that the World Bank or IMF may be better suited to offer institutional remedies for the doctrine.[227] This section looks at the solutions involving the World Bank and IMF in turn. It then looks at criticisms of both approaches.

Unlike the Security Council, a Board of Governors governs the World Bank, and voting is done by subscription.[228] The purpose of the World Bank, in part, is to "assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes."[229] The World Bank has been revisiting its anticorruption efforts over the last decade.[230] The Bank is already in the practice of categorizing corrupt states and monitoring corruption and budget transparency.[231] Continuing efforts could allow the World Bank to play a role in monitoring the use of debt funds.[232] The act of categorizing governments could also assist in developing an ex ante approach to odious debt.[233]

While there are procedural efficiency justifications to promoting the World Bank's role in evaluating potential odious debt claims, the Bank

222. *See* U.N. Charter arts. 39–51, http://www.un.org/en/documents/charter/ [http://perma.cc/3RLE-3HC9].

223. *See* Stephan, *supra* note 160, at 227.

224. *See id.* ("National governments may cite a Security Council resolution as a basis for adopting a domestic law, but a refusal to carry out a resolution may result only in another resolution.").

225. *See* U.N. Charter arts. 23(1), 27(3).

226. Stephan, *supra* note 160, at 227.

227. *See* Bolton & Skeel, *supra* note 122, at 104 ("For policing systematic plundering, the most logical decisionmaker would be either the World Bank or the IMF . . . ."); Ginsburg & Ulen, *supra* note 149, at 133 ("We believe the IMF and World Bank are better vehicles for addressing the odious debt problem than the United Nations.").

228. *See* Int'l Bank for Reconstruction and Dev. [IBRD], Articles of Agreement, art. V, §§ 2–3 (Dec. 27, 1945), http://siteresources.worldbank.org/EXTABOUTUS/Resources/ibrd-articlesofagreement.pdf [http://perma.cc/5P8R-MJB7].

229. *Id.* art. I.

230. *See* Ben-Shahar & Gulati, *supra* note 131, at 72; Damle, *supra* note 5, at 154.

231. *See Corruption Measurement*, WORLD BANK, http://go.worldbank.org/W9P7QIN6M0 (last visited Oct. 21, 2015) [http://perma.cc/J3M6-LXBY]; *see also* Damle, *supra* note 5, at 154; Feinerman, *supra* note 59, at 209.

232. *See* Ben-Shahar & Gulati, *supra* note 131, at 72.

233. *See infra* Part II.B.

itself does not support the doctrine.[234] The World Bank criticizes it for the lack of support found in customary international law and suggests a different approach of improved lending and borrowing practices.[235] The World Bank also advocates debt reduction rather than debt forgiveness.[236]

The IMF is also governed by a Board of Governors with voting done by subscription.[237] The IMF conducts regular financial reviews of its members.[238] It arguably collects better financial data about a sovereign than other outside parties and would likely uncover fund misappropriations that occur.[239] If the IMF took a role in the identification of odious debt, it could deny IMF funds to the odious regimes and declare any previous debts unenforceable. The IMF could also use its review process to establish an ex ante mechanism for labeling odious regimes.[240] In 2000, a U.S. advisory commission recommended a similar mechanism in a report on reforming international financial institutions.[241] It recommended that confirming the soundness of a country's public finance policies should be a prerequisite for IMF bailout funds during a crisis.[242]

The IMF has also proposed the Sovereign Debt Restructuring Mechanism[243] (SDRM). The SDRM was proposed as a framework to provide debtor countries and their creditors with incentives to quickly come to a restructuring agreement in an economically efficient manner.[244] The mechanism was based on four central bankruptcy principles:

(1) prevent creditors from blocking renegotiations by seeking repayment through the court system;

(2) encourage creditors to provide capital to assist with the debtor country's financing needs;

(3) remove the collective action problem by binding minority creditors, once approved by a sufficient majority; and

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234. *See* Vikram Nehru & Mark Thomas, *The Concept of Odious Debt: Some Considerations* 23 (World Bank Policy Research, Working Paper No. WPS4676, 2008).

235. *See id.* at 26–38.

236. *See* Michalowski & Bohoslavsky, *supra* note 147, at 106; Nehru & Thomas, *supra* note 234, at 35.

237. Int'l Monetary Fund [IMF], Articles of Agreement of the IMF, art. 12, § 5 [hereinafter Articles of Agreement of the IMF], https://www.imf.org/external/pubs/ft/aa/ [http://perma.cc/QF96-CDQT].

238. *See id.* art. IV; Bolton & Skeel, *supra* note 122, at 104.

239. *See* Patrick Bolton & David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?*, 53 EMORY L.J. 763, 809 (2004); Bolton & Skeel, *supra* note 122, at 104.

240. *See* Bolton & Skeel, *supra* note 122, at 104–05.

241. *See id.*

242. *See id.* at 105.

243. *See* Krueger, *supra* note 56.

244. *See* IMF, *IMF Board Discusses Possible Features of Sovereign Debt Restructuring Mechanism*, PIN No. 03/06 (2003) [hereinafter *IMF Board Discusses Possible Features*], https://www.imf.org/external/np/sec/pn/2003/pn0306.htm [http://perma.cc/9U32-ZAHR]. Most directors of the IMF "agreed that an amendment of the [IMF's] Articles would provide the most appropriate vehicle for the establishment of the SDRM." *Id.*

(4) provide some guarantee that the debtor would act responsibly during the process.[245]

Under the SDRM, authority would be given to a Sovereign Debt Dispute Resolution Forum (SDDRF) to rule on legal challenges to specific loans.[246] The SDDRF would be an independent body created under the IMF Articles of Agreement.[247] If issues arise that risk undermining a debtor sovereign's restructuring process, the SDDRF could provide a stay in the creditors' collection efforts.[248] In addition to dealing with traditional restructuring issues, the SDRM could permit sovereigns to petition the SDDRF to allow cancellation of odious debt.[249]

The SDRM faced immediate criticism.[250] The private sector in the United States and abroad was critical of the proposal to limit individual investors' rights and perhaps increase the frequency of restructurings.[251] Creditors were concerned that the proposal was merely a power grab by the IMF and criticized it for favoring debtor countries.[252] Some directors of the IMF Executive Board feared the SDRM's objectives actually went beyond the scope of the IMF's purposes.[253] They also questioned the appropriateness of amending the Articles of Agreement to allow for the creation of the new mechanism.[254]

Krueger argued that IMF involvement was "essential" to the SDRM's success.[255] She claimed that the IMF was the "most effective channel through which the international community can reach a judgment on the sustainability of a country's debt and of its economic policies."[256] She did admit, however, that the IMF would require some outside support in verifying creditor claims and occasionally adjudicating disputes among creditors and/or debtors.[257]

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245. *See* Krueger, *supra* note 56. The fourth element was later removed from the IMF's proposal. *See* IMF, *Report of the Managing Director to the International Monetary and Financial Committee on the IMF's Policy Agenda* 16–17 (Apr. 2003) [hereinafter *IMF Policy Agenda*], http://www.imf.org/external/np/omd/2003/041103.pdf [http://perma.cc/DU6N-XM4Z].

246. *See* Bolton & Skeel, *supra* note 239, at 779; *IMF Board Discusses Possible Features*, *supra* note 244.

247. *See IMF Board Discusses Possible Features*, *supra* note 244.

248. *See id.*

249. *See* Bradley N. Lewis, *Restructuring the Odious Debt Exception*, 25 B.U. INT'L L.J. 297, 337–39 (2007).

250. *See, e.g.*, Hagan, *supra* note 56, at 391, 392 n.251 (discussing opposition from the United States and the private sector).

251. *See id.* at 392–93.

252. *See* Gelpern, *supra* note 5, at 398; Hagan, *supra* note 56, at 345 (observing that "for an institution that is already perceived by many as being excessively powerful, concerns have been expressed about any reform that would give it any further authority").

253. *See IMF Board Discusses Possible Features*, *supra* note 244.

254. *See id.*

255. Krueger, *supra* note 56.

256. *Id.*

257. *See id.*

Two years after its proposal, the IMF acknowledged a lack of sufficient support by member nations and abandoned the project.[258] Just before being shelved in 2003, John Snow, then-U.S. Treasury Secretary, argued that the use of collective action clauses, not the SDRM, was the correct method for resolving restructuring issues.[259] Given the United States's presence in the IMF, it would be impossible to implement an SDRM-like infrastructure without U.S. support.[260] Moreover, it would be difficult to implement any restructuring mechanism—with or without the IMF—without U.S. support.[261]

While the World Bank and IMF are structured in a way to provide a more equal voting process than the Security Council, the SDRM example above shows that the organizations are not free from political sway.[262] In particular, Patrick Bolton and David A. Skeel, Jr. suggest that the IMF has "been driven more by political pressures by the United States or other G-7 members than by the economics of the crisis in question."[263] After all, the United States's voting shares are more than double that of the next highest voting member in the World Bank and almost three times that of the next highest voting member in the IMF.[264] Both organizations are also subject to an institutional bias. As lenders themselves, both organizations have been accused of consciously financing oppressive governments that ultimately use the funds to "affirmatively harm" their citizens.[265] The IMF in particular was criticized for trying to make restructurings easier through the SDRM and lowering the frequency with which the IMF would have to provide financial support.[266]

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258. *See IMF Policy Agenda*, *supra* note 245. More than 75 percent of voting power supported the SDRM, but 85 percent is necessary under the IMF's Articles of Amendment. *See* Articles of Agreement of the IMF, *supra* note 237, art. 28; Jack Boorman, Special Advisor to the Managing Dir., IMF, Speech: Dealing Justly with Debt (Apr. 30, 2003), http://www.imf.org/external/np/speeches/2003/043003.htm [http://perma.cc/SC4R-WD53].

259. *See* John W. Snow, U.S. Sec'y of Treasury, Statement at the Meeting of the International Monetary and Financial Committee (Apr. 12, 2003), http://www.imf.org/external/spring/2003/imfc/state/eng/usa.htm ("The source of [current restructuring] problems lies in the relationships and agreements of debtors and their creditors. It is these parties, not an international organization, that must assume responsibility for the solution.") [http://perma.cc/D85V-6YJX].

260. *See* Sedlak, *supra* note 38, at 1484. The United States holds more than 15 percent of voting shares and thus has de facto veto power in the IMF. *See IMF Members' Quotas and Voting Power, and IMF Board of Governors*, IMF (Sept. 18, 2015) [hereinafter *IMF Members' Quotas and Voting Power*], http://www.imf.org/external/np/sec/memdir/members.aspx [http://perma.cc/7TED-LF7B].

261. *See* Robert K. Rasmussen, *Sovereign Debt Restructuring, Odious Debt, and the Politics of Debt Relief*, 70 LAW & CONTEMP. PROBS. 249, 259 (2007) ("It is difficult to imagine the adoption of . . . an odious debt doctrine . . . without America's active support.").

262. *See* Feinerman, *supra* note 59, at 215; Rasmussen, *supra* note 261, at 259.

263. Bolton & Skeel, *supra* note 239, at 810.

264. *See Subscriptions and Voting Power of Member Countries*, IBRD, http://siteresources.worldbank.org/BODINT/Resources/278027-1215524804501/IBRDCountryVotingTable.pdf (last updated Oct. 1, 2015) [http://perma.cc/2UTP-HB3R]; *IMF Members' Quotas and Voting Power*, *supra* note 260.

265. Dickerson, *supra* note 168, at 56.

266. *See A Better Way to Go Bust*, ECONOMIST (Jan. 30, 2003), http://www.economist.com/node/1560022 (describing critics' worry that the IMF had a hidden agenda to remove

Even if the World Bank and the IMF were to overcome the difficulties discussed above, and fully accept the doctrine, there is a question of what rule of law they would each utilize in making their decisions. As already discussed, customary international law is insufficient.[267] The IMF would likely have to amend its Articles even to establish the SDRM.[268] The SDDRF (or an institutional remedy created by the World Bank) would have to adopt some rules for evaluating use of funds.[269] It would also need to have some legal authority to bind states and creditors.[270]

Each of the proposed solutions for use outside of the courtroom lacks either international support or an established institution to implement the proposal—or both. Moreover, each of these proposed solutions share one shortcoming: by the time they can be utilized, the damage has already been done; the despot has already left the sovereign with large debt obligations that never benefitted the people. Other strategies try to account for this inherent problem with the ex post approach.

B. The Ex Ante Approach

Ex ante approaches are applied before a bond has been issued. They seek to cut off financing before much of the financial hardship can be created. The alternative way to approach this problem is from an ex post perspective by excusing the debts of a sovereign once its despotic regime has been disposed but the financial hardship that it caused remains. This section first discusses a labeling mechanism proposed by ex ante proponents. It then discusses a relatively new contractual solution that has been proposed to ease the collective action problem in corporate defaults and, more recently, in sovereign defaults.

1. The Labeling Regime

Proponents of an ex ante approach diverge from Sack's model by seeking to identify odious regimes before they are able to issue bonds.[271] By labeling a regime "odious," potential creditors would effectively be put on notice that a successor government could repudiate the debts of its predecessor.[272] An ex ante approach would also incentivize creditors to

their own bailout support) [http://perma.cc/JH2G-KL3C]. *But see* Hagan, *supra* note 56, at 393 (arguing that the intent of the IMF was to provide a restructuring framework, not replace their financial support).

267. *See supra* Part II.A.1.

268. *See supra* note 244.

269. The SDDRF would have used the substantive law of the relevant nation in its dispute. *See* Hagan, *supra* note 56, at 383. However, there is no such law for evaluating what constitutes odious debt. *See generally* Part I.B.2.

270. *See* Hagan, *supra* note 56, at 386 ("[T]he binding effect of such actions assumes that all member countries have taken the necessary steps to ensure that the new treaty obligations conferring such powers on the [SDDRF] are given full legal effect in their territory.").

271. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1226.

272. *See* Jayachandran, Kremer & Shafter, *supra* note 72, at 5; Wyler, *supra* note 35, at 949.

focus on due diligence.[273] This section first looks at the basics of the regime. It then discusses which institution should be responsible for making ex ante labeling decisions.

a. Restricting Funds to Odious Regimes

Under the labeling regime, an international organization would label governments as "odious-debt prone."[274] Creditors would petition the organization for a ruling on a potential debtor sovereign based on the debtor's proposed use of funds and the creditor's due diligence model.[275] If approved by the organization, the debt would remain enforceable in the event of a regime change.[276]

Only debts incurred by governments given the odious-prone designation would be subject to possible cancellation.[277] Once a designation has been given, the creditor would be responsible for monitoring the use of funds.[278] If the creditor fails to make a good faith effort with its monitoring obligations and the funds are used for illegitimate purposes, the debt would be forgiven if the despotic regime then falls.[279]

Placing the burden of proof on the creditor alleviates some stress on the debtor, which is generally in desperate need of capital once a despotic regime has been overthrown.[280] The shift also makes the creditor's duty more onerous.[281] This could lead the capital markets to tighten and be more difficult to maneuver.[282] Ultimately, this would negatively impact regimes that have been deemed odious-prone, even if the regimes ultimately use bond proceeds for legitimate purposes.[283] Taft effectively rejected this labeling approach in his Tinoco ruling for similar reasons.[284]

Creditors who are effectively on notice will scrutinize a regime's debt offering more heavily.[285] As such, the ex ante labeling mechanism has the effect of attempting to halt lending to a despotic regime before it even

273. *See* Jayachandran, Kremer & Shafter, *supra* note 72, at 19–22.
274. *See id.* at 19.
275. *See id.*
276. *See id.* at 20.
277. *See id.* at 19.
278. *See id.* at 20.
279. *See id.* at 20–21.
280. *See* Wyler, *supra* note 35, at 976.
281. *See id.* at 976–77.
282. *See id.* at 980–81.
283. Regimes that have been labeled as odious-prone regimes may, for example, have their development slowed through an inability to access capital to fund necessary infrastructure projects. *See id.*
284. *See* Ludington, Gulati & Brophy, *supra* note 108, at 265–66 ("[A]ssuming that Taft wanted to make it easy for creditors to lend, he probably would not have put the burden on them to investigate ex ante whether a government was adequately democratic, or justify the 'legitimacy' of a regime ex post.").
285. *See* Bolton & Skeel, *supra* note 122, at 99 ("[T]he threat of subsequent annulment would discipline potential lenders, encouraging them not to lend too recklessly to odious regimes.").

starts.[286] This could ultimately expedite the downfall of the authoritative government.[287] However, it could also cut off vital financing for the country.[288] When it does not cut off financing, it could otherwise eliminate the availability of market interest rate debt instruments.[289] The approach itself has several risks and shortcomings; these are amplified by the lack of a labeling apparatus.

b. Creating a Labeling Institution

Labeling of a sovereign as odious-prone is subjective in nature.[290] As such, the institution making ex ante determinations would need to be composed of a group with similar viewpoints, allowing it to form a consensus regarding what is odious.[291]

The labeling could occur under the auspices of the U.S. executive branch.[292] However, the executive would be limited to ruling on U.S.-governed bonds, and the United States does not have as dominant role in global capital markets as it once did.[293] The U.N. is a possible solution, but it is not ideal. Its members represent a diverse group of players with varied opinions on what may or may not be odious.[294] The G-7 or Organisation for Economic Co-operation and Development[295] (OECD) countries could spearhead the effort.[296] The groups both exist for economic and financial purposes, however, and may not wish to involve themselves in such a politically driven endeavor.[297]

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286. *See* Buchheit, Gulati & Thompson, *supra* note 1, at 1226 ("It is the financial equivalent of what oncologists call 'starving the tumor.'").

287. *See id.* at 1227.

288. *See id.* This problem may be exacerbated when the regime uses the sovereign's income for despotic purposes, but uses debt proceeds for legitimate purposes.

289. *See* Jayachandran, Kremer & Shafter, *supra* note 72, at 2.

290. *See id.* at 22. The subjective element is on the part of the labeling institution rather than on the lender who, under the Sackian model, must show he was not subjectively aware of the odious use of funds. *See id.* at 18.

291. *See* Bolton & Skeel, *supra* note 122, at 105; Jayachandran, Kremer & Shafter, *supra* note 72, at 22.

292. *See* Jonathan Shafter, *The Due Diligence Model: An Executive Approach to Odious Debt Reform*, 32 N.C. J. INT'L. & COM. REG. 669, 691–94 (2007). The U.S. judiciary is less likely to weigh in as it would require reallocation of some foreign affairs power from the executive branch. *See id.* at 684.

293. *See id.* at 692–694. Only 36 percent of bonds were U.S.-dollar denominated at the end of 2006. *Id.* at 693.

294. *See* Jayachandran, Kremer & Shafter, *supra* note 72, at 22. However, as noted above, the Security Council already has power to make similar designations. *See* Ben-Shahar & Gulati, *supra* note 131, at 56.

295. The Organisation for Economic Co-operation and Development, established to run the Marshall Plan at the end of World War II, currently has thirty-four members and works toward promoting economically and socially sound policies across the world. *See History*, ORG. FOR ECON. CO-OPERATION AND DEV., http://www.oecd.org/about/history/ (last visited Oct. 21, 2015) [http://perma.cc/EZ3N-NLLK]; *About the OECD*, ORG. FOR ECON. CO-OPERATION AND DEV., http://www.oecd.org/about/ (last visited Oct. 21, 2015) [http://perma.cc/PG8W-ZYRM].

296. *See* Jayachandran, Kremer & Shafter, *supra* note 72, at 23.

297. *See id.* at 23 n.29.

An institutional labeling mechanism would have several shortcomings. Like the ex post approach, it would need to find authority upon which to act. As mentioned above, there is no internationally recognized definition of odious debt.[298] Consequently, the labeling institution would need to establish its own criteria for evaluating governments.[299] The untested institution and lack of precedent defining odious debt would also increase the investment risk for the parties involved. Additionally, individual bondholders may lack adequate incentive to request the labeling of a sovereign prior to lending.[300]

2. The Contractual Solution

Perhaps the solution is not in spotting despotic regimes before they start spending debt proceeds, but in spotting them before they finish using the funds. Professors Yankov Amihud, Kenneth Garbade, and Marcel Kahan propose the creation of a "supertrustee" role in the corporate context wherein the trustee would be given significantly more authority than it is currently given under a trust indenture.[301] This arrangement emphasizes increased monitoring duties.[302] This section first describes the trustee's traditional role. It then describes the proposed monitoring duty. Next, it describes the supertrustee's enforcement mechanisms. Then, it discusses the recourse available to bondholders under the doctrine before describing the proposed supertrustee compensation. It concludes by discussing barriers to the supertrustee model and the ideal circumstances for its adoption.

In a traditional corporate context, the trustee's role is very limited prior to default.[303] The Trust Indenture Act of 1939 requires the appointment of an indenture trustee for each corporate bond.[304] The trustee ensures debtor compliance with the indenture.[305] It generally does so by requiring the debtor to issue an annual compliance certificate to the trustee.[306] The trustee "may conclusively rely on" the certificates so that no extra due diligence is required.[307]

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298. *See generally supra* Part I.B.2.

299. *See* Ginsburg & Ulen, *supra* note 149, at 120–21.

300. A collective action problem can result when individual bondholders lack incentive to do something that will benefit the entire bondholder class. *See* Sedlak, *supra* note 38, at 1492.

301. *See* Amihud, Garbade & Kahan, *supra* note 13, at 451. More recently, Robert Auray proposed the use of a supertrustee for trust indentures in a sovereign context. *See generally* Robert Auray, *In Bonds We Trustee: A New Contractual Mechanism to Improve Sovereign Bond Restructurings*, 82 FORDHAM L. REV. 899 (2013). Auray proposed the adoption of a supertrustee in the sovereign bond context that would monitor, negotiate restructurings, and coordinate bondholders during a default. *Id.* at 931–34.

302. *See* Amihud, Garbade & Kahan, *supra* note 13, at 472–74.

303. *See* McDaniel, *supra* note 31, at 430.

304. *See* Trust Indenture Act of 1939, 15 U.S.C. § 77jjj(a)(1) (2012).

305. *See id.*

306. *See id.*

307. *Id.* § 77ooo(a)(2); *see also* McDaniel, *supra* note 31, at 430.

Bond ownership is often highly dispersed, and the bonds themselves are readily transferable.[308] As a result, it becomes difficult for creditors to obtain the consent of bondholders in the event an amendment or waiver is needed.[309] Thus, a collective action problem results: individual bondholders generally have a relatively small cut of the overall outstanding balance and lack incentive to monitor debtor compliance and take positive steps toward resolving any problems.[310]

This collective action problem would be resolved in the corporate context by appointing a supertrustee in the trust indenture.[311] Like a standard indenture trustee, the supertrustee would act on behalf of the bondholders.[312] As such, it would be in the company's self-interest to select a credible supertrustee that bondholders would approve of, to reduce risk and acquire more favorable lending terms.[313]

The supertrustee's defining task is its duty to monitor the borrower's compliance with the covenants in the indenture.[314] Unlike a traditional trustee that relies on certificates issued by the borrower for compliance with the indenture's terms and covenants, the supertrustee would be continuously engaged in independent monitoring.[315] A traditional trustee lacks a contractual obligation to monitor the debtor.[316] Accordingly, the new contractual arrangement would need to be laid out in the indenture. The supertrustee's duty would be to "engage in the type and intensity of monitoring which a reasonable lender in the private debt market would engage in under similar circumstances."[317]

The supertrustee would also have the ability to renegotiate bond covenants.[318] Trustees in the United States are generally only permitted to make technical amendments without bondholder consent.[319] Trustees in the United Kingdom are currently allowed some discretion to renegotiate nonmaterially prejudicial trust deed terms that do not result in substantial, permanent changes.[320] As a result of the stricter covenants and increased monitoring that would occur under the supertrustee model, renegotiations of key financial terms should occur less frequently.[321] Consequently, the proposed corporate model does not require the supertrustee to have the power to renegotiate core financial terms.[322] Doing so, however, could ease

308. *See supra* notes 20–21 and accompanying text.
309. *See* Amihud, Garbade & Kahan, *supra* note 13, at 459–60.
310. *See id.* at 459.
311. *See id.* at 471.
312. *See id.*
313. *See id.*
314. *See id.* at 472–74.
315. *See id.* at 473.
316. *See id.*
317. *Id.*
318. *Id.* at 474.
319. *See id.*
320. *See id.* at 477–78.
321. *See id.* at 475.
322. *See id.* at 474.

collective action and holdout problems.[323] Authors Amihud, Garbade, and Kahan propose that the corporate issuer have the option, but not the obligation, to allocate this power to the supertrustee.[324]

An indenture trustee generally holds the same enforcement capacity as the bondholders and is obliged to follow instructions from the majority-in-interest bondholders.[325] In the event of a material covenant breach under English law, the trustee must also seek bondholder approval for amendments.[326] The power to enforce the indenture and seek amendments after a material breach under the proposed model would stay exclusively with the supertrustee, absent a default by the company.[327] Given its ongoing monitoring obligations, the supertrustee would be in a better position to make these enforcement decisions.[328]

Only bondholders representing a material portion of the bonds (e.g., 10 percent), in aggregate, would be allowed to sue the supertrustee for a breach of its fiduciary duties.[329] The supertrustee would not be liable to the bondholders for poor decisions unless it acted in bad faith or it dealt with an irreconcilable conflict of interest—known as self-dealing in the corporate context.[330] Monetary liability of the supertrustee would be limited in the absence of willful, bad faith, or reckless actions.[331]

Amihud, Garbade, and Kahan also suggest limiting the bondholders' ability to replace the supertrustee.[332] The indenture could limit removal of the trustee to "for cause" reasons, such as acting in bad faith.[333] Alternatively, it could allow for the periodic election or reelection of the supertrustee, with limitations set by the company as to possible trustees.[334]

The supertrustee's compensation would be set when appointed by the issuer and would only be amendable by approval of the bondholders.[335] The compensation would need to be higher than standard indenture trustee fees in order to reflect the added cost of continuous monitoring.[336] It would also need to be positively correlated to increases in bond value in order to incentivize the supertrustee to complete its duties effectively.[337] Bondholders must also have adequate incentive to pay the supertrustee under a compensation structure that is significantly higher than that of the

323. *See id.* at 475.
324. *Id.* at 475–76.
325. *See id.* at 476–77; *Revised Model Simplified Indenture*, *supra* note 32, at 1137.
326. *See* Amihud, Garbade & Kahan, *supra* note 13, at 477 n.105.
327. *See id.* at 476.
328. *See id.*
329. *See id.* at 473.
330. *See id.* at 478. The authors analogize this limited recourse to the "business judgment rule" to which a board of directors is subject. *Id.*
331. *See id.* at 473–74.
332. *See id.* at 471.
333. *See id.* at 472.
334. *See id.*
335. *See id.* at 479.
336. *See id.*
337. *See id.* at 480. This could be done through a set of derivative securities that has a value negatively correlated to the spread between the bond and U.S. Treasury debt yields. *See id.*

standard indenture trustee.[338] Higher compensation for the supertrustee could be justified by establishing a credible reputation for monitoring issuers.[339] As mentioned above, bondholders lack incentive to monitor a relatively small bond investment.[340] They will have a greater incentive to monitor a supertrustee who is representing them on multiple issues.[341]

The supertrustee model would face barriers. In particular, the Trust Indenture Act currently allows trustees to rely on debtor compliance certificates.[342] It also requires unanimous bondholder consent to amendments of major terms under the indenture.[343] Barriers aside, the supertrustee would be most beneficial to relatively large, long-term debt issuances that could take advantage of economies of scale.[344] In order to take full advantage of the supertrustee model, it should be used for less than creditworthy or financially distressed borrowers where the supertrustee would likely need to play a more active role.[345]

III. MEETING IN THE MIDDLE: A SOLUTION THROUGH MONITORING

Since the odious debt doctrine's introduction in the early twentieth century, courts have yet to directly invoke it.[346] Sack envisioned an institution reviewing pleas for debt relief by sovereigns newly freed from despotic rulers.[347] Recent scholars have envisioned the prevention of lending to despotic regimes altogether.[348] Even with a growing foundation of scholarly work on the doctrine, it remains largely unused and even feared by countries that present textbook cases for its application.[349]

This part first addresses the insufficiencies that current approaches cannot overcome. It next proposes an intermediate solution that resolves some of the shortcomings of current approaches. It then dissects some criticisms that this proposed solution will likely face.

A. Insufficiencies with Current Proposals

Current approaches to dealing with odious debt can be categorized by solutions that limit funding ex ante and provide relief ex post. Each has

338. *See id.* at 479.
339. *See id.* at 481, 484–85.
340. *See supra* note 310 and accompanying text.
341. *See id.* at 482–83.
342. *See* Trust Indenture Act of 1939, 15 U.S.C. § 77jjj(a) (2012); Amihud, Garbade & Kahan, *supra* note 13, at 485. This barrier can be overcome because "even though the Trust Indenture Act creates a presumption that the indenture trustee can rely conclusively on compliance certificates provided by the company, the bond indenture can provide that the indenture trustee may not rely on such certificates." Amihud, Garbade & Kahan, *supra* note 13, at 486 (emphasis omitted).
343. *See* 15 U.S.C. § 77jjj(a); Amihud, Garbade & Kahan, *supra* note 13, at 487–88.
344. *See* Amihud, Garbade & Kahan, *supra* note 13, at 490.
345. *See id.* at 491.
346. *See supra* note 105 and accompanying text.
347. *See supra* note 78 and accompanying text.
348. *See generally supra* Part II.B.
349. *See supra* Part I.C.2.

inherent shortcomings. This section breaks down the inadequacies of each approach in turn.

The labeling mechanism proposed by some scholars is idealistic, but not practical. Bonds are issued to a large number of retail investors who individually lack the incentive to pursue an ex ante determination prior to purchasing a sovereign's bonds.[350] Like the collective action problem caused by NML Capital,[351] individual bondholders cannot afford significant pre-lending due diligence such as paying an institution to label each borrower they come across.[352]

Additionally, not all of a bond issuance will necessarily be used odiously. Denying capital to an odious-labeled country will stifle economic growth in the country while it is under the despotic regime's rule. This may accelerate the timeline in which the regime will be overthrown, but it will do so by burdening citizens of the sovereign.

To gain support for an ex ante approach, potential users must trust that the system will be able to identify odious and non-odious regimes correctly. This would not be an easy task. Regimes that incur odious debts may actually start out as legitimate governments. It is not unthinkable that a democratically appointed government could receive a green light from the labeling institution and then turn odious soon after.[353]

There is also no institution capable of labeling the regimes at present.[354] The World Bank already monitors foreign government corruption levels, but this is just one part of the problem.[355] If a new institution were established, it would require significant capital to start. Major economic players and contributors to other international institutions, such as the IMF and World Bank, would be likely capital providers. Yet, the United States, which is a large capital contributor to these institutions, is skeptical of any institutional remedy for sovereign debt-related issues.[356] Creditors are likely to be skeptical of the untested approach.

The ex post judicial mechanism was formulated by Sack[357] and sits on the opposite end of the spectrum from the ex ante approach. Unlike the ex ante method, this approach is entirely debtor centric. It provides relief for the debtor country, but leaves the bondholders empty-handed.[358] Where the labeling mechanism may put creditors on notice beforehand or keep bondholders from actually acquiring a sovereign's debt, the ex post approach simply forgives the debt without consideration to the bondholders.

Perhaps under Sack's third prong the bondholders should be left empty-handed because they were aware that the proceeds would be used for odious

350. *See supra* note 300 and accompanying text.
351. *See supra* notes 51–55 and accompanying text.
352. *See supra* note 300 and accompanying text.
353. The Tinoco regime actually gained support from citizens when it initially took office. *See* Great Britain v. Costa Rica, 1 R.I.A.A. 371, 378–79 (1923).
354. *See generally* Part II.B.
355. *See supra* note 231 and accompanying text.
356. *See supra* notes 259–61 and accompanying text.
357. *See supra* note 78 and accompanying text.
358. *See supra* notes 76–77 and accompanying text.

purposes.[359] However, this argument is not as simple with respect to bondholders as it is with respect to traditional creditors. Proving that all bondholders meet the third prong would be a near impossible task, leading to an ex post doctrinal approach with no actual application. If the third prong was waived, sovereigns could receive the relief they demand, but innocent bondholders would be out of luck. Bondholders would have a reason to be resentful toward the system and skeptical toward lending to other regimes in the future.

The approach provides relief to debtor countries by allowing them to escape a potential debt trap. The sovereigns are able to finance infrastructure projects and economic development in lieu of making interest and principal payments on previously incurred debts. However, an ex post approach cannot remedy the significant damage already caused; bond proceeds have already been used to suppress a sovereign's people or to assist a despotic leader in its escape.

B. Reforming the Roles of the Traditional Trustee and Fiscal Agent

Ex post solutions provide relief to sovereigns, but come too late to help bondholders. Ex ante solutions help bondholders, but risk denying sovereigns needed financing altogether. The needs of both the debtor and the creditors can be met by bridging the gap between these two approaches. A new solution that adopts key elements of the supertrustee model discussed in Part II may resolve the shortcomings of the current approaches.[360]

This Note proposes the apportionment of additional powers to the traditional bond trustee or fiscal agent in sovereign bond offerings.[361] It uses the term "monitoring agent" to refer to a trustee or fiscal agent with amplified powers, which this Note argues provides a solution to the odious debt problem. The monitoring agent solution will work best under an indenture trustee arrangement, but it may also have some application in a fiscal agency arrangement.[362]

This section first addresses the appointment of the monitoring agent. Next, it delves into the agent's increased responsibilities before discussing

359. *See supra* note 64 and accompanying text. This third prong has faced some criticism because requiring the lender have positive knowledge of the bond's usage permits the lender to be willfully ignorant. *See supra* notes 72–74 and accompanying text.

360. Similarities may be drawn between this Note's proposed solution for odious debt and Auray's sovereign debt solution discussed *supra* note 301. The solution proposed in this Note, however, limits the application to monitoring for odious uses of bond proceeds, does not allow the trustee to conduct renegotiations, and allows for a limited application under fiscal agency arrangements.

361. The proposed solution does not discuss odious uses of individual loans. As discussed above, individual lenders traditionally hold loans. *See supra* note 18 and accompanying text. In this context, lenders are more financially incentivized to monitor compliance with the terms of the loan and less at risk for collective action problems.

362. Ideally, sovereign bonds would be governed by a trust indenture with an appointed monitoring agent. However, holders of a bond issued under a fiscal agency agreement can nonetheless benefit from the monitoring agent model. *See infra* Part III.B.5.

how to keep the agent accountable to the bondholders. It then proposes a compensation structure for the monitoring agent. Next, it looks at features of the proposal that will be different under the fiscal agency agreement. Finally, it discusses situations in which the monitoring agent would be most effective.

1. Appointing a New Monitoring Agent

The sovereign debtor should appoint the initial monitoring agent.[363] The debtor would be incentivized to appoint a credible agent in order to lower the risk associated with its offering. Under a trust indenture, the monitoring agent should be subject to reelection every five years by the bondholders.[364] This added security to the bondholders would permit them to replace an agent that is neglecting its monitoring duties without having to go through the formal replacement process provided for in the trust indenture.[365] It would also put pressure on the agent to make a diligent monitoring effort. The sovereign should be allowed to limit the options for replacement agents by including a list of permitted agents in its offering documents.[366] Providing the sovereign with this capability would ensure it is not blindsided by a new monitoring agent that it fears does not fairly represent its interests.

There are institutional barriers to replacing monitoring agents. A five-year gap between elections would provide some level of security to the agent so it is willing to build the infrastructure necessary to maintain its monitoring efforts. A changeover of monitoring agents would be expensive because the new agent would lack the established processes of the previous agent. As such, it is unlikely that a change in monitoring agents would occur for a superficial reason.

2. Allocating Additional Responsibilities

The monitoring agent would need to ensure debt proceeds are used in an appropriate manner. The agent would be in charge of continuous monitoring and should be granted the authority to accelerate bonds once the issuer has breached its covenants on the use of proceeds. This delegation of powers permits the bondholders to maintain oversight and have the ability to act if the monitoring agent fails to act properly.

The monitoring agent's primary duty would be to monitor the use of proceeds. Limitations on the use of funds would be included in the underlying document. The sovereign would covenant not to use or allow funds to be used for any fraudulent, illegal, or corrupt purposes, or for any

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363. This approach is proposed in the corporate context discussed *supra* note 311 and accompanying text.

364. The monitoring agent would not be subject to reelection under the fiscal agency agreement. *See infra* Part III.B.5.

365. *See supra* notes 332–34 and accompanying text.

366. *See supra* note 334 and accompanying text.

purpose that subjugates its people.[367] It is unlikely that sovereigns will reject these covenants because doing so may imply odious intent.

The debtor sovereign would provide periodic reporting to the agent regarding fund usage, and the agent would have inspection rights in the event any reporting looks suspect. Additionally, the monitoring agent would monitor the political and economic stability of the country while the funds are being spent. Changes in stability could suggest a potential uprising or regime change and would cue the agent to conduct more aggressive monitoring. Major investment banks would be best suited for this role, as their preexisting infrastructure would make monitoring more economically efficient.

Once the sovereign has exhausted the proceeds, the increased monitoring duties would be eliminated. The monitoring agent would then be allowed to rely on the compliance certificates permitted under the Trust Indenture Act.[368] The underlying agreement between the bondholders and the monitoring agent would need to reflect the increased monitoring requirement while the proceeds are being used.

Both U.S. and English law permit the agent or trustee to accelerate bond payments if an event of default occurs.[369] Under this new structure, the monitoring agent's power to accelerate would also extend to breaches of any covenants regarding the use of bond proceeds. The benefit to accelerating payments is twofold: the acceleration stops additional funds from being used odiously and it provides creditors the ability to recoup their investments. This power should be shared with bondholders so that they may act if the agent fails to do so. This permits the bondholders to act unilaterally in order to avoid unnecessary loss.

Under U.K. bond issuances, the trustee is only allowed to renegotiate nonmaterial terms.[370] U.S. bond issuances only allow technical amendments to be made by the trustee.[371] Permitting the monitoring agent to renegotiate terms of the issuance has some advantages, but may be limited in its usefulness.[372] The additional duty would also result in higher fees to the monitoring agent. As such, the monitoring agent should only be permitted to negotiate technical amendments.[373] Renegotiation of other terms would be conducted between the debtor sovereign and the bondholders. This would alleviate increased costs to the monitoring agent framework and keep the agent's role in line with current standards.

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367. While many scholars also consider war debts to be odious, they are not included in this proposed solution. *See, e.g.*, *supra* note 91 and accompanying text. A covenant against incurring these debts is not feasible as it would essentially be a promise by the country not to be overthrown.

368. *See supra* note 343 and accompanying text.

369. *See supra* note 33 and accompanying text.

370. *See supra* note 320 and accompanying text.

371. *See supra* note 319.

372. *See supra* notes 323, 321 and accompanying text.

373. This is consistent with the current role of U.S. trustees. *See supra* note 319 and accompanying text.

3. Keeping the Agent in Line

The bondholders should have a limited right to sue the agent under a trust indenture in the event the agent fails to act when necessary.[374] Only bondholders representing a material portion of the outstanding debts should be permitted to sue the monitoring agent for breach of duty.[375] Amihud, Garbade, and Kahan suggest 10 percent may be a sufficient fraction in the corporate context,[376] but this rate would be too low in the sovereign context. A higher percentage should be used in order to ensure that a single large bondholder (e.g., a vulture fund) may not act on behalf of the entire group of bondholders. Allowing a single bondholder to sue on behalf of all debtholders would ultimately give large bondholders full bargaining power and risk forcing the monitoring agent to act when the action is not in the best interest of the overall bondholder group. The underlying agreement should dictate the level of bondholder support necessary in order to sue the monitoring agent.

The monitoring agent's liability should be limited in order to induce prospective agents to accept the position. However, limitations should not apply where the agent has acted willfully, recklessly, or in bad faith.[377] As such, bondholder relief should be limited if the agent negligently conducted its monitoring duties, but should not be limited if the agent accepted a bribe from a sovereign government to neglect its monitoring duties.

4. Compensating the Agent

The monitoring agent's duties and its potential liabilities would be higher than that of a traditional agent while bond proceeds are being used. As such, its compensation must adequately reflect this. The monitoring agent would receive increased compensation until the bond proceeds are exhausted and the increased monitoring duties are over. Once the monitoring agent is able to rely on compliance certificates from the sovereign, its compensation would revert to a typical trustee or fiscal agent fee schedule.

A fee arrangement that is positively tied to the bond's market value was proposed for a corporate indenture supertrustee.[378] Under this fee schedule, the trustee benefits from higher fees as the market value increases.[379] This arrangement in a sovereign context is inadvisable. If public perception of a sovereign's political status begins to shift, such as a rising fear that a regime

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374. Bondholders would not be able to sue under a fiscal agency agreement. This limitation is ultimately reflected in lower fees given to the fiscal agent. Nonetheless, the sovereign itself could still sue for a breach under the agreement. This would be helpful where the monitoring agent failed to monitor the use of proceeds, the despotic regime has since been overthrown, and the bondholders have accelerated the payments. *See infra* Part III.B.5.

375. *See supra* note 329 and accompanying text.

376. *See supra* note 329 and accompanying text.

377. *See supra* note 331 and accompanying text.

378. *See supra* note 337 and accompanying text.

379. *See supra* note 337 and accompanying text.

has developed despotic tendencies, its credit risk is likely to increase. This would decrease its market value just as the monitoring needs increase. A negative correlation between the fees and the current market value would also inadequately address this issue because it would not incentivize the monitoring agent to perform its duties more effectively. In order to adequately compensate the monitoring agent for the level of work and amount of liability it is taking on, the compensation would be inversely correlated to the unused bond proceeds. As the bond proceeds are used, the monitoring agent's compensation would decrease.

The higher the level of monitoring that is required, the higher the agent's fees during the monitoring period will need to be. Monitoring agents would otherwise lack adequate incentive to take on a risky sovereign's bond issuance. Larger fees for more at-risk sovereigns result in bondholders demanding higher interest rates. Interest rates reflect the level of risk associated with an investment. Bondholders would require higher interest rates from politically or economically unstable countries. As such, the monitoring agent's increased fee structure could be baked into the higher interest rates.

The agent's compensation throughout the life of the bond would be determined at appointment. Stable cash flows would encourage more financial institutions to seek out monitoring agent positions. The compensation would only be amended by the bondholders under a trust arrangement or the issuer under a fiscal agency agreement. However, the monitoring agent should reserve the right to petition the bondholders or issuer for an increased fee any time it is not being adequately compensated for its duties.

5. Fiscal Agency Agreement Considerations

There would be no bondholder reelection opportunity under a fiscal agency arrangement, because the monitoring agent would represent the sovereign debtor.[380] The agent would be appointed by the issuer and would only be subject to removal under the terms of the agreement.

It is in the best interests of both the bondholders and the sovereign's constituents to have proceeds used for non-odious purposes. Yet, the monitoring agent is more at risk for being induced to breach its monitoring duties under a fiscal agency agreement due to its direct relationship with the sovereign. As such, it is important that the sovereign's constituents (in particular, the government that has replaced a despotic regime) be permitted to sue the monitoring agent for breach of duties.

The monitoring agent's fees under a fiscal agency arrangement should be lower than under an indenture trustee arrangement, because of a lower level of immediate accountability under the fiscal agency arrangement. Bondholders are incentivized to sue any time the agent has breached its monitoring duties under the trust indenture. The sovereign, however, is

380. *See supra* note 26 and accompanying text.

only incentivized to sue for failure to monitor if it has replaced a previous regime that used the debts for odious purposes.

6. Utilizing the Monitoring Agent Appropriately

This Note proposes that the monitoring agent specifically be used to monitor for odious uses of debt. The monitoring agent should only be appointed for bond issuances that are seen as more "at risk." While the agent's fees will be lower where the sovereign is less risky, the fee will still be larger than that of a traditional fiscal agent or trustee.

The World Bank's data portal, which covers corruption and budget transparency, could be used to determine which at-risk countries should utilize a monitoring agent in their debt offerings.[381] The monitoring agent could be required when the sovereign's corruption and lack of transparency ratings are either greater than or significantly greater than (e.g., 20 percent greater than) the mean ratings.

C. Anticipated Criticisms to the Approach

This Note does not purport to solve all problems with respect to odious debt. There are risks and shortcomings to this approach; some are without merit and others will need to be left unresolved. This section first discusses the possibility that the monitoring agent will overuse its new powers. Next, it discusses the implications of allowing the monitoring agent to label a sovereign as odious. Finally, it elaborates on what issues have not been addressed by the monitoring agent solution.

1. The Overreaction Possibility

Opponents of the monitoring agent solution may argue that the creation of an agent empowered to identify odious uses of borrowed funds will overreact. The fear is that the monitoring agent will seek to accelerate bond payments at the mere sight of questionable uses of funds. This is unlikely due to the nature in which the monitoring agent is appointed. It is in a sovereign's best interest not to appoint a monitoring agent with a reputation for overreacting.

2. The Problem with Pointing the Finger

The doctrine of odious debt has political implications. By accelerating repayments, a monitoring agent claims that a government has used its debt proceeds to either subjugate its own people or for fraudulent, illegal, or corrupt purposes.[382] Should monitoring agents be allowed to make such allegations?

A sovereign is unlikely to concede that it has been using debt proceeds odiously without the ruling of an actual court. Sovereigns would be

381. *See supra* note 231 and accompanying text.
382. *See generally supra* Part I.B.2.

incentivized to renegotiate terms with the bondholders in order to avoid the risk of an adverse outcome in court. If negotiations fail, the question becomes which institution should be allowed to make findings at issue.

As discussed above, a new international body or arbitration panel is unlikely to gain support in the international community.[383] A traditional court system is a more likely avenue for resolving this use of proceeds issue. A court determination on the issue of whether a sovereign has been using funds odiously has political implications, but they may be exaggerated. For example, countries have been willing to waive their sovereign immunity for the last several decades.[384] Investors can already sue sovereign debtors for failing to meet their obligations under a bond issuance, and courts can already order specific performance from them.[385] As such, the use of the doctrine in order to invoke debt forgiveness is arguably just an ancillary part to the theory of sovereign immunity.

3. The Limitations to the Doctrine

The monitoring agent solution is intended to stop odious expenditures before complete damage is done. It is intended to help creditors recover part of their investment rather than being left empty-handed. The monitoring agent will not resolve all problems inherent to the odious debt doctrine. Monitoring agents will be incentivized to perform their duties adequately, but they will not be able to perform their roles flawlessly. It is possible that an agent's continuous monitoring will miss some odious uses of debt.

The solution does not address the forgiveness of odious debt under a trust indenture once a despotic regime has been overthrown. Sovereigns will need to defer to traditional debt restructurings with the bondholders when in this position. It does, however, permit a sovereign to sue a monitoring agent appointed under a fiscal agency agreement if it has breached its duties while a despotic regime was in place.

CONCLUSION

This Note provided a broad overview of sovereign debt and an in-depth look at the doctrine of odious debt. It outlined the proposed solutions for the odious debt doctrine that have developed over time, dividing the solutions between ex post and ex ante mechanisms. Lastly, it proposed an expanded role for the standard indenture trustee and fiscal agent in bond issuances.

In its expanded role, the agent would engage in continuous monitoring of the use of proceeds and have the power to accelerate bond payments. This Note recognizes that it is impossible to stop odious lending before it starts, but it provides a realistic way to enforce the odious debt doctrine by utilizing current actors and institutions. The solution benefits creditors by

383. *See supra* note 260 and accompanying text.
384. *See supra* Part I.B.4.c.
385. *See, e.g.*, *supra* notes 54–55 and accompanying text.

allowing them to demand payment when proceeds are used odiously. Moreover, the solution helps debtor nations by cutting short odious expenditures before the damage caused by despotic regimes is complete.