INSOLVENCY PRINCIPLES AND THE ODIOUS DEBT DOCTRINE: THE MISSING LINK IN THE DEBATE

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I
INTRODUCTION

Politicians in this country, as well as many members of the international human-rights community, view it as fundamentally unfair that the Iraqi people may be saddled with the debts Saddam Hussein's brutal regime incurred. Further, some in the human-rights community generally argue that rich (creditor) countries have a moral duty or obligation to protect citizens of poor (debtor) countries and that richer nations should forgive the debts of poorer nations to help reduce existing inequalities between developed and developing countries. Until recently, arguments that successor governments should not be forced to repay the debts of former leaders or regimes relied almost exclusively on philosophical or humanitarian grounds. This article joins the attempt by scholars in the insolvency community to shift the discussion from the human rights, to the insolvency, arena.

The article does not attempt to outline a framework that should be used to determine whether a debt should be declared odious nor does it propose any specific entity that should have the authority to determine the odiousness of a debt. Instead, the article evaluates the doctrine of odious debts using the insolvency framework found in the United States Bankruptcy Code. Part II of the article provides a brief overview of sovereign lending and notes that entities that lend to, or invest in, sovereigns understand ex ante that many of the typical creditor remedies available upon default (such as repossession of collateral and replacement of managers) simply are not available in the context of sovereign lending. Since sovereigns are atypical debtors, their debt restructurings do not resemble the typical insolvency proceeding or out-of-court workout that involve business debtors.

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Part III of the article then briefly describes the odious debt doctrine, discusses instances when it has been invoked to allow a sovereign to repudiate its debts, and briefly discusses the Iraqi debt situation. In considering what obligations a sovereign should have to repay a former regime's debts, the article emphasizes that even sovereigns who refuse to repay their debts cannot be liquidated and political leaders who refuse to repay the sovereign's debts cannot be replaced by lenders (at least not without military assistance). Thus, like consumers and businesses that reorganize in bankruptcy, financially troubled sovereigns will continue to exist notwithstanding their financial crises.

The article concludes by discussing instances where businesses are allowed to repudiate promises made to groups typically favored in our society (employees), are allowed to discharge debts owed to favored (often governmental) creditors, or, are allowed to subordinate certain creditor claims. Since debt restructuring is designed to rehabilitate people and businesses and to allow them to perform their core functions, courts allow debtors to break these promises if forcing debt repayment will prevent a business from rehabilitating itself in bankruptcy. The article argues that sovereign-debt restructurings should focus on the need both to rehabilitate the sovereign's finances and to allow the new leaders to perform the sovereign's principal "business" functions. Since the "business" of a sovereign is principally to provide for the needs of its citizens and to maintain the country's physical infrastructure, and a democratically elected government will be ineffective if it lacks the respect of its citizens or is unable to provide essential health and human welfare services for those citizens, it would be justifiable to forgive odious debts if forcing the sovereign to repay those debts would prevent the sovereign from restructuring itself politically and financially.

Finally, the article notes that an additional benefit to periodical invocation of the odious debt doctrine is that it reminds lenders that the doctrine may at some point gain acceptance in the international financial community. Though the doctrine may not ever be acknowledged by the lending community, creditors (like some involved in the Iraqi debts restructuring) will be forced to bargain during the restructuring in the shadow of the threat that the doctrine *might* be invoked and this fear may make some commercial lenders exercise more caution in the future when extending credit to regimes.

II
SOVEREIGN-DEBT LENDING

A. Private or Public Sector

Although most of the Iraqi debt is owed to other sovereigns,[1] sovereign debt generally is either held by domestic entities or by external private-sector

1. Martin A. Weiss, *Iraq's Debt Relief: Procedure and Potential Implications for International Debt Relief,* Congressional Research Service, Apr. 21, 2006, at 1–2, fig. 1.

creditors.[2] Private-sector sovereign lending generally has vacillated over the last two centuries between bank and bond lenders. Bond lending was the dominant form of private-sector, sovereign-debt financing in the nineteenth and early twentieth centuries, while bank lending became the norm for most of the twentieth century. Indeed, commercial banks (largely through medium- to long-term, syndicated bank-loan agreements) were the principal participants in sovereign lending until the 1990s. In the 1990s, sovereign-debt financing changed dramatically largely because of losses banks sustained in the Latin American financial crisis. Starting in the 1990s, the debts sovereigns owed to banks significantly decreased, and now most sovereign debt (whether domestic or external private-sector external) is bond debt.[3]

Most sovereign lending is unsecured. Moreover, even when the lending ostensibly *is* secured, sovereign lenders have significantly fewer options upon default than lenders to commercial entities (or to individuals) possess.[4] In general, sovereign lenders cannot exercise the same rights upon default that lenders can exercise when the defaulting debtor is a business or a person. For example, even if a lender has a security interest in the sovereign's oil revenue or exports, if the sovereign fails to repay the loan, the lender cannot "seize" or otherwise take over the sovereign nor can it easily seize control of oil wells or products located within the sovereign. Indeed, even using the judicial process to enforce its right to repayment likely will prove difficult for lenders who seek to sue a sovereign for repayment. If the lender sues in a sovereign court, it is unlikely that that court would rule in favor of the lender. Suing the sovereign in another country may not be permitted because sovereign immunity generally protects nation-states from suit unless they consent. Even when sovereigns have consented to suit, they generally are sued only in a limited number of other nations (generally, the United States and the United Kingdom). And, even if the lender is allowed to sue the sovereign, the success of the litigation depends largely on the lender's ability to locate the sovereign's assets and to sue before the sovereign has time to move the assets to another location.[5]

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2. Kevin Cowan et al., *Sovereign Debt in the Americas: New Data and Stylized Facts*, Inter-American Development Bank, Oct. 2006, at 14, 35, fig. 6, *available at* http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=846330; Paris Club, Fifty Years of Orderly Sovereign Debt Restructuring, Proceedings of the International Policy Forum, June 14, 2006, at 21, *available at* http://www.clubdeparis.org/cdp/sections/50-ans/anglais_071206web-pdf/downloadFile/file/anglais_071206web.pdf?nocache=1170431715.92.

3. Cowan et al., *supra* note 2; A. Mechele Dickerson, *A Politically Viable Approach to Sovereign Debt Restructuring*, 53 EMORY L.J. 997, 1012 (2004); Paris Club, *supra* note 2. *See generally* Joseph J. Norton, *International Syndicated Lending and Economic Development in Latin America: The Legal Context*, 9 ESSAYS IN INT'L FIN. & ECON. L. 7–8, 10–12 (1997).

4. Dickerson, *supra* note 3, at 1008.

5. *See* Patrick Bolton & David A. Skeel, Jr., *Redesigning the International Lender of Last Resort*, 6 CHI. J. INT'L L. 177, 192–93 (2005) (discussing creditor attempts to seize Argentina's U.S.-based assets, including military assets and payments to its embassy); Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1084–88 (discussing difficulties creditors face in suits against sovereigns).

Lenders to sovereigns are also prohibited from exercising a remedy that lenders to commercial entities increasingly use: forcing the debtor to replace its management team.[6] Lenders routinely condition debt forgiveness (or future lending) on the willingness of the firm's board of directors to fire existing managers or to make other drastic management changes.[7] In contrast, without the support of a well-armed military of their own,[8] sovereign lenders lack the ability to oust a sovereign's political leaders and install new leaders if the current leaders refuse to repay the creditor's debts.

B. International Financial Institutions

In general, the International Monetary Fund (IMF) lends to sovereigns when private lenders will make loans only on the terms prevailing in the capital-markets. The IMF often lends in its capacity as an international development institution that provides humanitarian aid,[9] rather than as a financial institution whose lending decisions are based on a debtor's creditworthiness or borrowing capacity. Some members of the financial community criticize this lending practice, contending that IMF lending creates a moral-hazard problem by encouraging sovereigns to borrow recklessly (knowing that an IMF bailout is likely) and by encouraging creditors to lend recklessly (knowing that the same bailout will ensure repayment of those imprudent loans).[10] Human-rights activists also criticize IMF lending and policies and accuse the IMF and the World Bank[11] of knowingly lending to repressive regimes who illegally divert the loan proceeds or use the funds in ways that affirmatively harm the countries' citizens.[12]

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6. Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1228 (2006); Jay Lawrence Westbrook, *The Control of Wealth and Bankruptcy*, 82 TEX. L. REV. 795, 843 (2004).

7. Douglas G. Baird, *The New Face of Chapter 11*, 12 AM. BANKR. INST. L. REV. 69, 93 (2004); Baird & Rasmussen, *supra* note 6, at 1228; Westbrook, *supra* note 6, at 843.

8. And, as the current controversy over, and decreasing public support for, the war in Iraq shows, the lender also would need the support of the people who are funding the effort to oust a political leader.

9. The IMF is an international organization of 184 member countries established to promote international monetary cooperation and exchange stability, to foster economic growth, and to provide temporary financial assistance to countries that are experiencing balance of payments difficulties caused by, for example, budget deficits, inflation, or currency valuation problems. International Monetary Fund, Article I—Purposes, http://www.imf.org/external/pubs/ft/aa/aa01.htm (last visited June 30, 2007).

10. Some critics suggest that the IMF should focus on providing short-term emergency lending to sovereigns who face a liquidity crisis rather than acting as a lender of last resort that essentially bails out the sovereign (and its lenders) or otherwise creates a moral-hazard problem by giving sovereigns an incentive to engage in opportunistic borrowing. Dickerson, *supra* note 3, at 1010 n.53.

11. In general, the World Bank provides finance and advice to developing nations to help them with their economic development, to help them reduce poverty, and to encourage and safeguard international investments in those developing nations. The World Bank, About Us – History, http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20653660~menuPK:72312~pagePK:51123644~piPK:329829~theSitePK:29708,00.html (last visited June 30, 2007).

12. Salil Tripathi, *The Corruption Crusader*, GUARDIAN UNLIMITED, Mar. 13, 2006, http://www.guardian.co.uk/comment/story/0,,1730009,00.html (last visited Oct. 2, 2007).

C. Default

1. Generally

To remedy a financial crisis, some sovereigns may choose to opportunistically default rather than raise taxes or radically cut public services for health care or education.[13] Though this option is always available, few sovereigns appear to willingly default or to otherwise indicate that they are repudiating their financial obligations. Sovereigns appear to avoid repudiating their debts or seeking a predefault debt restructuring because this might signal that they are not creditworthy and such a signal would hurt their reputation in, and access to, international capital markets.[14] In addition, even if the sovereign's leaders decide to repudiate its financial obligations, the restructuring process is necessarily a political one that will force leaders to negotiate with all groups (both domestic and external) affected by the debt restructuring. Leaders understandably resist restructurings that cause economic dislocation since they understand that overly burdening the country to repay debts may trigger a recession, force severe cuts in public expenditures on social programs, or force them to increase taxes. Leaders who are democratically elected justifiably avoid taking any of these actions because such actions would cause political upheaval and may threaten their political careers by giving citizens an incentive to oust them during the next election cycle.

2. Debt-Restructuring Procedures

Nations are often thwarted in their efforts to repudiate or radically reduce their debts because there is no uniform international statute, convention, or treaty that governs sovereign-debt restructurings. Despite recent discussions of an IMF-sponsored "sovereign debt restructuring mechanism," international financial institutions (IFIs), capital market lenders, and debtor-states thus far have all rejected any attempt to create a permanent sovereign-debt-restructuring mechanism.[15] Instead, sovereigns who are in default must use a multi-step procedure to restructure their debts.

a. *Official multilateral or bilateral debt.*

Sovereigns can reschedule debts they owe to other sovereigns (official bilateral debt) through an informal arrangement known as the Paris Club.[16] The Paris Club is an informal group of creditor governments from major industrialized countries that meets monthly (in Paris) to help debtor nations restructure their debts. The restructuring procedures used in Paris Club

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13. Fisch & Gentile, *supra* note 5, at 1048–51.

14. Dickerson, *supra* note 3, at 1007. While Argentina and Ecuador appear to have faced difficulty getting credit on the capital markets due to their recent defaults, they have been able to issue bonds for the Venezuelan government. Overseas Development Institute, *Re-examining Sovereign Debt: Forgiveness and Innovation*, Sept. 2006, at 4.

15. Weiss, *supra* note 1, at 11; Paris Club, *supra* note 2, at 25.

16. The Paris Club, http://www.clubdeparis.org/en/ (last visited June 30, 2007).

negotiations are generally viewed as closed and not at all transparent. The Paris Club members will recommend to their countries that they reduce the debts owed to them only if the IMF has certified that the debtor country cannot meet its debt-service obligations, the debtor country agrees to comply with certain policy changes specified by the IMF, and the debtor agrees that it offer terms to commercial creditors that are not more generous than the terms it negotiated with the Paris Club.[17] Sovereigns and their official creditors tend to reach agreements quickly (and relatively inexpensively) in a Paris Club rescheduling and Paris Club restructurings tend to be "successful" largely because public creditors are willing to make concessions based on geopolitical, nonfinancial considerations.[18]

b. *Commercial debt.*

Private negotiations between sovereigns and their private commercial bank lenders often occur in an arrangement known as the London Club. London Club negotiations, in contrast to those conducted during a Paris Club restructuring, tend to be lengthier and more expensive. Various reasons are cited for why London Club negotiations are not as efficient as Paris Club restructurings. First, unlike the relatively limited number of creditor governments involved with Paris Club restructurings, the considerably larger number of commercial creditors involved in London Club negotiations makes reaching an agreement with anything close to unanimous creditor consent (which is required) difficult. In addition, unlike official public creditors, commercial entities are less likely to forgive debt merely to solidify future or geopolitical relationships with the defaulting sovereign.[19]

3. Role of IFIs

While sovereigns and their public or private creditors are attempting to restructure a sovereign's debts, the sovereign often needs working capital. IFIs are asked (and often expected) to offer new loans to the sovereigns. When the IMF is the IFI, the loans are conditioned on the sovereign's agreement to reform certain economic policies. In addition to the reasons noted earlier, IMF lending is controversial because many believe the IMF makes loans based on the economic or political desires of its politically powerful members (often the United States). These creditor nations, some suggest, insist on an IMF bailout to protect loans made by the nations' domestic banking institutions or demand

17. Weiss, *supra* note 1, at 9. As an example, Malawi's debts were substantially reduced (from U.S. $363 million to U.S. $9 million) on October 19, 2006 after it completed requirements imposed by the IMF initiative for the Heavily Indebted Poor Countries. Specifically, after Malawi agreed to implement a poverty-reduction strategy and an economic program designed to encourage sustainable economic growth, the Paris Club members agreed to cancel U.S. $137 million and to grant additional debt relief of U.S. $217 million to Malawi. Paris Club, News - Malawi, http://www.clubdeparis.org/sections/traitements/malawi-20061019/switchLanguage/en (last visited Oct. 3, 2007).

18. Dickerson, *supra* note 3, at 1008–09.

19. *Id.* at 1009.

that the IMF provide support packages to countries for geopolitical rather than economic reasons.[20]

The World Bank and IMF also provide debt relief to low-income countries through the Debt Relief Initiative for Heavily Indebted Poor Countries (the HIPC Initiative) and the Multilateral Debt Relief Initiative (MDRI). Debtor nations are eligible for the HIPC Initiative if they meet certain income and indebtedness criteria. Eligible nations also must have a current track record of satisfactory performance under an IMF program, a Poverty Reduction Strategy (PRS), or an interim PRS in place, and an agreed plan to clear any arrears to foreign creditors. In general, the HIPC Initiative requires all creditors (multilateral, bilateral, or commercial) to help provide a fresh start to debtor nations and to help those nations reduce poverty. Once debtor nations accomplish certain goals and reach what is known as "the completion point," the debt relief then becomes irrevocable.[21]

Some critics argue that, despite the program's good intentions, it is inadequate because it does not force debtor nations to adequately reduce poverty or provide basic health care and education for their citizens, and that countries whose debts are restructured (or forgiven) still remain insolvent and continue to suffer substantial shortages of capital.[22] Finally, critics maintain that the HIPC Initiative does not allow debtor nations to repudiate odious debts if they ostensibly have the ability to repay the debts.

III

ODIOUS DEBTS

Many liberal and conservative organizations, both domestically and internationally, argue that the insolvency process used to resolve the debt crises of poor nations should be guided by noneconomic factors and that considering these factors would result in debt cancellation, not simply restructuring. That is, many outside of the financial community maintain that any insolvency framework involving sovereign debts should be based on principles related to

20. Daniel K. Tarullo, *The Role of the IMF in Sovereign Debt Restructuring*, 6 CHI. J. INT'L L. 287, 300 (2005).

21. In general, the debtor country must agree on a short list of completion-point triggers, which typically includes a continued track record of satisfactory performance on an IMF program; successful implementation of its poverty reduction strategy; and progress in improving health and education, governance, or fighting corruption. In essence, debt relief becomes irrevocable only when the debtor nation has made changes to give its creditors sufficient confidence that the debt relief will not be futile. The World Bank, News & Broadcast, http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20040942~menuPK:34480~pagePK:34370~theSitePK:4607,00.html (last visited June 30, 2007).

22. Africa Action, Critique of the HIPC Initiative, http://www.africaaction.org/action/hipc0206.htm (last visited June 30, 3007); ANN PETTIFOR, CHAPTER 9/11? RESOLVING INTERNATIONAL DEBT CRISES—THE JUBILEE FRAMEWORK FOR INTERNATIONAL INSOLVENCY 9 (2002), *available at* http://www.neweconomics.org/gen/uploads/9-11.pdf.

justice, morality, and human rights[23] and that the citizens of the debtor sovereign should be given the opportunity to help resolve the sovereign's financial crisis and help prevent future crises in a transparent, democratically accountable framework. Given these views, it is perhaps not surprising that much of the discussion of the treatment of odious debts has taken place in the international human-rights—not the insolvency—arena.

A. Origins, and an Explanation, of the Odious Debt Doctrine

Because of the public international law concept of state succession, a new government remains liable for the debts of its predecessor governments. Thus, whether the sovereign's political leaders are replaced as the result of a democratic process, a violent overthrow, or a war, the new government remains obligated to repay debts to its private, official bilateral, or international-organization creditors. Successor governments remain liable for the old regime's debts because of the view that those debts represent obligations of the state—not the debts of any particular political party or leader.[24]

Since a sovereign should incur only those debts that are in its interests, a number of political theorists, human-rights groups, and religious organizations reject the notion that a country should be forced to repay debts that were not incurred in the sovereign's interests.[25] The odious debt doctrine provides an exception to the general rule that successor governments remain liable for a prior regime's debts. In general, debts are considered odious if a despotic or autocratic leader or regime borrowed the money but did not use it to benefit the country's citizens *and* the creditors knew that the funds would be used to benefit the corrupt leaders or to finance harmful activities like genocide and other human-rights violations. In its earliest formulation, the doctrine provided that when an autocratic or despotic regime borrows to strengthen its reign or to repress the citizens of the country—not to provide for the needs or interest of the sovereign—then, if and when the despot goes, so should the debt.[26] Such

23. Africa Action, *supra* note 22 (argument by Africa advocacy group that many of the debts of African nations are illegitimate and should be cancelled); Nile Gardiner & Marc Miles, *Forgive the Iraqi Debt*, The Heritage Foundation, Apr. 30, 2003, *available at* http://www.heritage.org/Research/TradeandForeignAid/em871.cfm (discussing the economic and moral imperative of forgiving, not restructuring, the Iraqi debt); PETTIFOR, *supra* note 22, at 4.

24. Sean Hagan, *The IMF's Role in a Post-Conflict Situation*, 38 CASE W. RES. J. INT'L L. 59, 59–60 (2006); NANCY BIRDSALL & JOHN WILLIAMSON, DELIVERING ON DEBT RELIEF: FROM IMF GOLD TO A NEW AID ARCHITECTURE 52 (2002).

25. For an example, Jubilee USA—the U.S. arm of the international organization Jubilee Research—is a network of more than seventy religious or faith groups (including the Evangelical Lutheran Church in America, the Mennonite Central Committee, the Presbyterian Church USA, and the Sisters of the Holy Cross), environmental and labor organizations, community groups, and research institutes. Jubilee USA engages in public education and research and policy analyses that advocate debt cancellation for impoverished countries. *See* Jubilee USA Network, Who is Jubilee USA?, http://www.jubileeusa.org/jubilee.cgi?path=/about_the_network/member_organizations&page=who_are_we.html (last visited Jan. 1, 2007).

26. *See* Anna Gelpern, *What Iraq and Argentina Might Learn from Each Other*, 6 CHI. J. INT'L L. 391, 403 (2005) (discussing historical development of the concept); Alexander N. Sack, *Les Effets des Transformations des Etats sur leurs Dettes Publiques et Autres Obligations Financieres*, *in* ODIOUS

debts should be treated as personal debts of the former despot (or regime), not as an obligation of the current regime or the citizens of the sovereign. To do otherwise, it is argued, would force people to pay for their own repression.[27]

Under this doctrine, creditors (including IFIs) with knowledge that a political leader incurred debts to strengthen his regime, to repress political opponents, or to serve manifestly personal interests unrelated to the sovereign's interests would not be entitled to full repayment of those debts. Because such a debt was designed to benefit only the governing regime, not the citizens of the sovereign, under most formulations of the odious debt doctrine, the new regime would have the burden of proving that the prior regime's debts did not serve the interest of the sovereign and that the creditors had knowledge of how the funds were being used. If the creditors failed to rebut proof that the funds were *not* used to benefit the sovereign, then the debt would be deemed unenforceable.[28]

Some human-rights activists argue for a broader conceptualization of the doctrine whereby, in addition to the cancellation of odious debts, all "illegitimate debt" should be cancelled.[29] That is, loans would be cancelled if they were against the law or not sanctioned by applicable law; were unfair, improper or objectionable; or infringed public policy. Others argue that any debts of developing nations that arose because of "bad" lending policies or practices by private lenders or creditor nations should be written off.[30]

DEBTS: LOOSE LENDING, CORRUPTION, AND THE THIRD WORLD'S ENVIRONMENTAL LEGACY 165 (Patricia Adams trans., 1991), *available at* http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=content&ContentID=7759 (last visited Feb. 2, 2007).

27. Or, as stated by an Iraqi political leader, lenders who demand that Iraq repay Saddam Hussein's debts are, in essence, asking them "to pay for the knives they gave Saddam to slaughter us." Jubilee Iraq, http://www.jubileeiraq.org/files/iraqiviews.pdf (last visited Jan. 1, 2007).

28. PATRICIA ADAMS, ODIOUS DEBTS: LOOSE LENDING, CORRUPTION, AND THE THIRD WORLD'S ENVIRONMENTAL LEGACY ch. 17, *available at* http://www.probeinternational.org/probeint/OdiousDebts/OdiousDebts/chapter17.html (last visited Dec. 11, 2006).

29. Africa Action, *supra* note 22 (argument by Africa advocacy group that many of the debts of African nations are illegitimate and should be cancelled); Joyce Mulama, *Debt the Illegitimate Legacy of Africa's Dictators*, IPS NEWS, Jan. 26, 2007, *available at* http://www.zmag.org/content/showarticle.cfm?ItemID=11957 (reporting discussions at 2007 World Social Forum meeting where attendees characterized debts of poor countries as illegitimate); Paris Club, *supra* note 2, at 21, 62 (statement of advocacy officer for Eurodad: "It is high time that creditors take responsibility for their acts, acknowledge the existence of illegitimate debts and cancel them unconditionally.").

30. For example, one commentator suggests that the following debts should be deemed illegitimate: loans made to known corrupt officials; loans for "obviously bad projects"; and loans with usurious interest rates. JOSEPH HANLON, DEFINING ILLEGITIMATE DEBT AND LINKING ITS CANCELLATION TO ECONOMIC JUSTICE (2002), *available at* http://www.odiousdebts.org/odiousdebts/publications/DefiningIllegtimateDebt.pdf.

B. Invocation of the Doctrine of Odious Debts

1. Early Use of the Odious Debt Doctrine

Human-rights activists concede that the notion of allowing a successor regime to repudiate debts incurred by prior regimes is controversial.[31] Human-rights scholars stress, though, that the United States was one of the first nations to rely on the doctrine to refuse to repay debts. For example, after the United States won the Spanish-American War and seized Cuba from Spain, Spain demanded that the United States repay Cuba's debts to Spain. The United States refused this demand—not because the debts imposed an excessive burden on it—but because the loans had been imposed on the citizens of Cuba without their consent. Moreover, the United States contended that Spain understood the risky nature of lending to Cuba ex ante. In applying the concept of odious debts (and, consequently, refusing to pay Cuba's debts), the United States essentially argued that forcing Cuba to repay these debts would have perpetuated Spain's oppression of the Cuban people.[32]

Another such example was a 1923 arbitration involving debts owed a Canadian lender by Costa Rica. Former President and U.S. Supreme Court Chief Justice William H. Taft was the sole arbitrator in this dispute. Justice Taft initially reaffirmed the basic principle that successor governments are required to repay the debts of their predecessors. But he concluded that Costa Rica could unilaterally repudiate the debt owed to the lender because the loan had been incurred not to benefit Costa Rican citizens but to finance the leader's (and his brother's) escape from Costa Rica and because the lender knew (or should have known) those intentions.[33]

2. Recent Demands to Apply the Doctrine

The crisis in Iraq and the burgeoning costs associated with the war there have increased the interest of U.S. politicians in the odious debt doctrine and have renewed the call in the international human-rights community for the recognition and application of the doctrine to the mounting Iraqi debt. While everyone understood that *some* of the Iraqi debt had to be cancelled, some commentators suggested that no future Iraqi government should be forced to repay *any* of the debts associated with Saddam Hussein's brutal regime.[34] The

31. One critic characterized the doctrine as "an indeterminate, doctrinal impediment to the reemergence of a local economy in the global markets . . . ." Hiram Chodosh, *Rebuilding Nation Building: An Introduction*, 38 CASE W. RES. J. INT'L L. 1, 3 (2006).

32. ADAMS, *supra* note 28, at ch. 17; Ed Kinane, *Don't Saddle Iraqi People with Saddam's Bloody Debts,* POST-STANDARD, Dec. 18, 2005, at D1.

33. Gelpern, *supra* note 26, at 411 (describing arbitration proceeding).

34. Bill Day, *The Burden of Odious Debt*, SAN ANTONIO EXPRESS-NEWS, Dec. 27, 2003, at 2H; Frida Ghitis, *Iraq Burden; Where Credit Was Overdue . . .*, CHI. TRIB., Jan. 18, 2004, at C1; Editorial, *Iraq's Debt Must Be Forgiven*, SEATTLE POST-INTELLIGENCER, Oct. 23, 2003, at B7; Editorial, *Iraq's Odious Debts*, TIMES-PICAYUNE, Dec. 22, 2003, at 4; Maura Reynolds, *Bush Taps Baker for Iraq Task; The Former Secretary of State and Longtime Family Ally Is Named a Presidential Envoy. His Job Is to*

current Bush Administration appears to have helped convince other nations to forgive billions of Iraq's debts based, in part, on the Administration's concern that Hussein used the money to buy arms or build castles.[35] Other recent invocations of the doctrine on the Iraqi citizens' behalf include legislation introduced in Congress that would have encouraged the IMF and World Bank to waive much of the debt incurred during the Hussein regime and legislation involving proposed aid to Iraq.[36]

No one seems to know (or is willing to admit) the total amount of Iraq's foreign debt obligations.[37] When Saddam Hussein gained power in Iraq in 1979, the amount of Iraq's long-term foreign debt was insignificant, and it had cash reserves of $36 billion. But costs associated with Hussein's invasion of Iran (with the blessing of the United States) and his invasion of Kuwait in 1990 significantly increased Iraq's debts. Most agree that much of that debt is owed to other countries (most notably, France, Russia, and other Arab nations).[38] In addition to the borrowing during Hussein's regime, Iraq's debts continue to mount because of the remaining unpaid Gulf War reparation claims filed with the United Nations Compensation Commission based on the damage Hussein (and, thus, Iraq) inflicted on Kuwait, its oil fields, and Kuwaiti citizens. The amount of external debts tied to Hussein's regimes is estimated to be $125 billion, though some reports suggest it might actually exceed $200 billion.[39] And, it is too early to determine how much it will cost to rebuild Iraq whenever the war ends or to quantify the amount of lost development efforts associated with the ongoing war. In addition to the costs to finance the physical infrastructure that has been destroyed during the war, the new Iraqi government will also face massive costs involving the health, education, and general welfare needs of the Iraqi people.

Sway Creditors to Ease the War-Torn Nation's Steep Debt, L.A. TIMES, Dec. 6, 2003, at A1; Craig S. Smith, *Baghdad Bank Plundered as Iraq's Economy Falters,* N.Y. TIMES, Apr. 17, 2003, at B1.

35. Editorial, *Keeping Iraqi Elections on Track*, CHI. TRIB., Nov. 23, 2004, at C20;
David R. Francis, *Sweet Victory Ahead on Debt Relief?*, CHRISTIAN SCI. MONITOR, June 2, 2005, at 17.

36. Senator Evan Bayh commenting on the rationale behind the legislation, stated, "[I]f you do business by extending loans to dictators, you assume the risk of nonrepayment in the event that those dictators are overthrown. This is truly 'odious debt,' to use the term employed by international lawyers. The Iraqi people have the right to repudiate this debt. If they do not, the other nations that incurred it surely should do the right thing by forgiving it." 149 Cong. Rec. S12673 (daily ed. Oct. 16, 2003) (statement of Sen. Bayh). Ironically, the purpose of this amendment was to convert a grant into a loan because of Sen. Bayh's concern that it would be unfair for Russia, France, Germany, and other nations to be repaid (since they "propped up the tyrannical regime of Saddam Hussein") while the United States received nothing. *See id.*

37. Paul Blustein, *G-7 Agrees That Iraq Needs Help With Debt; Important Roles Seen for IMF, World Bank*, WASH. POST., Apr. 13, 2003, at A37; Weiss, *supra* note 1, at 1–2 (discussing disagreements on what Iraq owes and how interest on that debt should be calculated).

38. Weiss, *supra* note 1, at 1.

39. Reynolds, *supra* note 34, at A1; Smith, *supra* note 34, at B1; Editorial, *Iraq's Debt Must Be Forgiven*, *supra* note 34, at B7; Weiss, *supra* note 1, at 1–2. Not surprisingly, nations that lent to Iraq—especially those that helped finance the war with Iran—are not forthcoming about the amounts they are owed or the nature of the lending. Jim Hoagland, *Iraq Is One Place Where Sanctions Might Work*, WASH. POST, Sept. 15, 1988, at A25.

Just as U.S. politicians, scholars, and members of the human-rights community argue that Iraq should not be forced to repay Hussein's odious debts, the relatively recent debts of several other nations are also arguably subject to the odious debt doctrine. At the end of the brutal apartheid regime in South Africa, the human-rights community also argued that the apartheid-era debts should be forgiven because of their odious nature. The Truth and Reconciliation Commission campaigned for apartheid-era debts to be written off since so many of the loan proceeds were used to oppress black South Africans and to finance the apartheid military and police state. The new South African leaders did not repudiate the debts, most likely because they were concerned that doing so would harm the country's ability to attract foreign investment.[40] Likewise, perhaps for similar reasons, despite the suspect nature of loans incurred by "Baby Doc" Duvalier of Haiti, Ferdinand Marcos of Philippines, Mobutu Sese Seko of Zaire/Congo, President Suharto of Indonesia, and by former (and current) regimes in Rwanda and Nigeria, to date, at least, none of these countries has formally repudiated its debts.[41]

C. Current Opposition to the Doctrine

The international financial community, including IFIs, has rejected the validity of the odious debt doctrine. Specifically, the IMF and other NGOs have resisted efforts to interfere with contractual relations between a sovereign and its lenders by disqualifying odious debt from repayment. Representatives of the IMF have stated that such interference would constitute a radical change in the validity of creditor claims and the sanctity of contracts and that such a change would have adverse implications for the operation of capital markets.[42] The IMF appears to have accepted the contentions of capital market investors that introducing the new risk factor of potentially having their debts deemed odious and thus unenforceable would undermine the efficient operation of secondary sovereign bond markets and would have an adverse effect on emerging-market borrowers to issue bonds in the primary bond markets.[43]

The World Bank and the IMF consistently take the position that pressuring private lenders to voluntarily cancel debts would in the long run destabilize international lending and retard economic growth in developing countries.[44] These IFIs as well as private lenders argue that allowing subsequent regimes to

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40. *See* Michael Kremer & Seema Jayachandran, *Odious Debt*, 39 FIN. & DEV., June 2002, at 36; Report of the Reparation & Rehabilitation Committee, Reparations and the Business Sector, at 143, http://www.info.gov.za/otherdocs/2003/trc/2_5.pdf.

41. For a discussion of those debts, see Kremer & Jayachandran, *supra* note 40, at 2.

42. International Monetary Fund, Proposals for a Sovereign Debt Restructuring Mechanism (SDRM), IMF Factsheet, http://www.imf.org/external/np/exr/facts/sdrm.htm (last visited Mar. 31, 2007).

43. *See* Jack Boorman, Address at the Carnegie Council on Ethics and Int'l Affairs: Dealing Justly with Debt (Apr. 30, 2003), http://www.imf.org/external/np/speeches/2003/043003.htm; Raghuram Rajan, *Straight Talk Debt Relief and Growth: How to Craft an Optimal Debt Relief Proposal*, FIN. & DEV., June 2005, at 56, *available at* http://www.imf.org/external/pubs/ft/fandd/2005/06/straight.htm.

44. International Monetary Fund, *supra* note 42.

repudiate the debts of prior regimes violates the sanctity of contracts and, moreover, would create chaos in the international financial markets. Critics of the odious debt doctrine maintain that an ex post declaration that a debt is odious is unfair and not supported by general commercial principles since it is hard to anticipate which loans might be considered odious in the future. This risk of uncertainty would make lenders less likely to lend to the existing regime (even if legitimately elected) and would make lenders less likely to make loans to any developing nation. At least with respect to Iraq, supporters of the odious debt doctrine vigorously dispute this assertion, maintaining instead that the restructured Iraq would have little difficulty in the capital markets given the enormously profitable oil contracts that likely will be available in future years.[45]

Even though the World Bank does not support cancellation of odious debt, it has recently indicated that it will limit loans to leaders of countries deemed to be corrupt. That is, the Bank has indicated that it would change the way it designed and approved development projects for poor countries: the more likely it is that the money will be misused, the less likely it is that that the World Bank will dispense funds.[46] Indeed, funds the Bank promised to lend to countries (including India, Chad, Argentina, and Kenya) were either suspended or reduced because of these concerns.[47]

IV

USING AN INSOLVENCY FRAMEWORK TO ANALYZE THE ODIOUS DEBT DOCTRINE

A number of scholars and commentators, including many who are participating in this symposium, have proposed factors to determine whether a debt is odious so as to ensure that lenders can consider ex ante the risk associated with lending to a particular regime. They have also proposed the best way to structure a risk premium to compensate for an increased likelihood that a loan can be repudiated because of the odious nature of the debt.[48] Likewise, scholars, economists, and those in the international human-rights community have suggested giving various entities the authority to determine whether a particular debt should be deemed odious.[49] The purpose of this article, however,

45. At least with respect to Iraq, supporters of the odious debt doctrine vigorously dispute this assertion, maintaining instead that the restructured Iraq would have little difficulty in the capital markets given the enormously profitable oil contracts that likely will be available in future years. ADAMS, *supra* note 28, at ch. 17.

46. The World Bank, World Bank Group Historical Chronology 2005 (to September), http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/EXTARCHIVES/0,,contentMDK:20654185~menuPK:1689560~pagePK:36726~piPK:437378~theSitePK:29506,00.html (last visited Mar. 31, 2007).

47. Sebatian Mallaby, *Wolfowitz's Corruption Agenda*, WASH. POST., Feb. 20, 2006, at A21.

48. Odious Debts & State Corruption, held at Duke University School of Law, Jan. 26, 2007.

49. Commentators have suggested that an international NGO, a commission similar to the U.S.–Iran Claim Commission, an international commission that operated under the purview of the United Nations, an independent arbitration system, or a generally respected institution, group, or person could

is not to propose specific insolvency procedures that should be used to restructure odious debts. Likewise, the article does not attempt to determine whether an arbitration panel, an existing nongovernmental organization (NGO) or international organization, or the sovereign itself should have the authority to determine whether any particular debt is odious. Instead, the remainder of this article incorporates insolvency principles into the odious debt debate in an attempt to respond to the claim that allowing sovereigns to repudiate odious debt violates the basic principle that contracts must always be honored. Thus, from an insolvency perspective, if an agreed-upon entity (say, Congress) applies clear factors (as, for example, those in a federal bankruptcy statute) to determine whether a creditor's claim may be repaid, the debtor sovereign should be allowed to repudiate its debts only if doing so would enhance the sovereign's ability to effectively reorganize itself politically and financially.

Although this article does not attempt to specify factors that should be used to determine the odiousness of a debt, it explicitly rejects the argument advanced by some in the human-rights community that a democratically elected regime should have the ability to repudiate all loans simply because the loan was made to "illegitimate" governments[50] or that the new government should be able to reject loans it could repay without compromising its ability to restructure itself financially and politically. Given the difficulties associated with categorizing regimes as odious or nonodious, [51] the focus of an odious-debt analysis in an insolvency context simply should not be whether the regime is democratically elected. Adopting such an approach would allow all new democratically elected regimes to repudiate *all* debts of former despotic or autocratic regimes. Moreover, an interpretation of the odious debt doctrine providing that *all* debts of a despotic regime could be repudiated by future regimes would suggest that despotic regimes never borrow funds or use those funds to build or repair buildings and roads, or otherwise improve the country's infrastructure.[52] The United Nations (U.N.) monitors nations' activities to determine whether the nation (or its leaders) threatens world peace, and Amnesty International, Human Rights Watch, and other organizations monitor countries accused of violating the human rights of their citizens.[53] However, neither these nor any other independent international institution have the authority to proclaim that any particular regime is odious; indeed, Amnesty International's governing documents provide that it does not support or oppose

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assess the legitimacy of debts. Kremer & Jayachandran, *supra* note 40, at 39; Jubilee USA Network, *supra* note 25; Rajan, *supra* note 43.

50. HANLON, *supra* note 30.

51. Patrick Bolton & David Skeel, *Odious Debts or Odious Regimes?*, 70 LAW & CONTEMP. PROBS. (forthcoming Autumn 2007).

52. Of course, some would suggest that future lenders would stop lending to despots if they knew that loans to odious leaders could be repudiated by a democratically elected government.

53. Amnesty International, About Amnesty International, http://web.amnesty.org/pages/aboutai-index-eng (last visited Jan. 1, 2007); Human Rights Watch (HRW), About HRW, http://www.hrw.org/about/ (last visited Jan. 1, 2007); United Nations Security Council, Functions and Powers, http://www.un.org/Docs/sc/unsc_functions.html (last visited Jan. 1, 2007).

any government or political system.[54] The focus for any insolvency analysis of the odious debt doctrine should be on the use of the loan proceeds by the odious regime rather than a blanket declaration that all debts incurred by an odious regime can be repudiated.[55]

A. Sovereigns, Individuals, and Businesses

Unlike restructuring procedures applied to businesses or individuals under the Code, restructuring a sovereign's debt poses particular challenges: turnover managers cannot be dispatched to manage the sovereign that has defaulted on its loans and creditors cannot easily repossess the collateral that secures their debts. Like individuals, however, a sovereign will continue to exist whether it repays odious debts, refuses to repay those debts, or has the debts forgiven. And—whether or not the sovereign is deemed to have value—a sovereign (like a business reorganizing under Chapter 11) that cannot pay all its debts will continue to exist and operate as a sovereign. For these reasons, the Code's treatment of the debts of consumers and Chapter 11 debtors is instructive.

B. Basic Insolvency Principles

The Code's fresh-start policy recognizes that a consumer will continue to exist even after he receives the bankruptcy discharge—the discharge ends the person's contractual obligations, not the person himself. Likewise, Chapter 11 is specifically designed to help valuable albeit financially distressed businesses restructure their debts, then continue to operate and contribute to the American economy. Given these policies, not all of an individual's assets are liquidated simply because she cannot pay her debts, and businesses are often allowed to shed their debts but not be liquidated if they are deemed to be worth more as an ongoing concern than their parts would be worth if sold piecemeal in a liquidation.

Bankruptcy, at its core, lets debtors legally breach their contracts. Thus, whereas creditors are correct that the odious debt doctrine violates the sanctity of contracts, insolvency systems are, by design, used to reorder a debtor's

54. Amnesty International, *supra* note 53.

55. As one commentator noted, it would be unfair to penalize investors simply because they loaned money to Hussein, for many of them may have relied on the December 20, 1983 picture of the special envoy from President Reagan—former U.S. Defense Secretary Rumsfeld—shaking Hussein's hand. *See* Press Release, The National Security Archive, U.S. Documents Show Embrace of Saddam Hussein in Early 1980s Despite Chemical Weapons, External Aggression, Human Rights Abuses (Feb. 25, 2003), *available at* http://www.gwu.edu/~nsarchiv/NSAEBB/NSAEBB82/press.htm. Likewise, lenders may generally have relied on the U.S.'s former support of Hussein, notwithstanding his brutal, despotic regime, in deciding to loan money to Iraq. Stated differently, whereas it is reasonable to expect that lenders monitor the *use* of the loan proceeds, short of hiring human-rights consultants to determine whether the existing regime is "odious," it is unclear how the lenders would know that lending to Hussein was *per se* improper when U.S. officials supported his brutal regime (as long as he was invading Iran or otherwise tormenting a U.S. enemy) and encouraged lenders to invest in Iraq. Gelpern, *supra* note 26, at 412; Guy Gugliotta, *Bush, Others Said to Have Repeatedly Pressed Bank to Aid Iraq*, WASH. POST., Feb. 25, 1992, at A13.

contractual obligations, even if this results in a breach. The specific provisions that govern business reorganizations under Chapter 11 and consumer bankruptcies under both Chapters 7 and 13 of the Code allow businesses and people to restructure some debts and to repudiate all or parts of others in order to give the business or person a fresh start in life. For example, whereas the Code generally respects the sanctity of contracts and gives creditors formal "notice" of how their claims can be affected in a bankruptcy case, knowledgeable creditors understand that bankruptcy cases—especially a Chapter 11 reorganization—typically are a negotiated process and the result of the negotiation may be that they will receive less than they are entitled to under the terms of their contract. Indeed, large Chapter 11 reorganizations are essentially a series of negotiations between a Debtor in Possession (DIP), the DIP's prepetition creditors and shareholders, lenders who provide financing to the DIP during the reorganization, and the DIP's future lenders and owners. Because few claims are absolutely sacrosanct in bankruptcy, creditors know that certain Code provisions let the debtor, trustee in bankruptcy, and DIP alter the treatment the creditor's claim would have had under applicable nonbankruptcy laws.

1. Modifying Secured Claims

Most secured creditors can expect either to be paid in full in a bankruptcy proceeding or to receive the collateral that secures their debts.[56] Likewise, although the Code provides that Chapter 11 reorganization plans can modify the rights of the holders of secured claims, the expectation created under state law that a creditor will be repaid (or be allowed to seize the collateral) typically is not frustrated simply because the debtor sought to restructure its debts in bankruptcy.[57] Though the Code generally respects the protections creditors receive under Article 9 of the Uniform Commercial Code, at times those protections are curtailed.

For example, to discourage a debtor from granting "secret" liens and inducing other creditors to extend credit because of mistaken beliefs concerning the debtor's financial situation, Article 9 provides that other creditors or bona fide purchasers of real property would not be bound by a creditor's unperfected security interest.[58] However, the security interest *would* be enforceable against the debtor. In bankruptcy cases, though, the trustee or DIP has the authority to avoid a creditor's security interest if the creditor failed to properly perfect that interest. Thus a creditor who otherwise would have been entitled to repayment in full from the debtor as a secured creditor under state law could find that it will treated as an unsecured creditor in bankruptcy and, as a result, be repaid only a small percentage of its debt.[59]

56. 11 U.S.C. §§ 725, 1129(b)(2)(A) (2000).
57. *Id.* § 1123(b)(5).
58. U.C.C. § 9-317 (2001).
59. 11 U.S.C. § 544 (2000).

2. Modifying Unsecured Claims

As is true outside of bankruptcy, creditors who have unsecured claims receive fewer protections in bankruptcy than do secured creditors. Since most sovereign lending is unsecured, it is especially appropriate to consider how the Code might modify the rights of unsecured creditors. For example, unsecured creditors who receive payments during the period immediately before the debtor files for bankruptcy can, in some instances, be required to return those preferential payments even though the creditor almost always would be allowed to keep the payments under applicable state law.[60] The Code forces creditors who receive preferential payments to return these payments in most cases to avoid disrupting the Code's payment-priority scheme.[61] Although a creditor who is forced to disgorge a preferential payment is still entitled to seek repayment of the debt during the bankruptcy proceeding, depending on the debt–asset ratio and the terms of the Chapter 11 or 13 plan, the creditor may receive less in the bankruptcy case than the amount the creditor was forced to return to the debtor's bankruptcy estate as a preference.[62] Though the preference provisions are designed to discourage creditors from racing to dismantle a financially ailing debtor as it slides into insolvency, even a creditor who does not engage in aggressive prepetition collection activities or does not threaten a debtor in order to get a preferential payment nonetheless must disgorge the payment.

Although, in general, debtors cannot use a bankruptcy filing to rewrite their contracts or leases, the Code allows debtors to affect the rights of entities with whom they have contracted. The Code lets debtors reject (that is, refuse to perform) unfavorable contracts or leases.[63] And, although the Code typically treats claims that arose after the debtor filed for bankruptcy more favorably than claims that arose before the filing, it provides that any damages resulting from the debtor's postpetition breach of contract will be treated as if the breach occurred *before* the bankruptcy case was filed.[64] Again, though the contracting party may have done absolutely nothing wrong, the Code gives the debtor the right to convert what should be a favored postpetition claim that is entitled to

60. *Id.* § 547(b). Under most state fraudulent transfer laws, only insiders who have knowledge that the debtor is insolvent will be forced to return preferential payments. *See* Unif. Fraudulent Transfer Act 5(b).

61. Creditors who do not improve their financial positions relative to other similarly situated creditors may be allowed to keep preferential payments by relying on one of the preference exceptions found in 11 U.S.C. § 547(c).

62. Upon filing a petition for relief in bankruptcy, an estate that consists of the entire debtor's property, "wherever located and by whomever held," is created. 11 U.S.C. § 541(a). Unsecured creditors—who rarely are paid in full in a Chapter 11 bankruptcy—can be especially harmed if they are forced to return preferential payments. For example, an unsecured creditor who exercises its states' collection law remedies to, and receives payment in full of, its $100 debt during the ninety days preceding the bankruptcy would be forced to disgorge the $100 payment. If it receives only a ten percent distribution in the bankruptcy proceeding (or $10), it would feel as if not being allowed to keep the $90 caused it harm in an economic sense, especially since the creditor did nothing impermissible in obtaining full repayment before the company filed for bankruptcy.

63. 11 U.S.C. § 365(a).

64. 11 U.S.C. § 365(a), 502(g)(1).

repayment in full into a prepetition claim that likely will be paid only a small percentage.

3. Eliminating Favored Claims

Other favored creditors may face even more draconian treatment in bankruptcy. Former employees of companies owed pension or other employee benefits, creditors owed student-loan payments from debtors who cannot repay those debts without undue hardship, and secured creditors deemed to have engaged in inequitable conduct can all have their claims dramatically restructured, or even discharged, in a bankruptcy case. These creditors likely would conclude that principles embodied in the Code allowing this treatment violate the sanctity of their contracts by letting debtors repudiate debts that were otherwise valid.

D. The Corporate Bankruptcy Model and Odious Debt

1. "Legacy" Costs in Bankruptcy

Businesses in industries with high labor costs increasingly use Chapter 11 to restructure their "legacy" costs. Legacy costs generally are defined as defined benefit (DB) pension obligations, retiree medical benefits, and collective-bargaining agreements (CBAs).[65] In general, businesses cannot reject a CBA, and they are required to continue making retiree-benefit payments during the course of the Chapter 11 case. Moreover, the Employee Retirement Income Security Act of 1974 (ERISA) provides that a company can terminate a retirement plan only if it shows that it will be unable to repay all its debts under a Chapter 11 reorganization plan and that it would be unable to continue in business outside of bankruptcy.[66] The Code and ERISA make it difficult for businesses to terminate or modify employee-benefit plans. This protects the retirement security of workers, advances the public policy that favors collective bargaining,[67] and increasingly prevents businesses from shifting their liability to their employees onto the Pension Benefits Guaranty Corporation (PBGC).[68]

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65. *See generally* Dan Keating, *Good Intentions, Bad Economics: Retiree Insurance Benefits in Bankruptcy*, 43 VAND. L. REV. 161, 163 (1990) (arguing that the passage of Section 1114 of the Bankruptcy Code does little to increase the likelihood that retirees will receive benefits and pensions under corporate Chapter 11 restructuring).

66. 29 U.S.C. § 1342(c)(2)(B)(ii)(I)–(IV) (2000).

67. *See In re* Northwest Airlines Corp., 346 B.R. 307, 314 (Bankr. S.D.N.Y. 2006).

68. The PBGC is a wholly owned government corporation formed to protect employees from employers who underfunded (or failed to fund) their pension plans. The PBGC is statutorily required to provide timely and uninterrupted benefit payments. 29 U.S.C. § 1302(a). Though the PBGC was created to insure that vested participants in DB plans receive the benefits their employers promised them, the PBGC itself is facing a financial crisis. That is, while the PBGC had a $9.7 billion surplus in 2000, by the end of 2005, it had almost a $25 billion deficit. *In re* Kaiser Aluminum Corp., 456 F.3d 328, 346 (3d Cir. 2006). This multi-billion dollar deficit has caused the PBGC to routinely oppose companies' attempts to terminate their pension obligations in Chapter 11 reorganization proceedings. *Id.* at 328 (PBGC opposition to termination of pension plan); *In re* UAL Corp. (pilots' pension plan termination), 468 F.3d 444 (7th Cir. 2006) (PBGC opposition to termination of pension plan). As a result of the termination of the U.S. Airways and United Airlines' pension plans, the PBGC had claims

Because federal law and policies do not favor allowing employers to repudiate their promises to their current or former employees, a business attempting to reorganize under Chapter 11 may reject a CBA[69] or modify retiree benefits[70] only if it shows that these changes are necessary for the business to reorganize, if it assures that all affected parties are treated fairly and equitably, and if the treatment of the legacy costs is "clearly favored by the balance of the equities."[71] In determining whether the balance of the equities favors terminating or modifying the employee-benefit claims, courts consider a number of factors, including whether the debtor is likely to liquidate if it cannot modify its debts to the employees, whether other creditors' claims will be harmed if the legacy costs remain in place, the good or bad faith of the parties in dealing with the debtor's financial situation, and the relative abilities of the various parties to spread the costs associated with maintaining (or modifying) the legacy costs.[72]

Businesses that can show they cannot successfully reorganize and compete in the marketplace unless they terminate (or modify) their legacy costs likely would be allowed to breach their contractual promises to make future compensation payments to their employees (in the form of pensions or retiree medical benefits). Indeed, over the last two decades, steel and airline companies[73] have used Chapter 11 to terminate or severely reduce their legacy costs[74] even though their employees had already agreed to lower wages in the past, likely in exchange for receiving these future benefits.[75] Courts have increasingly allowed large airlines and steel companies to breach their CBAs or to otherwise terminate their pension plans when the company proved (or at least asserted) that it could not get debt or equity financing to reorganize and emerge from bankruptcy.[76] Courts appear willing to let businesses use Chapter

of $9.7 billion. Because of unfunded benefit guarantees, it is projected that the PBGC will run out of money by 2022. Julie Kosterlitz, *Pinched Promises*, NAT'L. J., Sept. 3, 2005, at 2650–51.

69. 11 U.S.C. § 1113 (2000).

70. *Id.* § 1114.

71. *Id.* § 1114(g). Debtors are also required to send the retirees' representative a proposal that explains how the debtor intends to treat the retirees' benefits claim and to make a good faith effort to confer with the representative to discuss the proposed modification. *In re* Delta Air Lines, 342 B.R. 685, 693–94 (Bankr. S.D.N.Y. 2006) (discussing requirements).

72. *In re* Northwest Airlines Corp., 346 B.R. 307, 329 (Bankr. S.D.N.Y. 2006).

73. Bethlehem Steel, LTV, National Steel, Kaiser Aluminum Corp., U.S. Airways, Delta Airlines, and United Airlines are among the companies who have used bankruptcy to reduce their legacy costs. Since 2000, there have been twenty-two airline bankruptcy filings. U.S. GOV'T. ACCOUNTABILITY OFFICE, COMMERCIAL AVIATION: BANKRUPTCY AND PENSION PROBLEMS ARE SYMPTOMS OF UNDERLYING STRUCTURAL ISSUES 3 (2005).

74. *See, e.g.*, *In re* Delta Air Lines, 342 B.R. at 685 (seeking rejection of CBA with flight attendants); *In re* Kaiser Aluminum Corp., 456 F.3d 328 (3d Cir. 2006) (seeking termination of pension plan); *In re* Northwest Airlines Corp., 346 B.R. at 307 (seeking rejection of CBA); *In re* U.S. Airways Group, Inc., 296 B.R. at 734 (Bankr. E.D. Va. 2003) (seeking termination of pilots' pension plan). *See* Kosterlitz, *supra* note 68, at 2651.

75. *See* Dan Keating, *Why the Bankruptcy Reform Act Left Labor Legacy Costs Alone*, 71 MO. L. REV. 985 (2006).

76. *In re* U.S. Airways, 296 B.R. at 734; *In re* Wire Rope Corp. of Am., Inc., 287 B.R. 771 (Bankr. W.D. Mo. 2002).

11 to repudiate their labor obligations because the only other option is liquidating the company, which would then terminate the wages and benefits for *all* the employees.

2. Odious Debt Analogy

The core "business" of a sovereign is to protect the safety and provide for the general welfare of its citizens—not just to have a high gross domestic product.[77] The odious debt doctrine is usually discussed using human-rights or social-justice terms. However, the essence of the doctrine is the desire to prevent a financially strapped nation from being forced to continue to struggle to repay loans that were not used to benefit the nation or its citizens. Even if it were theoretically possible for a successor regime to use the country's resources to repay odious debts over an extended period, the doctrine would excuse the successor from repaying those debts if doing so would significantly restrict the nation's ability to reorganize financially (by paying old debts and attracting new investments) and civically (by continuing to provide essential services to its citizens). It is consistent with general insolvency principles, policies expressed in Code provisions, and the odious debt doctrine to allow a nation saddled with enormous debts that provided little (or no) benefits to the citizens of the nation to repudiate those debts if repaying them would render a nation functionally insolvent and unable to perform the critical functions involved in governing.

United, Delta, Northwest, other airlines, and steel companies ostensibly *could* have maintained their legacy costs outside of bankruptcy if they had been prepared to radically reduce corporate earnings (or, the salaries of their managers). If these companies had agreed to radically restructure their businesses and stop flying planes or melting metal they perhaps could have maintained their legacy costs for a smaller workforce. Just as airlines and steel companies argued that forcing them to maintain their existing levels of employee benefits would radically undermine their reorganization efforts, a new political regime attempting to reorganize and restructure the country's debts justifiably could argue that repaying odious debts far into the future would undermine its restructuring efforts.

In the case of Iraq, a new government cannot be a model for responsible government in the Middle East, have credibility with its own oppressed populations, re-enter the international community, or attract new investments if that government either must tax its citizens, be rendered incapable of investing in the country's physical infrastructure, or be unable to provide crucial services to the Iraqi people. Because calculating the amount of Iraq's remaining unrestructured debts owed to non-Paris Club states and its ultimate war debts is not possible, it is difficult to determine whether Iraq has the capacity to repay

77. *See* Letter from Thomas Jefferson to Mons. D'Ivernois (Feb. 6, 1975), *in* THE WRITINGS OF THOMAS JEFFERSON 297 (Lipscomb ed., 1903) ("[I]t is to secure our just rights that we resort to government at all."); H. Jefferson Powell, *Enumerated Means and Unlimited Ends*, 94 MICH. L. REV. 651, 662 (1995).

those debts. Iraq's oil fields are still quite profitable but currently are in a state of disrepair. It seems likely, though, that the debts could be repaid if some (or all) future oil revenues were transferred to existing creditors for an extended period. However, diverting these revenues to repay those debts might create a debt overhang that discourages new investment and thus hampers the ability of the new government to attract new capital.

Countries, like Iraq, that are saddled with enormous debts that fairly could be construed as odious likely could repay those debts if they neglect or ignore the health, safety, or educational needs of their citizens. But, just as the airline and steel companies that filed for bankruptcy to shed their legacy costs would not have emerged from bankruptcy and been able to perform many of their prepetition critical functions, a nation saddled with enormous debts that provided little (or no) benefits to its citizens will be unable to perform the critical functions involved in governing: to provide security, to build and maintain physical infrastructure, and to provide other basic services for its citizens.

Forcing a country to repay odious debts over an extended period might render it politically insolvent, even if it remained balance-sheet solvent. Letting a sovereign repudiate odious debts that hamper the country's political and financial recovery would be consistent with insolvency principles generally, and with the Code's treatment of legacy costs specifically: only a sovereign that could show that it could not overcome its financial crisis and perform the business of being a sovereign should be able to repudiate its debts. The sovereign also would need to show that, in general, it is treating all creditors fairly and equitably. Moreover, like businesses seeking to reduce or eliminate their legacy costs, sovereigns would need to show that the creditors could spread the costs associated with odious debt repudiation better than citizens could bear the costs associated with repaying the debts. Finally, just as courts consider whether parties have made good faith efforts to address how a firm's legacy costs have affected the firm's financial condition and how to restructure those costs, the parties' good faith also should be considered when deciding whether a sovereign should be forced to repay odious debts. Bad faith creditors would be those who knew or should have known that the odious loans were not used to benefit the citizens and that, as a result, the loans would worsen the sovereign's financial situation while providing no (or few) benefits to the sovereign. It would be consistent with insolvency principles that govern the treatment of legacy costs to permit sovereigns to repudiate odious debts to creditors who have not acted in good faith.

Of course, a sovereign's decision to repudiate prior odious debts might affect the sovereign's future ability to borrow or otherwise attract new investments. However, if—as is true with businesses—lenders are unwilling to provide future capital to a sovereign because the odious debts create a debt overhang, sovereigns should be allowed to significantly modify or repudiate the odious debts in order to give potential lenders or investors an incentive to provide future capital. Indeed, letting sovereigns repudiate odious debts might actually give new lenders an incentive to lend. That is, if lenders understand that they can in effect eliminate or subordinate old debts by refusing to lend to a financially distressed sovereign unless the sovereign repudiates the odious debts or unless they are given a higher priority in payment (or a lien in sovereign assets), both current and potential future creditors may be more willing to lend to a sovereign who chooses to repudiate.

In short, allowing sovereigns to repudiate odious debts if repaying those debts potentially thwarts the sovereign's ability to effectively reorganize financially and politically is consistent with the Code's treatment of legacy costs for businesses that attempt to reorganize in Chapter 11.

E. The Consumer-Bankruptcy Model and Odious Debt

1. Student Loans

Some businesses that have filed for bankruptcy have gross revenues larger than some countries' gross domestic products.[78] The most obvious way to "fit" the odious debt concept within an insolvency framework would thus seem to be by making analogies to business reorganizations. Yet, despite the myriad differences between financially strapped people and financially troubled sovereigns, people and sovereigns share one primary characteristic: both will continue to exist regardless of whether they repay their debts or how they restructure those debts upon default. Thus, as another participant in this symposium has noted,[79] analyzing the treatment of sovereign debts using a consumer bankruptcy lens also can be instructive.

The Code's treatment of student loans in consumer bankruptcies provides perhaps the strongest consumer-bankruptcy analogy justifying sovereign repudiation of odious debts. In general, educational loans are not dischargeable, and student-loan creditors are favored in bankruptcy.[80] Notwithstanding the

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78. For example, in November 2006—while Delta Air Lines was reorganizing under Chapter 11—Delta had U.S. $2.7 billion in unrestricted cash, cash equivalents, and short-term investments. Delta's November 2006 net loss was $49 million and its November 2006 operating income was $52 million. Delta, Delta Air Lines Reports Monthly Results for November 2006, http://news.delta.com/article_display.cfm?article_id=10501 (last visited Dec. 29, 2006). In contrast, the 2005 Gross Domestic Product (and the projected 2006 GDP) of Guinea-Bissau—a country that is listed as a heavily indebted poor country that is eligible for HIPC Initiative assistance from the IMF—was less than a quarter of a billion. International Monetary Fund, Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative, http://www.imf.org/external/np/exr/facts/hipc.htm (last visited June 30, 2007); USDA Economic Research Service, Real Historical & Projected Gross Domestic Product and Growth Rate of GDP for Baseline Countries/Regions 2000-2017, http://www.ers.usda.gov/Data/Macroeconomics/Data/Projected RealGDPValues.xls (last visited June 30, 2007).

79. Robert K. Rasmussen, *Integrating a Theory of the State into Sovereign Debt Restructuring*, 53 EMORY L. J. 1159, 1163 (2004).

80. Indeed, a recent amendment to the Bankruptcy Code expands the protections these creditors receive. That is, until 2005, only loans made, insured, or guaranteed by a governmental unit or nonprofit institution were protected from discharge. Congress amended the Code to expand those protections to for-profit lenders. *See* 11 U.S.C. § 523(a)(8)(B) (2000).

favorable treatment student loans tend to receive, debtors can discharge all or part of student-loan debts if requiring repayment would impose an undue hardship on the debtor or the debtor's dependents.[81]

Most courts have adopted a three-part undue hardship test that considers whether (1) based on current income and expenses, the debtor can maintain a "minimal" standard of living for herself and her dependents and also repay the loans; (2) additional circumstances exist indicating that the debtor's financial state of affairs is likely to persist for a significant portion of the repayment period; and (3) the debtor has made a good faith effort to repay the loans.[82] Other courts use a "totality of the circumstances" test that considers the debtor's past, current, and reasonably reliable future financial resources; the amount of the debtor and the debtor's dependents' reasonable, necessary living expenses; and any other relevant facts or circumstances unique to the particular case.[83] These courts have not precisely defined the minimal standard of living a debtor and her dependents are entitled to in bankruptcy. They agree, though, that the debtor must have sufficient resources to satisfy the need for food, shelter, clothing, and medical treatment.[84] Courts routinely stress that "undue hardship" stops short of debtors' having to live in abject poverty in order to discharge their student loans.[85]

2. Odious Debt Analogy

Whereas the undue-hardship test is designed to be a rigorous one that prevents most debtors from discharging their loans, it nonetheless could be used to justify allowing a sovereign to discharge odious debts if forcing it to repay those debts would cause an undue hardship for the debtor (the sovereign) or for the debtor's dependents (the citizens). An undue-hardship test allowing a country to repudiate odious debts would need to take into consideration the sovereign's past, current, and reasonably reliable future financial resources—most likely its future export revenue and any possible future loans, investments, or tax revenue. Just as courts consider the amount of a debtor's dependents' reasonable, necessary living expenses when deciding whether to discharge a student loan, whether to allow a sovereign to repudiate odious debts might depend on the hardship debt repayment would have on its citizens. A sovereign that could show that repaying the odious debts would make attracting future investment impossible should be allowed to discharge the debt to avoid imposing an undue hardship on the citizens of the country. Finally, just as

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81. Saxman v. Educ. Credit Mgmt. BJR Corp. (*In re* Saxman), 325 F.3d 1168 (9th Cir. 2003).

82. Educ. Credit Mgmt. Corp. v. Mason (*In re* Mason), 464 F.3d 878, 881–82 (9th Cir. 2006). Most circuit courts have adopted this three-part test, originally applied in Brunner v. New York State Higher Educ. Svcs. Corp. (In re *Brunner*), 831 F.2d 395, 396 (2d Cir. 1987).

83. Long v. Educ. Credit Mgmt. Corp. (*In re* Long), 322 F.3d 549, 554 (8th Cir. 2003).

84. Gill v. Nelnet Loan Servs., Inc. (*In re* Gill), 326 B.R. 611, 626 (Bankr. E.D. Va. 2005).

85. Hornsby v. Tennessee Student Assistance Corp. (*In re* Hornsby), 144 F.3d 433, 438 (6th Cir. 1998); Doe v. Educ. Credit Mgmt. Corp. (*In re* Doe), 323 B.R. 111, 120 (Bankr. S.D.N.Y. 2005) (rejecting the argument that undue hardship should be assessed based on federal poverty guidelines); Shadwick v. United States Dep't. of Educ. (*In re* Shadwick), 341 B.R. 6, 11 (Bankr. W.D. Mo. 2006).

bankruptcy courts deciding whether to discharge a student loan consider other relevant facts or circumstances unique to that case, a sovereign should be able to show that the debts incurred did not benefit the citizens or that the loan proceeds had been looted or used for illegal purposes to support allowing it to repudiate those odious debts.

Some countries, like Iraq, might have significant future earning capacity based on oil or other exports. If a sovereign's inability to repay its debts does not appear likely to persist for the entire loan-repayment period, it should be allowed to partially repudiate only some of the odious loans or to partially repudiate only part of all odious loans. For example, it would be appropriate to allow the sovereign to repudiate penalties or interest on arrears imposed because of trade or other economic sanctions imposed against a brutal regime if the sovereign proved that it could not repay all odious debts and penalties without jeopardizing its ability to restructure financially and to provide basic services for its citizens.

F. The Principle of Equitable Subordination and Odious Debt

Finally, bankruptcy courts can reorder the priority of payment of creditors' claims, or can invalidate a lender's security interest in collateral, under the theory of equitable subordination. This theory, codified in Section 510(c) of the Code, allows courts to subordinate a creditor's claim if the court determines that the creditor engaged in inequitable or fraudulent conduct, that the misconduct harmed other creditors or conferred an unfair advantage on the individual creditor, and if equitably subordinating the claim is not inconsistent with the Code generally.[86] Equitable subordination is an unusual remedy that is used only in limited circumstances and most often triggered when the creditor is an insider. Although the misconduct needed to subordinate claims of noninsiders is greater than the misconduct necessary to subordinate insider claims, noninsiders also risk having their claims equitably subordinated if their conduct amounted to fraud, overreaching, or spoliation.[87] Courts interpreting the theory have determined that they can subordinate a creditor's claim even if the creditor's misconduct does not relate to its claim in the bankruptcy case.[88]

Using the doctrine of equitable subordination to justify the repudiation of odious debts would give lenders an incentive to engage in due diligence before making a loan and then to monitor the use of the loan. Creditors who are owed odious debts should be allowed to demonstrate that they took reasonable steps to ensure that the loan proceeds were being used to benefit the nation's citizens and that the funds were not being diverted to be used by despotic leaders, their friends, political supporters, or their families. Sovereign debts incurred as the

86. 11 U.S.C. § 510(c)(1) (2000); *In re* Racing Servs., Inc., 340 B.R. 73, 76 (B.A.P. 8th Cir. 2006); *In re* AutoStyle Plastics, Inc., 269 F.3d 726, 744 (6th Cir. 2001).

87. *In re* M. Paolella & Sons, Inc., 161 B.R. 107, 119 (Bankr. E.D. Pa. 1993).

88. *In re* Racing Servs., 340 B.R. at 77–78; Adam Feibelman, *Equitable Subordination, Fraudulent Transfer, and Sovereign Debt*, 70 LAW & CONTEMP. PROBS. (forthcoming Autumn 2007).

result of bribes, kickbacks, or the like are easily analogized to claims that are equitably subordinated in a bankruptcy proceeding.

Even if the lender did not itself engage in inequitable conduct, sovereigns should be allowed to repudiate odious debts. This debt repudiation is consistent with the doctrine of equitable subordination if the lender knew or should have known that the former regime was not using those funds for the benefit of the citizens because the creditor's misconduct (here, lending funds that would be knowingly used for illegitimate purposes) gave it an unfair advantage over other creditors or generally harmed other creditors. Although a sovereign's citizens do not have a traditional lending relationship with the nation-state, they are in effect its creditors because they essentially serve as guarantors of the sovereign's debts. Citizens effectively guarantee the sovereign's debts because, upon default, the sovereign will be forced to either tax them to repay the debts or forgo providing basic services to them if the sovereign cannot afford to repay old debts, obtain new capital, or provide services to its citizens. Since they would be harmed if the sovereign repaid the odious debts, they arguably satisfy the requirement that other creditors are harmed by the inequitable conduct of the creditor whose claim is being subordinated.

Allowing sovereigns to repudiate debts that are not clearly illegal but that could nonetheless be deemed odious should, like the subordination of debts in Chapter 11, be a rare occurrence. Any ex post declarations that odious debts will be equitably subordinated (to old nonodious debts or to future nonodious loans) might increase creditors' reluctance to lend to developing countries or may increase the costs of those loans. This is a legitimate concern, as is the concern that imposing additional requirements on lenders to monitor the use of the loan proceeds will increase the cost of borrowing for sovereigns. While there is no universally recognized list of "odious regimes," it is disingenuous to suggest that international lenders have no way to determine whether a regime is engaging in activities that harm its citizens and thus making an inappropriate use of loan proceeds. International organizations, including the United Nations (through its Security Council) routinely condemn nations that have despotic, brutal leaders or that otherwise engage in brutal practices. To alleviate the concerns that these ex post declarations will increase the cost of credit, a successor government should not be allowed to repudiate *all* loans to such regimes. However, the regimes' lenders can reasonably be on notice of the international community's view of the regime and thus be prepared to increase their monitoring of the loan proceeds. Moreover, just as the World Bank has recently created a list of countries with corrupt governments to whom it has refused to lend, it is not unreasonable to expect sovereign lenders to modify their lending practices to help ensure that they do not knowingly make loans to sovereigns who use loan proceeds for reasons that do not benefit the sovereigns' citizens.

With respect to Iraq, lenders knew or could have known with a reasonable monitoring process that Hussein was using the loan proceeds for reasons other than those provided in the lending agreement. Such lenders should not have been surprised if their loans were radically restructured or forgiven altogether. Similarly, such lenders should not have been surprised to find that they would not be repaid since it was common knowledge that Iraq had long refused to repay old debts unless the creditors agreed to make large new loans.[89] Perhaps most importantly, since most of Iraq's lenders were other nation-states—many in the Middle East—it is simply inconceivable that they did not know (or at least have reason to suspect) that the proceeds of some of their loans were being used to benefit Hussein, to finance the invasion of Iran (or Kuwait), to murder political opponents in Iraq, or to perpetuate genocide. Indeed, for at least the last thirty years, the international community was on notice that the Hussein regime consistently and persistently violated the economic, social, and cultural rights of a significant portion of the Iraqi citizenry. Similarly, it would have been consistent with the doctrine of equitable subordination to subordinate the loans made by nations who lent to South Africa during the apartheid era. When the United Nations Security Council imposed trade sanctions on South Africa, lenders should have been on notice that at least some of the money they lent to the apartheid government was used to violate the human rights of black South Africans. Lenders who continued to loan money to the old South African government through the 1980s (as many did) could not reasonably claim that they lacked notice of the potential odiousness of those post-sanction loans.[90]

V

CONCLUSION

For now, the international financial community and creditor nations like the United States have refused to acknowledge—much less publicly endorse—the odious debt doctrine. Nonetheless, the Bush Administration helped convince other nations to forgive billions of Iraq's debts based, in part, on the Administration's concern that Hussein used the money to buy arms or build castles. The persistent push by the human-rights community for formal acceptance of the doctrine, coupled with public statements by politicians in the United States and abroad that arguably support the doctrine, will continue to influence financial restructurings involving sovereigns who inherit odious debts and should make lenders skeptical when loaning funds to countries who have brutal, repressive regimes. Just as the parties to an out-of-court debt restructuring negotiate in the shadow of bankruptcy, the threat of having debts

89. Patrick Cockburn, *The Arms for Iraq Scandal: Oil Price Collapse and Iran War Prompted Credit Crisis*, THE INDEP., Dec. 12, 1992, at 8; Gugliotta, *supra* note 55.

90. The U.N. Resolution urged all member States "to induce transnational corporations, banks and financial institutions to withdraw effectively from South Africa and prevent them from: (i) Investing in South Africa . . . ; (iii) Engaging in commercial transactions with South Africa; [and] (iv) Granting loans and credits to South Africa." G.A. Res. 42/23, ¶ B1, U.N. Doc. A/RES/42/23 (Nov. 20, 1987), *available at* http://www.un.org/documents/ga/res/42/a42r023.htm.

repudiated because of the odious debt doctrine likely will continue to cause lenders to forgive such debts even if they do not think they have a moral or philosophical duty—and no actual legal duty—to do so.