Applied Legal History: Demystifying the Doctrine of Odious Debts

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"Odious debts" have been the subject of debate in academic, activist, and policymaking circles in recent years. The term refers to the debts of a nation that a despotic leader incurs against the interests of the populace. When the despot is overthrown, the new government — understandably — does not wish to repay creditors who helped prop up the despot. One argument has focused on whether customary international law supports a "doctrine" of odious debts that justifies the nonpayment of sovereign debts when three conditions are met: (1) the debts were incurred by a despotic ruler (without the consent of the populace); (2) the funds were used in ways that did not benefit the populace; and (3) the creditors were aware of the likely illegality of the loans. Advocates of this doctrine, which was synthesized by Alexander Sack in 1927, typically cite two examples of U.S. state practice for support: the negotiations between the United States and Spain following the Spanish-American War, in which the United States repudiated Cuba's colonial debt, and the Tinoco arbitration, which repudiated certain debts of the deposed Costa Rican dictator, Frederico Tinoco. Those historical precedents do not support the first condition of Sack's doctrine of odious debts, but do support the second two requirements. In addition to these two instances, United States history is rich with examples of debt repudiation by states. Those examples suggest a doctrine of odious debts that is broader and more flexible than the one written by Sack. Indeed, it may be appropriate to speak of the doctrines (not just doctrine) of odious debts.

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INTRODUCTION

After the United States toppled Saddam Hussein in 2003, the Bush administration had to address the question of responsibility for the sizeable unpaid debts of his regime. Discussions of that question quickly changed into a larger international debate on the question of odious debts — what to do about the sovereign debts of despotic regimes, and whether they could, or should, be repudiated by the successor government. Iraq's Saddam-era debts have by now been written down or renegotiated, but the general question of what to do about odious debts remains on the international agenda. Countries such as Norway and Ecuador are putting considerable energy into keeping the debate alive, and the Obama campaign listed odious debts as one of the issues that an Obama administration would address.¹

The starting point of almost every discussion in the modern debate has been the so-called "classical" definition of odious debt provided by Alexander Sack. Debts are odious and do not have to be paid by a successor regime if the following three conditions are met: (1) the regime incurring them was despotic (often understood to mean lacking the consent of the populace); (2) the debts produced no benefit for the populace; and (3) the creditors knew about the likely misuse of the funds they were advancing.²

If a case involving odious debts repudiation ever does find its way into court, the tribunal will have to determine whether the circumstances warrant an exception to the generally strict rule of governmental succession to debts. Given that there is no international treaty covering governmental succession, the tribunal will have to look to customary international law (CIL). CIL is the law that can be derived from the repeated historical practice of nations and opinio iuris et necessitas — the sense of obligation that drives that practice.³

Given that most sovereign borrowing takes place under contracts governed by

² ALEXANDER N. SACK, LES EFFETS DES TRANSFORMATIONS DES ÉTATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIÈRES 157-63 (1927).
the laws of either New York or the United Kingdom, the historical practices of these two jurisdictions regarding sovereign debt repudiation are likely to be of central importance to a modern tribunal deciding whether to incorporate some — or all — of the Sackian definition of odious debts into its analysis. The writings of prominent jurists, who synthesize and analyze precedent, are also among the pieces of evidence that would be used to determine historical practice and *opinio iuris*.

The modern literature typically relies on three pillars to support the odious debts edifice. Alexander Sack is the prominent jurist. Two incidents from U.S. history supply the evidence of state practice: the U.S. repudiation of Cuban colonial debt in negotiations following the Spanish-American War, and the arbitral ruling of then-Chief Justice William Howard Taft, repudiating the debts of the Costa Rican strongman, Frederico Tinoco.

This Article tests the strength of these pillars. A prior article by two of the current authors asserted that the Sack pillar was shaky. Odious debts proponents touted Alexander Sack as a former Tsarist minister and the foremost scholar of sovereign debt in his day. Research into Sack’s biography, however, revealed that he was neither a Tsarist minister, nor a prominent legal academic. Given that Sack’s biography bore little resemblance to his modern reputation, it raised the question whether the other historical pillars might be similarly unsound — either in providing support for the Sackian odious debts doctrine, or in differing in important respects from the story that the contemporary odious debts literature has accepted as true.

This Article also makes a preliminary inquiry into other instances of state repudiation of debts in U.S. history — in particular, to see whether there are examples that support the first condition of Sack’s test. A brief tour of debt repudiation in the nineteenth century shows multiple instances of the United States engaging in and ratifying repudiations of debts contracted by previous regimes. But the United States did not act according to Sack’s doctrine of odious debts; instead, its actions suggest a doctrine potentially broader and more flexible than Sack’s. This Article, therefore, returns to history with a specific purpose: to better understand the long-standing state practices that have been cited, not cited, or incorrectly cited, to support the repudiation of sovereign debts. The aim is to provide an excavation of historical events while addressing the contemporary implications of that history — in essence, applied legal history.

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5 *Id.*
Finally, this Article’s conclusion that there is little support in U.S. state practice for Sack’s first condition — that a regime be despotic for its debts to be odious — is relevant to the contemporary debate over the optimal regime for policing odious debts — whether it is preferable to use *ex ante* labeling of regimes as despotic, or *ex post* evaluations of debts as odious. Economists have argued in favor of *ex ante* labeling, but the Tinoco arbitration demonstrates how intractable such an approach could be. On the other hand, history shows that adjudicators have relied on *ex post* analysis of the uses to which debts were put, and the misbehavior of creditors, in determining whether a debt can be repudiated.

Part I of the Article focuses on the U.S.-Spain treaty negotiations in 1898; Part II focuses on the Tinoco arbitration in 1923. Part III examines the repudiation of sovereign debt in domestic U.S. history in three contexts: (1) the spate of state debt repudiation that took place following the financial panic of 1837; (2) the Fourteenth Amendment’s repudiation of Confederate debt following the Civil War; and (3) the repudiation of Reconstruction-era debts in the late nineteenth century.

**I. 1898 U.S.-SPAIN TREATY NEGOTIATIONS**

The odious debts discourse points to the U.S. repudiation of the Cuban debt following the war with Spain as historical precedent for the repudiation of odious debts. The standard narrative promoted by advocacy groups closely tracks the first two requirements of the Sackian definition of odious debts:

At the end of the 19th century, the United States government repudiated

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7 Some versions of the Cuban debt story also have the third condition of creditor awareness or collusion. See Lee C. Buchheit, *The Dilemma of Odious Debts,* 56 DUKE L.J. 1201, 1216 (“[The creditors] ‘took the obvious chances of their investment on so precarious a security.’”) (quoting ERNST H. FEILCHENFELD, *PUBLIC DEBTS AND STATE SUCCESSION* 341 (1931)); M.H. Hoeflich, *Through a Glass Darkly: Reflections upon the History of the International Law of Public Debt in Connection with State Succession,* 1982 U. ILL. L. REV. 39, 55 (describing the hard line taken by the American commissioners, who argued, with respect to the risks assumed by the creditors, that the “very pledge of the national credit, while it demonstrates on the one hand the national character of the debt, on the other hand proclaims the
the external debt owed by Cuba after seizing the island in the Spanish-American war. The U.S. authorities did so on the grounds that Cuba's debt had not been incurred for the benefit of the Cuban people, that it had been contracted without their consent, and that the loans had helped to finance their oppression by the Spanish colonial government.\footnote{James K. Boyce & Léonce Ndikumana, Africa's Debt: Who Owes Whom? (Nov. 22, 2002), \url{http://www.odiumsdebts.org/odiumsdebts/index.cfm?DSP =content&ContentID=7129}.}

However, an examination of the historical details complicates the Sackian narrative. The United States asserted its arguments against assuming the Cuban debt during the course of negotiating its peace treaty with Spain. The annexes to the Treaty, which detail the negotiations between the two countries, make clear that the United States did not much rely on its moral argument about the Cuban debt; instead, it pressed the argument that the majority of the Cuban debts were not chargeable, or local, to Cuba — essentially, an accounting argument. Therefore, the U.S.-Spain Treaty is not as strong an example of state practice of odious debts repudiation as sometimes suggested; nevertheless, the negotiations reveal the extent to which the United States and Spain were familiar with the moral arguments underlying the doctrine of odious debts.

By the time the United States intervened in the Cuban rebellion, Cuba was deeply in debt. The Cuban government was estimated to be $325 million in debt in 1896,\footnote{Susan J. Fernández, Encumbered Cuba: Capital Markets and Revolt, 1878-1895, at 138 (2002). Estimates of the Cuban debt at the end of the war range from $406 million to $520 million. See Robert P. Porter, Industrial Cuba: Being a Study of Present Commercial and Industrial Conditions, with Suggestions as to the Opportunities Presented in the Island for American Capital, Enterprise, and Labour 261 (New York, G.P. Putnam's Sons 1899).} mostly due to notes issued by Cuban banks that were used to finance Spain's ten-year battle against Cuban insurgents (1868-78) and other military forays in the Caribbean and Mexico.\footnote{Fernández, supra note 9, at 88-89; Porter, supra note 9, at 257.} Beginning in 1876, Spain had floated treasury and mortgage bonds in the European markets that were theoretically intended to consolidate and pay down the Cuban debt. These bonds were secured by property in Cuba and guaranteed by the nation of Spain and various Cuban revenue streams (customs, post-office and stamp revenues, indirect and direct taxes).\footnote{Fernández, supra note 9, at 109-11, 135-38.} It appears, however, that none of the
proceeds from the various bond issues had actually been used to pay off the Cuban debt, or even to benefit the island, for instance through investments in island industry. Instead, the proceeds stayed in and enriched Spain.\textsuperscript{12} Indeed, there is one example of a nervous European bond purchaser, no longer willing to rely on the word of the Spanish, traveling to Cuba to determine exactly how the money from a proposed loan would be spent and repaid.\textsuperscript{13} The island’s indebtedness had been reported in financial journals and the United States was presumably aware of the debt before entering into the war and the peace negotiations.\textsuperscript{14}

The United States and Spain devoted the first two weeks of treaty negotiations to resolving the Cuban debt. The United States entered the negotiations resolved not to accept responsibility for any of the Cuban debt; its preliminary peace protocol with Spain required Spain to "relinquish" control of Cuba and evacuate the island immediately, thereby granting Cuba her independence without transferring sovereignty, even temporarily, to the United States.\textsuperscript{15} The Spanish, however, had every intention of shifting at least a portion of the Cuban debt to the United States. On the third day of talks, Spain proposed a change to the wording of the protocol so that Spain would "transfer" sovereignty over Cuba to the United States, including the transfer of "[a]ll charges and obligations of every kind … which the Crown of Spain and her authorities in the Island of Cuba may have contracted lawfully in the exercise of sovereignty."\textsuperscript{16}

Spain stipulated that the transferred charges and obligations must have been levied and imposed in constitutional form and in

\footnotesize{12} Porter, supra note 9, at 257-59.
\footnotesize{13} Fernández, supra note 9, at 137.
\footnotesize{14} Id. at 135 n.49 (citing Banker’s Mag., Nov. 1887, at 367); id. at 137 n.52 (citing Banker’s Mag., Apr. 1892, at 771).
\footnotesize{15} Protocol of Agreement Between the United States and Spain, Embodying the Terms of a Basis for the Establishment of Peace Between the Two Countries, U.S.-Spain, Aug. 12, 1898, 30 Stat. 1742. Further, President McKinley instructed his peace commission to reject any claim that Spain might make for compensation for public property: "the relinquishment of sovereignty over and title to [territory] is universally understood to carry with it the public property of the Government.” William McKinley, Instructions to the Peace Commissioners, H.R. Doc. No. 1, at 828 (3d Sess. 1898), reprinted in Papers Relating to the Foreign Relations of the United States, with the Annual Message of the President, Transmitted to Congress December 5, 1898, at 904, 906 (1901) [this volume hereinafter Foreign Relations].
the exercise of its legitimate powers by the Crown of Spain, as the
sovereign of the Island of Cuba . . . [and] must have been for the
service of the Island of Cuba, or chargeable to its individual treasury.\textsuperscript{17}

In other words, Spain advanced a theory of debt repayment that rests on
the same moral basis as Sack's doctrine of odious debts repudiation; the
United States would only become responsible for debts that were lawfully
contracted by Spain as the legitimate sovereign of Cuba, and only for those
debts that either benefited Cuba or were "chargeable" to the Cuban treasury
(i.e., local).

In response to Spain's opening volley, the United States developed two
arguments for refusing to accept responsibility for the debt. First, it argued
that the debts were not chargeable to Cuba because Cuba had not contracted
them. The finances of the island were "exclusively controlled by the Spanish
Government"; Cuba was not legally authorized to contract its own debts or
float its own loans.\textsuperscript{18}

Second, the United States argued that there was no evidence that the
proceeds of the bonds secured by Cuban revenues had been used for local
Cuban projects; rather, the financial history of the island suggested that
the proceeds had been absorbed into the Spanish national budget. Prior
to 1861, Cuba had produced revenues well in excess of any government
expenses; it was only after Spain engaged in expensive military expeditions
in Mexico and Santo Domingo, and fought against the insurgency in Cuba
from 1868-78, that Cuba started operating at a loss and Spain started floating
loans to consolidate and pay down the debts. In other words, Cuba began
to operate at a loss because Spain was using Cuba's revenue streams to
pay for wars involving colonial interests that went well beyond its interest
in Cuba.\textsuperscript{19} As further proof of the Spanish (as opposed to Cuban) character
of the debt, the United States noted that the bonds secured by Cuban revenue
streams were issued and guaranteed by the government of Spain.\textsuperscript{20}

In essence, the United States was asserting a substance-over-form

\textsuperscript{17} Id. protocol no. 3, annex 2, art. IV, S. Doc. No. 62, at 29.
\textsuperscript{18} Id. protocol no. 5, annex, S. Doc. No. 62, at 49; see also I J.B. Moore,
International Law Digest 357 (1906); Treaty of Peace, supra note 16, protocol
no. 10, annex, S. Doc. No. 62, at 101 (reciting evidence from the Diario de las
Sesiones de Cortes, showing that Cuban representatives to the Cortes had objected
to the proposed Cuban budgets because the debt in the budget was national, not
local).

\textsuperscript{19} Treaty of Peace, supra note 16, protocol no. 5, annex, S. Doc. No. 62, at 49.
\textsuperscript{20} Id.
argument that "pierced the veil" of the Spanish treasury. In veil piercing doctrine, a corporate defendant is stripped of the legal fiction that its subsidiaries are different from the parent company if it appears the fiction is being used to perpetrate a fraud on the creditors. Along these lines, the United States argued that the Spanish national treasury was absorbing the surplus of the island and charging national obligations to the island, much as a parent company might abuse a subsidiary to make itself look more profitable. Thus Spain — the parent company — should be stripped of the fiction that it was a separate financial entity from Cuba — its subsidiary — because it had abused that fiction.

Only after questioning the characterization of the debt as Cuban did the United States assert its moral argument:

From the moral point of view, the proposal to impose [the debt] upon Cuba is equally untenable. If, as is sometimes asserted, the struggles for Cuban independence have been carried on and supported by a minority of the island, to impose upon the inhabitants as a whole the cost of suppressing the insurrections would be to punish the many for the deeds of the few. If, on the other hand, those struggles have, as the American Commissioners maintain, represented the hopes and aspirations of the body of the Cuban people, to crush the inhabitants by a burden created by Spain in the effort to oppose their independence, would be even more unjust.

Significantly, the United States did not question whether Spain had the

21 The term veil piercing was not in use in 1898. About three-quarters of a century later, in an unrelated dispute over debt but ironically also involving Cuba, the United States Supreme Court applied veil piercing analysis in the sovereign debt context. First Nat'l City Bank v. Banco Para El Comercio Exterior De Cuba, 462 U.S. 611, 629-33 (1983) (piercing the veil of the corporate form of Bancex because failing to do so "would cause . . . an injustice").

22 [A] corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons. United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 255 (E.D. Wis. 1905).

23 The indicia of such misbehavior also includes whether money is being shuttled back and forth across the accounts of the parent and the subsidiary, without clear indications of the purposes of the transfers, hence making a separation of assets difficult for creditors. For the basics on corporate veil piercing, see Stephen M. Bainbridge, Abolishing Veil Piercing, 26 J. CORP. L. 479 (2003).

right, as the sovereign of Cuba, to incur debts on behalf of the Cuban people. Similarly, the United States did not question whether Spain ruled Cuba with the consent of the Cuban people.\footnote{See also id. protocol no. 10, annex, S. Doc. No. 62, at 100 (reiterating that the United States had never questioned the legitimacy of the debt "as a national debt of Spain," or questioned whether the debts of an autocratic nation are legitimate).} Rather, the United States objected to the fairness of taxing the many for costs imposed by the few, and in the alternative, to the fairness of asking the Cuban people to pay for the rifles that killed the revolutionaries. In this last regard, the United States advanced an argument that supports the second condition of Sack's definition of odiousness — that the debts should result in some benefit to the populace of the state being asked to repay the debts, or else they are odious.\footnote{See also id. S. Doc. No. 62, at 107 ("[T]he American commissioners therefore felt that they are fully justified both in law and in morals in refusing to take upon themselves . . . the obligation of discharging the so-called colonial debts of Spain — debts, as heretofore shown, chiefly incurred in opposing the object for the attainment of which the resolution of intervention was adopted.").}

Spain's next tactic was to offer to submit the Cuban debts to arbitration for apportionment, and that the United States could only be held accountable for debts that were used for Cuban improvements.\footnote{Id. protocol no. 7, annex, art. II, S. Doc. No. 62, at 57.} Spain's acknowledgement that it was obligated to pay part of the Cuban debt was arguably an argument against interest and thus of significance in establishing\footnote{See A. Mark Weisbord, Reflections on a Convenient Untruth, 644 Va. J. Int'l L. 641, 644 (2008) (suggesting that a country's admission that it is obligated\textit{not} to collect on a debt is evidence of the legally doubtful status of that debt). See generally Ian Brownlie, Principles of Public International Law 7 (4th ed. 1990) (noting that\textit{opinio juris} is a country's sense of "legal obligation, as opposed to motives of courtesy, fairness, or morality"); J.R. Brierly, The Law of Nations: An Introduction to the International Law of Peace 61 (6th ed. 1963) (in proving\textit{opinio juris}, "what is sought for is a general recognition among states of a certain practice as obligatory"). Spain's arguments were not necessarily contrary to interest — it may have been seeking to preserve its reputation as a good debtor.}\textit{opinio juris et necessitas} for the odious debts doctrine.\footnote{Letter from Mr. Day to Mr. Hay (25 Oct., 1898), in Foreign Relations, supra note 15, at 931.}

After receiving the offer to arbitrate, the American commissioners privately cabled President McKinley to inquire whether they should "offer the good offices of the United States with the Cuban people to accept such indebtedness as had incurred for existing public improvements of a pacific nature." Spain's arguments for apportionment may have struck a chord with the American commissioners because they were based on the same principle...
developed by the Supreme Court in *Keith v. Clark* and *Texas v. White*, that while war-related debts could be repudiated, debts related to the day-to-day functioning of the government were legitimate and should be repaid. The commissioners would have been familiar with these cases, which had been decided within the past thirty years. McKinley made short work of the matter, however, by instructing the peace commission that the United States would not assume any Cuban debt under any circumstances, nor encourage Cuba to accept any of it. In this last regard, the United States’ decision to repudiate the Cuban debt seems less an example of state practice in refusing to pay odious debts than one of the “logic of the victor imposing the terms of peace on the vanquished.”

Spain eventually yielded to the United States on the issue of the Cuban debt, accepting instead a payment of $20 million for ceding the Philippine Islands to the United States. But Spain apparently never accepted the legitimacy of the U.S. argument regarding the debt. In 1909, after the United States had formally withdrawn from Cuba, Spain approached the newly independent government of Cuba and requested payment of some portion of the debt. Not surprisingly, Cuba declined the request, citing the Treaty of Paris as having extinguished any obligation of the island to service the Spanish debt. At that point, Spain was left to deal with its creditors — mostly French and British — who held the majority of the bonds formerly secured by Cuban revenue streams.

On a final note, the written record of the U.S.-Spain treaty negotiations reveals a stunning (but not surprising) absence of the viewpoints of Cubans, on whose behalf (putatively) the United States intervened in the war, and on whose behalf the United States negotiated with Spain. The United States did not invite a Cuban delegation or representative to Paris, and apparently did not consult with Cubans in advance of or during the negotiations. It is almost certain that Cuban representatives — had they been asked — would have rejected responsibility for the Spanish debt. To judge by speeches made in the Cortes (Spain’s parliament), Spain’s misuse of the Cuban budget was notorious. Thus it was apparent to the islanders that the debt was not local to

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30 See infra Part III.
31 Letter from Mr. Hay to Mr. Day, supra note 29, at 932.
34 SACK, supra note 2, at 144 (citing P. Fauchille).
the island; it is more difficult to know whether they also would have advanced a Sackian moral objection to the debt — one based on the despotic nature of Spanish control, on the use of the loans to suppress Cuban rebellion, or on creditor collusion.

The absence of a Cuban voice in the treaty negotiations suggests two directions for future historical research that is outside the scope of the Article. First, it suggests a question about the identity of the party raising the odious debts defense, and whether a claim for repudiation of odious debts must be asserted by — or at least affirmed by — the population newly liberated from the bonds of the despot. Second, it suggests an avenue for further historical inquiry into Cuban attitudes toward the Spanish debt — specifically, whether in 1909 Cuba rejected Spain’s advances to pay some of the debt strictly on the basis of the Treaty of Paris, or whether Cuba viewed the Spanish overture as an opportunity to repudiate odious debts, invoking explicitly moral justifications. If so, Spain’s acquiescence to Cuba’s position could be viewed as state practice accepting the repudiation of debts based on a doctrine containing at least some of the elements articulated by Sack.

Finally, while the U.S. repudiation of the Cuban debt turns out not to be a strong example of Sackian odious debt repudiation, the episode contributes to a historical understanding of the state practice of sovereign debt repudiation in two ways. First, the negotiations reveal that the United States and Spain, two major players on the international stage (albeit one whose glory days had come and gone), were conversant with the moral underpinnings of odious debt repudiation — the idea that the parent state could transfer only legitimate debts to a newly independent state. In this case, however, the United States’ familiarity with the idea did not translate into its accepting responsibility for the debts — or even into a willingness to investigate whether any of the debts were legitimate. Second, the negotiations reveal that the United States approached the question of debt repudiation from a pragmatic rather than a moral (or formalist) stance. Instead of asking whether the government that contracted the debt was despotic, it focused

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36 The absence of a Cuban voice also casts further doubt on the moral bona fides of the United States in making its moral argument against the Cuban debt. The United States asserted that it was an “agent of the Cuban people” in the negotiations, giving it the “duty” to object to the imposition of the debt. Id. S. Doc. No. 62, at 107. But Pérez and Weissman argue that the United States’ arguments about the Cuban debt were an “ex post facto moral . . . rationale to explain a political decision.” Perez & Weissman, supra note 32, at 719; see also Hoeflich, supra note 7, at 55 (describing the behavior of the United States as a “maximization of national self-interest” and the negotiation as a “clear instance of power politics”).
on how the proceeds of the loan were used. Apparently, the United States
considered the absorption of the proceeds into the budget of the parent state
(Spain) to be reason enough for repudiation. However, it appears that when
Spain indicated agreement with that general principle, the United States
simply asserted that it was not willing to take on the debts, regardless of the
accounting niceties.

II. THE TINOCO ARBITRATION, RECONSTRUCTED

The story of the Tinoco arbitration, in the form usually told in the odious
debts literature, is the following:

Th[e Tinoco] case involved the Royal Bank of Canada, a private
commercial bank . . . , which made a loan to the outgoing dictator
of Costa Rica, President Tinoco. The new Costa Rican government
challenged the debt before Chief Justice Taft of the U.S. Supreme
Court who was asked to sit as arbitrator.

In his 1923 ruling, Chief Justice Taft noted that the transactions in
question were "full of irregularities." They were also "made at a time
when the popularity of the Tinoco Government had disappeared, and
when the political and military movement aiming at the overthrow of
that Government was gaining strength."

The payments, Justice Taft discovered, were made to cover either
Frederico Tinoco’s expenses "in his approaching trip abroad," or his
brother’s salary and expenses in a diplomatic post to which Tinoco
appointed him.

The Royal Bank, Justice Taft ruled, cannot simply 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 régime . . . for its legitimate use."

"It has not done so," Justice Taft ruled. "The bank knew that this
money was to be used by the retiring president, F. Tinoco, for his
personal support after he had taken refuge in a foreign country. It
could not hold his own government for the money paid to him for this
purpose."

In conclusion, Justice Taft ruled, "The Royal Bank of Canada cannot
be deemed to have proved that the payments were made for legitimate
governmental use. Its claim must fail."

37 Patricia Adams, Probe Int’l, The Doctrine of Odious Debts: Using the Law
In this recitation, Tinoco’s debts fit Sack’s three-part definition of odious debts: (1) Tinoco was a despotic ruler who ruled without the consent of the populace; (2) Tinoco borrowed in the name of the state and used the funds for purely personal purposes, contrary to the interests of the state; and (3) the creditors knew about the despot’s financial misbehavior because of the patent irregularities in the contracting of the debt.

Before proceeding, some basic background on the arbitration is in order. The 1923 arbitration involved Great Britain and Costa Rica, and the arbitrator was William Howard Taft, the then sitting chief justice of the U.S. Supreme Court. Taft was also a former Yale law professor, colonial administrator of the Philippines, and president of the United States. In January 1917, the government of Costa Rica had been overthrown by Frederico Tinoco and his brother. Tinoco’s government lasted less than two years. In their departure from the country, the Tinoco brothers made away with the proceeds of a loan, contracted on behalf of the state, from the Royal Bank of Canada. Great Britain argued that Costa Rica was bound to honor the loans. Costa Rica responded that the Tinoco government was neither the de facto nor the de jure government of Costa Rica under international law and thus could not bind successor Costa Rican governments. Taft disagreed, holding the Tinoco government was "an actual sovereign government." Following the strict rule of government succession, a change of government has no effect upon the international obligations of the state.

Despite finding that the Tinoco government was de facto in control of the


The arbitration is reported in Aguilar-Amory and Royal Bank of Canada Claims (Gr. Brit. v. Costa Rica) (Tinoco Arbitration), 1 R.I.A.A. 369 (1923); see also Lee C. Buchheit et al., The Dilemma of Odious Debts, 56 DUKE L.J. 1201 (2006); Judicial Decisions Involving Questions of International Law, 18 AM. J. INT’L L. 147, 168 (1924).

39 Tinoco Arbitration, 1 R.I.A.A. at 380.
state, Taft, did not force Costa Rica to repay the loans because the bank failed to show that it had furnished money to the government for its legitimate use. In much quoted language, Taft found that the disputed transactions were not made "in regular course of business," but rather were "full of irregularities." Costa Rica was not liable for such loans because the bank knew that the money was to be used by Tinoco for his personal purposes, after his government had been overthrown. The legitimacy of Costa Rica's repudiation of the loans, therefore, had nothing to do with the questionable legal status of the Tinoco government. Instead, Costa Rica avoided responsibility for repaying the debts because the Royal Bank of Canada had extended the loans despite recognizing that they were not intended for the benefit of the people of Costa Rica.

A second transaction, known as the "Amory concession," was also at issue in the arbitration. Prior to Tinoco's ascension, British companies had found it difficult to gain a foothold in Costa Rican oil exploration. Although the British government, under pressure from the United States, had not recognized the Tinoco administration, a British company took advantage of the opportunity during Tinoco's regime to purchase a concession for oil exploration. Costa Rica argued that it should not have to recognize the Amory concession rights. Taft ruled for Costa Rica here as well, on the rationale that the concession was not properly approved under Costa Rica's own requirements for legislative approval of such concessions. Again, Taft made it clear that his ruling had nothing to do with the illegitimacy of the Tinoco regime.

A closer look at the history of the arbitration shows that it does not satisfy all three parts of Sack's definition, and most particularly, the first requirement that the debt be contracted by a despotic ruler. There are three aspects of the Tinoco arbitration that either complicate or nuance its support for Sack's odious debts doctrine: 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 to the Tinoco loans that is reminiscent of the arguments made by the American delegation in repudiating the Cuban debt.

40 Id. at 394.
41 Id.
42 The Amory concession is infrequently discussed in the odious debts literature. For a rare discussion, see Lineau, supra note 37, at 71-72 & n.29.
43 Tinoco Arbitration 1 R.I.A.A. at 398-99; Lineau, supra note 37, at 79.
44 Notably, Sack himself did not cite the Tinoco arbitration as supporting his doctrine of odious debts. He cites the Tinoco arbitration elsewhere in Les Effets, but not as an example of odious debts. See Ludington & Gulati, supra note 4.
A. Tinoco, the Despot?

The odious debts narrative relies on the fact that Frederico Tinoco was a despot who ruled without the consent of the people. But Tinoco’s dictatorial status is complicated, and irregularities surrounding the elections of the regimes that preceded and succeeded Tinoco cast doubt on the popular legitimacy of these governments as well. The history of Costa Rica in that period was one of domination by Western interests, with the United States and Great Britain being the two primary competitors for influence.\(^45\) Even with the benefit of hindsight, it is difficult to determine whether Tinoco’s rise and fall is merely the story of a foreign colonial power overthrowing a local despot.

Prior to Tinoco’s ascent, Costa Rica in 1913 had adopted a direct electoral system for its presidents.\(^46\) But Alfredo González Flores, Costa Rica’s first directly-elected president, was not on the ballot.\(^47\) Instead, he was a dark horse candidate elected by a consensus of the Costa Rican congress after the popular election had failed to produce a clear winner.\(^48\) González’ political support quickly evaporated, which paved the way for Tinoco, who had been González’ Minister of Defense, to seize power. At first (and he was in power for less than two years), Tinoco enjoyed a fair amount of popular support. He even held elections after the coup, in which he was elected president.\(^49\)

Tinoco’s government was never recognized by either the United States, then under the presidency of Woodrow Wilson,\(^50\) or Great Britain, which succumbed to U.S. pressure to withhold recognition.\(^51\) The U.S. hostility to the Tinoco government stemmed partly from Wilson’s goal to support

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\(^47\) *Id.*

\(^48\) *Id.* at 68. Although this was the constitutional way to resolve an undecided vote, the suggestions of electoral fraud compromised González’ claims of legitimacy. Baker, *supra* note 45, at 5.

\(^49\) Baker, *supra* note 45, at 8, 13. Tinoco had the support of all the political factions as well as several ex-presidents of Costa Rica.

\(^50\) *Id.* at 10, 12. Wilson had even gone so far as to declare that the United States would not honor any contracts or concessions granted by the Tinoco regime to a U.S. citizen. *See also* Thomas M. Leonard, *Central America and the United States: Overlooked Foreign Policy Objectives*, 50 *AMERICAS* 1, 12 (1993).

\(^51\) *See* Lineau, *supra* note 37, at 71 (citing Richard V. Salisbury, *Revolution and Recognition: A British Perspective on Isthmian Affairs During the 1920s*, 48 *AMERICAS* 331, 335 (1992)).
only constitutional governments in Latin America. At one point, the U.S. consul in Costa Rica asked for troops to protect U.S. property and citizens there. Officially, the request was denied. But in June 1919, ostensibly acting independently, a U.S. naval commander landed forces at the coastal city of Limon, leading to speculation that the U.S. government supported a regime change. In addition, Tinoco faced opposition from a counterrevolutionary group led by Julio Acosta, who in May of 1919 led an attack into Costa Rica to wrest control from Tinoco. In August 1919, Tinoco abdicated — with the funds from Royal Bank of Canada — and his government fell soon thereafter.

Acosta became president in an almost uncontested election at the end of 1919. Though the Acosta government was ostensibly more democratic, its credentials were just as problematic as those of Tinoco and his predecessor. Initially the United States refused to recognize the Acosta presidency for much the same reasons it would not recognize the Tinoco presidency, and at the time of the Tinoco arbitration it was still uncertain whether Acosta had truly restored the old constitution. In 1922, with Acosta as president, the Costa Rican congress enacted the Law of Nullities, which repudiated all contracts entered into by Tinoco.

The foregoing history complicates the use of the Tinoco arbitration as support for the consent requirement of Sack’s odious debts test in two ways. First, Tinoco initially enjoyed popular support and was elected president following his coup. This suggests that the consent condition of Sack’s odious debts test was not satisfied, at least at the beginning of Tinoco’s presidency.

52 See id. at 71; see also Dana Munro, Intervention and Dollar Diplomacy in the Caribbean 1900-1921, at 271 (1964).
53 The United Fruit Company was one of the biggest landowners in Costa Rica at the time; ironically it may have had a hand in enabling Tinoco to take power. See Lineau, supra note 37, at 70 n.20 (pointing to evidence suggesting the involvement of United Fruit’s founder, Minor Keith, in the coup that put the Tinocos in power); cf. Marcelo Bucheli, Good Dictator, Bad Dictator, United Fruit Company and Economic Nationalism in Central America (Univ. of Ill. Dep’t of Bus. Admin., Working Paper, 2006), available at http://www.business.uiuc.edu/working_papers/papers/06-0115.pdf.
54 Lineau, supra note 37, at 71 (citing Leonard, supra note 50, at 12).
55 See Baker, supra note 45, at 20.
56 Id.
57 Busey, supra note 46, at 68-69.
58 Baker, supra note 45, at 20-21. Acosta eventually restored the old constitution, but until he actually allowed free elections, the United States was unsure what diplomatic posture to take towards the Acosta government. Id. at 20-21.
It also shows how difficult it can be to determine whether a regime is actually despotic.

Second, the dubious legitimacy of the Acosta regime raises the question whether the odious debts defense can be mounted by a successor regime that is as unrepresentative or despotic as its predecessor — as Acosta may have been when his government enacted the Law of Nullities. From a policy perspective, successor despots should not be able to assert an odious debts defense, as it would undermine the goal of deterring future despots, which is one of the economic justifications for having an odious debts doctrine.60 The doctrine is not intended to provide a means for new despots to evade the creditors of a previous despotic regime.

B. Taft, the (Unlikely) Hero of the Odious Debts Movement?

The second set of complicating facts surrounding the Tinoco arbitration has to do with the biography of the arbitrator, Chief Justice Taft.61 In somewhat of a caricature, Taft has been described as "a stubborn defender of the status quo, champion of property rights, apologist for privilege, and inveterate critic of social democracy."62 For him, the preservation of strong property rights, including the rights of creditors investing in foreign debt, was crucial to economic stability and growth. Taft was also a proponent of "dollar diplomacy," a modification of the Monroe doctrine proposing that money rather than military power should be used to solidify U.S. influence in Latin America and elsewhere.63 Taft, in contrast to most of those sympathetic to the modern doctrine of odious debts, was focused on maximizing U.S. financial interests abroad rather than allowing an exception to the strict rule of governmental succession to debts. There is no evidence that he had any sympathy for the notions of universal human rights underpinning many

60 The argument is that prospective despots will be less motivated to become despotic leaders if they know they will have less access to foreign funds. See Kremer & Jayachandran, supra note 6.
62 Lineau, supra note 37, at 92; see also ALPHEUS THOMAS MASON, WILLIAM HOWARD TAFT: CHIEF JUSTICE 13 (1965).
63 See WALTER V. SCHOLES & MARIE V. SCHOLES, THE FOREIGN POLICIES OF THE TAFT ADMINISTRATION 35 (1970); Lineau, supra note 37, at 105-06.
contemporary claims regarding international law, including some of those being made within the odious debts movement.  
Taft’s conservatism is apparent in the first part of the Tinoco decision, where he sidesteps the question whether Tinoco was the legitimate representative of the populace (and, therefore, the state) of Costa Rica.  
The litigating parties likely expected this to be a crucial issue in the case, given Tinoco’s reputation as a despot, the fact that neither the United States nor Great Britain had recognized his government, and that the United States had explicitly withheld recognition because the Tinoco government was not adequately constitutional. In a 180-degree shift away from both the first element of Sack’s odious debts doctrine and Wilsonian policy, Taft ruled that the Tinoco government was legitimate simply by having de facto control of the state, regardless of popular support or the recognition of foreign states. For this reason, conventional international law treatises and articles cite the Tinoco arbitration as a conservative, if not reactionary, decision.  
For our purposes, it is clear that Taft in the Tinoco decision rejects the first element of the Sackian test — whether the leader is despotic. That element was irrelevant to Taft in deciding the ultimate question of whether the debt needed to be paid.  
Further light is shed on the significance of the Tinoco decision when it is examined through the lens of Taft’s promotion of dollar diplomacy. Taft believed that using finance, in the form of loans by private bankers who were then backed by the U.S. government, was the best method of extending U.S. influence internationally, and certainly a superior alternative to diplomacy through military force. During his presidency, Taft encouraged and facilitated U.S. financing to countries like Nicaragua, Honduras, and China. In Honduras, to encourage U.S. bankers to lend, the Taft government

64 *See generally Howse, supra* note 37; Linneau, *supra* note 37, at 68 (noting Taft’s conservatism).
65 *Aguilar-Amory and Royal Bank of Canada Claims (Gr. Brit. v. Costa Rica) (Tinoco Arbitration)*, 1 R.I.A.A. 369, 377-82 (1923). Not surprisingly, most odious debt advocates have ignored this part of Taft’s decision. Linneau, *supra* note 37, is an important exception and we draw upon her work.
proposed sending a U.S. official to help oversee the Honduran customs houses, so that the bankers could be assured repayment. In Nicaragua, where banks were willing to lend on a private basis, the Taft administration insisted that the loans be secured by customs revenues to ensure stability. Taft also believed that the key to maintaining U.S. influence in China was for the United States to participate in funding the Hukuang Railway.

Given the foregoing, it is unlikely that Taft, in the *Tinoco* ruling, was trying to establish a rule of odious debts that cut deep into the contractual rights of bondholders, as such a rule would have undermined the policy goals of dollar diplomacy. The success of dollar diplomacy relied on creditors' confidence about making foreign loans, particularly in Central America. In keeping with this goal, Taft would have favored establishing and enforcing legal rules that made lending (and the returns from lending) more — not less — predictable.

Furthermore, assuming 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*. Taft's reasoning in *Tinoco* effectively rejected an *ex ante* labeling approach to the problem of odious debts. In 1917, the United States had announced publicly that it would not recognize Tinoco's government unless it could prove that it was elected by "legal and constitutional means," and further stated that it would not support any financial claims made by American companies who had business dealings with the Tinoco government. If Taft had wanted to adopt the *ex ante* labeling concept, he could have ruled against Tinoco's creditors on the basis of these official statements that amounted to labeling the Tinoco government

69 *Id.* at 219.
71 Probably for similar reasons, Taft did not place much weight on the fact that the loans did not benefit the populace of Costa Rica, as this also burdens creditors with the risk of opportunistic defaults — a new government could come in and decide, *ex post*, to argue that certain projects had not resulted in good outcomes and were therefore odious. Creditors exposed to this type of risk would likely exit the market. By contrast, if creditors know that they are lending money to a head of state that intends to steal it, then they are in effect betting that he will be in power long enough to pay them back. That is a risk they can calculate.
72 Aguilar-Amory and Royal Bank of Canada Claims (Gr. Brit. v. Costa Rica) (*Tinoco*
problematic and its debts unenforceable. But Taft did not take that path, choosing instead to focus on the question of whether the debt was contracted for legitimate purposes and whether the creditors knew in advance about the illegal purposes of the loan. Taft’s analysis constitutes an *ex post* evaluation of the debts, instead of an *ex ante* evaluation of the regime.

But the foregoing does not suggest that Taft would have defended creditors in the face of evident misbehavior. Taft would have had little sympathy for creditor misbehavior that tended to destabilize a foreign government. Taft was a pragmatist; his dollar diplomacy valued stability in foreign governments, especially in Central America. In a speech to Congress, he explained, with respect to U.S. foreign policy in Central America:

[T]he United States has been glad to encourage and support American bankers who were willing to lend a helping hand to the financial rehabilitation of such countries because this financial rehabilitation and the protection of their customhouses from being the prey of would-be dictators would remove at one stroke the menace of foreign creditors and the menace of revolutionary disorder.

The actions of the Royal Bank of Canada in the Tinoco case were arguably destabilizing to the Costa Rican government. Tinoco did not obtain proper legislative approval of the Amory contracts; enforcing those contracts would thus have undermined the legislature’s ability to keep the executive in check. Tinoco’s loans were intended for the personal purposes of the abdicating dictator and his brother; enforcing those loans would potentially have encouraged more coups, as would-be dictators might have found the prospect of generating funds to support their retirements attractive.

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73 In Nicaragua, Taft’s government approved of a claims commission to evaluate which of the debts of the prior regime should be honored, including a loan that the prior government had negotiated with the British where the funds were supposed to be used for a war with El Salvador. See Munro, *supra* note 68, at 219-33. Significantly, Taft was willing to call into question loans that were made in the interest of destabilizing governments in Central America (at least those not supportive of U.S. interests).

74 Lineau, *supra* note 37, at 68, 88, 90.

75 WILLIAM H. TAFT, *MESSAGE OF THE PRESIDENT OF THE UNITED STATES ON OUR FOREIGN RELATIONS, COMMUNICATED TO THE TWO HOUSES OF CONGRESS, DECEMBER 3, 1912*, at 7-8, 10-11 (1912).
Viewed through the lens of conservatism and dollar diplomacy, Taft’s award in favor of the government of Costa Rica is consistent with his twin goals of advancing U.S. political and financial interests, and promoting stability in the Central American states. Taft placed the risk of creditor misbehavior — a risk well within the control of the creditors — squarely on the creditors themselves. It is more difficult, however, to view the Tinoco decision as support for a doctrine that values the interest in representative government over creditors’ interests.

C. Piercing the Veil

A final aspect of the Tinoco arbitration that adds nuance to the Sackian definition of odious debts is the way Taft stripped the Tinoco loans of the legal fiction of the state, employing substance-over-form analysis reminiscent of the "veil piercing" argument advanced by the United States in its treaty negotiations with Spain. As discussed in Part I, the United States "pierced the veil" of the financial relationship between Spain and Cuba, effectively stripping Spain of the fiction that its subsidiary, Cuba, had separate finances from its parent country. Once the fictional separation was removed, the subsidiary’s debts (Cuba’s) became the debts of the parent/ruler (Spain).76

In the Tinoco decision, Taft made clear that the Royal Bank’s case depended "not on the mere form of the transaction, but upon the good faith of the bank in the payment of money for the real use of the Costa Rican Government under the Tinoco régime."77 Taft was convinced by two facts that the fiction of the state had been abused, which justified removing the fiction of state responsibility from the loans: first, the Tinoco brothers borrowed the funds from the bank for "obviously personal and unlawful" purposes; and second, the bank knew of the improper nature of the loans.78 Once the fiction of state action was removed, the loans in effect became the personal loans of the Tinocos, except to the extent that the state (Costa Rica) received a benefit from the loans. Taft noted that although there was no direct benefit to the state from the loans, the state had confiscated the property of Tinoco’s brother from his widow. For that reason, Taft ruled that the state was at least partially responsible to the Bank, up to the value of the property that it had confiscated.79

76 See supra Part I.
77 Tinoco Arbitration, 1 R.I.A.A. at 394.
78 Id. at 393-94.
79 Id. at 395.
A precursor to Taft’s reasoning can be seen in the Jarvis case, an arbitration involving sovereign debt repudiation. In that case, Jarvis, a U.S. citizen, had assisted Paez, a would-be Venezuelan dictator, supplying him with arms and ammunition for an aborted coup attempt in 1849. Thirteen years later, Paez ascended to power in Venezuela and issued bonds to Jarvis to repay him for funding the prior coup attempt. The subsequent government in Venezuela challenged the validity of the bonds and won its case. As Taft explained it, the commissioner held that there had been no lawful consideration provided to the state for the Jarvis bonds; instead, the debts were personal to Paez. The Venezuelan state under Paez issued the bonds, as a formal matter. But the fiction of the state was removed, given that Paez was attempting to abuse the fiction of the state to repay personal debts.

The reasoning in the U.S.-Spain negotiations and the Tinoco decision is analogous to veil piercing in the corporate context. The legal fiction of the state makes it easier for third parties to contract with the state, and others respect the legal fiction of the state (or separate states) provided that the fiction is not abused. But that legal fiction can be abused, such as when a state’s ruler colludes with external creditors to unload an obligation on the people. And in such a case, a tribunal may remove the legal fiction and rule that the debts were personal to the person who incurred them in the name of the state.

III. REPUDIATING DEBTS OF STATES IN THE UNITED STATES

Despite not providing perfect support for Sack’s doctrine of odious debts, the U.S.-Spain Treaty and the Tinoco arbitration are both remarkable in that the United States — generally associated with strong support of property and contract rights — wound up in favor of repudiating debts. Just as surprising are the repudiations of debts contracted by state legislatures in the United States that occurred at various times during the nineteenth century. While classical liberalism, with its rigorous support of vested rights, is a central

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80 Interestingly, Taft discussed the Jarvis case before he reached the merits of the Tinoco arbitration, and so did not rely on it as precedent for finding the Tinoco loans illegitimate. Id. at 383; see also JACOB HARVEY RALSTON & W.T. SHERMAN DOYLE, VENEZUELAN ARBITRATIONS OF 1903, S. Doc. No. 316, at 145-50 (1903).
81 Tinoco Arbitration, 1 R.I.A.A. at 393.
motif of American history, there are a number of examples in American history of attacks on vested rights. Some of those attacks were successful.

We now turn to three periods in American history that are occasionally mentioned in the literature on odious debts. These are (1) the repudiation of debts by Mississippi, Arkansas, Florida and Michigan during the economic crisis of the 1830s; (2) the repudiation in the wake of the Civil War of debts incurred during the Civil War by the states of the former Confederate States of America; and (3) the repudiation of debts incurred by southern state governments dominated by African-Americans, Yankees, and pro-northern southerners during the period of Reconstruction following the Civil War. The latter debts were repudiated by the pro-southern legislatures that followed them in the 1870s in the wake of Reconstruction (in the period that was often called "redemption" and is perhaps best characterized as the period of "de-construction"). Together those episodes of repudiation, which feature claims that the debts in question were illegitimate, illuminate a more robust support for odious debts doctrine in U.S. history than is typically recognized.

A. The Antebellum Repudiations

Prior to the Civil War, and following the financial panic of 1837, four states — Mississippi, Arkansas, Florida, and Michigan — repudiated state debts

82 This image of the United States as the champion of vested rights was famously portrayed by Charles Beard, the Progressive-era historian. See CHARLES BEARD, AN ECONOMIC INTERPRETATION OF THE CONSTITUTION (1913). Beard depicted the Constitution as the product of moneyed interests in support of their property rights. Many historians on the left have subsequently employed such images of class conflict, indeed domination by the wealthy, to support an interpretation of American history as one of oppression. See, e.g., MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1790-1860 (1977). Other, more traditional historians have employed such images to support a robust constitutional regime of protection of property. See, e.g., JAMES W. ELY, THE GUARDIAN OF EVERY OTHER RIGHT: A CONSTITUTIONAL HISTORY OF THE RIGHT OF PROPERTY (1992).

83 See, e.g., BENJAMIN U. RATCHFORD, AMERICAN STATE DEBTS 104-34 (1941); Jeff A. King, The Doctrine of Odious Debt in International Law: A Restatement 57-59 (Jan. 21, 2007) (unpublished manuscript, on file with authors) (discussing briefly the southern states’ repudiations from 1836 to 1880, which included repudiation of states’ pre-Civil War debts, Civil War debts, and post-war debts).

84 Section four of the Fourteenth Amendment bars payment of debts of those states that rebelled against the United States. See infra Section III.B.; King, supra note 83, at 57; RATCHFORD, supra note 83, at 141-56 (discussing repudiation of southern states’ war debts and distinguishing states’ debts according to whether they involved war purposes).
owned largely by foreign investors.\textsuperscript{85} Arkansas repudiated one-half million dollars in debt; Florida four million; Michigan approximately 2.27 million; and Mississippi seven million.\textsuperscript{86} When challenged in court, the defaults were largely upheld either because a court determined that the loans had been contracted without the proper authority of the state,\textsuperscript{87} or because the Eleventh Amendment protected states from lawsuits brought in federal court.\textsuperscript{88}

The antebellum repudiations occurred during the era of Jacksonian democracy, when many questioned the protection of vested rights at the expense of the community of taxpayers. On the other side of the political spectrum, the Whigs (the forerunner of the Republican Party) viewed the Jacksonians' actions with suspicion, believing that they left property insecure and led to instability in the economy. In 1840, one writer in the \textit{North American Review} (a well-known Whig periodical) warned states about contracting more debts and warned creditors about the wisdom of extending further credit:


\textsuperscript{86} RATCHFORD, supra note 83, at 115; English, supra note 85, at 265. Mississippi's rejection of its 1830s debt was remembered for decades in London. When the Confederate States tried to raise money in London for their war effort in the 1860s, investors feared they might not be paid. In fact, the common knowledge of that default was used against the Confederacy's efforts to sell bonds in London in 1863, by United States' counsel Robert J. Walker, who had once been a Senator from Mississippi. ROBERT JOHN WALKER, JEFFERSON DAVIS, REPUDIATION, RECOGNITION AND SLAVERY (London, William Ridgway 2d ed. 1863). Nearly one hundred years after Mississippi's repudiation, Monaco unsuccessfully sued Mississippi in federal court to recover the debts owed on pre-war bonds. See Principality of Monaco v. Mississippi, 292 U.S. 313 (1934) (holding that the Supreme Court has no jurisdiction over a foreign sovereign's suit against a state without the state's consent); see also Grant v. Mississippi, 686 So. 2d 1078 (Miss. 1996) (denying recovery on 1833 bonds, which matured in 1873, because the statute of limitations expired in 1880).

\textsuperscript{87} See King, supra note 83, at 58-59.

The more usurious a contract is, the more oppressive it will be
felt by the borrower; and if, ultimately there should be found an
unwillingness to comply with its conditions . . . the greater will be the
disposition to seek in the severity of those conditions an excuse for
non-performance. 89

Benjamin R. Curtis, then a Whig lawyer and later a justice on the
United States Supreme Court, echoed these concerns in the North American
Review, in 1844. Curtis acknowledged that suits by individual creditors
against states would be difficult, if not impossible, because of the Eleventh
Amendment. 90 And though he supported payment of debt from the standpoint
of legal obligation, Curtis acknowledged that "rash and improvident" creditors
were as much to blame for the defaults as the borrowing states. 91 The
states' repudiations were understandable — if illegal — for the debts greatly
burdened a people who were neither wealthy nor had benefited much, if at all,
from the debts. 92

It is difficult to draw doctrinal inferences from the state repudiations of

89 Book Review, 51 N. Am. Rev. 316, 317 (1840) (reviewing ALEXANDER TROTTER,
Observations on the Financial Position and Credit of Such of the States
of the North American Union as Have Contracted Public Debts (London,
1839)).

90 Benjamin R. Curtis, Debts of the States, 58 N. Am. Rev. 109-54 (1844). Curtis' solution to the problem of sovereign default was for creditors to transfer bonds to sovereigns, like Great Britain, and have them proceed directly against the states in the United States Supreme Court. Id. See also CHRISTOPHER SHORTELL, RIGHTS, REMEDIES, AND THE IMPACT OF STATE SOVEREIGN IMMUNITY 57-83 (2008) (exploring "Debt Repudiation and Backlash in the 1840s").

91 Curtis, supra note 90, at 115 (acknowledging that it was "rash and improvident" to lend); see also id. at 122 ("If it is found that a State has been led astray partly by
the insane confidence of its creditors, those creditors much bear some of the blame
which always attaches to unsuccessful rashness.").

92 Id. at 115-16 (discussing argument among proponents of repudiation that the states received little benefit and that creditors were on notice that their loans were at
risk). Curtis acknowledged that there had been poor investments on all sides, and
that the poor investments were the result of innocent behavior. Id. at 117 ("The mere fact of insolvency furnishes no ground for inferring bad faith, or even bad
judgment. The circumstances under which the debts were contracted, and especially
the inducements which led to them, must be taken into account, before any decisions
unfavorable to the debtor can be justly made."). Curtis, however, thought the states
were honor-bound to pay the debt. Curtis recognized that there were legitimate
grounds for repudiation — where a legislature found a debt invalid "in point of
law or natural equity." Id. at 142. However, he thought the states were capable of
repaying the debt and they were dishonorably refusing to do so. Id. at 127, 153-54.
the 1830s because the repudiations were made by various state legislatures acting on a diverse set of motives and justifications. Nevertheless, there appear to be several core Sackian elements common to the repudiations, including a concern that the taxpayers of the repudiating states would be burdened with a crushing debt while having received little if any benefit from the loans, and that the creditors had some sense ex ante that the economy could not support repayment. There is no discussion of Sack’s first condition — the validity of the government that contracted the debt.

B. Repudiation of Confederate State Debts

In the aftermath of the Civil War (1861-65), the U.S. government required the former Confederate states to repudiate the debts they incurred during the war. The United States implemented this repudiation through section four of the Fourteenth Amendment, which repudiated all "debt or obligation incurred in aid of insurrection or rebellion against the United States." The former Confederate states were required to ratify the Fourteenth Amendment to regain full participation in Congress and in the United States.\(^{93}\) In interpreting the Fourteenth Amendment, however, the Supreme Court did not reject all Civil War-era debts of the Confederate states outright. Rather, it examined the purpose of each debt; debts in aid of rebellion were void, but debts incurred to maintain the peaceful, civil functions of government were valid and enforceable.

The Confederate government and its constituent states financed the Civil War in part by selling Cotton Bonds — bonds backed by guarantees on the cotton crop — to investors in the United Kingdom, the Americas, and even in the northern states. The Confederacy’s strategy, known as "King Cotton Diplomacy," was to entice foreign countries to intervene on the side of the Confederacy because of their financial interest in cotton.\(^{94}\) Cooler heads prevailed throughout Europe, but in the wake of the war, European creditors still sought payment on the bonds. That was not to be, for Congress was in

\(^{93}\) The Fourteenth Amendment also explicitly repudiates any claims "for the loss or emancipation of any slave." The uncompensated freeing of four million people can be viewed as one of the largest redistributions of wealth in United States history, and a dramatic example of the abrogation of vested property rights for moral reasons.

no mood to allow the payment of debts incurred by the South to prosecute the war.

There is little legislative history about the fourth section of the Fourteenth Amendment. Some have interpreted the scarcity of discussion to mean that the debt repudiation was a fundamental — and therefore uncontroversial — aspect of reuniting the United States.95 The repudiation ensured that the successor states did not have to (and were not permitted to) pay for the war against the United States. It also ensured that the financiers who supported the Confederacy were not restored to the place they had been before the war. Southern state courts and lower federal courts in the South began hearing cases on the debts — and declaring them invalid — in the 1860s.96

The issue of Confederate finance reached the United States Supreme Court on several occasions. This required the Court to develop a test to determine which Civil War-era obligations had been repudiated by the Fourteenth Amendment. In Texas v. White, Texas sought to reclaim bonds that it had been given by Congress in 1850 as part of the Compromise of 1850. Near the end of the Civil War, the "military board" of the State of Texas sold the bonds; the post-war government of Texas sought to reclaim the bonds, on the premise that the Texas government during the Civil War was not the owner of those bonds. Texas found a receptive ear in the United States Supreme Court in 1873. Chief Justice Waite’s majority opinion sought first to establish the principle that the Union was indestructible, and therefore the acts of the Texas government during the Civil War were considered valid and upheld. In Waite’s oft-quoted words, "The Constitution, in all its provisions, looks to an indestructible Union, composed of indestructible States."97 This position — required by northern interpretations of the Constitution before and during the war — foreclosed perhaps the most direct route to abrogation of the sale of the bonds: that the acts were ultra vires.

However, the Court went on to distinguish between bonds sold for normal

96 See, e.g., Thomas v. Taylor, 42 Miss. 651, 710 (1869) (repudiating Cotton Bonds because they were a financial instrument that was issued "in aid of the late rebellion, and therefore was not revived and continued in force by the ordinance of the Convention of 1865"); Branch v. Haas, 16 F. 53 (C.C.M.D. Ala. 1883) (repudiating Alabama's Confederate debt).
97 Texas v. White, 74 U.S. 700, 725 (1868).
state purposes and those used to support the war effort, suggesting that the former might be valid, while the latter clearly were not:

It may be said, perhaps with sufficient accuracy, that acts necessary to peace and good order among citizens, such, for example, as acts sanctioning and protecting marriage and the domestic relations, governing the course of descents, regulating the conveyance and transfer of property, personal and real, and providing remedies for injuries to person and estate, and other similar acts which would be valid if emanating from a lawful government, must be regarded in general as valid when proceeding from an actual though unlawful government; and that acts in furtherance or support of rebellion against the United States, or intended to defeat the just rights of citizens, and other acts of like nature, must, in general, be regarded as invalid. 98

The Court concluded that the purpose of the military board that sold the bonds was to levy war against the United States, and thus its sale of the bonds did not divest the state of Texas of its title in the bonds. 99 The reasoning of the case was confirmed by the fact that the later purchasers of the bonds bought them with notice that they were suspect; they had been traded below what their fair market value would have been, "had the title to them been unquestioned." 100 Thus purchasers of the bonds sold to finance the war could not recover on them.

In Keith v. Clark, the Supreme Court reiterated the rule it had announced in Texas v. White, that "a contract made in aid of the late rebellion, or in furtherance and support thereof, is void." 101 Keith v. Clark dealt with a dispute over whether a tax collector for the state of Tennessee had to accept notes issued by a state-chartered bank during the Civil War. A state law obligated its tax collectors to accept paper notes from the Bank of Tennessee for payment of taxes. The tax collector argued that the notes were invalid because they had been issued while the bank was under Confederate control. The decision in Keith turned on whether the notes were issued pursuant to the Confederate war effort or merely for the peaceful and ordinary actions of the state. If the former, they were void; if the latter, they were not. On the record before the Court, there was "nothing to warrant the conclusion that these notes were issued for the purpose of aiding the rebellion or in violation

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98 Id. at 734.
99 Id. at 734-35.
100 Id. at 736.
101 Keith v. Clark, 97 U.S. 454 (1878); see also Hanauer v. Doane, 79 U.S. 342 (1870).
of the laws or the Constitution of the United States"; on the contrary, the Supreme Court of Tennessee had found that "the bank during this time was engaged in a legitimate banking business." Keith put the onus on the tax collector, who sought to reject the notes, to show that the notes had been issued in support of the war effort.

C. Post-Reconstruction Repudiation

The southern states and their creditors nursed the memory of the forced repudiation for decades — well into the twentieth century. That memory of repudiation likely made it easier for southern states to contemplate debt repudiation in the wake of the Civil War.

This time the southern states turned to debts that had been incurred by the Reconstruction governments. Following the "compromise of 1877," when federal troops were removed from the southern states, southern legislatures frequently repudiated public debts contracted during Reconstruction, arguing that the debts had been contracted by corrupt carpetbag politicians for their own use. Though they may have been duly elected according to the law of


103 The rule is reiterated in Bruffy v. Williams, 96 U.S. 176, 192 (1878) ("Order was to be preserved, police regulations maintained, crime prosecuted, property protected, contracts enforced, marriages celebrated, estates settled, and the transfer and descent of property regulated, precisely as in time of peace. No one . . . seriously questions the validity of judicial or legislative acts in the insurrectionary States touching these and kindred subjects . . . .") (quoting Horn v. Lockhart, 84 U.S. (17 Wall.) 570 (1873)).

104 A.B. Moore, One Hundred Years of Reconstruction of the South, 9 J. S. Hist. 153, 157 (1943); James B. Sellers, The Economic Incidence of the Civil War in the South, 14 Miss. Valley Hist. Rev. 190 (1927). For a recent discussion of the Confederacy's war financing, see Herschel I. Grossman & Taejoon Han, War Debt, Moral Hazard and the Financing of the Confederacy, 28 J. Money Credit & Banking 200 (1996). These issues became salient again in public memory in the wake of the First World War, when the United States sought repayment of debts incurred during that war. European nations countered that southern states had never paid the obligations owed them. An article in Foreign Affairs suggested that the United States relieve foreign debt up to the amount of the debts owed by southern states from before the Civil War and from the war, too. See Charles Howland, Our Repudiated State Debts, 6 FOREIGN AFF. 395 (1928); John F. Hume, Responsibility for State Rugsy, 139 N. Am. Rev. 563 (1884).

105 The term "Reconstruction" refers to the period when southern states were reincorporated into the United States; it runs from 1865 to 1877.
the time, they were not the appropriate representatives of the people. The carpetbaggers and scalawags acted for their own benefit, so the argument went.\footnote{106}

Eight southern states engaged in large-scale repudiation or scaling down of their Reconstruction-era debt\footnote{107}:

<table>
<thead>
<tr>
<th>State</th>
<th>Repudiated</th>
<th>Scaled Down</th>
<th>Accrued Interest on Scaled Debt, Not Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>$3,703,000</td>
<td>$5,185,000</td>
<td>$4,574,000</td>
</tr>
<tr>
<td>Arkansas</td>
<td>$8,365,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Florida</td>
<td>$4,000,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Georgia</td>
<td>$7,746,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Louisiana</td>
<td>$14,442,000</td>
<td>$8,606,000</td>
<td>$911,000</td>
</tr>
<tr>
<td>North Carolina</td>
<td>$12,655,000</td>
<td>$9,037,000</td>
<td>$7,586,000</td>
</tr>
<tr>
<td>South Carolina</td>
<td>$11,553,000</td>
<td>$4,943,000</td>
<td></td>
</tr>
<tr>
<td>Tennessee</td>
<td></td>
<td>$13,000,000</td>
<td></td>
</tr>
</tbody>
</table>

In the 1940s, historians sympathetic to southern interests\footnote{108} assessed the costs and benefits of the Reconstruction-era repudiations:

\footnote{106}{That image of Reconstruction as an era of corrupt northern politicians and recently freed slaves defrauding the hardworking white southerners is one of the most important — and most frequently criticized — tropes of American history. That story, popularized by such works as Thomas Dixon’s novel \emph{The Clansman}, which was made into the movie \emph{Birth of a Nation}, inspired a toxic interpretation of American history, which supported disfranchisement of African-Americans. However, that toxic (and incorrect) history should not cause us to forget the precedent for repudiation of what are believed to be unjustly incurred public debts. \textit{See} J. Mills Thornton, \textit{Fiscal Policy and the Failure of Radical Reconstruction in the Lower South, in Race, Region, and Reconstruction: Essays in Honor of C. Vann Woodward} 349 (J. Morgan Kousser & James M. McPherson eds., 1982); \textit{see also} William A. Scott, \textit{The Repudiation of State Debts} (New York, Thomas Y. Crowell & Co. 1893); Robert P. Durden, \textit{Reconstruction Bonds and Twentieth-Century Politics: South Dakota v. North Carolina} (1962).}

\footnote{107}{Ritchford, supra note 83, at 192 (providing a comprehensive listing of postwar state debts that were repudiated or scaled down, as of 1890).}

\footnote{108}{Many historians during this era were sympathetic to southern interests. E. Merton Coulter described the period, for example, as the “Blackout of Honest Government.”}
Debt repudiation had both its advantages and disadvantages. It would teach future generations not to attempt another war of disruption and it would free the present generation of a great financial burden — as an instance, Georgia would be relieved of $18,000,000 of her $20,000,000 debt. Yet repudiation set a dangerous example for the future, and it well might weaken a state’s financial credit; and more particularly in this instance it would work a social and economic revolution, by bringing about the destruction of the southern upper classes who held this debt.¹⁰⁹

On balance, however, many historians concluded that the repudiations were justified because of the fraud and bribery involved in the authorization of the bonds and the impositions of taxes that were required to discharge such debts.¹¹⁰ As recently as the middle of the twentieth century, historians were advancing interpretations of Reconstruction debts based on images of corruption in the state legislatures. As one economist put it:

Lack of words and space prevents an adequate description of the legislators elected at this time. Negroes and carpetbaggers predominated. These were the most ignorant, corrupt, and venal lawmakers ever to hold office in this country. State officials were of the same caliber. Those in control were out to loot and plunder. The credit of the states was the vehicle whereby much of the stealing was accomplished. As soon as Congress readmitted the states the military authorities relinquished their powers, and these bands of thieves were free to plunder.¹¹¹

When the Democrats had succeeded, slowly and painfully, in wresting control from the carpetbaggers, they proceeded to make good their warnings that the Reconstruction debts would not be paid. In several instances they went farther and scaled down the debt incurred before Reconstruction.¹¹²

Viewed through the lens of the times, the post-Reconstruction repudiations

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¹¹⁰ id. at 34-35.
¹¹² Ratchford, supra note 83, at 169-70.
by Southern states were paradigmatic odious debt cases. According to the
governments that urged repudiation, these were the debts of prior illegitimate
governments that had contracted the debts for improper purposes. Once these
usurpers had been overthrown, the successor governments refused to repay
the debts that the despots had incurred in the name of the state.

The claims of the post-Reconstruction governments sound laughable
today — particularly, the claims that the Reconstruction governments were
illegitimate because they had been run by "negroes and carpetbaggers." At
the time, however, these views represented a majority view of the
white people in control in the states that repudiated their debts. This further
illustrates the difficulty in making moral judgments about the despotic nature
of a prior government. Such judgments are all too fluid; what may appear
to be a legitimate government to one set of voters and judges can soon be
seen as despotic. Years later, history may again reverse its judgment.

As a consequence of state debt repudiations, the Supreme Court heard
several cases arising from mandamus actions to compel municipalities to
abide by their contracts. In 1881, for example, the United States Supreme
Court compelled the city of New Orleans to levy $650,000 in annual
taxes to pay bonds issued under an 1873 act.113 Justice Field, writing for
the Court, warned of the "leprosy of repudiation." That case, *Louisiana v.
Pillsbury*, reaffirmed the usual doctrine that local governments must honor
the obligations of their predecessors, even though there was Louisiana
legislation that prohibited New Orleans from levying a tax to pay those
obligations.

The Supreme Court also heard three cases arising from North Carolina's
repudiation of debts.114 In *South Dakota v. North Carolina*, the state of
South Dakota successfully sued North Carolina for repayment of some of
its Reconstruction-era bonds. South Dakota's success in court prompted
North Carolina to settle with individuals for a fraction of the value of the
bonds.115 As with Pillsbury, the North Carolina suits illustrate the continuing
attempts to collect on repudiated debts and the ways that states tried to avoid
those debts, with significant, but not complete, success. None of those cases
robustly tests Sacks' formulation — or that of other odious debt doctrines

114 Baltzer v. North Carolina 161 U.S. 240, 245 (1896); Baltzer v. United States 161
post-Revolutionary settlement).
— because they primarily deal with the legal defenses available to states and municipalities that sought to repudiate their debts. However, the cases draw boundaries around the limits of the repudiations permitted under the United States Constitution. In all of these cases, the Court was reluctant to rule that the Reconstruction-era debts were legally problematic or odious on the basis of moral judgments about the despotic nature of the governments that had issued those loans.

**CONCLUSION**

The goal of this Article has been to explore in depth the two examples of state practice that are frequently cited as support for the odious debts doctrine, and to suggest additional historical events that might provide support for a doctrine different from Sack’s.

Our basic findings are straightforward. First, there is little or no support in the U.S. history examined here for the first condition in Sack’s three-part doctrine — the requirement that the debt-contracting regime be despotic. Neither the U.S.-Spain treaty negotiations nor the *Tinoco* arbitration support this element. Further, the Supreme Court cases construing the Fourteenth Amendment show that even the rebelling states were capable of incurring legitimate debt. Viewed in the modern context, these states would surely be branded despotic or illegitimate because of their proslavery stance; still, the debts they incurred for basic governance were valid, despite the terms of the Fourteenth Amendment. Put simply, U.S. state practice shows that bad regimes can incur good debts.

Second, there is support for the second condition in Sack’s doctrine — a hindsight-based substantive conclusion that the debts in question have not been used to benefit the populace. In its negotiations with Spain, the United States argued that the so-called Cuban debt had evidently not been used for the benefit of Cuba. Similarly, the Supreme Court in *Texas v. White* and *Keith v. Clark* suggested that an *ex post* analysis of the purpose and use of state

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116 The question whether this requirement is normatively sensible lies outside the scope of this article.
debts would determine whether they had been repudiated by the Fourteenth Amendment.\footnote{In 1938, there is another instance of the United States arguing that the uses to which a loan is put are relevant in determining whether successor regimes have to repay, and particularly, that when the loans benefited the populace, they have to be repaid. In the aftermath of the German invasion of Austria, Germany refused to pay U.S.-held loans that had been made to Austria. The United States argued that these loans should be paid because the loans "were made in time of peace, for constructive works and the relief of human suffering." Hoeflich, supra note 7, at 63 (quoting 1 Green Haywood Hackworth, Digest of International Law 545 (1940)).}

Third, there is support for the third part of Sack’s test — the requirement of creditor awareness or collusion. For Taft in the Tinoco arbitration, the key question regarding the money owed the Royal Bank of Canada was whether the creditor knew or should have known that Tinoco was borrowing the funds for personal purposes; if so, the debts were personal to Tinoco and not the obligations of Costa Rica.

More generally, Taft’s ruling reveals a pragmatic, substance-over-form strain of thinking in the U.S. approach to debt repudiation that perhaps can be traced to the Supreme Court in Texas v. White and Keith v. Clark. Adjudicators like Taft were willing to reject formalisms, as were the American commissioners negotiating the end of the war with Spain. At the end of the day, we do not have a neat alternative to offer to Sack’s three-part test for odious debts. But history suggests that adjudicators and the United States government have made pragmatic rather than formalistic determinations about whether the legal fictions of the state and state succession are being abused. When they are, adjudicators have been willing to find an exception to the rule of strict governmental succession.

By the standards of historians, this Article represents a minimal inquiry: it has relied almost entirely on secondary sources, which were assembled to address questions different from the ones asked here. Nevertheless, this inquiry has yielded indications of a doctrine different than Sack’s that, as a legal matter, would be easier to prove than the version being pushed by many contemporary advocates of the odious debts doctrine — easier to prove because it does not require a declaration that a regime is despotic. Given the foregoing, it is curious why those in the modern odious debts movement continue to push for the first element in Sack’s doctrine, especially since this particular element is extremely difficult to prove (as demonstrated by the Tinoco and post-Reconstruction examples).

Perhaps the odious debts movement does not ever intend to bring a lawsuit
(and given the weakness of Sack’s doctrine, that is a sensible choice). If, instead, the goals of the odious debts movement are political — and Sack’s doctrine is but a means to accomplishing political ends — it is easier to see why the activists are so wedded to Sack’s doctrine. The first condition of Sack’s test defines or labels a regime as despotic or illegitimate, and the political story about debt repudiation sells better if there is a despot at the center of the story. The moral story rallies support for the cause.

If advocates hope to win in a court, however, they might consider some of the alternative paths to the rejection of sovereign debt. This exploration of U.S. domestic debt repudiation suggests that history provides examples that could be mined to develop a new doctrine, one that is broader and more flexible than the one written by Sack. It is worthwhile for advocates to explore this history, not only to expand the doctrine and its applications but also to show that its application has not been rare in history. Because the past has implications for what a court will do today, the multiple episodes of repudiation of sovereign debt in U.S. history offer counsel for the future.\textsuperscript{118}

\textsuperscript{118} A similar point about the numerous instances of state repudiations of debt in U.S. and UK history has been made by Hoeflich, supra note 7. However, Hoeflich’s interpretation of these instances of repudiation is more cynical than ours. He suggests that there may be no real doctrine there, just countries acting in their own self-interest. \textit{Id.} at 69-70.